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Economic Bulletin

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Economic developments and policies

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

The international economy

Developments and policies in the industrial countries

The industrial economies grew more slowly over the first half of 1986 than had been forecast by the leading international organizations. Consequently, projections for economic activity have generally been revised downwards and now growth for the year as a whole is expected to be less than 3 per cent. The slower-than-predicted increase reflects the lag with which domestic demand has responded to the improvement in the terms of trade, while the negative impact on the industries related to energy production and exports to OPEC countries was immediate. Starting in the second quarter, however, and most especially in Europe, there have been signs of a strengthening of economic activity that, fueled primarily by household consumption, should continue through the end of the year (Table a1).

In the United States, GNP grew at a modest annual rate of 2.4 per cent over the first six months of the year. Fixed investment declined — and not only in the oil industry — as a result of lower profits and the uncertainty generated by the Administration's tax reform proposal, and the rate of stock accumulation also slowed. In Japan there was a sharp slowing down in the growth of output (1.1 per cent compared with nearly 5 per cent in the second half of 1985), chiefly because of a decline in exports. The economy is having some difficulty in making the transition from external to domestic demand as the prime mover of growth. West Germany and France experienced a pronounced recovery in the second quarter, led by domestic components, after the poor performance of the first quarter.

For the industrial countries as a whole foreign trade exerted a powerful negative influence on growth. While imports expanded faster than demand, export volume increased only modestly, reflecting again the sharp cutback in imports by countries producing oil and other primary commodities consequent upon the decline in the prices and thus in the purchasing power of their exports.

The unemployment rate in the United States declined to 6.8 per cent in August, its lowest level since the beginning of the eighties, but then rose to 7.0 per cent in September. The number of persons employed increased in Europe as well, continuing the positive trend that began in 1985. According to the forecasts of international organizations, however, the growth of the labour force is likely to offset these gains, so that the unemployment rate in the EEC will not vary significantly from last year's figure of 11 per cent.

The sharp fall in oil prices and the more moderate decline in the prices of other primary commodities, as well as, for Japan and the EC countries, the appreciation of their currencies against the dollar, led to substantial reductions in wholesale prices (Figure 1 and Table a4). Consumer prices have declined since the second quarter in West Germany and have held stable in Japan. The inflation rate has also settled at very low levels in other EC countries (France, United Kingdom) and in the United States, where the inflationary impact of the exchange depreciation has been moderated by lags in its effects on consumer prices. (Table a3).

Oil prices, after turning abruptly downwards at the close of 1985, continued to decline sharply

Figure 1

Oil and primary commodity prices and inflation in the industrial countries (1) (2)

(percentage changes on previous quarter)

Sources: IMF, OECD.

(1) Indicators for the seven major industrial countries; second quarter 1986 partially estimated. — (2) For oil, right-hand scale.

in the following months, falling on the spot market to levels less than $10 a barrel for the main types of crude. In August the OPEC countries agreed to reduce output over the next two months by 3 million barrels a day, equivalent to about 15 per cent of total production, and to restore the market shares that obtained through 1984. Following this announcement oil prices recovered to $15-16 a barrel. However, uncertainty over future trends springs not only from the difficulty of renewing the OPEC agreement but also from the attitudes of non-cartel oil producers, whose market share comes to about 60 per cent, and from the substantial stocks accumulated by importers in recent months.

Monetary conditions were generally eased as a result of the decision by policymakers in the leading countries not to correct divergences of the monetary aggregates from their target paths. The velocity of circulation has diminished. However, the decline in nominal interest rates was not accompanied by a corresponding fall in real interest rates. In the US and the UK a considerable overshooting of the aggregates relative to targets was tolerated, as in 1985. In West Germany too the central bank money supply exceeded the upper limit of the target range. The steadiness of German short-term interest rates over this period suggests that the overshooting reflects portfolio shifts towards more liquid assets owing to the decline in the price level.

Official interest rates were reduced in a concerted manner by the major countries in early March. This action was repeated in April by the US and Japan, followed by France, the UK, and Italy (Table a5). Subsequently, only in the US was the discount rate lowered further, to 5.5 per cent. The reluctance of the German authorities to reduce the interest rates under their control, considered justified by the excessive expansion of money and the Deutschemark's weakness in the EMS through June, impeded further reductions of official rates in the other European countries. Japan too felt that another discount rate reduction would be untimely, in view of the appropriateness of existing liquidity conditions. The divergences among the major countries in monetary policy stance have been reflected in large movements in exchange rates.

Nominal interest yields have declined at both short and long-term. For the longer maturities the decline was more general, and in some countries (the US, Germany, and France) it was more pronounced than for the shorter ones (Tables a5 and a6 and Figure 2). Adjusted for inflation, though recognizing the difficulty of measuring expectations when price movements are decelerating rapidly, interest rates remained at generally high levels, and in some countries they actually rose, particularly those on bank loans.

The easing of monetary conditions was transmitted to the international financial markets, imparting new vigour to fixed-rate issues, which expanded by about 60 per cent in the first half of 1986. Generally, the bond sector continued to develop as a result of the growing utilization of negotiable instruments.

In early September a momentary spreading of expectations that interest rates might move higher, together with a downwards revision of expected profits, caused a sharp fall in share prices in the major stock exchanges, after the phase of strong ascent that had set in at the start of the year.

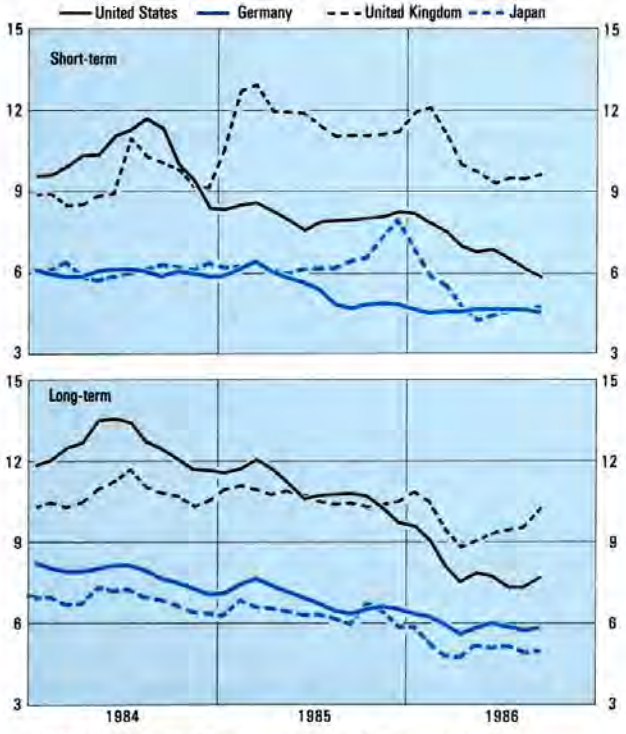
On the public finances front, developments in the major industrial nations showed less divergence than in the recent past. The ratio of the US budget deficit to GNP remained

unchanged, after rising steadily in earlier years, while in the other major countries as a group the fiscal stance became slightly less restrictive. In the United States, the 1986 fiscal year closed in October with a federal budget deficit of $224 billion, far above the $172 billion laid down in the Gramm-Rudman-Hollings Balanced Budget Act. Government estimates put the 1987 deficit at $170 billion, thanks to sharp cuts in defence spending and interest payments on the public debt. However, to achieve the target of $144 billion would appear very difficult, particularly as Congress has not so far approved the necessary spending cuts. In West Germany the income-tax cut that took effect this year was not large enough to interrupt the narrowing of the deficit, which in 1986 should come to less than 1 per cent of GNP. In Japan additional measures to stimulate domestic demand enacted in September should help to put right the restrictive stance that has prevailed so far. In France the budget deficit this year should be narrowed to about 3 per cent of GDP, and the budget for next year foresees a progressive further reduction (to 2.5 per cent in 1987 and budget balance in 1989). More generally, it envisages a decrease in government economic intervention in the economy, not least through a large programme of privatization.

Figure 2

Short and long-term interest rates (1)

(monthly averages)



(1) For sources and definitions, see Appendix, Tables a5 and a6.

Current payments imbalances, exchange rates and the problem of coordination

The exports of the industrial countries, by volume, were just 2 per cent greater in the first half of 1986 than in the first half of 1985, while imports expanded at more than three times that rate. Nevertheless, the exceptional improvement in the terms of trade, which should show a gain of 8 per cent for the year, will, according to IMF projections, enable this group of countries as a whole to register a balance-of-trade surplus for the first time since 1978. The aggregate balance of payments on current account should also improve appreciably, from a $54 billion deficit in 1985 to substantial equilibrium this year. Within the industrial area itself, however, payments imbalances have worsened. The US current account deficit will be about $123 billion in 1986 (compared with $118 billion in 1985 and $69 billion in the first six months of this year). The Japanese and German surpluses should expand to $83 billion and $31 billion respectively. Finally, France and Italy should also record surpluses (Table 1).

Table 1

Balance of payments on current account (1)

(billions of dollars)

	1984	1985	1986 (2)
United States	−106.5	−117.7	−123.0
Other industrial countries	44.5	64.2	123.0
of which: Japan	35.0	49.2	82.7
Germany	6.5	13.3	30.8
France	−0.8	−0.1	5.5
United Kingdom	2.1	4.9	2.3
Italy	−2.9	−4.2	5.3
Oil-exporting developing countries	−9.9	2.4	−44.7
Other developing countries	−22.6	−21.4	−12.9
Memorandum item:			
World discrepancy	−91.2	−70.7	−63.3

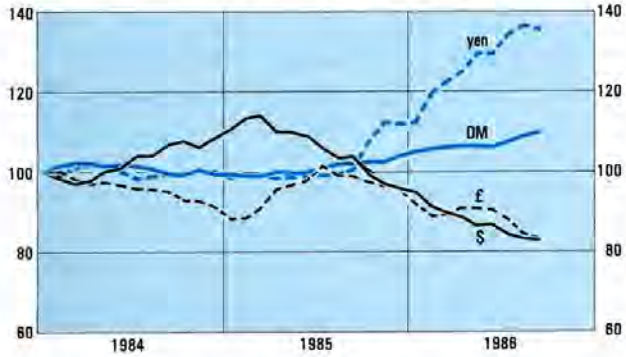
Source: IMF. For Italy, *Relazione previsionale e programmatica*.
(1) Including official transfers. — (2) Estimates.

In this context, the gradual descent of the dollar continued in the early months of the year, reinforced by the decision of the five leading industrial countries in September 1985 and accompanied by the concerted reduction in discount rates recounted above. Subsequently, the US authorities exerted more pressure on Germany and Japan to stimulate their domestic demand, also announcing publicly their intention otherwise to give way to a further decline of the dollar. In the summer months, and again around mid-September, there were some resultant disorderly developments in the foreign exchange markets. These led to a substantial depreciation of the dollar that basically reflects the lack of agreement on the appropriate course of economic policy in the principal countries.

Figure 3

Nominal effective exchange rates of the major currencies

(indices, January 1984 = 100)

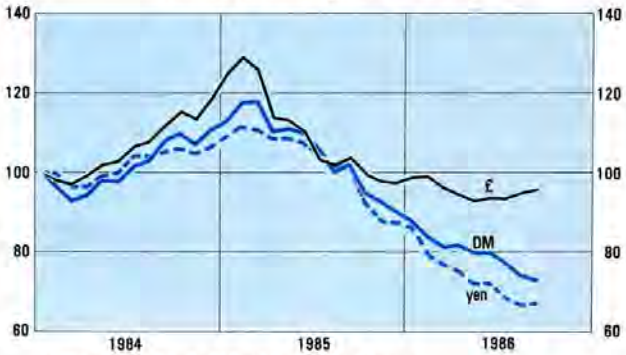


In mid-October the effective exchange rate of the dollar with respect to the currencies of the other leading industrial countries was about 13 per cent lower than at the start of the year, while over the same period the Deutschemark and the yen had appreciated by 6 and 20 per cent respectively (Figure 3). The sharper effective appreciation of the yen, which in 1985 had been due essentially to the greater share in Japan's foreign trade accounted for by the US, this year also reflected differential movements in the underlying bilateral exchange rates — the dollar fell by 22 per cent against the yen and only 19 per cent against the Deutschemark (Figure 4). Sterling depreciated by 15 per cent in trade-weighted terms, owing primarily to the decline in oil prices; holding virtually steady with respect to the dollar, the pound lost value significantly against the EEC currencies. This decline steepened around mid-September, despite support interventions, with sterling depreciating a further 5 per cent by mid-October following the unexpected, substantial deterioration in the external accounts of the UK revealed by the data for August.

Figure 4

Bilateral exchange rates of the dollar (1)

(indices, January 1984 = 100)



(1) Expressed in units of each currency per dollar.

The movements in nominal exchange rates have been reflected almost entirely in those of real rates, thanks to the narrowing of inflation differentials between the main industrial countries.

The variations in exchange rates have not yet had significant effects in correcting current account imbalances. Apart from the normal lag between changes in relative prices and those in trade volumes, the overall gain in competitiveness by the US has been limited by the fact that since 1985 there has been no depreciation in the real exchange rate of the dollar in relation to the newly industrializing countries of the Far East. These latter compete very effectively on the US market in industries and products having a high price elasticity, and they account for about 25 per cent of the US trade deficit. In addition, the relative exchange rate movements have been translated only partly into prices, as foreign exporters have sought to maintain their shares of the US market. Japanese manufacturers, for instance, cut their export prices in yen by 19 per cent between March 1985 and June 1986, thus significantly offsetting the loss in competitiveness caused by an appreciation against the dollar of more than 50 per cent.

The correction of external disequilibria has not yet been adequately underpinned by fiscal policies through their influence on the relative growth rates of the major economies. The discretionary impulse of fiscal policy, according to the IMF's cyclically-adjusted indicators, should turn out to be no better than neutral in the US in 1986 but still slightly restrictive in the other major countries as a group.

If the present configuration of fiscal policies remains unaltered, the distribution of current account balances that could tend to emerge in the medium run would risk being unsustainable, owing to the building up of very large debtor and creditor positions.

Exchange rate instability and the coordination of macroeconomic policies were among the issues discussed at the meetings of the Group of Seven and the Group of Ten in Washington. Though no joint operative decisions on interest rates and exchange rates were taken there, the meetings did express the shared resolve to act in more cooperative fashion in order, for one thing, to avoid generating further uncertainty in the markets. During subsequent IMF sessions there was discussion, in a broader framework, of instruments for multilateral surveillance. Such surveillance should centre on monitoring the medium-term international consistency of the economic policies of the major countries. There was general recognition of the usefulness of a system of indicators as the basis for surveillance, but there are still problems as regards their operative contents and the procedures for their application. As to the contents, the main difficulty appears to lie in defining an objective criterion for assessing the "sustainability" of current account imbalances. Moreover, such a definition is essential since on it depends the judgment regarding the consistency or inconsistency of policies in force. As regards procedures, some countries, including Italy, are of the opinion that the exercise of multilateral surveillance ought to envisage more binding mechanisms, going beyond peer pressure alone, for the formulation and implementation of the necessary corrective measures.

Following the EMS realignment in early April, the Deutschemark settled at the lower limit of the narrow band, the French franc and the lira at the upper limit. The relative strength of the latter two currencies resulted from inflows of short-term capital stimulated, against a bachground of favourable nominal yield differentials, by a reversal of exchange-rate expectations following the realignment. These inflows also gave rise to intervention involving purchases of Deutschemarks by France and Italy. The Deutschemark and the Dutch guilder began to appreciate rapidly in July, as did also the lira, which remained virtually stable in relation to the German currency (Figure 5). In August the Irish punt was devalued by 8 per cent against the other currencies governed by the European exchange-rate mechanism. This adjustment was provoked by the loss of competitiveness caused by the sharp depreciation of sterling in the months preceding. The UK is, in fact, Ireland's chief trading partner, accounting for some 40 per cent of its foreign trade.

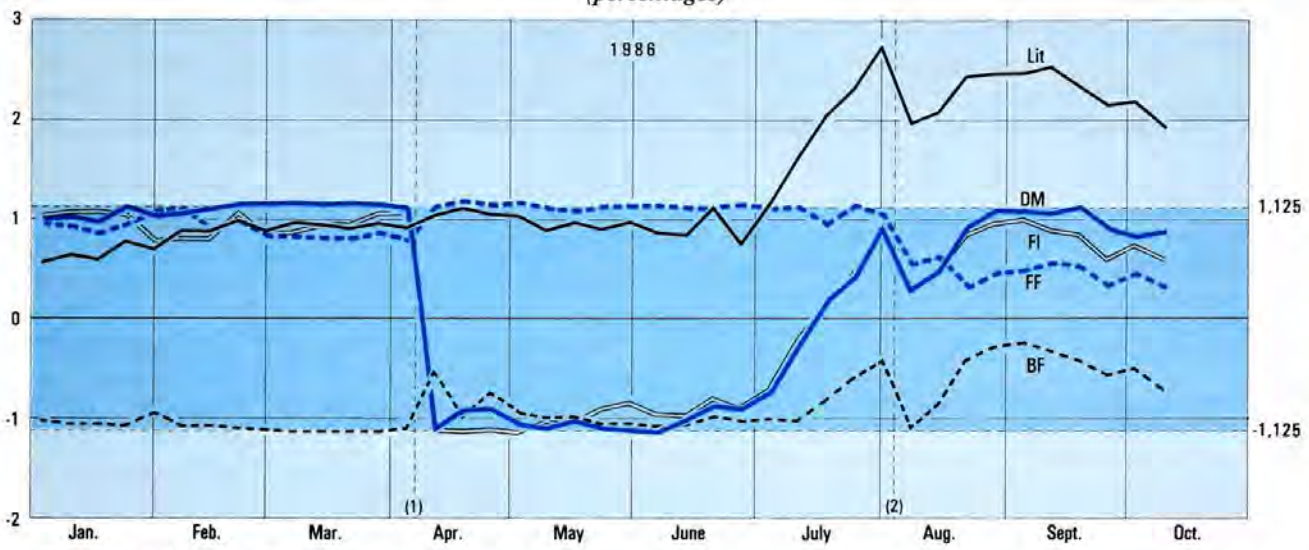
Since late August, with the dollar's decline becoming more pronounced, the movement of the Deutschemark to near the upper limit of the narrow band, in contraposition to the Danish krone, created severe strains within the system. The French franc was kept near its central rate with the DM, while the lira strengthened within the band, holding its position relative to the German currency. This exchange-rate configuration among the major currencies in the band means that the burden of market interventions, which for the most part have been made inside the permitted fluctuation margins, falls on the weaker currencies. More generally, the tendency towards more rigid exchange rate management within the EMS band, dictated by the desire to forestall speculative capital movements, was associated with considerably increased short-term capital flows and central bank interventions — a reflection partly of the limited support provided by the coordination of monetary policies. In France, this phenomenon was further fueled by the liberalization of exchange controls in the spring.

Since the beginning of the year, the variations in nominal effective exchange rates between the currencies participating in the European exchange-rate mechanism have been far from negligible. There has been an appreciation of the Deutschemark (2.8 per cent), the guilder (1.5 per

Figure 5

Divergence of market rates from EMS central parities

(percentages)



(1) Realignment of 7 April. — (2) Realignment of 4 August.

cent) and the lira (1.1 per cent), while the French franc has depreciated (5.7 per cent). As measured by the wholesale prices of manufactures, through August Italy and Germany lost in competitiveness (1.9 per cent), while gains were registered by the Netherlands (3.0 per cent), Denmark (2.1 per cent), and France (1.5 per cent).

The situation of the developing countries and the foreign debt

The modest expansion of world trade and the further decline in the prices of primary products have depressed the growth prospects of the developing countries. The reduction in export earnings, in view of the strict limits on further borrowing, has led to a sharp contraction in the capacity to import. Since the outbreak of the debt crisis in 1982 the availability of financing has become a rigid constraint, and as a consequence the development of imports has been closely correlated with movements in the purchasing power of exports.

For the oil exporting developing countries, a deterioration in the terms of trade of about 50 per cent has required a drastic adjustment of imports, which have contracted by some 20 per cent in volume. The costs of the adjustment are particularly burdensome for those most heavily indebted — Mexico, Venezuela and Nigeria — for which crude oil sales account for the bulk of overall export earnings (about two thirds for Mexico and more than 90 per cent for the other two countries in 1985). The trade surplus of the oil exporting developing countries should contract by well over two thirds this year, from $66 billion to $14 billion. The balance of payments on current account, which was in surplus in 1985, is likely to record a deficit of $45 billion this year (Table 1). The situation of the other developing countries (non-fuel exporters) is less uniform. Overall their current account deficit should narrow from $21 billion to $13 billion. In fact, the positive impact of the decline in crude oil prices and interest rates, together with the effect of domestic adjustment measures to increase export capacity, should offset the deterioration in their terms of trade. In the group of countries producing mainly primary materials, exporters will still have a substantial external deficit, while those exporting primarily manufactured goods should turn in a more satisfactory performance. According to IMF projections, the latter countries' export volume will expand by 6 per

cent, their trade deficit will narrow, and the balance of payments on current account will return to a small surplus.

For the indebted developing countries taken as a whole, the prospects of obtaining external financing to cover the larger current deficit are far from good. According to the latest IMF estimates, net private lending this year will not rise from the relatively low levels it has been at since 1982. Direct foreign investment continues to stagnate at about $11 billion. Nor will the financial flows through other official channels be any greater than in 1985.

Table 2

Developing countries' external debt and debt service

(billions of dollars and percentages)

	1982	1983	1984	1985	1986 (2)
Debtor developing countries					
Total debt (1)	763.2	808.7	848.7	915.8	967.3
Total debt/exports	151.3	160.7	154.0	168.8	179.5
Debt service/exports	24.7	22.3	23.2	24.0	25.5
of which:					
Primary commodities exporters					
Total debt (1)	359.3	385.0	411.7	434.9	459.2
Total debt/exports	240.3	254.9	250.8	270.4	277.9
Debt service/exports	37.9	32.3	31.4	32.1	35.2
15 most heavily indebted countries (3)					
Total debt (1)	382.2	384.3	408.0	418.0	431.1
Total debt/exports	269.2	289.4	270.3	285.1	324.8
Debt service/exports	49.4	41.6	40.8	40.0	47.4

Source: IMF.

(1) Gross amounts at end of period; excluding debt to IMF. — (2) Estimates. — (3) The countries referred to in the Baker Plan: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Ivory Coast, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, Yugoslavia.

The foreign debt of the developing countries will by the end of the year be nearly one trillion dollars (Table 2). Despite debt rescheduling and a decline of about half a percentage point in the average cost of the debt, debt service will rise to 25 per cent of export earnings for the debtor developing countries as a group and to nearly 50 per cent for the fifteen most heavily indebted among them. For the latter, since 1983 the contraction in new credit combined with heavy debt service payments has resulted in substantial net transfers of resources abroad. According to recent studies, this trend could continue for the rest of the decade.

The Baker Plan, announced by the United States in October 1985 at the IMF and World Bank meeting in Seoul, was based on the need to combine a return to growth-oriented strategies in the debtor countries with a restoration of normal credit flows. The implementation of the plan has proceeded slowly. The element lacking, above all, has been a recovery in bank lending to the developing countries. While the Baker Plan called for new lending totalling $20 billion between 1986 and 1988, preliminary BIS figures indicate that in June reporting banks' assets in these countries had not expanded at all since the end of 1985 and were only 3 per cent greater than at the end of 1984. Financing from multilateral institutions has provided significant support for the adjustment programmes put into effect by some of the most heavily indebted countries. The IMF's recent agreement with Mexico, in particular, satisfies the principal requisites indicated by the Baker Plan, in addition to building innovative mechanisms into the structure of the programme itself.

In its recent meeting in Washington, the Interim Committee of the IMF decided to keep the limits on access to Fund resources unchanged. This year the IMF also introduced a new type of credit, carrying concessional conditions, the Structural Adjustment Facility, which will have resources of 2.7 billion SDRs intended to assist the low-income countries. As to the World Bank, although net transfers to the developing countries as a whole were virtually nil in the 1986 fiscal year, reflecting above all the substantial increase in repayments and interest payments, new lending commitments expanded significantly. The Bank's programme for 1987 and subsequent years provides for annual commitments of some $15-20 billion. According to the Bank's calculations, a capital increase needs to be approved within the next year in order that its resources be consistent with the expected pace of future lending. As yet, however, no decision on the matter has been

reached, among other reasons because of continuing American hesitations. Finally, as for the replenishment of IDA resources, agreement was reached on the figure of $11.5 billion.

At the recent meeting of GATT ministers in Punta del Este, the members agreed on the need for new multilateral negotiations aimed at reducing existing restrictions on world trade. Such negotiations, which should be concluded within four years, will deal for the first time with agricultural products, the intention being to ensure freer access to markets and more competitive conditions, involving a reduction in existing direct and indirect subsidy arrangements. Another object of negotiation is services, which are steadily gaining in importance in international trade, giving rise to a need to lay down suitable principles and procedures. On this issue it was agreed, at the request of the developing countries, that the negotiations would be pursued outside the formal structure of GATT.

The Italian economy and the balance of payments

The course of the economy in the first part of 1986 was dominated by two factors, the depreciation of the dollar and the collapse of oil prices, which helped speed disinflation and a return to balance-of-payments surplus. However, the exceptional nature and magnitude of the resultant redistribution of purchasing power from exporters to importers of petroleum appears to have injected some elements of uncertainty into the choices of economic agents in the leading industrial countries. And these elements, combined with economic policies that have in some cases been slow to adapt to changing international conditions, appear in the short run to have held back the expansion of economic activity and of international trade. This climate of uncertainty could not help having some effect on Italian economic agents as well. After the pause in the second half of 1985, there was only a moderate strengthening of the upswing in the early part of this year.

As import and export volumes expanded at broadly similar rates, the pronounced improvement in the terms of trade produced a substantial improvement in the trade balance. Customs data for the first eight months of the year show a deficit of just over 3 trillion lire, coming entirely in the first quarter, as against the 17 trillion lira deficit in the same period of 1985. The improvement is largely attributable (10.8 trillion lire) to decreased expenditure for net energy supplies.

Disinflation, which had been halted in 1985, resumed. The deceleration was sharper and more evident for wholesale prices, because the raw materials component felt the full impact of the decline in energy prices and the depreciation of the dollar. Consumer price inflation eased more slowly owing to the usual lag in production cost cuts feeding through to retail prices, the faster rise in wholesale manufactures prices than in total unit costs, and to the continuing increase in the prices of government-controlled services.

The recovery in the demand for labour brought about by the current expansion has not been sufficient to absorb the growth in the labour force in the first half of the year, with the result that the unemployment rate rose still further.

Domestic demand and industrial output

Real GDP grew faster in the first half of 1986 than in each of the two preceding half-year periods. The decisive factor in putting development on a firmer basis was domestic demand.

The recovery of economic activity proceeded slowly. For one thing, growing US competitiveness and a weaker than expected increase in domestic demand in the principal countries held back the expansion of Italian exports. For another, expectations of further price declines led business firms and consumers to increase their spending only gradually.

Measures to compensate for fiscal drag and the deceleration of inflation more than offset the negative impact on households' real purchasing power of the postponement of collective bargaining contract renewals and less comprehensive wage indexation. Private consumption grew about as much in the first half of 1986 as in the second half of 1985. All types of consumer expenditure rose, particularly that on consumer durables and services.

After a pause in the second half of 1985, gross fixed investment expanded appreciably. In the second quarter of this year the volume of gross fixed investment was back at the peak reached in the second quarter of 1985.

Construction appears to be enjoying a modest recovery after years of deep recession. Moreover, in a phase of the cycle marked by widespread expectations of more robust growth, the significant rise in the rate of capacity utilization, together with the improved self-financing ability of firms thanks to greater recourse to the equity markets and stronger cash flow, have made possible a continuing expansion of investment in

machinery and equipment. Business investment appears now to be motivated not only by the need to complete the recovery of efficiency through modernization and the replacement of fixed capital, as in the last few years, but also by a desire to overcome the supply limitations that have emerged in some major productive sectors.

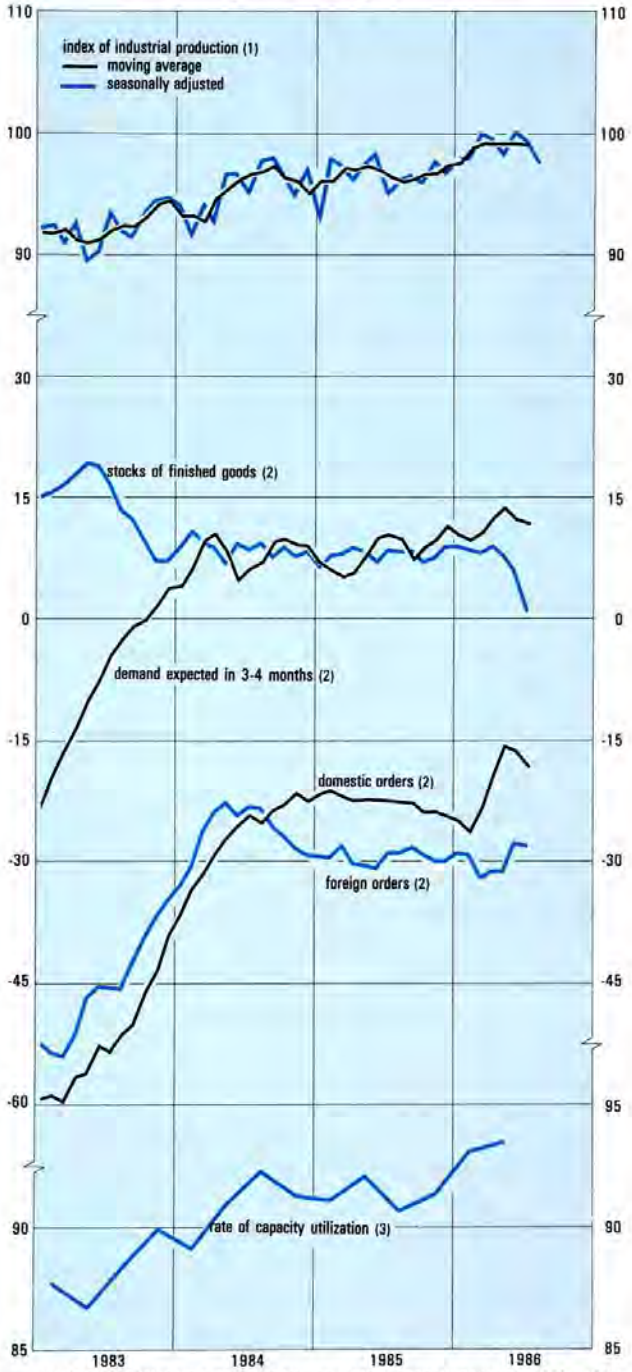
The strength of domestic demand has spurred industrial output. Over the first eight months of the year, on a corrected and seasonally adjusted basis, industrial production increased at an annual rate of 4 per cent and is now, for the first time after three years of economic expansion, almost back to the average for 1980. For the first half of the year, output was on average 2.7 per cent higher than in the second half of 1985 and 2.5 per cent more than in the first half of 1985 (Figure 6).

The recovery of production has affected most sectors. The fastest growth has been in the engineering and light manufacturing branches, where a number of important industries increased their output volume by 5 to 10 per cent over the first eight months. In terms of economic end-uses, the most dynamic sectors were final investment goods and final consumer goods, whose output volume increased in that period by nearly 4 and 3 per cent respectively (Table 3).

The strengthening of productive activity was accompanied by a gradual, steady improvement in demand expectations and household confidence. The state of expectations thus points to a reinforcement of growth in the remainder of the year, sustained once again by domestic demand.

Figure 6

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. — (3) Wharton method; based on Bank of Italy data.

N.B.: The moving averages are of three centred terms.

Employment, labour costs and prices

The latest labour force surveys confirm the persistence and to some extent exacerbation of the excess of labour supply over the demand for labour. In the first half total employment was 100,000 higher than in the same period of 1985, whereas the expansion of the labour force was twice as large.

Just as in recent years, the overall figure on employment conceals sharply divergent movements from sector to sector. Employment declined over the first six months most notably in

Table 3

Industrial production by branch and economic use

(percentage changes on previous period; indices corrected and seasonally adjusted; 1980=100)

	1984		1985		1986	
	Jan-June	July-Dec	Jan-June	July-Dec	Jan-June	Jan-July (1)
Fuel and power products, energy, gas and water	2.1	−3.0	3.6	—	1.3	2.1
Basic industry	2.0	2.8	−0.7	0.6	—	0.3
Engineering and metal products	−1.5	2.3	1.7	—	3.5	3.3
Electrical goods	2.0	2.1	2.6	−1.7	5.3	4.8
Transport equipment	−4.1	−1.7	−0.7	−0.7	8.2	7.7
"Light" industry	2.3	3.3	−1.4	−0.5	3.6	3.4
Textiles, clothing, leather and skin goods, shoes	3.9	3.3	−2.8	0.9	3.0	3.1
Wood products and furniture	3.3	4.0	−5.2	−3.8	10.9	9.4
Rubber and plastic products	0.7	7.4	−0.9	−0.9	9.0	8.9
Final investment goods	−2.4	5.1	2.2	0.6	3.7	3.7
Final consumption goods	1.1	3.1	−0.4	0.2	3.2	3.5
Intermediate goods	2.3	1.1	−0.5	−0.6	1.9	1.7
Overall index	1.1	2.4	—	−0.1	2.7	2.7

Source: Based on Istat data.
(1) Cumulative change over average for previous year.

construction (by 50,000) and agriculture (by 60,000). In industry excluding construction, continuing the trend that emerged last year, the decline was less pronounced or even marginal. Once again, it was only in the services sector, public as well as private, that employment expanded (by 226,000).

In the early part of the year the supply of labour continued to increase not only because of the familiar demographic factors and higher participation of the female population. It was also a result of improved economic conditions, which attracted back into the labour force many workers who had dropped out during recent years of prolonged recession. The latest survey has revealed that 50 per cent of the increase in the number of persons seeking work, or 113,000 persons, come from the groups just cited, which are more sensitive to cyclical factors. Together with a rise of about half a percentage point in the overall labour force participation rate (41.5 per cent in the first half of the year), there was also an increase in the unemployment rate, which was 11.2 per cent, as against 10.5 per cent in the first half of 1985.

The attenuation of the employment decline in industry, which the latest data show to be most pronounced in large-scale industry, is due partly to improved economic conditions but above all to the advanced phase of realization in which industrial restructuring now finds itself. As a direct consequence, resort to the Wage Supplementation Fund decreased further, reflecting primarily a sharp decline in ordinary benefits. In the first four months of the year 230 million hours were paid, representing a 25.4 per

cent decline compared to the same period of 1985; ordinary benefit hours paid were down by 30.8 per cent. Thus the share of special benefits in the total increased still further. This enhances the chances of initiating a reform of the Wage Supplementation Fund that might regain its original intent, along the lines laid out by the 1987 Finance Bill.

Following the healthy productivity gains achieved beginning at the end of 1983, output per worker in manufacturing industry (net of Wage Supplementation) remained stable in the first half of the year at the level attained in the first six months of 1985.

Wage and salary income per employee in industry, by contrast, was 8 per cent higher than in the first half of 1985. Although the new *scala mobile* mechanism, with less frequent adjustments and less sensitive to inflation, implies increases about a third less than those of the old system, real gross salaries were about 1 per cent higher than in the same period of the previous year. This was due principally to wage drift, which partially offset the delay in contract renewals.

With productivity approximately stationary, the increase in unit labour costs essentially reflected that in compensation per employee. The depreciation of the dollar and the fall in energy prices at origin produced better results with respect to the cost of other production inputs, which apparently declined by more than a full percentage point in the first six months. In that period total unit costs in manufacturing were thus apparently slightly more than two points higher than in the first half of 1985 (Table 4).

In the first six months producer prices for the domestic market rose nearly two percentage points more than total unit costs. Gross unit profit margins in industry thus widened on the domestic market, more than offsetting the narrowing of profit margins in markets abroad, which firms saw as necessary in order to hold on to their market shares. (This will be discussed in more detail in the next section.)

The widening of profit margins was not large enough, however, to prevent a resumption of the process of disinflation after the pause of the previous year. Over the first eight months, owing chiefly to the sharp fall in industrial raw materials prices, there was an 8 percentage point decline in the 12-month rate of inflation as measured by the general wholesale price index; in August the index was actually 2.1 per cent lower than a year earlier. Over the same period the twelve-month increase in manufactures prices was almost halved, from 6.3 per cent at end-1985 to 3.5 per cent in August 1986. Italy's inflation differential in relation to its major competitors thus narrowed in the first half on average by one point, falling to about 3 percentage points.

Table 4

Total unit costs and output prices in manufacturing

(percentage changes on corresponding period of previous year)

	1984	1985		1986	
		Year	4th	1st	2nd
Unit labour cost (1)	3.5	7.0	10.7	9.2	7.8
Total input costs	13.0	8.0	3.6	0.6	−2.9
domestic	11.5	8.1	6.6	3.0	0.7
imported	15.7	7.3	−1.5	−3.4	−8.5
Total unit costs	8.8	7.4	6.0	4.0	1.4
Output prices (2)	10.7	7.6	6.5	5.2	3.2
Average unit prices of manufactures exports	9.5	8.1	5.8	1.8	−0.4

Source: Based on Bank of Italy data.
(1) Net of Wage Supplementation. — (2) Consistent with the national accounts.

Retail price inflation also decelerated, although much less markedly than producer and wholesale prices. Over the first three quarters the pace of the increase in the cost of living was almost halved (3.1 per cent as against 5.9 per cent in the first nine months of 1985), and the twelve-month rate was cut by about 3 points to 5.8 per cent in September, the lowest in 14 years.

The scissors movement between wholesale and retail prices widened to almost 8 percentage points during the first eight months of the year from the 3 points registered in December 1985. Analysis shows that this growing divergence, attributed in the past mainly to wider retailers' profit margins, is now a reflection largely of the

different product composition of the two indices. Moreover, the Government's policy, introduced at the beginning of the year, of offsetting part of the decline in oil prices by higher excise taxes on some final consumption petroleum products, has had dual effects. On the one hand, it has helped to curb the rise in the budget deficit and encourage energy saving, while on the other it has made it more difficult to achieve a larger and more immediate deceleration of prices (see insert).

In view of the usual lag with which cost reductions become reflected in lower retail prices, the present favourable conditions with respect to production costs suggest that the slowdown in consumer prices will find firmer footing over the rest of the year. This should ensure an increase of less than 6 per cent on average for 1986 and a twelve-month inflation rate of 4.5 per cent by end-year.

The balance of payments on current account

Provisional figures for the period through June show a reduction of about two thirds in the external current account deficit compared with the first six months of 1985 (Table 5). An improvement in the merchandise trade balance of about 10 trillion lire was accompanied by a fall in the surplus on services of a little less than 1 trillion and a deterioration in the balance of public unilateral transfers of about 3 trillion.

The good merchandise trade performance continued during the summer. On the basis of customs data, the reduction in the deficit in the first eight months amounted to 13 trillion lire. Calculating imports on a cif basis, the deficit fell from 16,784 to 3,422 billion lire, as a result of a 2.1 per cent increase in exports and a 10.3 per cent decrease in imports compared with the first eight months of 1985.

The improvement in the terms of trade that got under way in July 1985 became very much larger this year and averaged 12.5 per cent in the first half of this year compared with the first half of 1985 (Table 6). Most of the improvement in the trade balance was due to the divergent paths followed by the average unit values of imports and exports. Indeed, at constant prices the deficit through June was virtually unchanged compared with the corresponding period in 1985.

Table 5

External current account on a transactions basis

(billions of lire)

	1985	1985 Jan-June	1986 Jan-June (1)
Memorandum item:			
Goods (cif-fob)	−23,115	−16,940	−6,745
. . . . .			
Goods (fob-fob)	−13,444	−11,881	−2,020
Services and transfers	5,412	1,982	−1,757
Foreign travel	12,362	5,178	4,468
Income from capital	−7,479	−4,038	−4,221
Public transfers	−559	440	−2,309
Other	1,128	402	305
Total . . .	**−8,032**	**−9,899**	**−3,777**

(1) Partly estimated.

Table 6

Foreign trade: values, prices, volumes and principal determinants

(percentage changes)

	1985 Jan-June / 1984 Jan-June	1986 Jan-June / 1985 Jan-June
Exports		
Value	18.1	3.8
Average unit value	9.2	−3.1
Volume	8.2	7.2
Imports		
Value	25.3	−8.7
Average unit value	11.1	−13.9
Volume	12.7	6.2
Total domestic demand	4.1	2.8
Capacity utilization	1.5	1.9
World demand (1)	5.3	2.0
Competitiveness (2)	1.1	−0.3
Terms of trade (3)	−1.7	12.5

Source: Based on Istat, OECD and IMF data.

(1) Exports of the OECD countries. — (2) In terms of wholesale prices; a minus sign indicates a gain. — (3) A minus sign indicates a deterioration.

The behaviour of consumer prices in 1986

After the steep decline in 1984 and the more modest slowing of 1985, the rate of increase of consumer prices again began to decelerate markedly as from the early months of 1986. The 12-month rate of increase of the aggregate cost-of-living index fell below 6 per cent towards the middle of the year and continued to fall thereafter, to an estimated 5 per cent in October 1986.

This braking was due to an important extent to the direct effects of the fall in the consumer prices of energy products: according to the consumer price index for the country as a whole, these prices fell by 7.7 per cent between December 1985 and June 1986 (the last month for which data are available). Since this aggregate has a weight of nearly 8.5 per cent in the Istat index, the direct impact of its fall can be estimated as trimming about 5-6 tenths of a percentage point from the rise in the general index during the period.

However, changes in taxes on the end-prices of oil products and domestic electricity tariff measures limited the benefits to final users of the fall in the lira prices of crude oil, notably curtailing their disinflationary effects. In terms of production prices, about half of the more than forty point drop (December 1985-July 1986) of the net-of-tax indicator of industrial prices of the domestic energy sector was counterbalanced by the increase in the tax on petroleum products. In terms of consumer prices, the effect of this fiscal manoeuvre can be assessed by comparing the behaviour of the "cost-of-living" index and that of the same index, but calculated net of changes in indirect taxes (1): whereas the former rose by about 2.2 percentage points between January and August 1986, that calculated net of indirect taxes showed a 1.6-point rise.

The new phase of withdrawal from inflation was accompanied, as is well-known, by the appearance of a marked gap between movements of consumer prices and those of wholesale prices, which slowed more rapidly (Table 1). International events reduced the validity of comparisons between the fully aggregated wholesale and retail indices, however. Relative prices changed drastically in the wake of the oil counter-shock, and this magnified the effects of the different composition of the two indices, contributing to the creation of a positive differential between the movements of the consumer and wholesale price indices (the latter excludes public and private services and weights raw materials and intermediate products heavily).

Table 1

Final prices

(percentage changes over the corresponding period)

	Wholesale prices		Consumer prices	
	General index	Final consumption goods (1)	General index	Goods (1)
1983	9.7	11.2	14.7	12.8
1984	10.4	9.7	10.8	9.7
1985	7.3	8.7	9.2	8.9
1985 — 4th qtr.	5.9	8.3	8.9	9.0
1986 — 1st qtr.	2.5	6.8	7.5	7.7
2nd "	−1.4	4.0	6.0	6.1
June	−1.8	3.5	5.7	5.5
June 86 / Dec. 85	−2.8	1.7	2.2	2.0

Source: Based on Istat data.
(1) Net of energy inputs.

Since the data relating to the "homogeneous basket of retailed products" are no longer published, some indication of the composition effects on final prices of the declines in producer prices can best be gained by making a comparison between the behaviour only of the prices of goods intended for final consumption in the wholesale index and of the "goods" component of the consumer index. On the basis of the two indicators so constructed, and purging them of their energy component, the differential between their rates of growth indicates that gross retail margins increased only modestly.

Table 2

Controlled and free consumer prices, by category

(percentage changes over the corresponding period)

	Controlled					Free		
	Goods		Services		Total	Goods	Services	Total
	non-energy	Total	rents	utilities (1)				
1983	12.7	14.3	18.8	19.9	15.8	13.6	15.2	14.0
1984	7.6	8.9	23.7	12.0	11.1	10.2	11.7	10.7
1985	7.7	7.2	5.8	9.6	7.5	9.3	11.6	9.9
1985 — 4th qtr.	8.2	7.2	8.1	7.8	7.5	9.2	10.1	9.5
1986 — 1st qtr.	7.1	4.0	9.7	12.9	6.6	7.9	8.0	7.9
2nd "	6.8	1.8	9.8	14.2	5.5	5.9	7.7	6.4
June	6.7	1.6	9.8	14.2	5.3	5.3	7.7	6.0
June 86 / Dec. 85	3.1	−1.2	3.8	10.7	2.0	1.8	3.8	2.4

Source: Based on Istat data.
(1)This aggregate does not include tariffs for the supply of domestic electricity, gas and drinking water, which are considered "goods" by Istat.

Lastly, a correct evaluation of the effect of the energy component on inflation during the period makes it possible also to assess the role played by controlled prices.

In the first two quarters of 1986, the rising trend of those prices subject to control was fairly moderate (Table 2). This price aggregate, consisting of utility tariffs, administered and monitored prices, elaborated by the Interministerial Committee on Prices, was the object of Government commitments, showing an increase, excluding rents, of 2 per cent (June 1986-June 1985). Considerably higher (5.3 per cent), but still lower than that of prices not subject to controls, was the rate of growth of the Bank of Italy indicator, which includes rents.

Moreover, the restrained movement of regulated prices seems largely due to the unusual movements of the energy component. In particular, the fall in the prices of energy products, almost all of which are monitored, was responsible for the notably slower rises in the prices of "controlled goods" as against those of uncontrolled goods. Indeed, non-energy controlled prices — essentially, that is, of tobacco, medicines and some foodstuffs — seem to have risen somewhat more than those of uncontrolled goods, and showed, in fact, a similar response to common determinants over the medium term.

Lastly, the overall rise in the price of services, which remained considerable in the autumn of 1986, concealed a marked deceleration in the uncontrolled component, though the rate of increase was still above 7 per cent. By constrast, the 12-month increase was above 14 per cent for domestic tariffs (i.e. public transport charges etc.), equivalent to 10 per cent for public tariffs as a whole, with rents also showing a fairly sustained rise.

(1) As from January 1986, this index is elaborated by Istat in order to serve as a real rate of indexation for some state securities, as required by Law 887 of 22 December 1984.

The recent behaviour of the prices of imported raw materials and exported manufactured goods

The fall in the dollar and the behaviour of raw materials prices on international markets were among the most important reasons for the fall in the average total unit values of imports. From mid-1985 onwards, all the main components of purchases abroad recorded considerable declines in their average unit values in lire: the most remarkable movement concerned energy products, followed by that of "minerals and metals" and then of agricultural raw materials.

Figure 1

Agricultural raw materials: international prices and average unit values of imports

(1980 indices = 100)

Source: Based on data from Istat and UNCTAD.

These reductions reflected the evolution of the respective international indicators of prices, also expressed in lire. In the case of oil products, the very high correlation was due to the close similarity of imports into Italy with those included in the said indicators. Average unit values and the international prices of agricultural raw materials, on the contrary, showed very dissimilar movements over certain periods: these differences were mainly due to the fact that many of Italy's agricultural imports originated in Europe, where the workings of the Common Agricultural Policy at times sustained the prices of these goods in relation to the declining trend of quotations on international markets (Figure 1). In the case of "minerals and metals" differences in the movements of the two indicators seemed to have been not only short-lived but also generally not important (Figure 2).

Figure 2

Minerals and metals: international prices and average unit values of imports

(1980 indices = 100)

Source: Based on data from Istat and UNCTAD.

Between the first half of 1985 and that of 1986, the fall in the average unit values of non-energy imported raw materials was greater by about 12 percentage points than that of semi-finished products. This was

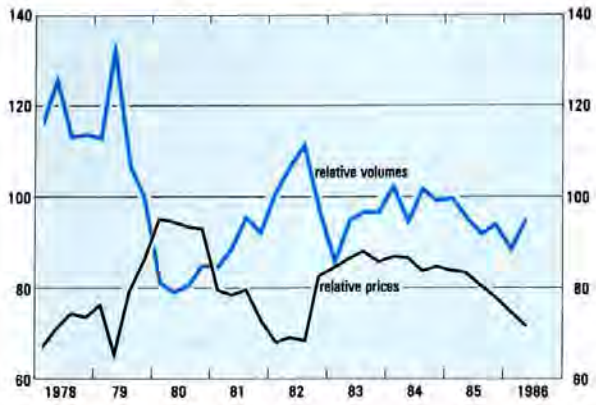
The depreciation of the dollar against the lira and the fall in oil prices in the first half of 1986, by respectively 21 and 32 per cent compared with the first half of 1985, contributed at different times and in different ways to the 13.9 per cent drop in import unit values between the two periods (Figure 7). The depreciation of the dollar, which is the invoicing currency for about 40 per cent of Italy's imports, began to produce a reduction in import prices as early as the third quarter of 1985. Since March 1986 this effect has been reinforced by the collapse in the price of oil, which, together with oil products purchased abroad, accounts for more than 20 per cent of

similar to the situation in the two years 1980-81 (Figure 3); in that period, when the relationship between the prices of the two categories of goods fell by 18 per cent, the volume of imports reacted quickly with a more rapid increase in purchases of raw materials than in those of semi-finished products. At a later stage, a partial recovery in the relative price of raw materials, together with the effect of the restructuring and specialization in Italian industry in causing a shift towards production with a higher value added, resulted in a tendency towards an increase in the share of semi-finished imports at the expense of that of raw materials. The declines in the prices of the latter from mid-1985 onwards did not result in any notable increase in import volume, at least not until the second half of 1986.

Figure 3

Imports of non-energy raw materials relative to those of semi-finished products: volume and prices

(seasonally adjusted; indices, 1970=100)



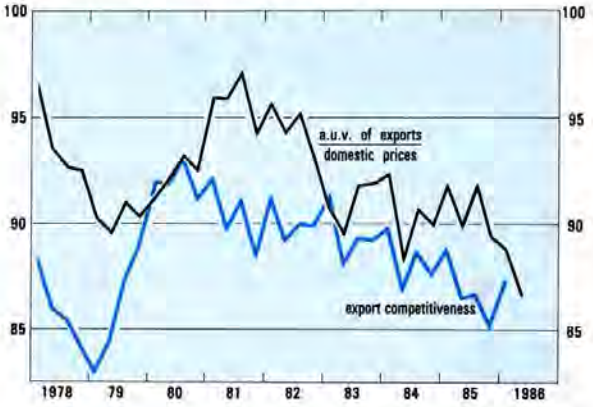
Source: Based on Istat data.

As from the summer of 1985, the stronger fall in the lira prices of raw materials than in those of manufactured exports contributed, with other factors, to the improvement of profit margins in industry. Throughout 1985 the prices of Italian manufactures on foreign markets rose less than did the international prices of the same goods. This tendency was reversed in the first quarter of 1986, though only a part of the competitive gain previously realized was lost (Figure 4). On average, between the beginning of 1985 and the first quarter of 1986, the movements of the prices charged by exporting industries on foreign markets helped to stimulate export volume; the increase in unit profits on foreign sales was less than it would have been if competitive conditions had remained unchanged. This seemed to confirm the increasing importance attributed by industrialists to foreign markets as an outlet for their products. The rates of growth of manufactures prices on the domestic market were, instead, higher than those of exports, thus demonstrating the more profitable conditions then prevailing there.

Figure 4

Manufactures: domestic production prices, average unit values of Italian and foreign exports

(indices, 1970=100)



Source: Based on Istat and IMF data.

Italy's total imports. The substantial reduction in the prices of energy products was offset in part by a 3.6 per cent increase in those of finished manufactured goods.

As to exports, the 3.1 per cent fall in average unit values was also the result of widely divergent changes in those of the main components. The steep fall in the prices of oil products was partly compensated by the increase in those of finished manufactured products (1.3 per cent).

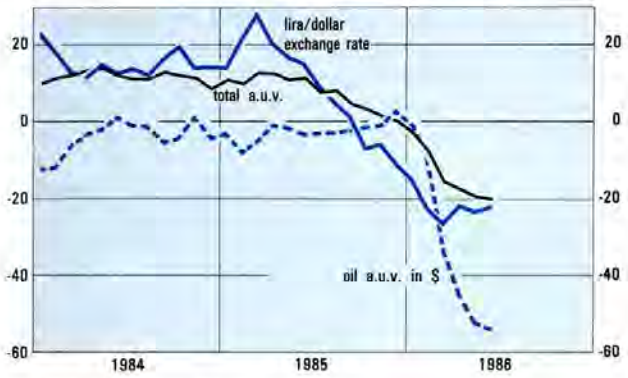
The prices of the exports of these latter thus rose less fast than their import equivalents. To the extent that the trend of Italy's import prices accurately reflects the development of prices in

international markets, the above figures suggest that Italian exporters sought to defend their market shares by increasing their prices at a much slower pace, or at any rate more slowly than their main competitors (see insert).

Figure 7

Average import unit values and principal determinants

(percentage changes on year-earlier month)



Source: Based on Istat data.

Exports benefited in volume terms from this pricing policy and increased by 7.2 per cent. This rapid rise nonetheless also reflected the low level of exports in the first six months of 1985. On a seasonally adjusted annual basis the growth in exports between the second half of 1985 and the first half of this year was equal to 3.5 per cent. World demand, measured by the twelve-month change in total OECD exports, expanded by 2 per cent, while the imports of the European Community excluding Italy expanded faster and gave a strong impetus to Italian exports to the area.

Another factor promoting exports to the Community was the gain in competitiveness in these markets in 1985, when the pronounced deterioration recorded in the early part of the year was followed by a steady recovery through August of the same year that totaled over 7 average points. From August 1985 to June 1986 Italy's competitiveness vis-à-vis the rest of the Community declined by about 3 points.

Italy's competitiveness vis-à-vis its thirteen main competitors in terms of the wholesale prices of manufactures remained virtually unchanged between the first half of 1985 and the first half of 1986. The sharp rise in the real exchange rate of the lira against the dollar was offset in full by the gains in competitiveness vis-à-vis the EC countries (3.4 per cent).

The growth in imports in volume terms between the first half of last year and the first half

Table 7

Merchandise trade by product groups

(billions of lire)

	EXPORTS (fob)		IMPORTS (cif)		BALANCE	
	January-August		January-August		January-August	
	1985	1986	1985	1986	1985	1986
Agriculture, forestry and fishery products	2,752	2,750	8,778	8,283	−6,026	−5,533
Energy products	4,793	2,955	30,473	17,814	−25,680	−14,859
Ferrous and non-ferrous metals	5,048	4,712	9,562	9,136	−4,514	−4,424
Minerals and non-metallic products	3,715	3,770	1,581	1,652	2,134	2,118
Chemical products	7,976	7,830	11,758	12,390	−3,782	−4,560
Engineering products	28,707	30,562	16,985	18,579	11,722	11,983
Transport equipment	7,762	8,376	9,121	9,007	−1,359	−631
Food, beverages and tobacco products	3,999	3,767	9,017	8,876	−5,018	−5,109
Textiles, leather and clothing products	18,523	20,270	5,974	6,044	12,549	14,226
Other	10,619	10,842	7,429	7,475	3,190	3,367
Total	**93,894**	**95,834**	**110,678**	**99,256**	**−16,784**	**−3,422**

Source: Istat.

of this amounted to 6.2 per cent (8 per cent on an annualized seasonally adjusted basis). This was in line with the rise in total domestic demand and the elasticity of imports in recent years. Purchases of semi-finished products and final consumer goods rose considerably, while those of final investment goods increased more slowly, though this was partly due to the high level of these imports in the first half of 1985.

The collapse in the price of oil produced far-reaching changes in the geographical and product composition of Italian trade. The breakdown by major product group shows that more than 80 per cent of the reduction in the deficit through August compared with 1985 can be attributed to energy products (Table 7). Overall, the surplus of the other groups rose from 8,896 to 11,437 billion lire, while the individual balances either improved or remained virtually unchanged, with the important exception of that of trade in chemical products. The textile and clothing industries substantially increased their surplus, which was the largest of all these macroeconomic groupings and about 20 per cent bigger than that of the engineering industry. Substantial improvements were made in the balances of the transport equipment and food industries, though both continued to be in deficit.

The geographical breakdown of merchandise trade in value terms through June of this year shows that the largest reduction was in the OPEC component (Table 8). The huge contraction in the imports from these countries was accompanied, however, by a sharp fall in the corresponding

Table 8

Merchandise trade by countries and areas

(billions of lire)

	EXPORTS (fob)		IMPORTS (cif)		BALANCE	
	January-June		January-June		January-June	
	1985	1986	1985	1986	1985	1986
EEC	**33,274**	**38,691**	**39,824**	**42,426**	**−6,550**	**−3,735**
Belgium-Luxembourg	2,106	2,420	3,180	3,670	−1,074	−1,250
France	9,901	11,595	10,572	11,287	−671	308
Germany	10,911	12,856	13,961	15,287	−3,050	−2,431
Netherlands	2,136	2,410	4,484	4,664	−2,348	−2,254
United Kingdom	4,651	5,156	4,166	4,009	485	1,147
Ireland	166	191	350	314	−184	−123
Denmark	552	693	670	777	−118	−84
Greece	1,279	1,101	595	553	684	548
Spain	1,188	1,722	1,587	1,637	−399	85
Portugal	384	547	259	228	125	319
United States	**8,358**	**7,833**	**5,588**	**4,762**	**2,770**	**3,071**
Japan	**827**	**854**	**1,406**	**1,627**	**−579**	**−773**
Canada	**853**	**950**	**525**	**440**	**328**	**510**
Eastern Europe	**2,299**	**2,087**	**4,238**	**3,330**	**−1,939**	**−1,243**
of which: USSR	1,377	1,131	2,418	1,806	−1,041	−675
OPEC	**7,336**	**5,202**	**15,238**	**9,189**	**−7,902**	**−3,987**
of which: Algeria	832	875	2,478	1,733	−1,646	−858
Saudi Arabia	2,077	1,253	1,794	1,461	283	−208
Libya	1,332	723	3,479	2,037	−2,147	−1,314
Other	**17,204**	**17,165**	**20,272**	**17,753**	**−3,068**	**−588**
Total	**70,151**	**72,782**	**87,091**	**79,527**	**−16,940**	**−6,745**

Source: Istat.

exports, presumably as a result of the reduction in oil-exporting countries' absorption capacity in the wake of the collapse in oil prices. The merchandise trade deficit with the rest of the European Community was reduced substantially, from 6,550 to 3,735 billion lire. This was primarily due to the rapid growth in exports to the area (16.3 per cent), which consequently rose to over 53 per cent of Italy's total exports. Country by country, the largest improvements were recorded in merchandise trade with France, the United Kingdom, Germany and Spain.

In the first six months of this year the structural surplus on trade in services continued the downward trend recorded in 1984-85 and contracted by about 1,000 billion lire compared with the corresponding period in 1985. The contribution of foreign travel dropped from 5,178 to 4,468 billion lire (Table a18). Receipts from inward tourism decreased by 9 per cent, while spending on outward tourism increased by 6 per cent. Since Italian consumer prices rose by about 6 per cent, foreign tourists' real expenditure actually fell by over 14 per cent. The number of nights spent in Italy remained unchanged, so that the fall was due to the reduction in average unit expenditure (14 per cent at constant prices). This result reflected both the decline in the purchasing power of the dollar and a shift in the geographical composition of inward tourist flows. In particular, there was a 20 per cent drop in the number of tourists from North America, whose unit expenditure has traditionally been higher than the average.

The deficit on income from capital did not change significantly compared with the first half of 1985. The currency diversification of Italy's foreign debt, which involved a substantial reduction of dollar-denominated liabilities, especially those of a short-term nature, meant that the debt service burden was only eased in part by the depreciation of the US currency. Furthermore, this gain was offset by the increase in Italy's net foreign debt.

The balance on public unilateral transfers to and from international organizations swung from a surplus of 440 billion lire in the first half of 1985 to a deficit of 2,309 billion. More than 80 per cent of this deterioration was attributable to transactions with the European Community, the balance on which swung between the same periods from a surplus of about 1 trillion lire to a deficit of the same size. The reduction in transfers from FEOGA was compounded by the doubling of the VAT-related contributions to the EC. The rise in transfers to non-EC international organizations was due, in turn, to Italy's increased commitment in the fields of development aid and multilateral cooperation.

Capital movements and the exchange rate

The current account deficit of about 4 trillion lire was offset by an overall capital inflow of more than 9 trillion lire (Table 9). Accordingly, the official reserves net of adjustments for exchange rate changes and the revaluation of gold increased by over 5 trillion lire.

Table 9

Capital movements
(billions of lire)

	1985	1985 Jan-June	1986 Jan-June (1)
Inward investment	4,165	3,429	3,410
Outward investment	−4,993	−1,347	−3,118
of which: investment funds	*−678*	—	*−1,527*
Foreign loans	7,063	3,418	1,815
Italian loans	−2,320	−1,153	−1,093
Trade credits, other capital flows and errors and omissions	−4,235	−191	1,192
Total non-bank capital flows and errors and omissions	**−320**	**4,156**	**2,206**
Bank capital flows	**−5,301**	**4,191**	**7,137**
Memorandum item:			
Variation in official reserves	−13,653	−1,552	5,140

(1) Partly estimated.

Provisional and partly estimated data indicate a net inflow of non-bank capital amounting to over 2.2 trillion lire, compared with one of 4,156 billion in the first six months of 1985. As regards

foreign capital, the flow of loans contracted abroad by Italian concerns was smaller, while net inward investment through June was virtually unchanged compared with the corresponding period in 1985. There was a large increase in gross inward investment, which averaged about 2 trillion lire per month through June, twice the level recorded twelve months earlier. In 1985 about 60 per cent of foreign investment was in listed shares and government securities.

Medium and long-term borrowing abroad slowed considerably. The corresponding net inflow dropped from 3,418 to a little less than 2,000 billion lire. Operations subject to authorization produced a net outflow as a result of large repayments. The amortization schedules for the whole of 1986 could involve outflows totaling more than 9 trillion lire. By contrast, there was an increase in the operations that have been liberalized. The limit on operations of this kind, which had been raised to 3 billion lire for transactions with EEC residents in June 1985, was increased to 5 billion lire in August of this year for loans with maturities of between one and eight years from residents in OECD countries.

As regards Italian capital movements, the upward trend of net outward investment continued. Starting from about 1 trillion lire in 1980, the net outflow rose to just under 5 trillion last year. Through 1984 the growth can be attributed to direct investment and reflected the internationalization of Italian firms. These firms undertook to acquire production facilities in other countries and to rationalize their corporate structures through the creation of holding companies based abroad. Since last year there has, in addition, been a growing volume of portfolio investment flows, partly because a proportion of Italian investment funds' investments abroad are exempt from the non-interest-bearing deposit against purchases of foreign exchange. Net outward investment in the first six months of 1986 totaled over 3 trillion lire (1,347 billion lire in the corresponding period of 1985). In particular, investment funds' purchases of foreign securities amounted to more than 1.5 trillion lire and continued at a high level in July and August (more than 1 trillion lire). The scope for additional deposit-free investments abroad by the funds during the rest of the year amounts to roughly 3 trillion lire.

Notwithstanding the reduction in the rate of the non-interest-bearing deposit to 25 per cent in October 1985, this constraint remained a serious obstacle to investment abroad. The deposits held by the Bank of Italy rose from 8 to 12 billion lire between the first half of 1985 and the first half of 1986. In August of this year the rate in question was further reduced to 15 per cent.

Comparison of the figures for foreign exchange settlements in connection with merchandise trade with the corresponding customs figures shows that there was a net inflow of trade credits amounting to about 2 trillion lire. The outflows recorded in the last part of 1985 as a result of exporters granting deferred payment and importers paying in advance appear to have flowed back in the first quarter of this year. The current reversed again in the second quarter, with a net outflow that can be attributed both to imports having decreased more than exports and to the high level of corporate liquidity.

The overall balance of payments through September recorded a deficit of 1,865 billion lire (4,368 billion in the first nine months of 1985). Bank capital movements resulted in a net inflow of 5,138 billion so that the official reserves increased by 3,273 billion, after adjustment for exchange rate changes and the revaluation of gold.

The rise in banks' foreign debt occurred mostly in the first quarter (4,957 billion lire), when the dollar depreciated strongly against the lira and the ceiling on lira loans was in force. Furthermore, starting in April the covered interest differential was positive again, with a value of about 1.5 percentage points on an annual basis. After the ceiling was abolished at the end of June, bank capital movements gave rise to a net outflow of more than 1.7 trillion lire in the third quarter. This, in conjunction with the small deficit recorded by the other items of the balance of payments, caused a 1,873 billion lira reduction in the official reserves.

Between January and September 1986 the nominal effective exchange rate of the lira appreciated by 6.8 per cent. The 17.8 per cent rise of the lira against the dollar was coupled with one of 2.4 per cent vis-à-vis the EC currencies, primarily owing to the sharp appreciation against sterling (14.4 per cent). Compared with June 1985, the month preceding its last EMS realignment, the lira still shows a 2.5 per cent depreciation vis-à-vis the EC currencies in nominal terms, notwithstanding its advance since January.

Public finances

The corrective action taken in the Finance Law for 1986, together with the effects of a number of measures introduced in 1985, countered the tendency for the budget deficit to expand. Net of settlements of past debts, the borrowing requirement of the state sector through September was virtually equal to that recorded the previous year (about 81.5 trillion lire; Table 10). The task of curbing the government's financing needs was made easier by the continued growth in economic activity, which boosted the yields of corporate income tax and local income tax on juridical persons as well as reducing the claims on the Wage Supplementation Fund. The reduction in the price of oil also made a sizable contribution by permitting an increase in the excise taxes on petrol and diesel oil. This should produce an extra 3.5 trillion lire in 1986 (5.5 trillion in a full year).

Table 10

Borrowing requirements (1)
(billions of lire)

	1984	1985	1986 (2)
State sector			
1st half	38.276 (38.276)	60.690 (51.885)	46.314 (45.900)
January-September	63.659 (63.659)	93.409 (81.449)	81.920 (81.378)
Public sector			
1st half	41.176 (41.176)	61.208 (54.598)	45.138 (44.724)

(1) Including settlements of past debts (the figures in brackets are net of the payments made in cash and securities). — (2) Provisional figures.

The less pronounced imbalance in public finances was primarily attributable to the deficit net of interest payments, which, excluding settlements of past debts, is expected to decrease from 37.4 trillion lire in the first nine months of 1985 to 27 trillion in the corresponding period this year. This improvement offsets the increase in interest payments caused by the large rise in the public debt and the changes made in 1985 in the frequency of Treasury credit certificate coupon payments. Owing to the lag with which the yields on outstanding floating rate securities are revised, the reduction in the rates on Treasury bills has not yet had an appreciable effect on debt service expenditure.

A substantial part of the reduction in the aforementioned deficit was due to the fall in outlays of a financial nature. In particular, the additions to the endowment funds of ENEL and the state-controlled enterprises were on a smaller scale and local authorities' bank deposits decreased by 640 billion lire through August (compared with an increase of 1,210 billion in the first eight months of 1985). The curbing of the borrowing requirement also owed much to the rise in revenues, which were boosted by the increases in the rates of social security contributions and indirect taxes.

* * *

The results of the first three quarters are consistent with the main fiscal policy objectives for 1986, i.e. to reduce the deficit net of interest payments and halt the expansion of the borrowing requirement. This success was due to various earlier measures producing their full effects in the first part of this year, primarily as a result of the lead time needed for their implementation. In particular there was: a) the full application of the provisions regarding the calculation of self-employed workers' taxable incomes and of the rules governing the conventional allowable expenses for those who choose to keep simplified accounts (the related legislation dates back to the beginning of 1985); b) the implementation of the centralized Treasury

account, which entailed the deposit with the Treasury by 1 June of the cash balances (amounting to about 1,500 billion lire) of a wide range of public bodies (that had been temporarily authorized to maintain bank deposits up to 4 per cent of their budget expenditures); c) the payment by the same date of the first instalment (about 1,165 billion) of the balances exceeding 4 per cent of the budget expenditures of some special statute regions and provinces (whose autonomous revenues had previously been exempted from the centralized Treasury account requirements); d) the transfer to the centralized Treasury account (in compliance with Decree Law 356 of July 1985) of the balances held by local authorities with special credit institutions in respect of loans disbursed but not spent; e) the receipt of payments in connection with the building offences condonation (3,000 billion) since a large proportion of these payments were delayed until the beginning of this year; and f) the settlement of social security contribution debts in compliance with the aforementioned decree law, for the most part in the period February-July. It finally needs to be remembered that the law in question also reduced the amount of social security contributions charged to the budget, thereby causing the revenues to rise by about 1,300 billion through September compared with the first nine months of last year.

This downward pressure on the borrowing requirement was supplemented by the effect of measures taken in the last part of 1985 and the early months of this year. In particular, these included the previously mentioned increases in the excise taxes on oil products, the change in the method used to calculate public employees' cost-of-living increases (resulting in a saving of 300 billion lire through September) and the provisions contained in the Finance Law. This was not approved until towards the end of February, but several measures were introduced earlier by means of decree laws and began to produce effects from the early months of this year, especially on the revenues of non-state public bodies (by raising social security contributions, health service charges and regulated prices) and on the outlays for some social security benefits (family allowances, pensions and the annuities paid by the Industrial Accidents Insurance Institute).

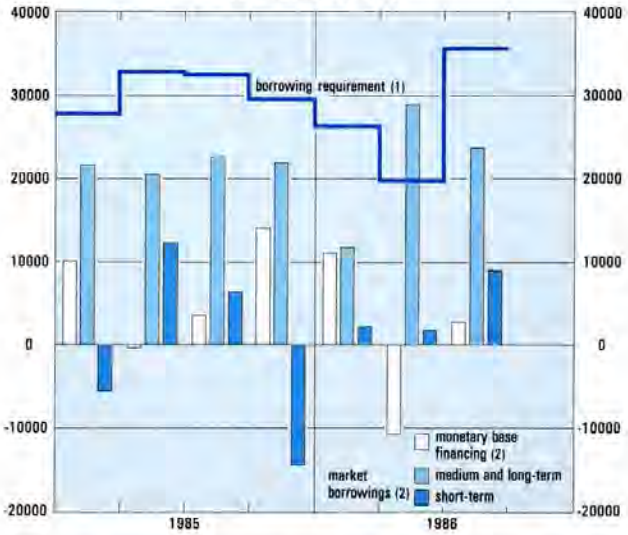
By contrast, the public sector's financing needs were increased by the restructuring of personal income tax (approved in April and expected to reduce revenues by about 5,400 billion lire this year), the disbursement starting in January of a part of the pension increases foreseen by Laws 140 and 141 of May 1985, together with the increase of most pensions to the minimum level paid to self-employed workers (the annual cost of this measure, which was part of the Finance Law, exceeds 700 billion lire).

Taken together, all the measures described above will result in a reduction in the borrowing requirement for 1986 of about 14 trillion lire (including the receipts from the increases in excise taxes matching the fall in the oil price, but excluding the effects of the authorization granted to ENEL and the state-controlled enterprises to contract debts to be amortized by the state, as discussed below). It is important to note, however, that the effects of some of the measures will be shortlived and that, even though others will reduce the level of public expenditure permanently, they will not slow its rate of growth, which has tended to exceed that of GDP in recent years.

Figure 8

State sector borrowing requirement and its financing

(billions of lire)



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

In the first nine months of this year nearly 80 per cent of the state sector borrowing requirement, including settlements of past debts, was financed by the sale of medium and long-term securities in the market. The corresponding figure in 1985 was less than 70 per cent (Figure 8). The proportion accounted for by net Treasury bill sales rose slightly, while that of central bank financing declined — in absolute terms by nearly 80 per cent. Over the same period the public debt expanded from 682 to 761 trillion lire.

Estimates of the results in the last quarter indicate that the 110 trillion lira objective for the state sector borrowing requirement net of settlements of past debts in 1986 will not be exceeded by much.

Table 11

Selected public finance balances

(billions of lire)

	1984	1985	1986(1)
State sector:			
Borrowing requirement, net of settlements of past debts	95,387	110,226	110,900
as a % of GDP	(15.5)	(16.1)	(14.5)
Settlements made in cash	—	2,187	1,000
Settlements made in securities	—	10,403	155
Total borrowing requirement	95,387	122,816	112,055
as a % of GDP	(15.5)	(17.9)	(14.6)
Borrowing requirement net of settlements and interest payments	37,794	46,770	37,900
as a % of GDP	(6.1)	(6.8)	(4.9)
Public sector:			
Borrowing requirement, net of settlements of past debts	101,857	112,259	113,000
as a % of GDP	(16.6)	(16.4)	(14.7)
Settlements made in cash	—	2,187	1,000
Settlements made in securities	—	5,270	155
Total borrowing requirement	101,857	119,716	114,155
as a % of GDP	(16.6)	(17.5)	(14.9)
Borrowing requirement net of settlements and interest payments	41,182	46,370	38,000
as a % of GDP	(6.7)	(6.8)	(5.0)

(1) The figures for the state sector are the official estimates published in the *Relazione Previsionale e Programmatica per il 1987*, those for the public sector are estimates consistent with those for the state sector.

The percentage ratio of this aggregate to GDP is expected to fall by more than one and a half points (Table 11). About half of this reduction will nonetheless have been contributed by items of a financial nature.

State sector expenditure and revenues

Disbursements by the state sector net of settlements of past debts amounted to 173.74 trillion lire through June. The increase compared with the first half of 1985 (9.3 per cent) was kept down by the fact that outlays of a financial nature did not rise. Current expenditure increased by 10 per cent owing to the rise in interest payments and purchases of goods and services. Expenditure on capital account increased by 7 per cent, with transfers to firms recording a pronounced rise and those to the regions a sizable fall.

Notwithstanding the absence of important labour contract increases and the application of the new six-monthly intervals for cost-of-living adjustments, employee costs in the state sector rose by 10.8 per cent. Purchases of goods and services rose even faster (14.6 per cent), primarily in connection with defense.

Interest expenditure net of reimbursements by the Bank of Italy increased by 22.7 per cent to 37.98 trillion lire. As mentioned earlier, this was largely due to the increase in the debt. Specifically, the interest payments on Treasury bills were down 7 per cent, while those on Treasury credit certificates were up 44 per cent. The decline in issue rates that started in February after over a year of near stability only affected Treasury bill interest payments, which are recorded in advance. By contrast, the payments in respect of floating rate securities reflected the level of interest rates in the period April-October 1985, which were only slightly down on those of the corresponding period in 1984. They were higher also because of the changeover from half-yearly to yearly coupons on issues in January-June 1985 and the resumption of issues with half-yearly coupons in the second part of the same year.

Current transfers increased by only 3.2 per cent. The very large increase in those regarding

the health service (nearly 15 per cent) was offset by the reductions in those to municipalities and provinces (−13.7 per cent) and social security institutions (−3 per cent). The reduction in the transfers to the former was attributable to the introduction of the centralized Treasury account, as well as to the aforementioned law requiring cash balances held with special credit institutions to be deposited with the Treasury, and to the delay in approving the law regulating local authority finances for 1986 (Law 488 of 9 August). The downturn in the transfers to the second group reflected the measures taken, as decribed above, to expand contributions and reduce benefits. The government action with regard to the latter focused on family allowances (granted within narrower income limits), wage supplementation payments (reduced by 5 per cent) and pensions (revalued every six months instead of every three).

Taken together, the measures regarding social security stabilized the deficit of INPS at its 1985 level. Indeed, the government transfers to this institution through June were down on the corresponding 1985 figure, 11.24 trillion lire as against 12.32 trillion. The improvement in the situation of INPS nonetheless does not appear to be firmly established. The increases in contributions are not sufficient to finance the continuous expansion in outlays associated with the maturation of the pension schemes; this expansion will be accelerated in coming years by the higher pensions approved in 1985 and the effects of the recent judgement of the Constitutional Court regarding the admissibility of supplementing each pension up to the min-minimum level in the event of a plurality of entitlements.

The growth in transfers on capital account (11.9 per cent) was basically due to the large increase from 1,990 to 3,420 billion lire in outlays that directly or indirectly benefit firms. In particular, these include the transfers to Mediocredito Centrale and Artigiancassa in connection with credit subsidies, and finance for shipowners and the shipbuilding industry. By contrast, there was a substantial reduction in the transfers to regions (from 2,770 to 2,040 billion lire), which reflected the decrease in the contributions disbursed to the Friuli Region for the reconstruction of the earthquake-stricken areas and to the National Transport Fund.

The acquisition of financial assets proceeded at much the same rate as in the first half of 1985 (nearly 7,900 billion lire), but their composition was very different. As mentioned, the additions to the endowment funds of state-controlled enterprises were smaller (1,500 as against 3,520 billion lire). In parallel with this reduction the state-controlled enterprises were authorized to make bond issues totaling 3,500 billion lire (the full amount was issued before the end of June) and to contract loans totaling 1,800 billion lire with the European Investment Bank (as from the middle of the year). In both cases the debt service (principal and interest) will be charged to the budget. The transfers to ENEL were also reduced (from 500 to 345 billion) and in lieu the Agency was authorized to increase its own revenues and to issue bonds or contract loans with the EIB for a total of 1,000 billion lire. On the other hand, the quarterly report of the Treasury Minister to Parliament reveals a sharp upturn in the activity of the Deposits and Loans Fund, which lent 800 billion lire to local health units to cover the deficits they had accumulated in the last few years (in 1985 these disbursements did not start until the second half of the year). The Fund also granted loans to SIP, Società Italiana per l'Esercizio delle Telecomunicazioni p.a., amounting to 860 billion lire and took up securities issued by special credit institutions for 900 billion lire (345 billion in the first half of 1985). The total financing provided by the state sector to these institutions rose from 1,010 to 1,580 billion lire, while that disbursed to local authorities remained virtually unchanged at 1,430 billion.

State sector fiscal revenues (including the VAT for reimbursements and accruing to the EEC but excluding accounting operations involving special statute regions and tax collection commissions) amounted to 100.5 trillion lire in the first half of the year. Compared with the corresponding period last year, this represents an increase of 25 per cent, but the comparison is distorted by the payment on account of the tax on bank deposit interest having been made in June instead of July. When the figures for the first eight months are compared, the increase is found to have been only 14 per cent. The Ministry of Finance assessment

figures (which suffer less from the delays to which the recording of receipts is subject) show an even smaller increase of less than 10 per cent.

A substantial contribution to the 14 per cent increase in direct tax receipts through August was made by the rises (of respectively 40 and 33 per cent) in the receipts from corporate income tax and local income tax on juridical persons. This reflected both the improvement in company profits in 1985 and the change made last year in the regulations governing the deductibility of interest expenditure from entrepreneurial income for tax purposes.

The payments of the balances due from physical persons in respect of self-assessed IRPEF and ILOR rose by respectively 23 and 18 per cent. This was partly due to the changes made in the regulations, in particular the conventional determination of taxable income for some categories of taxpayers and the restriction placed on the distribution of taxable income among the members of family businesses (in compliance with the provisions issued at the beginning of 1985). The figures available nonetheless suggest that the results of the above changes have been much smaller than expected, especially as regards IRPEF revenues. It is possible, however, that in this case the effect has been partly obscured by taxpayers' increasing use of the permitted deductions from taxable income.

The growth of only 6 per cent in the income tax withheld from private sector wages and salaries clearly reveals the effects of the relief granted since Jannuary, perhaps on a larger scale than expected. The withholding tax on the incomes of self-employed workers was unaffected by the above relief and grew much faster (25 per cent), while that levied on government employees grew by only 5 per cent.

Receipts from the flat-rate tax on interest rose by 19 per cent. This reflected both the increase in the tax base and the smaller than normal balances paid on bank deposit interest at the beginning of 1985 owing to a part of the liability having been paid in 1984.

As regards indirect taxes (which also yielded 14 per cent more through August), there was a sharp rise in the revenues from the duties on mineral oil products (29 per cent). This was the result of the higher rates introduced in December 1985 and the numerous variations made subsequently to offset the reduction in producer prices caused by the fall in the price of oil.

The decrease in the international prices of raw materials (especially that of oil) and the depreciation of the dollar curtailed VAT receipts from imports by more than 10 per cent according to the Ministry of Finance. VAT revenues from domestic transactions, which tend partly to offset variations in those from imports, rose by nearly 20 per cent. Total VAT revenues (gross of reimbursements and the part accruing to the EEC) expanded by 7 per cent.

Money and financial markets

Monetary policy

1986 began in the middle of a serious exchange rate crisis that was not justified by the performance of the fundamental variables in the Italian economy and which had severe repercussions on the money and financial markets as well as on the conduct of monetary policy itself. The development of the crisis and how it was overcome have been described in the previous issue of this Bulletin and in more detail in the Annual Report for 1985. The ceiling on bank lending, which had been reintroduced in January, was allowed to lapse when it expired as planned at the end of June.

In general the ceiling performed its function of limiting the availability of credit in lire and helping to dispel expectations of a devaluation. After exploding in the last few months of 1985, loans in lire dropped back to a level that was more consistent with the underlying state of the economy and not far in total from that foreseen when the measure was introduced. As was to be expected, there was some circumvention, especially during the first quarter. The forms of finance substituting for bank loans, in particular the lending of the special credit institutions, expanded briskly (Table 12), and the banks resorted again to accounting practices designed to curb the volume of loans outstanding at the end of the month, the reporting date for the control of the ceiling. On the whole, however, such activity did not seriously undermine the effectiveness of the measure, partly in view of its limited duration.

The large improvement in the terms of trade as from the beginning of the year helped to ease inflationary pressures and to reduce the trade deficit, thereby creating the conditions for faster growth in economic activity. The combined effect of these positive factors was to increase the scope for reducing the budget deficit. These favourable developments together with the weathering of the foreign exchange storm allowed monetary policy to adopt a less restrictive stance from March onwards and to foster a general reduction in interest rates.

Table 12

Total domestic credit

(annualized percentage changes) (1)

	1985	1986	
	Year	Jan-Aug	Objective
Bank lending (2)	15.5	6.2	
Special credit institution lending	9.5	10.1	
Net bond issues	7.4	29.1	
Non-state sector financing (2)	12.9	8.8	7.0
State sector domestic borrowing requirement (3)	21.8	16.8	
Total domestic credit (2)	18.0	13.7	13.2

(1) Seasonally adjusted. — (2) Corrected for exchange rate variations and the funding of past debts. — (3) Net of contributions to financial intermediaries' endowment funds and of funding operations.

This action is part of an overall strategy for monetary policy, based on an assessment of the partly contradictory messages coming from the various indicators. On the one hand there is the appreciation of the effective exchange rate of the lira and the increase in real interest rates. On the other there is the growth in credit to the non-state sector at an annualized rate of 8.8 per cent through August, compared with an objective of 7 per cent. Moreover, this rapid expansion of credit has gone hand in hand with a high level of corporate profits and substantial issues of shares. Notwithstanding these developments the monetary authorities have decided not to take drastic measures to counter this overshoot of credit to the non-state sector, though steps will be taken to reduce it gradually.

An important element in the overall situation is the very small growth in the money supply, M2. This reflected the slowdown in bank deposits, which expanded through August at an annualized rate of less than 6 per cent (Table 13). Owing to the faster increase in currency in circulation and Post Office deposits, M2 grew by about 7.5 per cent on an annual basis, which was close to the lower limit of the 7-11 per cent target range.

Table 13

Monetary aggregates

(annualized percentage changes) (1)

	1985		1986	
	Jan-Aug	Year (3)	Jan-Aug (2)(3)	Objective
Bank reserves (4) . .	12.1	18.1	−2.7	
Monetary base (4) .	12.2	14.6	2.9	
Bank deposits	13.4	10.1	5.9	
Money supply net of CDs (M2A) . . .	13.3	10.1	7.3	
Money supply (M2) .	14.2	11.1	7.5	7-11

(1) Seasonally adjusted. — (2) Provisional. — (3) The figures for bank reserves and monetary base are distorted as a result of industrial action at the Bank of Italy at the end of 1985. — (4) Corrected for the change in the compulsory reserve ratio.

The small growth in M2 was also due to the influence of financial innovation in causing a shift in the non-state sector's financial portfolio (Table 14). The share of the total flow of new financial assets consisting of M2 was only 29 per cent through August, compared with 40 per cent in 1985. The share of investment fund units rose sharply from 12 per cent to 28 per cent. The information available also suggests an increase in the share of portfolio management services, which include the custody, administration and buying and selling of securities. Both these developments may have contributed to a process of dis-intermediation in respect of banks. Investment funds can intermediate in securities at less onerous fiscal and fiscal-related conditions than banks. In turn, portfolio management services permit banks to cut back their balance sheets and hence to avoid costs such as the withholding tax on deposit interest and those associated with compulsory reserves.

Table 14

Financial assets of the private sector

(percentage composition) (1)

	Stocks		Flows	
	1985 Dec	1986 Aug	1985 Year	1986 Jan-Aug
Money (M2)	58.1	54.5	39.2	28.7
of which: bank deposits .	45.3	41.8	24.7	15.4
Treasury bills and acceptances	15.4	13.2	12.4	−5.8
Medium-term securities . .	21.7	23.8	35.6	46.5
Investment fund units . . .	2.2	4.0	11.6	28.3
Other	2.6	2.5	1.2	2.3
Total . . .	100.0	100.0	100.0	100.0

(1) Seasonally adjusted.

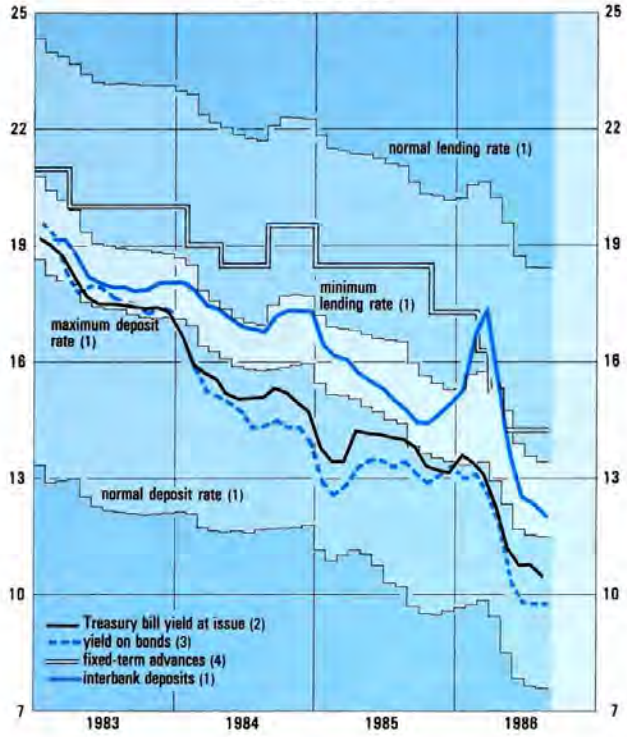
The combined effect of these factors has been to increase the already large differential between the growth rate of total domestic financial assets (excluding shares but including investment fund units) and that of money. In August this gap was equal to 9 percentage points, compared with 7 at the end of 1985.

The impression that the slowdown in the growth of bank deposits and money stems in part from shifts in portfolio preference is confirmed by the fact that the yield differential with respect to government securities narrowed over the year. Specifically, at the end of June Treasury bills were yielding 6 points more than deposits after tax, while in September this gap had narrowed to barely 4.5 points (Figure 9). The evidence of an autonomous shift in the demand for money remains even when one considers that the demand for government securities was sustained by widespread expectations of a reduction in interest rates and the consequent prospect of capital gains.

Since the interest rate on deposits and other liquid assets did not change to any great extent, the decrease in the differential between the rates on government securities and money was mainly

Figure 9

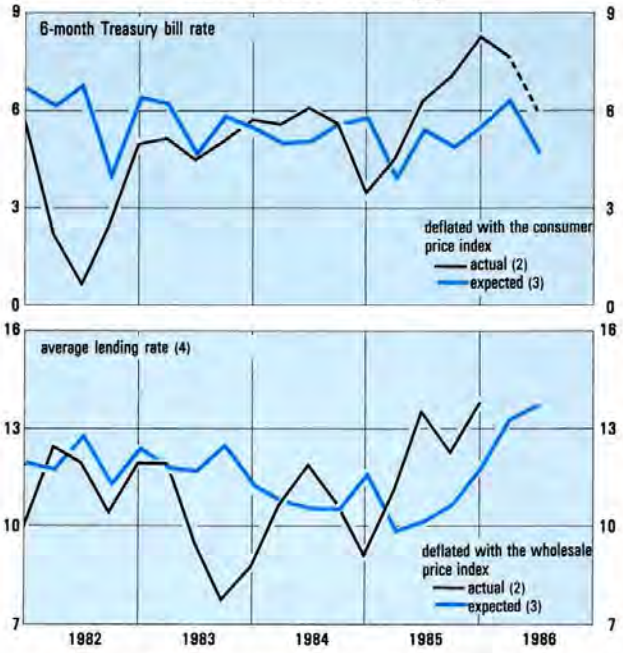
Interest rates



(1) Based on returns made every ten days (see Table a27). — (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.

Figure 10

Real interest rates (1)



(1) Estimated values of interest rates net of inflation; yields refer to the six months following. — (2) The deflator is the effective change in prices over the six months following the observation period, on an annual basis. The deflator of the Treasury bill rate is based on the consumer price index and the last observation is partly estimated. The deflator of the lending rate is based on an index of manufacturing production prices. — (3) The deflator is the expected change in prices calculated by the Bank of Italy on *Mondo Economico* data (expected inflation in the six months following the observation of the interest rate, calculated on the basis of quarterly inflation expectations). The deflators of the Treasury bill rate and the lending rate are the expectations regarding respectively consumer and wholesale prices. — (4) The nominal rate on lira loans is provided by the Bank of Italy Central Risks Office.

caused by the fall in the Treasury bill rate, which was particularly pronounced in the first part of the year. In March the average yield on Treasury bills was already below its end-December level and the three following months saw this value drop by about 2.5 points in response to three successive reductions in the official discount rate. The decline in interest rates continued from mid-June to mid-September, albeit more slowly, and amounted to more than half a point. The reduction in nominal yields was about equal to that in both expected and actual inflation. Indeed, the real yield at the beginning of the autumn was below the end-1985 level, though the average for the period was well above that recorded in 1985 (Figure 10).

On 19 September a Decree Law imposed a withholding tax at the rate of 6.25 per cent on the interest on subsequent issues of government securities. The rate will rise to 12.50 per cent from 1 October 1987. For individuals the withholding tax is in settlement of their liabilities, while it is on account for legal persons, whose interest income from new issues of government securities is now part of their taxable income.

At the end-September auction, the first after the introduction of the tax, the pre-tax yield on Treasury bills rose, depending on the maturity, by between 20 and 40 basis points compared with the previous auction. Net of the withholding tax, yields maintained their downward trend, falling by between roughly 30 and 50 basis points to below 10 per cent for the first time since 1975. The gradual decline in yields went a step further at the first October auction, with falls of 10-20 basis points.

In the secondary market the quotations of Treasury bonds rose significantly when the withholding tax was introduced, as did those of

Treasury credit certificates, though the latter subsequently fell back to the levels prevailing before its introduction.

After rising by more than one percentage point between December 1985 and March 1986 as a result of the monetary restrictions imposed by the Bank of Italy, the average bank lending rate fell by about three points by the autumn. Notwithstanding this large reduction, the sharp slowing down of both expected and actual inflation caused the real cost of credit to climb steeply (Figure 10). It should be noted, however, that some bank loans are granted at rates below the prime rate.

The cost of repurchase agreements with the Bank of Italy (see insert), which fell by seven percentage points from its March peak to the value obtaining at the beginning of June and then by nearly two more points over the following four months, exerted a strong influence on bank rates and especially on those in both the traditional and the overnight segments of the interbank market. By the autumn these had fallen by 6-7 points from the peak recorded in the first quarter. The reduction in money market rates was achieved while maintaining strict control over bank liquidity, which, apart from sporadic peaks, averaged between 3 and 4 trillion lire, including central bank refinancing.

The curb kept on bank liquidity was an integral part of the tight control kept on the monetary base. The small growth in the latter from the beginning of the year, at an annualized rate of 4 per cent through September, was partly due to the abnormal expansion that occurred at the end of 1985. The slowdown was nonetheless considerable even if the effect of that rapid build-up is attenuated by comparing the September twelve-month increase (8 per cent) with that as of January 1986 (10 per cent). Not only has the growth of the monetary base been returned to a path compatible with monetary stability but its composition shows a better balance. 1985 ended with a substantial creation of monetary base through domestic channels, primarily via the Treasury. A resultant outflow of resources caused a drain on the foreign currency reserves. By contrast, during the first nine months of this year the domestic channels caused a destruction of monetary base totaling about 4.7 trillion lire. In particular, the Treasury limited its contribution to the expansion of liquidity to 3.1 trillion. The monetary base created by the inflow of foreign currency reserves (3.8 trillion) partly offset that destroyed via the domestic channels (Table 15).

Table 15

Monetary base

(changes in billions of lire)

	1985		1986 (1)
	Jan-Sept	Year	Jan-Sept
Sources			
Foreign sector	−4,671	−13,679	3,816
Treasury	13,268	27,518	3,137
Borrowing requirement	*93,409*	*122,816*	*81,919*
(excluding settlements of post debts)	*(81,450)*	*(110,226)*	*(81,377)*
Outstanding securities excluding BI	*−76,332*	*−82,586*	*−76,522*
Other financing (2)	*−3,809*	*−12,712*	*−2,260*
Refinancing of banks	1,970	5,881	−5,209
Other sectors	−2,886	−644	−2,664
Total	**7,681**	**19,076**	**−920**
Uses			
Currency in circulation	−382	4,003	−353
Bank reserves	8,063	15,073	−567

(1) Provisional. — (2) Includes PO deposits, foreign loans and other minor items.

Compared with the first nine months of 1985, the development of the state sector borrowing requirement can be divided into two periods: in the first five months of 1986, net of settlements of past debts, it exceeded the corresponding 1985 figure by about 4 trillion lire, while in the four following months it was substantially lower than a year earlier, with the overall result that the total through September was virtually the same as in the preceding year.

The slowdown in the growth of the borrowing requirement during the summer allowed it to be financed without excessive strains at a time of weak demand for government securities. At the

Bank of Italy intervention in the money market

At the beginning of 1986, measures were taken to stem the outflow of exchange reserves. In order to increase the efficacy of these measures, the Bank also made a number of coordinated interventions in the money market. In January, the high demand for liquidity, resulting from the heavy payments in that month to meet the obligatory reserve requirement, was increasingly met by the granting of temporary financing based on repurchase agreements. These operations were at rates that, in the last ten days, exceeded those on fixed-term advances. The latter which had amounted to 6.2 trillion at end-December 1985, subsequently fell by more than 3.0 trillion. Moreover, in the presence of speculative pressures on exchange rates, one indication of which was the continuing negative values of the interest differential net of forward discount between the lira and the other principal currencies, the demand for liquid funds was not satisfied in its entirety, causing the cost of overnight money to rise above the rates charged by the Bank of Italy.

February saw an inflow of foreign currency reserves; in the presence of a large Treasury borrowing requirement, the offer of financing based on repurchase agreements remained limited. The rate on overnight deposits, though lower than at end-January, continued high and remained above the average cost of fixed-term advances until mid-March. Thereafter, as expectations of exchange rate stability became more generalised and as the rate of growth of the borrowing requirement slowed, the process of reducing interest rates was resumed. The end-March change in the discount rate was followed by two further cuts in April and May which were fully reflected in the rates for temporary financing. The effective cost of fixed-term operations, i.e. including the surcharge, increased by one percentage point in May due to the surcharges imposed on a limited number of operators; such operations were extinguished by the end of the month.

The Bank's open market operations in the first half consisted almost entirely of purchases, in contrast with the predominance of sales in the same period of the previous year. The market financing of a high proportion of the Treasury cash deficit, together with the modest creation of the monetary base via other channels, made the continuance of temporary financing to the banking system necessary. The latter transactions were renewed for gradually decreasing amounts until April; at the end of that month they amounted to 4.6 trillion as compared to 15.3 trillion at end-January. Such operations rose again in May concomitant with important commitments made by the banking system on the primary bond market for government securities. By the end of June, following consistent surpluses in the Treasury's cash flow, they reached 12.3 trillion.

The trend was reversed in July when net subscriptions for government securities fell short of the Treasury's borrowing requirement by 10.0 trillion and the expansionary effect on the monetary base was fully offset through a reduction in securities held under repurchase agreements by an amount corresponding to the increase of the previous month.

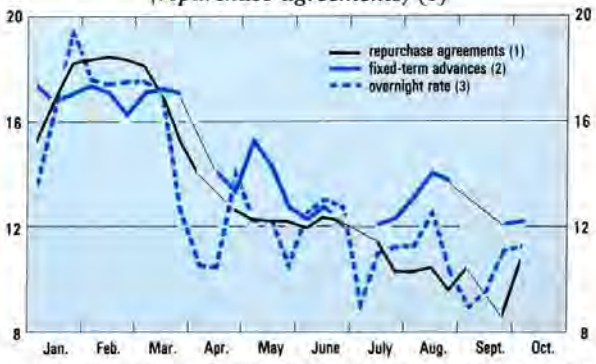
As in July and in the early months of the year, control of the monetary base in August and September was assured by the gradual extinction of such temporary financing. Only in mid-September, and for the first time in twelve months, were any temporary sales operations undertaken and even then they terminated within the month.

The withholding tax on the yields of new issues of government securities, introduced on September 19, was not followed by any shortfall in sales at the auction at the end of that month. This result was favoured by both the limited change in post-tax yields and the commitment of the banks belonging to the group of intermediaries set up about two years ago to facilitate the placement of Treasury bills on issue.

In the presence of temporary Bank of Italy financing intended to steady the primary market, the less stable demand for government securities resulting from the changes in their tax treatment led to greater variability of the rates on repurchase operations in the second half of September and the first half of October. The minimum cost of such operations varied between a lower limit of 8.6 per cent and a higher one of 12.05 per cent between end-September and mid-October.

Rates on Bank of Italy operations and the rate on overnight deposits

(repurchase agreements) (1)



(1) Simple average of the minimum rates on operations undertaken in the ten-day period. — (2) Weighted average of rates on operations undertaken in the decade. — (3) Simple average of bid prices.

auctions between the end of June and the beginning of August the demand for medium and long-term paper, in particular, was lower than the authorities had foreseen. In the preceding months the strong expectations of lower yields, which as the weeks passed were confirmed by the reduction in interest rates, had led market participants to anticipate their purchases. In the second half of August, with the renewal of expectations of a fall in yields, demand picked up strongly again and the sale of government securities became easier.

The combined effect of the borrowing requirement and lending to the non-state sector was a slowdown in the expansion of total domestic credit. The twelve-month increase in August was 16 per cent, compared with 18 per cent in December 1985. In the first eight months of 1986 this aggregate expanded at an annualized rate of less than 14 per cent, which was close to the objective (Table 12).

Financial markets

The share market has made considerable progress this year towards establishing itself in a new and more important role. Through September listed companies made share issues totaling 9.4 trillion lire, an unprecedented volume for the Italian market (Table 16). In the whole of 1985 new issues amounted to less than 5 trillion lire. There have also been substantial public offers of shares by firms wishing to broaden their shareholder bases in preparation for stock exchange listing. No less than 27 companies were listed in the first nine months of this year, compared with a total of 13 in 1985.

Share issues are nonetheless still highly concentrated in a few major groups. The five with the largest volumes accounted for about 70 per cent of the total. It is also noteworthy that ordinary shares, which are the only ones giving shareholders a say in the management of companies, account for little more than one third of the total shares issued, the greater part consisting of savings shares (see insert).

Notwithstanding the large flow of new issues and thanks also to the activity of institutional investors, share prices on the Milan stock exchange rose over the first nine months by around 70 per cent on average, which was much more than in other industrial countries. The rise in prices was extremely rapid in the first quarter, in line with the pace of the last few months of 1985. In the spring the upward pressure eased and in the second half of May and in June there was an extensive shake-out. The subsequent upturn in July and August was followed by renewed weakness in September, at the end of which the index had returned to its April level.

Table 16

Gross share issues

(billions of lire)

	1984 Year	1985 Year	1985 Jan-Sept	1986 (1) Jan-Sept
Listed shares	**5,980**	**4,991**	**1,935**	**9,425**
state-controlled companies	3,970	2,161	409	1,760
private sector companies	2,010	2,830	1,526	7,665
Unlisted shares	**5,804**	**9,986**	**5,033**	**1,954**
state-controlled companies	2,434	7,348	2,768	941
private sector companies	3,370	2,638	2,265	1,013
Total	**11,784**	**14,977**	**6,968**	**11,379**
state-controlled companies	6,404	9,509	3,177	2,701
private sector companies	5,380	5,468	3,791	8,678

(1) Provisional.

The share purchases of the investment funds were concentrated in the months when prices were weakest and new issues greatest. The funds' share portfolio expanded from 5.1 trillion lire in December 1985 to 17.4 trillion in September of this year. Two thirds of this increase was due to new investments and one third to the rise in share prices over the period in question.

Italian shares were not the only part of the investment funds' portfolio to expand rapidly: their investments abroad exempt from the non-interest-bearing deposit grew from about 0.7 trillion lire last December to 3.4 trillion in September of this year; at the same time their holdings of government securities more than tripled, increasing by 23 trillion lire (Table 17).

Against this increase in the investment funds' portfolio of government securities, there was a substantial decrease in credit intermediaries'

holdings of such paper (13.7 trillion lire through August). The growth in the public's holdings of government securities was larger than that recorded last year. The total demand for securities may have been boosted by the broader range of financial intermediation services having attracted new savers to the financial market.

Table 17

Portfolios of Italian investment funds

(billions of lire)

	Lira securities			Foreign currency securities		Total
	Government (1)	Bonds	Shares	Bonds	Shares	
1984 — Dec. ...	772	171	176	—	—	1,119
1985 — Dec. ...	11,269	1,876	5,095	322	356	18,918
1986 — Mar. ...	20,364	3,177	10,824	486	665	35,516
Apr. (2)	24,925	3,929	12,893	495	790	43,032
May (2)	28,899	4,411	13,904	593	1,103	48,910
June (2)	30,641	4,217	14,238	560	1,646	51,302
July (2)	31,411	4,606	16,113	818	1,761	54,709
Aug. (2)	33,075	4,981	18,211	1,069	2,195	59,531
Sept.(2)	34,476	4,949	17,405	1,160	2,238	60,228

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

The net issue of government securities amounted to about 70 trillion lire in the first quarter of 1986 (Table 18). This was close to the corresponding figure for 1985 (net of securities issued to fund past debts). Sales benefited from renewed market interest in fixed rate securities, and in those convertible into fixed rate securities, as a result of expectations of reductions in interest rates. The net issues of Treasury bonds with maturities ranging from 2 to 5 years amounted to 27.5 trillion lire and provided total resources net of coupon payments equal to nearly 22 trillion lire (see the item "Net proceeds" in Table 18).

Table 18

Government securities (1)

(billions of lire)

	Issues		Net proceeds (3)	
	Gross	Net (2)	Total	Market (4)
Treasury bills				
1984 Year	227,747	9,300	−11,981	−4,812
1985 Year	256,281	13,181	−8,116	−20,341
1985 Jan.-Sept....	195,500	18,370	2,155	1,393
1986 Jan.-Sept.(5)	185,000	7,000	−23,081	−18,198
Treasury credit certificates				
1984 Year	95,250	56,738	31,413	30,525
1985 Year	97,210	78,567	51,111	42,697
1985 Jan.-Sept....	74,143	55,840	34,537	31,280
1986 Jan.-Sept.(5)	52,937	36,442	6,959	7,729
Treasury bonds				
1984 Year	17,750	8,433	4,328	885
1985 Year	17,289	3,975	−1,065	611
1985 Jan.-Sept....	10,288	2,141	−1,658	−200
1986 Jan.-Sept.(5)	42,651	27,522	23,553	22,026
Other				
1984 Year	1,688	−1,988	−3,842	−2,125
1985 Year	13,775	10,381	8,306	9,339
1985 Jan.-Sept....	12,302	8,908	7,109	8,600
1986 Jan.-Sept.(5)	2,361	−822	−3,244	−1,408
Total				
1984 Year	342,435	72,483	19,918	24,473
1985 Year	384,555	106,104	50,236	32,306
1985 Jan.-Sept....	292,233	85,259	42,143	41,073
1986 Jan.-Sept.(5)	282,949	70,142	4,187	10,149

(1) The 1985 figures include the securities issued to fund past debts amounting in net terms to 9,923 billion lire. — (2) Net of discounts and redemptions. For Treasury bills, net of redemptions only. — (3) Gross issues less redemptions, discounts and coupons paid. For Treasury bills, gross issues less redemptions and discounts. — (4) Total net proceeds less the part in respect of the Bank of Italy. — (5) Provisional.

Credit intermediaries

The disintermediation of bank lending associated with the slow growth in deposits is now involving areas and categories of customers that had previously been exempt as well as spreading from large to small banks. The economic significance of this development is really even greater since large banks can more easily expand their activity through subsidiaries in new markets.

Savings shares

In the first nine months of 1986, issues of savings shares by companies quoted on the stock exchange were particularly large, amounting to 5,583 billion, or 59 per cent of total issues by quoted companies (Table 1). Such shares can be issued by companies whose ordinary shares are quoted on the stock exchange to an amount which, together with limited voting shares, does not exceed 50 per cent of authorized capital.

Table 1

Offer of shares by type: January-September 1986

(billions of lire)

	Options	Public offers	Total
Savings shares	5,583	—	5,583
Savings bank savings shares	230	538	768
Preference shares	33	208	241
Ordinary shares	3,579	1,369	4,948
Total	**9,425**	**2,115**	**11,540**

Since savings shares carry no voting rights, they enjoy certain compensatory privileges as regards the distribution of profits. In fact, at least 5 per cent of the nominal value of savings shares must be allocated to such shares as dividend from net income; should a smaller dividend be distributed in any one year, savings shareholders are entitled to receive the difference in the two following financial years. Savings shareholders also have the right to a dividend which is higher by at least 2 per cent of their nominal value than that paid on ordinary shares. Finally, savings shareholders are privileged compared with other shareholders in the event that the authorised capital has to be written down as a result of losses or that the company has to be liquidated.

Savings shares, which may be quoted on the same exchanges as company's ordinary shares, can be registered or non-registered. In the latter case the related dividends are subject to a 15 per cent final withholding tax. In the case of registered shares, the shareholder can opt for the payment of a withholding tax on account.

Their legally-based privileges would suggest that savings shares should bear higher prices than ordinary shares. But these advantages (the most important being the right to a 5 per cent minimal dividend and to the dividend mark-up) refer to the nominal value, which is usually lower than the market value. In addition, the market attaches value to the right of ordinary shareholders to nominate the board of directors. In view of these considerations, savings shares are quoted at a lower price than ordinary shares. By way of illustration, the price of savings shares at end-August 1986 was, on average, 61 per cent lower (and 81 per cent lower at end-December 1985) than that of ordinary shares (Table 2), with the range of fluctuation having a low of 43 per cent to a high of 96 per cent. Prices of savings shares were in no case higher than those of ordinary shares, indicating that the right to vote, even when control of the

The fact that the slowdown in deposits has been primarily among savings accounts, which represent a store of value rather than a means of payment, confirms that it is partly due to financial innovation. The recent changes in the regulations governing certificates of deposit (see insert) will enable banks to pursue more flexible fund-raising policies.

The sectoral, maturity and currency compositions of bank lending were considerably influenced in the first part of the year by the introduction and then the abolishment of the ceiling. Short-term lending to enterprises, in particular financial ones, was the most variable component. Having surged at the end of 1985, it contracted rapidly until the ceiling expired in June and actually recorded negative growth in the first six months. In July, however, it expanded considerably again. Lending to households, general government and at long-

company by the majority shareholders was exercised via very large shareholdings, was much appreciated by the market.

Table 2

Non-convertible savings shares quoted on the Milan Stock Exchange

(29 August 1986)

	Average	Minimum	Maximum
Minimim dividend / Nominal value (%)	6.71	5	20
Dividend mark-up / Nominal value (%)	2.48	2	4
Market value / Nominal value (%)	7.12	0.90	47.60
Minimum dividend / Market value (%)	1.79	0.21	7.76
Dividend mark-up / Market value (%)	0.66	0.08	3.33
Savings share price / Ordinary share price (%)	61.39	43	95.71
Net dividend on savings shares (1) / Price of savings shares (%)	1.70	0.34	5.16

(1) Exclusively for the shares on which a dividend had been declared before the observation date. The last distributed dividend was adopted, net of withholding tax, adjusted for increases in capital.

At the same date the ratio between market value and nominal value of non-convertible savings shares was on average equal to 7.1, ranging from a minimum of 0.9 to a maximum of 47.6. These high values generally reflected the size of capital reserves compared with the value of equity. A more balanced relationship, by means of a transfer of reserves to equity, would have favoured savings shareholders, given that their privileges are related to nominal values.

In particular, the minimum annual dividend guaranteed on issue by companies averaged 6.7 per cent of the nominal value, varying from a maximum of 20 per cent to the legal minimum of 5 per cent. In relation to the market values, however, the protection afforded by the minimum dividend — which is only valid profits permitting — fell to 1.8 per cent. It may also be noted that the protection offered by the minimum dividend is only valid if profits have been generated during the year: the availability of accumulated profits, that is of reserves, is not sufficient. The clause is therefore more meaningful for savings shares issued by companies with more stable incomes, even if the right to the minimum dividend from the income of the following two years does lessen this advantage.

The dividend mark-up on savings shares over ordinary shares was on average equal to 2.5 per cent of nominal value, with the range going from a maximum of 4 per cent to the legal minimum of 2 per cent, but it declines to 0.7 per cent if related to market value. Moreover, the ratio of net dividend to price (dividend yield) of savings shares averaged 1.7 per cent. The wide spectrum of values observed, from a minimum of 0.34 per cent to a maximum of 5.16, is explained by diverse expectations with regard to both dividend growth rates and the prices of the shares themselves.

term to non-financial companies followed a much more regular course. In particular, the growth in loans to households continued at the over 20 per cent rate reached in 1985. Banks' foreign currency lending, which had increased very considerably during the application of the ceiling (by 6.2 trillion lire), decreased significantly from July on and partly offset the large swings in lira lending.

The lending of the special credit institutions recorded very lively growth in the first six months of 1986. In June the rate of growth from the beginning of the year was more than 14 per cent, a substantial increase on last December's rate of around 9 per cent. As was to be expected after the introduction of the ceiling on bank lending, a major contribution to this acceleration was made by the industrial credit institutions and especially

Certificates of Bank Deposits

Certificates of bank deposits (CDs) are bank liabilities in the form of bearer bonds. Their holding by the general public has various positive aspects that, at the end of 1982, led the monetary authorities to take steps to encourage their issue.

A first advantage of such certificates is that they give banks the possibility of structuring their policy as regards borrowing rates in a more rational way. CDs, in fact, allow banks better to differentiate the yields on deposits according to whether they are held mainly as a means of payment or as a financial investment. Since deposits held mainly as an investment have lower unit costs of management and require the holding of less liquid funds it follows that they should be better remunerated than deposits held mainly for payment purposes: such discrimination could also allow the banking system to compete more effectively with other forms of investment without prejudicing its overall income.

Use of CDs also facilitates the management of monetary policy. Given the close degree of substitutability between the certificates and other financial instruments, their yield should respond to events on the money market more rapidly than do the rates on other categories of deposit. An increase in their share of liabilities thus heightens the sensitivity of lending rates to those directly influenced by the authorities and reinforces the ability of the indirect tools of monetary policy to influence aggregate demand.

In view of these considerations the monetary authorities introduced, for certificates with certain requisites, the benefit of a higher yield on the obligatory reserve requirement than that connected with other forms of borrowing: 9.5 per cent as compared to 5.5 per cent (Treasury Decree of 28 December 1982 and the Bank of Italy measure of 25 January 1983). Among the most important characteristics required of the banks on issues of deposit certificates may be cited: fixed rates of return over their entire life; a duration of not less than 6 months and not more than 18; equal yields on certificates of equal duration independently of the amount subscribed; and a minimum denomination of a million lire. In order to prevent the shortening of maturities, individual banks were forbidden to extinguish or purchase CDs issued by themselves before the due date or to accept them as security on loans.

The placement of CDs proceeded at a rather fast pace for about two years: early in 1985 they amounted to 3 per cent of total deposits. In the second half of that year, however, it began to slow down and declined futher in 1986: in the first eight months of 1986 the amount of CDs increased by about 4.2 trillion as compared to 5.2 trillion in the same period of the previous year. Notwithstanding the slow movement of other forms of deposit, the importance of CDs in total borrowing rose rather slowly, reaching 4 per cent towards the end of 1985.

their short-term lending. The real estate and agricultural credit institutions also recorded faster loan expansion than in 1985.

In July and August the lending of the special credit institutions slowed sharply and the growth rate from the beginning of the year dropped below 12 per cent. The major factor in this development was again the lending of the industrial credit institutions.

In sectoral terms the development of lending through July showed a pattern similar to that recorded in 1985. Financial companies, broadly interpreted to include leasing and money-management companies, accounted for about half the change in the special credit institutions' outstanding loans. Direct lending to industry remained at a low level and, in line with the trend of the last few years, the growth came primarily from loans to small and medium-sized firms.

Notwithstanding the buoyant growth of lending, the special credit institutions' raising of new resources was relatively limited. This

The slowing in the growth of CDs was partly attributable to a lower supply from the banks, which were reluctant to issue fixed-rate liabilities at a time of rapidly falling market yields. What is more, the certificates remained a form of time deposit instead of evolving into a money market instrument; such an evolution, by increasing their degree of liquidity, would encourage their use. Lastly, companies showed no interest in buying CDs: their excessively long duration meant that they could not effectively be used in cash management and their yield, taking their tax treatment into account, was not competitive with other forms of employment of liquid reserves.

To meet these difficulties, and to make CDs more suited to the needs of banking clients, the monetary authorities made changes, effective as from 1 November 1986, in the rules regarding them. The possible role of the various intermediaries on the secondary market was also better defined (Treasury Decree of 17 July 1986 and the Bank of Italy measure of 21 August 1986).

The higher remuneration on the obligatory reserve requirement was extended to certificates with a maturity of between 3 and 6 months and a value of not less than 100 million. At the same time, this remuneration was cut to 8.5 per cent in view of the fall in market yields: when CDs were first issued in January 1983, the return on Treasury Bills was about 19 per cent as against about 10 per cent in August 1986. Banks were also allowed to offer two different rates for the same maturity, depending on whether or not the denomination of certificates exceeded one billion lire.

As regards the development of the secondary market, the various categories of banks and their associated institutions were reminded that they could undertake initiatives intended to encourage dealing in certificates as long as such initiatives did not compromise the duration of the certificates. In particular, an issuing bank could facilitate the purchase and sale of its certificates by clients, using its own organization to help bring together supply and demand; the bank could not, however, lend funds to a seller until the operation was completed. Financial and financial-management companies associated with the issuing bank could buy and sell on behalf of clients. As regards the centralised credit institutions as well as other types of lending institutions, it was made clear that their interventions were to be on their own behalf and not on that of the issuing bank and that their operations were not to be financed by funds supplied by the issuing bank.

Another stimulus to the placement of CDs could arise from the October 1986 decision to tax the interest on State securities which, of all financial assets, are most closely akin to the certificates in terms of substitutability.

skew led to a reduction in their liquid balances held in government securities, which had risen to an exceptionally high level in 1985. Disinvestment of this kind appears consistent with the institutions' expectations that the lending boom might soon run out of steam. This view is confirmed, moreover, by the flow of loan applications, which, though still strong, has fallen off compared with the unusual December-March period.

Short-term prospects: international and domestic

Projections for the Italian economy in 1986

Analysis of the available cyclical indicators suggests that the growth of economic activity, which was slow but steady over the first half of the year, experienced a pause during the summer months. The index of industrial production, normalized and seasonally adjusted, declined in July-August 1 per cent on average in relation to the second quarter. The preliminary figures for September point to a slight recovery. Business expectations remain moderately optimistic, chiefly on the strength of domestic orders; export orders continue to be essentially stagnant.

The sharp improvement in the terms of trade in the first half of the year continued in July and August. In particular, the unit value of imports continued to decline appreciably under the combined influence of lower oil prices and the depreciation of the dollar. For the two months Italy achieved a trade surplus of more than 3 trillion lire, compared with virtual balance in the same months of 1985.

The steady fall in import prices helped to bring down the inflation rate over twelve months almost to 5 per cent by October. However, the gap between the movements of domestic consumer and wholesale prices remained large. For the fourth consecutive month, wholesale prices were about 2 per cent lower than in the corresponding month of 1985.

The increase in production expected for the fourth quarter should make it possible to achieve a rise in real output for the year estimated, according to the Government's *Relazione previsionale e programmatica,* at 2.8 per cent as against 2.3 per cent in 1985 (Table 19).

After a pause in the second half of 1985, investment in machinery, equipment, and transport has begun to grow again, stimulated by a strong capacity utilization and encouraged by a strong improvement in firms' cash flow. On average for the year, such investment should expand by about 4.5 per cent. With construction outlays expected to rise by about 1 per cent, total fixed investment should grow by slightly under 3 per cent. Such a development would be the outcome almost entirely of the ongoing restructuring of the productive sector. Finally, the data in the *Relazione previsionale* indicate that stock building should be quite robust, involving mainly raw materials, fuels, and agricultural products.

Table 19

Projection and planning scenario for the Italian economy

	1985	1986 (1)	1987 (2)
	(% changes)		
Real aggregates			
GDP	2.3	2.8	3.5
Domestic demand	2.4	3.1	4.2
Real external balance (2)	−1.1	−1.5	−2.7
Deflators			
GDP	8.8	8.9	4.3
Private consumption	9.4	6.2	4.0
Terms of trade (2)	1.0	11.6	0.8
	(percentages)		
Financial balances/GDP			
External current account balance (IMF)	−1.2	1.0	0.7
State sector borrowing requirement (net of settlements of past debts)	16.1	14.5	12.1

(1) *Relazione previsionale e programmatica sul 1987.* — (2) Percentage change in the index computed as ratio between volume index numbers of exports and imports in the national accounts.

The increase in consumer spending for 1986 as a whole will be less than that in households' disposable income. The lags with which households' spending decisions are adjusting to improvements in their purchasing power, together with uncertainty about the duration and extent of gains deriving from the improvement in the terms

of trade, has led to a decrease in the propensity to consume. Other factors contributing to the decrease have been the appreciable rise in income from sources other than wages and salaries and the persisting high level of real interest rates.

The greater penetration of Italian products on the markets of the industrial countries has more than offset the contraction of exports to the OPEC area. For the year as a whole, in fact, Italian exports should expand by 5.8 per cent. Although this rate of increase is more than two points below that in 1985, it is nonetheless faster than the expansion in world demand.

In volume terms, however, the balance of traded goods will continue to deteriorate. The increase in the volume of goods and services imports, equal at constant prices to 7.4 per cent, will exceed that indicated for exports. The improvement in the terms of trade, which is estimated on average to be more than 10 per cent for the year as a whole, will contribute to a balance-of-payments surplus on current account equivalent to about 1 per cent of GDP, as against a deficit of 8 trillion lire in 1985.

On average for the year the rise in the implicit price deflator for consumption should be 6.2 per cent; by end-year the annual rate of increase could be down to about 4.5 per cent. This progress is due essentially to lower prices in lire for imported goods. The parallel rise in the implicit prices of domestically produced goods, is estimated at 8.9 per cent, or about the same as last year.

Because of their varying incidence on the two different baskets, the fall in oil and primary materials prices in lire has had a stronger impact on wholesale than on retail prices. Specifically, wholesale prices could on average for the year show an actual decline. Those relating to manufactures alone will on the contrary rise by about 3 per cent, with unit costs of industrial output remaining essentially stable. Even taking account of differences in pricing policy between the domestic and international markets, which is apparently keeping export prices for industrial products relatively unchanged, overall profit margins for industrial firms will show a further improvement.

To the effects of measures to reduce the government deficit were added those of the continuing economic expansion and the slowing down of inflation. Estimates based on results for the first three quarters of 1986 indicate that the total state sector borrowing requirement for the year will be virtually unchanged in nominal terms (110.9 trillion lire as against 110.2 trillion in 1985, net of settlements of past debts). In relation to GDP, this would represent a decline by more than 1.5 percentage points, from 16.1 to 14.5 per cent. This achievement will come about as a result of a reduction in the deficit net of interest payments by about 9 trillion lire, offset by an increase in the burden of financial payments, primarily because of the expansion of the public debt and the issue as from the first half of 1985 of Treasury credit certificates bearing annual rather than six-monthly coupons. Given the lag in the adjustment of the yields of floating rate securities already issued, the pronounced decline in interest rates on new issues of Treasury bills will not make its full effects felt until 1987.

A large part of the reduction in the borrowing requirement net of interest payments stems from the decline in the deficit on financial transactions account. This in turn was due to measures aimed at bringing back to the Treasury a portion of the liquid funds held by public bodies as well as to a cutting back of appropriations to state-controlled corporations. These have instead been authorized to borrow in the market, with the amortization of such loans to be borne by the Government.

Leaving these factors out of consideration, the state sector borrowing requirement will expand at about the same pace as inflation. Moreover, taking account of the slower erosion in the purchasing power of public debt, thanks to the deceleration of inflation, public finance can be expected during the year to exert a moderate expansionary impulse on economic activity.

Monetary policy took advantage of the room for manoeuvre offered by the decline in inflation, the improvement in the balance of payments and the substantial achievement of the objectives for public finance. The entire structure of interest rates was lowered, and it became possible to expand credit to the non-state sector by slightly more than had been targeted. This took place with the lira holding steady in the exchange markets and the successful placement of virtually all new issues of government securities.

Table 20

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 (2)			
	billions of lire	% change	total	domestic (A)	change		change		ratio GDP	change		ratio to to GDP	
					billions of lire	%	billions of lire	%	(3)	billions of lire	%	(3)	(4)
1975	125,378	13.2	16,444	14,218	16,814	18.6	31,031	22.5	24.8	26,512	22.4	21.1	115.4
1976	156,657	24.9	14,867	14,208	19,752	18.7	33,960	20.1	21.7	28,131	19.5	18.0	110.3
1977	190,083	21.3	22,567	17,973	17,281	13.8	35,254	17.4	18.5	35,364	20.5	18.6	109.7
1978	222,254	16.9	34,305	31,763	17,495	12.7	49,258	20.7	22.2	48,161	23.1	21.7	115.7
1979	270,198	21.6	30,403	28,562	25,261	16.5	53,823	18.7	19.9	57,714	22.5	21.4	116.8
1980	338,743	25.4	37,018	34,015	29,219	16.4	63,235	18.5	18.7	51,338	16.3	15.2	108.6
1981 (1)	401,579	18.6	53,293	45,239	28,098	13.5	73,336	18.1	18.3	70,589	19.2	17.6	109.4
1982 (1)	470,484	17.2	72,702	69,036	31,604	13.4	100,640	20.9	21.4	89,588	20.4	19.0	112.6
1983	539,844	14.7	88,257	85,194	35,432	13.2	120,626	20.7	22.3	106,931	20.2	19.8	118.2
1984 (5)	615,119	13.9	95,387	91,400	48,322	15.6	139,723	19.7	22.7	129,379	20.3	21.0	124.9
1985 (6)	684,843	11.3	110,226	107,109	46,476	13.0	153,585	18.1	22.4	136,156	17.7	19.9	132.7
					(37,000)	(10.3)	(144,000)	(16.9)	(21.0)				
1986 (6) (7)	752,000	10.5	110,000	105,000	28,000	7.0	133,000	13.2	17.7	132,000	14.6	17.6	138.4
					(37,500)	(9.5)	(142,500)	(14.3)	(18.9)				
1986 (8)	**766,920**	**12.0**	**110,900**	**108,000**	**28,000**	**7.0**	**136,000**	**13.5**	**17.7**	**133,000**	**14.7**	**17.3**	**135.9**
1987 (7)	**827,912**	**8.0**	**100,000**	**97,000**	**30,000**	**7.0**	**127,000**	**11.1**	**15.3**	**123,000**	**11.8**	**14.9**	**140.8**

(1) Net of the effects of the non-interest-bearing deposit on external payments. — (2) Domestic, net of shares. — (3) Based on period flows. — (4) Based on end-of-period stocks. — (5) Lending to the non-state sector has been corrected for the distortions in banking statistics connected with the elimination of the ceiling on bank lending. — (6) Changes in lending to the non-state sector and total domestic credit in brackets have been corrected for the anomalous bulge in bank lending in lire in November and December 1985. — (7) Planning scenario.

N.B.: The total borrowing requirements for 1985 and 1986 do not include settlements of past debts in securities or cash; the latter are included, however, in domestic borrowing requirement.

More recent developments tend to confirm the tendencies commented upon. Yields on government securities have continued to decline gradually over the latest weeks. At the end-October auction the yield on twelve-month Treasury bills, net of the new flat-rate tax, was just over 9 per cent, about 70 basis points below the level existing just before the introduction of the tax on 19 September and nearly 4 points lower than in December 1985. Bank rates, especially lending rates, have also declined significantly.

Bank lending expanded in the first nine months of the year at an annual pace of about 8 per cent. An acceleration of lending in the third quarter brought the annual growth rate in credit to the non-state sector to above 9 per cent by the end of September, as compared with a target of 7 per cent. Deposits also gained new momentum in September and by the end of the month were more than 7 per cent above their level at the beginning of the year. Correspondingly, the expansion of the money supply M2 exceeded 8 per cent at an annual rate. Partly owing to the effects of financial innovation, however, money growth remains near the lower limit of the target range of 7 to 11 per cent.

Abundant corporate liquidity, together with the resources available through self-financing and recourse to equity markets, may permit a slowing down in domestic credit to the non-state sector as the year draws to a close. On the basis of current indications money supply growth for the year as a whole is expected to be close to the lower limit of

the target range set. Total financial assets, fueled by a public debt that is expanding twice as fast as credit to the private sector, will increase by about 15 per cent during the year. At the end of 1986 the ratio of financial wealth to GDP is likely to be about 3 percentage points higher than in December 1985 (Table 20).

The prospects for 1987

The international scenario

After the disappointing performance of the first half of 1986, the pace of economic activity in the second half is expected to pick up speed in the industrial countries, especially in Europe, stimulated by faster growth in private consumption. This more buoyant trend should continue next year. According to the forecasts of international institutions the world economy is expected to grow on average in 1987 at a rate of about 3 per cent, or slightly faster than this year (Table 21). The gains in employment realized this year in the United States and Europe should become stronger. Despite the forecast expansion of the labour force, the unemployment rate is expected to fall below 8 per cent in the industrial countries as a whole and below 11 per cent in those of Europe.

Inflation, which in the OECD area in August was down to an annual rate of 2.4 per cent as measured by consumer prices, may well increase again, though only slightly. This would reflect both the coming to an end of the favourable effects of various exogenous factors and the strengthening influence of those of a domestic cost nature. In the US, in particular, consumer prices could be influenced by the effects of exchange depreciation, which have so far been quite modest. For the industrial countries as a whole, the increase of the GNP deflator next year should remain around 3 per cent.

On average for the year, the trend in the terms of trade will continue to favour the industrial countries in 1987, though to a lesser extent than this year. There is still some uncertainty about oil prices, however. The aggregate balance of trade for the industrial countries should remain in surplus, but the balance on current account will most likely turn negative again. The US current account deficit should remain unchanged at about the $120 billion forecast for 1986. In contrast, the surpluses recorded by Germany and Japan will contract, though only modestly. The deficit on current account for the developing countries as a whole should diminish by about $10 billion as a result of the change in the balance for the fuel exporting countries.

The principal international institutions are in agreement that, in the absence of corrective alterations in present economic policies, the re-equilibration of current account balances between the leading industrial economies would take much too long. There would be a risk of generating exchange market instability and of bringing about a restrictive monetary policy in the US with recessionary effects on the world economy.

Efforts to correct the existing imbalances, while maintaing conditions of stability and growth, would call for coordinated economic policies — expansionary in Japan and Germany, restrictive in the United States. Indeed, it must be borne in mind that the fiscal tightening foreseen for 1987 in the United States does not appear sufficient, by itself, to achieve this objective. On the other hand, if implemented on the scale planned, it could lead to a decline in the growth pace of world economic activity.

A slowing down of growth in the industrial economies could, in particular, jeopardize the efforts being made to adjust the external position of the developing countries and give rise to new strains in the international financial system.

The 1987 planning scenario for the Italian economy

The improvement in the external accounts and the decline recorded in inflation have strengthened the growth prospects of the Italian economy. However, the achievement of concrete results appears to depend on the country's ability to go on with measures designed to resolve its structural problems. The international outlook described above does not seem likely to make any significant contribution to Italian economic growth.

Table 21

Forecasts of some macroeconomic aggregates

(percentage changes on previous year)

	1985	1986	1987		1985	1986	1987
GNP/GDP (1)				**Current balances** (2)			
Industrial countries	3.0	2.7	3.1	Industrial countries	−53.5	—	−11.6
of which:				*of which:*			
United States	2.7	2.7	3.5	United States	−117.7	−123.0	−123.0
Japan	4.5	2.6	2.9	Japan	49.2	82.7	74.1
Europe	2.4	2.6	2.4	Europe	25.4	55.7	47.3
Developing countries	3.2	2.7	2.9	Developing countries	−19.0	−57.6	−46.5
of which:				*of which:*			
Fuel exporters	0.1	−1.2	0.5	Fuel exporters	4.3	−38.9	−24.0
Non-fuel-exporters	4.8	4.4	3.9	Non-fuel-exporters	−23.3	−18.7	−22.5
Consumer prices				**Unemployment rate** (3)			
Industrial countries	4.0	2.2	3.0	Industrial countries	8.1	8.0	7.8
of which:				*of which:*			
United States	3.5	2.0	3.5	United States	7.2	6.9	6.5
Japan	2.1	0.5	0.5	Japan	2.6	2.8	3.0
Europe	5.3	2.7	3.1	Europe	10.8	10.9	10.7
World trade (1)	**3.1**	**4.3**	**3.8**				
Exports (1)				**Imports** (1)			
Industrial countries	4.3	3.0	3.1	Industrial countries	4.8	7.5	4.9
Developing countries	0.7	5.8	5.2	Developing countries	−1.1	−3.7	0.7

Source: IMF *World Economic Outlook*.
(1) At constant prices. — (2) Billions of dollars. — (3) Level.

Government economic policy for 1987 is designed to achieve a GDP growth rate of 3.5 per cent and a further slowing of inflation. In concrete terms, the policy aims will involve a reduction in the Treasury's borrowing requirement, the carrying out of important public works and infrastructural investments, as well as the adoption of an appropriate incomes policy.

If Italy is to maintain and possibly enlarge its share in international markets, which are growing only modestly, it is essential to achieve gains in competitiveness. This can be done only by curbing costs and prices and raising productivity. In this way it would be possible to consolidate the country's external accounts, which are now exposed to the risk of a reversal in the trend of the terms of trade, as well as to derive a stimulus to economic activity through sustained export growth and a rescaling of imports.

The implementation of a coherent incomes policy is a necessary condition for expanding employment while at the same time making it possible to complete the process of disinflation. Such a policy needs to be flanked by corporate pricing policies that can assist in the anti-inflationary effort and investment policies designed not only to increase productivity but also to expand productive capacity. This latter is required to prevent the re-emergence of supply-side bottlenecks, to make real gains in providing employment opportunities and to overcome the territorial disparities from which Italy still suffers.

The choices in the matter of contract renewals in the private and public sectors appear crucial. The demands currently under discussion would entail — given the decrease in the share of employer social security contributions financed

by government — a rise in labour costs per employee of about 3 percentage points more than the expected increase in prices. Given that the beneficial effects of the decline in oil prices are diminishing, a meeting in substance of these demands would seriously compromise efforts aimed at the slowing down of inflation.

An enhancement of the resources available for investment and thus of the economy's prospects for growth depends on success in carrying out the plan, initiated this year, to put the public finances on a sound footing. The forecast for next year envisages the state sector borrowing requirement being kept within 100 trillion lire, compared with 110.9 trillion expected for 1986. This outcome would be the result primarily of a further reduction in the deficit net of interest payments. Despite the growth of public debt, financial outlays should also begin to fall back, thanks to the decline in interest rates this year.

The aforementioned objective is not an easy one: it calls for strong corrective action. The process of budget rehabilitation begun this year does not yet seem firmly established. The effects of some of the adjustment measures adopted are of a transitory nature or diminish in importance over time. Moreover, the effect of the decline in inflation in curbing the budget deficit is smaller than one might at first suppose. True, slower inflation cuts down expenditure, but it also has fairly substantial effects on the revenue side, in view of the progressive income tax and the sharp contraction in receipts from the flat-rate withholding tax on interest income as interest rates decline. Provided there is no change in the lira price of oil, however, some help in achieving the objective in question will come when the full impact is felt of this year's fiscal decision to direct part of the benefits of lower oil prices towards reducing the budgetary imbalance.

Adjustment of the public finances has been begun with the Finance Bill for 1987 and some other measures, including the introduction of taxation on interest income from government securities. In particular, the 1987 Finance Bill establishes ceilings on government transfers of funds to the main spending units. The completion of these moves now necessitates a final drafting of the bills announced by the Government with a view to modifying spending procedures in the various sectors or to finding new sources of revenue.

In the long run, the adjustment of the public finances as outlined in the financial planning document should be facilitated by the modification of the budget decision-making process by two resolutions passed by the Budget Committees of the Senate and the Chamber of Deputies. The resolutions are intended to establish closer linkages between analyses of basic economic trends, planned objectives, and decisions taken year by year.

In line with earlier plans for reducing the public budget deficit, the financial planning document lays down specific guidelines for drafting the Government budget and those of the autonomous spending authorities. On the assumption that total tax revenues remain constant relative to GDP, that the increase in current expenditure does not exceed the expected inflation rate and that capital expenditure expands at the same rate as GDP, the document forecasts a balanced budget, net of interest payments, by 1990. Presumably the interest burden will also ease considerably with the decline in nominal and real interest rates.

The need to take full advantage of the opportunities for price stability inherent in the improvement in the terms of trade will require, again in 1987, rigorous monetary and exchange rate policy. Successful pursuit of such a policy would be facilitated by a decrease in the public sector borrowing requirement. Accordingly, the expansion of credit to the non-state sector is targeted at around 7 per cent. This objective takes account of the positive trend of profits and the increased flow of funds to corporations from the equity market. It is also compatible with the funding of the investment required to achieve the Government's planned rise in output and employment. Limited divergences from the target can be tolerated if they seem compatible with this macroeconomic framework.

Given the forecast state sector borrowing requirement, total domestic credit should expand by about 11 per cent in 1987. This would diminish the flow of credit by a further two percentage points in relation to GDP. Nevertheless, total

The main provisions of the Finance Bill for 1987

In terms of economic policy management, the design of the Finance Bill for 1987 is based fundamentally on a curbing of allocations to the decentralised spending bodies, in particular for health and social security; in addition, there are to be increased allocations on capital account for projects relating to environmental protection, the better exploitation of Italy's cultural wealth and the reconstruction of earthquake disaster areas.

Personnel. *The allocations for the renewal of contracts for employees of the State and of the autonomous government agencies, fixed by the 1986 Finance Law at 350 billion for each of the following two years, are increased by 684 billion for 1987 (297 billion of this sum pertains to expenditure authorized for 1986) and by 361 billion for 1988; expenditure for 1989 is set at 1,800 billion. The restrictions on increasing personnel are extended to 1987.*

Social Security. *Budget transfers and advances to INPS are together fixed at 33 trillion (as compared to the 32 trillion appropriated under the 1986 Law).*

The family income limit below which families are eligible for allowances and token prescription charges are increased by 4 per cent. In the special fund for current expenditure, which appropriates funds for expenditure under bills not yet approved by Parliament, 7.3 trillion is set aside for the extension of the fiscalization of sickness insurance premiums. The allocation reduces the degree of fiscalization: on the basis of the sums allocated for the period January-November 1986 under Law 440 of 31 July 1986 and the increase in salaries over 1986 forecast for 1987, the continuance of the 1986 rates into 1987 would have cost more than 8.0 trillion.

Health. *The financing from the budget of the current expenditure of the National Health Service is fixed at 46.2, 47.6 and 49.05 trillion for 1987, 1988 and 1989 respectively. As in previous years, these appropriations are increased in line with the projected rate of inflation; those for 1987 and 1988 are, however, considerably higher than the allocations under the 1986 Finance Law, the difference being due to the application of the expected inflation rate, in the 1987 Finance Bill, to the final accounts of health expenditure in 1985, which exceeded the original appropriation.*

ENEL and the state-controlled enterprises. *ENEL is authorized to issue bonds on the domestic market or to raise loans from the European Investment Bank (EIB) to a total of 1 trillion in each of the three years 1987, 1988 and 1989 (financing of the same type and to the same amount was previously authorized for 1986). Capital and interest are to be charged to the budget and capital repayment used to increase the endowment fund of ENEL. Similar appropriations amounting to 650 billion, 400 billion and 300 billion for the same three years respectively are allocated to each of the state holding companies, IRI and EFIM. It should be noted that the 1986 Finance Law allowed IRI to obtain loans from the EIB for a further 1.3 trillion.*

In all, in 1987 the state-controlled enterprises are empowered to contract debts in the above forms to an amount of 1.95 trillion, as compared to the 5.3 trillion of 1986. Such operations, by limiting the amounts allocated to the endowment funds of these enterprises in the related years, shift the cost to the budget forward to later years.

Public Works. *Appropriations of 2 trillion are made for the financing of projects which can be executed immediately (the so-called FIO projects); CIPE, the Interministerial Committee for Economic Planning, is also empowered to authorise borrowing from the EIB up to a limit of 1.5 trillion for such projects. Allocations of 300 billion, 400 billion and 500 billion for 1987, 1988 and 1989 respectively are provided for expenditure on projects which, while raising youth employment and taking advantage of advanced technology, help to make better use of Italy's cultural wealth.*

Allocations of 6 trillion are made for the continuation of work in the earthquake-damaged areas of the Campania and Basilicata regions and 3 trillion for the completion of housing projects in the Naples area (1 trillion and 500 billion respectively in 1987).

Other. *The allocation to the national fund to provide for the current deficit of the transport bodies is fixed at 4,464 billion, representing an increase of 4 per cent on the preceding year. Amounts of 450 and 500 million are provided, respectively, for the endowment fund of SACE and the special rotating fund for technological innovation.*

financial assets would continue to grow faster than output, rising from 136 to 141 per cent of GDP. The money supply — whose growth will continue to be influenced, to an extent that is hard to estimate, by the new forms of fund-raising — will presumably expand more slowly. To keep the growth of the money supply in the 6-9 per cent range, the stock of outstanding government securities, investment fund units and other non-monetary portfolio assets will have to expand nearly twice as fast as GDP.

The gradual decline in interest rates, in connection with the further slowdown in inflation and reduced uncertainty about the prospects for the Italian economy, can proceed in 1987, consistent with the planning framework and with the projected behaviour of the monetary and credit aggregates.

The commentaries are based on the information and statistics available at 24 October.

Articles

New decision-making procedures for public finance

The difficulty in slowing down the rate of increase of the public sector borrowing requirement can partly be attributed to the underlying conflict between structural budget deficits and the de facto cyclical nature of the legislative process for regulating public finance established by the 1978 reform of Government accounts (Law 468).

The Finance Bill introduced by the reform did not significantly modify the expansionary tendency of deficits, which have often exceeded Government limits. This strength of underlying factors tending to increase expenditures is the principal cause of this situation; an additional cause is the inadequate treatment accorded to structural problems in the procedures followed in public finance decisions and medium and long-term trends have so far been examined only in part (1).

In these circumstances, the need for corrections which will be immediately effective often leads to an increase of revenues rather than a reduction of expenditures. Even excluding interest payments, the ratio of expenditure to domestic product is higher in Italy than the average of the main industrialized countries with a similar economic structure.

The scale of the measures needed to decrease the growth of the deficit has resulted in nearly every sector being involved, but they have not been taken in accordance with an organic vision of the reform of these sectors.

The above-mentioned factors contributed to the considerable time taken to discuss each Finance Bill. The approval of the proposed measures was often accompanied by changes which significantly reduced their range.

* * *

1. The Parliamentary budget commission approved two parallel resolutions (10-11 June) involving new procedures for a more incisive budget policy; they are in an experimental phase for this year. These new procedures call for the definition of multi-year planning objectives, the insertion of these objectives in medium and long-term trends and the identification of procedures and instruments which will guarantee the desired results.

These resolutions required the Government to present an economic and financial planning document by the end of June, providing a provisional scenario of the international and Italian economies, the financial flows associated with unchanged legislation for the budget, the state sector and the enlarged public sector for the 1987-89 period. In addition, it was to indicate the objectives for the state sector borrowing requirements (and, in the Senate motion, for the enlarged public sector), the inflation rate, and the rate of growth of gross domestic product and employment.

The rules for the formulation of the state budget and of those for local authorities and social security institutions were to be indicated in the part of the document dedicated to public finance objectives. The measures for sectoral

intervention in parallel with the Finance Bill, reduced to its "essential nucleus", were also to be indicated. In accordance with this new procedure, the effect of normative sectoral legislative intervention was to be included in the Finace Bill through the introduction of "special negative funds" in addition to special funds (which make appropriations for measures still in Parliament). These "special negative funds" were to indicate items connected with the approval of measures designed to contain expenditures or to increase revenues and conditioning the approval of measures involving current expenditures.

2. These resolutions were approved after the Parliamentary commission had completed a study of government accounts. This study was undertaken in response to criticism of the length and difficulty of the budget sessions and of the excessive concentration of legislative measures in the Finance Bill. This criticism had been advanced from various quarters and was echoed by the presidents of the two legislative branches.

The final document produced by the Parliamentary study outlined new procedures similar to those adopted in the United States with the 1974 reform, confirmed with slight modifications in the ordinary procedures laid down by the Gramm-Rudman-Hollings Act. In particular, decisions as to the choice of objectives and instruments for fiscal policy measures were separated from those regarding the legislative approval of those instruments; while interventions for single sectors are included in separate measures which follow a course parallel to that of the budget.

3. According to indications contained in the documents leading to the two motions, trends in public finance in the medium-to-long term should be evaluated assuming that existing legislation will remain unchanged. With this method, forecasts of expenditures are more significant and the margin of uncertainty is reduced. Forecasts of expenditures that are in a sense fixed (wages, pensions, family allowances, etc.) are to take account of the demographic, economic and institutional factors regulating public intervention in the various areas of intervention. For the discretionary part of expenditures (principally the purchase of goods and services and investments), past policies and commitments are to be assumed unchanged.

The reference aggregates are the budget, the state sector, and the "enlarged" public sector. The enlarged public sector gives an immediate picture of total tax and social security receipts and tariff income, as well as an idea of expenditures. By analyzing the final destination of resources, it also permits forecasts to be made of expenditure, assuming no changes in the laws regarding beneficiaries. Reference to the state sector aggregate can be useful for an analysis of the appropriations to the various public bodies. The disbursements of this sector consist primarily of transfers to local authorities and social security institutions. These transfers cover a large part of their expenditures. As far as revenues go, almost all of tax revenues and health insurance contributions and a great part of tariff income are concentrated in this sector.

An analysis of this type allows us to overcome the progressive loss of importance of budget flows compared with state and public sector flows and the limited significance of the forecasts based on current legislation.

In the context outlined here, it is the budget on a cash basis to which we must dedicate most attention in determining the trend and objective of the state sector borrowing requirement. On the one hand, this approach is of greater help in understanding the effects of government action on economic activity than the accrual approach and, on the other, it is compatible with the analysis of financial and credit flows. Nevertheless, the principal instrument for determining the financial effects of the policies adopted continues to be the budget on an accrual basis. Through the variation in transfers to local authorities and social security institutions, it registers the legislative changes introduced in the various sectors and, by adapting to the rules established, it promotes the attainment of the objectives fixed for the medium term.

The final report of the Chamber of Deputies Budget Commission fixes the period of reference for economic and financial planning at five years, and the targets for the ratios of tax, social security and tariff revenues to GDP, together with that of

public expenditure and the various budget and public debt balances must be stated. The budget is disaggregated only to the level of titles and categories of expenditure and indicates the target of the net balance to be financed excluding interest payments. Changes in the amounts laid down in previous multi-year budgets have to be justified indicating whether they derive from changes in policies or the underlying macroeconomic assumptions. In this way, medium-term planning and budget decisions for the year following the reference year are linked, albeit flexibly.

According to the Parliamentary commissions, the implementation of fiscal policy is to be through several bills, presented immediately after the approval of the reference framework described. Each bill should refer to a single area of intervention. Corrective measures should modify spending and revenue laws and be based on a comprehensive view of existing legislation. They should aim to rationalize the function of the government and not merely to regulate the flows of receipts and disbursements.

The Finance Bill, which must be presented together with the budget by 15 September (while the *Relazione Previsionale e Programmatica* must be presented by 15 June), continues to provide special funds for legislative measures in Parliament; but, in order to increase the cogency of the system, their use is to be dependent on approval of the corrective measures included in the "special negative fund".

4. The proposed changes throw into relief the need for well structured interventions in the main areas of expenditure. They also provide a reference framework for fiscal policy decisions which will ensure the clear identification of trends, planning choices and corrective measures. Procedural changes by themselves cannot solve the problems of the public finances; they nonetheless provide institutional arrangements fostering their examination and the adoption of adequate solutions.

The new procedures, and particularly the earlier definition of the reference framework, should guarantee that decisions about public finance will be made after more informed reflection and be more consistent with the desired development of the economy.

The short time allowed for the preparation of the economic and financial planning document and the successive government crisis did not permit the original presentation date (the end of June) to be respected, nor was it possible to complete the required analyses. In particular, the Ministry of the Treasury document *Obiettivi e strumenti della manovra di bilancio per il biennio 1987-89* contained no information on the enlarged public sector and that on the state sector was incomplete. The analysis is limited to the budget, and in particular to that on an accruals basis, while specific indications about sectoral interventions were not provided. Notwithstanding these limitations, the analysis has already played an important role in the definition of fiscal policy.

The government document proceeds in the direction indicated in previous analyses and forecasts a progressive reduction in the state sector borrowing requirement net of interest, until it is eliminated in 1990. The rules to be followed to achieve this result are: the tax to GDP ratio must remain constant at the 1986 level; the growth of current expenditures must be in line with the target rate of inflation; and the increase of expenditures on capital account must be in line with growth in gross domestic product.

The procedures indicated in the final documents reporting the results of the study on the reform of Law 468/1978 by the Budget Commissions of the Chamber of Deputies and the Senate will presumably be fully implemented as regards both their timing and their content. Parliament could approve the interventions indicated by passing legislative guidelines (as proposed by the Commissions). The Corte dei Conti has suggested that the effectiveness of the new procedure would be enhanced if the trend and planning versions of the multi-year budget were approved by law at the same time (cf. *Decisioni e relazioni della Corte dei Conti sul rendiconto generale dello Stato per l'esercizio finanziario 1985*, p. 44).

(1) The budget contains a three-year forecast. Since this is formulated on the basis of "the law in force", it does not permit the identification of trends in public finance. This is because Government budget allocations to other expenditure centers are set for a shorter time than that in which the costs associated with the performance of the functions entrusted to them are borne. Moreover, several difficulties connected with the interpretation of Law 468/1978 have impeded the realization of the multi-year planning budget, which was drawn up only once on an experimental basis.

The wealth of Italian households (1975-1985)

1. Introduction

The amount and composition of households' net wealth are of fundamental importance for the interpretation of consumption behaviour. This is true both for a life cycle hypothesis (Modigliani, 1975) and for the allocation of savings between real and financial assets based on a classical approach to portfolio choices (Tobin, 1980). This information is also essential for the measurement of the changes in wealth in real terms. We can avoid intermingling income and wealth accounts if we evaluate the losses and gains on capital account due to both inflation and the fluctuations in relative prices of the various assets (1). Nevertheless, the testing of the theory by empirical studies was and still is impeded by lack of data.

Several researchers have provided estimates of Italian households' total wealth. Siesto (1973) published estimates referring to 1970 of the wealth of the institutional sectors defined by the European system of accounts (ESA). In his work he supplemented Istat data on fixed capital, Bank of Italy flow-of-funds data, and National Institute of Agrarian Economics (INEA) data on agricultural land.

For the 1948-82 period, Della Torre (1984) calculated the total wealth of all the economic agents in the flow-of-funds accounts (2). He based his estimates on Bank of Italy statistics and used Istat series, with his own up-dates, for industrial fixed assets and for dwellings the Tresoldi-Visco (1975) series for households' wealth, which stopped at 1973. Lecaldano-Marotta-Masera (1985) estimated households' financial and property wealth from 1970-82. Fazio (1986) estimated total wealth from 1975-84, including both the real and the financial components.

The present study brings these estimates up to date. It examines the financial wealth of households in detail, using the Bank of Italy's flow-of-funds accounts, with the revisions of the 1985 Annual Report. Lastly, with due caution, it compares Italy to the three principal EEC countries (France, West Germany and the United Kingdom). The aim is to provide a preliminary reference point for the empirical study of Italian households from 1975-85.

2. Methodological aspects

The estimation of household's total net wealth raises numerous problems involving evaluation criteria, the share covered by the instruments covered and their assignment to the various holder sectors. The latter aspect is particularly important when comparing the changes in wealth with the saving of each economic agent.

In principle, having information about the size of stocks of the various components of wealth should make it possible to calculate wealth at current prices either by summing the stocks of real and financial assets or by taking the flow of savings and adding the gains and losses on capital account due to variations in market prices (leaving aside other problems such as alternative classifications of agents and instruments).

It is difficult to use this method in Italy owing to the different classifications of the household sector adopted in national and flow-of-funds accounts. In the national accounts, the household sector includes businesses with less than twenty employees in the agricultural sector, less than fifty in the services sector and less than one hundred in industry. Consequently, households' disposable income and saving are distorted by the inclusion of units whose accounts are characterized by the productive nature, in the strict sense, of their activity, particularly as regards interest payable and operating profit.

On the other hand, in the flow-of-funds accounts the household sector includes households in the strict sense and private non-profit institutions.

Table 1

Net financial wealth of households

(end-of-period amounts in billions of lire)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Notes and coin	9.8	11.1	12.5	14.6	16.5	19.2	22.6	25.3	28.4	31.2	34.0
Bank deposits	64.1	79.1	98.3	117.2	139.7	160.5	180.6	220.2	245.4	276.0	307.3
Postal deposits	11.8	14.1	16.5	20.3	24.8	28.5	30.4	33.2	36.9	42.5	50.5
Treasury bills	0.2	2.3	5.5	8.8	16.2	30.4	52.2	62.7	78.7	99.2	114.7
Deposits and savings certificates of special credit institutions	3.7	3.7	3.9	4.9	5.4	5.8	7.1	14.0	15.4	19.6	21.2
Treasury credit certificates	—	—	1.2	3.6	6.4	8.0	11.4	17.3	47.4	75.3	108.5
Other government securities (1)	4.5	5.2	5.0	8.1	9.4	8.2	9.6	8.4	12.0	17.6	19.2
Other medium and long-term securities in lire (2)	11.8	11.3	10.5	10.7	10.4	9.5	10.5	13.4	17.9	21.6	24.5
Italian investment fund units	—	—	—	—	—	—	—	—	—	1.1	19.8
Italian shares	6.5	7.4	4.6	5.2	6.1	21.9	26.4	20.7	25.4	33.8	73.0
Italian participations	1.1	1.4	1.7	2.0	2.4	2.7	4.1	4.6	7.6	12.9	12.9
Foreign assets (3)	2.0	2.2	2.1	2.2	2.6	3.6	3.6	4.6	4.7	6.5	9.3
Actuarial reserves	9.5	11.1	12.9	14.9	17.0	20.1	22.8	27.0	32.0	37.6	44.6
Severance pay provisions	19.0	22.2	24.6	27.1	30.5	34.8	39.1	43.6	48.6	54.5	60.5
Other assets (4)	0.1	0.1	0.1	0.2	0.5	1.8	2.9	2.7	2.6	2.3	2.2
Total assets	**144.0**	**171.1**	**199.5**	**240.0**	**287.8**	**354.9**	**423.4**	**497.6**	**602.9**	**731.7**	**902.2**
Bank loans	4.8	5.5	6.4	7.8	10.4	13.9	15.9	18.1	20.4	24.6	30.3
Special credit institution loans	6.9	7.2	7.7	8.0	8.5	9.3	11.1	12.9	14.6	16.2	18.0
Other liabilities (5)	0.4	0.5	0.8	1.0	1.1	1.4	1.7	2.2	2.6	3.1	3.5
Total liabilities	**12.1**	**13.2**	**14.8**	**16.9**	**20.0**	**24.7**	**28.6**	**33.2**	**37.5**	**43.9**	**51.9**
Net financial wealth	131.9	157.9	184.6	223.2	267.8	330.2	394.7	464.5	565.3	687.9	850.3

Sources: See Appendix 1. Rounding may cause discrepancies in totals in this and the other tables. — (1) Treasury bonds, Deposits and Loans Fund certificates, other Government securities, bonds issued by autonomous agencies, by local authorities and on behalf of the Treasury. — (2) Bonds issued by firms and special credit institutions. — (3) Foreign bonds in lire and foreign currency and units of Luxembourg-based investment funds. — (4) Banker's acceptances, atypical securitues and Bank of Italy cashier's cheques and cheques. — (5) Bad debts on loans of banks, insurance companies and social security institutions.

In line with the objectives of this paper indicated in the introduction, the wealth of households (defined as units of consumption) should not include productive capital goods or corresponding net financial liabilities.

In addition to these problems of estimation, there are problems of a strictly statistical order. Since 1964, the Bank of Italy has published detailed flow-of-funds accounts for the various instruments and holder and issuer sectors. Nevertheless, the availability since 1975 of the so-called "Reporting matrix" information system for banks and the methodological changes introduced for several instruments (Italian shares and participations, investment fund units, provisions for severance pay and company pensions) do not permit a homogeneous series to be compiled of the household sector's financial assets and liabilities going back beyond 1975 (1976 for flows).

As regards the evaluation criteria adopted in the flow-of-funds accounts, lira securities are

Table 2

Composition of households' financial assets and liabilities

(percentages)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Notes and coin	6.8	6.5	6.3	6.1	5.7	5.4	5.3	5.1	4.7	4.3	3.8
Bank deposits	44.5	46.2	49.3	48.8	48.5	45.2	42.7	44.3	40.7	37.7	34.1
Postal deposits	8.2	8.2	8.3	8.5	8.6	8.0	7.2	6.7	6.1	5.8	5.6
Treasury bills	0.1	1.3	2.7	3.7	5.6	8.6	12.3	12.6	13.1	13.6	12.7
Deposits and savings certificates of special credit institutions	2.6	2.1	2.0	2.1	1.9	1.6	1.7	2.8	2.5	2.7	2.3
Treasury credit certificates	—	—	0.6	1.5	2.2	2.3	2.7	3.5	7.9	10.3	12.0
Other government securities	3.1	3.0	2.5	3.4	3.3	2.3	2.3	1.7	2.0	2.4	2.1
Other medium and long-term securities in lire	8.2	6.6	5.3	4.5	3.6	2.7	2.5	2.7	3.0	2.9	2.7
Italian investment fund units	—	—	—	—	—	—	—	—	—	0.2	2.2
Italian shares	4.5	4.3	2.3	2.2	2.1	6.2	6.2	4.2	4.2	4.6	8.1
Italian participations	0.8	0.8	0.8	0.8	0.8	0.8	1.0	0.9	1.3	1.8	1.4
Foreign assets	1.4	1.3	1.0	0.9	0.9	1.0	0.9	0.9	0.8	0.9	1.0
Actuarial reserves	6.6	6.5	6.5	6.2	5.9	5.7	5.4	5.4	5.3	5.1	4.9
Severance pay provisions	13.2	13.0	12.3	11.3	10.6	9.8	9.2	8.8	8.1	7.4	6.7
Other assets	0.1	0.1	0.1	0.1	0.2	0.5	0.7	0.5	0.4	0.3	0.2
Total assets . . .	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Bank loans	39.9	41.5	43.4	46.5	51.9	56.4	55.4	54.6	54.2	56.0	58.4
Special credit institution loans	56.5	54.4	51.5	47.7	42.5	37.8	38.8	38.8	38.9	37.0	34.7
Other assets	3.7	4.1	5.1	5.9	5.6	5.9	5.8	6.6	6.9	7.0	6.8
Total liabilities . . .	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Financial wealth/disposable income	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.3	1.4	1.5

Sources: See Appendices 1 and 3.

registered at face value; only Italian shares and participations and investment fund units are stated at market value.

In principle, the information on which the estimates of flows of shares and securities are based only covers the primary market. It does not therefore permit us to record changes in ownership between sectors resulting from transactions on the secondary market. For both instruments issues are recorded net, taking account of issue discounts, redemptions for securities, and double-counting and premiums for shares. As for investment fund units, flows are made up of net subscriptions.

Leaving aside changes in ownership due to secondary market transactions, the difference between the change in the value of the stock of a financial instrument and the corresponding flow represents the gain or loss on capital account.

This paper estimates three components of real wealth: dwellings, agricultural land and durable consumer goods, as outlined in Appendix 2. Lack of data prevents the inclusion of other assets attributable to households in the strict sense: such as patents, royalties, jewelry and antiques (3), non-residential buildings, land suitable for construction and so forth.

Table 3

Households' financial assets and liabilities

(changes in billions of lire)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Notes and coin	1,251	1,413	2,163	1,874	2,717	3,381	2,669	3,068	2,813	2,862
Bank deposits	15,026	19,257	18,892	22,433	20,877	20,023	39,648	25,143	30,652	31,241
Postal deposit	2,239	2,452	3,771	4,448	3,695	1,915	2,800	3,687	5,664	7,990
Treasury bills	2,119	3,167	3,346	7,406	14,173	21,845	10,765	13,874	19,845	14,134
Deposit and savings certificates of special credit institutions	−58	236	1,033	423	414	1,356	6,858	1,364	4,271	1,543
Treasury credit certificates	77	1,186	2,428	2,684	1,409	3,208	5,268	29,475	27,942	31,609
Other government securities	634	−98	2,896	948	−1,484	1,179	−1,465	3,332	5,370	1,321
Other medium and long-term securities in lire	−332	−1,038	−2	−669	−1,122	895	2,714	4,528	3,654	2,940
Italian investment fund units	—	—	—	—	—	—	—	—	1,055	15,256
Italian shares	924	181	138	132	761	663	87	203	141	1,335
Italian participations	—	—	—	—	—	—	—	—	—	—
Foreign assets	−219	−130	−17	−44	308	374	146	85	545	664
Actuarial reserves	1,543	1,873	1,981	2,158	3,081	2,693	4,192	4,985	5,625	7,039
Severance pay provisions	3,287	2,345	2,540	3,337	4,321	4,273	4,563	4,989	5,842	6,000
Other assets	13	17	85	276	1,306	1,143	7	−70	−295	−51
Total assets	**26,504**	**30,862**	**39,255**	**45,407**	**50,454**	**62,948**	**78,251**	**94,664**	**113,124**	**123,883**
Bank loans	623	976	1,396	2,531	3,560	1,930	2,249	2,260	4,201	5,759
Special credit institution loans	307	486	392	449	839	1,782	1,766	1,720	1,614	1,817
Other liabilities	96	215	234	134	325	215	538	378	506	455
Total liabilities	**1,026**	**1,677**	**2,022**	**3,114**	**4,723**	**3,927**	**4,552**	**4,358**	**6,321**	**8,032**
Financial balance	25,478	29,185	37,233	42,293	45,731	59,021	73,699	90,306	106,803	115,851

3. Changes in financial wealth and its composition

The ratio of net financial wealth to disposable income remained stable at 1.2 in the 1975-82 period, and then rose to 1.5 in 1985 (Tables 1 and 2). In this period, the ratio of financial liabilities to gross financial assets was relatively low, decreasing from 8.4 to 5.8 per cent. It should be noted that, due to a lack of systematic information, the flow-of-funds accounts do not yet include non-bank consumer credit. Some researchers estimate that this type of credit amounted to 5,000 billion lire at end-1985, or one third of the short-term bank lending to households.

There has been a sizable change in the composition of financial assets between M2 money (currency in circulation plus bank and PO deposits) and government securities. The former increased from 59.5 to 63.9 per cent of total wealth between 1975 and 1977, and then decreased to 58.6 per cent in 1980 and to 43.5 per cent in 1985; the latter increased from 3.2 per cent in 1975 to 26.8 per cent in 1985, reflecting the

Table 4

Households' wealth

(end-of-period amounts in billions of lire)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Real assets	**341.5**	**418.1**	**473.5**	**565.1**	**718.1**	**934.0**	**1,075.7**	**1,368.1**	**1,462.1**	**1,584.5**	**1,610.8**
Dwellings	276.6	339.3	378.7	448.8	568.0	755.2	876.5	1,147.0	1,222.5	1,328.9	1,340.1
Agricultural land	33.7	39.3	47.0	58.8	74.5	86.5	88.3	86.6	86.5	87.1	87.7
Durable consumer goods	31.2	39.5	47.8	57.5	75.6	92.3	110.9	134.5	153.1	168.5	183.0
Financial assets	**144.0**	**170.2**	**199.5**	**240.0**	**287.8**	**354.9**	**423.4**	**497.6**	**602.9**	**731.7**	**902.2**
Monetary assets	89.5	107.9	131.3	157.1	186.3	214.0	240.7	292.7	325.9	369.3	413.0
of which: postal deposits	11.8	14.1	16.5	20.3	24.8	28.5	30.4	33.2	36.9	42.5	50.5
Government securities	4.6	7.5	11.7	20.6	32.1	46.6	73.3	88.4	138.1	192.1	242.4
Shares and participations (1)	9.6	11.0	8.3	9.4	11.1	28.1	34.1	29.9	37.7	54.3	115.0
Actuarial reserves and severance pay provisions	28.5	33.3	37.5	42.0	47.5	54.9	61.9	70.6	80.6	92.1	105.1
Other assets	11.8	11.4	10.7	10.9	10.8	11.3	13.4	16.0	20.5	23.9	26.7
Financial liabilities	**12.1**	**13.2**	**14.8**	**16.9**	**20.0**	**24.7**	**28.6**	**33.2**	**37.5**	**43.9**	**51.9**
Long-term liabilities	9.3	9.9	11.0	12.3	14.1	16.6	19.7	22.8	26.0	30.2	34.9
Other liabilities	2.9	3.2	3.9	4.6	5.9	8.1	8.9	10.4	11.5	13.7	17.0
Wealth	**473.4**	**576.0**	**658.1**	**788.3**	**985.9**	**1,264.2**	**1,470.4**	**1,832.6**	**2,027.4**	**2,272.3**	**2,461.1**
Disposable income	*108.8*	*132.1*	*158.3*	*186.6*	*223.0*	*273.9*	*330.1*	*386.2*	*440.7*	*504.5*	*559.9*

Sources: See Appendices 2 and 3.
(1) Includes Italian and Luxemburg based investment fund units.

growth in the public debt and monetary policies aimed at encouraging its absorption by households. Taken together, these two categories represented 62.7 per cent of gross financial assets in 1975 and 70.3 per cent in 1985. The two instruments that lost ground in this period were severance pay provisions, the share of which halved, and other medium-long term securities, which dropped by a third. Severance pay provisions were affected by the 1977 reduction in the degree of wage indexation and the abolition of the indexation of existing provisions, both partially re-established from 1982.

The part made up of Italian shares reflected the changes in share prices, as is demonstrated by the two periods 1979-80 and 1984-85. In the last two years, Italian investment funds have contributed to this increase; through these funds, households hold shares, government securities and foreign assets indirectly.

Households' direct holdings of foreign assets consist of units of Luxembourg based investment funds, foreign bonds denominated in lire and a part of those denominated in foreign exchange. They have remained steady at about 1 per cent of gross financial assets. (4)

A comparison of the stocks and flows of new financial assets (Tables 1 and 3) permits a preliminary evaluation of the gains and losses on capital account deriving from changes in share prices. Bearing in mind the problems discussed in section 2, the two tables indicate that, while net subscriptions amounted to 1,335 billion lire in 1985, the stock of shares registered an increase of 39,200 billion lire compared with 1984, as a result of an increase in share prices of more than 100

Table 5

Composition of households' wealth

(percentages)

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Real assets	**72.1**	**72.6**	**71.9**	**71.7**	**72.8**	**73.9**	**73.2**	**74.7**	**72.1**	**69.7**	**65.4**
Dwellings	58.4	58.9	57.5	56.9	57.6	59.7	59.6	62.6	60.3	58.5	54.4
Agricultural land	7.1	6.8	7.1	7.5	7.6	6.8	6.0	4.7	4.3	3.8	3.6
Durable consumer goods	6.6	6.9	7.3	7.3	7.7	7.3	7.5	7.3	7.6	7.4	7.4
Financial assets	**30.4**	**29.7**	**30.3**	**30.5**	**29.2**	**28.1**	**28.8**	**27.2**	**29.7**	**32.2**	**36.7**
Monetary assets	18.9	18.7	19.9	19.9	18.9	16.9	16.4	16.0	16.1	16.3	16.8
Government securities	1.0	1.3	1.8	2.6	3.3	3.7	5.0	4.8	6.8	8.5	9.9
Shares and participations (1)	2.0	1.9	1.3	1.2	1.1	2.2	2.3	1.6	1.9	2.4	4.7
Actuarial reserves and severance pay provisions	6.0	5.8	5.7	5.3	4.8	4.3	4.2	3.9	4.0	4.1	4.3
Other assets	2.5	2.0	1.6	1.4	1.1	0.9	0.9	0.9	1.0	1.0	1.1
Financial liabilities	**2.6**	**2.3**	**2.3**	**2.1**	**2.0**	**2.0**	**1.9**	**1.8**	**1.9**	**1.9**	**2.1**
Long-term liabilities	2.0	1.7	1.7	1.6	1.4	1.3	1.3	1.2	1.3	1.3	1.4
Other liabilities	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.7
Wealth	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
Disposable income	*4.4*	*4.4*	*4.2*	*4.2*	*4.4*	*4.6*	*4.5*	*4.8*	*4.6*	*4.5*	*4.4*

Sources: See Appendices 2 and 3.
(1) Includes Italian and Luxembourg based investment fund units.

per cent. The valuation of unlisted shares using the prices of shares listed on the Milan stock exchange probably results in an overestimate of the capital gains.

Households' financial balance will not be analysed here in view of the primarily statistical and descriptive objective of this study. (5)

4. Changes in total wealth and its composition

Examination of households' wealth in the 1975-85 period reveals three principal points: 1) the large share of the real component, which was greater than 70 per cent except for the last two years; 2) the low proportion of financial liabilities (about 2 per cent); and 3) the absence of change in the ratio of wealth to disposable income, which remained more or less constant at 4.4-4.5 (Tables 4 and 5).

This stability is particularly significant since, according to the life cycle hypothesis, in the most simple case of a stationary economy with a zero real interest rate in which each individual has a constant flow of consumption during his life and a constant income during his working life, the ratio of wealth to income is equal to half of the number of years of retirement (for example, for a typical value of 10 years, the ratio is 5). Empirical studies with special reference to the United States have also shown that the aggregate ratio of wealth to income lies between 4 and 5, taking account of the medium-term rates of growth of industrialized countries (Modigliani, 1966 and 1975).

Between 1975 and 1985, the importance of real wealth meant that variations in the ratio were principally determined by the value of dwellings, which increased rapidly in 1979 and 1981 and remained stable in the 1984-85 period. The share

Table 6

Composition of households' wealth

(percentage)

	France		Germany	UK			Italy		
	1975	1979	1977	1975	1980	1984	1975	1980	1984
Real assets	**76.3**	**76.2**	**76.0**	**64.8**	**67.4**	**60.8**	**72.1**	**73.9**	**69.7**
Dwellings	53.5	55.2	39.2	47.5	51.2	48.1	58.4	59.7	58.5
Agricultural land	15.1	13.3	22.8	3.7	4.4	2.9	7.1	6.8	3.8
Durable consumer goods	7.7	7.7	14.0	13.6	11.8	9.7	6.6	7.3	7.4
Financial assets	**34.2**	**36.8**	**40.3**	**49.6**	**46.9**	**56.4**	**30.4**	**28.1**	**32.2**
Monetary assets	23.0	24.1	23.0	20.7	18.3	18.6	18.9	16.9	16.3
Government securities	—	—	—	2.9	2.1	2.0	1.0	3.7	8.5
Shares and participations (1)	6.1	6.6	2.2	9.0	6.6	8.5	2.0	2.2	2.4
Actuarial reserves and severance pay provisions (2)	2.4	2.5	8.6	12.0	15.8	22.5	6.0	4.3	4.1
Other assets	(3) 2.7	(3) 3.6	(3) 6.5	5.0	4.1	4.8	2.5	0.9	1.0
Financial liabilities	**10.5**	**13.0**	**16.2**	**14.4**	**14.3**	**17.2**	**2.6**	**2.0**	**1.9**
Long-term liabilities	8.7	10.9	15.0	9.5	9.0	11.1	2.0	1.3	1.3
Other liabilities	1.8	2.1	1.2	4.9	5.3	6.1	0.6	0.6	0.6
Wealth	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Wealth/income	*3.6*	*3.6*	*4.0*	*3.8*	*4.0*	*4.6*	*4.4*	*4.6*	*4.5*
	(4.0)	*(4.5)*	*(4.4)*	*(4.1)*	*(4.2)*	*(4.8)*			

Sources: See Appendix 3.
(1) For the United Kingdom, inclusive of unit trust units and for Italy of Italian and Luxembourg based investment fund units. — (2) Including, for Italy, severance pay provisions. — (3) For France and West Germany, other assets include claims on the public sector.
N.B. The wealth/income ratios in parentheses refer to total wealth, including productive capital goods.

of durable consumer goods varied between 7 and 8 per cent; it was greater than that of agricultural land, the share of which fell by half between 1979 and 1985.

High real interest rates contributed substantially to the roughly nine-point reduction of the share of the real components of wealth, between 1982 and 1985. On the one hand, these high rates encouraged financial investment, particularly in government securities; on the other, they lowered the relative advantage of investing in dwellings, with a consequent reduction in their prices.

5. International comparisons

The regular publication of statistics of wealth accounts per agent is also relatively rare outside Italy, even though several international organizations have sponsored research projects with this objective in mind (in particular the Statistical Institute of the European Community and the OECD). When making international comparisons account obviously has to be taken of the problems inevitably deriving from the diversity of national sources.

For the sake of uniformity, the comparison of wealth should not take into consideration capital goods or the corresponding net financial liabilities attributable to households in connection with the exercise of a productive activity. This was done for the real components, but it was not possible to net out the corresponding financial debt. Other things being equal, we would therefore expect the net financial assets of the households in a country like France to be less than those in, for example, the United Kingdom, because of the greater presence of individual firms in the former. For the same reason, the

aggregate for Italy should also be larger, since the flow-of-funds accounts of the Bank of Italy include households only as units of consumption.

The comparison between France, West Germany and the United Kingdom reveals some significant differences as well as some similarities.

The similarities lie in the wealth/disposable income ratio, which has a value of about 4 except for France, and in the real wealth/total wealth ratio, which is about two thirds on average.

On the other hand, there are structural differences in the composition of both real and financial wealth. The share of dwellings in real wealth is greater in Italy than in the other countries. But durable goods and agricultural land are less important, particularly compared with West Germany. Even bearing in mind the foregoing considerations, the financial debt of Italian households appears decidedly low. This probably indicates an area in which the Italian financial structure will be modified in the future. A look at the French and English cases reveals the tendency for financial liabilities to increase (in the United Kingdom this is principally attributable to mortgage debt, which accounts for more than 90 per cent of long-term liabilities).

An examination of the only other country with recent data, the United Kingdom, reveals that, as in Italy, the share of real wealth declined in the 1980-84 period of disinflation, thus reversing the trend of the previous five-year period. This change was principally due to the downward trend of the relative prices of dwellings and agricultural land. In the financial assets sector, in Italy the share of government securities (with the exclusion of those held indirectly through investment funds) more than doubled, rising from 3.7 to 8.5 per cent; while in Great Britain there was an increase in shares held both directly and, above all, indirectly through pension funds.

APPENDIX 1 — **Financial wealth: method of estimation**

The Bank of Italy's Annual Report for 1985 modified the method of estimation and the number of instruments considered among households' financial assets and liabilities.

In particular, these changes regarded Italian investment fund units, severance pay and company pension funds, and Italian shares and participations.

The units of Italian investment funds, which reflect the portfolio value of these new intermediaries, have been entirely attributed to households in view of the limited importance of life insurance companies, which are the only other possible buyers. For the sake of uniformity, Luxembourg based investment fund units, which were previously included among foreign shares, have been included in the item "investment fund units" as assets of households and liabilities of the foreign sector.

In Italy, the pension funds foreseen in the European System of Accounts have primarily been in the form of severance pay provisions and company pension funds, in that these represent employees' claims on private and semi-public employers that fall due at the termination of employment. This is why the net change in severance pay provisions, even though they are not immediately available, are included in the saving of the household sector in the national accounts, which, moreover, do not supply an estimate of stocks.

The method used to reconstruct the flow-of-funds accounts was basically the following. The ratio of the net change in severance pay provisions to the stock at the end of 1982, taken from the survey of large companies' assets and liabilities for 1982 (Istat, 1985), was extrapolated to the universe. For the remaining years, the flows as shown in the national accounts were summed algebraically. The sectors on which households had claims of this kind were firms, insurance companies, BI-IUC, banks and special credit institutions.

Annual accounts data were used for the Bank of Italy and the other credit institutions. The outstanding amounts of the provisions made by insurance companies at the end of 1975 were obtained by assuming the same proportional relationship between the net change in the provisions of insurance companies and banks in 1976 to the corresponding stocks at the end of 1975. The data for the corporate sector were obtained as a residual.

The valuation of shares and the determination of holder sectors involve considerable difficulties for the compilers of national and flow-of-funds accounts. The situation is further complicated in Italy for various reasons: the low capitalization of the stock exchange, at least until recently; the limited representativeness of listed shares compared with total shares; the lack of reliable information regarding individuals' shareholdings obtained from income tax statements or through special surveys; and, lastly, the lumping of financial companies together with industrial companies in the flow-of-funds accounts. The availability of information on a large sample of firms from the Centrale dei Bilanci should improve the data base.

Italian shares were dealt with separately from participations in the last Annual Report. The estimates of the market value of shares were obtained by the following procedure. The stock of listed and unlisted shares at face value by issuing sector (source Assonime), was revalued using the settlement prices of the Milan stock exchange (source Sasip). In all probability this resulted in an overestimate since the price of an unlisted share is almost certainly less than that of a listed share, but in the absence of alternative data there was no choice. Once the shares held by credit institutions, insurance companies, Italian investment funds, public bodies and foreign investors had been determined by means of balance sheet and balance-of-payments data, the holdings of the private sector, comprising households and firms, were obtained as a residual. The next subdivision was based on a Bank of Italy survey of the accounts of a small sample of firms, which presumably led to households' shareholdings being underestimated in recent years.

Italian participations held by households (including private non-profit institutions) comprise the net worth not attributable to other

sectors of the banks that are not established as companies limited by shares.

A financial instrument which is relatively rare compared with other European countries and which is not yet included in the flow-of-funds accounts because of the difficulty of gathering data is non-bank consumer credit. In large part it is composed of personal loans, instalment credit, and finance leasing, largely for the purchase of vehicles. This component of household indebtedness has been variously estimated at 5,000 billion lire at the end of 1985.

APPENDIX 2 — **Real wealth: estimation methods**

The real wealth of households defined as units of consumption has been reconstructed distinguishing between agricultural land, durable consumer goods and dwellings.

INEA publishes regular estimates of the mid-year market value of agricultural land. This has been attributed entirely to households for lack of information about the share of agricultural property held by large firms, which in any case is not likely to be material. End-of-year values were obtained as the mean of successive figures.

The stock of durable consumer goods at 1970 prices (appliances, furniture and vehicles) was obtained by using the most simple version of the perpetual inventory method: an initial stock, a constant rate of depreciation (d) and the expenditure on durable goods related by the well-known formula

$$\text{Stock} = (1-d)\,\text{Stock}_{-1} + (1-d/2)\,\text{Expenditure}$$

The initial stock for the end of 1969 was taken from Manfroni (1976). Following the literature, (6) the rate of depreciation was fixed at 5 per cent quarterly, and it was assumed that even goods purchased that quarter depreciated. The purchase cost of durable goods was taken from the national accounts. The deflator of this variable was used to evaluate the aggregate thus obtained at current prices.

It was difficult to estimate the value of wealth in dwellings because of the lack of official data; Istat has not published data since 1971.

Guarini-Venanzoni (1985) reviewed the state of the subject. Lecaldano et al. (1985) gave several estimates for the 1970-1982 period based on a reconstruction of the number of dwellings and two series of market prices which include land values. Turning first to the problem of prices, the first series was obtained as a weighted average, with the weights deriving from the percentage distribution between owner occupiers and tenants, of the head of household's self assessed value of his dwelling. This series was taken from the Bank of Italy's sample survey of Italian households' budgets. The second series was a simple average of prices per square meter registered in transactions for new or remodernized dwellings in provincial capitals, in various other large cities and in minor towns, classified by population size and geographical area and published in *Il Consulente Immobiliare.*

Even though this source publishes data which approximate market prices, the fact that it provides figures only for new and recently remodernized dwellings constitutes a serious obstacle to its use in a valuation of the total stock. Although the first source is not similarly limited, it is not based on market transactions, but on replies about occupied dwellings so that unoccupied dwellings, including vacation houses, are not included.

As far as the physical stock goes, the 1981 census report, with 21,853,000 dwellings at the end of October 1981 as opposed to 17,434,000 in 1971, showed that the flow of registered completions of new dwellings had caused an underestimate of about 50 per cent on average over the ten-year period. Various researchers have noted that the phenomenon of unauthorized dwellings primarily regards vacation houses.

Since we were interested in obtaining the value of housing property, and did not have an

appropriate price for the category "vacation house", it did not seem feasible to redistribute the annual flows so as to respect the constraint of the results of the two census reports. Following the methodology outlined in the above-mentioned study, we have kept the 1971 census report as our point of reference, updating the estimates through 1982 based on net completions with the national accounts' data on investment in dwellings. The prices used were those of the Bank of Italy survey on family budgets; with the exception of 1985, when the survey was not effected. The update was made by varying the end of 1984 figures in accordance with the price changes determined by *Il Consulente Immobiliare*. Lastly, in contrast with the above-mentioned study, 90 per cent of housing property was attributed to households, extrapolating the information on property titles for occupied housing for 1981 (Istat, 1983).

The estimates used in the present study can be assessed by comparing them with other studies. According to Censis (1984), the value of total housing property in 1984 was 1,285,000 billion lire, as opposed to the 1,476,000 obtained following the criteria used here. Guarini and Venanzoni, who use the Censis estimate, have noted that it is not possible to judge the accuracy of the procedure used by Censis for lack of a description of the method adopted.

In an unpublished study, Manfroni (1985) updates to 1983 the Istat estimates, which have been discountinued since 1971. He bases his estimates for the 1981 census report. The value obtained for housing property at the end of 1983 was 972,542 billion lire, as opposed to the 1,358,300 of the present study. The author uses the change of the national accounts deflator of investment in dwellings to revalue the average price per room, referred to 1970, assuming that the unit value of the stock rises in line with that of new dwellings, and, in particular, that the construction cost index underlying the deflator is representative of market prices.

The estimates obtained by the present study are higher than those of both the other studies; this indicates that we have not underestimated the current price value by failing to redistribute the flow of new dwellings to take account of the 1981 census report figures. On the other hand, if we had done this, our estimates would have been overvalued since we were not able to take account of the presumably lower price of vacation houses.

APPENDIX 3 — **Statistical sources**

Italy: (i) financial assets and liabilities of households: Bank of Italy

(ii) agricultural land: INEA, *Annuario INEA dell'agricoltura italiana,* various years

(iii) dwellings: Istat statistics, *Il Consulente Immobiliare* and Bank of Italy. See Appendix 2.

(iv) durable consumer goods: Istat, *Annuario di Contabilità nazionale,* and Manfroni (1986). See also Appendix 2.

France: calculations based on INSEE (1984) "Dix ans de comptes de patrimoine 1970-79", No. 455 of *Les Collections de l'INSEE,* series C, No. 116. The estimate for durable goods for 1975 is taken from INSEE, Economie et Statistique, No. 114, September 1979. For 1979, it was assumed that the share of durable goods remained constant compared with the other components of real wealth.

West Germany: the calculations are based on Goldsmith (1985).

United Kingdom: the calculations are based on CSO, Financial Statistics, February, various years.

Disposable income, defined as the sum of national consumption and households' gross saving was taken from OECD National Accounts, 1971-83. For Italy, Bank of Italy estimates for 1984 and 1985.

FOOTNOTES

(1) For an introduction to this subject see Bulletin No. 1, "The Inflation Adjustment of Financial Balances", and the literature it mentions.

(2) The Bank of Italy's flow-of-funds accounts consider 12 categories: households, (including private non-profit institutions), firms, BI-UIC, banks, special credit institutions, Italian investment funds (from 1984), insurance companies, central government, local government, social security institutions, autonomous government agencies and the foreign sector.

(3) According to the Bank of Italy survey on household budgets in 1984, the average household owned valuables for about 2,600,000 lire. In view of the high degree of reluctance to provide information on financial assets, this is probably an underestimate. Since it was not possible to make a comparison with other sources, they were not included among the components of real wealth.

(4) For lack of reliable data, the flow-of-funds accounts do not include financial assets held abroad illegally.

(5) For a recent study see Lecaldano, Marotta and Masera (1985).

(6) In the METRIC econometric model for France, the depreciation rate is equal to 4 per cent per quarter. For the United Kingdom, Muellbauer (1980) puts it at 5.6 per cent.

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Speeches

The Banking System and the Payments System

by Tommaso Padoa-Schioppa, Deputy Director General of the Bank of Italy
Address before Associazione Nazionale Aziende Ordinarie di Credito and Istituto Centrale di Banche e Banchieri
Rome, 18 March 1986

1. Introduction

"In many countries, new technology is not only permitting improvements in productivity but is also rapidly changing the payments system, the efficiency and security of which are essential to the soundness of the currency. The banks play a fundamental role in the payments system, one that they cannot renounce. Italy has ground to make up, despite a number of significant achievements. A study prepared recently at the Bank for International Settlements shows that both the new and more sophisticated payment methods and the traditional bank payment instruments are less widely used in Italy than in other countries, partly on account of the habits of the public."

Thus, in three short sentences in his Concluding Remarks to the *Annual Report* for 1984, the Governor of the Bank of Italy distilled issues, developments, problems and challenges which have increasingly engaged the attention of the banking world and students of monetary affairs. And as the impact of technology on money and finance demands continual adaptation of approach and operating strategies, it is becoming clear that what seemed at first to be merely a technique of mechanization actually has ever more profound implications for the very nature of monetary and financial phenomena and the theory by which we describe and interpret them.

The economist or bank manager who sets out to treat these issues must first of all try to defend himself against the complications of technology. My remarks today will therefore devote only small space to this subject. Instead, the main thrust will be to discuss, on the terrain and in the terms of banking and monetary affairs, issues that the central banker, the bank manager, and the economist often leave to the field of electronic data processing.

2. The old techniques

The payments system we studied in books is based on two forms of money — banknotes and deposits (bank or postal). In more general terms, these may be defined as the sight liabilities of the central bank, known also as monetary base (including currency), and the sight liabilities of the banks (or the Post Office), called bank or deposit money. Payment is the act whereby money, in either form, is transferred from one person to another. The payment has been completed when the recipient can in turn dispose of the money to effect another payment. With currency the payment is effected by the passage of the banknote from hand to hand. With deposit money it is effected by ordering the bank (or post office) to transfer the deposit claim from one person to another.

By its nature the banknote is universally accepted; as legal tender it is an instrument of payment with absolute power to discharge obligations. That piece of paper itself *is* and does not merely represent the financial wealth that is transferred by the transaction, so that the payment operation is completed with the physical passage of the note from one person to the other. Hence both the advantage and the risks of the banknote, which make it suitable only for transactions involving limited sums.

Payment via bank or postal money is more complicated, because the paper instrument employed — the most common is the cheque — is not in and of itself financial wealth for its recipient. The payment is thus concluded at a different time and place from those in which the piece of paper is handed from one person to the other, and is concluded not by the transactors themselves but by their banks.

The separation between the means of payment and money makes these banking instruments much more convenient and economical than currency and coins, or legal tender. They eliminate the problems and costs inherent in the distribution, changing, safekeeping, verification, and counting of that peculiar "commodity" constituted by banknotes. For the personal cheque, however, this separation is also a limitation, because its recipient cannot be certain it is good, and because it takes longer to settle transactions than with cash. These problems are attenuated but not eliminated by bank giro transfers.

The separation between money and payment instruments, combined with the fact that bank money is created by operators that are part of the economy and act according to the needs of business rather than of government, has another significant implication: namely, that to settle a transaction by means of deposit money, that money itself need not necessarily exist prior to the transaction. Payments can be made not only on the basis of pre-existing financial assets but also against a line of credit.

Note that the two forms of payment and the two kinds of money are separated not so much by the legal barrier (the one being "legal tender" and the other "fiduciary") as by the thin but sturdy membrane of habit and the kinds of costs and risks involved in their respective use. Since barter is not prohibited, any "thing" that becomes a universally acknowledged means of payment gains the status of money, i.e. becomes a form of wealth for its possessor. Less than twenty years ago I personally had a Milanese department store refuse to accept a 50,000 lira banknote. A few years later, during the great coin shortage, privately printed notes (mini-cheques) in denominations ranging from 50 to 200 lire effectively became money, regardless of legal dispute as to the value of a printed signature. Reportedly, in Gierek's Poland an instrument that enjoyed widespread circulation was a Polish half-dollar banknote.

To these two forms of money correspond two distinct payments systems, each with its own problems, features, organization, institutions, and controls, though we find significant interaction and numerous points of contact between the two.

In the banknote payments system, the action of the issuing institution consists in the production, territorial distribution, and replacement of the currency. For the rest, it is the economic agents themselves who see to the custody and transmission of the means of payment, so the network of their economic intercourse in production and exchange is coextensive with the payments network.

In the deposit money system, production and institutional arrangements are different and more complex, because they comprise the indispensable links with the banknote system and because distribution, transmission, accounting, and record-keeping are largely the work not of the agents engaged in production and exchange but of the banks. The system therefore requires an extensive network linking together the points where this banking instrument can be converted into legal tender, for the transmission from one to another both of currency and of the messages conveying payment orders. These "points" (bank branches today) are also the interface between economic agents and the banking system.

3. The new possibilities

The traditional arrangements thus briefly outlined are now undergoing a radical transformation, thanks to advances in electronics

and telecommunications. New technology is drastically cutting the cost of sending messages, reducing the time required to reach their destination virtually to zero, enormously expanding the capacity to store and process data, and lowering unit costs.

As a consequence, it is now technically feasible to create a new payment instrument combining the features of legal tender with those of deposit money and offering the advantages of both. This instrument, while remaining distinct from the underlying financial assets, would nonetheless like legal tender make it possible to settle transactions on the spot, at the moment of the exchange. The person accepting payment by this means takes no risk, because financial cover is proved by the instant crediting of the sum due to his own account. The need to check the quality of the payment instrument is eliminated. And checking the identity of the person using it is immensely simplified, thanks to a personal identification code.

Such a system implies either a home computer terminal or the use of magnetic cards for making purchases via point-of-sale (POS) terminals that permit real-time linkage with the data bank of the institution providing the service.

Though technically feasible, such instruments have so far been used only in local experiments intended to verify the economic advantage of their large-scale use. There has been faster diffusion of other systems which, though offering appreciable benefits to users, are not qualitatively different from the traditional ones. Automated teller machines (ATM) and cash dispensers (CD) certainly make the distribution of cash easier and more convenient, but essentially the service they provide is no different from the traditional teller's window. And credit cards, while making it possible to settle a number of different transactions in a single operation, still imply resort to a traditional banking instrument, such as the cheque or the preauthorized debit order.

To sum up the significance of these developments in a phrase, it could be said that thanks to them the economy may take a "quantum leap in efficiency". And it is worth a few words to specify precisely what that means.

First of all, this leap in efficiency will involve radical reduction of transaction costs — the time needed to procure cash, the interval before a cheque or payment order is credited, the work of formulating, transmitting, verifying, and recording messages from customer to bank, from branch to head office, from bank to bank. Taken all together, these form a myriad of small irritants, a source of friction that can slow and at times even impede economic movement, much as the Lilliputians managed to pinion Gulliver.

In our case, however — and in economic theory — a leap in efficiency also has another meaning, namely a great enhancement of the constantly evolving parameter identified as the degree of perfection of markets. The area in which exchanges can take place and the number of economic agents taking part will be vastly extended, because agents far removed physically from the point of exchange will have access to the information needed to make the transaction. In selecting his bank the customer will have a wider range of alternatives, because he will be freed from territorial constraints. And the same goes for financial products, whose features can be easily displayed in data accessible to any terminal linked into the network. The reduction of recording costs, finally, should shorten the response time of prices to new information. And the greater possibilities of analyzing the economic effects of decisions will permit checking divergence from objectives and correcting policy choices.

The ever more efficient functioning of financial markets and the diffusion of low-risk securities will lead banks to hold as balance sheet assets only securities which can be easily liquidated and to transfer to the liabilities side the higher average yield on assets. The distinction between "sight" deposits and securities will be increasingly blurred from the standpoint of both yield and liquidity.

Finally, the new technology will enable banks to offer their customers not only more economical services but qualitatively new services: financial instruments "constructed" by calculation, cash management services, payments clearing, and so on.

In short, we should look forward to: a drastic reduction in transaction costs; broader, deeper, and more transparent markets; an enhancement of the capacity of economic agents to optimize

choices; the creation of new financial products; and the possibility of differentiated, personalized customer services.

We seem to hear anew the words with which Francesco Ferrara hailed the advantages of paper over metallic money in 1873: "The banknote eliminates the defects of metallic money. It annihilates two great enemies of mankind, time and space."

4. A system behind the times

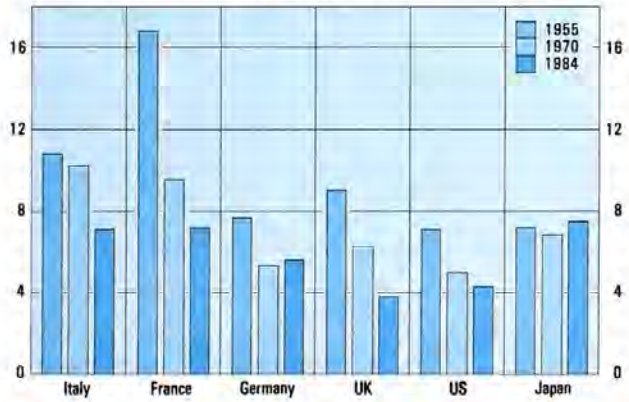
Today's transformation is part of a long-standing historical trend: the evolution from barter through metallic, then paper, money to money of account. This evolution is conventionally described as a series of stages, in each of which a new instrument supplants its predecessor. In reality, however, all these payment instruments, even the most ancient, are simultaneously present in modern society, partly because each meets the specific exigencies of particular kinds of transaction and certain customer segments and partly just because habits and traditions are slow to change.

What kind of stratification prevails in Italy today among the various instruments of payment? It is commonly said that our country still uses the "banknote system" of payment. Cash has a dominant role, out of keeping with the economy's level of development.

Figure 1

Ratio of currency in circulation to GDP

(1955-1970-1984)



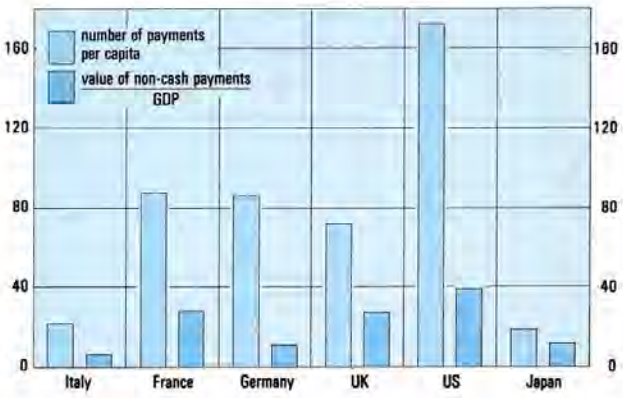
Source: IMF.

Truth to tell, in 1984 the ratio of currency in circulation to GDP in Italy was about the same as in France and Japan and only slightly higher than in West Germany; only the US and the UK had markedly lower ratios. The ratio of currency in circulation to household consumption follows a similar pattern. The significance of such comparisons is undercut, however, by the fact that the velocity of currency circulation may vary substantially from country to country. In fact, not all of the stock of money is necessarily utilized in exchanges. And the number of transactions effected by a single banknote in a given time period is influenced by technical and organizational factors, such as the quality of the paper and the number of banknote distribution centres. In Italy, where central bank branches are more numerous than elsewhere, on the average, the number of notes in circulation when the observation is taken, i.e. at the end of the business day, can be considerably lower than it is in the course of the day.

Figure 2

Use of non-cash payments (1)

(1983)



Source: BIS.

(1) Payments by cheque, credit card, giro transfer, direct debit.

To illustrate the importance of cash in an economy, one needs to refer to the number of payments effected by other means, and the sums involved. And here we find an average of 22 such payments annually per capita in Italy, as against 88 in France and a peak of 172 in the US. And the ratio of the total value of such non-cash payments to GDP is lower in Italy than in all the other

advanced economies. If, finally, we rule out the possibility of enormous transnational differences in the ratio of number of transactions to GDP, we must conclude that in Italy cash continues in all likelihood to play a dominant role, at least compared with other countries.

Evidence in support of this thesis comes from a survey commissioned by the Italian Bankers' Association (ABI), which found that 55 per cent of Italians who receive an income said they take it in cash, and 38 per cent keep it in that form for the entire month. The survey also found that 8 per cent ordinarily made payments of more than one million lire in cash, while only 24 per cent felt that the possibility of loss or theft represented a significant disadvantage.

Turning from cash to *bank means of payment,* the first indication of their relative unimportance in Italy is that the use of the current account is not at all widespread. In 1983 there were 27 current accounts for every 100 residents in Italy, as against 66 in France, 82 in Germany, and 136 in the US (Table 1). The situation varies from region to region, but even in the northwest of Italy, which leads the way with 49 current accounts per 100 residents, reliance on this means of payment is modest.

Table 1

Number and average size of current accounts

(December 1983)

	Number of accounts per 100 residents	Average size (in millions of lire)
Italy	27	13.0
France	66	3.8
Germany	82	2.3
US	136	5.5
Japan	202	3.0

Source: BIS.

Moreover, among bank means of payment, cheques make up a larger share here than in most of the other large industrial economies. They make up 85 per cent of non-cash payments in Italy as against 82 per cent in France, 63 per cent in the UK, 19 per cent in Japan and 11 per cent in Germany. In the United States the share accounted for by cheques is also very high (92 per cent).

Giro transfers and customer payment orders are also quite commonly used in Italy, especially by firms and for payments involving large sums. While the average value of cheques issued by companies was slightly over 3 million lire, the average sum involved in giro transfers was almost 30 million; 13 per cent of all non-cash payments in the country were giro transfers, a figure significantly exceeded only by the 34 per cent registered in Germany and virtually equalled by that in the UK.

Table 2

Composition of non-cash payments

(percentages) (1)

Instrument	Italy	France	Germany	UK	US	Japan
Cheque	85	82	11	63	92	19
Giro transfer	13	2	34	12	—	1
Credit card	1	2	—	8	7	10
Non-paper (2)	1	14	55	17	1	70
Total	**100**	**100**	**100**	**100**	**100**	**100**

(1) Of the number of payments. — (2) Giro transfer without paper instruments; automatic payment or collection orders.

Finally, the banker's draft has a special position in Italy. The ABI survey found that 12 per cent of Italians are paid their salaries in the form of a banker's draft. The banks encourage their use, despite the fact that they do not lead to a lasting relationship with the customer, because it offers them a cost-free source of funds during the interval between the issue and the cashing of the draft. A survey of banks adhering to the Interbank Convention on Problems of Automation has found that the average value of the banker's drafts used for remuneration of labour is just over 300,000 lire; and since average incomes are certainly well above this figure, it is likely that several drafts are used to pay each person's monthly earnings.

Finally, with regard to *non-paper instruments* and credit cards, Italy stands last among the major industrial countries.

Direct debiting and preauthorized payment orders, which, requiring no written document, yield substantial cost economies, are most common in Germany, where they make up 55 per cent of all non-cash payments, and in Japan, where they cover 70 per cent. Recently, this form of payment has gathered momentum in France as well.

Table 3

ATMs and POS terminals

	Number of automated tellers (1985)	Number of POS terminals (1985)	Number of ATM - CD networks (1985)	Percentage of ATMs in shared networks (1985)
Italy	2,500	—	1	60
France	7,000	40,000	1	..
Germany	2,500	100	1	90
United Kingdom	6,800(1984)	100(1984)	3(1983)	47(1983)
United States	64,000	14,000	250	40
Japan	45,000	5,000(1983)	5(1983)	39(1983)

Source: BIS.

The use of cash dispensers, automated teller machines capable of taking deposits, and POS terminals for electronic funds transfer is still in its infancy. An exception here is the use made of automated tellers to distribute banknotes, which has found fertile soil in the Italian public's widespread preference for cash. Even so, the number of these machines is still much lower than in other countries (Table 3).

5. What role will the banks play?

Non-cash payments instruments, then, are less common here than in other countries. And of those non-cash instruments, a considerable portion consists of payments based on written documents, which take longer to execute. The electronic services and procedures introduced so far use state-of-the-art technology, but they handle a far smaller volume of business than had been anticipated, and they also pose some security problems.

The path of change that lies before us is plain to see, because it has already been traveled by the technology and the development of more advanced systems elsewhere. Regardless of possible uncertainty over the ultimate outcome of some innovations and imperfect knowledge of Italian realities, we can be certain of several things: that the new payment systems will come into widespread use; that this will produce a quantum leap in efficiency within the next few years; and therefore that there is a large market to serve.

But, if our path has been laid out, we still do not know how fast we can travel it, which firms will move ahead first, or what role the banking system will play. All these things depend on the initiative and readiness to change of many agents: not only the banks and the central bank, but also the Post Office, the telecommunications sector, the electronics industry, enterprises, retailers, and consumers.

There are factors that spur change and others that work against it. One such brake consists in the habits of the public, which, especially in such spheres as money and trade, will not easily relinquish age-old rites and symbols. But a stimulus to change comes from the great practical advantages the new system has to offer its users. And owing to these partially counterposed forces, the change will be gradual and the new will not eliminate the old at a stroke but take its place alongside it.

What role will the banks play?

For many decades now two factors have given the banking system a kind of monopoly on the payments service: the exclusive "licence" to gather deposits from the public and the "barriers" constituted by both the installation and the operating costs of a network capable of running the system and by the expense of filing and managing the payments data.

Now, however, the new technology permits the instantaneous transfer of deposits over great distances, which potentially disrupts the

geographically given "deposit-taking and lending" base. And that same technology will put the provision of a "communications and filing" service (for orders, data, and information in general) within reach of anyone capable of setting up a communications system whose network and terminals reach a large clientele.

Developments along these lines have taken place recently in other countries. Securities houses and investment funds have captured a significant share of the payments market in Japan and in the United States. In the US a giant retail chain, Sears, has penetrated the credit card market so effectively that its card is now marketed by banks. In Germany the first large-scale testing of POS terminals has been done by a software company. To be sure, the banks still have substantial advantages over their potential competitors. They alone enjoy the backing of the central bank as lender of last resort and as a supervisory authority, thus strengthening the public's confidence that claims on them are convertible into legal tender. Only the banks have an ongoing network of established business relationships and they alone offer a full range of monetary and credit services. And in Italy, the issuing of cheques by anyone but a bank is prohibited by law. Nevertheless, the banking system cannot underestimate the danger that its comparative advantages may be undermined by the advance of technology. And the only way for banks to face the threat is to take the initiative in this transformation, to their own advantage and that of the entire community.

There is no shortage of fields for immediate application.

First of all, through agreements with companies and other economic agents, the use of the current account must be popularized, for this is the foundation stone for any future development of bank-based means of payment.

Systems compatible with the clientele's socio-economic condition and with the habitual inclination to traditional instruments can be devised. In Japan, where as in Italy cash is the most common instrument of payment, the initial phase of the transformation to electronics consisted, as in this country, in the installation of banknote distribution machines. But whereas in Japan there were 45,000 ATMs and CDs in operation in 1985, in Italy there were just 2,500. Of course, the popularization of equipment linked to the cash payments system represents but modest progress, and it could even hinder further advances. Nonetheless, in the meantime it accustoms the public to the use of electronic cards and systems and gets the banks started towards the revision of organization, procedures, and strategies for geographical expansion. In fact, in virtually all countries POS networks are developing in close connection with ATMs and use the same magnetic cards.

There is one major customer segment, namely industrial firms and the large retailers, that is fully conscious of the importance of these innovations and is urging their more rapid introduction. In this area it is anything but certain that demand is lagging behind supply, and at the same time there is a greater risk, for the banks, that the gap between demand and supply will be filled by new agents. Finally, the quick success of the Bancomat cash dispenser system suggests that Italian households too are much more inclined to change than is commonly thought.

For the banks, a more determined advance along the path of transformation entails a sort of revolution. It means not only introducing the new equipment; not only applying cost-cutting techniques; not only carrying out internal reorganization. It also means rethinking the very nature of their business and their corporate structure from the bottom up. The old "deposit bank", based on deposit-taking and lending and organized in a far-flung branch network in which the management of the cash payments system and the "capture" of households' savings are combined, is bound up with the payments system that emerged around the turn of the century. And that bank will be transformed by the transition to a new payments system.

Just how important and far-reaching this transformation is will be felt in all of the many traditional areas of prime interest to the banks, because the transformation of the payments system opens prospects and poses completely new problems in each of them. I shall dwell briefly on three in particular: pricing, the bank branch, and interbank cooperation.

6. Pricing

For the economy as a whole deposit money generates enormous savings of resources that would otherwise have to be used by every economic agent to make the banknote system work. For the banks that organize and run it, however, the deposit money service is costly. And only part of this cost is billed to customers. Costs are covered and profits made in another way, namely via the creation and lending of that very deposit money whose transfer as payment from one agent to another the banks see to. The fact is that a bank deposit — which enables the depositor to avoid the costly cash system and avail himself of the convenient, economical deposit system — is more costly for the bank than for the depositor.

Today the execution of payments is seen almost as an extra, a courtesy to the customer, in whom the bank is really interested as a source of funds. The price that counts is that of the principal product, i.e. the deposit, even if when this price is set the cost of this all-important courtesy service is, or should be, taken into account. The common use of value dating in addition to commissions as a method of pricing fits into this approach — an approach whereby the bank's income from the payments service ultimately depends on two variables, interest rates and the amount of the payment, that have nothing whatever to do with the cost of producing the service.

Now, however, with the separation of the deposit-taking and lending function from that of filing and communication, with the rise of a payments system almost totally distinct from the custody of savings, a radical change in approach is called for. The pricing of payments services needs to be made independent of the yields on financial assets.

This change will face difficulties and obstacles that are anything but minor.

The first obstacle is the traditional mental attitude of the banks and their customers. Today it is almost as if the service of payment were considered "free goods" with respect to which there is no point in economizing, making cost-benefit studies or even calculating the exact cost. And yet this service does have a cost. And, perhaps paradoxically, its users and its producers need to become fully aware of it just now that the new technology will make it possible to reduce it drastically.

Economic theory teaches that the purpose of prices is to orient supply and demand in the search for optimal allocation of resources. If the price of a service is to perform this "signpost" function, it must be related to the cost of production. But we know that in a multi-product business it is no easy matter to devise accounting systems capable of apportioning the costs among the services for which they are incurred. And this is itself a second problem. With no reliable information as to the costs of the traditional payments services, it is impossible to estimate the profitability of the new ones or gauge the return on investment in automation.

This problem is complicated by the need not only to measure costs but also to forecast their evolution. For if the objective set were the immediate coverage of the new systems' installation costs, we would risk braking the growth of demand and failing to take full advantage of economies of scale. Only a widely used system can offer the full advantage of the new techniques to its users; only on this condition can costs be reduced to the minimum and thus charged entirely to the customer.

In order to guide demand, not only must prices cover costs, they must also be immediately perceptible to the users of the payments service. Clarity and transparency are indispensable prerequisites for efficient markets. The banks' clientele will shift their preferences from the slow, costly traditional services to the fast, cheap new ones only when both the former and the latter are properly billed.

The path to embark upon is that of separating the pricing of payments services from the remuneration of savings. Producers of payments services will have to derive their earnings increasingly from the speed, not the slowness, of their service to the customer. By contrast the return to savings should depend on the stability of the deposit. A joint pricing system like the one now in use risks not being competitive on either of the two fronts on which banks are engaged and threatens to drive both savings deposits and payments services outside of the banking system.

There is, here, a "market" difficulty. The individual bank is hesitant to take the step of introducing correct, transparent pricing for fear of losing out to its competitors, still mired in the old methods. This impasse, typical of oligopolistic competition, threatens to work to the disadvantage of the entire banking industry, which will be at once less profitable and behind the times in products. Overcoming these difficulties through a new approach to service quality and pricing should be thought of as an investment whose fruits will come in time, an investment which will repay the individual bank that makes it even if made ahead of the competition.

7. The bank branch

Now a second difficult topic: the bank branch.

For decades the "network" through which the payments system has operated has been fundamentally made up of a combination of bank branches and postal communications. For decades the bank branch has been the basic "contact point" between the bank and its customers for the entire range of banking services: from the most thoroughly standardized, such as converting deposits into cash and informing of account balances, to the more personalized, such as financial consulting and credit assistance. The technical feasibility of automating the more repetitive operations and the decreasing importance of conversion of deposits into cash and vice versa are now altering the channels through which payment services are made available to the public. This process is stripping the traditional bank branch of major functions for which it was once indispensable and which constituted its main organizational frame.

Today, a thorough rethinking of the structure of this network is obligatory. The cluster of services traditionally grouped together in the bank branch must be reclassified and distinctly identified with reference to the new techniques used to produce them and deliver them to the customer. And on the basis of these techniques, the services will be got to the client by a variety of instruments and "vehicles". The traditional bank branch will be one of the points of the new network, but it will be flanked by consulting offices, automated teller machines, points of sale, terminals, home telephones. And communications, which in the paper-based system were handled by the post office, will come to form an integral part of the transactions themselves and the equipment by which they are carried out.

Offices will very likely have to be dismantled and put back together differently to reflect the changing importance of space and labour in the production process in banking. The bank branch proper will increasingly be an independent centre of operations designed to offer its customers not only the traditional banking services but also advice in choosing among the financial instruments and operations available.

In recent years we have already seen a significant extension of the range of "contact points". Automated teller machines and cash dispensers, which at first were found only at bank branches, have been installed at considerable distances from them: in airports, railroad stations, supermarkets, department stores, and industrial complexes. And in addition to POS terminals, a great variety of means now offer banking services to the customer: the home terminal, the telephone network, and the post office.

The change in the shape of the system has been and will continue to be accompanied by an evolution in the guidelines for banking supervision. The Italian Banking Law, Article 28, gives the Bank of Italy authorization powers in matters of the geographical structure of the banking system. These powers are exercised on the basis of directives issued by the Interministerial Committee for Credit and Savings, which has several times taken up the question of automated teller machines.

At first the Committee made a sharp distinction between machines installed at the premises of the bank branch and those installed at other locations. The latter were subject to regulations analogous to those governing the establishment of a new branch. In 1980, in order to encourage the use of the new technique, banks were exempted from prior authorization by the Bank of Italy for the installation of automated tellers at corporations and public agencies.

Automated tellers and cash dispensers are apparently performing the function of supplementing and rationalizing rather than supplanting the ordinary branch network. Even if the operations they can perform are greatly extended, these machines cannot offer the full range of banking services. Therefore they are more highly appreciated when they are located in areas where branches are already in operation and when the bank has already established its customer relationships. Nor should we overlook the fact that supplying the machines with banknotes and periodically checking their working order are inevitable constraints on their physical distance from the branch itself. The experience of other countries, where automated tellers are more common and perform more varied operations, confirms that while they offer appreciable cost benefits their impact on the overall conditions of competition is limited.

Regulations will have to take all this into consideration. Provided that the fundamental exigencies of security are observed, the authorization process could give the banks additional potential for optimizing their territorial network through the installation of automated teller machines.

In rearranging the products supplied by different types of service industries under the impulse of competition, deregulation and technological change, the possession of a vast distribution network has become an invaluable asset that can be put to a variety of uses. In the years to come it will be crucial for banks to take the best possible advantage of their far-flung, dense, and very costly branch network.

8. Cooperation and competition

A third area in which the evolution of the payments system will necessitate rethinking strategies is in the interaction between competition and cooperation.

The present system itself, of course, already requires interbank cooperation. The banks must be in communication to exchange messages, and they must carry out movements in reciprocal credit and deposit accounts in settlement of payments. But this type of cooperation is limited to interbank services; it does not extend to payment instruments or direct customer services.

In the situation that is now unfolding, spurs to closer collaboration come both from the suppliers of payments services and from their users.

On the supply side, the stimulus stems above all from the cost structure of the new systems. The combined use of computers and advanced telecommunications systems to effect payments has very high installation costs and rapidly diminishing marginal operating costs. Both for the bank and for the economy as a whole, optimal benefits from such a system come only with a very large volume of business. Estimates in the United States, for instance, indicate that the minimum on the cost curve is reached only once at least 1,000 ATMs are linked together, each performing at least 2,000-2,500 operations a month. Moreover, there are risks and costs deriving from uncertainties as to the public's acceptance of the innovations and the need to inform the market of them. Cooperation agreements are indispensable to overcome the technical and economic barriers, which are such as to prevent any single bank from entering the market on its own.

The stimulus to cooperation is also substantial on the demand side. Today the bank customer can cash a cheque only at his own bank and at branches where he is known. With magnetic cards, personal identification codes, and direct access to the computer memory, the customer's relationship with the bank can be depersonalized, benefiting him in direct proportion to the extent of the network of access points. The advantage in cooperation is all the more evident in the case of the use of magnetic cards at POS terminals.

The multiplicity of arguments for cooperation, however, is not such as to make a case for the existence of a natural monopoly on the supply of bank instruments of payment. First of all, the cost of the new technology has diminished significantly in the last few years and will fall still further in the next few. Telecommunications itself, until just a few years ago considered a classic case of natural monopoly, has turned into a highly competitive industry. Second, beyond certain limits concentration can give rise to diseconomies owing to the greater vulnerability of highly centralized systems compared with more pluralistic ones. Nor are concentration's benefits

to the customer beyond dispute, as is shown by the simultaneous presence in the same cities of "national" and local banks and the coexistence of a variety of means for the settlement of transactions.

The most telling argument against an exclusively cooperation-oriented approach, however, is that this would deprive the development of the payments system of the powerful engine of competition, the stimulus to action inherent in the determination on the part of each firm or group of firms to do better than its competitors. In a highly innovative field, where spirit of initiative and the willingness to take risks in the search for new products and processes are indispensable, turning off the engine of competition can mean condemning the system to immobility.

The mix of cooperation and competition in payments services, then, cannot be too heavily weighted in favour of either extreme. There must be an appropriate balancing of the two elements, which is hard to define in the abstract since its features will depend on institutional, environmental and technical factors that vary from place to place and change over time.

To formulate criteria for determining the balance between cooperation and competition in practice is no easy matter, and is certainly beyond the scope of my remarks here. For the individual bank, the criterion needs to be such as to permit an optimization of profitability and growth in the medium to long term. For the monetary authorities, the criterion will derive from objectives with regard to system stability, security and efficiency. Just as the automobile industry has drawn a line between cooperation in the field of components and competition in the marketing of the final product, so the payments services industry has to establish the boundaries between the needed price and product competition and the joint installation of infrastructures.

The policy orientations of central banks and the authorities that regulate banking competition vary from country to country, and they have changed with the evolution of products and markets. In some countries, such as the United States, Japan, and the United Kingdom, the authorities have left the market free to generate the forms of cooperation judged to be most suitable. A strong tendency to concentration has emerged but so far has not led to monopoly situations. Elsewhere, as in France and West Germany, the solution favoured has been the creation of a single network embracing all the banks. Almost everywhere there is extensive cooperation in the installation of basic infrastructures and in interbank data transmission services. For the latter, however, signs of a disintegration of the traditional monopolies have emerged internationally.

The Bancomat experience in Italy suggests that when the employment of the new technology is in its infancy, an integrated network can assist in popularizing innovative services. The appropriateness of this choice, however, must be subject to continuous re-examination in the light of technological advances and the evolution of market conditions.

9. The monetary authority

To stress the role and responsibilities of the monetary authority in the operation of the payments system is to repeat a commonplace. But at the same time it is to discover, in the very origins of central banking, the key to new problems and tasks.

For it is self-evident that in its supervisory capacity, the monetary authority cannot remain indifferent to developments that will have weighty consequences for the structure of the credit market, that could, during the transition, cause instability in some parts of the system, and that engender new risks for some kinds of intermediaries. And it is equally self-evident that, in its responsibility for monetary policy, the monetary authority will have to act to make sure that the transformation of the financial markets does not jeopardize the conduct of monetary stability.

This way of approaching the problem, however — in terms of its implications for monetary policy or banking supervision — does not do full justice to the autonomous central bank's institutional duty as the core of the payments system. Its obligation here is primary, not derivative, and it stems from the fundamental

public interest in the proper working of the monetary system.

In truth, even before the central bank was endowed with discretionary powers to control the money supply for macroeconomic ends and before banking supervision came into being, the granting of the privilege of emission on certain institutions implied the assignment to them of the essentially public duty of "making the payments system work", of guaranteeing the quality of payments instruments for the entire economy. The institute of emission ensured the proper functioning of the entire payments system because its banknote was practically the only instrument accepted.

With the rise of deposit money, the tasks of central banks as active participants in the payments system underwent a change. The duties connected with the banknote system contracted, but those connected with deposit money expanded. To make the system work properly and economically, basic infrastructures were brought into being, the most important of them being the clearing house service. The payments service came to be operated largely by banks, and its efficiency and stability were guaranteed by a dual mechanism: market competition and banking supervision.

The ultimate outcome of the evolution that has now begun is still too uncertain for us to depict the new methods the central bank will use to discharge its responsibilities in the payments system of the future. The importance of some of the services it itself supplies could be diminished — let me simply mention the trend to a decreasing use of notes and coin, and the potential development of interbank services in the market itself. At the same time, however, new types of intervention may be required to pursue certain general interests which the market, left to itself, will not necessarily satisfy. The unity of the system, security, market stability, confidence in the new instruments, setting standards, the promotion of common infrastructures, the working out of codes of conduct, the establishment of the boundary between cooperation and competition — all these are areas in which the central bank is instrumental and irreplaceable. Central bank action could be needed to keep possible malfunctioning of the payments system from disrupting the financial markets or to ensure compatibility and link-up between different networks for purposes of clearing-house operations and the settlement of balances. It could prove necessary to extend supervision to new intermediaries or to adopt new instruments to limit the risks connected with the rapid increase in the number of transactions.

10. Conclusion

For a century now modern economies have been working with a payments system combining cash and deposit money. This system has underpinned, accompanied, and furthered a process in which well-being has increased enormously, trade has expanded and exchange intensified, national and international markets have been integrated. Though with significant exceptions in particular times and places, this system has conveyed the choices and economic actions of hundreds of millions of persons who interacted without even knowing of one another's existence, with the invaluable assistance of a common and on the whole stable measure of value. On its foundations arose the credit systems, hinging on the large deposit banks; monetary policy, based on the special relationship of complementarity and substitutability between legal tender and bank deposit money; modern central banks, the linch-pin between banking systems and governments; banking and commercial legislation; banking supervision; and modern monetary theory.

It would be ingenuous to expect the sudden disappearance of this complex reality. But it would be rash not to see how closely it is tied to one particular payments technology, and how it is thus bound to be transformed with the emergence of a new technology. New techniques always appear at first in the guise of a more efficient, cheaper way of doing "the same old things". Only later does it become clear that they are the bearers of "new things", new possibilities, new needs, new market arrangements, new fortunes, new ways of existing and of doing business.

The payments system is the essential connective tissue of economies based on exchange and the division of labour. The

evolution and the extension of that system will bring about a transformation of those economies, starting with the enterprises that provide payments services themselves. To understand the meaning and direction of the changes we are experiencing, to grasp the potential of the new technology, to organize the translation of that potential into operational practice, to guide credit institutions through this transformation, to safeguard the overriding needs of stability and security inherent in money itself — these are the tasks that await bank managers and central bankers in the years to come.

A system is defined as "a regularly interacting or interdependent group of items forming a unified whole". The word appears twice in the title of my talk, but the reference is one and the same. Banks form a "system" because payments constitute a "system," because a monetary exchange economy is a unified whole. And if in the scholastic description of institutional arrangements the banking system is defined as consisting of the banks plus the central bank, this is because the former and the latter as institutions form that "unified whole" that performs payments services for the economy. This is the vision of the system with which, in the years to come, we must face the hard, important problems posed by a period of far-reaching and thoroughgoing transformation.

The Circulation and Value of Shares

By Antonio Fazio, Deputy Director General of the Bank of Italy

Speech given at the inauguration of the premises of Montetitoli S.p.A. (*)

Milan, 2 April 1986

First, I should like to thank the Chairman of Montetitoli, Mr. Ugolini, for kindly inviting me to speak on this important occasion. My remarks will cover both technical and more generally economic aspects of the share market.

1. My technical considerations will be based on data regarding the activity of Montetitoli provided by Mr. Ugolini. This morning I visited the clearing house of the Bank of Italy's Milan offices. On the premises there were some 200,000 paper documents, i.e. securities, relating to the March monthly settlement, confidently and skilfully handled by some of the Bank's employees. Of course at the Bank of Italy we are used to handling large quantities of paper documents representing financial claims, but in our case they are banknotes. Unlike share and bond certificates, banknotes are highly standardized, with just a few types in circulation. They can therefore be sorted, counted, and in general handled very rapidly with the help of mechanical and automated equipment. Our banknote collection centres and our branches use Toshiba and GAO machines to go through enormous numbers of banknotes every hour, counting and sorting them by type, amount of wear, and any suspicion of counterfeiting.

Things are very different for share and bond certificates because automated handling is not possible. The tasks performed by clearing houses are multiple and sensitive and on some days turnover can amount to trillions of lire. Despite the problems, which have been intensified of late by the increase in turnover on stock exchanges, the books are always closed with perfect accuracy.

2. The circulation of paper documents on this enormous scale, with each representing — or rather, legally speaking, embodying — rights, is a relatively recent phenomenon, and perhaps typically Italian. Other financially advanced countries have long had centralized securities clearing systems and more recently have introduced book-entry systems, whereby movements of documents are entirely replaced by accounting entries. The growth in the volume of securities in circulation and of the related transactions stems primarily from the large amount and recent rapid increase of financial assets in Italy, coupled with their very widespread possession by Italian households.

My own belief is that the circulation of shares and bonds should, or at least could, evolve along the same lines as the historical development of the circulation of money itself. Initially money was only metallic, but it later took the form of banknotes issued by banks and currency issuing institutions. Later there was a further shift to commercial bank deposits and settlement by cheque. These developments both followed and produced far-reaching changes in the structure of the economy. The commercial banks became the primary source of monetary creation. Operating practice preceded the regulatory framework. This new economic function required and led to legal and institutional adaptation.

The characteristics of money have been accorded to instruments that previously lacked them. An eminent economist, Don Patinkin, recently noted that right up to the 1960s official

(*) Montetitoli is a company set up to provide "services designed to rationalize the custody and circulation of securities, in particular through the management of the system of centralized administration based on the fungibility of securities". The shares in Montetitoli can only be held by banks, other credit institutions and organizations performing analogous functions in other countries.

statistics on the money supply as we understand it today were not compiled anywhere, not even in the US or the UK, where these concepts had largely derived their theoretical impetus. This was because until quite recently money was understood to consist exclusively of metallic coins and banknotes. I think the same sort of operational and theoretical transformation could well take place with respect to other credit instruments subject to frequent exchange involving considerable sums, in particular bonds and shares.

We may have to get used to the idea that the claims of the possessors of such financial instruments will only exist as entries in the accounts of debtors, without being embodied in a piece of paper. Or, more simply, we shall have to get used to buying and selling securities without any physical transfer of certificates but simply through accounting entries.

3. Montetitoli and the centralized clearing of government securities by the Bank of Italy are already important steps in this direction. Table 1 shows that 80 per cent of government securities are held in the Bank of Italy's centralized clearing house, making it possible to carry out a large number of transactions involving enormous sums quickly and in perfect security.

The centralization of government securities has proved indispensable to the orderly working of markets that have grown exceptionally fast.

In a recent study I showed that public debt service, i.e. the value of maturing securities and coupons, amounts in a year to about half the gross domestic product. Every month the government issues some 30 trillion lire worth of securities. For the most part, subscriptions, interest payments and reimbursements are effected through the banking system, whose average liquidity is little more than 3 trillion lire. If the securities were all actually cashed on maturity and subscribed anew, that liquidity would have to be turned over ten times a month just to handle the movement of public securities.

Of course, the centralized clearing house does handle some withdrawals and new deposits every day, but the amounts are small. Since some circulation of securities, especially of smaller denominations, is natural, it does not appear feasible to push the rate of centralized handling much above 80 per cent.

Table 1

Bank of Italy centralized management of government securities

(outstanding amounts in billions of lire)

	Centrally managed (A)	Total in circulation (B)	Percentage ratio (A/B)	Number of accounts
31-01-84	198,351	304,767	65.1	124
29-02-84	205,148	311,934	65.8	»
30-03-84	213,559	316,867	67.4	»
30-04-84	224,395	327,976	68.4	»
31-05-84	238,086	335,108	71.0	»
29-06-84	242,157	340,608	71.1	»
31-07-84	248,575	347,706	71.5	»
31-08-84	260,669	351,956	74.1	»
28-09-84	270,426	364,238	74.2	»
31-10-84	272,956	370,301	73.7	»
30-11-84	279,231	373,603	74.7	»
31-12-84	283,729	380,446	74.6	231
31-01-85	286,308	383,252	74.7	»
28-02-85	293,809	403,534	72.8	»
29-03-85	306,044	409,211	74.8	»
30-04-85	314,203	419,675	74.9	»
31-05-85	325,458	426,136	76.4	»
28-06-85	335,535	433,483	77.4	»
31-07-85	343,473	439,529	78.1	»
30-08-85	352,821	448,992	78.6	»
30-09-85	362,625	461,396	78.6	»
31-10-85	375,553	470,293	79.9	»
28-02-86	392,508	490,032	80.1	532 (*)

(*) In 1985 accounts were opened for all stockbrokers after the "centralized clearing" procedure became fully operational. — Secondary market accounting transfers in 1985: 110 trillion lire.

All the economic policy problems of the public debt naturally remain, namely its large volume, short average maturity and resulting high cost of debt servicing. The large amount of financial savings accumulated by Italian households ensures that the securities will be subscribed, provided that they offer satisfactory yield, risk and liquidity conditions.

The proper functioning of the primary and secondary markets, to which centralized handling contributes, improves the liquidity and risk conditions of government securities, thereby fostering the broadening of the related markets and reducing the cost of the debt to the Treasury.

Moreover, for some years now monetary policy measures and regulation of the economy's liquidity have centred largely on open market operations in securities. And the volume, frequency, and rapidity of these operations also require well functioning financial markets.

These structural improvements in the government securities market have not so far been extended to the share market. Table 2, which shows the volume of share delivery promissory notes issued in relation to the volume of share certificates to be delivered to the clearing house of the Milan stock exchange, highlights the growing difficulty of transferring shares. Settlement in this market takes place only once a month (not daily as for other securities), and nonetheless in recent months a quarter of the shares traded have not been delivered. This has

Table 2

Share delivery promissory notes

(Milan monthly settlements — values at settlement prices in billions of lire)

	Securities not delivered to clearing house A	Securities delivered to clearing house B	Total for delivery (A) + (B) = (C)	Turnover on Milan stock exchange D	A/C (percentage ratios)	A/D (percentage ratios)
1983 - Jan.	22	100	122	206	17.7	10.5
Feb.	28	202	230	692	12.3	4.1
Mar.	28	236	264	880	10.6	3.2
Apr.	31	313	344	733	9.0	4.2
May	26	166	192	490	13.3	5.2
June	16	416	432	336	3.7	4.8
July	15	206	221	465	6.9	3.3
Aug.	33	157	191	448	17.5	7.4
Sept.	13	155	168	447	7.8	2.9
Oct.	11	124	135	343	8.4	3.3
Nov.	14	128	142	289	9.7	4.8
Dec.	22	149	170	429	12.8	5.1
TOTAL	**259**	**2,352**	**2,611**	**5,758**	**9.9**	**4.5**
1984 - Jan.	34	180	214	685	16.0	5.1
Feb.	29	367	396	1,226	7.4	2.4
Mar.	28	190	218	600	12.7	4.6
Apr.	16	147	164	495	10	3.3
May	11	171	182	398	6.0	2.8
June	14	211	224	494	6.1	2.8
July	25	170	195	373	12.8	6.7
Aug.	32	173	205	462	15.5	6.9
Sept.	26	160	186	595	14.2	4.4
Oct.	52	205	257	554	20.2	9.4
Nov.	34	244	278	548	12.3	6.2
Dec.	57	253	310	572	18.3	9.9
TOTAL	**358**	**2,471**	**2,829**	**7,012**	**12.7**	**5.1**
1985 - Jan.	80	331	411	867	19.5	9.2
Feb.	149	698	848	2,107	17.6	7.1
Mar.	92	522	614	1,772	15.0	5.2
Apr.	87	362	449	1,146	19.3	7.6
May	78	618	696	1,099	11.2	7.1
June	148	679	827	1,832	17.9	8.1
July	379	1,012	1,392	2,317	27.2	16.4
Aug.	365	602	967	2,094	37.7	17.4
Sept.	334	739	1,073	2,267	31.1	14.7
Oct.	427	816	1,243	3,236	34.3	13.2
Nov.	461	773	1,234	2,944	37.3	15.6
Dec.	369	1,132	1,501	3,761	24.6	9.8
TOTAL	**2,969**	**8,286**	**11,255**	**25,441**	**26.4**	**11.7**

resulted in a large volume of share delivery promissory notes and hindered the prompt and orderly execution of orders.

Physical bottlenecks have emerged in the transfer, under conditions of security and bookkeeping certainty, of share certificates from one bank's safe to the clearing house and on to another bank, and quite possibly back again within a matter of days.

The existing obstacles to Montetitoli's effective role in handling these transactions need to be quickly overcome to keep technical limitations from blocking the growth and development of the share market.

4. As regards the technical functioning of the market, it is worth briefly mentioning the register of stolen and lost securities (Anagrafe Titoli Obbligazionari Sottrati o Smarriti — ATOSS), a centralized record designed to contend with the circulation of certificates stolen or gone astray. Tables 3 and 4 offer some statistics on this scheme, which has not yet been joined by all the credit institutions. We certainly hope that they will all do so shortly.

Table 3

Number of securities out of normal circulation

	1981	1982	1983	1984	1985
Missing or stolen .	69,903	70,092	69,727	76,275	69,752
Seized	55,797	61,625	60,466	63,364	54,093
TOTAL ..... of which:	**125,700**	**131,717**	**130,193**	**139,639**	**123,845**
— government securities ...	86,430	92,122	93,536	96,446	87,480
— other	39,270	39,595	36,657	43,193	36,365

Number of securities leaving and re-entering normal circulation annually

	1983	1984	1985
Seized	2,976	6,078	3,359
Released	2,972	1,250	11,765
Missing or stolen .	2,381	11,792	4,163
Recovered	1,524	1,767	1,411
TOTAL	**9,853**	**20,887**	**20,698**

Table 4

Membership of ATOSS (1)

(Register of Stolen or Missing Securities)

Year of joining	No. of banks flow	No. of banks stock	Legal category	% of category (3)
1981	42	42	Public-law banks	100
1982	10	52		
1983	3	55	Bank of national interest	100
1984	10	65		
1985	8	73		
1986 - members ..	22	95	Ordinary credit banks	30
(4) - applicants .	57	152	Cooperative banks	26
			Savings and 1st class pledge banks	57
			Rural and artisans' banks	100 (2)

(1) The figures do not include the issuing bodies that are already members (6) or those that have applied for membership (4). — (2) The rural and artisans' banks are represented by Coopeld (the accounting bureau that is also used by ICCREA - Central Institute for Rural and Artisans' Banks), the Lombardy Federation and the Trentino Alto Adige Federation. — (3) The banks belonging to ATOSS (95) together with those that have applied for membership (57) account for nearly all the securities business of the financial system. — (4) The percentages include both member banks and applicant banks.

In recent years ATOSS has succeeded in retrieving or at least dealing appropriately with a good number of missing or stolen certificates.

In short, the Bank of Italy is committed to improving the efficiency and security of the circulation of credit instruments and financial assets in general, and has been developing a series of procedures, in cooperation with the banking system (including the Interbank Society for Automation). Tommaso Padoa-Schioppa, Deputy Director General of the Bank of Italy, treated these issues in a recent talk at the Association of Ordinary Credit Banks in Rome. The expansion of services raises the problem of determining the right price for them, a price that covers their cost and makes it possible to improve their efficiency. The pricing of services concerns both the customers of banks and the operators who use the Bank of Italy's services, which until now have been completely free of charge.

5. Mr. Ugolini's invitation also led me to re-examine some issues that were studied more than twenty years ago. To begin, I shall briefly comment on a series of figures on the Italian share market prepared in collaboration with

Bruno Bianchi, and which we hope to use as the basis for a more thorough analysis in a future study.

My starting point will be the very sharp increase in share prices in 1959-60 and the subsequent crisis. At the time some commentators linked this rise and fall with the level of bank liquidity, which expanded considerably in 1958-59 and then became very tight in the early sixties.

Today bank liquidity amounts on average to little more than 3 trillion lire, or less than 1 per cent of total deposits; in 1958 this ratio rose to no less than 13 per cent. In passing, this is evidence of the progress that has been made in increasing the efficiency of the management of means of payment and, more specifically, of banks' liquidity management. During the fifties liquidity had stood at around 5-6 per cent of deposits, but the large balance-of-payments surpluses recorded towards the end of the decade lifted it, as I said, to 13 per cent. Since this was accompanied by a rapid increase in share prices (Figure 1), it was natural to link the two developments.

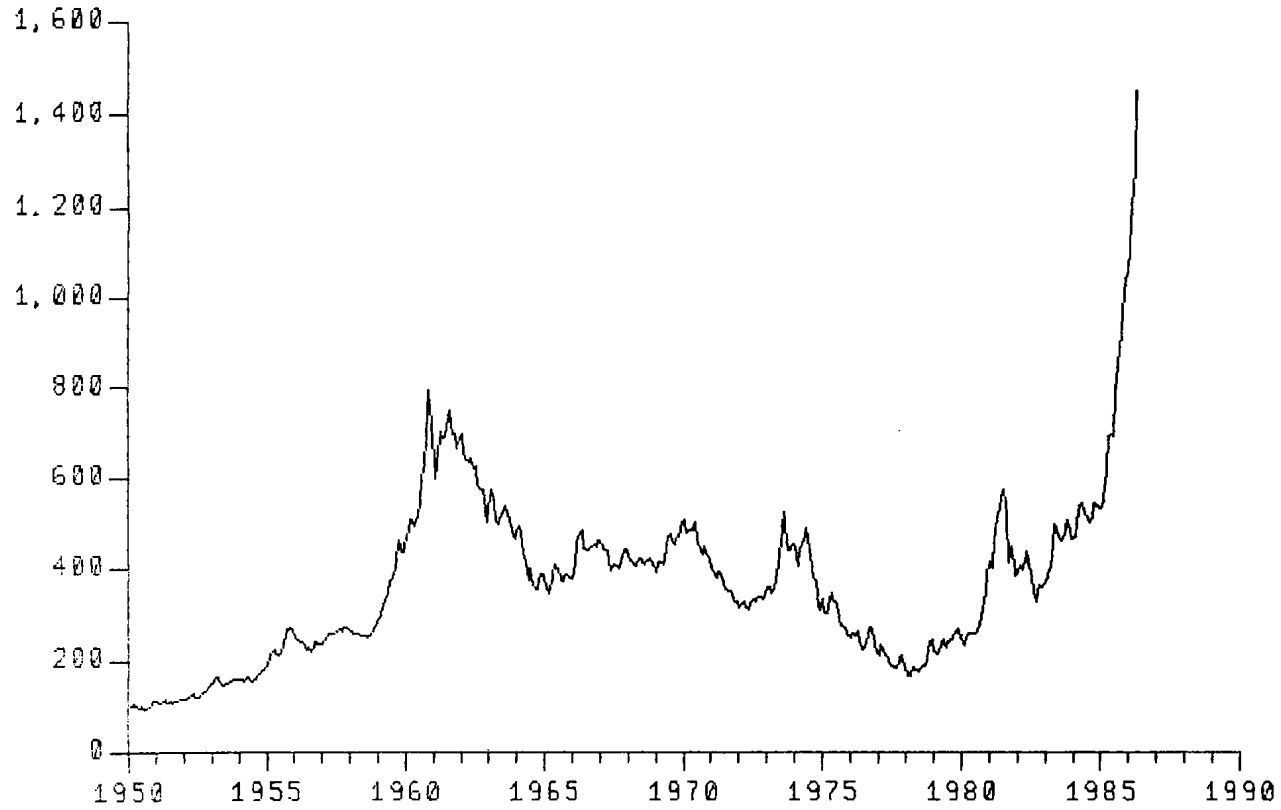
Attention focused on this relationship particularly in the subsequent period of falling share prices (which went hand in hand with a reduction in bank liquidity).

Even with the technical and statistical tools then available, which were less refined and powerful than those we now have, it was possible to show that share prices had little or nothing to do with the level of bank liquidity. The two variables showed a high statistical correlation, but the share price cycle taken as a whole was not determined by the changes in bank liquidity.

Figure 1

Share price index (*)

(Dec. 1949 = 100; monthly data)



(*) Index of the ex-dividend prices of a sample of shares listed on the Milan stock exchange.

Franco Modigliani basically agreed with this conclusion. In particular, he argued that the large-scale distribution of bonus shares by numerous companies towards the end of the fifties had convinced investors that corporate profitability was actually higher than was indicated by dividends and declared profits (with undistributed profits being reinvested and thereby creating good growth prospects).

An analysis performed at the time also showed that share prices (average quarterly values) at time $(t+1)$ were on the whole a fairly stable function of those at (t), $(t-1)$ and $(t-2)$, i.e. of the prices and their changes in the preceding quarters. In other words, movements in share prices were autoregressive with reference to a period of several quarters, i.e. an essentially speculative pattern based on the extrapolation of current trends. Belief in high profits and expectations of further growth triggered the rise in share prices at the end of the fifties, but after this had gathered pace for a time, there was a sharp reversal (partly due to political events and the expectation that a penalizing tax withholding system would be introduced).

There are two types of speculation. One is based on economic agents' perception of the existence of an equilibrium level, however defined, of the financial market (or of the market for goods or foreign exchange) and of a divergence of the current situation from that level. In such conditions economic agents will seek to make profits by undertaking operations that will bring the current price closer to the equilibrium price. The effects of speculation of this kind on the allocation of resources are seen as positive in economic analysis.

The second type of speculation is based on purely mechanical extrapolation of more or less recent performance or of developments in other markets. Figure 2 shows how closely the upturn in share prices in Italy at the end of the fifties paralleled those recorded in Germany and France (though much less so those in the United Kingdom and the United States). Those were the years of the inception of the European Common Market, and there was probably a tendency for developments in Germany and France to be reflected in Italy. Expectations of a rise in Italian share prices were fueled not only by the prospects of growth in connection with the opening of the European market but also by the rise in share prices elsewhere, especially in the major economies on which Italian businessmen's attention was perhaps most concentrated (Germany and France).

The share index used for Italy in the figures annexed to this paper is that compiled by the Bank of Italy and mainly represents the industrial shares quoted on the Milan stock exchange. The differences between this index and others covering a larger range of shares are however not significant for our purposes.

The extent to which share price movements in Italy paralleled those in Germany and France is truly striking (Figure 2). The pattern in the United Kingdom and the United States was more regular and quite different from that in Italy. There were undoubtedly some common factors influencing company results and share prices in the various countries. It is possible, nonetheless, that Italian investors may have been less impressed by the accounts of Italian companies than by the performance of foreign share markets.

To assume that prices will continue to rise merely because they rose until yesterday or the day before and that every three or six months there will be a shake-out in conformity with some mechanical rule may serve as a description of reality, but it is of absolutely no help in guiding individual behaviour or allocating resources.

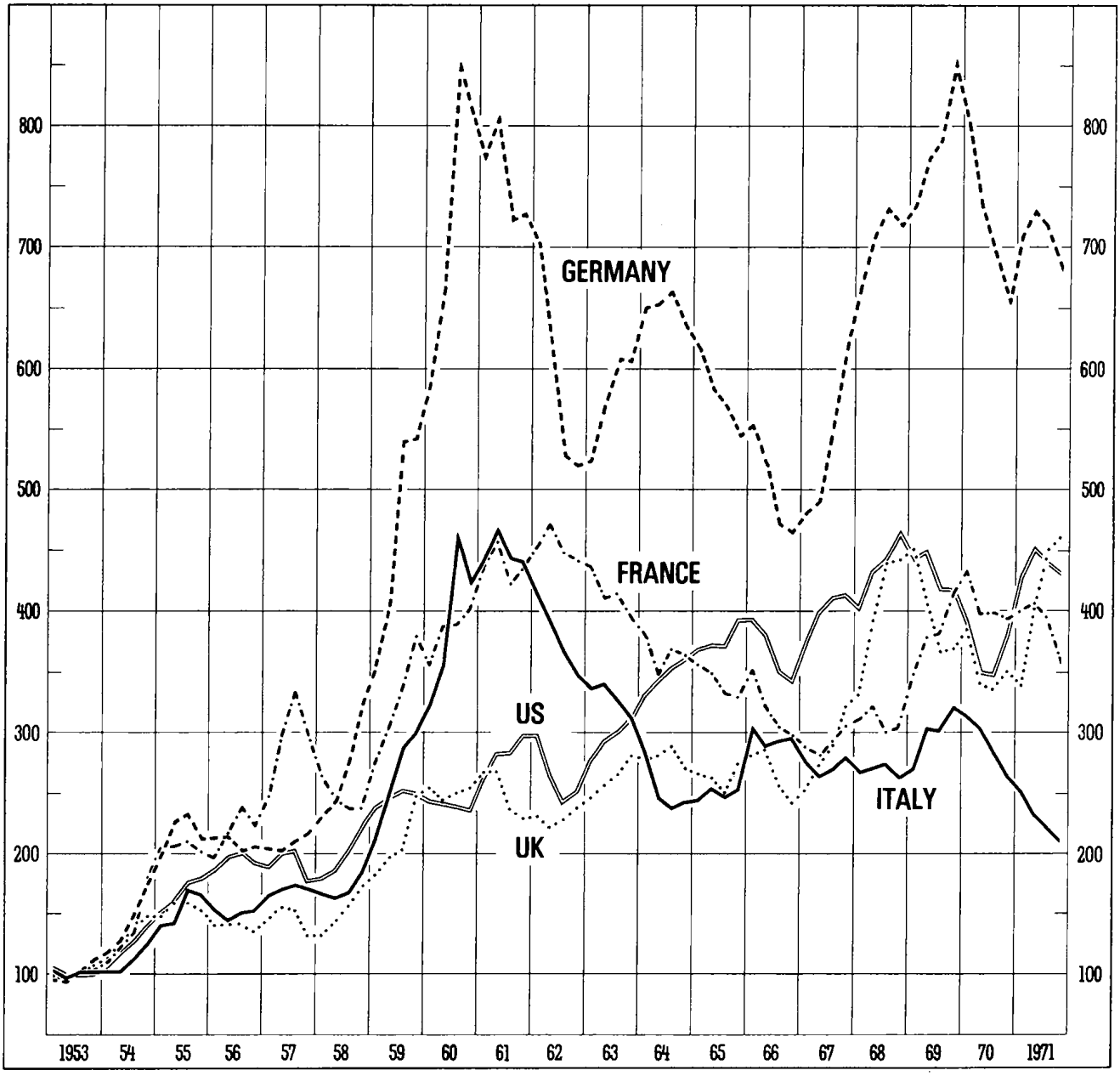
6. Looking at share prices over the last fifteen years (Figure 1), the highlights are the 1973 rise, the period of weakness in conjunction with the oil crisis and the sharp rise and fall recorded in 1980-81. Compared with previous experience, the 1985-86 rise has been both very steep and sustained, though the effect is accentuated by the linear scale adopted.

After the 1961 slide, the behaviour of Italian share prices was subjected to a great deal of analysis. In a series of studies Paolo Savona and I constructed a simple theoretical model of share price behaviour and then tested it empirically on data for a sample of companies whose accounts could be reconstructed for a certain number of years. The model considers the value of a share to be determined in relation to the overall yield of the company, measured as net profits adjusted for

Figure 2

Share prices in selected countries

(1953 = 100)



any accelerated depreciation or unspecified prudential allocations to provisions. It also takes account of expectations of higher yields and the uncertainty surrounding present and future yields. In the absence of unusual expectations of growth or of uncertainty about the yield, the value of a share is equal to the expected flow of net profits, assuming that this can be correctly estimated and will remain constant over time, divided by the real interest rate.

If there is uncertainty about the flow of profits continuing in the future, a downward adjustment of the net profit is made with a coefficient reflecting the degree of instability. If the profit is

expected to increase in real terms, the value of the share will be equal to the profit itself, discounted if necessary to take account of uncertainty, divided by the difference between the real interest rate and the growth rate. This worked well, for example, for the growth stocks of the sixties, of which IBM was a classic example cited by financial analysts.

With this model, if the share is correctly valued, a high price-earnings ratio implies expectations of substantial growth in the flow of profits.

The undistributed portion of profits is also reflected in share values since its reinvestment will later generate extra earnings at a rate in line with the current yield. When information about a company's accounts and growth prospects is lacking or incomplete, its dividend can be considered indicative of present and future profits.

The specialized press often takes these factors into adequate account in the financial analyses it publishes, though the same cannot perhaps be said of many market operators and private investors.

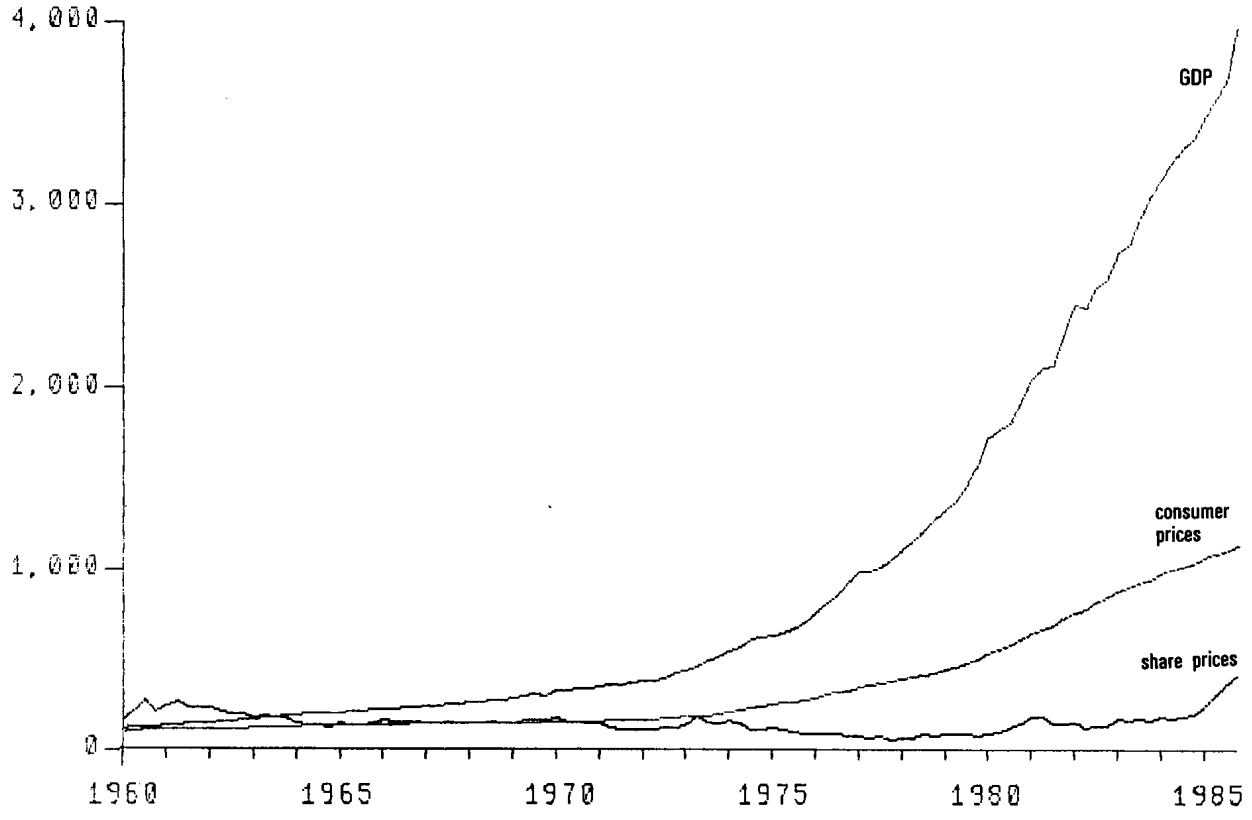
And yet we are dealing, at the most elementary level, with simple relationships between the return on shares, interest rates and the growth of profits over time. Notwithstanding some praiseworthy exceptions, the growth in turnover and the development of institutions have unfortunately not yet been matched by an increase in the quantity (or quality) of financial analysis and market research, or even by an adequate level of availability of such information.

It is hard to imagine individual investors being able to carry out such thorough analyses. Banks and other intermediaries and institutional investors can provide adequate support in this respect and enable customers to discriminate. The

Figure 3

Share prices, consumer prices and GDP in Italy

(indices; 1955-59 = 100; quarterly data)



press ought, perhaps, to give less space to sensational news and more to thorough financial studies. Sensational news can trigger the extrapolative mechanism, which nearly always leads to mistakes and losses.

7. Interest rates, both nominal and real, have risen over the last ten years as a result of the restrictive monetary policies pursued in Italy and other major industrial countries to reduce payments imbalances and curb the effects of growing budget deficits.

For instance, the yield on index-linked Treasury certificates issued two years ago is now around 5.50 per cent, which is in line with the real yields implicit in the nominal interest rates on other financial assets and government securities in particular.

The high real rate of interest has been reflected in the yield on productive investments in recent years. The preponderance of restructuring projects designed to reduce labour costs compared with the construction of new plant has helped to increase the yield on investment (as a result, at a constant level of production, of lower labour costs).

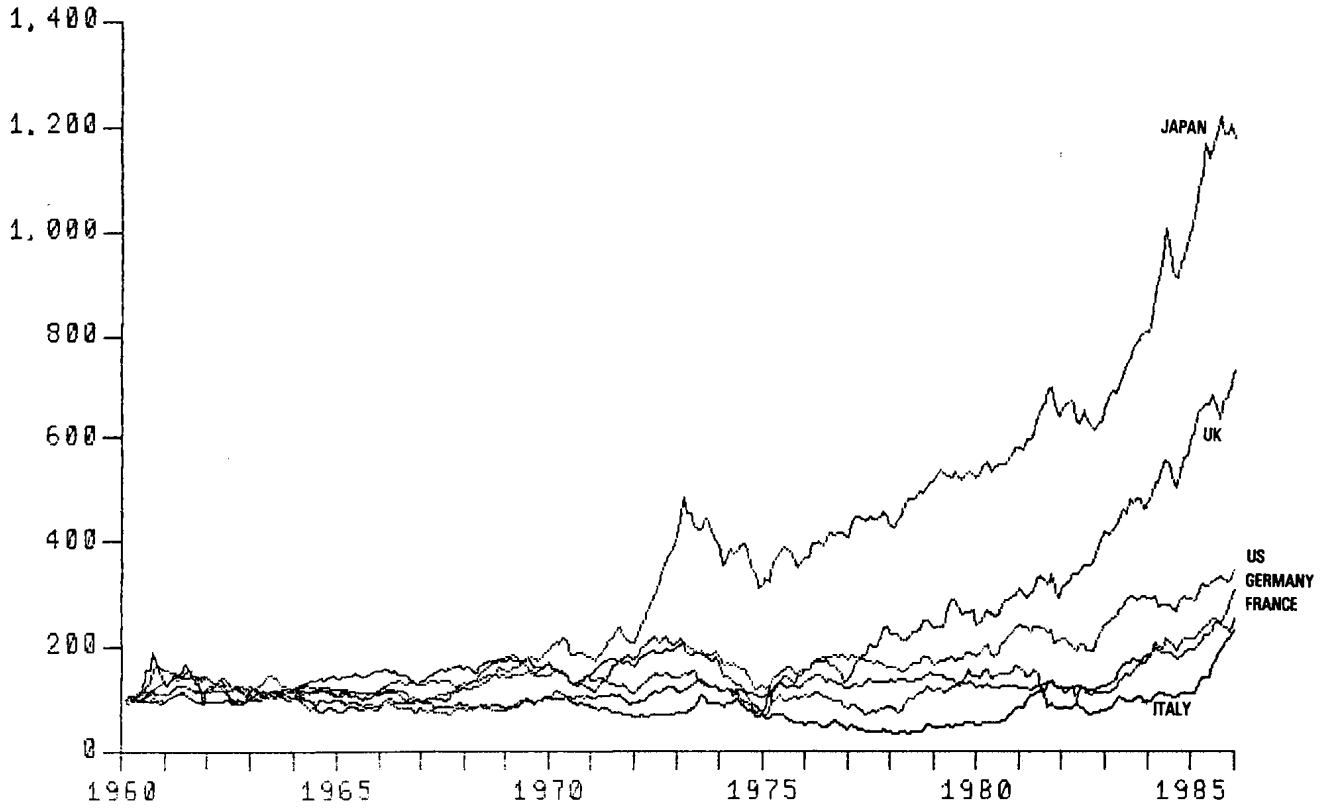
The overall price-earnings ratio of shares in 1985 indicates a yield consistent with that offered on government securities (taking account of uncertainty and growth prospects). For some shares the ratio was particularly low, suggesting uncertainty about future profits; for others it was very high, possibly owing to expectations of higher net profits in the future. If the price of a share does not pass this simple test it cannot be considered in equilibrium and (from this standpoint) the reasons for the divergence have to be sought.

8. With reference to the total capitalization of the (official) stock exchange, it is worth testing

Figure 4

Share price indices

(Dec. 1959 = 100)



the hypothesis that, insofar as they represent a real value, shares can provide protection from inflation and reflect the growth of the economy. Share values should fully incorporate inflation since they take account of the monetary growth in profits, discounted back with a real rate of interest. In addition, if the share of profits in national income remains unchanged, the value of shares must also reflect GDP growth.

Notwithstanding the surge recorded in 1985, the share price index is far from having kept up with the inflation and GDP growth of the last twenty odd years (Figure 3). The 1985 recovery closed a part of the gap, not so much between the share price and GDP indices, as between the share price and consumer price indices (other price indices could be used but this is the closest to the deflator of national income). The value of the index deflated in this way is about a quarter of its value in 1959.

The increase in share prices over the last twenty-five years has been much smaller in Italy than in Japan, the United Kingdom, Germany and France (Figure 4). If share values are deflated by the wholesale price indices, the gap between the performance of Italian shares and those of the other countries widens. If the base year is taken as 1959 (when share prices were at a reasonably representative level in the various markets) and share values are deflated by the index of wholesale prices (which rose less than consumer prices), the Italian index is much lower than the French one (which only partially kept up with inflation) and than the German and British ones (which fully kept up with inflation). The best performance has been that of the Japanese index, which rose fivefold in real terms compared with 1959.

9. To get back to the performance of the market in 1985, it is worth investigating the operations of

Figure 5

Share prices indices deflated with the wholesale price index

(Dec. 1959 = 100)

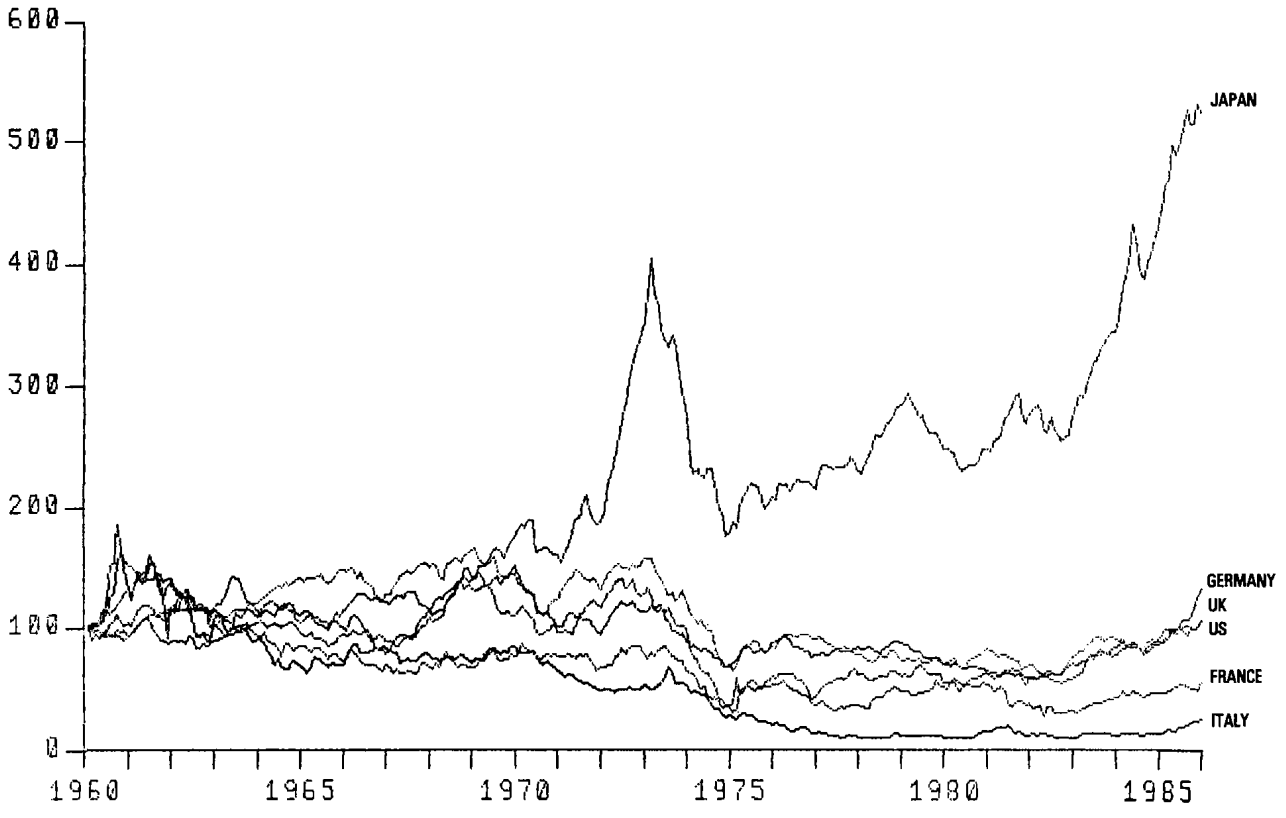


Table 5

Net assets of investment funds as percentage of GDP

	United States (1)	Japan	Germany (2)	France (3)	United Kingdom	Italy
1970	4.8	1.7	1.6	1.7	2.7	0.4
1971	5.1	2.0	1.4	1.9	3.4	0.4
1972	5.0	2.6	1.6	2.2	4.1	0.5
1973	3.5	2.2	1.4	2.1	2.7	0.4
1974	2.4	2.1	1.2	1.6	1.5	0.3
1975	2.7	2.3	1.5	1.7	2.3	0.3
1976	2.8	2.5	1.6	1.5	2.0	0.3
1977	2.3	2.5	2.2	1.4	2.4	0.2
1978	2.1	2.8	2.4	1.7	2.3	0.2
1979	2.0	2.8	2.2	1.9	2.0	0.2
1980	2.3	2.6	1.9	2.2	2.2	0.3
1981	1.8	2.9	1.7	2.3	2.3	0.4
1982	2.5	3.5	1.8	2.9	2.8	0.4
1983	3.4	5.1	2.0	4.8	3.9	0.5
1984	4.4	5.6	2.2	6.3	4.7	0.9
1985 (4) ..	4.8	5.9	2.4	6.9	4.7	4.0

Sources: For net assets, G. Palladino, *Fondi comuni mobiliari;* For GDP, IMF, *International Financial Statistics.*

(1) Open-ended investment companies, excluding money market funds. — (2) Excluding "special funds for workers" which as of mid-1985 had assets more or less equivalent to those of funds offered to the general public given here. — (3) Excluding SICAVs, which as of mid-1985 had assets approximately 2.5 times greater than those of the investment funds considered here. — (4) June except for Italy (December).

investment funds, since these are sometimes indicated as one of the causes of the rise in share prices.

The role played by investment funds in the recent development of the Italian financial market has undoubtedly been important. In little more than a year after starting business they had acquired net assets equivalent to 4 per cent of national income, a figure that equalled or exceeded those recorded by their counterparts in the United States, France, Japan and Germany (Table 5).

Such international comparisons obviously have to be qualified since the results they give differ depending on which types of fund are included. The growth of Italian funds has nonetheless been extraordinarily fast and has involved a very substantial shift in the composition of savers' financial portfolios, primarily through the substitution of fund units for bank deposits.

The monthly net sales of units amounted to 4,308 billion lire in January 1986, to 4,312 billion in February, and to about the same in March (Table 6).

Table 6

Italian investment funds

(billions of lire)

	Net fund-raising (A)	Shares		Share price index (% change)	B/A (%) (2)	Net assets
		Purchases (B) (1)	Outstanding (C)			
1984 - Dec.	....	....	176.4	6.7	....	1,163.1
1985 - Jan.	1,142.9	175.6	389.6	14.6	15.4	2,341.4
Feb.	1,345.7	168.2	582.1	5.2	12.5	3,747.1
Mar.	1,300.3	200.3	774.6	−1.1	15.4	5,038.4
Apr.	1,517.3	187.2	1.008.4	5.4	12.3	6,659.2
May	1,089.1	296.4	1,437.4	11.5	27.2	7,932.9
June	882.7	321.9	1,851.6	5.8	36.5	9,073.5
July	1,441.0	316.6	2,322.0	7.7	22.0	10,756.4
Aug.	975.2	219.0	2,767.4	9.3	22.5	12,013.3
Sept.	1,131.3	301.7	3,266.4	6.8	26.7	13,412.6
Oct.	1,926.5	460.9	3,799.4	2.1	23.9	15,607.9
Nov.	1,553.7	264.2	4,376.3	8.0	17.0	17,564.8
Dec.	1,669.6	483.8	5,092.9	5.0	29.0	19,783.7
1986 - Jan.	4,308.4	614.4	5,973.5	4.9	14.3	24,141.7
Feb.	4,312.3	701.7	8,134.5	23.2	16.3	29,900.9

(1) Estimate of the portion of the funds' net fund-raising invested in shares, obtained by adjusting the funds' stock of shares (C) by changes in the share price index. — (2) Percentage of funds' net fund-raising invested in shares.

Partly owing to the rise in share prices, funds' net assets had risen to 29,900 billion lire at the end of February.

To judge by the size of their net purchases, it would appear that investment funds took up a large proportion of the new issues that were made. In view of the limited supply of shares in the market, the demand from investment funds may well have fueled the rise in prices.

If the share of households' financial assets invested in investment funds has now almost reached a steady state (it is similar to those found in other countries), most of the road to equilibrium will have been traveled in barely one year.

It also needs to be considered that investment funds' demand for shares tends to stimulate the supply of equity capital, causing it to increase in relation to fixed investment (Table 7) and to total credit to the private sector (Table 8). By enabling a larger share of fixed investment to be financed in this way, investment funds' demand helps to improve companies' financial situations.

Analysis of the share issues of listed and unlisted companies shows that the relative importance of the former has increased over the last five years (Table 9). Stock exchange listing has given companies an advantage in placing new shares; a virtuous circle has been created between

Table 7

Share market indicators

(percentages)

	Share issues (1)		Shares held by the private sector	Market capitalization
	Gross fixed investment	GDP	Total financial assets (2)	GDP
1961	8.6	2.0		45.0
1962	10.4	2.5		35.3
1963	4.4	1.0		27.0
1964	6.1	1.4	22.4	18.4
1965	5.2	1.0	23.7	16.5
1966	5.9	1.1	23.1	16.2
1967	4.2	0.8	19.2	14.1
1968	4.4	0.9	17.0	13.3
1969	5.7	1.2	18.3	15.0
1970	7.4	1.6	14.5	12.5
1971	7.0	1.4	16.1	9.7
1972	9.2	1.8	10.9	10.8
1973	11.7	2.4	12.8	11.0
1974	3.3	0.7	8.5	6.9
1975	6.6	1.4	13.1	6.0
1976	6.2	1.3	12.3	4.3
1977	6.0	1.2	10.4	2.9
1978	8.7	1.6	11.8	3.8
1979	7.6	1.4	15.3	3.8
1980	6.2	1.2	29.9	6.5
1981	10.9	2.2	26.9	7.0
1982	7.7	1.5	23.1	5.9
1983	13.0	2.3	25.7	6.5
1984	10.7	1.9	28.1	7.9
1985	13.0	2.4		14.5

(1) Gross share issues by listed and unlisted companies in both the public and the private sectors. — (2) Excluding investment fund units.

Table 8

Borrowing and share issues by the non-state sector

(billions of lire)

	Borrowing by non-state sector	Share issues		Total		B/A+B	C/A+C
		Gross	Net (1)	A + B	A + C	(percentages)	
	A	B	C				
1975	16,814	1,692	1,672	18,506	18,486	9.1	9.0
1976	19,752	1,959	1,872	21,711	21,624	9.0	8.7
1977	17,281	2,251	1,846	19,532	19,127	11.5	9.6
1978	17,495	3,608	2,985	21,103	20,480	17.1	14.6
1979	25,261	3,894	2,732	29,155	27,993	13.3	9.7
1980	29,219	4,133	3,085	33,352	32,304	12.4	9.5
1981	28,098	8,812	7,186	36,910	35,284	23.9	20.4
1982	31,604	6,892	6,004	38,496	37,608	17.9	16.0
1983	35,432	12,534	10,899	47,966	46,331	26.1	23.5
1984	48,256	11,784	9,774	60,040	58,030	19.6	16.8
1985	45,000	16,049	13,000	61,049	58,000	26.3	22.4
1975/1980 – average	20,970	2,923	2,365	23,893	23,336	12.2	10.1
1981/1985 – average	37,678	11,214	9,373	38,092	47,050	29.4	19.9

(1) Gross issues, net of double-counting in connection with inter-company investments.

Table 9

Gross share issues

	1961-1971	1972-1980	1981-1985	1984	1985
	billions of lire				
	(annual averages)			(annual figures)	
Listed companies	124	800	4,852	5,980	5,806
state-controlled		527	3,246	3,970	3,039
private		273	1,606	2,010	2,767
Unlisted companies	459	1,632	6,362	5,804	10,243
state-controlled		565	3,662	2,434	7,379
private		1,067	2,700	3,370	2,864
Total	583	2,432	11,214	11,784	16,049
state-controlled		1,092	6,908	6,404	10,418
private		1,340	4,306	5,380	5,631
	percentages				
Listed companies	21.3	32.9	43.3	50.7	36.1
state-controlled		21.7	28.9	33.7	18.9
private		11.2	14.3	17.0	17.2
Unlisted companies	78.7	67.1	56.7	49.3	63.8
state-controlled		23.2	32.7	20.7	46.0
private		43.9	24.0	28.6	17.8
Total	100.0	100.0	100.0	100.0	100.0
state-controlled		44.9	61.6	54.4	64.9
private		55.1	38.4	45.6	35.1

the performance of share prices and the volume of funds raised on the stock exchange.

10. In the last part of my talk I shall look more closely at the relationship between profitability and share prices in the last few years and especially in 1985. For this purpose I have taken the net profits of two groups of generally profitable companies that have been listed for at least five years. The first group, surveyed for the period 1976-79, comprises 131 companies; the second group, studied in 1980-84, comprises 118 companies (nearly all included in the first group). The market capitalization of these groups has been calculated using December share prices (Table 10), and the net profits have been taken from "La politica dei dividendi delle società quotate", published in 1985 by the Steering Committee of the stockbrokers of the Milan stock exchange.

The ratio of these two series, as calculated above, gives a price-earnings value which fluctuated between a maximum of 21.6 and a minimum of 17, excluding the 1977 and 1980 values. The inverse ratio of profits to prices therefore fluctuated between 5 and 6 per cent, excluding the same two years as above. It should be noted that the values of the ratios vary with the period to which share prices refer. In a rising market, taking the year-end prices will raise the ratio of prices to earnings and lower the inverse ratio.

Table 10

Dividends, net profits, and market capitalization

	A Market capitalization (December)	B Net profits (1)	C Dividends (1)	A/B Market capitalization / Profits	A/C Market capitalization / Dividends	B/C Profits/ Dividends
1976	5,948	302.8	217.5	19.6	27.3	1.4
1977	4,791	379.8	256.8	12.6	18.6	1.5
1978	7,324	430.6	288.9	17.0	25.3	1.5
1979	8,901	507.6	340.7	17.5	26.1	1.5
1980	21,482	609.4	374.6	35.2	57.3	1.6
1981	27,409	1,266.5	544.4	21.6	50.3	2.3
1982	25,555	1,328.6	907.2	19.2	28.2	1.5
1983	32,834	1,921.4	1,221.8	17.1	26.9	1.6
1984	45,772	2,496.3	1,595.7	18.3	28.7	1.6
1985*	98,933	4,400*	2,750*	22.5	36.0	1.6
1985**	88,648**	3,925**		22.6		

Source: *La Politica dei Dividendi delle Società Quotate* published by the Steering Committee of the stockbrokers of the Milan stock exchange, 1980 and 1985.

(1) Net profits and dividends were calculated for a sample of 131 companies in the years 1976-1979 and one of 118 companies for 1980-1984, all listed for at least five years. Profits are recorded for the years in which they were earned, though not made public until the subsequent year. Profits and dividends are given only for profitable companies. — (*) Provisional and estimated data. — (**) For the 110 profitable companies whose 1985 results were available as of 10 June 1986.

The ratio of earnings to prices is to be interpreted as the (real) yield of an investment in the company, adjusted for the risk factor, less the expected rate of profits growth.

In 1977 the price-earnings ratio was around 13. This particularly low value can be attributed to the pronounced imbalance in the economy and the severe stance of monetary and fiscal policy.

The 1980 figure of 35 also appears out of line, but on the high side. It was probably due to the premature discounting of an increase in profits that did not come through until the following year.

Turning to 1985, if all the profitable listed companies are conservatively estimated to have earned net profits amounting to around 4.5 trillion lire, the price-earnings ratio of the sample group of companies defined above does not appear out of line with the situation in previous years (*).

If this estimate of profits is correct, the surge in share prices in 1985 may plausibly be seen as basically reflecting the parallel improvement in profits.

There was, then, method in the madness of the 1985 stock market boom.

11. The figures in question nonetheless need to be treated with considerable caution since small values obtained as the difference between large ones can show wide swings. Company profits are figures of this kind, and so, for instance, is the balance of payments. Small shifts in gross flows can cause large differences in net balances. Since profit estimates are the difference between large volumes of revenues and expenditures, they can fluctuate considerably in practice.

There is also all the uncertainty about the way net profits are calculated, though, on the one hand, it can be assumed that the methods used change little from one year to another and, on the other, that net profits vary less owing to the offsetting effect of depreciation.

Bearing these reservations in mind, the above nonetheless suggests that the increase in share prices in 1985 can be explained in terms of the parallel increase in profits, seen by investors as of a lasting nature (i.e. not limited to the year in question).

The yield on shares remained unchanged at around 5 per cent, which is compatible, as argued above, with the real rate of interest ruling in the financial market.

It is difficult to foresee what turn events will take in 1986 and, in particular, whether profits will grow further. The new oil situation and the favourable movements of many other economic variables have undoubtedly generated considerable optimism among businessmen and in financial markets. Daily rates of increase in share prices of 2-3 per cent are nonetheless more than a little high. There is evidence that it is now small savers who are buying and pushing up prices. It is well known, however, that such investors have little access to careful analyses.

A rough assessment of the doubling of share prices in 1985 is that, taken as a whole, it was not irrational since firms' net profits also rose sharply, leaving the ratio of market capitalization to profits approximately in line with its long-term value. However, there is a need for more extensive analyses of the role of expectations with special reference to profits and share prices.

12. Share prices have continued to rise rapidly since the end of 1985. The price-earnings ratio in March can be calculated for a number of companies using their 1985 profits (since those for the first part of 1986 are not yet available). Since share prices had risen substantially, the value of the ratio (as defined) is obviously higher than that previously found for the whole market. In addition, it was calculated as the average of company ratios rather than as the ratio of aggregates (or averages). The average of 41 companies' price-earnings ratios was 56, with a minimum of about 12 and a maximum of 995 (Table 11). In June 1985 the corresponding average ratio for 123 companies based on 1984 profits was 51. In May 1981 a sample of 127 companies had an average P/E ratio of 156, with a minimum of 10 and a maximum of 8,031. It is interesting to note that, compared with end-1980, share prices rose significantly in the early months of 1981, as they did this year.

As starting points, March 1986 and May 1981 were different for the reasons described above. March 1986 appears more solidly based, especially in view of the less extreme values of the indices.

(*) The figure given in the speech was 5 billion lire, but the data available in mid-June (albeit incomplete) on 110 profitable companies suggested a reduction of roughly 10 per cent.

Table 11

Price-earnings ratio

	May 1981	June 1985	March 1986
Number of shares	127 (1)	123 (2)	41 (3)
Average (4)	156.2	51.2	56.4
Minimum value	9.9		11.9
Maximum value	8,031.5		995.4
Difference between min and max	8,022.4		983.5
Standard deviation	741.0	194	151.4
Standard deviation/average	4.7	3.8	2.7
Number of non-profitable companies	28	14	
Amount of losses (billions of lire)	2,487.0	219.3	

(1) For the 103 companies profitable in 1980, out of the 131 listed on the Milan Stock Exchange. — (2) The number of companies profitable in 1984. — (3) Shares of companies whose 1985 results had been published. — (4) Arithmetic mean of price-earnings ratios for all shares.

I cannot, of course, pass a definitive judgment on today's prices (i.e. those ruling at end-March 1986). In particular, I am not in a position to determine whether and to what extent the market is behaving abnormally. Nonetheless, the possibility that some of the P/E ratios in the range reflect overvalued shares cannot be excluded.

The outlook for many companies' profits is undoubtedly excellent thanks to developments at the international level. However, the forecasts of all the leading economic research institutions indicate that the industrial economies are not likely to grow at a pace of much more than 3 per cent for the next few years.

I have no conclusions to offer, except perhaps to invite market operators and the press to intensify their analyses of companies' situations with the aim of helping savers to make rational choices.

Financial Innovation, International Markets and the Conduct of Monetary Policy

by Lamberto Dini, Director General of the Bank of Italy
Speech given at the Center for International Monetary and Banking Studies
Geneva, 30 April 1986

I. Main features and causes of financial innovation

Financial innovation can be thought of as the result of an investment increasing the financial flexibility of households, firms and intermediaries and providing credit and investment instruments better suited to new demands. Its return is lower costs and greater availability of funds for borrowers; higher returns and liquidity and lower risks for investors; shares of intermediation, margins and fees for intermediaries.

A common feature of many new instruments and channels of intermediation has been that they facilitate circumvention of constraints imposed on financial intermediaries for the purpose of monetary control or solvency protection. Hence, it is not surprising that innovation tends to accelerate at times of high interest rates and restrictive monetary policy, since these raise the opportunity cost of respecting existing constraints. Once innovations have been made, however, in general they do not disappear with their immediate causes, instead becoming permanent features of intermediation. The interaction between market developments and regulatory environment must therefore be recognized as a major determinant of the timing and direction of innovation.

The birth and growth of international banking markets, for instance, was favored by the interest rate ceilings and reserve requirements imposed on commercial banks in national markets; and the introduction of an interest equalization tax in the United States in the early sixties led to the creation of the Eurobond market. In these markets the currency denomination of transactions was made independent of the country where the instrument was created or the contracting parties were resident.

After proceeding relatively slowly during the fifties and sixties, financial innovation picked up during the seventies. The emergence of large imbalances in international payments after the first oil shock led to very rapid growth of international banking activity. Thanks to their increasing size, sophistication and efficiency, international banking markets provided a suitable environment for the development of innovations as well as a driving force in the integration of national financial markets.

With the acceleration of inflation, rising and more variable interest rates prompted international banks to seek ways to reconcile borrowers' demand for medium and long-term finance with investors' preference for liquid assets with low interest rate risk. A solution was found with roll-over credits, i.e. medium-term loans carrying variable interest rates, which permitted them to match medium-term maturities with short-term interest rate risk. Variable interest rates were also extended to the securities market with the introduction of floating rate notes, which helped maintain the flow of savings to the long end of financial markets, since the reduction of interest rate risk makes these instruments liquid in spite of their long maturity.

Rising interest rates led to other important innovations, particularly in the United States. Non-bank intermediaries started to compete directly with banks in the latter's traditional preserve, the provision of monetary services, by offering attractive market-related returns. The creation of money market accounts — deposit-like instruments carrying money market interest rates — was the most prominent such development, and it led to large-scale losses of deposits by banks and thrift institutions, which were still subject to interest rate ceilings. Banks countered by introducing money market certificates (nonnegotiable time deposits with

maximum rates equal to those on 6-month Treasury bills), then NOW accounts (interest bearing checking accounts) and, after the removal of the ceilings on time deposit rates, ATS (automatic transfer) accounts.

Growing competitive pressure on the banking system led the authorities to remove the constraints on the interest rates that banks could pay on their liabilities. Deregulation was thus set in motion by the need to restore banks' ability to compete, and also to eliminate controls which were being increasingly circumvented with consequent distortions in the functioning of financial markets.

In the early eighties financial innovation accelerated sharply in all major international financial centres, with even more far-reaching changes in instruments and services as well as in the structure of intermediation. A number of factors were at the origin of this development. First, there was a fundamental change in the macroeconomic environment. In all major industrial countries monetary policy was committed to the objective of a lasting deceleration of inflation: it not only turned restrictive, leading to large positive real interest rates, but remained so for several years. Also, more rigid implementation of quantitative techniques of monetary control and uncoordinated policy mixes in major countries led to an unprecedented variability of nominal and real exchange rates. In this unstable and uncertain environment, there was an enormously increased incentive to design new instruments to cope with the risks of financial transactions.

A second factor encouraging innovation was that in the new climate, more favourable to competition and free markets, deregulation of financial markets took on a momentum of its own. National financial markets were opened to foreign investors, firms and intermediaries. Many constraints on the operational scope of intermediaries were also removed, including increasingly the traditional barriers between different types of intermediary. Deregulation was further prompted not only by the need to modify obsolete regulatory structures, but also by recognition of the key role of financial structures in determining economic performance and the ability to compete on a global scale.

Financial markets responded to the new environment by developing techniques to "unbundle" the different risks of financial transactions: the interest rate, liquidity, currency denomination and maturity of financial instruments began to be separately priced and negotiated on separate markets, with an unprecedented proliferation of possibilities to invest, borrow, hedge or speculate. A larger share of intermediation started to flow through securities markets, which were able to respond rapidly to the demands for new instruments. This is the essence of the process of "securitization", so often referred to by the mounting literature on innovation, which is reflected in the increased share of negotiable instruments in financial portfolios.

Securitization and the shift of intermediation towards direct credit markets found additional impulse in the foreign debt crisis and in the emerging payments imbalances between the main industrial countries. The "flight to quality" by savers and intermediaries seeking outlets for their funds thus coincided with rising demand for funds on international markets by industrial countries' public and private borrowers, which remained creditworthy and had access to the securities markets, reserved to prime borrowers.

Certain changes in the structure of intermediation further strengthened the trend towards securitization. In both the debt and the equity markets, savings were increasingly channeled through institutions such as insurance companies, pension and investment funds. Run by sophisticated financial experts, these institutions do not need the assistance of traditional intermediaries in managing their portfolios and tend to deal in large amounts directly with investment banks and brokerage houses. Underwriting has also been profoundly modified. The increased volatility of financial markets has made issuers of securities unwilling to wait while large syndicates of underwriters are assembled. That method has been replaced by "block" competitive bidding for newly-issued stock, which greatly increases underwriters' capital needs. Consequently, there has been powerful pressure for concentration on both sides of the market.

Faced with a decline in their traditional business and with more stringent supervisory requirements on the quality of their assets, banks started to look for ways to reduce the need for capital while preserving their share of intermediation. They have thus expanded their activities as suppliers of services in the capital and foreign exchange markets; in particular, they have provided back-up facilities for securities issues and other kinds of financial assistance to their customers that do not increase the size of their balance sheets. The rapid expansion of banks' off-balance-sheet operations is indeed a main feature of financial market developments in recent years.

The increased importance of financial and advisory services in the activities of banks and other intermediaries has also produced another consequence, which, though less visible, may actually be the most important. In today's financial markets where the traditional matching of functions with intermediaries has lost relevance, competition turns basically on intermediaries' ability to create new instruments and operations. These, however, can be quickly imitated, so that no permanent competitive advantage is ever gained. Hence, keeping ahead in the market is strictly linked to a capacity for constant innovation. Innovation thus becomes a permanent feature of competition in financial markets.

Finally, a major factor facilitating innovation and the worldwide integration of financial markets has been technological advances in communications and data processing. The pricing of instruments, the analysis of continuously updated positions and market developments, the rapid exchange of instruments in unprecedented amounts, would all be inconceivable without the improvement which has taken place in communications and computer technology. This progress has also eliminated space and time barriers between national markets, so that the participants in the main financial centres have basically the same information at the same time. Trading continues around the clock in a global world market in which information is processed instantaneously.

A brief description of the distinguishing features of some of the new instruments will help show how they perform their tasks. Market risk — that is, the risk of adverse changes in interest or exchange rates — can be hedged against with contracts such as options, financial futures and forward rate agreements (FRAs). The latter make it possible to fix an interest rate in advance for a set future date, thereby protecting the operator from an undesired level of interest rates on that date. Of course, the same purpose could be achieved by negotiating a deposit or a loan for future delivery. The truly innovatory feature is that FRAs can hedge risks without necessarily involving a lending or borrowing operation, thus separating the financing from the hedging function.

This feature is also shared by options, another instrument to manage interest or exchange rate risk whose market has been expanding very rapidly. An option is a contract conveying the right, but not the obligation, to buy or sell a specified financial instrument at a fixed price before or at a future date; it is thus possible, for a fee, to limit to a predetermined maximum amount the interest or exchange risk of a transaction.

Market and credit risk can also be managed without changing balance sheet aggregates through resort to a swap. An interest rate swap, for instance, can be used to exchange a stream of floating rate interest payments for one at fixed rates. Both parties in the transaction benefit insofar as they can raise the money they need in the market where they can obtain the best terms, and are then able to convert their loans into the kind of financing they need on better terms and conditions than they could have obtained directly. This example shows that swaps also perform the function of opening markets to borrowers for whom direct access would be more difficult or costly. Swaps have indeed become a main force in promoting the integration of world financial markets.

Note issuance and revolving underwriting facilities (NIFs and RUFs) deserve special mention since they extend the traditional functions of syndicated Euromarket loans. These facilities are back-up credit lines provided for several years by underwriting banks in connection with short-term note issues. Borrowers raise the needed financing through repeated issues of short-term paper, placed with other

intermediaries or directly in the market, and only turn to the underwriting banks if their notes cannot be placed or an increase in interest rates makes their placement too expensive. Here again the innovation consists in a separation of functions: finance is provided by sources other than the banks that organize the facility; investors are protected against interest rate risk since they provide finance by purchasing negotiable short-term paper, though they remain liable for the credit risk of the operation; borrowers can rely flexibly on the back-up facility as a liquidity reserve for protracted periods.

II. Implications of innovation for monetary policy

As a result of financial innovation, deregulation and international integration of financial markets, international capital flows have become more mobile and sensitive to fluctuations in interest rate differentials and to changes in expectations regarding exchange rates. As a consequence, the exchange rate takes on a greater role in the transmission of monetary policy impulses, since actual or perceived shifts in relative monetary conditions in major markets lead rapidly to exchange rate changes. The external sector thus becomes more important in determining the effects of monetary policy on actual and expected inflation, relative prices, the level and composition of output.

On the other hand, the different adjustment speed of the real and monetary "sectors" of the economy imply a tendency for the exchange rate to overshoot. There is thus an increased danger that active use of monetary policy may destabilize exchange rates and, through this channel, the real economy. The increased sensitivity of exchange rates to individual countries' policies also implies that there will tend to be larger spill-over effects on other economies, particularly when the major countries are involved.

Traditional "channels" and instruments of monetary policy have also been substantially affected.

With intermediation concentrating in the banking system, almost everywhere controls on banks — e.g. reserve requirements, interest rate ceilings, constraints on the growth and composition of banks' assets — have played an important role in monetary control techniques. Credit rationing mechanisms also enhanced the effectiveness of raising interest rates in checking loan demand, since banks reassessed the financial position and creditworthiness of their debtors accordingly. The development of close substitutes for bank credit and the decline in banks' share in intermediation have reduced the relative weight of these mechanisms.

Quantitative rationing of bank credit tends to be offset either by recourse to new bank operations that cannot be controlled by traditional instruments or by an expansion of credit from unconstrained financial institutions. More in general, the creation of monetary instruments not subject to reserve requirements and interest rate ceilings tends to decrease the direct "mechanical" impact of monetary base changes on the overall supply of credit and on monetary conditions. Of course, the relevance of this issue may vary a great deal from country to country, and can only be assessed with reference to specific situations and institutional settings.

Indeed, the very notion of monetary policy rests on the existence of "outside" assets (monetary base) whose supply is under the authorities' control. It has been argued that technological innovation, with the reduction in transaction costs it implies, will eventually make the demand for monetary base disappear. This line of argument, however, should not be stretched too far. Although transaction costs have come down considerably in recent years, cash is still far from being an economically inefficient means of payment for many categories of transactions. Even in the countries where the new technologies have been most widely adopted, there are no signs of cash disappearing.

It is true, however, that the burden traditionally placed on banks for prudential and monetary control purposes has contributed to making bank credit relatively less efficient compared with other forms of financing. Bank customers have been induced to seek alternative sources of funds.

It is difficult to predict how much further bank disintermediation will run. It has been

suggested that the erosion of banks' market share will soon reach a limit because of the specific information content of bank credit. According to this view, credit granted by banks rests on information that is both more detailed and more confidential than that freely available in the market. Certain categories of borrowers, it is argued, have no alternative to bank credit, since information asymmetries and transaction costs prevent them from going directly to the market.

Historically banks have also indirectly produced information through their lending, but there are indications that the situation is changing. Credit-rating companies are spreading through financial markets, providing an alternative solution to the information problem. Banks themselves are taking steps to mobilize their assets: "loan stripping" in the United States already contains the potential for creating a secondary market for bank loans.

Altogether, there seems to be little doubt that the reduced role of direct controls on the banking system will not be reversed even if bank disintermediation stops tomorrow. In general, the ability of intermediaries to cushion and absorb restrictive impulses is likely to have increased, and monetary control has probably become less precise as regards the results its instruments will produce as well. Indeed, the very definition of "money" becomes considerably more uncertain, and reference in monetary control procedures to specific monetary or credit aggregates as intermediate targets becomes more difficult and liable to errors of judgment. Therefore, monetary policy will have to rely more on indirect, interest-rate mechanisms to achieve its objectives.

The consequences of innovation for the effects of interest rates on the interest-sensitive components of aggregate demand are also debated. In principle, wider recourse to variable rate financing and to the new risk management techniques makes the financial system more responsive to the actions of the monetary authorities. Changes in the interest rates under the authorities' control are reflected more rapidly and fully in the whole structure of interest rates. In particular, rising interest rates will spread to a larger share of outstanding debt and hence affect debtors' cash flows more quickly. Leveraged borrowers may thus encounter liquidity problems, which would intensify the restrictive impact of monetary policy and the responsiveness of aggregate demand to interest rate increases. In some cases this may actually become a constraining factor on the willingness or ability to tighten monetary conditions, when the potential adverse repercussions on cash flows and liquidity assume macroeconomic proportions. We may recall in this regard the direct influence played by developing countries' debt difficulties on US monetary policy in certain recent periods; similarly, in some countries the presence of a large stock of public debt carrying floating rates has made their central banks more wary of large rises in interest rates.

On the other hand, some of the effects of financial innovation tend to weaken the interest rate link betwen monetary policy and the real economy. The greater flexibility of the new financial instruments has made it possible for an increasing number of non-financial enterprises to engage in liquidity management. Debtors may thus be partially shielded against rising interest rates. Moreover, monetary policy can rely less on locking-in effects: in the past, when interest rates were "high" and thought likely to remain so only temporarily, the private sector was induced to postpone its borrowing decisions for fear of being "locked in" at the higher interest rates. Extensive recourse to floating rates makes this behaviour less common.

Consequently, even though monetary impulses spread through the financial system more rapidly, they may be attenuated by portfolio adjustments. Monetary authorities will find it harder to influence interest rate differentials. In particular, the presence of monetary assets carrying market yields will make it difficult to induce a shift in money demand via interest rate control.

What ultimately matters, of course, is whether monetary policy alters the relative rates of return on financial and real assets. If so, monetary policy will continue to have an impact on aggregate demand, with increased financial flexibility tending to reduce its effects and increased sensitivity and ability to react to interest rate changes of agents and markets making for greater responsiveness.

III. Implications of innovation for systemic stability

As I recalled earlier, financial innovation can be regarded primarily as a market response to the specific needs of certain categories of operators and to their interaction with external constraints on intermediaries. Thus in general innovation will increase the micro-efficiency of financial markets, by allowing economic agents to match their financial assets and liabilities more closely to their preferences, objectives and expectations. But it may also entail a rise in systemic risks and instability, particularly since innovation has led to the erosion or removal of a number of regulatory provisions designed to enhance the stability and solvency of intermediaries.

Financial innovation can affect systemic risk in several ways. First, when markets for new financial assets develop at a very rapid pace, precise assessment of the risks involved becomes more difficult, among other things for lack of a "past experience" yardstick. Market participants will tend to follow rule-of-thumb pricing approaches based on their experience with traditional instruments. This is what happened, for instance, in the currency options market during 1984 and 1985, leading to sizeable losses for many operators.

Competition may also result in risks being underpriced. There is indeed already some evidence of this: for instance, the fees associated with NIFs are generally little more than half those on stand-by commitments associated with commercial paper, even though the two instruments are fairly close substitutes and involve similar risks.

Another important feature of the new instruments is that they are more easily exchanged in the market. As the chain of transactions gets longer, though, it may become increasingly difficult for the last buyer to have an accurate picture of the ultimate debtor's creditworthiness. A similar "dilution" of the assessment of credit risks occurred in the second half of the seventies for syndicated loans, which were exchanged extensively in the interbank market, thus encouraging many small banks with little experience of international banking to get involved in what seemed a safe and profitable business.

A problem of a different nature arises with instruments such as foreign currency and interest rate options, which involve asymmetrical risks for the parties involved. There is no limit, for instance, on the profit the buyer of an option can make if prices move in his favour, whereas the loss is limited to the premium paid to the writer if prices move against him. By contrast, the writer's gain is limited to the premium, while there is no limit to the loss he can incur, unless of course he too hedges his risk. The development of the options market has been characterized by the presence of a large number of buyers and a comparatively small number of large institutions acting as writers. Thus, the transfer of risks through this instrument has probably resulted in the ultimate exposure becoming more concentrated.

Whether or not financial innovation is conducive to higher systemic risk ultimately depends on agents' attitudes towards the new techniques. It needs to be recognized that risk remains an inextricable element of financial transactions: somewhere the buck has to stop. Even though some of the new instruments appear to improve individual operators' liquidity and risk position, they do not, and cannot, eliminate risk from financial markets.

Moreover, financial innovation may have somewhat impaired banks' ability to provide liquidity support for other market participants. Besides losing market shares in recent years, commercial banks have suffered a deterioration in the quality of their assets, as their prime customers have switched to the direct credit market and other channels of intermediation offering better terms. They are also more dependent on liability management at market conditions for their own funding. As events at Continental Illinois clearly showed, a bank that relies heavily on liability management while keeping an asset portfolio of less than prime quality is vulnerable to liquidity strains.

IV. The role of prudential regulation and supervision in the face of innovation

In view of the developments I have described, the supervisory authorities are concerned lest a greater share of the risks in the economy should

ultimately be carried by the banking system, hence threatening its stability.

In general, the risks connected with the various new operations are similar to those normally associated with lending. However, the commitments associated with NIFs and in general with stand-by credit lines need to be regularly assessed in light of market liquidity and the likelihood of their being drawn on. Besides that of illiquidity, other risks may be involved. In some circumstances a credit risk may materialize, since NIFs and RUFs can involve banks in financing customers that the market has turned down. Interest and exchange rate risks are incurred whenever banks enter into swap, option or forward-rate contracts with the aim not so much of hedging as of taking up open positions. What is relevant is the multiple combination of risks now often found, which makes it difficult to assess the riskiness of individual operations and may cause operators to be unduly optimistic or to accept unprofitable pricing.

I could give other examples, but these are sufficient to highlight the fact that specialist staff and managers versed in the new activities are an essential prerequisite for any bank operating in these markets. Technical know-how is not enough, however. Banks must also set up internal recording systems that classify the new operations according to their type and riskiness so as to permit centralized control of the risks incurred and of their interconnections. The need for such control is, of course, all the greater for bank groups, in which overall exposure must be assessed on a consolidated basis.

In order to determine their overall risk positions, banks have to overcome other difficulties and take further precautions. The liquidity gained by transforming loan contracts into negotiable financial instruments may evaporate at the very moment the funds are required, if market conditions change. Moreover, banks cannot stop assessing the creditworthiness of borrowers just because the debt is now negotiable — it is so only if it is highly rated.

The maintenance of stability thus depends as much on banks' ability to develop adequate managerial resources and internal control systems as on their capital strength. The warning issued by the G-10 Governors last September was explicit on this last aspect.

The precautions banks are required to take do not relieve the supervisory authorities of their obligation to scrutinize the new types of business. Prudential returns must be supplemented so that the authorities' assessment can take banks' off-balance-sheet business fully into account. The first response to the problems raised by financial innovation, then, is appropriately modified regulation of what is already regulated, i.e. the banking industry. Indeed, supervisory authorities in various countries have already decided to take account of off-balance-sheet operations in the calculation of capital ratios.

Complementary measures covering other financial operators are also required, in order to preserve financial stability and, in addition, to avoid the creation of competitive disadvantages for banks, which would then be confronted with the alternative of losing market shares or circummventing the rule. In general, a decline in the share of regulated business would weaken the overall effectiveness of supervision. Moreover, attempts to improve the stability of an integrated system by concentrating controls on a single part can be frustrated by the possibility of crisis situations spreading from other, unregulated parts of the system. Financial conglomerates, of course, are particularly vulnerable in this respect. Finally, setting prudential ratios at consolidated level is only feasible with certain group structures and within the framework of specific supervisory regulations. Such ratios become less and less satisfactory as more non-banking activities are included.

It ought therefore to be recognized that deregulation in the banking industry proper needs to be accompanied by enhanced controls in other parts of the financial system now subject to little or no regulation.

In countries with a highly integrated financial services industry, considerable interest has emerged in functional, as opposed to institutional, supervision. Under functional supervision a given activity is always subject to the same set of controls, regardless of the financial institution involved. Even under this approach, however, effective supervision would still require as a minimum that within each

financial institution the different activities should be managed by separate departments.

An alternative approach would be to try to maintain a separation via regulation between markets and intermediaries providing different services. The need for transparency and effectiveness in banking supervision is indeed an argument in favor of this approach, especially when the services provided are quite distinct. Conceivably, access to a given market could then be made conditional on meeting certain requirements, to be assessed through an authorization procedure. Rules and controls would obviously have to be tailored to the specific features and requirements of each single market. Indeed, it is not possible to identify general, universally valid solutions to these problems, since they inevitably depend on existing institutional structures.

Controls on non-bank operators could be less thorough than those on banks, while still providing a minimum of protection for savers. Furthermore, as already mentioned, the regulatory system as a whole must ensure that in each market similar competitive conditions prevail for all operators. In a system of this kind risks of contagion within a group can be minimized by establishing capital requirements for each operator.

Both the functional and the compartmentalization approaches leave open a number of issues with no ready solution.

The need for a comprehensive vision of financial groups is satisfied only in some cases, e.g. by the "bank holding company" model established in the United States and the banking groups subject to consolidated supervision under EEC regulations. We have in fact already experienced cases in which no authority was responsible for supervising an entire group, or was even in a position to do it.

Problems of cooperation and coordination also arise at the national level among authorities with different supervisory responsibilities and purposes. At the international level, of course, there is the added complication of different national legislative frameworks.

Banking supervisors have had considerable experience with difficulties of this kind. Since the seventies they have been working on allocating responsibilities in the supervision of banks' foreign establishments. After twelve years, and thanks to the work of the Basle Supervisors' Committee, a solution has been found in principle, though its implementation is not yet complete.

V. Concluding remarks

Financial innovation and the worldwide integration of financial markets are confronting monetary and supervisory authorities with major challenges. It is fair to say that we have only just begun to appreciate their scope: an important contribution in this regard has been provided by a comprehensive study prepared, under the aegis of the Bank for International Settlements, by a study group of central banks chaired by S. Cross of the New York Fed, which was published a few days ago.

The changes under way in our financial structures provide for reduced costs and larger and more flexible availability of financing. Unprecedented opportunities are available to borrow and to invest, and profitable new businesses are open for intermediaries. At the same time, these changes entail risks of increased systemic instability. New instruments are changing risk management fundamentally, and the perception of this may yet not be as full as desirable.

What attitude, then, should monetary and supervisory authorities take in the face of these developments? Of course, I cannot provide exhaustive answers, only some preliminary thoughts.

One thing ought to be clear. Our financial environment has been permanently altered. These changes are not going to recede. Indeed, as I have argued, there are grounds for believing that innovation has become a permanent feature of our environment. Therefore, we have to learn to live with innovation, to cope with the new problems while at the same time reaping all the benefits it provides. Indeed, I see no reason in principle why we should discourage a process

that is improving the overall efficiency and effectiveness of our financial structures.

The task for monetary and supervisory authorities is to ensure that this process does not endanger the stability of the financial system. At the microeconomic level, the authorities must seek ways to reduce potential threats to stability without discouraging innovation, first of all by making sure that markets and intermediaries develop a full understanding of the risks involved in new operations and that this results in appropriate pricing and management techniques for their portfolios. This outcome can be favoured by preventing the blurring of dividing lines between intermediaries from going too far. At all events, it is essential that intermediaries develop accounting and management techniques that permit full and separate evaluation of the new risks within their overall activities.

The new risks assumed by the banks have to be explicitly taken into account and included in capital ratios. Ratios must be computed on a consolidated basis in bank groups and must reflect an adequate allotment of own funds to each unit within the group, in relation to its assigned function. Suitable forms of regulation and supervision must be extended to cover all financial operators.

For these controls to work effectively, however, continuous regulatory coordination and cooperation among the various supervisory authorities within each country and internationally are indispensable.

At the macroeconomic level, now that inflation is under control in the major industrial countries, maintaining a stable and sound financial framework may mean first of all avoiding the generation of large new shocks with monetary policies.

In the seventies, inflation and instability in the real economy had led central banks to stress quantitative aggregates as intermediate targets and to assign less weight to interest and exchange rate stabilization. Financial innovation has rendered aggregates a less reliable guide for policy and has led to placing greater emphasis on interest rates. Also, the role of exchange rates in the transmission mechanism of monetary policy has increased. The enhanced responsiveness of the financial sector, including international capital flows, and the associated greater uncertainty over the effects of monetary policy, seem to imply that greater attention should be paid to avoiding excessive oscillations in interest and exchange rates.

One important component of this proposition has to do with international coordination of policies. As is now widely acknowledged, to a significant extent the large misalignments in the exchange rates of the main currencies and the instability in international liquidity conditions of recent years were the result of uncoordinated monetary policies and monetary-fiscal mixes in the major countries. Increased financial integration, capital mobility and exchange rate responsiveness to monetary policy strengthen the need for international coordination in this area, since the potential external repercussions and interactions of national policies are also much greater. Reinforcing cooperation in this regard should thus be an integral part of our policy strategy for maintaining a more stable financial environment.

The Control of Banking and Financial Intermediation

Report presented by Antonio Fazio, Deputy Director General of the Bank of Italy, to the Ministerial Committee on the revision of credit regulations coordinated by the Treasury Under Secretary, the Honorable Carlo Fracanzani

Rome, 23 September 1986

Reflections on the central problem of public controls on financial market participants and their activities, as well as on the adequacy of current regulations, can be developed by recalling the trends and events that have marked Italy's monetary and financial history, together with the steps taken from time to time by the authorities.

1. State intervention in monetary and credit matters was initially designed to regulate the activities and statutes of the banks of issue.

In the wider sense banking activity was regulated until the early decades of this century by the legislation governing industry and commerce.

As the importance of banking grew, however, the role that banks play in the circulation of money became increasingly evident. Initially, economic theory saw the granting of credit and the taking of deposits as increasing the velocity of circulation of money (comprising coins and the notes of the banks of issue). This view was explicitly stated by Wicksell (1906), I. Fisher (1911) and Pigou (1917). Although in his *Tract on Monetary Reform* (1932) Keynes discussed at length the value of the monetary unit and the function of banks in this connection, his conceptual position was still close to that described above. It was only much later in *A Treatise on Money* (1930) that he explicitly recognized the monetary nature of banking activity. Deposits in checking accounts, in view of their effects on prices and economic activity, were considered equivalent in all respects to the money created by banks of issue. Economic theory subsequently adopted this point of view.

At the turn of this century, moreover, banks were clearly seen in several countries to be involved in the financing of production and investment cycles, with repercussions on saving and the circulation and value of money.

In Italy the commercial banks played an active part in financing the building investment cycle of 1906-07 and later the production cycle connected with the First World War. In both cases the subsequent phase of depression created liquidity and solvency problems for the banks involved.

The bills submitted to Parliament by Nitti (1913), Ciuffelli (1918) and Chiesa (1920) were early, unsuccessful attempts to set the credit sector within a special regulatory framework. These provided for administrative intervention and supervision with powers of inspection assigned to government bodies. The bills were also formulated to take account of the economic gap and historical lag that marked Italy's industrialization.

2. In Italy the response to the general economic difficulties of the twenties, and in particular to those of the credit sector, came in 1926. The Bank of Italy was designated as the sole bank of issue (Royal Decree Law 812/1926) and as the body responsible for banking supervision, to be conducted through prudential controls and inspections. At the same time the establishment of new banks, the opening of branches and mergers between banks were subjected to authorization by the Ministry of Finance (Royal Decree Law 1511/1926).

The cycle of the late twenties saw the Italian banking system, with resources that consisted primarily of short-term deposits, again actively financing substantial fixed investment projects, in part through the acquisition of large shareholdings in industrial firms.

The need for access to substantial low-cost funds led industrial groups to bid actively for ownership shares in major banks. Delicate problems arose regarding the compatibility of firms' shareholdings in banks with the financial equilibrium of the economy.

The economic crisis that began in the United States in 1929 also involved that country's banking system, which suffered heavy withdrawals of deposits that were not completely offset by the central bank.

The difficulties of banks amplified those of the productive system and this, in turn, had a feedback effect on the banking system, the final result being a huge fall in output, employment and credit, together with the loss of a sizable proportion of the saving accumulated in bank deposits.

The United States countered the new situation regarding credit and money with the introduction of a deposit insurance scheme and the Glass-Steagall Act, which was passed in 1933 and had the effect of restricting deposit banks to short-term lending activities.

The depression was transmitted to Europe through trade and the exchange rate system. Italy also suffered from serious difficulties in industry coupled with liquidity crises in the banking sector.

As early as 1931 the government intervened by transferring bank shareholdings in leading industrial groups to public holding companies, which were financed by an injection of public funds.

Subsequently the Istituto per la Ricostruzione Industriale (IRI) was set up and took control of the firms in difficulty and the principal banks involved in their financing. The Istituto Mobiliare Italiano (IMI) was also founded with the task of providing medium and long-term finance for research and production out of resources provided by the government and funds raised in the bond market.

3. The 1936 Banking Law defined the taking of deposits and the granting of loans as "functions of public interest".

This definition was primarily in response to the earlier unfavourable experience of instability, in major sectors of the economy and in the total volume of savings, stemming from crises of individual intermediaries.

The definition does not exclude intermediaries' operational choices from being of an entrepreneurial nature. But, in contrast with most other firms, credit intermediaries normally borrow and invest funds that are large multiples of their own capital.

Furthermore, the business of granting credit and taking deposits is related at every stage with the increase in income and saving produced by such investment.

Recognition that a large part of banks' liabilities are of a monetary nature was the other important reason for subjecting the banking system to special rules and foreseeing more comprehensive public intervention in the various aspects of banking business than for other types of commercial firms.

The introduction of authorization procedures for the establishment and merger of banks and changes in their networks, the creation of a supervisory body and the provision made for special public intervention in crises and failures are all evidence of the importance attributed to credit for the overall stability of the economy and of the consequent public interest in the proper working of the credit system.

Concern for monetary stability was also a factor in the planning of instruments with which to regulate the total volume of banking intermediation. However, these were not used until the immediate post-war period, when inflation was aggravated by the excessive expansion of bank credit and money, and then again in the seventies, when restrictions on bank credit were applied to regain control over the economic cycle.

Together with the authorization requirement introduced for shareholdings in industrial and entrepreneurial concerns, the distinction, based on UK and US practice, between short-term credit, granted by banks at maturities of up to 18 months with the backing of sight and short-term deposits, and medium and long-term credit, granted mainly with the proceeds of bond issues, removed another of the causes of the instability encountered on several earlier occasions.

Maturity transformation by the credit system was not entirely eliminated. The average maturity of banks' liabilities remained much shorter than that of their assets. Nonetheless, the mismatch was kept within bounds, and the central bank's role in controlling liquidity and, in particular, acting as lender of last resort was sufficient to cope with possible disequilibria.

Evidence of two other concerns can be seen in the subjection to authorization procedures of firms' fund-raising with the public by way of share and bond issues when banks were involved, even if only in the placement of such securities.

In the first place, there was the need for financial intermediation to be covered comprehensively. Experience had clearly convinced the authorities of what was to be universally recognized in the sixties — the oneness of financial intermediation. According to this view, the various forms of collecting savings to finance entrepreneurial activity and investment are at least partly interchangeable.

The binding nature of the control when banks are involved can be seen as further evidence of the authorities' concern about the ability of the banking system to create credit beyond the limit compatible with the formation of saving in conditions of economic stability.

The global approach to the problem of financial intermediation is confirmed by the expression "saving in every form" used in Article 1 of the Banking Law, even though the usual interpretation, especially that of the Bank of Italy, with regard to the bodies to be subjected to supervision, subsequently restricted the scope of this provision to saving used for the granting of credit.

Comprehensiveness was also pursued in the regulations issued by the Interministerial Committee set up under the 1936 Banking Law. These extended the documentation and authorization requirements for credit activity to businesses that granted credit without taking deposits from the public.

It almost goes without saying that banks, medium-term credit institutions, bond and share issues, and non-deposit-taking credit institutions accounted for the whole of financial intermediation business at the time.

Finally, as regards the possible control exercised by industrial firms over bank capital and thus over the allocation of credit, the 1936 Law only restricted banks' acquisition of interests in firms, while no explicit mention was made of investments in the opposite direction.

This apparent incongruence was undoubtedly a reflection of the broad range of regulatory instruments provided by the Banking Law and the small size of the financial market at the time. More basically, it stemmed from the public nature of the most important credit institutions (the public-law institutions and savings banks). Other contributory factors include the impossibility of other forms of credit intermediaries being controlled through shareholdings (the cooperative banks) and IRI's control of the most important industrial stock companies. The risk of companies acquiring interests in banks was virtually negligible in practice.

At the institutional level the 1936 Law placed at the top of the system a Committee of Ministers (chaired by the head of the Government) with authority to issue directives to the newly created supervisory body, the Credit Inspectorate (headed by the Governor of the Bank of Italy), regarding its task of protecting savings and controlling credit business.

4. At the end of the Second World War the Committee of Ministers was replaced by the Interministerial Committee for Credit and Savings, chaired by the Minister of the Treasury. In turn, the functions of the Inspectorate were transferred to the Bank of Italy. This shift integrated the Bank's prerogatives in monetary matters, and the changes in its organizational structure made by the 1936 Law also served to promote the same end.

Decree Law 544/1948 (subsequently amended by Law 1333/1964) set a limit on the amount the Treasury could borrow from the central bank. After some unsuccessful attempts, a system of reserve requirements was established in the autumn of 1947 with the aim of curbing the excessive expansion of banking intermediation.

In the period of monetary stability that lasted from the end of the forties to the early sixties, the global approach of the authorities to the control of the financial market received

strong confirmation. Law 428/1955 subjected to authorization all issues of bonds and shares above a certain limit, with no change being made in the provisions of the Banking Law applying to operations that involved the credit system in any way.

Interest in the process of credit intermediation as a whole and its influence on economic activity re-emerged in the legislation that led to the setting up of Italy's national economic planning institutions in the second half of the sixties. These included the Interministerial Committee for Economic Planning (chaired by the Prime Minister), which issues annual directives on the global distribution of credit flows between the private sector and the public sector in conformity with the availability of financial saving.

The high rate of inflation in the second half of the seventies encouraged the birth of so-called "atypical securities". These consisted of participation notes offered for sale in the form of promises of income, of which a part was fixed and the rest variable in accordance with the yields earned by the, for the most part property, enterprises invested in.

Atypical securities involved forms of fund-raising and investment of savings that did not fall within the framework of credit institutions' activities and were deliberately different from shares and bonds.

The most important reason underlying their introduction was the high inflation rate, which generated capital gains and expectations of such gains in the property market. The deliberate differentiation of these products from bonds and shares, which was justified in part by the different nature of the business, made it possible to circumvent all the controls on traditional forms of deposit-taking as well as often providing tax advantages.

The questionable investment policies of some issuers and their failure to achieve the yields that subscribers had been promised, together with the slowdown in inflation and the fall in property values subsequently led to a deep crisis in this sector, which in some years had raised funds amounting to about 0.5 per cent of the total volume of intermediation.

Slower economic growth in the second half of the seventies, coupled with the structural difficulties of several major capital-intensive industries (basic chemicals, steel, shipbuilding and construction) making substantial use of oil either as a raw material or as a source of energy, had a powerful effect on the activity of the medium-term credit institutions.

Notwithstanding heavy losses on some loans, the relationship between fund-raising and lending prescribed by the Banking Law demonstrated its ability to prevent acute crises from developing. It nonetheless became clear how far these institutions had adapted their business to the needs of managing the subsidies and grants provided by government departments under a succession of laws with the aim of promoting the development of economic sectors and geographical areas selected by the competent political and institutional authorities. This process had resulted in the medium-term credit institutions becoming highly dependent on this type of activity.

Government intervention, primarily by way of taking over non-performing loans through the assignment of securities issued by the Deposits and Loans Fund, restored the institutions to a sound footing. But it left open the problem of a structural contraction in their basic field of operations, the financing of large-scale fixed investments.

The problem of the internal organization and operations of these institutions was tackled in Law 23/1981, which authorized them to undertake adjustments of a structural nature with the aim of enhancing their adaptability and hence their efficiency.

A uniform set of norms was established to replace those governing credit institutions subject to the 1936 Banking Law and the slightly different ones governing institutions that had been set up subsequently.

On the other hand, various supervisory controls to which the medium-term credit institutions had been or were liable to be subjected were abolished. At the same time, the range of operations they could undertake was considerably broadened in the belief that control over bond issues would be sufficient to restrict the total volume of intermediation if this proved to be necessary.

The resulting inability of the authorities to influence the volume of these institutions' lending directly, together with their broader range of operations, led in the following years, during phases of monetary restraint, to difficulties in controlling the total flow of credit to the economy. In practice, the restrictions, sometimes extremely tight, that the central bank imposed on bank lending thus came to be bypassed by credit operations being shifted to the medium-term credit institutions.

Although there has been a significant recovery in recent years, the basic weakness of fixed investment activity has persisted, as has also a high level of financing out of cash flow or with other forms of credit that will be discussed below or through issues of bonds and shares. This situation has continued to stimulate reflection on the possibility of further extending the range of medium-term credit institutions' activities and on their relationship with banks.

5. The discussion triggered by the problems inherent in the enlargement of the shareholder base of many companies and the consequent concentration of control in the hands of a small minority led between 1970 and 1974 to the drafting of numerous proposals for reform. These contributed to the formulation of the Law finally approved (Law 216/1974), which was intended to reequilibrate the balance of power among the various interests involved. The new norms distinguished between holders of ordinary shares, which confer powers of direction and control, and investors in savings shares, which provide a home, often only temporary, for savings.

This new approach, which sought to promote the use of capital in accordance with the interests of investors, was based on the presumption of public control designed to protect the holders of savings shares. In particular, the accuracy and completeness of information was to be monitored so as to permit soundly-based investment choices.

The experience of other countries in this field led to the creation of the Consob (the Companies and Stock Exchange Commission), entrusted with the task of exercising control over both listed companies and non-corporate entities that issue listed securities, including as well companies and entities operating as financial investment concerns. At the same time most of the previously dispersed responsibility for the regulation of stock exchanges was assigned to the Consob in more detail.

Article 12 of Law 77/1983, which will be discussed below, extended the responsibility of the Consob to all forms of fund-raising involving the public, independently of whether the securities in question are listed or not. This brought all issues of atypical securities into the information control net. The Bank of Italy was also empowered to intervene for the purpose of exercising overall control of financial flows.

Law 281/1985 gave precise definition to the legal nature of the Consob in order to allow it to establish an organizational framework and to endow it with decision-making authority and broader regulatory powers.

In the exercise of these powers, problems touching upon the powers of other bodies having delegated authority to exercise control over intermediaries are resolved by reference to the respective spheres of authority.

In particular, with regard to the overlapping of authority provided for under current legislation relating to financial and credit intermediation, reference to the genesis and rationale of the regulations in question helps to identify precisely the ambit and purpose of the powers assigned respectively to the Consob and the Bank of Italy.

The task of the Consob is basically to ensure the smooth functioning of the financial market. It is therefore responsible for requiring operators to observe well-defined rules regarding the publicizing of planned operations. In the light of the information they receive, savers make their choices after making their own assessment of the solvency and reliability of operators.

6. Law 77/1983 authorized the setting up of investment funds in Italy, thereby permitting a further diversification of financial wealth, especially for households. It thus sought both to stabilize these financial assets, which continue to be fueled by a substantial flow of savings, and to channel a sizable proportion of them into shares.

Parliament decided to entrust the supervision of these new intermediaries and their operations to the Bank of Italy.

In the initial period of rapid growth in investment fund sales it was found, as was to be

expected, that these occurred largely at the expense of bank intermediation. The shift probably involved not bank deposits that were being held for immediate liquidity needs but rather those that were deterred by risk aversion and cost considerations from being invested directly in shares and bonds.

The experience of the investment funds, subject to information controls by the Consob and to supervision by the Bank of Italy as far as liquidity conditions and risk distribution are concerned, shows that the presence of specific public controls is not a hindrance to the growth of a market and is viewed favourably by savers. The controls do not appear to restrict intermediaries' normal operation, and they make an effective contribution in the long term to their stability and thus, in a system with abundant financial saving such as Italy's, to their growth.

7. Law 74/1975 and the ensuing legislative decree approved by Presidential Decree 350/1985 implemented the Community Directive with respect to the freedom of establishment and of carrying on credit business. This new legislation reduces the discretionary factor in authorizing the creation of credit institutions and explicitly confirms the entrepreneurial nature of banking.

In this context reference also needs to be made to Law 114/1986, which implemented EEC Directive 350/1983 and provided for cooperation between the supervisory authorities of the Community countries. Accordingly, the consolidated accounts of credit institutions operating in more than one country must be transmitted to the supervisory authorities of the different countries concerned. Law 281/1985 mentioned above also laid down the criteria for identifying shareholders in banks and credit institutions set up in the form of stock companies.

The business of credit granting — pursued within the general limits set by economic policy and special regulations governing credit, and in conformity with an entrepreneurial approach based on the optimization of risk and yield conditions — requires that credit decisions should be free from external, non-transparent influences, which can among other things derive from those who exercise ownership control over credit institutions.

The scope for creating new banks and credit institutions in the form of companies based on share ownership may revive the problems that were solved in the thirties through the public ownership of credit institutions and consequently, even though they had earlier caused serious difficulties, were ignored in the 1936 Banking Law and subsequent legislation.

One can envisage the possibility of a partly distorted use of the scope for creating new credit intermediaries insofar as the aim is to provide financial support for particular sectors and groups rather than to enhance competition in accordance with entrepreneurial principles.

The exploitation of control over an intermediary's share capital to serve sectoral ends would inevitably distort and weaken competition.

It is an opportune time to take advantage of the possibility offered by Law 281/1985 to prepare legislation that incorporates into our regulatory system the EEC Directive on the freedom of establishment so as to ensure that its effects are consistent with the original aims.

8. In Italy, as in other countries, the late seventies and early eighties saw the emergence of new forms of credit activity conducted by specialized intermediaries that, at least until now, have depended primarily on the credit system for their resources.

These new activities include leasing and factoring.

The Bank of Italy has estimated that at the end of 1985 leasing and factoring companies had claims outstanding amounting to 6,200 and 5,200 billion lire respectively. The proportion of these intermediaries' funds obtained from credit institutions was about 85 per cent for both groups. A sizable proportion (37 per cent) of the finance provided by leasing companies was medium and long term, while virtually all that provided by factoring companies was short term.

Leasing business, which expanded by 20 per cent in 1984 and 30 per cent in 1985, is in the hands of several dozen specialized companies, most of which are owned and controlled by the banking sector. Leasing has developed especially fast in connection with relatively small investments — often in advanced technologies — with

short useful lives and high rates of depreciation. Typically, such investments have been made in the last few years by small and medium-sized firms to reorganize their production.

In many cases the benefits associated with such operations are enhanced by favourable tax treatment.

Leasing companies, which, as mentioned, are mostly financed by banks, may seek to develop an independent fund-raising capability. In such case they would in effect become fully-fledged credit institutions.

Factoring companies include firms tied both to credit institutions and to industrial and commercial groups. The advantage to be gained from using factoring services is that they enable industrial and commercial firms to obtain finance in exchange for their (usually trade) credits. Factoring companies can in this way provide finance primarily with reference to the validity and collectability of the related credits and thus at least in part independently of the firms' own situations.

Factoring activity has also boomed, expanding by 50 per cent in 1985. The increasing role of factoring companies tied to industrial groups may well give rise to delicate problems in connection with the intermingling of credit, industrial and commercial activity that it entails.

To a considerable extent leasing and factoring replace or supplement the operations of industrial credit institutions and banks respectively . As long as these two activities are financed primarily by credit institutions, overall financial flows can be indirectly equilibrated by controlling the original sources of funds. When they grow to a significant size, however, there will obviously be the problem, independently of the nature of the operations, of the impossibility of making the same checks as in the banking system and thus of ensuring the stability of the system as a whole.

It therefore appears reasonable to foresee for these intermediaries the introduction of specific supervisory procedures to supplement those applying to credit institutions. Such supervision will need to take account of the technical features of the operations involved and of the requirement that such intermediaries' capital be independent of that of banks.

Another form of credit activity that has developed in the last few years with no special regulation and little awareness of its nature and scale is consumer credit provided by non-banks. The volume of such credit outstanding at the end of 1985 is estimated at around 5,000 billion lire. A large part of this business is in connection with instalment plan sales of durable goods, but in other cases it is conducted independently by finance companies and other entities whose fund-raising sources are unknown. In macroeconomic terms this activity is still not particularly important, but problems could nonetheless arise in connection with the way it is conducted, the conditions offered to borrowers and the security they are required to provide.

The European Community is examining a proposal for a Directive aimed at achieving uniform regulation of consumer credit. In the field of consumer protection the proposal envisages a series of obligations and constraints on both suppliers of goods and services and providers of finance.

9. The rapid and persistent expansion of Italy's budget deficit in the second half of the seventies was accompanied by an increase in the volume of banking intermediation in relation to income and the total flow of financial assets.

The spending of the government in excess of revenues transformed itself into financial saving, primarily in the form of bank deposits that the credit institutions reinvested in government securities (mostly Treasury bills at the time). The movements in interest rates at the end of the seventies, the need on stabilization grounds for tighter control over bank intermediation (achieved in part through increases in the compulsory reserve requirement), and the heavier taxation of deposit income all provided an inducement to savers to become more directly involved in the process of subscribing to issues of government securities. The credit system organized and adapted itself along these lines and was able to benefit substantially from the transactions in question.

This was the start of a growing interest on the public's part to invest directly in government

securities, a tendency that the policies pursued by the monetary authorities in the eighties have helped to strengthen.

While the volume of bank deposits has increased during the eighties in line with nominal GDP, financial savings in the form of public and private security holdings have grown two or three times as fast, albeit from a low initial level.

The placement of government paper with savers necessarily has to be performed in large part by the banking system, which participates in the auctions and then retails the securities through its branch network.

In the early stages investors turned to their banks not only for the subscription of securities but also for services such as the cashing of coupons, secondary market sales and purchases, and the other operations associated with the management of individual securities portfolios.

Subsequently banks set about systematically developing portfolio management capability for private and public sector securities as well as shares, and considerably broadened their customer bases for these services.

The flow of portfolio management business handled directly by banks, which is shown in their memorandum accounts, or by subsidiary and related companies, amounted in 1985 to about 14,000 billion lire (in the same year bank deposits increased by about 40,000 billion). The growth in this line of business appears to be accelerating.

The same activity is also performed by non-banks in the securities trading sector and, even though the amounts involved are smaller, they are nonetheless significant and rising. Nor can individual operators be ignored. Though the volume of business they do is not significant at the macroeconomic level, it may well be important for individuals and at the local level. The legal instruments used in the relationship between holders of trust accounts and banks and trust companies are those foreseen in the civil code together with those of less clear content and application of the codified Law on private insurance.

Even in the absence of explicit attempts to attract fiduciary savings, the universally known willingness of banks and financial operators to provide such services makes them a form of deposit-taking in economic terms.

The instructions that assignors give to trustees are virtually always of a general nature. Banks standardize, or at any rate are in a position to standardize, the forms of investment used without difficulty and the dividing line compared with investments of a credit nature can easily be blurred, especially when savings are invested in paper issued by firms.

The ban on "unsegregated" management of such forms of savings by banks is another, albeit faint, dividing line compared with the activity of investment funds.

Since the Law provides that the latter shall be supervised by the Bank of Italy, it appears advisable that the trust business of banks should be defined in a way that would more clearly reveal their importance, among other things for monetary policy, the limits and aims of which need to be studied further.

Non-bank entities performing similar functions should be treated consistently.

The distinction between the funds raised by banks and those raised by investment funds lies in the liquid and hence monetary nature of the former, while the characteristic feature of the latter is that they are easily realizable in a broad market, but at a price that is variable though not influenced by the redemption of units.

Trustee deposits with banks similarly benefit from counterpart investments in securities with broad markets but enjoy as well the liquidity services that banks supply in relation to such securities. Even though the monetary nature of such deposits is debatable, further increases in their volume coupled with the development of new techniques could give rise to problems.

It goes without saying that forms of liquidity management performed by banks involving items that are currently treated off balance sheet can also be seen as an additional channel for the creation of money requiring closer monitoring than is possible today.

10. The considerable growth in macroeconomic terms of financial intermediation, together with the related techniques and transactions, suggests the possible emergence of new forms of financial intermediaries in response to particular needs.

In the first place, merchant banking activity. Discussion of this subject has been stimulated by the bill the Government has tabled in Parliament, but analysis of its provisions would be out of place here.

It is nonetheless necessary to examine the possibility of introducing adequate controls, in line with practice in other countries, on the activities of operators in the financial market who make block purchases of public and private sector securities at issue for subsequent placement with the public.

Bills are being prepared for the authorization and regulation of closed-end investment funds. These serve basically as a means of supplying "unsegregated" equity capital to firms that would find it extremely risky and costly to seek a stock exchange listing. Such legislation would also enable the existing forms of atypical fund-raising to be set in a regulatory framework.

In view of the aims of this type of intermediation, it would need to be subjected to the controls foreseen for share issues and possibly others of the kind laid down for investment funds.

In practice this type of intermediation provides indirect recourse to the share market for groups of companies (which can either stay the same or change) using techniques for attracting the public's savings taken over from open-end investment funds.

Real estate investment funds should also be based on a similar model in view of the type of investment to be financed. In contrast with the investments of securities investment funds, the marketability of their investments is low. The controls for such funds could be a modified version of those used for share issues and, as regards the supply of information, those adopted for the sale of open-end investment fund units.

11. This reflection on major financial developments would be incomplete without some comment, albeit brief, on recent changes in the insurance market. The forms of financial intermediation involved in insurance business are changing and taking on greater importance. There is therefore a greater need to know about and assess these changes, bearing in mind the overall expansion in the volume of these activities.

The importance for total credit and savings flows of the growing range of operations open to insurance companies is obvious. The theoretical debate on the organization of supervision in the various sectors of the financial system highlights the difficulty of establishing a common reference model. The need for organizational linkages to be created between the various sectors to ensure effective control of these flows nonetheless appears undeniable.

12. The EEC Directive on banking and the problems connected with the incorporation of its provisions in Italian law have already been mentioned.

Subsequent EEC Directives will tend to affect the pursuit of credit intermediation and require adaption and harmonization vis-à-vis the existing rules. Failure to solve these problems will not only have implications for the stability of the financial system but in some cases may actually thwart the aims of the Directives.

Among the Directives that have already been announced, there are some regarding the relationship between national banking systems and residents in other Community countries. Liberalization measures in this field in conjunction with complete exchange rate stability presuppose harmonization of the various financial systems, and ultimately full unification of the different economies.

Underlying the legislation in the credit field there is concern, stemming from unfavourable historical experience, about the control of money and the stability of the financial and economic systems. We must keep these basic considerations in mind in this period of market mutations and far-reaching innovation and adaptation in the monetary and credit regulatory system.

Statement by Carlo A. Ciampi, Governor of the Bank of Italy, before the 5th Committees of the Italian Senate and Chamber of Deputies in joint session on 8 October 1986

Part of the fact-finding procedure preceding the examination of the budget for 1987

1. For some time the Bank of Italy has indicated that the adjustment of public finances must proceed through action designed to eliminate the imbalances at their source, which lies in the deficit net of interest payments. At the same time steps must be taken to reduce the interest burden, which is the derived component of the overall deficit.

The reduction in Treasury recourse to the market will facilitate the fall in interest rates, not only in nominal terms as inflation slows but also in real terms until these are brought below the GDP growth rate.

This is the strategy to be followed to reestablish control over the expansion of public debt.

The innovations in the procedures for regulating public finances recently approved by the Budget Committees of the Senate and the Chamber of Deputies can make an important contribution to the implementation of the fiscal adjustment programme. They have the effect of tightening the link between analyses at medium-term, the decisions taken year by year and the planned instrumentation.

2. Even when settlements of past debts are excluded, the 1985 state sector borrowing requirement net of interest payments, following the moderate decline recorded in 1984 (38 trillion lire compared with 41 trillion in 1983), rose to 46 trillion lire (Table 1). On the basis of results for the first nine months of this year it can be estimated that this balance will show a decline of 9 trillion lire for 1986 as a whole. Accordingly, this aggregate should fall as a percentage of GDP by two percentage points, after having risen last year to 6.8 per cent from 6.1 per cent in 1984.

Table 1

State sector borrowing requirement

	Borrowing requirement (billions of lire)	GDP ratio %	Interest payments (billions of lire)	GDP ratio %	Borrowing requirement net of interest (billions of lire)	GDP ratio %	Public debt at 31 December (billions of lire)	GDP ratio %
1977	17,188	9.0	8,000	4.2	9,188	4.8	109,885	57.8
1978	29,094	13.1	11,681	5.3	17,413	7.8	144,744	65.1
1979	29,589	11.0	14,414	5.3	15,175	5.6	175,515	65.0
1980	35,886	10.6	19,235	5.7	16,651	4.9	212,671	62.8
1981	49,595	12.4	27,328	6.8	22,267	5.5	267,755	66.7
1982	70,693	15.0	38,914	8.3	31,779	6.8	342,173	72.8
1983	88,257	16.3	47,105	8.7	41,152	7.6	433,601	80.3
1984	95,387	15.5	57,593	9.4	37,794	6.1	531,940	86.5
1985	110,225	16.1	63,810	9.3	46,415	6.8	656,620	95.9
1986	110,000	14.3	(1) 73,000	9.5	37,000	4.8	769,620	100.4

(1) In contrast with the similar table submitted last year, all the figures for the borrowing requirement exclude settlements of past debts in both cash and securities.
(2) Estimate.

For its part, the state sector's interest burden will rise in 1986 to 73 trillion lire (64 trillion in 1985) as a result of the increase in total debt and, to a lesser extent, of the issue since 1985 of securities with annual coupons, which reduced interest payments in that year by postponing a part for six months. On the other hand, the sizable fall in interest rates during 1986 will produce its full effect only next year owing to the lag implicit in the method used to calculate the yield on Treasury credit certificates.

3. The budget strategy outlined by the Government for 1987 is designed to continue the action started this year. The state sector's total borrowing requirement should be kept within 100 trillion lire, bringing it down to 12.1 per cent in relation to GDP.

This result is to be achieved through:

a) a further reduction in the deficit net of interest payments, of much the same size as that recorded this year; and

b) a reduction in the interest burden. The increase corresponding to the growth in total debt should be more than offset by the effect of the fall in interest rates over the whole range of government securities.

The first of these two objectives will not be easy to achieve because it requires corrective action on a substantial scale. The reduction in the deficit net of interest payments achieved in 1986 cannot be seen as establishing a trend that will continue automatically. Some of the measures that produced this result were of a one-shot nature or at any rate destined to taper off in their effects.

It also needs to be noted that, while the fall in inflation slows the rate of increase in expenditure, it has a similar and possibly greater effect on revenues. It is enough to refer to the progressive nature of personal income tax and the reduction in the yield of the tax on bank deposit income as interest rates come down. By contrast, revenues should gain from the decisions already taken to transfer part of the benefits of the fall in oil prices to the state.

The indications and analysis of the Government's Forecasting and Planning Report, together with its estimates of the state sector revenues and expenditures, show that the corrective action in question consists primarily in limitations on appropriations to non-state public bodies. The action has been initiated with the presentation of the Finance Bill for 1987. Its full implementation will depend on the bills the Government has announced for the various areas of intervention.

4. Progress in putting Italy's public finances on a sound footing will permit an increase in the share of resources available for investment, with beneficial effects on the competitiveness of the whole economy, growth and employment.

In 1986 the fall in oil and primary material prices together with the depreciation of the dollar loosened the constraints on growth imposed by the external accounts. These developments also assisted progress towards monetary stability along a path that had already been followed for several years, with success, under adverse external conditions.

Though in the first half of the year the industrial economies grew more slowly than expected, limiting the contribution of external demand to Italy's growth, the GDP increase for 1986 as a whole, as indicated in the Government's Report, represents a larger gain than that recorded in 1985 (2.8 per cent as against 2.3 per cent).

With regard to inflation, the general index of wholesale prices, influenced by the fall in oil prices, has recorded some actual declines, while the rate of consumer price inflation should slow down to less than 5 per cent by the end of the year.

The balance of payments on current account should swing from a deficit of 8 billion lire in 1985 to a surplus equivalent to about 1 per cent of GDP.

These are undoubtedly positive results, but the adjustment of Italy's economy is not yet complete: in terms of consumer prices, inflation is still running at twice the rate as in the other western industrial countries; the wholesale prices of manufactures are rising faster than unit costs; the improvement in the terms of trade, which accounts in large part for the surplus on current account, does not imply a permanent easing of

the external constraint. The estimated outturn for the year at the macroeconomic level indicates a further worsening in volume terms of the merchandise trade balance. This means that Italy runs the risk of incurring heavy deficits on its trade balance in the event of a reversal of the recent shift in the terms of trade.

The increasing openness of the Italian economy has accentuated its dependence on the cycle of international activity. For 1987 the leading international organizations do not foresee a turnaround in the terms of trade of industrial manufactures next year, but neither do they expect the growth in world trade to accelerate significantly. Real output in the industrial countries is forecast to rise only a little faster than in 1986.

In line with this scenario, the 1987 forecasts for the Italian economy indicate GDP growth of 3 per cent, a larger rise in domestic demand, a further slowdown in inflation and a surplus on the external current account.

The Government's planning objective reflects the political will to achieve faster growth of around 3.5 per cent. It can be pursued without creating new imbalances provided that a firm line is followed in curbing the budget deficit and consolidating the improvement in price and cost inflation through a suitable policy for incomes.

A satisfactory competitive position, which has to be gained by holding down costs and prices and by raising productivity, is a prerequisite for Italian exports to increase their share of world markets that will be growing rather slowly. The enlargement of the productive base and increased public intervention in the construction of infrastructures and the correction of regional imbalances presuppose a reduction in the budget deficit on current account.

Last May I presented a simulation exercise carried out by the Research Department of the Bank of Italy for the period 1986-88. It assumed the implementation of the fiscal policy proposed by the Minister of the Treasury, the continuation of the policy for incomes, an oil price of between 15 and 20 dollars per barrel, and growth in world trade of between 3.5 and 4 per cent. The resulting improvement in public finances would permit GDP to grow at an annual average rate of around 3 per cent over the three years. Domestic demand would increase by about 4 per cent, with household consumption rising at a slightly slower pace and gross fixed investment a little faster. Inflation would settle at between 3.5 and 4 per cent. External equilibrium would be maintained with the current account recording small surpluses. The increase in employment would be sufficient to absorb the growth in the labour force.

The preliminary results of a new, but still incomplete, exercise, moved forward to cover 1987-89, confirm the earlier indications, despite a lower forecast for the growth in world trade.

This scenario is dependent on external factors such as the continuance of favourable terms of trade and presupposes an active domestic economic policy. Curbing the budget deficit would not depress the level of economic activity since production and investment would benefit from the improved expectations and lower real interest rates that the decrease in the borrowing requirement would permit.

5. I shall now turn to the movements of the main credit and monetary aggregates in 1986 and to the forecasts for 1987.

In conformity with the macroeconomic framework established in the Government's Forecasting and Planning Report for 1986, the following objectives were set in September of last year:

— a 9 per cent expansion in credit to the non-state sector. At the beginning of 1986 this figure was reduced to 7 per cent, but solely with the aim of offsetting the abnormal increase in bank lending in the second half of 1985. As you will remember, this contributed to the exchange crisis that broke out at the end of that year and was defused by the measures taken in mid-January, including the temporary reintroduction of the ceiling on bank loans;
— the increase in total domestic credit, which includes credit to the non-state sector and the part of the state sector borrowing requirement financed domestically, was set at a little more than 13 per cent;
— the growth in M2, which comprises currency in circulation and bank and Post Office deposits, was fixed between 7 and 11 per cent. A target range was considered

necessary in view of the changes taking place in the financial structure and in the behaviour of operators as a result of the fall in the inflation rate. Both types of change increase the variability of the composition of financial wealth.

To date there has been an overshooting of the target for credit to the non-state sector and a smaller-than-expected growth in the money supply.

Lending to the non-state sector slowed down at the beginning of the year, when the ceiling imposed on bank lending was particularly restrictive. In April it began to gather pace again and accelerated still more after the ceiling expired at the end of June. Through August this aggregate increased at a seasonally adjusted annual rate of 8.8 per cent, or two percentage points above target.

The state sector borrowing requirement net of settlements of past debts amounted in January-September, according to provisional data, to 81.4 trillion lire, or roughly the same level as in the corresponding period in 1985. The borrowing pattern appears consistent with the objective for the year of 110 trillion lire.

In consequence total domestic credit expansion through August was one percentage point above the 13 per cent figure indicated in the planning framework. In the first eight months of 1985 the corresponding rate of increase had been 16.7 per cent (Table 2).

Table 2

Monetary and credit aggregates

(percentage changes)

	1984	1985	1985 Jan-Aug (1)	1986 Jan-Aug (1)
Bank deposits	11.6	10.1	13.4	5.8
Bank loans	17.1	15.6	12.2	6.3
Credit to the non-state sector	15.6	12.9	10.2	8.8
Total domestic credit	19.7	18.0	16.7	13.7

(1) Seasonally adjusted growth rates on an annual basis. The 1986 figures are provisional.

Up to August the growth in M2, the most liquid component of financial wealth, remained close to 7 per cent, i.e. at the lower limit of the target range. The slowdown in the growth of this aggregate (compared with the 11 per cent increase recorded in 1985) was associated with the rapid expansion of new instruments for attracting financial savings. In particular, the net fund-raising of investment funds over the first nine months was close to 35 trillion lire, or more than double the figure for the whole of 1985.

In parallel with the slower monetary growth, the monetary base, which is the aggregate most directly controllable by the central bank, increased in the twelve months to September by 8.1 per cent, with the component utilized by the banks to meet their compulsory reserve requirements and liquidity needs increasing by 7.2 per cent. In the preceding twelve-month period these increases were 14.2 and 16.5 per cent respectively.

The success of the package of monetary policy measures introduced at the beginning of the year brought the foreign exchange crisis quickly to an end and curbed the abnormal expansion in bank lending. Subsequently it permitted a resumption of the downward movement in the nominal yields on government securities and the official discount rate. In the spring the latter was lowered on three occasions, each time by one point. The yield on twelve-month Treasury bills fell from 13.19 per cent at the beginning of the year to 9.72 per cent (after tax) at the end-September auction. The yield on Treasury bonds decreased over the same period from 13.33 to 9.32 per cent (again after tax). The reduction of interest rates, implemented gradually against a background of improving expectations with regard to the course of inflation, did not prevent the placement of a substantial volume of government securities on the market. At the same time a further lengthening of the average maturity of the public debt became possible, testifying to the improvement in savers' general economic expectations. In August of this year the average maturity to redemption was 43 months, compared with the low of 14 months recorded in August 1982.

In the first nine months of 1986 the Treasury covered 3.6 per cent of its needs by borrowing

Table 3

Financing of the state-sector borrowing requirement

	1981	1982	1983	1984	1985	1985 January-September	1986 (1) January-September
				(billions of lire)			
Borrowing requirement	53,293	72,702	88,257	95,387	122,816	93,409	81,845
(net of settlements of past debts)	(49,595)	(70,693)	(88,257)	(95,387)	(110,225)	(81,450)	(81,353)
Financing							
Market securities (2)	33,665	52,363	74,829	75,431	72,183	66,358	76,314
Securities issued to consolidate debts	—	—	—	—	10,403	9,974	—
PO deposits and foreign loans (3)	5,395	7,663	8,914	9,929	12,712	3,809	2,592
Monetary base	14,233	12,676	4,514	10,027	27,518	13,268	2,939
of which: BI overdraft and extraordinary advance (4)	6,186	6,598	−622	10,554	6,340	7,122	6,625
				(percentage composition)			
Borrowing requirement	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Financing							
Market securities (2)	63.2	72.0	84.8	79.1	58.8	71.0	93.2
Securities issued to consolidate debts	—	—	—	—	8.5	10.7	—
PO deposits and foreign loans (3)	10.1	10.6	10.1	10.4	10.3	4.1	3.2
Monetary base	26.7	17.4	5.1	10.5	22.4	14.2	3.6
of which: BI overdraft and extraordinary advance (4)	11.6	9.1	−0.7	11.1	5.2	7.6	8.1

(1) Provisional figures. — (2) Excluding Bank of Italy sales of securities to banks in connection with advances granted under Ministerial Decree 27.9.1974. — (3) Includes other minor items. — (4) The Bank of Italy granted an extraordinary advance of 8 trillion lire in 1983, which was repaid in 1984.

directly from the central bank, compared with 14.2 per cent in the same period of 1985 (Table 3).

The decline in inflation, the return to external balance and the success in holding the budget deficit within the predetermined limits permitted monetary policy to lend support to activity in the real sector, foster the downward trend in nominal interest rates and accept a larger-than-planned expansion in credit to the non-state sector.

Over the rest of this year a slowing down of lending to the non-state sector looks appropriate in order to bring its expansion back towards the path originally set, particularly in view of the expected further reduction in price inflation. This conviction is reinforced by awareness that external factors, which thanks to the fall in oil prices and the dollar contributed strongly to the cooling off of inflation in 1986, will have a weaker effect as time goes on. The burden of achieving the further improvements needed in the future will once again fall on domestic factors.

6. The Government's planning framework for 1987 makes it possible to indicate the main lines of conduct that monetary policy will be following in a few months.

Credit to the non-state sector is set to expand by 7 per cent, which is slightly less than the 8 per cent growth projected for nominal GDP. This small difference seems appropriate in view of firms' scope for both self-financing and raising equity capital.

The uncertainties still surrounding the domestic and international forecasts, together with the difficulty of precisely quantifying financial flows supplementary to those included

Table 4

The debt of the public sector (1)

(end-of-period figures)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986 September (2)
						(billions of current lire)					
Treasury bills ...	27,648	32,297	37,966	47,562	72,764	106,456	139,481	150,442	159,332	172,472	181,338
Medium & long-term Treasury paper	32,494	49,809	70,273	79,767	77,788	85,449	109,784	180,225	244,107	339,650	402,753
of which:											
bonds	6,384	7,500	17,170	18,819	17,102	21,024	19,354	23,109	31,778	36,003	63,825
certificates .	—	5,493	15,143	25,348	28,090	30,982	59,018	126,085	182,702	262,399	298,421
PO deposits	16,023	19,234	24,105	30,853	33,048	35,639	39,225	44,162	50,219	59,487	61,853
BI overdraft and extraodinary advance (2) ..	5,216	4,796	6,706	10,182	19,126	25,312	31,910	31,288	41,842	48,182	54,768
(Overdraft limit) .	(6,204)	(7,782)	(11,195)	(15,358)	(20,595)	(25,331)	(29,620)	(36,757)	(43,124)	(51,142)	(56,766)
Foreign loans ...	1,474	1,616	1,941	2,392	3,433	6,578	9,731	12,505	16,285	18,254	18,610
Other debt	19,541	16,192	17,215	19,900	22,082	23,696	31,334	36,739	48,416	43,738	41,378
Total ...	**102,396**	**123,944**	**158,206**	**190,657**	**228,240**	**283,130**	**361,466**	**455,361**	**560,200**	**681,783**	**760,700**
						(percentage composition)					
Treasury bills ...	27.0	26.0	24.0	25.0	31.9	37.6	38.6	33.0	28.4	25.3	23.8
Medium & long-term Treasury paper	31.7	40.2	44.4	41.8	34.1	30.2	30.4	39.6	43.6	49.8	53.0
of which:											
bonds	6.2	6.1	10.9	9.9	7.5	7.4	5.4	5.1	5.7	5.3	8.4
certificates .	—	4.4	9.6	13.3	12.3	10.9	16.3	27.7	32.6	38.5	39.2
PO deposits	15.7	15.5	15.2	16.2	14.5	12.6	10.8	9.7	9.0	8.7	8.1
BI overdraft and extraordinary advance (3) ..	5.1	3.9	4.3	5.3	8.4	8.9	8.8	6.9	7.5	7.1	7.2
Foreign loans ...	1.4	1.3	1.2	1.3	1.5	2.3	2.7	2.7	2.9	2.7	2.5
Other debt	19.1	13.1	10.9	10.4	9.6	8.4	8.7	8.1	8.6	6.4	5.4
Total ...	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Public debt / GDP % ..	65.4	65.2	71.2	70.6	67.4	70.5	76.8	84.4	91.1	(3) 99.6	103.7

(1) The debt of the public sector includes not only that of the state sector (the Treasury, the Deposits and Loans Fund, the Southern Italy Development Fund and the non-market autonomous government agencies) but also that of local authorities, social security institutions and other central government bodies. Rounding may cause discrepancies in the totals. — (2) Provisional figures. — (3) The Bank of Italy granted an extraordinary advance of 8 trillion lire in 1983, which was repaid in 1984.

in total domestic credit, mean that small divergences from the planned expansion in credit to the non-state sector will be acceptable provided they are consistent with the movements projected for real and nominal variables and the balance of payments.

With the overall state sector borrowing requirement limited to 100 trillion lire, total domestic credit would expand by around 11 per cent. The private sector's financial assets would grow at about the same rate so that by the end of 1987 they would be equivalent to more than 40 per cent of GDP, an increase of five percentage points compared with the end of this year. The stabilization of this ratio is inevitably a lengthy process.

As regards the money supply, the difficulty of foreseeing how financial innovations will develop points to the appropriateness of a growth range of 6 to 9 per cent. Such a result will again call for an increase in households' and firms' holdings of non-liquid financial assets. These basically comprise public and private sector securities and units of investment funds and will amount in total to nearly twice the value of nominal GDP.

7. As stated earlier, implementation of the envisaged steps towards sounder public finances and a coherent incomes policy will enlarge the scope for investment. It will make it possible to continue with the reduction in interest rates, while at the same time maintaining the rigorous stance of credit and monetary policy required on domestic and external grounds.

Furthermore, the policy measures described above would slow the growth of the public debt in relation to GDP (Table 4). Given the projected average inflation rate and assuming a decline in the real yields on government securities, interest payments should not increase and, indeed, are likely to decrease in nominal terms in 1987-88. Subsequently, a petering out of the decline in inflation will curb the reduction in the interest burden. It will therefore be all the more necessary to reduce the state sector borrowing requirement net of interest payments in accordance with the adjustment plan which foresees a total elimination of this deficit by 1990.

Address by the Governor of the Bank of Italy Carlo A. Ciampi

29th National Congress of the Italian Forex Club

Sorrento, 25 October 1986

1. The state of the international economy

The world economy has not to the full realized the potential for improvement implicit in the decline in oil prices. Disinflation, especially in the industrial countries, has been advanced decisively. But the gains on other, no less important fronts are still unsatisfactory: the expansion of output and employment, the curbing of the developing countries' external debt, and the search for new balance-of-payments equilibria among the industrial countries.

In the industrial world, the slowing down of inflation and the rise in disposable income have not by themselves provided a sufficient stimulus to demand: not to consumer demand, even less to that of investment. Policy measures to sustain demand have also been lacking. The United States was not in a position to activate them, while Japan and Germany have been disinclined to do so. The risk that recessionary forces may spread themselves through the world economy is compounded by the new flare-up of the external debt problem and the constraint this will place on the imports of the LDCs.

Current forecasts point to slower world economic growth in 1986 than in the last two years. Real output in the industrial countries should expand by about 2.7 per cent, which is half a percentage point lower than the rate forecast a year ago, before these countries got the benefit of the sharpest improvement in the terms of trade since the early 1950s. Unemployment will not decrease, particularly in Europe.

The situation of the developing countries is the one that gives rise to the greatest concern. For the oil exporters, the decline in revenues from sales of crude oil, together with their debt burdens, caused an immediate, drastic fall in growth rates and imports.

For the other developing countries, the benefits of lower oil prices have been almost completely offset by the further decline in the prices of primary commodities, which are now at a new postwar low in relation to the prices of manufactures. These countries too have been obliged by an exacerbation of the external constraint to curb their purchases from abroad.

The most heavily indebted of these countries, which had managed to achieve overall current account balance in 1985, will register a renewed deficit of more than $10 billion this year. Thus some part of a five-year-long effort to restore payments balance has been undone. These efforts had entailed a decline in per capita incomes, a slowdown in investment, and a cut in imports of nearly 40 per cent in volume terms.

The deterioration of the less developed economies is a reason for concern in and of itself and also because of its possible impact on international financial stability. Interdependence among the different economic areas has become closer over the past decade, and a fall in the capacity to import of the kind that is now taking place in the developing countries appreciably affects the volume of world trade. World trade itself is threatened by protectionist measures and by the increasingly widespread practice of bilateral negotiations contrary to the generally proclaimed principle of multilateralism.

The problems that must be dealt with if we are to avoid a debt crisis are first and foremost financial ones. Credit support to countries in difficulties must be continued. Making such support conditional on the implementation of realistic adjustment policies remains fundamental, even if it is necessary to find new formulas, influenced by changes in the state of the international economy and by the special characteristics of individual cases. The settlement reached in the case of Mexico conforms to these

guidelines. It is right and proper, as well as vital, for these countries to prevent the outflow of capital, which not infrequently nullifies the benefits of external credits. At the same time, a further decline in international interest rates, which are still high, is desirable. The lending banks need to strengthen their capital bases and reserves, and many countries have introduced appropriate tax benefits for the creation of provisions against this particular risk.

At the same time, it is essential to envisage financial measures as being part of a picture that extends to the "real" economic aspects as well. The last fifteen years have shown that sharp variations in the prices of primary commodities, either upward or downward, have undesirable repercussions for the entire world economy.

At the international level the price system is faced with difficulties in ensuring balanced growth between the supply of the primary sector and that of the industrial sector. When the task of restoring balance is entrusted to relative prices, virtually the entire burden of adjustment falls upon the more competitive market, the primary goods market. Their price movements are subject to wide fluctuations.

In recent years these prices have moved around a trend headed downwards. If this has benefited the fight against inflation in the importing countries, it has also caused uncertainty and stagnation internationally. The supply of foodstuffs has expanded strongly, dispelling the fears of shortage that were widespread in the early seventies, and now tends to exceed demand. For most other primary products, there has been a slowing down of demand as a result of the raw materials economies achieved in industrial production.

The solutions must be sought along two lines: one lies in the need to improve the efficiency, integration, and stability of primary product markets, and the other in the need for a sufficient, regular expansion of world demand.

Arrangements and measures to put international markets for primary products in order have been proposed many times since as far back as the fifties, but they have never come to much. Indeed, there is a widespread belief that such measures are not practicable. But this belief must be rejected, for the experience of the last fifteen years underlines the strong need for them.

As regards primary materials other than oil, these measures should provide for better coordination on the international level of the management of stocks aimed at stabilizing prices. The farm price supports of the industrial countries hamper the adjustment of supply and demand, depress international commodity prices, and harm the agricultural exports of the less developed countries.

With regard to oil, joint initiatives by the consumer and producer countries are needed. Here too the objective should be to stabilize prices to our mutual advantage. The very existence of an organization of exporters whose stated purpose is to regulate prices could turn out to be helpful.

Although the developing countries need to intensify their adjustment efforts, their policies cannot hope to succeed without faster world economic growth. And this in turn can come only from the industrial countries, which likewise have an obligation to guarantee more open markets for LDC exports.

After a slowdown in the early months of this year, the industrial economies are now showing signs of recovery. The forecast is for a rise in the growth rate to 3 per cent for 1987, led by domestic demand. Longer-term forecasts extending to the early nineties project about the same growth rate.

Sustained, non-inflationary growth is within reach of the industrial economies. But to achieve it we shall require well-coordinated economic policies, in particular of demand management. Failing these, growth in the industrial countries could prove to be barely sufficient to prevent an increase in unemployment and an exacerbation of the LDCs' debt problems.

We must therefore enquire into the causes that may impede the industrial area — which is decisive for the entire world economy — from performing as well as the medium-term scenario suggests and realizing its full potential for growth.

Many industrial countries have pursued policies of "putting one's own house in order". Budget deficits have been reduced, except in the US and Italy, and even there some progress is being made. Inflationary impulses from abroad

have dropped away. Domestic costs have been brought back under control. Inflation, on the average, is about as low as can be expected. The flexibility of labour markets has increased. Companies are profitable and enjoy ample access to capital markets. A significant portion of the labour force is in search of employment.

Nonetheless, the present economic cycle is marked by a sluggishness of capital formation. Investment is held back by uncertainty, which is especially pronounced in the exchange markets. Real interest rates, both short-term and long-term, remain high. The short-sightedness of having permitted enormous trade imbalances to build up among the leading economies is now apparent.

Swept along by a vigorous economic recovery that lifted the world economy out of severe recession following the second oil shock, the United States — being as a reserve currency country relatively insensitive to external constraints, and having a low private propensity to save — allowed the dollar to appreciate by 50 per cent and pushed the Federal Government's budget deficit from 2.5 to 5.0 per cent of GNP. Just the opposite strategies were followed by Germany and Japan, countries with a high propensity to save. The result of this policy divergence was the emergence of a huge US current payments deficit and very large surpluses in the other two countries. Correspondingly, there were enormous capital flows and financial transactions, which drove up the exchange rate of the dollar and accentuated the trade imbalance. The absorption of saving from abroad has radically changed the net international payments position of the United States. It has shifted from net assets of about $150 billion in 1982 to a net liability position that by the end of this year will make the United States the world's principal debtor. No one can fail to see the risks, and not merely of an economic nature, implicit in such a rapid and profound transformation of international financial flows.

Concerted intervention by the central banks of the major industrial countries made possible, between March 1985 and the beginning of last summer, a broad realignment of exchange rates towards values more consistent with economic fundamentals. In the last few months differences of opinion over further appropriate measures have begun to emerge.

Despite its magnitude, the depreciation of the dollar has so far failed to produce any appreciable improvement in the US balance of trade. There has been no gain in the competitiveness of US products with respect to significant areas of the world economy, ranging from Latin America to the newly industrializing countries of the Far East. Japanese manufacturers have even managed to cut their export prices in yen significantly, limiting the loss of competitiveness due to the yen's appreciation against the dollar. Above all, however, it takes time for changes in the terms of trade to have a substantial impact on the volume of imports and exports. And this is all the more true when, as in this case, the deficit to be corrected is enormous.

It would be a mistake to persist with the depreciation of the dollar until the adjustment process is manifestly under way: a period of substantial exchange-rate stability is needed in order for the effects to unfold fully. Moreover, if the downward course of the dollar were to continue, the US would be exposed increasingly to imported inflation; funding the federal deficit with foreign savings could become more difficult; and the growth of external debt would risk spinning into a perverse cycle. US economic policy could find itself faced with a dilemma: an inflationary expansion of the money supply or else a rise in interest rates with heightened risks of world recession and an exacerbation of the LDCs' debt burden.

The slowness with which exchange-rate adjustments, by themselves, act to correct payments imbalances directs our attention back to the underlying causes, mentioned above, of these imbalances. Recent experience confirms that a currency realignment is only effective when it accompanies a demand management policy to re-equilibrate saving and investment in the principal economies. Central to this process must be the gradual reduction of the US budget deficit. Its necessary counterpart is offsetting measures by Germany and Japan to provide incentives for the domestic utilization of savings. Without such measures a balanced configuration of capital flows and exchange rates cannot be achieved. They are equally indispensable to prevent the contraction of the US government deficit from having a deflationary impact on the entire

world economy. Monetary policies, even while continuing to pursue the objective of price stability, can become more flexible in their stance and make their own contribution to correcting the payments imbalances.

These problems were raised, and possible solutions suggested, at the recent IMF meeting in Washington. Calls were made for stricter multilateral surveillance based on indicators designed to check the consistency between national economic policies in the medium term. There is an urgent need to settle still open questions regarding the operational content of the indicators and the procedures for their use. Finally, in a world in which elements of uncertainty are widespread, it is important that the expressed intentions and actions of national policymakers, though motivated mainly by domestic conditions, reflect greater concern for the international repercussions; and they should be formulated so as to constitute reliable points of reference.

2. Italy's external accounts and economic adjustment

The international situation sketched out above has helped the Italian economy on the cost and price side but not in the expansion of output and employment. And this should be borne in mind in assessing our economy's performance on the two fronts.

The growth of output proceeded over the first half of this year at a regular and acceptably fast pace, though slightly slower than forecast, spurred primarily by investment and consumer expenditure. After a pause during the summer months, this expansion is continuing. Looking to the immediate future, the domestic components of demand show no signs of weakening.

Under the influence of falling oil prices and the sharp depreciation of the dollar, wholesale price inflation slowed down rapidly and since this spring has actually been negative. In August the general wholesale price index was 2.1 per cent below its year-earlier level. Despite the decision to offset part of the decline in the prices of petroleum products by increasing the tax share of the government, consumer price inflation has also decelerated appreciably; however, the decline has been held back by price trends in the sectors least exposed to international competition. Provisional figures for October indicate that the twelve-month rise in the cost of living, which was 8.6 per cent last December, has fallen to just over 5 per cent. This is still twice as fast as the EEC average, but even so the differential has narrowed by about two percentage points in the past year.

Production and wholesale prices, although they have decelerated faster than those in the distributive and retail sectors, have not fully reflected the gains on the cost front. In the first half of the year final manufactures prices rose about two points more than costs, while the export prices of manufactures rose less than costs. The widening of profit margins on the domestic market thus more than offset the narrowing on markets abroad, where it was needed to safeguard competitiveness.

Between the first half of 1985 and the first half of this year, the cost of imported factors of production decreased by 6 per cent while that of domestic factors rose by 2 per cent. Unit labour costs increased by 7 per cent; on average for this year as a whole, this last increase should come down to 5.5 per cent.

The incidence of primary materials on total variable costs in industry exceeds that of all the other components put together. In the last few years personnel costs have tended to decline as a share of overall costs, while the share of spending on services has increased. Debt servicing amounts to about 3 per cent of total variable costs, and it too is shrinking with the decrease in corporate indebtedness and the decline in interest rates.

The changes in international relative prices and the depreciation of the dollar not only slowed inflation but also sharply altered the values of the goods traded. The improvement has been greater than expected. Over the first three quarters Italy's merchandise trade deficit was only 4.2 trillion lire, compared with 17.5 trillion in the same period of 1985.

The more detailed statistics available for the first six months show that import prices in lire were 14 per cent down on the corresponding period in 1985. The dollar, which is the invoicing currency for 40 per cent of total imports, was 21

per cent down against the lira. There was a 32 per cent fall in the dollar price of crude oil, which, together with other oil products purchased abroad, accounts for more than 20 per cent of Italy's imports. In line with developments in international markets there were also large reductions in the lira prices of primary materials, with the exception of those of agricultural products, which were sustained by the EC's agricultural policy. The lira prices of imported manufactures rose by about 4 per cent.

The fall in the average unit values of exports amounted to 3 per cent and was entirely attributable to oil products that were processed and then re-exported. Other export prices, including those for manufactures, rose by 1 per cent. This rise was nonetheless smaller than that recorded by the corresponding prices in international markets, reflecting the earlier-mentioned need to maintain competitiveness.

Though the real exchange rate of the lira against the other Community currencies has risen during 1986, it fell between the first half of 1985 and the first half of this year far enough to offset the loss of competitiveness vis-à-vis the dollar area. Together with more lively demand conditions in the Community, this has helped to boost Italy's exports. In value terms, sales to Community countries expanded by 16 per cent, those to the United States and the OPEC countries contracted by respectively 6 and 29 per cent, while exports to the other countries were unchanged.

With imports in value terms falling even more sharply, there was a 4 trillion lira improvement in the trade deficit with the OPEC countries, a small increase in the surplus with the United States and reductions of around 3 trillion lire in the deficits with the rest of the Community and with all other countries respectively.

The dominant role of the terms of trade in the improvement of merchandise trade is confirmed by the sectoral balances. More than 90 per cent of the reduction in the trade deficit through September of this year compared with the first nine months of 1985 was attributable to energy products. The other category to make a sizable positive contribution was textiles and clothing, while the trade deficit in chemical products worsened considerably and that in food and agricultural goods remained very large.

Viewed in long term perspective, this year's movements in the prices of oil and the dollar have reversed the developments of the twelve preceding years. Over that period the worsening in the terms of trade had strong repercussions on both domestic prices and the balance of payments. They contributed to double-digit inflation and in value terms to trade balances of a kind that made volume adjustments seem often of marginal importance.

The economic policy response to the first oil crisis put the economy on a disinflationary course and successfully fostered external adjustment. But the progress made in 1977-79 was annulled by the new rise in the price of oil and the renewed strength of the dollar.

After the second oil shock inflation reached its peak in 1980 with annual rates of 22-23 per cent for both consumer and wholesale prices. The fight against inflation was made more difficult by the persistence of adverse external conditions, in particular by the continuous appreciation of the dollar. And yet it was in this period that the tide of inflation was turned. In the autumn of 1984, notwithstanding an oil price of $30-35 per barrel and a dollar exchange rate on the point of rising above 2,000 lire, inflation dropped back into single figures for the first time in ten years.

The risk that disinflationary efforts might lead to de-industrialization was avoided by integrating incomes policy with monetary and exchange rate policy. The latter, far from introducing into the productive system attitudes of resignation and neglect, acted as a useful discipline and spur to efficiency. Business firms, sustained by public support, responded positively to these policies and made far-reaching changes in their productive structures.

Italy's economic problem today consists in completing what has been started and in knowing how to turn to its long-run advantage a terms-of-trade improvement that cannot prudently be assumed as irreversible.

To clarify further the extent of the problem, it is useful to revert to an analysis of the external accounts, which remain the basic constraint on Italy's growth.

The outstanding feature of the estimated outturn for 1986 is the improvement in the merchandise balance. Although in volume terms exports will have expanded faster than world trade, their growth rate will be less than two thirds that of imports, which have held on to their ability to penetrate the domestic market.

The trade balance is progressing well in value figures, but not in terms of constant prices. This is indicative of the precariousness of the improvement and of Italy's vulnerability to external developments.

Regarding other items of the current account, the surplus on tourism has suffered not only from non-economic factors and the fall of the dollar but also from losses of competitiveness. In the first eight months the number of visitors from Canada and the United States fell by more than 20 per cent and was compensated only partially by the increase in those from European countries. Outward tourism has continued to expand at a fast pace, partly as a result of the liberalization of exchange controls. The surplus on tourism in the first eight months is estimated to have decreased by about 1.5 trillion lire.

In the same period the deficit on income from capital, which had reached the equivalent of 60 per cent of the surplus on tourism in 1985, remained unchanged. The improvement in the current account can be expected to start having a significant effect on the interest burden only in the last few months of 1986. The government appropriations made in recent years to fund development aid have led to a sharp rise in public transfers to poor countries.

After recording a deficit of 8 trillion lire in 1985, the current account is likely to swing to a surplus of about the same amount this year.

Italy's external financial position has improved, in line with the better performance of the current account. Allowing for the effects of exchange variations and excluding gold reserves, net indebtedness should fall in relation to GDP from 7.6 per cent at the end of 1985 to about 6 per cent at the end of this year. At the same time the composition of Italy's external assets and liabilities has changed substantially. Among the former, there has been a relatively large increase in the private components of direct and portfolio investment abroad. Among the liabilities, a reduction in medium and long-term debt has been attended by an increase in short-term borrowings.

Italy's high degree of openness in commercial trade is being matched by increasing international financial integration. Partly as a result of the choice of liberalization measures adopted in recent years, capital movements unconnected with trade in goods are growing in importance. In the first nine months of 1986 capital outflows of various kinds exceeded inflows, with the overall balance of payments, both current and capital account, recording a shortfall of 1,866 billion lire.

The solidity of the country's international financial position is a guarantee for the future. It has to derive from the formation of real saving and not simply from gains provided by the terms of trade. The sustainability of external equilibrium over time depends primarily on our ability to compete in markets both at home and abroad.

The Government's objective for 1987, set out in its Forecasting and Planning Report, is to push the growth rate up to 3.5 per cent, primarily with the aim of improving the employment situation. This objective will require rigorous policies and consistent behaviour on the part of all factors of production.

Inflation has been considerably reduced and is now running at little more than 5 per cent. However, it has not been completely eradicated. External factors should not prevent us from further slowing down the rise in prices next year, but the exceptionally favourable influence of these factors in 1986 is now waning and additional progress will depend on our behaviour.

The choices to be made in the remaining part of this year with regard to public finances and the renewal of public and private sector wage agreements are of decisive importance. Over the last five years of economic adjustment those in employment have maintained or slightly increased their real gross earnings. Even today, with an economy having one of the highest growth rates in Europe, the creation of new jobs is failing to keep pace with the expansion in the labour force. In the second quarter of this year the seasonally adjusted rate of unemployment inclusive of workers on Wage Supplementation rose to 12.6 per cent.

If employment is really to be given top priority, a social pact will in effect have to be implemented and respected, though it may not need to involve formal commitments.

A policy for industrial prices aiming further to widen profit margins would not be in the general interest of the country. Neither would this be served by a policy that caused both labour and corporate incomes to rise in nominal terms. This would bring to a halt the growth phase just getting under way, postpone indefinitely the hope of reduced unemployment, rekindle inflation and erode the contact established with the advanced economies.

All our efforts must be aimed at completing the country's return to a sound economic footing and initiating a cycle of investment which, by broadening our productive base, might help to sustain growth while giving weight to the problems of Southern Italy.

To make more resources available for private and public investment, further steps will have to be taken to reduce the budget deficit.

The problem of public finances, which until recently appeared almost insuperable, could under existing conditions be reduced to less dramatic proportions within the space of two years. Notwithstanding the increase in the public debt, the fall in interest rates means that the total interest burden is likely to remain unchanged in 1987 and 1988, or even to decrease. If at the same time we succeed in reducing the deficit net of interest payments, the total borrowing requirement will come down to the equivalent of 10 per cent of GDP by the end of the second year.

In the present situation a monetary policy designed to keep the growth in credit and monetary aggregates in line with predetermined objectives does not conflict with the prospect of a fall in interest rates. In terms of nominal interest rates, the implication is that inflation should slow down further and, in real rate terms, that the demand for liquidity should ease as a result of reduced uncertainty and a better equilibrated economy.

The 100 trillion lira borrowing requirement foreseen by the Finance Bill for 1987 is in itself a demanding objective. Going on to achieve the results outlined above in 1988 while laying the foundations for further progress will require supplementary action in the major problem areas of current expenditure. Even if the effects may initially be small, such basic interventions are necessary because the problem of the public finances is a very tenacious one.

The ongoing Parliamentary debate on the Finance Bill has revealed a widespread desire to expand public investment. In such case policy consistency would imply the need for a correspondingly tighter curb on current expenditure and the related deficit.

The control of incomes and the rehabilitation of public finances are themselves interrelated and tie in closely as well with monetary and exchange rate policy. Together, these form the configuration of policies that, on several occasions during the Italian economy's most difficult years, I suggested was the one necessary to restore lasting and balanced growth at the minimum cost.

To lay solid foundations for the achievement of the country's potential for growth requires consistent policy choices and tenacious implementation.

There is always the risk that, even if only by omission, we might lapse into a retrogressive phase which could undo everything — and it is much — that has been accomplished so far.

The prediction of those who until recently believed Italy was bound to undergo a severe crisis has been refuted. Success has not been achieved by improvisation or by good luck but has been built on several years of unremitting effort, which has had the support, at times through logical confrontation, of all the factors of production.

The credibility that Italy enjoys today rests partly on the anticipation that these efforts will be completed; it is therefore up to all of us to see that they are carried out to the full.

3. Exchange reform in Italy and the EEC

The progress made in returning the economy to a sound footing has permitted a further rationalization and liberalization of Italy's

exchange regime. As I mentioned at your meeting last year, this revision was initiated in 1981 and speeded up as from the end of 1984. The efforts to develop an exchange control system corresponding to the needs of market operators has been based on a medium-term strategy.

I hardly need to remind the members of the Forex Club of all the steps in this process and I shall recall only the most recent: the abolishment of the requirement to finance exports in foreign currency; the increase in the permitted duration of foreign currency accounts; the reduction of the non-interest-bearing deposit on investment abroad to 15 per cent; and the return to external convertibility of Italian banknotes. The growth in capital flows, together with the fact that the net flow has both been outward and tended to exceed the current account surplus, confirms that the liberalization measures have been not only gradual but also substantial.

While the exchange controls were being relaxed by means of administrative provisions, the reform of the law was advancing. It was approved by Parliament a few days ago. The twelve months provided by the law for the Government to issue delegated decrees implementing the new principles will be of great importance for the objective of providing the public with a clear, streamlined and efficient legislative framework.

Law 599 of 26 September 1986 also made considerable changes in penal exchange control legislation that had been made much harsher in a particularly difficult moment for the Italian economy and then left virtually unchanged for over ten years.

Major macroeconomic issues will have to be faced in implementing the basic principle of the new legislation. Inverting the previous approach of "everything is forbidden except what is expressly permitted", the general rule is now "everything is allowed except what is expressly prohibited". The spirit of the new law and the expectations of the country provide clear guidelines for operators in assessing their opportunities for trade and investment.

Regarding the problems underlying the choices that will have to be made, I should like to offer some comments of both substance and approach.

I hold it essential that we reaffirm and fully implement the pre-eminent principle of *freedom of trade.* This is fundamental for a better allocation of resources at the world level and hence for growth and employment. Industrial and commercial firms need to know with absolute certainty that the international flow of goods will not be obstructed in any way. This certainty is threatened today by a resurging spectre of protectionism and its ensuing prospect of market fragmentation and a brake on economic activity.

The relationship of freedom of capital movements to this key principle is one of complementary subordination. The two cannot and must not be allowed to come into conflict.

Accordingly, as we move towards a more liberal regime, it will be necessary to fix the scope and instruments of potential intervention in international financial transactions. There will have to be an *ex ante* decision as to which types of transaction will be liable to restrictions when the needs of monetary policy or the balance of payments, to which the new law subjects such restrictive measures, call for their application.

In the first place a distinction has to be made between financial transactions connected with productive activity in the broad sense and those serving to take advantage of transitory opportunities for profit offered by actual or expected changes in the returns on financial assets denominated in different currencies.

This does not imply a lack of appreciation for the valuable contribution that more integrated money and financial markets can make to the growth of international economic activity. I am merely expressing my conviction, supported by recent studies conducted by international institutions, that some categories of financial intermediation have an inherent destabilizing potential which can have major repercussions on world trade. Affirming the need to be able to control financial flows of these kinds implies a commitment not to make merchandise trade bear the cost of adjusting imbalances produced by financial market forces, which can cause exchange rates to diverge from their fundamental equilibrium values.

It is surprising that, with the strains and imbalances which international events thrust constantly before our eyes, these considerations

come often to be obscured and even to be taken by some as evidence of cultural backwardness.

Regarding the practicalities of intervention one may usefully recall certain technical points. An exchange control system aiming to regulate capital flows temporarily in cases of need must provide for the possibility of influencing the yield differential between domestic and foreign assets. This variable is a function of both interest rates and exchange rate expectations. A variety of instruments can be used to lower the yields on foreign assets. They have different implications for efficiency and operating costs and raise various problems regarding conformance with Community guidelines. As time passes, moreover, their effectiveness tends to wane and they create distortions.

Recourse to such instruments, chosen on the basis of an analysis of their costs and benefits, cannot be considered as a permanent substitute for other economic policy interventions. Their use gains time in which to assess the causes and extent of the undesired developments and then to tackle them with monetary, fiscal and incomes policy measures. In the end, responsibility for overcoming external disequilibria falls on macroeconomic policy. The greater the international integration of a country's economic and financial system, the more this holds true.

Accordingly, just as it would be imprudent to underrate the risks that freedom of capital movements involves for the domestic and external equilibrium of the Italian economy, it is necessary to resist every attempt to reproduce today's system of controls, in a sort of photographic negative, under the new arrangements.

The important *de jure condendo* phase through which Italy is passing has coincided with renewed EEC activity in the liberalization of capital movements. The aim is to establish a single European market for goods, services and factors of production by 1992. This project has far-reaching implications not only for capital movements but also for banking and financial services. It involves the commitment to remove restrictions introduced in the past according to a predetermined timetable and to prepare new Directives on capital movements, monetary flows and banking activity.

These plans are of great importance but unfortunately they have been formulated at a time of strains and instability in international monetary relations. At certain times the dollar's downward slide has put the cohesion of the EMS to a test. Underlying these strains it is possible to detect the increased influence of financial transactions, often unrelated to actual or foreseeable developments in fundamental economic conditions.

As with the creation of the common market for goods in the fifties, exchange liberalization will provide a good opportunity for Italy to establish itself in world financial markets. As then, it will be necessary to take up the challenge that always accompanies the release of market forces — the challenge to succeed in respecting the rules of the game that we shall have helped to draw up, strengthening the economy and pursuing policies that safeguard external competitiveness.

The new phase of liberalization entails obligations and constraints not only for Italy but for the whole European Community. A system consisting of many countries, seeking to maintain fixed exchange rates among themselves and to liberalize both trade flows and capital movements, cannot operate with conflicting national economic policies and widely differing regulatory systems for markets and intermediaries. It is true that the EEC policy of promoting coordination and harmonization *before* undertaking liberalization came to a dead end. But it needs to be very strongly emphasized that the option "libéralisation d'abord" also lacks in realism. Indeed, it can even threaten the ultimate aims the process is intended to achieve unless *simultaneous* steps are taken to strengthen the procedures and instruments for the coordination of monetary and fiscal policies and to harmonize the basic aspects of national regulations.

The experience of the major industrialized countries, which have policies of complete freedom for capital movements, shows that financial flows do not necessarily promote convergence. Indeed, they may render imbalances more acute by causing undesired changes in real exchange rates and encouraging protectionism. If serious tensions were to develop in Europe, where there is a common market and an agreement to maintain stable exchange rates, a country that

found itself in difficulty in coping with large outflows of capital and did not wish to restrict them would paradoxically have to choose between trade restrictions and withdrawal from the EMS. In this way two basic pillars of European economic integration would be undermined.

The Community authorities are well aware of these grounds for concern and did not consider it advisable in confirming the objective of a "single integrated internal market" to drop the safeguards provided in Articles 73 and 108 of the Treaty of Rome. The aim, in practice, was to indicate that removal of permanent restrictions on capital movements within the Community does not imply renouncing the ability to control them. The Directive on movements of a monetary nature will also be based on the principle that restrictions on short-term inflows may be introduced for purposes of domestic monetary control. The issue is nonetheless broader than this. Difficulties in monetary control can be caused not only by inflows but also by outflows of capital. The latter, moreover, can produce serious balance-of-payments problems, even under conditions of complete financial integration.

This is not a call for a reconsideration of existing undertakings. The aim is to promote discussion within the Community institutions leading to understandings on how to cope with crises in countries' capital markets and external accounts so as to safeguard the working of the EMS and freedom of trade. One wants to avoid that, through a failure to prepare adequate supports, one is forced to take retrogressive steps. This would undermine faith in the pursuit of the ultimate objective of economic and monetary unification.

The prevention and, if ever necessary, the management of crises would benefit from a reorganization of the EEC financial instruments. In addition to increasing their availability, it will be necessary to redefine the cases in which they can be used, with explicit reference to "outflows of capital". The financial armoury must act as a deterrent, so the possibility for countries to have rapid recourse to it on an adequate scale should be made clear.

Italy has raised these issues in the Community. Calm examination of the problems that exchange liberalization can bring, together with the preparation of instruments for anticipating and coping with them, is the best way to ensure accident-free progress. We have acted in this belief. And, as convinced supporters of European unification, it is in this sense that we believe ourselves to be making a concrete contribution, based on the pragmatic implementation of a strategic line of action, to the integration of the European economy and the strengthening of the Community's institutions.

Appendix

Statistical tables

The world economy

The Italian economy

Money, credit and interest rates

Table a1

Gross product, implicit price deflator and current account balance

	US	Japan	Germany	France	UK	Italy	Canada
			Real GNP (1)				
			(% changes on previous period; seasonally adjusted data)				
1980	−0.2	4.3	1.5	1.0	−2.3	3.9	1.5
1981	1.9	3.7	—	0.2	−1.3	0.2	3.7
1982	−2.5	3.1	−1.0	2.0	1.3	−0.5	−3.3
1983	3.6	3.2	1.5	0.7	3.6	−0.2	3.1
1984	6.4	5.1	3.0	1.6	2.0	2.8	5.5
1985	2.7	4.6	2.4	1.3	3.1	2.3	4.0
1985 — 1st qtr	0.8	0.4	−0.8	−0.2	1.0	0.3	0.8
2nd "	0.6	1.4	1.7	0.9	1.1	1.3	0.4
3rd "	1.0	0.7	1.7	1.0	—0.1	0.6	0.8
4th "	0.5	1.4	−0.1	0.6	0.8	−0.2	1.8
1986 — 1st qtr	0.9	−0.5	−1.7	0.1	1.1	−0.3	0.5
2nd "	0.2	0.9	2.0	1.1	0.5	2.8	0.8
			GNP deflator (1)				
			(% changes on previous period; seasonally adjusted data)				
1980	9.1	3.8	4.8	11.8	19.9	20.8	10.6
1981	9.6	3.2	4.0	12.0	11.8	18.3	10.8
1982	6.5	1.8	4.4	12.0	7.3	17.8	8.9
1983	3.9	0.8	3.2	9.4	5.1	14.9	4.9
1984	3.9	1.3	1.9	7.0	4.0	10.8	3.6
1985	3.3	1.6	2.1	6.1	6.0	8.8	3.4
1985 — 1st qtr	0.9	0.7	0.8	1.3	1.9	2.7	1.0
2nd "	0.9	0.2	−0.3	2.0	1.1	2.8	1.2
3rd "	0.6	0.6	1.3	1.9	1.7	2.0	1.2
4th "	0.9	0.4	0.6	0.6	2.4	1.6	0.4
1986 — 1st qtr	0.5	0.6	1.4	1.1	0.5	2.3	0.4
2nd "	0.6	....	....	....	....	2.1	....
			Current account balance (2)				
			(billions of dollars)				
1980	1.9	−10.7	−15.9	−4.2	7.5	−9.7	−1.0
1981	6.3	4.8	−5.0	−4.8	13.1	−8.2	−5.1
1982	−9.1	6.8	3.9	−12.1	6.9	−5.5	2.1
1983	−46.6	20.8	4.2	−5.2	4.7	0.8	1.4
1984	−106.5	35.0	6.8	−0.9	1.9	−2.9	1.9
1985	−117.7	49.2	13.9	0.9	5.3	−4.2	−1.9
1985 — 1st qtr	−26.1	6.8	1.5	−1.7	−0.8	−1.4	−0.7
2nd "	−29.4	13.3	3.0	1.1	1.3	−2.4	—0.3
3rd "	−28.5	13.1	2.0	—	2.1	0.2	—0.6
4th "	−33.7	16.0	7.4	1.5	2.7	−0.6	−0.3
1986 — 1st qtr	−34.0	12.7	6.9	−0.4	0.2	−1.8	−2.0
2nd "	−34.7	23.2	8.2	1.0	....	0.6	−1.3

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 and Italy.

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	−3.4	−1.6	0.9
1982	−7.1	0.4	−2.9	−2.0	1.9	−3.1	−10.7
1983	6.0	3.6	0.7	1.0	3.6	−3.2	6.0
1984	11.5	11.0	3.4	2.0	1.3	3.4	8.5
1985	2.2	4.5	5.4	—	4.7	1.2	4.2
1984 — 2nd qtr.	1.8	2.5	−4.0	−3.0	−1.8	2.2	0.9
3rd "	1.6	1.7	6.3	2.0	0.2	1.8	3.0
4th "	−0.2	2.6	1.0	—	1.3	−0.8	−0.1
1985 — 1st qtr.	0.5	−0.3	1.0	−1.0	2.6	−0.1	0.2
2nd "	0.3	2.2	1.0	—	2.3	1.0	1.2
3rd "	0.5	—	1.9	3.0	−0.6	−1.0	2.2
4th "	0.5	−0.8	—	—	—	0.7	1.5
1986 — 1st qtr.	0.1	0.1	—	−2.9	0.8	2.0	−0.3
2nd "	−0.7	0.2	0.9	....	−0.7	0.5	....
1985 — July	−0.2	1.6	2.9	3.0	0.1	−2.3	1.5
Aug.	0.9	−1.1	−2.8	—	0.4	0.8	—
Sept.	−0.1	−0.7	—	−2.0	1.1	0.4	−0.1
Oct.	−0.6	0.2	2.9	1.0	−0.8	−0.8	0.9
Nov.	0.9	−0.4	—	3.0	1.2	2.1	0.8
Dec.	0.8	0.2	−4.6	−4.8	−2.3	−1.1	−0.1
1986 — Jan.	0.3	—	2.9	—	1.0	1.3	0.2
Feb.	−0.9	0.4	—	1.0	1.4	0.2	0.6
Mar.	−1.0	−0.5	−0.9	—	−0.4	2.0	−3.1
Apr.	0.8	0.1	3.8	4.0	0.7	−0.4	3.1
May.	−0.6	0.3	−3.7	−5.8	−1.8	−1.8	−2.1
June	−0.3	0.2	1.9	3.1	−1.2	2.3	....
July	−0.1	−0.3	1.4	....	....	−0.9	....

Sources: National bulletins and OECD.

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	2.1	2.2	5.8	6.3	9.2	4.0
1984 — 2nd qtr.	4.3	2.1	2.8	7.8	4.6	11.4	4.6
3rd "	4.2	2.0	2.0	7.3	4.7	10.5	3.8
4th "	4.1	2.4	2.1	6.8	5.2	9.4	3.8
1985 — 1st qtr.	3.5	2.0	2.3	6.5	5.9	9.3	3.7
2nd "	3.7	2.1	2.5	6.4	7.3	9.4	4.0
3rd "	3.4	2.2	2.2	5.6	6.6	9.1	4.1
4th "	3.5	1.9	1.8	4.8	5.5	8.9	4.2
1986 — 1st qtr.	3.1	1.4	0.7	3.6	4.9	7.5	4.2
2nd "	1.6	0.9	−0.1	2.4	2.7	6.1	3.8
1985 — July	3.6	2.4	2.3	6.1	7.4	9.4	3.8
Aug.	3.3	2.5	2.1	5.6	6.5	9.1	4.1
Sept.	3.2	1.9	2.2	5.3	6.0	8.8	4.2
Oct.	3.2	2.1	1.8	4.9	5.5	8.9	4.3
Nov.	3.6	1.9	1.8	4.8	5.4	8.9	4.0
Dec.	3.7	1.6	1.8	4.7	5.6	8.8	4.4
1986 — Jan.	3.9	1.4	1.3	4.2	5.6	8.2	4.2
Feb.	3.2	1.8	0.7	3.4	5.1	7.3	4.2
Mar.	2.2	1.1	0.2	3.0	4.3	7.0	4.1
Apr.	1.5	0.9	−0.1	2.6	3.1	6.4	3.8
May	1.5	1.1	−0.2	2.3	2.7	6.1	4.0
June	1.8	0.6	−0.2	2.3	2.4	5.8	3.7
July	1.6	0.1	−0.4	2.0	2.2	....	4.1
Aug.	1.6	0.1	−0.4	2.0	....	....	4.3

Sources: National bulletins and OECD.

Wholesale prices

(% changes on corresponding period)

	US	Japan	Germany (1)	France (1)	UK (1)	Italy	Canada (1)
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	6.7
1983	1.8	−1.9	1.5	11.4	5.5	9.7	3.5
1984	2.7	—	2.8	13.1	6.1	10.4	4.5
1985	−0.9	−1.0	2.0	3.9	5.5	7.3	2.7
1984 — 2nd qtr.	3.6	−1.0	3.1	14.1	6.3	11.5	4.6
3rd "	2.7	—	2.7	12.1	6.2	10.3	4.4
4th "	0.9	1.0	2.5	10.3	6.1	8.8	4.1
1985 — 1st qtr.	—	1.0	2.7	8.7	5.9	8.4	3.6
2nd "	−0.9	—	2.6	6.5	5.6	8.3	2.8
3rd "	−1.7	−2.0	2.0	3.2	5.6	6.9	2.0
4th "	—	−4.0	0.9	−1.1	5.1	5.9	2.6
1986 — 1st qtr.	−1.7	−5.9	−1.3	....	5.0	2.5	2.3
2nd "	−3.5	−9.0	−3.0	....	4.5	−1.4	0.4
1985 — July	−0.9	−1.0	2.2	3.2	5.6	7.5	2.0
Aug.	−1.7	−2.0	2.0	3.2	5.7	6.9	1.9
Sept.	−0.9	−2.0	1.8	0.6	5.5	6.4	2.2
Oct.	—	−3.0	1.1	−0.6	5.1	5.9	2.5
Nov.	−0.9	−4.0	1.1	−1.3	5.2	5.8	2.4
Dec.	—	−4.0	0.6	−1.8	5.2	5.9	2.7
1986 — Jan.	—	−5.0	−0.3	....	5.1	4.8	2.9
Feb.	−1.7	−5.9	−1.4	....	4.9	2.5	2.6
Mar.	−2.6	−7.9	−2.0	....	4.9	0.3	1.5
Apr.	−3.5	−8.9	−2.6	....	4.5	−0.8	0.9
May	−3.5	−9.9	−3.2	....	4.6	−1.8	—
June	−3.5	−10.0	−3.2	....	4.5	−1.8	0.2
July	−3.5	−11.0	−3.8	....	4.4	−2.2	0.2
Aug.	−1.8	−11.2	....	....	4.3	−2.1	0.6

Sources: National bulletins and OECD.
(1) Producer prices of manufactures.

Table a5

Short-term interest rates

	US	Japan	Germany	France	UK	Italy	Canada
Official reference rates (1) *(end-of-period data)*							
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 — 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	9.3
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
1986 — Jan.	7.5	4.5	4.0	9.5	12.5	15.0	10.8
Feb.	7.5	4.5	4.0	9.5	12.5	15.0	11.8
Mar.	7.0	4.0	3.5	9.5	11.5	14.0	10.4
Apr.	6.5	3.5	3.5	9.5	10.5	13.0	9.3
May	6.5	3.5	3.5	9.5	10.0	12.0	8.6
June	6.5	3.5	3.5	9.5	10.0	12.0	8.8
July	6.0	3.5	3.5	9.5	10.0	12.0	....
Aug.	5.5	3.5	3.5	9.5	10.0	12.0	....
Money market rates (2) *(monthly averages)*							
1980 — Dec.	18.9	9.5	10.2	10.9	13.1	17.0	17.0
1981 — Dec.	12.4	6.7	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 — 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.	8.3	8.0	4.8	9.0	11.1	13.1	9.2
1986 — Jan.	8.1	6.8	4.7	8.8	11.9	13.7	10.5
Feb.	7.9	5.8	4.5	8.8	12.0	13.6	11.5
Mar.	7.5	5.5	4.5	8.5	11.1	13.2	10.2
Apr.	7.0	4.7	4.5	8.2	10.0	12.4	9.0
May	6.8	4.2	4.6	7.5	9.7	11.2	8.3
June	6.9	4.4	4.6	7.2	9.3	10.8	8.6
July	6.6	4.6	4.6	7.2	9.5	10.7	....
Aug.	6.2	4.6	4.6	7.0	9.4	10.4	....

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.

Long-term interest rates and share price indices

(monthly averages)

	US	Japan	Germany	France	UK	Italy	Canada
				Bond rates (1)			
1980 — Dec.	12.5	9.4	8.9	13.7	13.7	16.2	12.7
1981 — Dec.	13.7	7.9	9.7	16.0	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	6.9	8.2	13.3	10.4	17.7	12.0
1984 — Dec.	11.6	6.3	7.0	11.8	10.5	14.5	11.7
1985 — Aug.	10.7	6.1	6.4	10.8	10.4	14.1	10.8
Sept.	10.8	5.9	6.3	10.9	10.4	13.8	11.0
Oct.	10.7	6.7	6.5	10.7	10.2	13.8	10.7
Nov.	10.2	6.4	6.6	10.5	10.4	13.7	10.3
Dec.	9.7	5.8	6.5	10.5	10.5	13.7	10.0
1986 — Jan.	9.6	5.8	6.3	10.3	10.8	13.5	10.5
Feb.	9.1	5.2	6.2	9.7	10.4	13.8	10.0
Mar.	8.1	4.7	5.9	8.7	9.4	13.4	9.5
Apr.	7.5	4.7	5.5	7.9	8.8	12.3	9.3
May	7.8	5.1	5.8	7.8	9.0	10.9	9.5
June	7.7	5.0	6.0	8.2	9.3	10.9	9.4
July	7.3	5.1	5.8	7.8	9.4	11.1	....
Aug.	7.3	4.8	5.7	7.7	9.5	10.8	....
				Share price indices (1975 = 100)			
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 — 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	290.0
1986 — Jan.	244.7	332.5	314.0	376.2	510.5	484.2	284.3
Feb.	257.7	342.2	301.5	410.0	541.6	546.4	285.6
Mar.	272.5	370.8	313.0	443.2	592.0	685.6	304.7
Apr.	278.7	396.2	333.6	517.3	613.4	819.5	307.9
May	279.9	404.8	309.4	532.6	595.7	924.4	312.2
June	289.1	427.9	300.1	477.4	599.8	773.1	308.6
July	283.2	447.4	282.3	461.3	593.9	786.1	....
Aug.	285.6	476.1	303.5	530.8	588.7	896.9	....

Sources: National bulletins and IMF.
(1) Rates on government bonds.

Table a7

Interest rates and US dollar premium/discount on international markets

(end-of-period data)

	US dollar	Japanese yen	Deutsche-mark	Pound sterling	US dollar	Japanese yen	Deutsche-mark	Pound sterling
	Rates on 3-month Eurodeposits				**Rates on 12-month Eurodeposits**			
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 — Dec.	7.88	6.56	4.75	11.81	7.94	6.38	4.81	11.69
1986 — Jan.	7.94	6.13	4.57	12.81	8.13	6.00	4.63	12.63
Feb.	7.75	5.88	4.44	12.31	7.75	6.56	4.38	11.69
Mar.	7.31	5.25	4.44	11.31	7.25	5.06	4.44	10.25
Apr.	6.75	4.81	4.50	10.38	6.81	4.69	4.44	9.50
May	7.00	4.75	4.56	9.81	7.25	4.88	4.75	9.44
June	6.75	4.88	4.50	9.81	6.81	4.63	4.63	9.63
July	6.38	4.75	4.56	9.94	6.50	4.69	4.63	9.94
Aug.	5.56	4.75	4.31	9.81	5.69	4.63	4.31	9.56
Sept.	6.06	4.94	4.56	10.56	6.25	4.84	4.69	10.88
	3-month US dollar premium/discount				**12-month US dollar premium/discount**			
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 — Dec.		1.32	3.13	−3.93		1.56	3.13	−3.75
1986 — Jan.		1.81	3.37	−4.87		2.13	3.50	−4.50
Feb.		1.87	3.31	−4.56		1.19	3.37	−3.94
Mar.		2.06	2.87	−4.00		2.19	2.81	−3.00
Apr.		1.94	2.25	−3.63		2.12	2.37	−2.69
May		2.25	2.44	−2.81		2.37	2.50	−2.19
June		1.87	2.25	−3.06		2.18	2.18	−2.82
July		1.63	1.82	−3.56		1.81	1.87	−3.44
Aug.		0.81	1.25	−4.25		1.06	1.38	−3.87
Sept.		1.12	1.50	−4.50		1.41	1.56	−4.63

Source: Morgan Guaranty, *World Financial Markets.*

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	1,113.5	1,189.2	589.50
1981	1,138.0	5.1567	502.91	209.18	2,286.7	580.30	1,341.9	1,263.4	397.50
1982	1,353.6	5.4382	557.26	206.08	2,362.0	666.47	1,494.4	1,323.7	456.90
1983	1,519.2	6.3995	594.53	199.43	2,301.7	722.77	1,624.0	1,349.7	381.50
1984	1,756.5	7.3905	617.27	201.08	2,339.8	747.54	1,800.4	1,380.9	308.30
1985	1,909.7	8.0240	650.26	213.08	2,462.5	780.26	1,931.4	1,442.1	326.15
1984 — 3rd qtr. ..	1,797.4	7.3831	616.26	200.81	2,332.3	736.22	1,819.1	1,379.0	343.75
4th " ..	1,809.2	7.6843	619.20	202.00	2,301.0	751.21	1,879.4	1,380.9	308.30
1985 — 1st qtr. ..	2,021.5	7.8515	620.96	203.12	2,253.9	733.96	1,954.8	1,381.6	329.25
2nd " ..	1,970.5	7.8587	638.01	209.20	2,474.1	759.60	1,955.4	1,430.4	317.75
3rd " ..	1,896.6	7.9333	664.06	217.77	2,602.1	805.63	1,948.2	1,483.6	325.75
4th " ..	1,751.7	8.4526	677.37	222.00	2,515.0	820.74	1,888.8	1,494.1	327.00
1986 — 1st qtr. ..	1,599.6	8.5203	680.94	221.77	2,302.3	808.52	1,799.4	1,476.1	344.00
2nd " ..	1,538.9	9.0712	685.67	215.56	2,321.9	825.61	1,786.7	1,475.7	346.75
3rd " ..	1,436.9	9.2194	688.50	211.85	2,141.3	851.35	1,728.3	1.454,4	423.20
1985 — Aug.	1,871.4	7.8896	670.45	219.56	2,593.1	816.34	1,933.9	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	1,901.7	1,492.9	325.10
Nov.	1,751.2	8.6050	675.58	221.71	2,522.3	823.23	1,891.4	1,492.5	325.30
Dec.	1,713.4	8.4619	681.84	223.07	2,480.9	815.31	1,867.2	1,497.2	327.00
1986 — Jan.	1,665.3	8.3237	681.86	222.26	2,372.0	805.27	1,828.3	1,484.9	350.50
Feb.	1,587.9	8.6071	680.55	221.77	2,268.7	812.35	1,792.9	1,472.4	338.15
Mar.	1,542.3	8.6400	680.36	221.25	2,262.7	818.10	1,771.1	1,470.6	344.00
Apr.	1,556.9	8.8883	684.81	216.13	2,329.3	818.55	1,790.5	1,476.1	345.75
May	1,528.7	9.1655	685.94	215.29	2,325.5	824.87	1,786.4	1,476.0	343.20
June	1,531.5	9.1549	686.23	215.28	2,310.8	833.45	1,783.6	1,475.1	346.75
July	1,478.5	9.3234	686.58	213.35	2,232.2	847.04	1,758.4	1,463.9	357.50
Aug.	1,420.8	9.2217	688.62	211.29	2,110.9	854.96	1,717.0	1,450.5	384.70
Sept.	1,408.2	9.1086	690.41	210.79	2,073.9	852.57	1,704.6	1,448.1	423.20

(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	108.9	100.3	113.1	96.8	94.0	102.2	90.7	102.6
1982	120.1	100.1	106.2	102.6	86.8	98.3	85.0	110.9
1983	123.1	101.5	116.3	106.5	80.5	91.1	82.0	115.8
1984	131.1	98.4	123.5	106.1	77.7	87.6	78.5	114.7
1985	135.4	93.7	126.0	106.2	78.4	87.1	74.2	113.6
1984 — 3rd qtr.	134.0	97.5	122.1	105.8	77.5	87.0	78.4	112.8
4th "	137.2	98.0	123.6	105.0	77.2	84.3	77.6	114.1
1985 — 1st qtr.	144.2	96.7	122.3	104.5	77.1	81.3	77.0	110.7
2nd "	140.0	94.4	121.9	105.1	77.7	88.1	75.0	111.5
3rd "	133.6	93.5	123.2	106.7	78.8	91.0	72.6	115.0
4th "	124.0	90.6	136.5	108.4	80.1	87.8	72.2	116.9
1986 — 1st qtr.	117.5	87.5	145.8	111.1	81.3	81.9	73.4	117.6
2nd "	111.5	87.7	157.9	111.9	78.7	82.7	73.6	120.0
3rd "	106.5	86.7	167.5	114.2	78.3	77.5	74.7	126.1
1985 — Aug.	132.1	93.6	123.0	107.3	79.1	90.3	72.2	116.2
Sept.	133.2	92.9	124.5	107.0	79.0	90.0	72.1	115.7
Oct.	126.1	91.7	132.8	108.0	79.8	88.5	72.2	117.3
Nov.	123.2	90.6	139.0	108.0	79.9	88.0	72.2	117.3
Dec.	122.4	89.2	138.3	109.3	80.5	86.8	72.1	116.2
1986 — Jan.	121.5	88.2	138.7	110.5	80.9	84.0	72.9	116.1
Feb.	116.6	87.3	147.9	111.2	81.5	80.8	73.5	118.4
Mar.	114.1	87.0	150.9	111.6	81.6	81.1	73.8	118.2
Apr.	113.2	87.8	153.8	111.8	78.9	82.9	73.5	118.8
May	110.4	88.1	160.0	111.9	78.5	82.8	73.6	119.8
June	110.9	87.3	160.0	112.0	78.6	82.3	73.6	121.1
July	107.8	87.3	166.1	112.8	78.3	80.2	74.1	124.1
Aug.	105.8	86.3	168.8	114.6	78.3	76.7	74.9	127.1
Sept.	105.7	86.4	167.8	115.3	78.3	75.6	75.1	127.1

(1) Weighted on the basis of shares in trade with the 14 leading countries. — For the method of calculation, see the "*Note Metodologiche*" section of the Appendix to Banca d'Italia, *Relazione Annuale sul 1983*.

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	112.5	100.6	104.7	93.3	97.5	102.7	97.9	99.6
1982	121.2	103.1	94.0	96.4	94.3	100.0	97.9	103.6
1983	122.4	106.5	99.4	96.9	92.0	94.0	100.3	104.6
1984	128.6	105.8	101.8	94.4	91.7	91.8	101.7	102.3
1985	130.4	102.8	100.8	93.2	95.5	94.0	101.1	100.2
1984 — 2nd qtr.	125.3	104.8	103.0	95.3	91.9	93.0	101.8	102.4
3rd "	131.2	105.4	100.4	93.9	91.8	91.5	102.1	100.6
4th "	133.7	105.8	101.0	92.9	92.3	88.9	102.1	101.7
1985 — 1st qtr.	138.8	105.8	99.2	92.0	92.6	86.2	102.6	98.6
2nd "	134.9	103.1	97.7	92.1	94.4	94.9	101.0	98.8
3rd "	128.3	102.7	98.4	93.7	96.5	98.7	98.2	101.1
4th "	119.7	99.7	108.0	95.0	98.5	96.2	98.1	102.5
1986 — 1st qtr.	111.7	98.9	115.2	97.4	100.3	92.1	101.2	102.3
2nd "	104.9	99.9	124.2	97.8	98.8	95.9	101.9	103.5
1985 — June	134.1	103.1	97.6	92.1	94.6	96.2	101.2	98.8
July	129.8	103.3	97.9	92.9	95.9	100.2	98.6	99.9
Aug.	127.3	102.5	98.3	94.2	96.9	98.1	97.9	101.4
Sept.	127.8	102.2	99.1	93.9	96.5	98.0	98.0	101.9
Oct.	121.5	100.8	105.4	94.8	97.9	96.6	98.6	103.2
Nov.	119.1	99.7	109.6	94.6	98.3	96.4	98.7	102.9
Dec.	118.5	98.5	108.8	95.6	99.2	95.6	99.2	101.3
1986 — Jan.	116.9	98.4	109.4	96.6	99.7	93.1	100.7	101.4
Feb.	111.0	98.9	116.8	97.6	100.2	90.9	101.1	103.1
Mar.	107.4	99.4	119.3	98.0	101.1	92.3	101.8	102.5
Apr.	106.1	100.5	121.1	97.9	98.6	95.8	101.6	103.1
May	104.0	100.0	126.2	97.9	98.6	96.3	101.8	103.3
June (2)	104.7	99.2	125.2	97.7	99.2	95.7	102.2	104.2
July (2)	101.1	99.9	129.8	98.1	99.8	93.7	102.8	106.7
Aug. (2)	99.5	98.9	131.8	99.6	99.8	90.0	104.4	109.0

Source: Based on IMF, OECD and Istat data. For the method of calculation, see the *Note Metodologiche* section of the Appendix to Banca d'Italia, *Relazione Annuale sul 1983*.

(1) Based on wholesale prices of manufactures. The construction of an index of Italian producer prices including oil products, to improve comparability with the other countries, and the similar transformation of the OECD index for the Netherlands (Main Economic Indicators) have entailed a revision of the series shown in this table. — (2) Provisional and partly estimated data.

Table a11

Sources and uses of income

(% changes on previous period)

	SOURCES			USES					
				Gross fixed investment					
	GDP	Imports	Total	Buildings	Equipment and vehicles	Total	Household consumption	Other domestic uses	Exports
					At 1970 prices				
1981	0.2	−5.3	−0.8	0.5	0.8	0.6	0.5	−14.7	5.2
1982	−0.5	1.5	−0.2	−3.2	−7.3	−5.2	0.5	2.2	0.4
1983	−0.2	−0.4	−0.2	−1.9	−6.1	−3.8	−0.3	−1.5	3.4
1984	2.8	9.2	4.0	−0.5	14.1	6.2	1.9	6.2	6.5
1985	2.3	9.4	3.6	−1.7	10.0	4.1	1.9	2.3	8.2
1984 — 1st qtr.	0.9	2.8	1.2	−0.1	3.8	1.7	1.0	5.0	−0.5
2nd ".	0.4	3.6	0.9	−1.3	5.6	2.0	0.3	4.6	−0.4
3rd ".	1.3	3.6	1.7	1.6	3.1	2.3	−0.1	0.9	6.6
4th ".	—	5.6	1.1	−1.5	5.9	2.2	0.3	2.9	1.1
1985 — 1st qtr.	0.3	1.1	0.4	−0.9	3.4	1.3	0.7	−4.4	2.2
2nd ".	1.3	−0.8	0.9	0.6	−0.3	0.1	0.8	4.2	−0.2
3rd ".	0.6	0.8	0.6	−1.5	−0.5	−1.0	0.7	−1.3	2.7
4th ".	−0.2	5.7	0.9	0.5	−1.5	−0.6	0.3	2.3	2.5
1986 — 1st qtr.	−0.3	2.9	0.3	−1.7	−1.6	−1.7	0.4	3.5	−0.3
2th ".	2.8	−3.5	1.5	1.0	5.2	3.2	0.9	−2.1	4.1
					Implicit price deflators				
1981	18.3	27.7	20.0	22.7	17.3	20.5	19.2	24.8	20.7
1982	17.8	11.6	16.6	18.0	13.5	16.4	17.1	16.1	15.7
1983	14.9	5.4	12.8	14.1	8.8	12.3	15.2	13.7	7.3
1984	10.8	11.0	11.0	11.4	8.4	9.0	11.1	13.1	10.4
1985	8.8	7.3	8.7	9.2	6.7	7.1	9.4	8.9	8.2
1984 — 1st qtr.	2.6	2.3	2.6	2.9	3.2	2.7	2.6	0.7	3.0
2nd ".	2.1	2.7	2.3	2.3	1.6	1.4	2.6	2.9	0.5
3rd ".	1.2	2.3	1.5	2.1	2.1	2.0	2.0	−0.8	2.1
4th ".	1.5	2.4	1.9	2.4	−0.1	0.7	2.0	1.6	2.3
1985 — 1st qtr.	2.7	3.9	3.0	2.8	1.0	1.6	2.7	6.0	3.5
2nd ".	2.8	1.9	2.5	2.1	3.7	2.9	2.6	1.8	2.1
3rd ".	2.0	−2.6	1.0	1.7	2.2	1.8	1.8	−0.8	0.7
4th ".	1.6	−1.7	1.0	1.0	1.5	1.4	1.8	1.0	−1.3
1986 — 1st qtr.	2.3	−6.0	0.5	−0.1	1.4	0.6	1.6	0.2	−2.5
2nd ".	2.1	−8.2	0.1	0.7	−0.4	−0.1	1.2	−0.3	−1.5

Source: Istat, seasonally adjusted data.

Industrial production and business opinion indicators

(seasonally adjusted data (1))

	INDUSTRIAL PRODUCTION				ISCO BUSINESS OPINION INDICATORS				
					Changes in level of orders			Expected demand in 3-4 months	Stocks of finished goods vis-à-vis normal (2)
	General index	Consumer goods	Investment goods	Intermediate goods	Domestic	Foreign	Total		
	(indices, 1980 = 100)				*(average balance of monthly responses)*				
1981	98.4	97.4	103.4	97.4	−46.8	−42.0	−45.7	−12.5	16.6
1982	95.4	97.6	95.8	93.7	−53.6	−49.1	−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	94.4	95.2	−27.0	−26.6	−24.6	7.5	8.4
1985	96.5	97.5	99.2	94.9	−22.5	−30.1	−20.8	8.2	7.7
1981 — 1st qtr.	98.8	96.1	105.0	98.5	−47.3	−45.6	−46.4	−15.3	16.7
2nd "	99.9	98.2	107.1	98.7	−48.5	−44.7	−48.0	−9.9	18.7
3rd "	97.7	97.6	102.4	96.1	−45.5	−39.2	−41.9	−13.2	17.3
4th "	97.3	97.9	99.0	96.3	−45.9	−38.5	−46.7	−11.6	13.7
1982 — 1st qtr.	98.7	98.8	101.3	97.7	−49.1	−43.3	−47.1	−8.4	15.7
2nd "	95.7	97.3	96.9	94.2	−50.4	−47.3	−50.4	−11.5	18.0
3rd "	94.8	97.4	94.3	93.2	−54.6	−53.0	−53.9	−15.5	19.7
4th "	92.4	97.1	90.8	89.8	−60.3	−53.1	−59.1	−22.3	16.0
1983 — 1st qtr.	91.9	95.8	91.7	89.3	−59.0	−53.0	−58.6	−18.1	15.7
2nd "	90.9	93.4	90.5	89.4	−56.8	−46.9	−55.4	−10.8	19.0
3rd "	92.4	93.5	93.3	91.3	−50.9	−46.4	−48.5	−3.1	13.7
4th "	94.1	94.1	95.1	93.8	−43.1	−37.2	−42.4	1.5	7.0
1984 — 1st qtr.	93.3	92.9	92.2	93.9	−33.5	−30.5	−30.9	6.6	10.7
2nd "	95.4	96.8	92.1	95.5	−27.9	−23.0	−25.2	8.0	6.7
3rd "	96.9	97.8	96.2	96.4	−25.3	−23.7	−23.8	6.8	9.0
4th "	96.2	97.6	97.1	94.9	−21.4	−29.1	−18.3	8.5	7.3
1985 — 1st qtr.	96.1	96.7	98.5	94.9	−21.3	−29.6	−20.8	6.4	7.7
2nd "	97.2	98.2	99.6	95.6	−23.0	−30.6	−22.0	7.0	8.0
3rd "	95.9	97.1	97.8	94.5	−22.3	−29.3	−19.1	10.1	8.0
4th "	96.9	98.1	100.9	94.7	−23.4	−30.8	−21.3	9.5	7.0
1986 — 1st qtr.	98.8	101.0	101.8	96.3	−26.6	−29.3	−23.5	10.1	8.0
2nd "	99.4	100.5	105.0	96.7	−16.4	−31.6	−20.4	13.0	7.3

Source: Based on Istat and Isco data.

(1) Industrial production data are also adjusted for trading-day variations. — (2) Raw data.

Table a13

Labour statistics

(seasonally adjusted data in thousands)

	MANUFACTURING INDUSTRY			THE ECONOMY (1)						
	Employment			Employment						
	Total	Employees	Employees excluding those on wage supplementation	Agriculture	Industry	Services	Total	Unemployment	Labour force	Unemployment rate %
1980	5,652	4,896	4,749	2,895	7,708	9,928	20,531	1,687	22,218	7.6
1981	5,568	4,802	4,503	2,690	7,630	10,201	20,521	1,944	22,465	8.7
1982	5,460	4,695	4,354	2,516	7,516	10,470	20,502	2,069	22,571	9.2
1983	5,301	4,546	4,134	2,525	7,321	10,727	20,573	2,302	22,874	10.1
1984	5,111	4,362	3,927	2,397	7,016	11,236	20,650	2,386	23,036	10.4
1985	5,009	4,263	3,893	2,304	6,884	11,587	20,774	2,500	23,274	10.7
1982 —1st qtr.	5,519	4,752	4,448	2,537	7,594	10,432	20,563	2,025	22,588	9.0
2nd "	5,490	4,723	4,390	2,533	7,537	10,453	20,523	2,040	22,563	9.0
3rd "	5,437	4,672	4,318	2,506	7,480	10,454	20,440	2,086	22,526	9.3
4th "	5,394	4,633	4,260	2,487	7,454	10,541	20,482	2,126	22,608	9.4
1983 —1st qtr.	5,361	4,607	4,208	2,494	7,397	10,659	20,550	2,232	22,782	9.8
2nd "	5,318	4,566	4,122	2,512	7,344	10,711	20,566	2,272	22,839	9.9
3rd "	5,284	4,532	4,129	2,554	7,308	10,700	20,563	2,300	22,862	10.1
4th "	5,241	4,480	4,077	2,539	7,233	10,840	20,612	2,402	23,014	10.4
1984 —1st qtr.	5,181	4,421	4,017	2,470	7,116	10,997	20,584	2,422	23,005	10.5
2nd "	5,130	4,376	3,942	2,404	7,042	11,145	20,592	2,373	22,965	10.3
3rd "	5,089	4,340	3,878	2,381	6,969	11,360	20,711	2,363	23,074	10.2
4th "	5,045	4,313	3,871	2,332	6,938	11,443	20,713	2,387	23,100	10.3
1985 —1st qtr.	5,004	4,282	3,849	2,293	6,933	11,472	20,698	2,392	23,090	10.4
2nd "	4,998	4,257	3,873	2,309	6,884	11,581	20,774	2,447	23,221	10.5
3rd "	5,016	4,259	3,923	2,300	6,858	11,628	20,786	2,551	23,337	10.9
4th "	5,020	4,256	3,928	2,313	6,859	11,667	20,839	2,610	23,448	11.1
1986 —1st qtr.	4,995	4,234	3,896	2,277	6,864	11,731	20,872	2,657	23,529	11.3
2nd "	4,970	4,213	3,871	....	....	....	....	....	....	....

Source: Based on Istat data. For manufacturing industry, national accounts data.

(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.

Productivity and labour costs in manufacturing industry

(% changes on corresponding period)

	Productivity			Gross wages and salaries per employee		Labour costs	
		Per worker					
	Hourly	Including employees on wage supplementation	Excluding employees on wage supplementation	Including employees on wage supplementation	Excluding employees on wage supplementation	Per employee including employees on wage supplementation	Per unit of output
1980	5.6	5.7	6.1	20.6	21.2	19.3	12.8
1981	3.1	0.6	3.5	21.3	25.4	20.1	19.5
1982	1.7	−0.5	0.5	15.8	17.1	17.9	18.4
1983	2.3	0.8	2.4	12.9	15.1	14.7	13.8
1984	5.0	7.6	8.4	11.4	12.5	11.1	3.3
1985	2.7	3.9	2.6	10.5	8.8	11.4	7.3
1982 —1st qtr.	2.3	2.2	3.1	19.9	21.1	21.1	18.6
2nd "	1.3	−1.2	−0.2	14.2	15.6	16.3	18.0
3rd "	2.5	−0.7	0.4	15.1	16.7	17.6	18.7
4th "	1.0	−2.0	−1.2	14.4	15.6	16.9	19.6
1983 —1st qtr.	3.0	−0.9	1.1	12.5	15.3	14.9	16.5
2nd "	1.5	−1.5	1.0	13.1	16.5	15.3	17.6
3rd "	1.6	2.0	3.2	14.1	15.8	15.7	13.7
4th "	2.8	3.6	4.5	11.8	13.0	12.9	9.1
1984 —1st qtr.	3.0	7.3	7.7	15.7	16.3	15.8	8.0
2nd "	5.5	7.6	7.8	12.3	12.6	12.0	4.2
3rd "	5.2	6.7	8.4	8.7	10.8	8.3	1.9
4th "	6.2	8.7	9.9	9.2	10.7	8.9	0.4
1985 —1st qtr.	4.6	3.9	4.9	9.3	10.5	9.9	5.9
2nd "	3.2	6.0	5.1	11.1	10.0	12.1	5.6
3rd "	3.0	4.6	1.9	10.2	6.9	11.4	6.0
4th "	−0.1	1.1	−1.3	11.2	8.1	12.3	10.7
1986 —1st qtr.	0.1	0.8	−1.2	9.4	6.9	10.4	9.2
2nd "	2.1	1.9	1.0	9.0	7.9	9.9	7.8

Source: Based on Istat data.

Table a15

Costs, profits and prices in manufacturing industry (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
1980	19.5	31.8	23.9	28.1	25.9	24.2	18.7	20.7
1981	17.8	2.4	12.0	17.9	14.8	21.0	16.6	20.3
1982	15.3	15.7	15.4	9.7	12.5	21.7	16.5	14.5
1983	11.0	4.4	8.7	7.7	8.2	20.7	11.9	12.4
1984	6.7	23.7	12.3	17.0	14.6	22.8	10.6	13.0
1985	8.9	9.6	9.2	8.4	8.8	23.0	7.6	8.0
1982 —1st qtr.	18.5	22.1	19.8	16.7	18.2	22.5	19.3	18.9
2nd "	14.2	20.5	16.4	9.2	12.9	23.1	17.1	14.2
3rd "	15.1	17.2	15.8	7.7	11.7	21.1	15.6	12.5
4th "	13.6	4.0	10.2	5.8	8.1	20.1	14.2	12.8
1983 —1st qtr.	11.4	3.1	8.5	5.5	7.0	21.5	12.7	12.3
2nd "	11.5	−6.4	5.0	5.9	5.4	20.0	11.8	13.4
3rd "	12.2	4.9	9.8	8.6	9.2	20.1	11.6	12.1
4th "	9.1	16.9	11.6	10.9	11.3	21.4	11.5	11.9
1984 —1st qtr.	11.1	16.0	12.8	17.5	15.0	21.8	11.4	14.0
2nd "	7.3	30.0	14.6	17.0	15.8	23.0	11.6	12.6
3rd "	3.7	27.5	11.4	16.4	13.8	23.1	10.6	12.8
4th "	4.8	21.7	10.6	17.1	13.8	23.2	9.1	12.5
1985 —1st qtr.	6.4	5.8	6.2	10.1	8.1	21.2	8.3	10.8
2nd "	9.0	9.8	9.3	11.8	10.5	22.8	8.2	10.5
3rd "	9.3	13.4	10.8	8.6	9.7	24.1	7.5	7.4
4th "	10.8	9.3	10.2	3.4	6.8	23.9	6.6	3.6
1986 —1st qtr.	9.2	13.9	10.8	2.4	6.6	23.0	5.5	0.6
2nd "	8.8	15.5	11.3	1.4	6.4	25.2	3.4	−2.9

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).

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	22.9	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	16.4	16.0
1983	11.3	13.1	8.0	9.7	12.3	14.1	18.2	14.7	14.9	13.9
1984	9.8	9.8	10.9	10.4	9.1	10.4	13.3	10.8	10.6	11.1
1985	8.3	7.8	6.5	7.3	8.7	8.6	10.4	9.2	8.6	8.5
1984 — 1st qtr.	10.3	11.7	11.1	10.8	10.1	11.6	14.9	12.1	12.2	12.4
2nd "	10.8	10.4	12.3	11.5	10.2	10.8	13.6	11.4	11.3	12.0
3rd "	9.7	9.2	11.1	10.3	8.5	9.9	13.4	10.5	10.2	11.3
4th "	8.4	8.2	9.3	8.9	7.7	9.4	11.2	9.4	8.8	8.8
1985 — 1st qtr.	8.1	8.2	8.6	8.4	8.2	8.5	11.6	9.2	8.6	8.6
2nd "	9.0	8.1	7.8	8.3	8.5	9.0	10.9	9.5	8.8	8.7
3rd "	8.3	7.8	5.7	6.9	8.8	8.8	9.8	9.1	8.5	8.4
4th "	8.0	7.2	4.0	5.9	9.2	8.2	9.4	8.9	8.6	8.1
1986 — 1st qtr.	5.5	6.8	−0.7	2.5	7.7	6.0	9.2	7.5	7.6	6.6
2nd "	2.5	5.8	−6.0	−1.4	5.8	3.7	9.3	6.0	6.4	5.5
3rd "									5.9	
1985 — 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.	8.1	7.2	4.1	5.9	8.8	8.5	9.4	8.8	8.6	7.8
1986 — Jan.	7.0	6.3	2.7	4.8	8.4	7.5	9.0	8.2	8.0	7.2
Feb.	5.4	7.1	−0.5	2.5	7.7	5.7	9.2	7.3	7.6	6.5
Mar.	4.3	6.8	−4.2	0.3	7.1	4.8	9.4	7.0	7.2	6.1
Apr.	3.2	5.8	−5.2	−0.8	6.2	4.1	9.4	6.4	6.6	5.3
May	2.4	5.7	−6.6	−1.8	5.8	3.8	9.2	6.1	6.4	5.7
June	1.9	5.8	−6.4	−1.8	5.3	3.3	9.3	5.7	6.3	5.7
July	2.0	5.6	−7.2	−2.2					5.9	5.9
Aug.	2.5	5.8	−7.5	−2.1					5.9	6.2
Sept.									5.8	

Source: Istat.

Italy's real exchange rates (1)

(indices, 1980 = 100)

	with respect to:							
	Germany	France	UK	Belgium	Netherlands	US	EEC countries (2)	13 industrial countries (3)
1981	103.4	100.6	93.0	105.0	101.3	80.0	101.3	97.9
1982	101.2	104.1	95.0	115.2	97.3	74.2	102.1	97.9
1983	102.9	108.7	101.9	122.5	100.0	72.0	105.7	100.3
1984	106.4	110.6	104.2	127.7	104.9	67.2	108.8	101.7
1985	106.2	105.6	100.9	126.1	106.0	66.3	106.9	100.1
1984 — 1st qtr.	104.6	110.7	101.7	127.0	103.3	69.4	107.6	101.0
2nd "	105.6	110.4	103.4	127.5	104.3	69.7	108.3	101.8
3rd "	107.2	110.7	104.6	127.8	105.5	65.9	109.3	102.1
4th "	108.1	110.4	107.0	128.5	106.3	63.9	110.0	102.1
1985 — 1st qtr.	109.3	110.6	110.1	129.2	107.2	61.5	111.0	102.6
2nd "	108.0	107.4	100.9	127.8	107.0	63.9	108.2	101.0
3rd "	104.2	102.8	94.8	123.8	104.3	66.8	104.1	98.2
4th "	103.6	101.7	98.5	123.7	105.6	72.8	104.1	98.1
1986 — 1st qtr.	103.9	102.2	105.8	124.9	110.8	81.0	105.6	101.2
2nd "	104.1	104.0	102.5	125.2	113.6	85.5	106.1	101.9
1984 — July	105.2	103.7	93.7	124.8	105.2	65.8	104.8	98.6
Aug.	103.4	102.1	95.4	123.0	103.9	67.6	103.6	97.9
Sept.	103.8	102.6	95.5	123.6	103.7	67.1	103.9	98.0
Oct.	103.6	102.0	97.6	123.6	105.2	71.3	104.0	98.6
Nov.	103.8	101.6	98.1	123.3	105.3	72.4	104.0	98.7
Dec.	103.5	101.4	99.6	124.2	106.3	74.4	104.1	99.2
1986 — Jan.	104.1	102.4	103.9	125.1	109.5	77.1	105.5	100.7
Feb.	103.6	102.2	106.9	124.5	110.6	81.2	105.6	101.1
Mar.	103.9	102.0	106.4	125.0	112.2	84.8	105.8	101.8
Apr.	103.8	103.9	102.4	123.9	113.4	84.6	105.8	101.6
May	103.9	104.2	102.0	125.5	113.0	85.9	106.0	101.8
June (4)	104.5	103.9	103.0	126.0	114.3	85.9	106.4	102.2
July (4)	104.6	103.9	106.1	126.1	114.6	89.7	106.9	102.8
Aug. (4)	104.7	105.4	112.4	128.1	114.6	93.5	108.2	104.4

(1) Based on wholesale prices of manufactures. The construction of an index of Italian producer prices including oil products, to improve comparability with the other countries, and the similar transformation of the OECD index for the Netherlands (Main Economic Indicators) have entailed a revision of the series shown in this table. — (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.

Balance of payments on a settlements basis (1)

(billions of lire)

	Goods (2)	Services and transfers				Balance on current account	Non-bank capital flows plus errors and omissions	Bank capital flows (3)	Change in official reserves (3)
		Foreign 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	−18,352	11,412	−7,554	7,240	11,098	−7,254	7,311	5,138	−5,195
1985 (4)	−18,711	12,362	−8,381	7,237	11,218	−7,493	−859	−5,301	13,653
1984 — 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	2,979	23
May	−1,139	1,193	−745	871	1,319	180	316	797	−1,293
June	−490	1,409	−770	415	1,054	564	571	649	−1,784
July	−981	1,906	−641	618	1,883	902	327	−1,466	237
Aug.	386	1,386	−617	860	1,629	2,015	−344	−2,092	421
Sept.	−1,839	1,430	−634	639	1,435	−404	−1,121	−940	2,465
Oct.	−1,569	1,108	−915	−66	127	−1,442	822	−1,179	1,799
Nov.	−1,247	702	−603	455	554	−693	−1,238	−689	2,620
Dec.	−2,546	652	−483	620	789	−1,757	324	−3,126	4,559
1986 — Jan.	−1,196	432	−758	257	−69	−1,265	−1,779	388	2,656
Feb.	−1,221	358	−475	136	19	−1,202	−376	2,274	−696
Mar.	−1,073	604	−741	288	151	−922	−1,152	2,928	−854
Apr.	−821	701	−920	303	84	−737	3,024	−1	−2,286
May	−143	1,132	−665	−104	363	220	1,335	2,181	−3,736
June	−313	1,241	−663	541	1,119	806	51	−631	−226
July								−39	−971
Aug.								−1,433	781

(1) Data for the last 3 months are provisional. — (2) Imports: cif; exports: fob. — (3) Adjusted for exchange rate variations and, in the case of official reserves, for the price of gold; a minus sign indicates an increase in net assets. — (4) Annual totals may not coincide with the sum of the monthly totals because of the provisional nature of the data.

Table a19

External position of BI-UIC (1)

	Short-term position							Medium and long-term position	Total official reserves (2)
	Assets					Liabilities	Balance (2)		
	Gold	Convertible currencies	ECU	SDR	Reserve position in the IMF				
	(billions of lire)								
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 — Sept. ..	41,091	19,979	13,260	1,719	2,059	−130	77,978	−450	77,528
Oct. ...	41,091	18,071	12,015	1,709	2,049	−72	74,863	−460	74,403
Nov. ...	41,091	15,327	12,120	1,731	1,970	−120	72,119	−466	71,653
Dec. ...	39,530	16,536	7,139	879	1,946	−205	68,825	−616	65,209
1986 — Jan. ...	39,530	13,673	6,260	847	1,840	−101	62,049	−639	61,410
Feb. ...	39,530	13,832	6,221	902	1,769	−123	62,131	−662	61,469
Mar. ...	36,595	12,444	8,796	929	1,821	−56	60,529	−686	59,843
Apr. ...	36,595	12,919	10,583	911	1,788	−206	62,590	−670	61,920
May ...	36,595	16,877	10,597	945	1,835	−135	66,714	−672	66,042
June ...	36,815	17,018	10,582	928	1,803	−190	66,956	−782	66,174
July ...	36,815	17,330	10,134	904	1,766	−128	66,821	−769	66,052
Aug. ...	36,815	16,411	10,102	916	1,761	−155	65,850	−789	65,061
Sept. ..	34,824	14,405	10,082	933	1,730	−299	61,675	−777	60,898
	(millions of dollars)								
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 — Sept. ..	22,770	11,071	7,348	953	1,141	−72	43,210	−249	42,962
Oct. ...	22,770	10,227	6,799	967	1,160	−41	41,882	−260	41,622
Nov. ...	22,770	8,982	7,102	1,014	1,154	−70	40,952	−273	40,679
Dec. ...	23,558	9,885	4,254	524	1,160	−122	39,228	−367	38,861
1986 — Jan. ...	23,558	8,395	3,843	520	1,130	−62	37,384	−392	36,992
Feb. ...	23,558	9,158	4,119	597	1,171	−81	38,521	−438	38,083
Mar. ...	23,151	7,872	5,564	588	1,152	−35	38,292	−434	37,858
Apr. ...	23,151	8,607	7,051	607	1,191	−137	40,469	−446	40,023
May ...	23,151	10,650	6,687	596	1,158	−85	42,157	−423	41,734
June ...	24,365	11,263	7,004	614	1,193	−126	44,313	−517	43,796
July ...	24,365	12,042	7,042	628	1,227	−89	45,215	−534	44,681
Aug. ...	24,365	11,596	7,138	647	1,244	−109	44,882	−558	44,324
Sept. ..	24,954	10,322	7,225	668	1,240	−214	44,195	−556	43,639

(1) Data for the last 4 months are provisional. — (2) The dollar values may not coincide with the sum of the single components because of rounding.

State sector borrowing requirement (1)

(billions of lire)

	Budget revenues			Budget disbursements			Deficit (—)	Other transactions (2)	Borrowing requirement (—)	Borrowing requirement net of debt settlements in securities	of which: settlements of past debts in cash
	Fiscal	Other	Total	Current expenditure	Capital expenditure	Total					
1980	72,015	18,303	90,318	−110,697	−20,517	−131,214	−40,896	3,878	−37,018	−36,079	−193
1981	89,240	19,448	108,688	−131,662	−22,394	−154,056	−45,368	−7,925	−53,293	−49,613	−17
1982	114,668	40,515	155,183	−176,469	−35,439	−211,908	−56,725	−15,977	−72,702	−71,990	−1,298
1983	144,603	36,700	181,303	−203,258	−50,868	−254,126	−72,823	−15,434	−88,257	−88,257	—
1984	162,625	41,502	204,127	−248,302	−48,761	−297,063	−92,936	−2,451	−95,387	−95,387	—
1985	177,664	46,649	224,313	−283,423	−54,988	−338,411	−114,098	−8,718	−122,816	−112,413	−2,187
1984 — 1st qtr.	35,532	4,947	40,479	−49,794	−7,068	−56,862	−16,383	−2,040	−18,423	−18,423	—
2nd "	39,611	5,867	45,478	−54,026	−13,468	−67,494	−22,016	2,163	−19,853	−19,853	—
3rd "	34,211	12,918	47,129	−67,542	−8,696	−76,238	−29,109	3,726	−25,383	−25,383	—
4th "	53,271	17,770	71,041	−76,940	−19,529	−96,469	−25,428	−6,300	−31,728	−31,728	—
1985 — 1st qtr.	35,337	7,393	42,730	−59,499	−11,998	−71,497	−28,767	904	−27,863	−27,863	−981
2nd "	43,134	7,041	50,175	−73,682	−8,917	−82,599	−32,424	−403	−32,827	−25,791	−788
3rd "	42,002	7,325	49,327	−69,784	−13,706	−83,490	−34,163	1,444	−32,719	−29,780	−216
4th "	57,191	24,890	82,081	−80,458	−20,367	−100,825	−18,744	−10,664	−29,408	−28,979	−202
1986 — 1st qtr.	42,727	7,378	50,105	−62,845	−1,650	−64,495	−14,390	−11,952	−26,342	−26,342	−336
2nd "	55,143	11,116	66,259	−69,488	−14,814	−84,302	−18,043	−1,929	−19,972	−19,972	−78
3rd (3)	37,660	11,313	48,973	−87,125	−17,475	−104,600	−55,627	20,021	−35,606	−35,606	−128
1985 — Oct.	16,979	3,967	20,946	−16,984	−3,817	−20,801	145	−7,389	−7,244	−7,093	−164
Nov.	13,392	8,067	21,459	−30,922	−2,911	−33,833	−12,374	−1,556	−13,931	−13,931	—
Dec.	26,820	12,856	39,676	−32,552	−13,639	−46,191	−6,515	−1,719	−8,234	−7,956	−38
1986 — Jan.	15,550	2,483	18,033	−13,029	−258	−13,287	4,746	−5,776	−1,030	−1,030	−203
Feb.	13,623	2,250	15,873	−16,449	−212	−16,661	−788	−11,919	−12,707	−12,707	−95
Mar.	13,554	2,645	16,199	−33,367	−1,180	−34,547	−18,348	5,743	−12,605	−12,605	−38
Apr.	12,946	5,291	18,237	−23.786	−3,090	−26,876	−8,639	−5,367	−14,006	−14,006	−15
May	14,696	3,147	17,843	−29,291	−2,566	−31,857	−14,014	3,814	−10,200	−10,200	−3
June	27,501	2,678	30,179	−16,411	−9,158	−25,569	4,610	−376	4,234	4,234	−60
July	12,979	4,122	17,101	−25,837	−9,890	−35,727	−18,626	4,776	−13,850	−13,850	−77
Aug.(3)	13,712	2.979	16,691	−43,870	−5,039	−48,909	−32,218	24,374	−7,844	−7,844	−47
Sept.(3)	10,969	4,212	15,181	−17,418	−2,546	−19,964	−4,783	−9,129	−13,912	−13,912	−4

(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		Treasury bills	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		Total	of which: Treasury overdraft with B.I.					
1980	−1,553	2,691	25,500	10,236	8,944	2,195	787	−148	37,018	9,740
1981	7,354	2,816	33,783	6,734	6,186	2,591	2,515	316	53,293	14,233
1982	23,473	27,378	32,604	8,883	6,598	3,586	2,570	1,586	72,702	12,676
1983	69,315	66,652	11,071	−1,125	−8,622	4,937	1,259	2,800	88,257	4,514
1984	62,763	56,738	9,300	13,288	18,555	6,057	2,271	1,709	95,387	10,028
1985	93,196	78,567	13,181	3,689	6,340	9,268	2,937	545	122,816	27,518
1984 — 1st qtr.	19,562	16,913	−5,370	2,093	10,471	1,525	533	80	18,423	5,102
2nd "	17,158	15,939	6,597	−4,282	−4,663	47	−7	340	19,853	−3,850
3rd "	12,674	12,443	8,122	2,794	2,746	439	1,327	26	25,383	1,138
4th "	13,369	11,444	−49	12,683	10,000	4,046	418	1,262	31,728	7,639
1985 — 1st qtr.	23,272	19,445	−2,166	5,948	8,201	1,486	−685	8	27,863	10,135
2nd "	23,772	15,651	10,183	−2,172	−1,757	246	1,977	−1.178	32,827	−405
3rd "	20,905	20,745	10,353	−535	678	−7	911	1.091	32,719	3,538
4th "	25.247	22,727	−5,189	447	−782	7,543	735	624	29,408	14,249
1986 — 1st qtr.	17,909	11,346	−2,039	9,572	8,266	1,198	−91	−207	26,342	11,155
2nd "	31,667	19,889	400	−12,839	−10,806	188	395	161	19,972	−10,889
3rd " (3)	15,626	7,267	10,344	8.932	9.127	880	51	−228	35,606	2,774
1985 — Oct.	11,226	10,316	−2,602	−2,464	−3,016	358	42	684	7,243	5,441
Nov.	8.186	6,285	−1,921	7,318	6,808	613	−98	−167	13,931	5,786
Dec.	5,836	6,126	−666	−4,406	−4,575	6,572	792	107	8,234	3,022
1986 — Jan.	4,254	5,419	−4,581	−1,528	−2,579	2,645	−46	287	1,030	8,447
Feb.	6,423	2,888	290	6,856	5,036	−602	−40	−221	12,706	−734
Mar.	7,231	3,039	2,252	4,244	5,808	−844	−6	−273	12,605	3,443
Apr.	12,962	9,438	1,449	−308	−1,159	−371	83	191	14,006	−4,258
May	13,369	7,463	−16	−3,516	−1,946	58	316	−10	10,200	−3,227
June	5,336	2,988	−1,033	−9,016	−7,701	501	−3	−20	−4,234	−3,404
July	560	779	6,453	6.030	5,932	674	−6	138	13,850	3,211
Aug. (3)	6,386	2,278	1,079	342	−396	256	57	−276	7,844	−1,171
Sept. (3)	8,680	4,210	2,812	2,560	3,591	−50	—	−90	13,912	734

(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.

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	Public sector total	of which: state sector
1979 — Dec. . .	52,008	43,905	30,853	16,680	1,563	145,010	43,255	188,265	173,123
1980 — Dec. . .	49,527	70,123	33,048	16,432	1,700	171,830	52,978	224,808	209,238
1981 — Dec. . .	55,802	98,357	35,639	18,420	1,779	209,996	66,555	276,552	261,178
1982 — Mar. . .	59,655	105,828	35,583	17,746	1,803	220,614	68,666	289,281	274,076
June . .	58,774	120,449	35,227	18,310	1,845	234,605	69,631	304,236	288,872
Sept. .	70,552	132,245	35,010	19,662	1,899	259,368	69,055	328,423	312,826
Dec. . .	80,893	127,395	39,225	23,613	1,938	273,065	78,670	351,735	332,442
1983 — Mar. . .	91,447	123,316	39,737	23,271	1,979	279,751	85,052	364,802	345,835
June . .	110,738	133,400	39,644	24,272	2,019	310,073	75,961	386,034	366,922
Sept. .	133,986	139,489	39,893	25,061	2,084	340,513	74,647	415,160	395,865
Dec. . .	149,832	137,772	44,162	29,312	2,147	363,226	79,631	442,856	421,095
1984 — Mar. . .	166,060	134,946	45,687	30,616	2,196	379,505	82,915	462,419	439,409
June . . .	182,673	140,311	45,734	32,570	2,246	403,534	80,740	484,274	459,614
Sept. . .	194,354	150,098	46,173	34,314	2,290	427,229	83,208	510,437	484,023
Dec. . .	207,740	152,691	50,219	38,024	2,379	451,052	92,863	543,916	515,655
1985 — Mar. . .	230,765	147,367	51,705	38,837	2,429	471,103	102,991	574,094	545,002
June . .	251,252	159,769	51,951	37,357	2,434	502,763	102,664	605,427	576,649
Sept. .	272,974	165,434	51,944	35,940	2,457	528,749	106,014	634,764	608,480
Dec. . .	294,567	150,814	59,487	35,925	2,450	543,243	120,286	663,529	638,366
1986 — Jan. . .	289,297	145,875	62,132	36,286	2,465	536,055	128,799	664,854	639,627
Feb. . .	299,202	150,405	61,530	35,439	2,452	549,028	128,098	677,126	652,538
Mar. . .	306,868	153,153	60,686	34,931	2,456	558,094	131,536	689,630	665,273
Apr. . .	322,970	155,715	60,315	35,257	2,457	576,714	127,127	703,840	679,349
May . .	334,974	156,890	60,372	35,031	2,403	589,670	123,976	713,646	689,425
June . .	336,205	154,377	60,874	34,776	2,404	588,636	120,596	709,232	685,244

(1) Rounding may cause discrepancies in totals.

Monetary base (1)

(billions of lire)

	SOURCES						
		Treasury					
	Foreign sector	Total	of which: BI-UIC government securities	of which: Treasury overdraft with BI	*memorandum item: unused credit on Treasury current account*	Refinancing	Other sectors
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	40,245	41,842	*1,282*	2,882	—6,569
1985 — Sept.	18,019	104,540	50,232	48,965	*1,777*	4,852	—9,455
Oct.	16,219	109,981	58,139	45,949	*4,815*	3,332	—9,720
Nov. (2)	13,599	115,767	56,595	52,757	*—1,912*	3,012	—9,911
Dec.	9,012	118,774	64,019	48,182	*2,960*	8,763	—7,197
1986 — Jan.	6,382	127,220	73,974	45,603	*8,772*	5,500	—8,340
Feb.	7,090	126,486	66,395	50,639	*6,433*	5,650	—9,758
Mar. (3)	8,121	129,929	65,588	56,448	*724*	9,660	—17,002
Apr.	10,096	125,671	61,640	55,289	*1,932*	2,931	—11,364
May	13,835	122,444	61,992	53,343	*4,010*	2,531	—9,823
June	14,218	119,040	67,616	45,641	*11,442*	4,385	—7,578
July	15,108	122,252	64,764	51,573	*5,113*	4,238	—9,383
Aug. (5)	14,826	121,081	63,234	51,177	*5,589*	2,998	—10,530
Sept. (5)	12,827	121,815	61,408	54,768	*2,051*	3,553	—9,763

	USES						
	Non-state sector		Banks				TOTAL MONETARY BASE
	Total	of which: notes and coin	Compulsory reserves	Deposit against overshoots of lending ceiling	Liquidity	Total	
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	59,065	96,428
1984 — Dec.	41,225	41,195	63,872	—	5,178	69,050	110,275
1985 — Sept.	40,843	40,693	74,276	—	2,837	77,113	117,956
Oct.	40.585	40,403	75,893	—	3,333	79,226	119.811
Nov. (2)	41,812	41,638	76,307	—	4,347	80,654	122,466
Dec.	45,228	44,998	76,086	—	8,038	84,123	129,351
1986 — Jan.	42,587	42,326	84,813	—	3,363	88,175	130,762
Feb.	42,950	42,768	83,020	555	2,944	86,519	129,469
Mar. (4)	44,644	44,390	80,832	877	4,355	86,064	130,708
Apr.	42,862	42,719	80,258	568	3,646	84,472	127,333
May	43,109	42,960	80,309	842	4,725	85,877	128,986
June (4)	43,804	43,620	79,795	1,339	5,126	86,260	130,064
July (4)	45,779	45,576	80,410	1,518	4,510	86,437	132,216
Aug. (5)	45,117	44,917	80,493	11	2,755	83,259	128,376
Sept. (5)	44,876	44,786	80,439	6	3,112	83,557	128,433

(1) Rounding may cause discrepancies in totals. — (2) Data not consistent with BI-UIC accounts, because they are reconstructed to take account of the entries suspended due to strikes by Bank of Italy staff. — (3) The figures for refinancing and for "other sectors" are affected by the temporary accounting procedures used due to strikes in preceding months. — (4) Banks' liquidity is abnormally high in these months because of an increase in credits with the Bank of Italy, due to the accounting entry of the settlements of the month's security purchases on the last day of the month, which cannot be cleared by transfer to final vendors until the following day. — (5) Provisional and partly estimated data.

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	−744	12,604	4,081	9,092	−927	359
1984	5,141	10,027	−218	−1,103	13,847	3,861	8,855	−2	1,133
1985	−13,679	27,519	5,881	−645	19,076	4,002	12,213	—	2,860
1985 — Sept. ..	−2,463	642	1,735	−3	−90	−209	47	—	72
Oct. ...	−1,801	5,441	−1,520	−266	1,855	−258	1,617	—	496
Nov. (3).	−2,620	5,786	−320	−191	2,655	1,227	414	—	1,014
Dec.	−4,587	3,023	5,751	2,698	6,884	3,415	−221	—	3,690
1986 — Jan.	−2,630	8,447	−3,262	−1,143	1,412	−2,640	8,727	—	−4,675
Feb.	708	−734	150	−1,418	−1,294	362	−1,793	555	−418
Mar.(4-5)	1,031	3,443	4,010	−7,245	1,239	1,695	−2,188	322	1,410
Apr.	1,975	−4,258	−6,729	5,638	−3,375	−1,782	−574	−309	−709
May	3,739	−3,227	−400	1,541	1,652	247	51	275	1,079
June (4)	383	−3,404	1,854	2,245	1,079	695	−515	497	401
July (4) .	890	3,211	−147	−1,805	2,151	1,973	615	179	−617
Aug. (6)	−282	−1,171	−1,240	−1,147	−3,840	−662	83	−1,507	−1,754
Sept. (6)	−1,999	734	555	767	57	−241	−54	−5	357

Monetary base financing of the Treasury

(billions of lire)

	Borrowing requirement	Net sales of securities						Other forms of non-monetary base financing	Monetary base financing
		Primary market			Open market		TOTAL		
		Treasury bills	Treasury credit certificates	Other	Total	of which: repurchase agreements (2)			
1982	72,653	−6,947	−20,490	4,018	−28,944	−401	−52,363	−7,614	12,676
1983	88,257	8,632	−59,603	−2,250	−21,609	−1,628	−74,829	−8,914	4,514
1984	95,387	−13,187	−54,436	−2,796	−5,012	2,661	−75,431	−9,929	10,027
1985	122,816	1,802	−68,695	−14,213	−1,480	4,933	−82,586	−12,711	27,519
1985 — Sept. ..	14,717	−3,238	−9,213	−2,642	753	791	−14,340	265	642
Oct. ...	7,243	3,635	−9,989	−1,290	6,928	7,204	−716	−1,086	5,441
Nov. (3).	13,931	4,063	−5,796	−1,738	−4,338	−4,361	−7,809	−336	5,786
Dec. ...	8,234	6,233	−4,893	291	639	610	2,271	−7,483	3,023
1986 — Jan. ...	1,030	4,115	−4,123	375	9,916	11,037	10,283	−2,866	8,447
Feb. ...	12,707	−2,710	−2,809	−3,219	−5,555	−5,518	−14,293	852	−734
Mar. ...	12,605	−2,190	−2,092	−4,088	−1,920	−1,371	−10,290	1,128	3,443
Apr. ...	14,006	−1,879	−9,008	−2,741	−4,733	−3,795	−18,360	96	−4,258
May ...	10,200	−834	−7,928	−5,767	1,529	1,284	−13,000	−427	−3,227
June ...	−4,234	204	−2,958	−2,316	6,390	6,408	1,321	−491	−3,404
July ...	13,850	−3,899	724	73	−6,763	−6,698	−9,865	−774	3,211
Aug. (6)	7,844	−1,643	−2,182	−3,907	−1,264	−1,235	−8,996	−19	−1,171
Sept. (6)	13,912	−2,334	−4,453	−4,356	−2,175	−910	−13,318	140	734

(1) Rounding may cause discrepancies in totals. — (2) Open market sales of securities exclude those made against advances under the Ministerial Decree of 27 Sept. 1974. — (3) Data not consistent with BI-UIC accounts, because they are reconstructed to take account of the entries suspended due to strikes by Bank of Italy staff. — (4) Banks' liquidity is abnormally high in these months because of an increase in credits with the Bank of Italy, due to the accounting entry of the settlements of the month's security purchases on the last day of the month, which cannot be cleared by transfer to final vendors until the following day. — (5) The figures for refinancing and for "other sectors" are affected by the temporary accounting procedures used due to strikes in preceding months. — (6) Provisional data.

BI-UIC operations in government securities (1)

(billions of lire)

	Primary market		Open market				Variations in BI-UIC portfolio
	Subscriptions	Redemptions	Total	of which: repurchase agreements: Financing of subscriptions	of which: repurchase agreements: Other purchases	of which: repurchase agreements: Sales	
Treasury bills							
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	25,549	10,566	35	−386	1,075	−1,200	15,018
1985 — 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.	5,994	427	918	253	715	—	6,485
1986 — Jan.	2,380	2,846	823	320	1,444	—	356
Feb.	569	2,988	−1,822	300	−2,099	—	−4,241
Mar.	2,250	2,187	−558	−208	−230	—	−495
Apr.	654	1,084	−683	477	−165	—	−1,113
May	150	1,000	−339	−1,129	785	—	−1,189
June	2,269	3,098	2,314	1,304	1,009	—	1,485
July	5,195	2,641	−1,069	459	−1,529	—	1,486
Aug. (2)	118	682	465	252	192	—	−99
Sept. (2)	873	395	−711	1,091	−482	—	−233
Treasury credit certificates							
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	9,962	91	750	—	2,551	−455	10,621
1985 — Sept.	328	—	−52	—	—	—	276
Oct.	327	—	2,934	—	3,037	—	3,261
Nov.	489	—	−523	—	−990	—	−34
Dec.	1,233	—	135	—	54	—	1,368
1986 — Jan.	1,557	261	7,581	—	7,862	—	8,877
Feb.	79	—	−3,352	—	−2,965	—	−3,273
Mar.	950	4	−646	436	−794	—	301
Apr.	430	—	−3,604	−25	−4,070	—	−3,174
May	−373	93	1,712	−411	2,046	—	1,246
June	72	42	3,222	—	3,697	—	3,252
July	2,010	507	−4,602	100	−5,392	—	−3,099
Aug. (2)	168	72	−1,650	−100	−1,543	—	−1,554
Sept. (2)	68	311	−1,322	—	−1,392	—	−1,565

(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.

BI-UIC operations in government securities (1)

(billions of lire)

	Primary market		Open market				Variations in BI-UIC portfolio
	Subscriptions	Redemptions	Total	of which: repurchase agreements			
				Financing of subscriptions	Other purchases	Sales	
Other government securities							
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	3,912	3,497	−2,264	—	38	—	−1,849
1985 — Sept.	—	—	−1	—	—	—	−1
Oct.	288	669	671	—	671	—	290
Nov.	164	—	−221	—	221	—	−57
Dec.	—	—	−413	—	−412	—	−413
1986 — Jan.	35	825	1,512	—	1,411	—	722
Feb.	317	—	−381	—	−754	—	−65
Mar.	105	—	−717	—	−575	—	−612
Apr.	953	169	−446	—	−12	—	338
May	139	—	156	—	−7	—	295
June	33	—	854	—	398	—	887
July	1,900	2,046	−1,092	—	−336	—	−1,238
Aug. (2)	202	—	−79	—	−36	—	123
Sept. (2)	125	11	−142	—	−127	—	−28
TOTAL							
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	39,423	14,154	−1,479	−386	3,664	−1,655	23,790
1985 — Sept.	828	1,034	753	791	—	—	547
Oct.	2,003	1,025	6,928	154	7,050	—	7,907
Nov.	4,153	1,358	−4,338	−618	−3,743	—	−1,544
Dec.	7,227	427	639	253	357	—	7,440
1986 — Jan.	3,971	3,932	9,916	320	10,717	—	9,955
Feb.	964	2,988	−5,555	300	−5,818	—	−7,579
Mar.	3,305	2,191	−1,920	228	−1,599	—	−806
Apr.	2,037	1,253	−4,733	452	−4,247	—	−3,949
May	−84	1,093	1,529	−1,540	2,824	—	352
June	2,374	3,140	6,390	1,304	5,104	—	5,624
July	9,105	5,194	−6,763	559	−7,257	—	−2,852
Aug. (2)	488	754	−1,264	152	−1,387	—	−1,530
Sept. (2)	1,066	717	−2,175	1,091	−2,001	—	−1,826

(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.

Repurchase agrements

(billions

		Amount offered	Amount taken up	Maturity (days)	Yields	
					Minimum	Weighted average
			Temporary purchases (2)			
			1985			
15	Nov.	750	750	7	15.10	15.37
25	"	2,500	2,500	5-29	15.35	15.44
27	"	1,000	1,000	23-26	15.75	15.76
29	"	1,750	1,750	14-24	15.80	15.81
3	Dec.	1,000	1,000	2-20	16.16	16.29
4	"	1,000	1,000	9-26	16.50	15.56
5	"	6,000	6,000	6-25	15.50	15.86
16	"	1,500	1,500	7-11	16.75	16.86
17	"	2,000	2,000	9-16	16.50	16.73
27	"	2,000	2,000	6-14	16.80	16.95
			1986			
7	Jan.	3,000	3,000	6-27	15.25	15.82
15	"	1,500	1,500	5-19	16.75	16.75
23	"	4,000	4,000	5-11	15.75	17.93
27	"	5,000	5,000	3-18	18.05	18.25
28	"	1,000	1,000	23	18.30	18.38
29	"	1,000	1,000	16-22	18.40	18.41
30	"	1,500	1,500	7-21	18.55	18.60
31	"	2,500	2,500	17-20	18.75	18.90
3	Feb.	3,000	3,000	14-17	19.00	19.02
6	"	3,000	3,000	14-27	17.85	18.07
14	"	1,500	1,500	7-17	18.25	18.88
17	"	1,000	1,000	1-14	18.80	19.05
20	"	3,000	3,000	11	18.55	18.79
25	"	3,000	3,000	6-16	18.30	18.56
28	"	1,250	1,250	7-14	18.40	18.61
3	Mar.	1,750	1,750	8-16	18.80	18.87
6	"	2,500	2,500	11-14	17.50	17.88
14	Mar.	3,750	3,750	11-18	17.30	17.52
20	"	1,250	1,250	12	16.60	16.68
25	"	3,250	3,250	7-9	15.25	15.33
2	Apr.	1,750	1,750	7-12	14.05	14.21
4	"	1,500	1,500	4-6	14.05	14.12
21	"	750	730	9-11	13.00	13.50
24	"	1,250	1,250	8-18	13.00	13.19
28	"	2,500	2,500	1-14	12.00	12.33
5	May	3,500	3,500	4-29	12.30	12.55
15	"	500	500	15-19	12.55	12.59
20	"	2,500	2,500	14-27	11.75	12.31
26	"	1,250	1,200	4-21	12.15	12.28
4-5	June	3,250	3,250	6-15	11.80	12.04
5	"	750	750	18-22	12.10	12.15
16	"	4,000	4,000	3-15	12.20	12.44
19	"	1,500	1,500	12	12.55	12.55
25	"	2,750	2,750	6-19	12.65	12.88
30	"	3,500	3,500	1-11	11.75	12.64
14	July	750	750	15-18	11.50	11.55
24	"	2,000	1,815	3-15	10.50	11.07
25	"	3,300	3,300	3-7	10.25	10.34
4	Aug.	2,000	2,000	3-14	10.35	10.49
11	"	1,250	1,250	7-10	10.50	10.66
25	"	4,000	4,000	1-7	9.55	10.37
2	Sept.	2,000	2,000	2-9	10.05	10.43
25	"	3,000	2,750	4-5	8.60	9.12
2	Oct.	2,000	2,000	6-8	10.15	10.50
3	"	750	750	3-11	11.05	11.52
7	"	750	750	7	12.05	12.14
8	"	500	500	8-9	10.20	11.55
10	"	750	750	11-20	10.25	10.26
14	"	1,000	1,000	16	11.05	11.05
15	"	4,250	4,250	1-19	9.40	9.85

(1) Purchases at Treasury bill auctions by the syndicate of banks the Bank of Italy is prepared to finance. — (2) Repurchase agreements based on

by the Bank of Italy

of lire)

	Maximum amount (1)	Actual amount	Maturity (days)
Financing of purchases at Treasury bill auctions (3)			
1 9 8 5			
13 Sept.	841	773	3
27 "	3,900	1,582	4
11 Oct.	1,268	893	14
25 "	2,323	1,000	20
14 Nov.	63	34	8
22 "	1,845	405	12
27 Dec.	2,066	590	7
1 9 8 6			
15 Jan.	250	121	16
30 "	7,593	900	14
14 Feb.	613	155	14
28 "	4,030	1,200	14
14 Mar.	161	73	13
28 "	4,540	992	12
15 Apr.	801	681	21
30 "	3,741	1,215	14
15 May	485	355	15
30 "	3,361	1,796	24
16 June	429	269	15
30 "	3,039	1,385	11
15 July	991	822	8
30 "	3,376	2,103	12
13 Aug.	719	400	6
29 "	4,052	2,355	10
15 Sept.	482	281	9
30 "	8,141	3,446	7
15 Oct.	295	194	15

	Amount offered	Amount taken up	Maturity (days)	Yields	
				Maximum	Weighted average
Temporary sales (2)					
1 9 8 5					
10 Sept.	750	750	15	13.60	13.34
11 "	750	750	14	13.60	13.47
12 "	700	520	13-14	13.95	13.79
1 9 8 6					
18 Sept.	1,250	1,160	7	11.00	10.63

competitive bid auctions. — (3) The rate applied is that of the auction corresponding to the date of transaction.

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			
				to banks and the private sector		Subscribed by BI-UIC	Total
				Competitive bid	Other		
3 months							
1986 — mid-Mar. ...	—	—	—	—	—	—	—
end-Mar. ...	2,500	94	3,841	2,498	2	—	2,500
mid-Apr. ...	—	—	—	—	—	—	—
end-Apr. ...	4,000	91	3,853	3,851	2	147	4,000
mid-May ...	—	—	—	—	—	—	—
end-May ...	2,000	91	2,263	1,996	4	—	2,000
mid-June ...	—	—	—	—	—	—	—
end-June ...	2,500	92	2,216	2,214	2	—	2,216
mid-July ...	—	—	—	—	—	—	—
end-July ...	4,500	92	4,974	4,496	4	—	4,974
mid-Aug. ...	—	—	—	—	—	—	—
end-Aug. ...	3,500	91	3,782	3,500	—	—	3,500
mid-Sept. ..	—	—	—	—	—	—	—
end-Sept. ..	4,000	91	4,734	3,998	2	—	4,000
mid-Oct. ...	—	—	—	—	—	—	—
6 months							
1986 — mid-Mar. ...	1,250	185	771	771	—	450	1,221
end-Mar. ...	7,500	186	8,099	7,496	4	—	7,500
mid-Apr. ...	1,250	183	1,243	1,243	—	7	1,250
end-Apr. ...	7,000	183	7,865	6,996	4	—	7,000
mid-May ...	750	183	876	750	—	—	750
end-May ...	6,000	182	6,086	5,997	3	—	6,000
mid-June ...	750	182	821	750	—	—	750
end-June ...	9,000	183	7,572	7,570	2	1,428	9,000
mid-July ...	2,500	184	2,123	2,123	—	337	2,550
end-July ...	11,500	184	9,199	9,192	7	2,301	11,500
mid-Aug. ...	1,000	183	1,308	1,000	—	—	1,000
end-Aug. ...	7,000	182	7,625	7,000	—	—	7,000
mid-Sept. ..	1,500	182	1,005	1,005	—	495	1,500
end-Sept. ..	7,500	181	7,377	7,377	—	123	7,500
mid-Oct. ...	1,000	182	776	776	—	—	776
12 months							
1986 — mid-Mar. ...	1,750	367	896	—	896	800	1,696
end-Mar. ...	10,000	367	8,950	—	8,950	1,000	9,950
mid-Apr. ...	1,750	365	1,208	—	1,208	500	1,708
end-Apr. ...	7,000	365	7,859	—	7,000	—	7,000
mid-May ...	1,000	365	847	—	847	150	997
end-May ...	5,500	364	5,696	—	5,500	—	5,500
mid-June ...	1,000	364	716	—	716	284	1,000
end-June ...	7,500	365	6,943	—	6,943	557	7,500
mid-July ...	1,500	365	862	—	862	638	1,500
end-July ...	10,000	365	8,120	—	8,120	1,880	10,000
mid-Aug. ...	1,000	365	883	—	883	117	1,000
end-Aug. ...	7,000	367	7,041	—	7,000	—	7,000
mid-Sept. ..	1,250	365	995	—	995	255	1,250
end-Sept. ..	7,000	365	7,782	—	7,000	—	7,000
mid-Oct. ...	1,250	365	841	—	841	409	1,250

Treasury bill auctions

(prices and yields)

	PRICES		YIELDS (1)					
			Simple			Compound		
	Floor	Average tender price	Floor-price	At auction		Floor-price	At auction	
				Competitive bid	Other		Competitive bid	Other
3 months								
1986 — mid-Mar. ...	—	—	—	—	—	—	—	—
end-Mar. ...	96.70	96.80	13.25	12.84	12.42	13.92	13.46	13.01
mid-Apr. ...	—	—	—	—	—	—	—	
end-Apr. ...	97.00	97.00	12.41	12.41	11.98	12.99	12.99	12.53
mid-May ...	—	—	—	—	—	—	—	
end-May ...	97.30	97.30	11.13	11.13	10.71	11.60	11.60	11.14
mid-June ...	—	—	—	—	—	—	—	
end-June ...	97.35	97.35	10.80	10.80	10.38	11.24	11.24	10.79
mid-July ...	—	—	—	—	—	—	—	
end-July ...	97.35	97.35	10.80	10.80	10.38	11.24	11.24	10.79
mid-Aug. ...	—	—	—	—	—	—	—	
end-Aug. ...	97.45	97.45	10.50	10.50	10.07	10.92	10.92	10.46
mid-Sept. ..	—	—	—	—	—	—	—	
end-Sept. ..	97.45	97.45	10.50	10.50	10.07	10.92	10.92	10.46
mid-Oct. ...	—	—	—	—	—	—	—	
6 months								
1986 — mid-Mar. ...	93.75	93.75	13.15	13.15	12.93	13.58	13.58	13.34
end-Mar. ...	93.80	93.90	12.97	12.75	12.53	13.38	13.15	12.91
mid-Apr. ...	94.10	94.10	12.51	12.51	12.28	12.90	12.90	12.66
end-Apr. ...	94.30	94.35	12.06	11.94	11.72	12.42	12.30	12.06
mid-May ...	94.65	94.65	11.27	11.27	11.05	11.59	11.59	11.36
end-May ...	94.80	94.85	11.00	10.89	10.67	11.30	11.19	10.95
mid-June ...	95.00	95.00	10.56	10.56	10.33	10.83	10.83	10.60
end-June ...	95.00	95.00	10.50	10.50	10.28	10.77	10.77	10.54
mid-July ...	95.00	95.00	10.44	10.44	10.22	10.71	10.71	10.48
end-July ...	95.00	95.00	10.44	10.44	10.22	10.71	10.71	10.48
mid-Aug. ...	95.10	95.10	10.28	10.28	10.06	10.54	10.54	10.31
end-Aug. ...	95.20	95.20	10.11	10.11	9.89	10.37	10.37	10.14
mid-Sept. ..	95.25	95.25	10.00	10.00	9.78	10.25	10.25	10.02
end-Sept. ..	95.10	95.10	10.39	10.39	10.17	10.66	10.66	10.43
mid-Oct. ...	95.15	95.15	10.22	10.22	10.00	10.48	10.48	10.25
12 months								
1986 — mid-Mar. ...	88.40	88.40	13.05	—	13.05	13.05	—	13.05
end-Mar. ...	88.55	88.55	12.86	—	12.86	12.86	—	12.86
mid-Apr. ...	88.90	88.90	12.49	—	12.49	12.49	—	12.49
end-Apr. ...	89.25	89.50	12.04	—	11.73	12.04	—	11.73
mid-May ...	89.90	89.90	11.23	—	11.23	11.23	—	11.23
end-May ...	90.15	90.15	10.96	—	10.96	10.96	—	10.96
mid-June ...	90.40	90.40	10.65	—	10.65	10.65	—	10.65
end-June ...	90.45	90.45	10.56	—	10.56	10.56	—	10.56
mid-July ...	90.45	90.45	10.56	—	10.56	10.56	—	10.56
end-July ...	90.45	90.45	10.56	—	10.56	10.56	—	10.56
mid-Aug. ...	90.60	90.60	10.38	—	10.38	10.38	—	10.38
end-Aug. ...	90.65	90.65	10.26	—	10.26	10.26	—	10.26
mid-Sept. ..	90.85	90.85	10.07	—	10.07	10.07	—	10.07
end-Sept. ...	90.55	90.65	10.44	—	10.31	10.44	—	10.31
mid-Oct. ...	90.75	90.75	10.19	—	10.19	10.19	—	10.19

(1) Calendar year. Starting with end-September 1986 interest payments are subject to a 6.25 per cent flat-rate with holding tax.

Interest rates

	Rates on BI-UIC loans		Yields						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	Bonds of industrial credit institutions	
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 — Sept.	15.50	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.	15.00	16.97	14.34	13.73	13.19	13.58	13.46	12.97	15.25
Feb.	"	16.76	14.17	13.59	13.08	13.40	13.83	13.07	16.71
Mar.	14.00	16.99	13.46	13.19	12.88	13.07	13.37	12.55	17.39
Apr.	13.00	13.31	12.99	12.39	11.84	12.28	12.28	11.69	15.50
May	12.00	13.41	11.60	11.23	11.00	11.18	10.89	10.28	13.47
June	"	12.35	11.24	10.78	10.57	10.74	10.86	9.80	12.50
July	"	12.21	11.24	10.71	10.56	10.75	11.06	9.74	12.31
Aug.	"	13.69	10.92	10.39	10.27	10.44	10.81	9.72	11.95
Sept.	"	12.00	10.92	10.61	10.28	10.54	10.43	9.54	11.68

	Bank rates (4)								
	Lending in lire				Deposit rates			Certificates of deposit	
	ABI prime rate (5)	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 — 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.	15.88	15.29	20.23	16.86	13.37	9.67	10.17	13.15	13.51
Feb.	16.00	15.65	20.55	17.45	13.36	9.73	10.22	13.16	13.52
Mar.	"	15.76	20.63	17.75	13.41	9.82	10.28	13.27	13.59
Apr.	15.25	15.42	20.21	17.53	12.94	9.43	9.98	13.02	13.43
May	14.50	14.78	19.57	17.02	12.35	8.46	9.36	12.48	12.76
June	13.50	13.88	18.73	16.20	11.67	7.82	8.59	11.84	11.70
July	13.50	13.54	18.44	15.50	11.51	7.63	8.31	11.63	11.49
Aug.	13.50	13.38	18.43	15.24	11.48	7.57	8.28	11.53	11.39
Sept.	13.00	13.18	—	14.92	11.17	—	8.13	11.43	11.29

(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; gross of the flat-rate withholding tax introduced by Decree Law 556, 19 Sept. 1986. — (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 *"Note Metodologiche"* in the Appendix to Banca d'Italia, *Relazione Annuale*. — (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)

	ASSETS								
		Credits						Interbank accounts	
	Bank reserves	Loans		Treasury bills (3) (10)	Other securities (4) (10)	Shares and equity partecipations	Bad debts (5)	Total	of which: special credit institutions
	(1)	in lire (2)	in foreign currency						
1983 — Dec. ...	58,007	157,226	21,574	47,972	132,118	6,602	11,566	97,164	7,662
1984 — Dec. ...	67,807	185,063	30,531	42,292	144,746	8,600	14,570	102,789	8,277
1985 — June ...	74,285	191,780	31,015	30,334	156,255	8,778	16,208	73,448	6,520
July ...	75,244	198,457	31,135	27,265	156,237	8,752	16,505	70,907	5,870
Aug. ...	75,744	195,217	29,374	29,127	157,206	8,686	16,693	72,937	6,445
Sept. ...	75,885	195,946	28,467	30,404	162,643	8,936	16,969	71,517	6,210
Oct.	77,508	200,467	27,178	25,618	166,275	9,264	17,338	71,038	6,860
Nov.	79,278	205,158	26,214	25,091	169,513	9,235	17,520	82,679	7,356
Dec.	82,718	220,052	24,171	25,646	173,612	9,422	17,800	106,014	9,141
1986 — Jan.	86,303	213,791	24,157	14,362	161,052	9,715	18,338	80,279	7,853
Feb.	85,290	207,832	25,611	13,944	161,290	9,870	18,490	71,305	7,724
Mar.	83,717	204,670	27,844	13,277	163,596	10,079	18,786	73,189	8,655
Apr.	83,167	209,376	28,495	16,794	168,290	10,001	19,120	74,495	8,775
May	84,545	208,754	29,733	17,066	169,220	9,992	19,389	75,066	8,695
June	84,125	209,482	29,663	16,567	166,065	10,326	19,552	71,264	7,515
July	84,299	220,455	28,923	21,404	164,598	10,546	20,076	68,067	6,580
Aug.	82,896	217,284	27,575	22,074	165,757	10,476	20,274	73,641	6,872

	LIABILITIES								
	Deposits (6)		Other domestic funds (7)	Loans from BI-UIC	Interbank accounts		Equity capital	Net foreign position (8)	Bankers' acceptances issued (9)
	Total	of which: current accounts			Total	of which: special credit institutions			
1983 — Dec. ...	372,240	202,690	3,568	6,349	88,572	5,252	29,518	20,398	1,590
1984 — Dec. ...	415,581	227,668	4,949	2,864	93,751	4,518	36,989	27,716	609
1985 — June ...	410,718	217,576	5,541	2,574	70,571	5,002	41,609	31,485	462
July ...	414,333	220,729	5,416	2,670	66,151	4,283	42,087	32,391	456
Aug.	414,780	219,610	5,352	3,093	66,059	3,952	42,090	32,481	456
Sept. ...	420,848	224,925	5,616	4,827	63,907	4,332	42,398	34,662	424
Oct. ...	422,048	225,486	5,548	3,309	61,759	3,845	42,731	30,062	422
Nov.	421,486	224,539	6,002	2,991	73,904	3,458	42,907	34,850	415
Dec.	457,743	250,282	6,467	8,740	94,338	4,459	43,179	25,806	377
1986 — Jan.	446,959	239,400	6,584	5,451	71,652	5,218	43,185	27,248	443
Feb.	438,354	234,614	6,477	4,090	64,046	4,863	43,440	28,902	784
Mar.	438,426	237,338	6,355	2,691	64,286	4,800	46,016	31,923	1,010
Apr.	440,682	241,064	6,732	2,872	63,947	4,570	49,674	32,611	1,044
May	438,316	240,282	6,395	2,512	63,219	4,844	49,778	34,519	918
June	440,038	242,219	5,979	4,335	62,677	5,500	50,160	....	803
July	440,833	242,354	6,327	4,218	62,768	5,384	50,965	....	647
Aug.	440,751	240,449	6,301	2,977	66,300	4,757	51,009	....	564

(1) Comprises lira liquidity (excluding deposits with the PO and the Deposits and Loans Fund), compulsory reserves, collateral in respect of bankers' drafts, and the non-interest-bearing deposit against ceiling overshoots. The data for November and December 1985 and January and February 1986 have been reworked to correct for suspended accounting entries due to strikes by Bank of Italy personnel. — (2) Including investment in bankers' acceptances. — (3) At face value. — (4) Italian and foreign lira securities for trading, investment and repurchase agreements at balance sheet value (shares are excluded). — (5) Including protested bills. — (6) Lira deposits by non-bank resident customers. — (7) Trust accounts and residents' foreign-exchange accounts. — (8) Source, UIC. — (9) Bankers' acceptances issued are included among guarantee commitments. Only those acquired by banks represent actual disbursement of funds by the banking system. — (10) Securities subject to repurchase agreements are included in the case of temporary purchases and excluded in that of temporary sales.

Principal assets and liabilities of the special credit institutions

(billions of lire)

	ASSETS								
	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 — 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	−10,184
Nov.	3,269	4,206	18,144	131,849	69,141	35,865	3,990	8,205	−9,629
Dec.	3,575	4,601	16,441	135,988	72,323	36,096	3,781	8,593	−8,238
1986 — Jan.	4,225	5,330	17,037	136,566	72,853	36,260	3,557	8,060	−10,920
Feb.	4,577	5,590	16,108	138,535	74,346	36,575	3,487	8,056	−11,964
Mar.	4,731	5,580	15,329	141,376	76,392	37,142	3,613	8,058	−12,006
Apr.	4,544	5,238	14,340	142,262	76,943	37,483	3,466	8,056	−9,928
May....	4,367	5,113	14,690	143,540	77,746	37,849	3,557	8,056	−9,622
June	4,399	5,137	15,720	142,008	76,537	38,015	3,323	7,619	−7,290
July	5,616	6,103	16,085	142,748	76,660	38,464	3,067	7,614	−11,446
Aug. (3) .	4,300	5,100	16,800	143,200	76,600	38,700	3,100	7,600	−11,400

	LIABILITIES								
	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 — Sept. ...	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	7,147	3,058	5,469	2,467	19,550
Nov.	24,604	93,802	37,600	35,578	7,145	3,480	5,483	2,509	19,742
Dec.	25,549	95,022	37,736	36,192	7,145	5,513	5,365	2,521	20,051
1986 — Jan.	25,743	95,118	37,698	36,344	6,546	4,286	5,616	2,477	19,844
Feb.	26,039	95,188	37,517	36,549	6,524	4,175	5,790	2,521	19,575
Mar.	26,305	95,709	37,914	36,668	6,523	4,754	5,911	2,541	20,207
Apr.	26,433	96,176	38,407	36,828	6,512	5,367	6,058	2,576	20,312
May	26,879	97,042	39,210	36,934	6,512	5,036	6,333	2,601	20,931
June	27,743	97,879	39,576	37,295	6,490	4,207	6,400	2,544	21,254
July	27,791	97,201	38,929	37,432	6,107	3,055	6,347	2,452	21,218
Aug. (3) .	27,700	97,300	38,800	37,700	6,100	3,200	6,400	2,500	21,200

(1) Excluding financing of compulsory stockpiling. — (2) Gross of exchange rate variations. — (3) Partially estimated data.

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. 85	Mar. 86	July 86		Dec. 85	Mar. 86	July 86
General government	8,255	−30.1	−35.6	−25.8	22,115	12.2	6.4	5.4
Credit and insurance institutions	12,158	70.7	23.5	25.7	6,180	41.2	54.4	42.8
Non-financial firms	201,494	12.6	6.1	8.6	100,645	8.1	10.2	12.1
Agriculture, forestry and fisheries	8,135	16.0	12.1	13.7	6,937	14.9	19.0	19.9
Industry	126,231	6.7	1.9	2.9	58,733	6.7	6.8	8.1
Mining and quarrying	1,626	−1.1	−32.2	−11.2	1.107	6.5	−9.6	13.3
Food and related products	11,889	6.6	2.6	3.8	5,375	14.0	16.4	19.1
Textiles	9,630	10.9	6.7	−1.3	2,384	4.5	7.6	11.5
Clothing, footwear, hides & leather	8,602	25.1	16.2	12.2	1,025	20.5	17.1	12.0
Wood, wooden furniture & fittings	5,413	18.6	13.9	9.6	1,138	13.0	13.8	19.2
Basic metals	6,893	−13.6	−8.5	−3.6	3,037	0.8	0.2	−3.1
Engineering	27,725	8.7	5.8	7.1	12,266	8.7	8.8	11.5
Vehicles	6,424	2.2	−7.8	−3.5	3,882	−1.9	−7.7	−8.9
Non-ferrous mineral products	4,973	10.2	1.6	−5.5	2,345	11.1	5.9	11.3
Chemicals, oil & coal products	10,105	−9.3	−14.8	−9.8	4,292	−6.9	−0.3	−1.5
Rubber and plastics	3,455	2.4	3.2	0.8	1,142	5.2	7.8	10.6
Paper, printing, publishing and related products	4,241	2.1	−7.3	−8.1	1,600	25.2	17.2	15.2
Still and motion picture equipment, sundry manufactures	902	9.1	9.8	7.6	300	31.3	28.7	34.5
Construction and plant installation	22,515	21.1	13.4	16.4	16,048	5.9	6.9	9.6
Production and distribution of power, gas and water	1,838	−17.5	−21.9	−31.0	2,792	19.4	22.4	5.2
Distributive trades, other commercial activities and miscellaneous services	52,421	21.8	15.8	18.1	15,187	10.4	15.4	19.0
Lodging and catering	2,440	28.5	23.1	26.8	1,858	21.6	21.5	20.7
Transport and communications	6,142	17.0	6.8	10.0	14,591	−2.1	−0.4	5.2
Coordination and financial services to enterprises	6,125	51.2	13.5	59.6	3,339	129.6	177.6	123.8
Non-profit institutions, households and unclassifiable	10,183	32.1	33.2	36.0	2,694	33.6	27.3	33.1
TOTAL (RESIDENT CUSTOMERS)	232,090	12.8	5.1	8.5	131,634	10.3	11.3	12.4
of which: public enterprises	*19,840*	*1.4*	*−18.7*	*4.9*	*25,278*	*3.7*	*8.5*	*9.8*
of which: state controlled	*16,360*	*−1.6*	*−22.4*	*13.7*	*20,452*	*7.7*	*12.6*	*10.6*
leading private sector firms (1)	*44,334*	*−4.6*	*−14.7*	....	*28,177*	*2.4*	*3.5*	....
other (1)	*149,478*	*21.6*	*14.8*	....	*53,370*	*14.0*	*16.3*	....

Source: Bank of Italy, Central Risks Office.
(1) From June 1986 on, the data on leading and other private firms are not comparable to those up to that date because of a change in the sample.

Net issues of securities

(billions of lire)

	ISSUERS			Total bonds and government securities	INVESTORS				Shares
	Public sector	Special credit institutions	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	94,074	5,178	2,195	101,447	8,910	510	27,336	64,691	12,220
1984 — 3rd qtr.	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	1,155	426	25,185	1,110	153	255	23,667	2,443
2nd "	23,963	1,514	945	26,422	3,982	124	10,305	12,011	2,331
3rd "	20,556	1,146	166	21,868	−593	280	6,166	16,015	1,520
4th "	25,951	1,363	658	27,972	4,411	−47	10,610	12,998	5,926
1986 — 1st qtr.	18,012	627	4,021	22,660	5,961	431	−10,153	26,421	1883
2nd " (1)	31,854	2,061	−355	33,560	2,846	337	442	29,935	4,053
1985 — Aug.	4,766	−55	24	4,735	244	154	1,018	3,319	564
Sept.	12,276	1,553	−96	13,733	282	145	5,349	7,957	521
Oct.	11,125	−52	831	11,904	3,530	−15	3,409	4,980	1,430
Nov.	8,570	233	45	8,848	−91	−3	3,051	5,891	326
Dec.	6,256	1,182	−218	7,220	972	−29	4,150	2,127	4,170
1986 — Jan.	4,238	79	2,074	6,391	9,616	389	−12,569	8,955	950
Feb.	6,513	55	1,410	7,978	−3,342	−51	194	11,177	601
Mar.	7,261	493	537	8,291	−313	93	2,222	6,289	332
Apr.	13,001	432	−36	13,397	−2,847	−2	3,961	12,285	1,124
May	13,486	835	−150	14,171	1,541	230	−281	12,681	844
June (1)	5,367	794	−169	5,992	4,152	109	−3,238	4,969	2,085
July (1)	598	−705	1,279	1,172	−4,317	−16	−1,912	7,417	1,040
Aug. (1)	6,201	50	−11	6,240	−1,410	−29	1,173	6,506	1,568

(1) Provisional data.

Issue conditions of government securities

ABI number	Maturity	Date of issue	Price at issue	Yield at issue (1)	Amount offered (bill. of lire)	Amount taken up (bill. of lire)	Spread	First coupon
Treasury credit certificates								
12848 (2) .	1.1.96	1.1.86	98.50	14.20	6,000	5,100	0.75	14.00
12849 (2) .	1.1.96 C.	1.1.86	100.00	—	2,000	400	0.75	14.00
12850 (3) .	17.1.91	17.1.86	99.75	13.84	2,000	2,000	0.30	6.75
12851 (2) .	1.2.96	1.2.86	98.50	14.29	5,000	2,400	0.75	14.30
12852 (3) .	18.2.91	18.2.86	99.75	14.00	2,000	525	0.30	7.00
12854 (2) .	1.3.96	1.3.86	98.50	14.16	3,000	2,580	0.75	14.30
12855 (3) .	18.3.91	18.3.86	99.75	13.81	1,000	1,000	0.30	7.00
12856 (2) .	1.4.96	1.4.86	98.75	13.86	5,000	5,000	0.75	13.80
12857 (2) .	18.4.92 C.	18.4.86	100.00	—	4,500	4,500	0.70	13.50
12858 (2) .	1.5.96	1.5.86	99.25	12.63	5,000	5,000	0.75	12.50
12859 (2) .	19.5.92 C.	19.5.86	100.00	—	3,000	3,000	0.60	11.90
12861 (2) .	1.6.96	1.6.86	99.50	11.75	2,500	2,500	0.75	11.50
12862 (2) .	18.6.93 C.	18.6.86	100.00	—	1,000	1,000	0.50	11.00
12863 (2) .	1.7.96	1.7.86	99.50	11.35	6,500	4,200	0.75	11.15
12864 (2) .	17.7.93 C.	17.7.86	100.00	—	2,000	800	0.50	11.00
12865 (2) .	1.8.96	1.8.86	99.50	11.10	4,500	4,500	0.75	11.15
12866 (2) .	19.8.93 C.	19.8.86	100.00	—	1,250	1,250	0.50	10.75
12867 (2) .	1.9.96	1.9.86	99.50	11.04	8,000	8,000	0.75	10.75
12868 (2) .	18.9.93 C.	18.9.86	100.00	—	1,500	1,500	0.50	10.50

ABI number	Maturity	Date of issue	Price of issue	Yield at issue	Amount offered (bill. of lire)	Amount taken up (bill. of lire)	Coupon
Treasury bonds							
12491	1.1.89	1.1.86	98.75	13.44	7,000	4,299	6.25
12492	1.1.90	1.1.86	98.75	13.33		2,427	6.25
12493	1.2.88	1.2.86	98.75	13.67	2,500	1,500	6.25
12494	1.2.89	1.2.86	98.75	13.44		500	6.25
12495	1.2.90	1.2.86	98.75	13.33		500	6.25
12496	1.3.89	1.3.86	98.75	13.33	4,300	2,100	6.25
12497	1.3.90	1.3.86	98.75	13.24		900	6.25
12498	1.3.91	1.3.86	98.75	13.18		1,300	6.25
12499	1.4.89	1.4.86	99.50	12.58	10,000	3,600	6.00
12600	1.4.90	1.4.86	99.50	12.53		6,400	6.00
12601	1.5.89	1.5.86	99.25	11.09	5,000	2,737	5.25
12602	1.5.90	1.5.86	99.25	11.02		2,263	5.25
12603	1.6.90	1.6.86	99.75	10.33	2,500	2,500	5.00
12604	1.7.90	1.7.86	99.00	10.05	6,000	4,650	4.75
12605	1.8.90	1.8.86	99.00	10.05	2,500	2,500	4.75
12606	1.9.90	1.9.86	99.50	9.62	4,600	4,600	4.625

ABI number	Maturity	Date of issue	Price of issue	Yield at issue	Amount taken up (mill. of ECUs) (4)	Lira/ECU exchange rate at issue	Coupon
Treasury certificates in ECUs							
12853	21.2.94	21.2.86	100	8.74	800	1,473.25	8.75
12860	26.5.94	26.5.86	100	6.89	800	1,477.37	6.90

(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 10.83 per cent for Treasury credit certificates 1.9.96. — (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.

Table a33

Treasury credit certificates, Treasury certificates in ECUs and index-linked Treasury certificates

	Expected yields (1)			Total return indices (2)				
					Treasury certificates in ECUs (3)			
	Treasury credit certificates	Treasury certificates in ECUs (3)	Index-linked Treasury certificates	Treasury credit certificates	Interest	Price	Exchange rate	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	3.40	191.33	118.89	106.57	104.59	132.51
1985	14.68	9.88	4.61	226.18	132.42	111 76	109.64	162.52
1984 — 3rd qtr	16.52	11.51	3.24	195.66	120 44	106.06	104.55	133.55
4th "	16.35	11.46	4.07	203.75	124.00	106.46	104.34	137 74
1985 — 1st qtr	14.63	10 16	4.39	214.91	127 16	111 17	104.50	147.74
2nd "	14.84	10.41	4.67	222.22	130.86	109.84	108.39	155 77
3rd "	14.86	9 74	4.56	229.91	134 14	112.09	112.42	169.08
4th "	14.38	9.21	4.81	237.68	137.54	113.94	113.26	177.50
1986 — 1st qtr	14.44	8.56	5.02	246.51	141 12	116.18	111.90	183.45
2nd "	13.11	8.41	5.04	256.27	144 71	116.43	111.86	188.46
3rd "	11.47	8.61	3.96	266.02	146 14	114.92	110.25	185.17
1985 — Sept.	14 70	9.54	4.46	232.84	135.23	112.78	113.14	172.55
Oct.	14.59	9.21	4.54	235.50	136.32	114.06	113.15	175.93
Nov	14.29	9 41	4.95	237.61	137.59	113.09	113.08	175.94
Dec	14.26	9.00	4.95	239.92	138 71	114.68	113.55	180.63
1986 — Jan	14 14	8.21	4.89	244.21	139.87	117.86	112.63	185.68
Feb	14.65	8.62	4.91	246.31	141 11	115.91	111.63	182.57
Mar	14.53	8.86	5.25	249.02	142.39	114 77	111.43	182.11
Apr	14.01	8.45	5.28	253.32	143.49	116.43	111.89	186.94
May	13.12	8.35	5.19	256.26	144.74	116.68	111.87	188.92
June	12.19	8 42	4.65	259.23	145.91	116.17	111.81	189.52
July	11 74	8.60	4.20	263.37	145.53	115.15	111.03	186.06
Aug.	11.58	8 72	3.88	266.02	145.89	114.51	109.96	183.70
Sept.	11 10	8.52	3.80	268.67	147.00	115.11	109 76	185.74

(1) The expected yield on Treasury credit certificates assumes no change in interest rates. That on Treasury credit certificates in ECUs is not comparable with the expected yields on lira investments. The expected yield on index-linked certificates is the real yield to maturity calculated measuring inflation by the GDP deflator at factor costs the yield so obtained is equal to the sum of the current real payments on the bond and the deflated price of the bond. — (2) The base dates (= 100) of the indices are 31 Dec. 1980 for Treasury credit certificates and 26 Jan. 1983 for Treasury certificates in ECUs. — (3) The breakdown of the index into its interest, price, and exchange rate components is multiplicative.

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
1981	73,336	28,098	45,238	—	18 1	—	13.5
1982	100,640	31,604	69,036	—	20.9	—	13.4
1983	120,626	35,432	85,194	—	20 7	—	13.2
1984	143,722	52,322	91,400	—	20 4	—	17.2
1985	153,585	46,476	107,109	—	18.0	—	13.0
1984 — July	18,476	10,677	7,799	4.3	20.9	4 4	16.7
Aug	6,353	−649	7,002	4.2	20 7	4.3	17 7
Sept.	12,978	4,122	8,856	5.3	21.0	5 1	19.2
Oct.	14,844	5,622	9,222	5 1	20 7	4.3	18.3
Nov	13,883	4,281	9,602	5.3	20.3	4.2	17.9
Dec	19,515	7,598	11,917	4.6	20.4	1.9	17.2
1985 — Jan	8,830	2,853	5,977	4.5	20.3	2.6	16 1
Feb	8,781	−45	8,826	4.2	20 1	2.2	15 4
Mar	14,815	1,595	13,220	4.6	20.3	2.9	15.0
Apr	13,609	4,886	8,723	4.6	19.8	2.5	14.5
May	10,713	2,192	8,521	4.8	19 7	3.0	14.5
June	6,020	−1,319	7,339	3.7	19.5	2.3	12.8
July	16,670	7,943	8,727	3.5	18.8	1.8	11.6
Aug.	4,021	−2,554	6,575	3.0	18.3	1.2	11.0
Sept.	15,030	1,017	14,013	4.2	18.3	2.5	10.0
Oct.	11,882	7,507	4,375	4.0	17.6	3.2	10 4
Nov	19,233	5,323	13,910	4.9	17.9	3.7	10.5
Dec.	23,981	17,078	6,903	4.5	18.0	4 7	13.0
1986 — Jan (5)	−2,645	−3,181	536	3.6	16.5	3.4	11.2
Feb	12,159	−580	12,739	3.1	16.7	2.7	11.0
Mar	14,482	2,111	12,371	3.1	16.4	1.3	11 1
Apr	20,301	6,581	13,720	5.0	16.9	2.7	11.4
May	10,785	1,357	9,428	4 7	16.7	3.2	11 1
June	−5,584	−1,200	−4,384	2.8	15.3	2.4	11.2
July	26,568	12,829	13,739	2.8	16.1	2.6	12.3
Aug	3,873	−3,933	7,806	2.4	16.0	2,0	12,0

(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 the financing of the non-state sector

Table a35

Monetary aggregates and their counterparts

(changes in billions of lire)

	1983	1984	1985		1986			
			Year	Jan-June	April	May	June	Jan-June
A) BI-UIC								
ASSETS								
Foreign sector *(a1)*	8,788	5,195	−13,750	−1,552	2,285	3,732	....	....
State sector *(a2)* (1)	1,125	13,529	27,365	9,803	−4,154	−3,209	−3,394	444
Banks *(a3)*	2,768	−3,550	5,674	−229	−6,936	−1,212	2,970	−3,493
Special credit institutions *(a4)*	241	433	−273	−318	45	1	−68	392
Other *(a5)*	−491	−2,129	−300	−1,011	5,281	1,548	....	....
LIABILITIES								
Non-state sector *(a6)*	3,862	3,562	3,851	−202	−1,692	283	683	−1,252
Banks *(a7)*	8,569	9,916	14,865	6,895	−1,787	577	1,518	3,026
B) Banks								
ASSETS								
BI-UIC *(b1=a7)*	8,569	9,916	14,865	6,895	−1,787	577	1,518	3,026
Foreign sector *(b2)*	−4,996	−5,138	5,398	−4,191	1	−2,103	....	....
State sector *(b3)* (1)	21,416	4,678	11,707	731	6,220	2,494	2,405	−11,868
Non-state sector *(b4)*	23,157	38,160	30,160	6,692	5,795	130	916	−1,658
Special credit institutions *(b5)*	4,632	2,115	1,130	−2,536	42	−640	−1,188	−2,528
Other *(b6)*	−9,623	−9,481	−15,144	−11,970	−14,171	−3,985	....	....
LIABILITIES								
Non-state sector:								
current accounts *(b7)*	21,893	26,248	22,676	−10,046	3,604	−501	1,613	−8,860
savings deposits *(b8)*	17,867	14,064	13,777	−445	−2,069	−2,203	−573	−13,465
repurchase agreements *(b9)*	−3,371	32	102	707	404	51	−176	1,673
banks' CDs *(b10)*	3,257	4,276	5,753	5,666	598	615	357	3,838
BI-UIC *(b11=a3)*	2,768	−3,550	5,674	−229	−6,936	−1,212	2,970	−3,493
State sector *(b12)*	741	−820	134	−32	499	−277	325	451

(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.

Monetary aggregates and their counterparts

(changes in billions of lire)

	1983	1984	1985		1986			
			Year	Jan-June	April	May	June	Jan-June
C) State sector								
DOMESTIC BORROWING REQUIREMENT *(c1)*	86,999	93,117	115,037	54,557	13,923	9,884	−4,230	46,010
LIABILITIES TOWARDS:								
Non-state sector								
PO savings:								
current accounts *(c2)*	2,235	657	2,221	433	−356	−315	189	−753
savings deposits *(c3)*	3,687	5,664	7,990	1,338	294	259	432	2,318
Treasury bills and other government securities *(c4)*	54,294	63,870	59,872	41,660	6,196	8,464	7,829	51,925
BI-UIC *(c5=a2)*	1,125	13,529	27,365	9,803	−4,154	−3,209	−3,394	444
Banks *(c6=b3-b12)*	20,675	5,498	11,573	763	5,721	2,771	2,079	−12,319
Other *(c7)*	4,983	3,899	6,016	560	6,222	1,914	−11,365	4,395
D) Monetary aggregates and their counterparts *(consolidated account of liquidity-creating bodies)*								
MONETARY AGGREGATES								
M1 *(d1=a6+b7+c2)*	27,989	30,466	28,747	−9,814	1,556	−534	2,485	−10,865
Savings deposits *(d2=b8+c3)*	21,554	19,728	21,767	893	−1,774	−1,944	−141	−11,146
Repurchase agreements *(d3=b9)*	−3,371	32	102	707	404	51	−176	1,673
M2A *(d4=d1+d2+d3)*	46,172	50,227	50,616	−8,214	186	−2,427	2,168	−20,338
Banks' CDs *(d5=b10)*	3,257	4,276	5,753	5,666	598	615	357	3,838
M2 *(d6=d4+d5)*	49,429	54,503	56,369	−2,548	784	−1,812	2,525	−16,500
SOURCES								
Foreign sector *(d7=a1+b2)*	3,792	57	−8,352	−5,743	2,286	1,629	....	....
State sector *(d8=c1−c4−c7)*	27,722	25,348	49,149	12,337	1,505	−494	−694	10,310
Non-state sector *(d9=b4)*	23,157	38,160	30,160	6,692	5,795	130	916	−1,660
Special credit institutions *(d10=a4+b5)*	4,873	2,548	857	−2,853	88	−639	−1,256	2,136
Other *(d11=a5+b6)*	−10,115	−11,610	−15,445	−12,981	−8,890	−2,438	....	....

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
1981 — Dec.	185,657	340,737	340,737	403,028	10.2	10.0	10.0	16.3
1982 — Dec.	216,640	402,227	402,227	475,560	16.7	18.0	18.0	18.0
1983 Dec.	244,629	448,399	451,656	540,237	12.9	11.5	12.3	13.6
1984 July	236,556	438,344	444,754	553,601	11.6	10.9	11.7	14.2
Aug.	233,596	437,356	443,960	554,318	10.7	10.3	11.1	13.6
Sept.	238,120	444,027	450,729	561,945	10.8	10.7	11.5	13.9
Oct.	241,292	447,932	455,029	569,197	11.5	11.0	11.9	14.6
Nov.	241,179	449,275	456,558	573,131	12.6	11.8	12.7	15.1
Dec.	275,095	498,626	506,159	615,885	12.5	11.2	12.1	14.0
1985 — Jan.	266,818	492,281	502,174	615,878	14.5	12.8	13.9	14.0
Feb.	260,502	484,666	495,847	614,541	14.3	13.0	14.2	14.1
Mar.	262,239	486,375	498,329	617,022	14.0	13.0	14.3	14.0
Apr.	263,922	488,897	501,266	623,155	14.3	13.4	14.7	14.7
May	259,943	484,890	497,719	624,394	13.7	13.0	14.4	14.9
June	265,281	490,411	503,610	631,355	13.8	13.2	14.6	15.3
July	270,210	496,703	509,545	639,947	14.2	13.3	14.6	15.6
Aug.	268,368	496,982	509,750	641,599	14.9	13.6	14.8	15.7
Sept.	272,245	501,341	514,401	647,826	14.3	12.9	14.1	15.3
Oct.	273,643	503,371	516,606	648,094	13.4	12.4	13.5	13.9
Nov.	273,888	504,258	517,494	649,305	13.6	12.2	13.3	13,3
Dec.	303,842	549,242	562,528	687,799	10.4	10.2	11.1	11.7
1986 — Jan. (5)	292,644	538,472	553,041	684,422	9.7	9.4	10.1	11.1
Feb.	286,660	528,880	544,039	680,797	10.0	9,1	9,7	10.8
Mar.	289,470	528,977	544,531	685,032	10.4	8.8	9.3	11.0
Apr.	291,026	529,163	545,315	684,642	10.3	8.2	8.8	9.9
May	290,492	526,736	543,504	683,404	11.8	8.6	9.2	9.5
June	292,978	528,904	546,028	683,698	10.4	7.8	8.4	8.3
July	295,315	532,483	549,783	687,524	9.3	7.2	7.9	7.4
Aug.	292,009	531,163	548,657	686,762	8.8	6.9	7.6	7.0

(1) Notes and coin and current accounts. — (2) M1 plus 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.

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:							State sector (4)	Foreign sector (5)	Unclassified
		Banks (1)	Special credit institutions (1)	Bonds	State sector (2)	Shares	Other domestic liabilities (3)	Foreign sector			
1981	76,367	15,202	14,521	756	6,291	4,475	2,835	9,463	42,231	−7,675	−11,732
1982	89,494	11,351	13,461	4,412	11,592	4,054	2,230	3,517	58,982	−10,048	−10,057
1983	122,245	21,462	11,549	2,422	14,139	8,555	3,000	1,720	71,864	706	−13,172
1984	138,060	35,927	14,469	1,925	10,781	6,857	3,300	1,355	82,209	−7,254	−11,509
1985	145,090	33,379	11,409	1,694	11,093	7,998	4,192	5,065	99,154	−7,493	−21,394
1984 — July	11,715	8,802	1,306	570	168	1,798	544	−693	7,824	672	−9,276
Aug.	2,034	−2,023	1,358	16	271	13	421	867	6,927	1,333	−7,149
Sept.	11,258	3,142	565	415	864	458	359	−1,058	9,763	−616	−2,634
Oct.	10,711	3,140	1,914	569	−226	340	216	−195	9,003	−375	−3,675
Nov.	8,503	2,514	1,685	82	400	—	−91	1,335	10,865	−691	−7,596
Dec.	45,077	3,485	4,526	−413	818	2,368	116	332	9,498	−1,940	26,287
1985 — Jan.	7,644	3,501	−295	−352	2,523	645	812	1,020	2,730	−495	−2,446
Feb.	7,127	−1,074	1,015	14	460	−44	435	819	8,476	−1,766	−1,208
Mar.	9,283	−557	1,491	660	411	599	581	−64	12,999	−2,425	−4,412
Apr.	10,222	4,625	461	−200	345	1,094	96	−16	9,631	−2,172	−3,642
May	4,620	379	526	1,286	1,143	−1,253	202	2,228	9,218	180	−9,289
June	13,489	−499	−543	−278	2,777	275	46	356	4,392	564	6,399
July	11,670	7,130	681	132	−81	−66	520	704	8,796	902	−7,048
Aug.	4,442	−4,070	1,486	30	479	696	411	−361	6,189	2,015	2,433
Sept.	14,705	428	671	−83	3,371	129	473	25	11,073	−404	−978
Oct.	6,918	6,211	463	833	−1,464	1,244	313	346	5,832	−1,442	−5,418
Nov.	7,441	3,911	1,414	−2	425	−354	120	271	13,473	−693	−11,124
Dec.	47,530	13,385	4,038	−346	704	5,032	184	−263	6,347	−1,757	20,206
1986 — (6) Jan.	6,181	−6,033	800	2,052	284	1,405	877	−59	236	−1,265	7,884
Feb.	9,450	−3,986	1,992	1,415	943	533	752	97	11,812	−1,202	−2,906
Mar.	13,009	−1,184	2,906	390	570	587	736	−500	11,683	−922	−1,257
Apr.	12,504	5,653	951	−22	332	−957	326	1,924	12,716	−737	−7,682
May	5,581	270	1,237	−150	1,479	−774	91	1,780	8,617	742	−7,711
June		918	−1,705	−413	2,525		25		−7,330		
July		10,805	749	1,276	316		369		13,082		
Aug.		−4,343	410	—	698		115				

(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

The discount rate was reduced from 15 to 12 per cent, in three steps (22 March, 25 April and 27 May). In July the securities investment requirement for banks was renewed. In the course of the second half the banks will have to replenish the holdings of certain types of securities in their portfolios as of 30 June 1986. Also in July, the yield on the portion of compulsory reserves held against certificates of deposit was lowered from 9.5 to 8.5 per cent.

Fiscal policy

The Finance Law for 1986 was passed on 28 February. The orientation of the law is restrictive. Specifically, it places a ceiling on salaries in the public sector for 1986-88, decreases the frequency of cost-of-living adjustment of pensions from quarterly to semi-annual, and fixes the size of health care contributions for public and private employers.

The January decree law reforming individual income tax brackets, was ratified by Parliament in April as amended in March.

On 19 September a decree law ended the tax-exempt status of interest income on government securities. A flat-rate withholding tax of 6.25 per cent was imposed on new securities issued up to 30 September 1987, rising to 12.50 per cent on those issued thereafter.

Exchange provisions

Italian exchange regulations were liberalized in the course of 1986. Specifically, the foreign exchange financing requirement on exports with payment deferred less than 18 months was lifted, as was the ban on external payments prior to the date fixed by contract. The non-interest-bearing deposit on foreign investment was reduced. The amount of foreign borrowing not subject to prior authorization was increased. The convertibility of lira banknotes was restored. And in September Parliament passed a law empowering the Government to reform and liberalize exchange legislation.

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*

Labour force

— *employed persons (excluding conscripts) plus job seekers (unemployed persons, first job seekers and other job seekers)*

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*

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*

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).

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.

Under-employed persons

— *persons working less than 26 hours in the survey week owing to lack of demand for labour*

Unemployment

— *Persons out of work + First job seekers + Other job seekers*

Unemployment rate

— *ratio of job seekers to the labour force.*

Unemployment rate adjusted for Wage Supplementation

— *ratio of job seekers plus equivalent full-time workers on Wage Supplementation to the labour force.*

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).*

List of abbreviations

ABI	—	*Associazione bancaria italiana* — Italian Banking Association —
BI-UIC	—	*Banca d'Italia-Ufficio italiano cambi* — Bank of Italy-Italian Foreign Exchange Office —
CICR	—	*Comitato interministeriale per il credito e il risparmio* — Interministerial Committee for Credit and Savings (Credit Committee) —
CIP	—	*Comitato interministeriale per i prezzi* — Interministerial Committee on Prices —
CIPE	—	*Comitato interministeriale per la programmazione economica* — Interministerial Committee for Economic Planning —
Confindustria	—	*Confederazione generale dell'industria italiana* — Confederation of Italian Industry —
Consob	—	*Commissione nazionale per le società e la borsa* — Companies and Stock Exchange Commission —
EFIM	—	*Ente partecipazioni e finanziamento industria manifatturiera* — Shareholding and Financing Agency for Manufacturing Industry —
ENEL	—	*Ente nazionale energia elettrica* — National Electricity Agency —
ENI	—	*Ente nazionale idrocarburi* — National Hydrocarbon Agency —
ILOR	—	*Imposta locale sui redditi* — Local income tax —
INA	—	*Istituto nazionale assicurazioni* — National Insurance Institute —
INPS	—	*Istituto nazionale per la previdenza sociale* — National Social Security Institute —
INVIM	—	*Imposta nazionale sul valore immobiliare* — Capital gains tax on property —
IRI	—	*Istituto per la ricostruzione industriale* — Institute for Industrial Reconstruction —
IRPEF	—	*Imposta sul reddito delle persone fisiche* — Personal income tax —
IRPEG	—	*Imposta sul reddito delle persone giuridiche* — Corporate income tax —
Isco	—	*Istituto nazionale per lo studio della congiuntura* — National Institute for the Study of the Economic Situation —
Istat	—	*Istituto centrale di statistica* — Central Institute for Statistics —
SACE	—	*Sezioni specifiche per l'assicurazione del credito all'esportazione* — Special Department for the Insurance of Export Credits —
SOCOF	—	*Sovraimposta comunale sui fabbricati* — Municipal surtax on buildings —
UIC	—	*Ufficio italiano cambi* — Italian Foreign Exchange Office —

MANAGEMENT OF THE BANK OF ITALY

as at 31 October 1986

THE DIRECTORATE

Carlo Azeglio CIAMPI	— Governor
Lamberto DINI	— Director General
Antonio FAZIO	— Deputy Director General
Tommaso PADOA-SCHIOPPA	— Deputy Director General

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 GIANNOCCOLI	— Accountant General
Giorgio MAYDA	— Inspector General