BANCA D'ITALIA

Economic Bulletin

Number 7 October 1988

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SYMBOLS AND CONVENTIONS

— when the phenomenon in question does not occur, or does occur and is observed but not in this case;

.... when the phenomenon occurs but its value is not known;

.. when the value is known but is less than the minimum figure considered significant.

"Post Office deposits" includes PO savings certificates.

Economic Developments and Policies

The international economy

The economic situation and economic policy in the industrial countries

Economic activity in the seven leading industrial countries expanded faster than expected in the first half of 1988, with GDP rising on average by about 5 per cent on an annual basis. For the year as a whole the leading international organizations revised their forecasts for growth upwards by more than one percentage point (to 4.1 per cent; Table 1). Thus the expansion that began in 1983 showed renewed vigour instead of weakening, as had been feared after the stock market collapse in October 1987.

The predictions made at that time did not fully take into account the underlying strength of the industrial nations' economies, particularly the healthy capital base of firms and the lagged effects of improved terms of trade resulting from lower oil prices. Further, by assuring their readiness to provide the market with liquidity, the monetary authorities contributed to a decline in interest rates from the high levels reached in October and to a restoration of confidence, thus helping to counteract the repercussions of wealth losses on share holdings.

Thanks to this combination of factors there was no slowdown in aggregate demand. On the contrary, the present phase of the economic cycle is marked by growth both of investment, which expanded in January-June at an average annual rate of around 10 per cent, and of private consumption. International trade has picked up considerably as a result of trends in domestic demand in the industrial countries. For 1988 as a whole the IMF expects trade to grow by about 7

Table 1

Gross product, domestic demand and net exports in the leading industrial countries

(constant prices; % changes on previous year)

	1986	1987	1988	1988 H1
United States				
GNP	2.8	3.4	4.0	4.5
Domestic demand	3.7	3.0	3.0	3.6
Net exports (1)	−0.9	0.2	0.9	0.9
Japan				
GNP	2.4	4.2	5.8	6.4
Domestic demand	4.0	5.1	7.4	8.6
Net exports (1)	−1.4	−0.7	−1.4	−2.2
Germany				
GNP	2.5	1.7	2.9	3.9
Domestic demand	3.8	2.9	3.2	4.6
Net exports (1)	−1.1	−1.1	−0.2	−0.7
France				
GDP	2.2	2.4	2.9	3.7
Domestic demand	4.4	3.7	3.0	3.6
Net exports (1)	−2.2	−1.2	−0.1	0.1
Italy				
GDP	2.9	3.1	3.6	3.3
Domestic demand	3.2	4.7	4.2	2.3
Net exports (1)	−0.4	−1.6	−0.8	1.0
United Kingdom				
GDP	2.9	4.2	4.0	4.0
Domestic demand	3.8	4.6	6.1	6.9
Net exports (1)	−0.8	−0.6	−2.1	−2.9
Canada				
GDP	3.2	4.0	4.2	5.1
Domestic demand	3.9	4.7	5.3	6.4
Net exports (1)	−0.7	−0.6	−1.0	−1.3

Sources: IMF and national bulletins; for Italy: *Relazione previsionale e programmatica.*
(1) Changes as a percentage of previous year's GNP/GDP.

per cent, helped by increases in exports from both industrial and developing countries (6.8 and 7.3 per cent respectively).

In the first half of the year gross product in the United States grew by 4.5 per cent on an annual basis (Table 1). Exports and non-residential investment registered sharp increases (21 and 16.3 per cent respectively), while private consumption continued to rise, though more slowly (2.5 per cent). In Japan gross product expanded over the same period by 6.4 per cent, confirming the acceleration that began towards the close of 1986. The Japanese economy is still feeling the stimulatory effects of the fiscal measures introduced last year. In Europe, too, economic growth was rapid, though it is expected to be somewhat more moderate in the second half of the year (Table 1). The United Kingdom recorded the highest growth (4 per cent), in consequence of a sharp increase in domestic demand (6.9 per cent). In Germany and France gross product rose by 3.9 and 3.7 per cent respectively, and in both countries growth for the year as a whole should be well above that in 1987, partly as a result of the improvement in net exports. In Italy the GDP expanded by 3.3 per cent in the first six months and is expected to rise by 3.6 per cent for the whole year.

Notwithstanding the continuation of the expansionary phase, improvements in the employment situation seem to have come to a standstill. This holds true both in countries such as the United States and Japan, where unemployment fell during the summer close to the lowest levels recorded in the seventies (5.4 and 2.6 per cent respectively) and in those of continental Europe, where rigidities in the labour market and the still unused margins of productive capacity kept unemployment figures high (10.4 and 11.7 per cent in France and Italy respectively and 8.1 per cent in Germany). Only the United Kingdom recorded a further drop in unemployment, which declined to 8 per cent in July from 9.8 per cent in the same period of 1987.

The rise in international prices for primary products together with the growth in domestic demand led in some countries to signs of inflationary strains in the first part of the year. The pace of consumer price increases accelerated during the summer and in August the annual rate compared with six months previously had reached 5 per cent in the United States and 8 per cent in the United Kingdom, against 4 per cent in both countries at the start of the year. In France inflation climbed from 2.4 per cent in January to 3.3 per cent in August. In Japan and Germany the increase in consumer prices was less than 1 per cent on an annual basis and showed signs of slowing down during the summer.

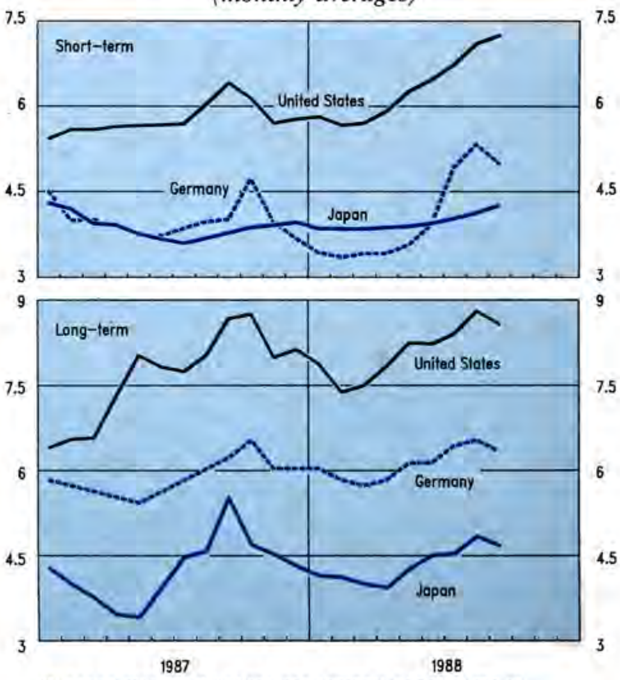
The symptoms of a revival of inflation led the authorities of the leading industrial countries to pursue more rigorous monetary policies, keeping the expansion of liquidity within the targets and seeking to counter inflationary expectations.

The phase of rising interest rates began in the United States, after the earlier easing of monetary policies at the end of 1987 and in the first months of 1988. From May onwards the growth of the monetary aggregates progressively slowed down. Short-term yields on the money market rose swiftly and in the summer surpassed the levels reached prior to last October's stock market crash (Figure 1). At the beginning of August the discount rate, which had remained at 6 per cent

Figure 1

Short and long-term interest rates (1)

(monthly averages)



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

since September 1987, was increased by half a percentage point. In Germany the money market rates rose during the summer in particular and were accompanied by a three-stage upward adjustment in the rate for Bundesbank repurchase agreements and an increase in the discount rate at the end of August. The rise of German interest rates was matched by similar increases in other European countries. An exception was France, where the firmness of the franc initially led the authorities to encourage a reduction in money market rates; however, towards the end of August the French rates, too, were increased. In Japan short-term rates underwent no abrupt changes, though the moderately upward trend that began last year continued.

At the long end of the market interest rates rose very little, remaining below the levels reached last autumn. Yield curves flattened out considerably and in the three leading economies the spread between long and short-term rates fell to around one percentage point, almost half that of October 1987. Thus the economic policy action based on monetary measures had an immediate impact on inflationary expectations. However, the absence of any incisive fiscal measures that would permit aggregate demand to be brought under control without penalizing investment, and that would help as well to overcome international payments imbalances, leaves the operation looking half-finished. Furthermore, in longer term perspective, it will be necessary to intervene on a structural level in order to strengthen the flexibility of markets and eliminate existing distorsions.

In the course of 1988 fiscal policies have maintained an essentially neutral stance in relation to economic activity. In the United States the sharp reduction in the budget deficit in 1987 was not followed by further progress, and it is estimated that the deficit for the fiscal year just ended will remain unchanged at around 150 billion dollars. In Germany the deficit is expected to be equivalent to 3.4 per cent of GDP, against 2.7 per cent in 1987, and will thus have a moderately expansionary influence. In Japan the positive impulse emanating from the budget appears to be less strong than it was last year.

Cyclical trends in the developing economies continue to show notable differences. The economic and financial situation in the 15 most heavily indebted countries is expected to worsen still further this year in spite of the expansion in world demand and the rise in prices for non-oil primary products. Economic growth is slowing sharply, while inflation has flared up again and current account balances have failed to record any significant improvement over 1987. By contrast, countries that export chiefly manufactured goods continue to grow at a fast pace, under the influence not only of exports but also of an acceleration of domestic demand.

International payments imbalances and exchange rate movements

Some progress was made in the first half of 1988 towards reducing international payments imbalances, but the adjustment process is not yet strong enough to indicate any definite redressing of present disequilibria sufficient to strengthen the stability of exchange rates between the principal currencies.

In the United States the merchandise trade deficit narrowed by about 32 billion dollars on an annual basis by comparison with the second half of 1987 (Table 2). Exports in value terms rose at an annual rate of 31 per cent in relation to the previous half-year, while imports increased by 11 per cent. The reduction in the deficit occurred mainly in trade with developing countries and the EEC (Table 2). Except in relation to Germany, where the US deficit has fallen but remains high (around 12 billion dollars), the trade position with the countries of the Community was in balance.

Japan's trade surplus narrowed by about 9 billion dollars, almost entirely because of a decline in its bilateral balance with the United States. In Germany, on the other hand, the trade surplus grew by around 6 billion dollars: the surplus vis-à-vis the United States contracted by around 3 billion dollars, while that with the other EEC countries as a group widened further.

The latest figures indicate, for July and August, a continuing, though slower, fall in the US trade deficit (which over these two months totaled 21.7 billion dollars, compared with 29 billion in the same period last year) and a further increase in the trade surplus of Japan (15.1

Table 2

Trade and current account balances

(billions of dollars on an annual basis)

	Current account balances			Trade balances					
				Total			*of which:* with United States (3)		
	1987		1988	1987		1988	1987		1988
	I	II	I	I	II	I	I	II	I
Industrial countries	−40.0	−67.3	−52.0	−83.6	−89.2	−105.2	97.2	102.8	78.0
of which: United States	−157.0	−151.0	−140.6	−168.8	−171.7	−139.9	—	—	—
Japan	87.6	86.6	75.6	96.8	95.9	87.0	59.5	60.2	51.9
EEC	39.6	38.4	37.0	−10.0	6.6	−16.8 (1)	21.6	27.0	12.1
of which: Germany	46.8	42.4	48.3	64.0	66.7	72.3	16.4	16.2	12.8
France	−1.9	−6.4	2.3	−9.7	−8.9	−7.5	2.8	3.7	2.8
Italy	−2.3	0.2	−7.8	−7.2	−9.2	−8.7	5.4	6.9	5.2
United Kingdom	2.3	−7.8	−20.4	−11.3	−20.8	−30.3	3.2	4.6	0.1
Developing countries	−6.2	19.5	....	49.9	63.3	....	63.2	72.8	55.9
of which: NICs (2)	32.0	28.9	....	10.6	24.1	....	35.5	39.9	27.8

Sources: OECD and national bulletins; for trade balances with United States: US Department of Commerce.
(1) First quarter. — (2) Newly industrializing countries in the Far East: South Korea, Hong Kong, Singapore and Taiwan. — (3) Not seasonally adjusted figures.

billion dollars against 14.7) and of Germany (10.9 against 8.9).

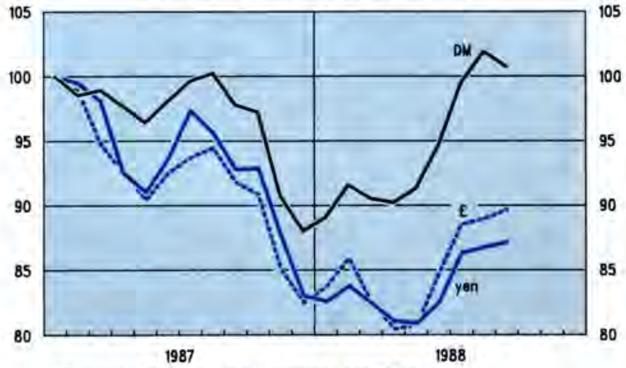
Current account balances for the first two quarters of 1988 showed signs of a partial return towards equilibrium. In the United States the reduction in the current account deficit was less than that in the trade sector. This was the result of a sharp deterioration in the balance of invisibles, caused in turn partly by a build-up in the country's net external debt position in recent years (to over 400 billion dollars). In the first half of the year the current account recorded a deficit of 140 billion dollars on an annual basis, only 10 billion dollars less than in the preceding six months. In Japan the surplus fell to 76 billion dollars, 11 billion less than the second half of last year, while that in Germany rose to almost 48 billion dollars.

The monthly variations of the US trade balance had a marked effect on operators' attitudes to the dollar. After a phase of slight depreciation between March and April, the positive signals coming from the monthly trade figures, together with an increase in interest rates, helped to strengthen the dollar, which rose against the Deutschemark and, more moderately, the yen (10 and 7 per cent respectively between April and July; Figure 2). During August and September the dollar fluctuated in value between 1.84 and 1.92 Deutschemarks and 133 and 139 yen. In the same period intervention was undertaken, principally by the European central

Figure 2

Bilateral exchange rates of the dollar (1)

(indices, January 1987=100)

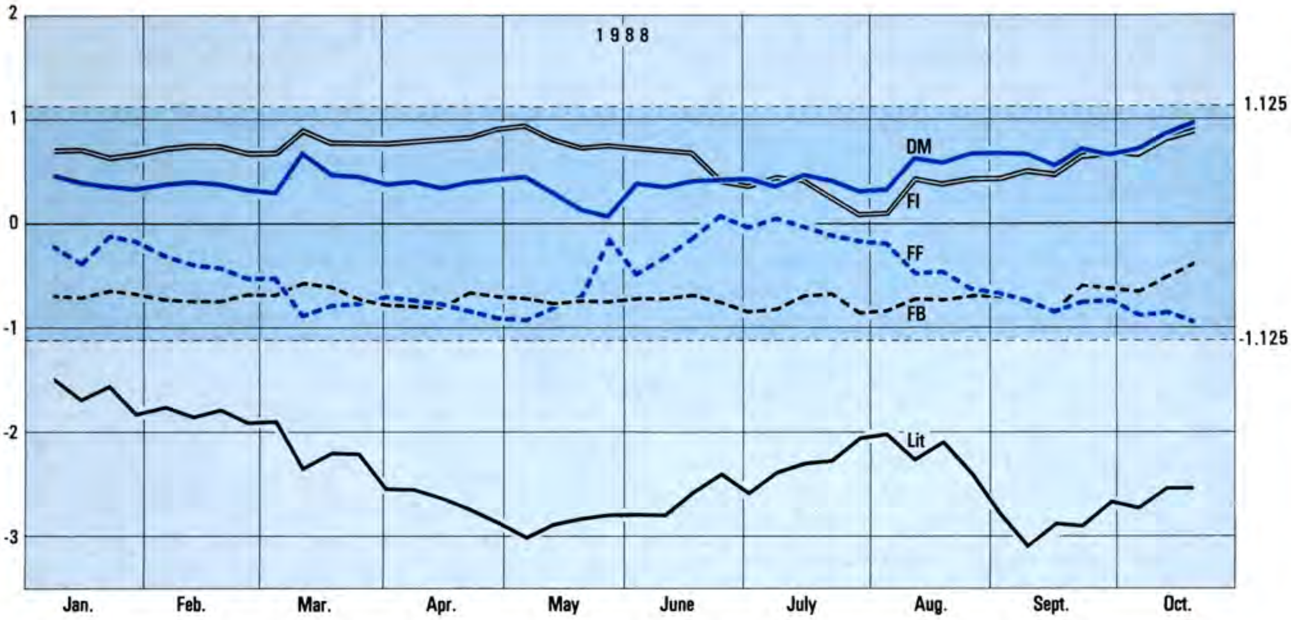


(1) Expressed in units of each currency per dollar.

Figure 3

Divergence of market rates from EMS central parities

(percentages; end-of-week data)



banks and the Federal Reserve, in order to avoid an excessive appreciation of the dollar, which could have jeopardized the process of adjustment. Notwithstanding this, the nominal effective exchange rate of the dollar rose over the first eight months of the year by about 5 per cent. As the inflation rate for wholesale prices of US manufactures was greater than that of the principal competitors, the appreciation in real terms was over 6 per cent. Over the same period the real effective exchange rates of the yen and the Deutschemark fell by 1.7 and 2.9 per cent respectively, thus temporarily halting the tendency towards appreciation that began in 1985.

From the second week of October, following publication of the US trade figures, the dollar began to slip below 1.80 Deutschemarks and 127 yen.

Within the EMS exchange rates moved in line with the fundamentals, keeping fairly close to trends in relative prices. As agreed at the Basle-Nyborg meetings, rates of exchange were allowed greater flexibility of movement within the fluctuation band, so that market developments could be taken into account and possible speculative pressures could be better countered. In March, on the occasion of elections in France, the downward pressure on the franc warranted a temporary slippage of the French currency towards the lower part of the narrow band. Concurrently, the lira fell to around 3 percentage points below the centre of the band (Figure 3). Both currencies subsequently climbed back towards the centre of the band, thanks to a change in market conditions caused partly by a rallying of the dollar.

Since early July contrasting movements in interest rates in France and Germany have led to a reduction of the nominal differential between them to around 2.5 percentage points. Although the narrowing of the gap was less marked in real terms, it nonetheless sparked downward pressure on the French franc in the second half of August. When the official German discount rate was raised by half a point on 25 August, the Deutschemark appreciated further, in spite of the fact that the other participants in the exchange rate mechanism also raised their rates at the same time. However, the flexible approach of the authorities made it possible to scotch the speculative pressure quickly. After touching lows of 3.41 francs and 748 lire against the Deutschemark in the first week of September, the franc and the lira later rallied, partly as a result of intervention by the central banks. After the second week of September the lira gradually became stronger, returning by mid-October to a level 2.5 per cent below the centre of the fluctuation band (Figure 3).

In October the French franc came under renewed downward pressure, partly owing to uncertainty about the outcome of public sector wage negotiations. The French monetary authorities raised the intervention rate from 7 to 7.25 per cent.

The exchange rate of the pound sterling recorded large variations. After appreciating strongly in the first five months of the year, against both the dollar and the Deutschemark, it fell during the next two months, following the publication of data showing a rapid deterioration in the trade balance (the deficit more than doubled in the first half of 1988 compared with the same period of 1987 and amounted to around 5 per cent of GDP). A sharp increase in short-term interest rates, designed to counteract the acceleration of domestic demand and inflationary pressures, brought sterling back above 3.22 Deutschemarks in mid-August; in September it fell again to around 3.10 Deutschemarks.

International financial markets and the debt problem

Activity on the international capital markets has been stimulated by the growth of the industrial economies and by a reappearance of private capital in the financing of current account imbalances. In the first half of the year gross financing amounted to 194 billion dollars, over 20 per cent more than in the first half of 1987 (Table 3). Bond issues increased, thus reversing a two-year downward trend caused by fears of insufficient liquidity in the market. Banks have continued to develop their international business at a brisk pace and credits granted rose by almost 40 per cent against the first half of last year.

On the whole, the retrenchment in the process of securitization in international financial activity that had been expected after the collapse of the stock markets did not take place. There was nonetheless an accentuation of the tendency towards favouring more reliable borrowers. The share of funds raised by industrial nations rose by comparison with the previous two years, to exceed 90 per cent.

No significant changes took place in the currency distribution of financial market activity. In the first half of the year dollar-denominated bonds accounted for around 30 per cent of the total, as in 1987. Dollar-denominated issues were followed by bonds denominated in Swiss francs (13 per cent), pounds sterling (12 per cent), yen (10 per cent) and Deutschemarks (9 per cent). The ECU share was unchanged at around 5 per cent. The ECU market stands to benefit from new issues scheduled by the UK Treasury, the first of which was made in October, for a total of 500 million. The short-term nature (from 1 to 6 months) and the liquidity of these new instruments will add to the depth and efficiency of the ECU market, the largest share of which is represented by securities issued by the Italian Treasury.

The most heavily indebted developing nations continue to face major difficulties in raising loans in the international markets. According to IMF estimates, the net contribution provided by commercial banks in 1988 will be negative, for the fourth year in succession. The exposure of the BIS reporting banks vis-à-vis the 15 most indebted nations, adjusted for exchange rate changes, fell by 4 billion dollars in the first quarter of this year, after contracting by 10 billion dollars in 1987. Nor has this development been counterbalanced by a growth in net public financing, which though still positive is expected to drop from 14.5 billion dollars in 1987 to 9 billion this year.

The strategy for dealing with the debt question rests on the implementation of adjustment programmes in the debtor countries, on the granting of new public and private financing on a case-by-case basis and on favourable trends in the industrial economies. This approach has enabled serious crises to be averted, but the overall situation is still a cause for concern. Although

Table 3

International capital markets
(billions of dollars)

	1986	1987	1987 H1	1987 H2	1988 H1
Gross bond issues (1)	228.1	180.8	102.2	78.6	119.3
of which: floating rate	*51.1*	*11.2*	*3.9*	*7.3*	*7.4*
equity-related	*26.9*	*39.3*	*17.1*	*22.2*	*19.4*
Syndicated loans (2)	63.2	95.4	42.3	53.1	58.0
Back-up facilities (3)	30.0	31.2	11.8	19.4	16.5
Total gross lending	**321.3**	**307.4**	**156.3**	**151.1**	**193.8**
% breakdown by borrowers					
OECD countries	89.0	86.4	85.5	87.3	91.1
of which: United States	*15.2*	*14.9*	*15.2*	*14.6*	*15.3*
OPEC countries	1.5	0.9	0.9	0.9	0.6
Other developing countries	4.6	7.5	9.0	6.0	4.8
Eastern Europe	1.2	1.2	1.2	1.2	0.6
Other	3.7	4.0	3.4	4.6	2.9

Source: OECD.
(1) Euromarket issues plus foreign issues in domestic markets. — (2) Announced medium and long-term Eurocredits and foreign loans. — (3) Lines of credit granted in connection with the issue of securities.

growth in the industrial countries over the last three years has been greater than was initially considered necessary to ensure the operation's success, the stop-go implementation of the restructuring programmes in the debtor countries and the reluctance of the commercial banks to grant new loans have made it impossible to overcome the debt problem. Negotiations between the debtor countries and international organizations are still fraught with difficulties. An exception is Brazil, which has recently reached an accord with the IMF for a stand-by loan of over 1.1 billion SDRs and has also agreed on a financial plan with the commercial banks that provides for a rescheduling of existing loans in the amount of 61 billion dollars and new financing of 5 billion. The plan comprises a broad range of options for the banks, including the issue of exit bonds (long-term securities offered in exchange for existing loans with a view to exempting certain banks from future financing packages) and new money bonds (bonds issued by the state and sold to the banks in the framework of a financing package). These instruments were included in earlier debt restructuring programmes, but on a more limited basis. The US government has granted Mexico a bridging loan, which is linked to future World Bank and IMF financing programmes and which will help to cover the increased external deficit arising from the fall in oil prices.

After getting under way in 1987, the tendency towards rapid growth of secondary market trading in loans to debtor countries strengthened further in the first half of 1988. A significant contribution to this has come from the development of debt-equity swap programmes by countries such as Argentina and Brazil, as well as from the participation of a growing number of US banks. The latter, having strengthened their capital positions as a result of provisions set aside in recent years, have begun to operate actively in the debt market. During the first half of 1988 such operations totaled 2.8 billion dollars, 20 per cent more than the average for 1987. Secondary market prices for debt nonetheless remain low and subject to wide fluctuations owing to the uncertainties surrounding the different countries' prospects for achieving financial stabilization.

In September the Paris Club defined the means by which the industrial countries can help to lighten the debt burden of the poorest nations, as agreed at the Toronto summit. According to circumstances and specific needs, creditor nations will be able to choose between three solutions: (i) the immediate cancellation of one third of outstanding loans and the funding of the remainder at market rates over 14 years, with a grace period of 8 years; (ii) restructuring at market rates over 25 years, including a grace period of 14; (iii) funding at subsidized rates over 14 years, with a grace period of 8.

The Italian economy and the balance of payments

Output increased briskly in the first half of the year. Domestic demand continued to grow at a rapid pace and the quickening of world demand meant that exports also made a significant contribution to the expansion in gross product. Nevertheless, the deficit on the current account of the balance of payments was around 3.4 trillion lire higher than in the first half of 1987, owing mainly to the deterioration in invisible trade.

Fixed investment and the consumption of durable consumer goods showed particularly rapid growth. Investment in machinery and transport equipment continued to increase rapidly and investment in construction began to pick up. The substantial and unforeseen expansion in domestic demand in the other industrialized countries led to better cyclical synchronization between Italy and the world economy.

Consumer price inflation remained unchanged, continuing at a rate of around 5 per cent from January to June. The rate of increase in wholesale prices, on the other hand, accelerated from 3.9 to 5 per cent between January and August. Unit production costs in industry rose more rapidly than in 1987 and by more than output prices, the reverse of the situation observed in past years.

The growth in production had a positive effect on employment, which increased not only in services but also in manufacturing industry, where it meant a reversal of the continuous contraction that had been under way since 1980. In the first half of 1988 the unemployment rate was higher than in the same period of 1987 but slightly lower on a seasonally adjusted basis than in the second half of last year.

Domestic demand and industrial output

In the first half of 1988 domestic demand, net of the variation in stocks, was 3.9 per cent higher than a year earlier.

Household consumption continued to rise in the first half, increasing by 3.8 per cent in relation to the same period of 1987 under the stimulus of the budget deficit and the continued effects of the improvement in the terms of trade. Preliminary estimates suggest that disposable income is expanding faster than in 1987. As in the past, the largest growth occurred in the consumption of durable goods; the latest data on purchases of motor vehicles indicate an increase of 8.2 per cent in the first nine months of the year.

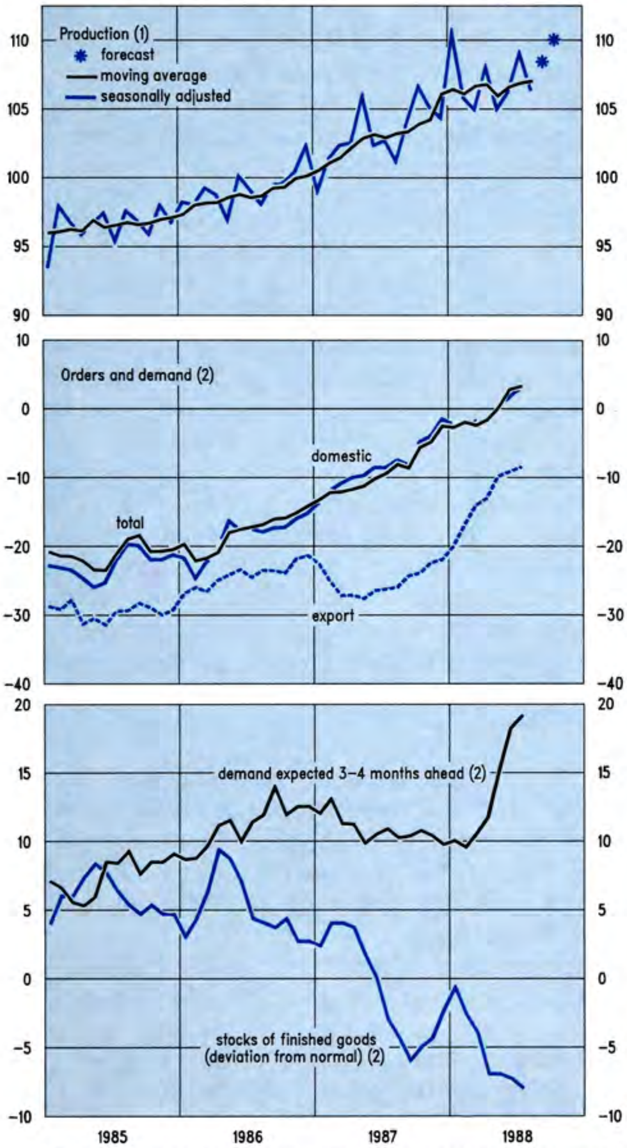
The expansion in gross fixed investment remained brisk, with growth at an annual rate of 5.4 per cent in the first half of the year. It was boosted by the good prospects for demand, the substantial amount of liquid funds accumulated by enterprises in recent years and the high level of capacity utilization. Investment in machinery and transport equipment, which had risen substantially in 1987, continued to grow rapidly and building activity also increased. The index of residential building permits, which anticipates changes in housing investment, was already showing a sharp rise in 1987 after two years of steady decline. The signs of a recovery in corporate expenditure on new premises confirm the increased scale of investment to expand the productive base.

The growth in both domestic and export demand led to a significant increase in industrial activity (Figure 4). In the first six months of the year the seasonally adjusted index of industrial output was 2.6 per cent higher than in the previous half year and 4.4 per cent higher than in the corresponding period of 1987. There was a particularly sharp acceleration in the first quarter but a slight decline in the second; however, preliminary data and estimates based on electricity consumption indicate a revival in output in the third quarter. The Isco-Mondo Economico indicators of industrial orders and expected demand confirm that a favourable climate will continue to prevail. Stocks of finished goods, which had been run down in the first half of the year to meet the strong growth in demand, are still below the levels businesses regard as normal.

Capacity utilization is close to the peaks recorded in early 1980. This is confirmed by the Isco and Bank of Italy indicators, although the quarterly data are highly erratic in both

Figure 4

Industrial output, demand and stocks



(1) Overall index of industrial production, data seasonally adjusted (1980 = 100); based on Istat data. The moving average is calculated from five centred terms. The forecasts are based on electricity consumption. — (2) Centred moving averages (three terms) of monthly replies to Isco-ME surveys of businessmen; seasonally adjusted, except for stocks of finished goods.

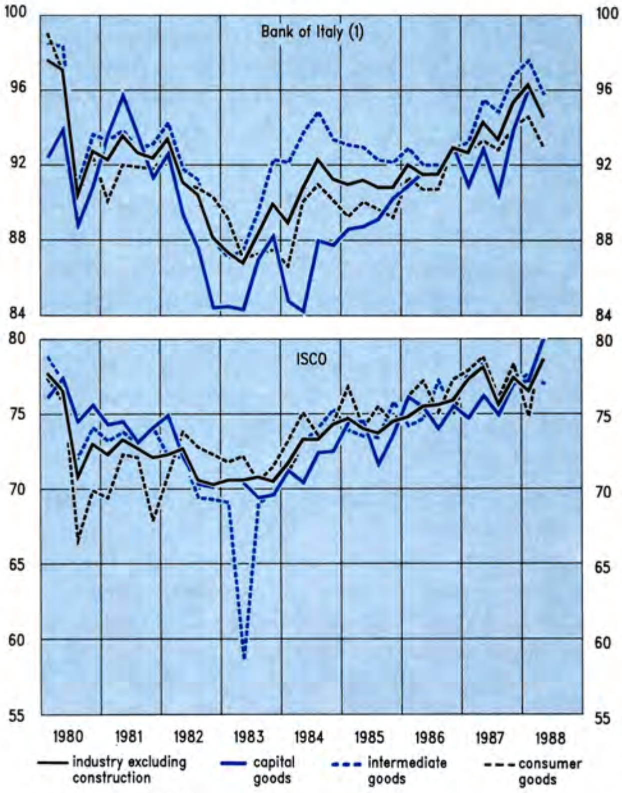
(Figure 5). However, the risk of supply bottlenecks is reduced by the greater flexibility industry has now achieved.

The growth in output was not uniform in all sectors of industry. Indeed, production decreased in the textile, clothing and footwear sector. The largest increases occurred in office and data processing machinery, precision instruments, non-metallic minerals extraction and processing, transport equipment and in paper, printing and publishing. Classified in terms of uses, the products to show the fastest growth were final capital goods, intermediate goods for use in the same industry and durable consumer goods.

Figure 5

Capacity utilization rates

(percentages)



(1) Wharton method.

Employment, production costs and prices

The growth in output led to a rise in employment; the total demand for labour, as reflected in the average of the labour force survey figures for January, April and June, was 1.5 per cent higher than in the corresponding period of 1987. The greatest increase occurred in services, confirming the trend that has been under way for some time, while employment in agriculture continued to decline. In previous years the growth in the output of industry excluding construction had led to an increase in average hours worked per employee, and especially in the use of overtime, but had not halted the decline in employment; now, however, it has also brought an increase in employment, which was 1.9 per cent higher than in the same period of 1987. The sector's positive contribution is even greater if one considers the reduction in recourse to Wage Supplementation, which between January and May was around 17 per cent less than a year earlier. Over the same period the number of hours for which Wage Supplementation benefits were paid in the construction industry also declined considerably (by about 31 per cent) owing to the recovery in the sector's output.

The increase in the demand for labour caused the unemployment rate to fall slightly to 12 per cent on a seasonally adjusted basis in the first half of the year. Including the full-time worker equivalent of the hours compensated by the Wage Supplementation Fund, the rate was 13.1 per cent, compared with a peak of 13.5 per cent in the third quarter of 1987 (Table a14). This development was all the more significant in that it was not associated with a halt in the growth in the labour supply. The labour force from January to April averaged almost 400,000 higher than in the same period of 1987 and the rate of increase of 1.6 per cent was faster than that recorded the preceding year. The factors behind this development were the increase in the population of working age (1 per cent for persons between the ages of 14 and 64) and the rise in the female participation rate from 34.5 to 34.9 per cent for women of more than 14 years of age. In the first half of the nineties the demographic component of the growth in the labour force should gradually diminish with the reversal of the trend in the central age groups of the population.

Disparities between different areas continue to widen, however. Unemployment is concentrated in the South, where it is continuing to rise significantly owing to the comparatively fast increase in the working-age population and the less satisfactory growth in the demand for labour. In the North, by contrast, the unemployment rate has been declining slowly for some time, despite the continued rise in the participation rate (Table 4).

Table 4

Unemployment and participation rates by region

(percentages)

	North	Centre	South	Italy
	unemployment rate			
1984	8.1	9.1	13.6	10.1
1985	8.0	9.2	14.2	10.3
1986	8.0	9.7	16.5	11.1
1987	7.8	9.7	19.2	12.0
1987 (1)	7.8	9.7	19.0	11.8
1988 (1)	6.9	10.0	20.5	12.0
	participation rate			
1984	43.6	41.8	36.5	40.7
1985	43.5	42.3	37.0	40.9
1986	44.1	42.6	37.7	41.5
1987	44.5	42.5	38.0	41.8
1987 (1)	44.5	42.5	38.1	41.7
1988 (1)	44.9	43.2	38.6	42.3

Source: Based on Istat data and the labour force survey.
(1) Average for January-July.

In the first half of the year minimum contractual wages in most branches of industry excluding construction were almost 6 per cent higher than in the same period of 1987; the increase in the construction industry was slightly larger, since the labour contract was not signed until towards the end of last year. In general government the contractual increases were far higher (around 13 per cent in the first six months), and the effects of the substantial increases awarded to school staff will not begin to emerge until the second half of the year. However, it should be remembered that public employees received substantial arrears in the course of 1987, since wage and salary adjustments under the new contracts were effective from the beginning of the preceding year; the rate of growth in earnings between the first half of 1987 and the first half of this year was therefore lower than that in contractual wages and salaries. In the private sector too, and especially in industry excluding construction, supplementary wage bargaining at company level is accentuating wage growth. The rise in per capita earnings is also due partly to the widespread use of overtime. Labour costs are likely to rise at a slightly faster rate than earnings owing to adjustments in employers' social security contributions decided by the Government at the beginning of the summer and to the system for granting fixed per capita relief from contributions.

In manufacturing industry the price indicators for imported inputs show an accentuation of cost pressures, except in energy prices, which were about 10 per cent lower in the first half of the year than in the same period of 1987. By contrast, the prices of raw materials other than energy showed a rise of 17 per cent over the same period owing to the steep rise in world market prices expressed in dollars from the second half of 1987 onwards. Although the rise has now come to an end, the recent depreciation of the lira against the dollar will have a negative effect.

The prices of domestic inputs also rose, especially those of services. Total inputs therefore increased in price by more than 5 per cent between the first half of 1987 and the same period of this year.

Taking movements in labour costs and productivity into account, the twelve-month rate of increase in industry's variable unit costs is in the region of 5 per cent.

Output prices increased less rapidly, thus reversing the sign of the differential recorded in recent years between the rise in prices and that in unit costs. The profit margins achieved by manufacturing industry in the wake of the oil counter-shock, when prices slowed down less markedly than costs, have up to now enabled firms to absorb part of the rise in costs (Table 5).

Measured in terms of consumer prices, inflation remained at a twelve-month rate of around 5 per cent in the first half of the year. The cost-of-living index did not show an acceleration in the summer months, despite the changes in indirect taxation, which became fully effective in August. The prices of regulated goods and services increased somewhat less than those of unregulated products, thanks mainly to the moderate increases in public utility charges, which were 4.1 per cent higher in the first seven months of the year by comparison with the same period of 1987. The largest increases in prices not subject to control or surveillance were in services and non-food goods, especially services.

Table 5

Variable unit costs and final output prices in manufacturing

(% changes on year-earlier period)

	1986	1987		1988 (1)
	Year	Year	H2	H1
Input prices				
Domestic	−1.4	4.0	6.3	4.0
of which: services	*3.7*	*6.2*	*7.1*	*5.8*
Imported	−7.5	−1.4	2.6	7.9
of which: energy	*−51.4*	*−5.9*	*24.7*	*−9.6*
non-energy raw materials	*−5.9*	*−2.5*	*2.5*	*17.0*
Total	−3.7	2.0	5.0	5.3
Unit labour costs	3.2	1.8	2.8	4.5
Variable unit costs	−0.2	1.9	3.8	4.9
Output prices	2.9	2.3	2.8	3.8

(1) Provisional and, for imported goods and services, estimated data.

The balance of payments on current account

According to provisional unadjusted data, the current account of the balance of payments recorded a deficit of 4.9 trillion lire in the first half of 1988, about 3.4 trillion more than in the same period of 1987 (Table 6).

The behaviour of trade flows was determined largely by the growth in demand both at home and abroad, while changes in relative prices had only a minor impact. The trade deficit was

800 billion lire higher than in the first half of 1987. Customs data show that the deficit on a cif-fob basis amounted to 8,279 billion lire, a deterioration of around 1,200 billion by comparison with the same period of last year.[1] Whereas the energy deficit contracted owing to the fall in oil prices and the reduction in the volume of oil imports, there was a deterioration in the balance on other items.

Table 6

Current account of the balance of payments

(balances in billions of lire)

	1987		1988
	Year	H1	H1
Memorandum item:			
Goods (cif-fob)	−11,142	−7,089	−8,279
Goods (fob-fob)	141	−1,671	−2,498
Services and transfers	−1,427	155	−2,415
Foreign travel	9,902	4,411	3,454
Investment income	−8,573	−4,426	−4,726
Public transfers	−2,961	−262	−789
Other	205	432	−354
Total	**−1,286**	**−1,516**	**−4,913**

The surplus from tourism contracted by 1 trillion lire, while the deficit on investment income was 300 billion lire higher than in the same period of 1987. Overall, the services and transfers account showed a deficit of 2,400 billion lire, a deterioration of 2,550 billion compared with the first six months of last year.

Customs data show that in the first five months of the year exports were 5.1 per cent higher in volume terms than in the same period of 1987, whereas imports increased by 6.1 per cent. The terms of trade remained virtually unchanged, since the unit prices of exports and imports increased by 3.5 and 3.6 per cent respectively. In June exports were 15 per cent higher in value terms than in the same month of 1987, with imports showing an increase of 14 per cent. Assuming the change in average unit prices in June to have been broadly in line with developments in May, and hence that the terms of trade remained unchanged, the volume of exports in the first half of 1988 is estimated to have been more than 6 per cent higher than a year earlier while the volume of imports probably increased by around 7 per cent (Table 7).

The acceleration in exports reflected the strengthening of world demand, which has been growing much faster than forecast since the middle of 1987.

Table 7

Foreign trade: values, prices, volumes

(percentage changes)

	1987 H1 / 1986 H1	1988 H1 / 1987 H1
Exports		
Value	−4.0	10.0
Average unit value (1)	−0.5	3.7
Volume (1)	−3.8	6.1
Imports		
Value	−0.7	10.6
Average unit value (1)	−7.9	3.7
Volume (1)	7.8	6.7
Terms of trade (1)	8.0	—

(1) Partly estimated data.

In the first half of the year domestic demand grew more rapidly in the major industrial countries than in Italy, thus eliminating the previous growth differential in Italy's favour. The gradual change in Italy's relative cyclical position provided greater scope for an increase in Italian exports, which were nevertheless limited by the high level of capacity utilization, and at the same time permitted an increase in export prices, given that the trend in competitiveness was not unfavourable.

(1) The aggregated customs data on merchandise trade in 1987 to which reference is made here are the final figures used in the Government's *Relazione generale sulla situazione economica del paese.*

2

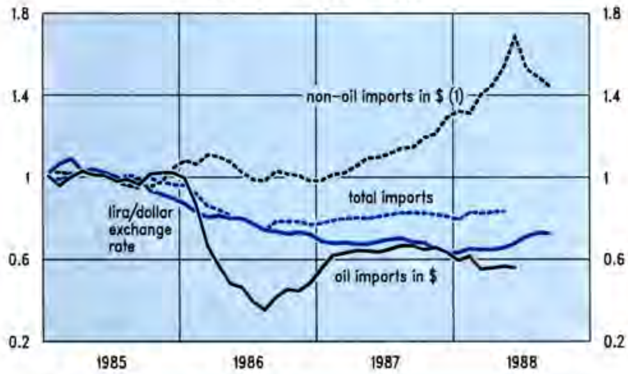
In the first six months of 1988 the growth in the volume of trade flows was influenced only slightly by the change in competitiveness, which showed an improvement of 0.3 per cent over the corresponding half of 1987 in relation both to Italy's thirteen main competitors and to the EEC countries. However, if the comparison is based on the six months to the end of March 1988 in order to show more clearly the lagged effects of changes in the real exchange rate on trade flows, the improvement works out at 0.5 per cent. The gain in relation to the main Community countries was more substantial, 1.2 per cent.

The terms of trade remained unchanged, thanks partly to the rise of just under 4 per cent in average unit export prices between the six months to the end of March 1987 and the same period of 1988. Since the end of 1986 exporters have been taking advantage of the growth in world trade to increase their profit margins, which they had had to trim in the preceding two years to defend their market share. Average unit import prices were affected by two opposing factors — on the one hand an increase of more than 30 per cent in relation to the first half of 1987 in world market prices of non-oil primary products expressed in dollars and on the other a fall of about 10 per cent in the dollar price of oil. In lira terms, costs also benefited from the depreciation of about 4 per cent in the dollar between the first half of 1987 and the same period of 1988 (Figure 6).

Figure 6

Average unit values of imports and main price determinants

(1985 indices = 1)



Sources: Economist, Istat and IMF.
(1) Economist index.

The deterioration in the trade balance in non-energy items affected six sectors out of nine; in the remaining three — food products, "other products" and non-metallic mineral products — there was an improvement in the position in relation to the preceding year (Table 8). The deficit on food products declined by almost 400 billion lire in the period from January to June, although at present there is no evidence of a continuing steady improvement. There was an increase of 600 billion lire in the deficit on chemical products, while that on transport equipment rose by about 350 billion, with imports increasing by 15.1 per cent in the first five months of the year (by about 11 per cent in volume) and exports by 5.5 per cent. The expansion in imports reflects a shift in demand towards cars with a cubic capacity of more than 1,500 cc, a section of the market in which Italian manufacturers are not well represented at the moment.

According to preliminary data, in the first five months of the year Italian exports to EEC countries were around 14 per cent higher than a year earlier, but those to OPEC countries and the United States stagnated. Within Europe, demand from Spain and the United Kingdom was particularly strong, owing in the first instance to the opening of the Spanish market as a result of Spain's accession to the European Community and in the second to buoyant growth in domestic demand in the United Kingdom.

In the first half of the year receipts from tourism remained broadly unchanged by comparison with the same period of 1987 but expenditure increased by almost 40 per cent, leading to a deterioration of 1 trillion lire in the account. On the receipts side, virtual stagnation in the number of stays by foreigners was accompanied by a reduction in spending in real terms. However, these developments are only one aspect of a general deterioration in the tourism account (see insert). The gradual erosion of the surplus is attributable not only to increased competition from other Mediterranean countries and the problems of environmental protection but also to the growing tendency for residents to take their holidays abroad, made possible by higher incomes and facilitated by the removal of exchange controls.

Table 8

Merchandise trade by product group
(billions of lire)

	EXPORTS (fob)		IMPORTS (cif)		BALANCE	
	January-June		January-June		January-June	
	1987	1988	1987	1988	1987	1988
Agriculture, forestry and fishery products	1,773	2,148	6,734	6,879	−4,961	−4,731
Energy products	1,401	1,481	10,716	9,150	−9,315	−7,669
Ferrous and non-ferrous metals	3,055	3,756	6,863	7,923	−3,808	−4,167
Non-metallic mineral products	2,832	3,573	1,375	1,703	1,457	1,870
Chemical products	5,798	7,009	10,079	11,901	−4,281	−4,892
Engineering products	23,058	26,147	16,373	20,070	6,685	6,077
Transport equipment	6,695	7,464	7,943	9,073	−1,248	−1,609
Food, beverages and tobacco products	2,717	3,209	6,821	7,163	−4,104	−3,954
Textiles, leather and clothing products	14,275	14,994	5,452	6,321	8,823	8,673
Other	8,245	9,755	6,618	7,632	1,627	2,123
Total (1)	**69,849**	**79,536**	**78,974**	**87,815**	**−9,125**	**−8,279**

Source: Istat.
(1) The total for 1987 does not correspond to the sum of the finalized aggregate data used in the Government Report on the Economic Situation.

In the first half of the year there was a deficit of some 800 billion lire on official transfers to international organizations. Contributions to the EEC remained broadly unchanged, despite a fall in payments of VAT. By contrast, there was a sharp increase in transfers to non-EEC countries, mainly in the form of development aid. Receipts showed a slight overall decrease by comparison with the first six months of 1987, with transfers from the EAGGF contracting by around 300 billion lire.

Capital movements and the exchange rate

In the first six months of this year there was an overall net inflow of around 6.8 trillion lire on account of capital movements, including bank capital and errors and omissions. The main factors in this development were a substantial inflow of foreign capital (more than 11 trillion lire) and a fairly small outflow of Italian funds (6.3 trillion). In view of the current account deficit of 4.9 trillion lire, the increase in the official reserves came to about 1.9 trillion lire, after adjustment for exchange rate changes and the revaluation of gold reserves (Table 9).

Table 9

Capital movements
(billions of lire)

	1987	1987 H1	1988 H1
Inward investment	539	501	6,899
Outward investment	−7,816	−3,198	−5,437
Foreign loans	12,337	4,076	4,728
Italian loans	−2,370	−1,531	−844
Trade credits, other capital flows and errors and omissions	−202	−133	−3,256
Total non-bank capital flows and errors and omissions	**2,488**	**−285**	**2,090**
Bank capital flows	**5,573**	**4,185**	**4,695**
Memorandum item:			
Change in official reserves	−6,775	−2,384	−1,872

Recent tourism trends and new indicators of competitiveness

In the first half of 1988 the tourism account deteriorated in relation to the corresponding period of the preceding year, with the surplus contracting from 4.4 to about 3.5 trillion lire. Expenditure abroad increased by nearly 40 per cent, having already risen by an average of 35 per cent in 1987 as a whole, whereas receipts from tourism decreased slightly, in contrast to growth of 7 per cent last year. In real terms, expenditure in Italy by foreign visitors fell by 6 per cent, but spending abroad by Italian travellers increased by 33 per cent.

The 1988 data therefore confirm the trends observed in recent years: on the one hand very rapid growth in expenditure and on the other a continuous slowdown in the increase in receipts (Figure 1).

Figure 1

Real expenditure by Italian and foreign tourists

(seasonally adjusted, in billions of lire at 1980 prices)

Source: Based on Bank of Italy, Istat and OECD data.

These trends are explained only in part by the behaviour of price competitiveness, defined as the ratio of consumer prices in Italy to an average of consumer prices abroad converted into lire and weighted according to each country's relative importance for the two sides of Italy's tourism account.

The system of weighting used hitherto has been revised in order to obtain as accurate an indicator as possible. The previous system was based on information on the nationality composition of tourist flows at the end of the seventies and did not take account of competition from countries such as Greece, Spain and Yugoslavia as far as inward tourism was concerned.

The practice adopted for inward tourism resembles the double weighting method used to construct the competitiveness indicator for merchandise exports, which is very similar. In this case foreign travellers of the various nationalities are treated as potential "markets" for Italian tourist services, while tourist "destinations" (excluding Italy but including the travellers' country of origin) are Italy's main "international competitors" for the supply of tourist services. The first step is to consider the relative importance of the various "markets" for Italy, expressed in terms of the nationality composition of foreigners' stays in all types of accommodation in Italy. Next the importance of Italy's main competitors for each "market" is taken into account. In this way it is possible to derive a structure of weights expressing the ability of each country to compete with the Italian tourist industry in all "markets". The data for this exercise were drawn from a recent OECD publication (National Tourist Markets), which collates detailed statistics on the destinations of tourist flows from all OECD countries. The weights were calculated on the basis of average flows in the most recent years for which data are available, 1984 and 1985 in most cases. The competitor countries considered are Austria, Belgium, Switzerland, the United Kingdom, France, Germany, the Nether-

According to provisional and partly estimated data, non-bank capital movements showed a surplus of 2.1 trillion lire for the first half-year; in the same period of 1987 there had been a deficit of 285 billion lire.

The inflows of foreign capital consisted of a small increase in net borrowing accompanied by a substantial rise in net investment, which touched 7 trillion lire, compared with an inflow of 500 billion in the same period of 1987.

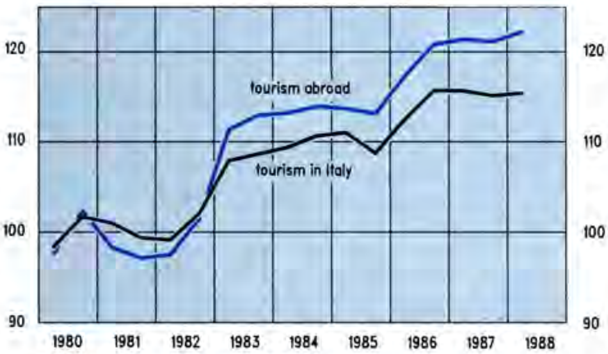
The net outflow of Italian capital came to more than 800 billion in lending and almost 5,500 billion in investment, compared with net outflows of 1.5 and more than 3 trillion lire respectively in the first six months of 1987. Outward portfolio investment amounted to 3.6 trillion lire, an increase of 2.2 trillion over the previous year. The inflow of net foreign investment gained momentum in the second half of 1987; in the first five months of this year new foreign investment *lands, the United States, Spain, Greece and Yugoslavia. The same group was used for Italian travel abroad, except that here the weighting structure reflects Italian preferences for various foreign destinations, based on Istat surveys of the holidays, travel and sports of Italians in 1982 and 1985.*

The new indicators (Figure 2) both show two periods of declining price competitiveness; the first, in 1983, was due to a widening of the inflation differential to Italy's disadvantage and entailed a loss of competitiveness of about 8 per cent on inward tourism and more than 12 per cent on outward tourism, while the second, in 1986, was less severe and led to losses of 4 and 5 per cent respectively. Italy's competitiveness has remained virtually unchanged since 1987.

Figure 2

Indicators of price competitiveness

(index figures, 1980 = 100)



Source: Based on Istat and OECD data.

The large increase in Italian travel abroad in the eighties is difficult to explain solely in terms of the loss in competitiveness. It stems more from an increase in the proportion of income spent on consumption of this type, which is still far lower than in other OECD countries. The start of the adjustment in 1984 coincided with abolition of the main restrictions on the exportation of foreign exchange for travel purposes; the flow of expenditure rose by almost 30 per cent that year. The same rate of growth was recorded in 1987, again in connection with increases in foreign exchange allowances for travel abroad. The rates of growth last year and in the first half of 1988 suggest that expenditure on foreign travel is still lower than people would wish and that it will therefore continue to rise rapidly.

The ability of the competitiveness indicator to explain developments in inward tourism appears to be no less problematic. From 1982 onwards, when international tourist demand was reviving strongly, the rate of increase in receipts slowed down sharply in both nominal and real terms; this development was not reflected in the behaviour of relative prices except in 1984, when the substantial loss of competitiveness in the preceding year made itself felt. Even if 1986 is disregarded in view of the exceptional circumstances that caused a dramatic fall in US tourism that year, there is a fairly clear flattening of the positive trend the series displayed in the seventies. The traditional determinants — international tourist demand and price competitiveness — may not be sufficient in themselves to explain this phenomenon. Its causes should therefore be sought in the overall competitiveness of the Italian tourist trade — in terms of quality of service and adequacy of accommodation — and the effectiveness of the measures taken to protect our natural and artistic heritage.

averaged almost 2.5 trillion a month. In the first quarter net portfolio investment came to 2 trillion lire, out of total investment of 3.3 trillion. Foreigners made net sales of bonds and shares but purchased Italian government securities amounting to almost 2.2 trillion lire, mostly in Treasury bills (Table 10).

In the first half of this year net Italian portfolio investment abroad amounted to around 600 billion lire a month. The scale of the net outflows appears to be consistent with a natural process of portfolio adjustment after the liberalization of exchange controls in May 1987.

On the basis of preliminary estimates and including errors and omissions, trade credit recorded a net outflow of 2.5 trillion lire in the first half-year, compared with one of 400 billion in the comparable period of 1987. There were net outflows of just over 1 trillion lire in this item in the second half of 1987, when the covered interest

The new exchange control legislation

The new exchange control legislation, (1) *which became fully effective on 1 October 1988, completes the transition from a system in which residents were prohibited from entering into commitments towards non-residents except in connection with transactions that were expressly authorized, to one in which foreign transactions can be carried out freely, subject only to expressly stated exceptions and limitations.*

The liberalization now taking place affects a wide range of economic relationships, and not only in the European Community. The new regulations give operators much greater freedom than in the past by deregulating many operations that had previously required individual authorization.

Except for short-term investments (bonds with a residual life of 180 days or less), portfolio investment abroad and the formation of holding companies or the acquisition of interests in such companies are free of restrictions and are no longer subject to the non-interest-bearing deposit requirement. The banks have been given greater scope for foreign exchange operations and residents are now free to borrow abroad and to obtain foreign currency finance from resident banks, whether or not connected with foreign transactions. The other innovations regarding non-banks include the possibility of exchanging foreign assets and liabilities (except foreign currency) against lire and abolition of the limits on the exportation of payment instruments for tourist purposes. Finally, the range of matters to which the principle of tacit approval can be applied has been extended and foreign exchange offences have been decriminalized.

In the event of tensions in the foreign exchange market, the authorities will be able to deviate from the principle of free economic relations with correspondents abroad by imposing temporary restrictions selected from a predetermined list and expressly stating the reasons for their action.

A number of permanent *restrictions deriving from the principle of the foreign exchange monopoly remain in force. There is provision for general exemptions to be made by administrative order, including those required in connection with the implementation of the Single European Act and with progressive monetary integration in Europe. The following summary lists the measures according to the operators whose activities are being regulated.*

Residents other than banks

Residents other than banks are obliged:

a) *to deliver foreign exchange to authorized banks within 60 days of receipt for conversion into lire or crediting to any accounts they may hold. This requirement does not apply to foreign banknotes up to the equivalent of 2,500,000 lire or SDR 1,250, whichever is the greater. The time limit set for foreign currency accounts is 120 days for both "converted" foreign exchange (purchased with lire to settle authorized transactions) and "directly acquired" foreign exchange (resulting from payments received from abroad);*

b) *to deposit foreign transferable securities with authorized intermediaries (the Bank of Italy, authorized banks, Monte Titoli S.p.A. and foreign banks and institutions with functions comparable to those of Monte Titoli) within 90 days of actual receipt.*

In addition, they are prohibited *from:*

a) *exporting, holding or depositing funds in foreign currency or lire abroad. There is provision for exceptions to be made to this prohibition in certain cases in order to allow special foreign currency accounts to be opened with non-resident banks;*

b) *opening credit lines in foreign currency or lire for non-residents;*

c) *carrying out forward or option transactions in foreign exchange with non-residents.*

For statistical and monitoring purposes, foreign currency transfers and foreign exchange transactions must be channelled *via authorized intermediaries (the Bank of Italy, the Italian Foreign Exchange Office, authorized banks and, subject to certain limitations, the Postal Administration).*

Residents travelling abroad for purposes of tourism, medical treatment, business or study may export the following payment instruments: *credit cards, Italian banknotes up to 1 million lire, payment instruments in foreign currencies and external lire without limit provided any amount in excess of the equivalent of 2,500,000 lire has been acquired legitimately from authorized banks, and cheques for drawing on normal domestic accounts provided all cheques issued abroad are made out to non-residents, are for amounts not exceeding 5 million lire and are non-transferable.*

Banks

Banks authorized to carry out foreign exchange and foreign currency operations (2) *are exempted from the obligations and prohibitions set out above. However, they are subject to the following* obligations:

a) *their* foreign exchange position *on a daily basis may not exceed 5 per cent of their spot foreign exchange assets as at the end of 1987; premises and bank participations abroad, the endowment funds of their foreign branches and similar assets are not taken into account when calculating the position;*

b) *they may have a* net creditor external position in foreign currencies *only up to the limit permitted for the overall foreign exchange position;*

c) *they may not have a* net creditor external position in lire; *in other words, their lending in lire abroad may not exceed their fund-raising in lire from non-residents;*

d) *forward transactions may be offset against spot operations in the opposite direction only up to the* spot-against-forward ceiling, *allotted to each bank by the Italian Foreign Exchange Office and increased by not less than 50 per cent in relation to the situation prevailing on 30 September 1988. Authorized banks may also write* foreign exchange options *for sale to residents and non-residents, provided that such operations are matched globally by transactions in the opposite direction according to currency, amount and maturity.*

(1) For further information on the individual measures, see the article on "The Reform of Italy's Exchange Controls" on page 51.

(2) Authorization may also be granted by the Bank of Italy for individual categories of transaction; in addition, the Bank has the power to authorize operators other than banks to carry out foreign currency transactions and to determine the framework within which they shall operate.

Table 10

Inward portfolio investment

(billions of lire)

	Total	Government securities — of which: Treasury bills	Treasury bonds	Securities in ECUs	Treasury credit certificates	Bonds	Shares	Total investment
1987 — 1st qtr.	1,591	−176	2	1,075	690	−63	−1,579	−51
2nd "	−1,822	59	−551	710	−2,040	35	−157	−1,945
3rd "	−1,141	−210	−226	−79	−629	−10	−670	−1,823
4th "	999	894	−167	432	−161	64	−1,957	−896
Year	−373	567	−942	2,138	−2,140	26	−4,363	−4,715
1988 — 1st qtr.	2,187	1,417	5	418	287	−187	−101	1,999

rate differential vis-à-vis the dollar and the Deutschemark was negative or zero. In the first quarter of this year, however, the covered differential turned positive, in conjunction with net inflows of 1.8 trillion lire. In the second, by contrast, there were net outflows of 4.3 trillion lire, probably due to the strong acceleration in export growth.

In the first nine months of 1988 the overall balance of payments recorded a surplus of 1,878 billion lire, compared with a deficit of 1,530 billion in the same period of last year. Movements of bank capital gave rise to a net inflow of 3,406 billion lire, after exchange rate adjustments. As a result, official reserves increased by 5,284 billion lire, after adjustment for exchange rate changes and the revaluation of gold reserves. The increase in the banks' external liabilities occurred mainly in the first six months of year (4,500 billion), whereas in the third there were net outflows of around 1 trillion lire. Movements of non-bank capital, net of trade credit, generated an inflow of some 10 trillion lire in the period from January to September. The trends evident in the first half of the year continued in the third quarter; in particular, net inward investment recorded a inflow of more than 4.3 trillion lire.

Between January and September the nominal trade-weighted exchange rate of the lira declined by 5.5 per cent. The depreciation worked out at 13 per cent against the dollar but only 1.6 per cent against the EEC currencies, mainly as a result of the lira's decline against the pound sterling. During the summer the exchange rate of the lira against the EMS currencies showed greater flexibility in both directions than in the past, in line with the Basle-Nyborg agreement (see the chapter on the international economy).

Public finances

After the Finance Law for 1988 had been approved in March, the Government published a revised estimate of the state sector borrowing requirement: 122,000 billion lire, a substantial increase on that indicated during the laborious process of getting the budget approved. On 30 May a plan for the rehabilitation of the public finances was published and a new target set for the state sector borrowing requirement: 114,450 billion. In the same month, and again in July, corrective measures were introduced with the aim of bringing the borrowing requirement into line with the objective and reducing the sector's expansionary impulse on aggregate demand.

Even though the borrowing requirement is likely to overshoot the target set in May by around 4,000 billion lire, it should come close to achieving the objective in relation to GDP owing to the faster growth of the economy (Table 11).

Table 11

Selected public finance balances

(billions of lire)

	1986	1987	1988
State sector:			
Borrowing requirement, net of settlements of past debts	109,557	113,659	118,000 (1)
as a % of GDP	(12.1)	(11.6)	(11.0)
Settlements made in cash	606	132	70
Settlements made in securities	—	421	60
Total borrowing requirement	110,163	114,212	118,130
as a % of GDP	(12.2)	(11.6)	(11.1)
Borrowing requirement net of interest payments and settlements of past debts	36,377	37,397	30,500
as a % of GDP	(4.0)	(3.8)	(2.9)
Public sector:			
Total borrowing requirement	110,133	114,289	118,500 (2)
as a % of GDP	(12.2)	(11.6)	(11.1)
Borrowing requirement net of interest payments and settlements of past debts	31,466	33,045	27,000 (2)
as a % of GDP	(3.5)	(3.4)	(2.5)

(1) The official estimate published in *Relazione trimestrale sulla stima del fabbisogno di cassa*, submitted to Parliament by the Treasury Minister on 28.9.1988. — (2) Estimates in line with those for the state sector shown above.

The balance net of interest payments should be close to the target set and show a reduction of nearly 7,000 billion compared with 1987. This continues the downward trend in the ratio of this aggregate to GDP, which got under way in 1984. On the one hand, the reduction achieved in 1988 reflects the cyclical strength of the economy, on the other, it is due to fiscal measures that served principally to anticipate revenues originally attributable to 1989.

The increase in interest payments compared with 1987 has resulted entirely from the growth in the debt, since on average for the year the ratio of interest to the stock of debt has remained virtually unchanged, despite the raising of interest rates in the summer to promote internal and external equilibrium and the shift in investors' preferences from long and medium-term securities to those with short maturities, the interest on which is booked when they are issued.

In the first nine months of 1988 the state sector borrowing requirement grew by about 8,900 billion lire compared with that recorded in the corresponding period of 1987 (Table 12). However, to interpret these figures correctly, it is necessary to bear several factors in mind. In particular, the revenues provided by corporate

Table 12

Borrowing requirement (1)

(billions of lire)

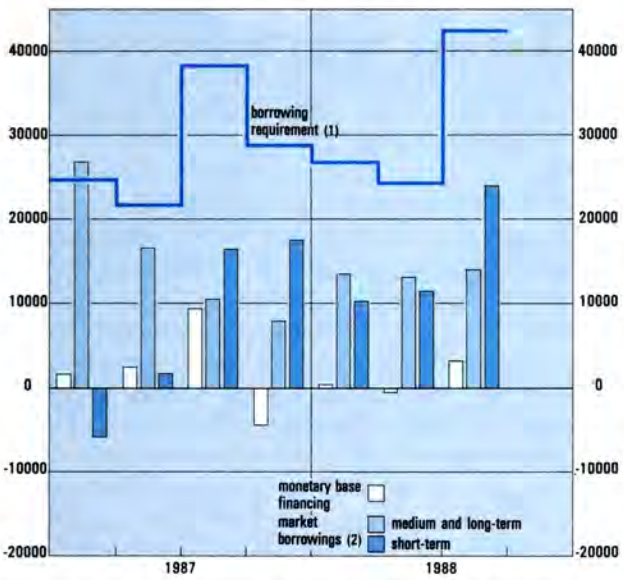
	1986	1987	1988 (2)
State sector			
First half	46,336	46,776	51,353
January-September	82,547	85,238	94,126
Public sector			
First half	45,333	47,861	51,505

(1) Gross of settlements of past debts. — (2) Provisional.

income tax and the withholding tax on bank deposit interest were curtailed by the increases in the payments on account that were introduced in 1987 with the aim of reducing the borrowing for that year (the shortfall will, of course, be made good with the payments on account to be made in the last part of this year). In addition, the measures adopted in May and July, and forecast to bring in 5,700 billion lire of revenue in a full year, will produce most of their effects in the last quarter. Finally, the comparison is influenced to a considerable extent by the increase in debt service entailed by the greater recourse made to Treasury bills from the last part of 1987 on.

Figure 7

State sector borrowing requirement and its financing



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

In the first three quarters of the year, 89 per cent of the borrowing requirement was financed through sales of securities in the market, compared with 78 per cent in the corresponding period of 1987 (Figure 7). There was, however, a pronounced shift in the distribution of security issues by maturity and holder: more than half the net issues comprised Treasury bills (as against 20 per cent in the first half of 1987), and almost all the purchases of medium and long-term securities were made by households.

At the end of September the debt of the public sector, including the part held by the Bank of Italy, amounted to more than 1,000 trillion lire (Figure 8). The large differential between the rates at which the public debt and gross domestic product are growing, estimated at nearly 6 points for the whole year, confirms the need to eliminate the borrowing requirement net of interest payments in accordance with the Government's plan. The new budget procedures laid down by Law 362 in August should contribute to the achievement of this goal.

Figure 8

The public debt (1)

(as a percentage of GDP)

(1) The figure for 1988 is an estimate.

State sector revenues and expenditures

The disbursements of the state sector in the first six months of the year amounted to 207,030 billion lire, an increase of 9.6 per cent on the first half of 1987 (Table 13). The growth was especially rapid for loans and advances and, among current items (up 8.9 per cent), for interest payments and transfers to regions. Outlays on capital account only expanded by 7.2 per cent.

Compared with the first half of 1987, spending on wages and salaries rose by 8.9 per cent. When this figure is corrected for the irregularity with which the withholding tax on wages and salaries is accounted for, it falls to 6.5 per cent. This increase can be attributed largely to the working of automatic mechanisms (wage indexation and career paths) and to an increase in employment. By way of comparison, the contractual wage increases that came into force on 1 January 1988 were matched by the disbursement in the early part of 1987 of backpayments regarding 1986.

Table 13

Main items of the consolidated accounts of the state sector on a cash basis

(billions of lire; % changes on year-before period)

	1987 H1	1988 H1	1988/1987
Current expenditure	**166,424**	**181,275**	**8.9**
of which:			
wages and salaries	31,432	34,222	8.9
pensions	8,913	9,529	6.9
goods and services	10,110	10,482	3.7
current transfers	73,140	77,832	6.4
of which to:			
social security institutions	15,570	15,276	−1.9
regions	29,528	33,115	12.1
communes and provinces	13,946	14,404	3.3
households	4,886	5,276	8.0
enterprises	6,213	5,993	−3.5
net interest	37,055	41,708	12.6
Capital expenditure	**16,065**	**17,224**	**7.2**
of which:			
fixed capital	5,831	6,978	19.7
capital transfers	10,234	10,246	0.1
Financial items	**6,449**	**8,534**	**32.3**
of which:			
investments	1,678	967	−42.4
loans and advances	4,080	7,102	74.1
Total expenditure	**188,938**	**207,033**	**9.6**

Source: *Relazione trimestrale sulla stima del fabbisogno di cassa*, submitted to Parliament by the Treasury Minister on 28 September 1988.

Interest payments in the first six months totaled 41,710 billion, an increase of 12.6 per cent on the corresponding period of 1987 that stemmed from the rise in the debt and the larger proportion of Treasury bills in new issues. The average interest rates on Treasury bills were nearly one percentage point higher than in the first half of 1987. Most of this increase came in connection with the doubling in September 1987 of the rate of the withholding tax on income from government securities. The interest payments on Treasury bills rose by 42 per cent, compared with a 36 per cent increase in the volume of net issues. At the longer end of the market, the interest paid on Treasury credit certificates remained virtually unchanged, partly as a result of the reduced recourse to such securities in financing the borrowing requirement from mid-1987 on.

Current transfers expanded by 6.4 per cent, with those to regions jumping by 12 per cent in connection with the increase in the funds allocated to the national health service from 22,130 to 26,020 billion. Transfers to households in the form of war and disability pensions continued to rise, though more slowly; Decree Law 173 of 30 May 1988 has placed restrictions on the granting of disability pensions.

Transfers to the social security institutions were unchanged, though those to INPS, net of the contributions charged to the budget, rose by nearly 5 per cent to 13,000 billion lire. The stabilization of these institutions' deficits was primarily due to the rise in contributions, attributable on the one hand to the higher rates introduced at the beginning of the year for the self-employed and agricultural employees, and on the other to the steps taken by INPS and INAIL to recover unpaid contributions. The parties involved in this action have recognized debts totaling around 3,500 billion lire. However, only about half this amount was actually paid. Receipts will also be boosted in the second half of the year by the increase in the rate paid by employers to cover early retirements from 0.15 to 0.60 per cent, as provided in the measures introduced at the end of May. By contrast, the contributions attributable to the national health service were negatively affected by the relief granted as of 1 January to employee workers and state pensioners.

The rise in social security spending was slowed by the further fall in outlays on wage supplementation and the absence of an annual revaluation of pensions in line with the increase in earnings in real terms owing to the fact that the relevant index showed no change in the reference period for the revaluation of 1 January 1988. On the other hand, social security spending was boosted in particular by the biennial revaluation, with effect from 1 July 1987, of the annuities paid by INAIL, the changes as of 1 January 1988 in the regulations governing family allowances and the increase as of the same date in the minimum pensions of the self-employed to the level of those paid to employees.

As regards outlays on capital account, transfer payments were unchanged, while direct investment rose by nearly 20 per cent as a result of the increased activity of the autonomous government agencies, the State Railways and the Southern Italy Development Agency. Among the transfers on capital account, those to the rest of the enlarged public sector increased from 1,180 to 1,730 billion, and those to enterprises from 2,530 to 3,190 billion. Among the latter, there was a substantial increase in the disbursements of the Southern Italy Development Agency, which is beginning to carry out its activity with greater regularity.

The increase in financial items (32 per cent) was due entirely to the growth in loans and advances, up 74 per cent compared with the first half of 1987 (in which, however, disbursements were below the level recorded in the first half of 1986). In particular, the loans disbursed by the Deposits and Loans Fund to local health units to cover their deficits in respect of prior years jumped from 150 to 2,370 billion lire. The Fund's lending to other local authority bodies rose from 2,980 to 3,680 billion. At 250 billion the capital contributed to public enterprises was unchanged compared with the first half of 1987, while the amount contributed to special credit institutions dropped by a half. Furthermore, there was a decrease in the Deposits and Loans Fund's purchases of bonds issued by these institutions.

In the first half of 1988 the state's fiscal revenues (including the receipts used for refunds and those accruing to the EEC, but excluding accounting transactions with special statute regions and tax collection commissions) rose by around 13 per cent compared with the corresponding period of 1987 and totaled 120,000 billion lire. Provisional figures for the first three quarters indicate a slightly larger increase. This result, which points to a rise in the ratio of tax revenues to GDP for the year as a whole, was primarily attributable to the strong growth in the withholding tax on income from government securities and the rises in personal income tax withheld on wages and salaries and VAT and other indirect taxes, as a result, in the case of the latter, of the numerous rate increases introduced in 1987 and 1988.

As regards the IRPEF yield, the rise in earnings, together with fiscal drag, which was only offset in part by the increase in allowances, resulted in an increase of around 15 per cent in the tax withheld from the wages and salaries of employees in the private sector. The increase for public sector employees was only slightly smaller.

The balances paid in settlement of self-assessed personal income tax liabilities rose by nearly 10 per cent, while the income tax balances paid by corporate entities decreased by around one third. This decrease, which had not been foreseen in the official estimates, reflected both the small growth in taxable income (in particular, bank profits fell) and the increases in the rates for IRPEG and ILOR on-account payments at the end of 1987, which had the effect of anticipating receipts amounting to around 900 billion lire to 1987. In addition, the yield was affected by the increase between 1986 and 1987 in the withholding tax on income from government securities, since this counts as a payment on account of IRPEG and therefore reduces the balance to be paid the following year.

The withholding tax levied on income from government securities rose to 2,900 billion lire through September, compared with 900 billion in the first nine months of 1987. This result was due to the replacement of maturing exempt issues with new ones liable to the tax and to the increase in the rate from 6.25 to 12.5 per cent as of September 1987. By contrast, the yield of the withholding tax on bank deposit interest was unchanged (amounting to around 5,500 billion), notwithstanding the payment on account having been raised in June from 45 to 60 per cent with the aim of bringing forward to 1988 the effects of the increase in the tax rate in respect of freely available deposits (from 25 to 30 per cent). The explanation lies in the fact that banks were allowed to offset their tax credits in respect of 1987 against the June payment on account. In addition, the balance paid in March of this year was negatively affected (by around 1,100 billion) by the increase from 45 to 55 per cent in the payment on account made in October 1987.

Indirect tax revenues rose by more than 15 per cent. Ministry of Finance figures for VAT receipts in the period through August show an 11 per cent rise in respect of domestic transactions and one of 12 per cent in respect of imports, a reflection of the strength of economic activity. There was an even larger increase in the yield from stamp duties (20 per cent, including the yield of the special tax on stock exchange contracts) as a result of the increases introduced in September 1987. There was also a substantial rise in receipts from excise taxes (13 per cent), which can be attributed to the introduction of higher rates: in addition to the frequent changes made in the rate for mineral oils, increases were introduced in the rates for methane, LPG, spirits and beer. Among the other indirect taxes, it is worth noting the increase in receipts from government licence fees (including the company registration fee) and the road tax and surtax, which were increased at the beginning of the year, and the doubling of the revenue from the game of "lotto", which has been reorganized and made more widespread.

In the last quarter of the year the rate of growth in tax revenues should rise slightly: the time allowed for the payment of VAT has been reduced (starting in October) and the basic rate raised from 18 to 19 per cent; the on-account IRPEF and ILOR personal income tax payments to be made in November have been increased from 92 to 95 per cent of the prior year's liability; and further increases introduced in the excise taxes on oil products and methane.

The money and financial markets

The money and credit aggregates and monetary policy

So far this year, the growth of the money supply has been consistent with the objectives of the planning framework. At the same time, there has been a strong expansion of credit to the non-state sector brought about by faster-than-expected real growth, and in particular by the rising demand for capital goods. In view of the stimulus to domestic demand generated by the public sector borrowing requirement, monetary policy was committed to preventing the sharp rise in credit from damaging the balance of trade, which was showing signs of deterioration early in the year, and from rekindling inflation, the threat of which was posed by rising raw materials prices. It was also necessary to provide sufficient non-monetary financing of the Treasury, whose cash needs were increased by substantial redemptions of maturing securities.

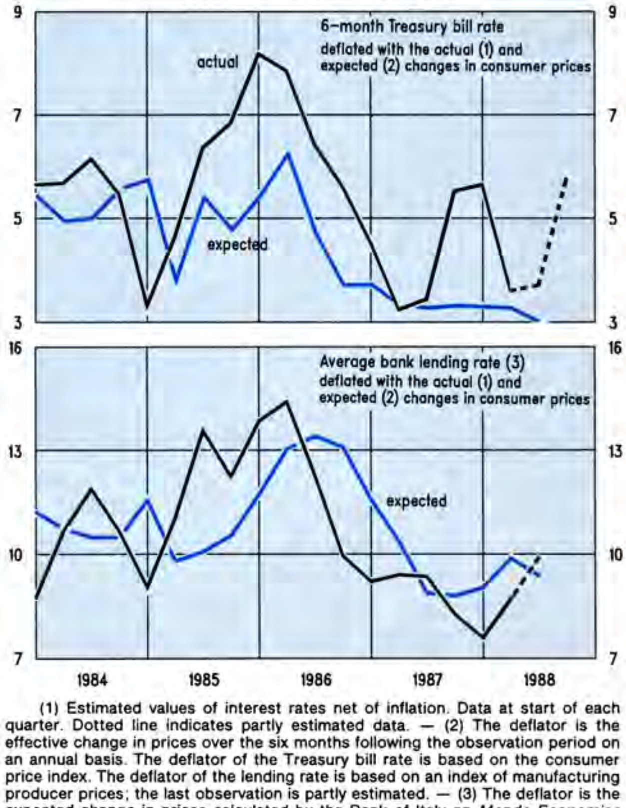
With the rate of inflation holding steady, rises in the nominal yields on government securities between July and September halted the decline in real interest rates that had taken place in the early months of the year and facilitated the financing of the deficit, which had at times proved difficult (Figure 9).

At the same time the banks gradually raised their lending rates, which until summer had been declining. Owing in part to the resultant rise in the real cost of borrowing, the expansion of lending showed signs of slowing down, returning to a pace more consistent with the orderly growth of real economic activity. On average, lending to the non-state sector expanded at an annual rate of 17.5 per cent over the period January-May but slowed to 15.3 per cent for January-August (Table 14). The target range had been fixed at 6-10 per cent.

The course of lending to the non-state sector was largely influenced by the movements in its banking component. With the expiry in March of the ceiling on credits in lire, and faced with a relatively slow growth in deposits, the banks sold off large amounts of their security holdings to help finance a rapid expansion of lending, whose annualized growth rate in 1988 reached a peak of 19.3 per cent for the months January-May. A slowdown during the summer brought this rate down to 16.2 per cent, seasonally adjusted, for the first eight months. The lira component of lending expanded more rapidly, rising at an annual rate of 18.1 per cent in January-August.

Figure 9

Real interest rates (1)



(1) Estimated values of interest rates net of inflation. Data at start of each quarter. Dotted line indicates partly estimated data. — (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. The deflator of the lending rate is based on an index of manufacturing producer prices; the last observation is partly estimated. — (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.

Lending by special credit institutions also recorded strong growth, amounting on an annual basis to 14.7 per cent over the first eight months. However, in contrast with past experiences, it had not accelerated while the lending ceiling was in effect. Lending by special credit institutions was especially responsive to industrial credit needs, in particular those directly connected with investment activity, and to the real estate sector. The growth of special credit was favoured not only by a reduction in the tax levied in lieu of the loan registration tax and stamp duty but also by a contraction of corporate bond issues. From end-December to end-August net redemptions of corporate bonds came to 450 billion lire, as against net issues of 1,900 billion in the same period of 1987.

Table 14

Total domestic credit
(percentage changes) (1)

	1987		1988 (2)	
	Jan.-Aug.	Year	Jan.-Aug.	Target range
Bank lending (3)	11.5	8.3	17.4	
Special credit institution lending	12.8	13.3	15.4	
Net bond issues	9.5	12.2	−2.0	
Non-state sector financing	**11.8**	**10.3**	**15.3**	**6-10**
State sector domestic borrowing requirement (4)	14.5	14.9	13.5	
Total domestic credit (4)	**13.5**	**13.1**	**14.2**	

(1) Annualized, seasonally adjusted. — (2) Provisional. — (3) Corrected for exchange rate variations and the funding of past debts. — (4) Net of contributions to financial intermediaries' endowment funds and of funding operations.

With credit to the non-state sector and the state sector borrowing requirement rising faster than expected, total domestic credit expanded in the period January-August by 104.5 trillion lire, or at an annual rate of 14.2 per cent compared with the year's target rate of 10.4 per cent.

Over the same period, the money supply (M2) increased at a 7.3 per cent pace (Table 15), but in a discontinuous way. After a negligible rise in the first quarter, M2 recorded a modest acceleration from April onwards, but it was not until July that its expansion reached the lower limit of the target range of 6-9 per cent. The relatively slow growth of deposits was a result not only of the higher withholding tax on interest income but also of policy decisions by the banks aimed at improving their profitability after the deterioration suffered in 1987. They accepted a widening of the yield differential between government securities and bank deposits and in consequence a more active disintermediation process. Continuing the trend of the last few years, banks encouraged the use of certificates of deposit, yields on which are not subject to the higher tax. Net of CDs, the money supply (M2A) expanded at an annual rate of only 4.2 per cent over the first eight months.

Table 15

Monetary variables
(percentage changes) (1)

	1987		1988 (2)	
	Jan.-Aug.	Year	Jan.-Aug.	Target range
Bank reserves (3)	10.3	9.2	9.1	
Monetary base (3)	10.0	9.2	8.5	
Bank deposits	7.4	6.8	6.3	
Money supply net of CDs (M2A)	7.9	6.8	4.2	
Money supply (M2)	8.9	8.3	7.3	6-9

(1) Annualized and seasonally adjusted. — (2) Provisional. — (3) Corrected for the change in the compulsory reserve ratio.

On the basis of data available for the first seven months of 1988, total domestic financial assets held by the non-state sector, net of shares, grew at an annual pace of 15 per cent. The large difference between the rate of growth of the money supply and that of financial wealth reflects substantial purchases of government securities (77 trillion lire as against 61 trillion in the same period of 1987) and purchases by households and firms of CDs issued by special credit institutions. The rise in these items offset the contraction in holdings of investment fund shares, which had already got under way in the second half of 1987 (Table 16).

A large part of the demand for securities was directed to Treasury bills, confirming the growing preference for short-term assets. In the medium-term portion of the market, private investors concentrated on fixed-income securities. Purchases of Treasury bonds, some issues of which again have a two-year maturity, were greater than in 1987. Acquisitions of Treasury credit certificates, though still substantial, diminished in relation to 1987.

Table 16

Financial assets (1)

(percentage composition)

	Stocks		Flows	
	Dec. 1987	July 1988	Jan.-July	
			1987	1988
Money (M2)	52.5	50.3	34.8	26.0
of which:				
bank deposits	42.0	40.0	24.7	17.1
Treasury bills and acceptances	14.2	14.1	−0.9	12.2
Special credit institutions CDS	2.1	2.9	0.3	11.4
Medium-term securities	26.2	28.7	59.0	57.1
Investment fund units	4.8	3.9	6.9	−6.7
Total	**100.0**	**100.0**	**100.0**	**100.0**

(1) Domestic financial assets of the non-state sector, excluding direct holdings of shares; seasonally adjusted. Inclusion of minor items may cause discrepancies in the totals.

Despite the purchases of government securities by households and firms, the Treasury at times found it difficult to meet its growing financial requirement on the market. The supply of securities was swollen by sales by the banks, which were thus able to expand lending despite slow deposit growth, and by the investment funds, which were pressed to meet redemptions. In the early months of the year this excess supply was reflected, in the floating rate segment in particular, in a resumption of the downward trend in prices on the secondary market after a pause late in 1987.

The growth of the monetary base, like that of bank deposits, slowed down in the early part of the year and then accelerated somewhat. Over the first nine months the monetary base expanded by 6.5 trillion lire, or at an adjusted annual rate of 10.2 per cent, the same as in the first three quarters of 1987. The control of domestic channels of monetary creation was of particular importance in order to offset a heavy inflow of foreign exchange (equivalent to over 5.0 trillion lire, as against 300 billion lire in January-September 1987). The inflow derived in part from Treasury borrowing abroad and from non-residents' purchases of Italian government securities. Monetary base financing of the deficit was thus held to less than 3.5 trillion lire, as against 13.6 trillion in the first nine months of 1987 (Table 17).

Table 17

Monetary base

(changes in billions of lire)

	1987		1988 (1)
	Jan.-Sept.	Year	Jan.-Sept.
Sources			
Foreign sector	328	6,756	5,075
Treasury	13,586	9,240	3,488
Borrowing requirement	*85,238*	*114,212*	*94,126*
(excluding settlements of past debts	*(84,990)*	*(113,659)*	*(94,004)*
Outstanding securities excluding BI	*−66,157*	*−84,657*	*−81,616*
Other financing (2)	*−5,495*	*−20,315*	*−9,022*
Refinancing of banks	−1,169	−730	−177
Other sectors	−6,396	−1,320	−1,921
Total	**6,349**	**13,946**	**6,465**
Uses			
Currency in circulation	−594	4,387	−651
Bank reserves	6,943	9,559	7,116
Compulsory reserves	*7,407*	*8,740*	*7,143*
Deposits against loans in excess of ceiling	—	*657*	*−657*
Liquidity	*−464*	*162*	*630*

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

The first signs of sluggish sales of Treasury credit certificates emerged in February, and the difficulty persisted in March, in concomitance with exchange market pressure on the lira. The decline in government securities yields was halted. The Bank of Italy intervened to limit the

Bank of Italy intervention in the money market

The first few months of the year were marked by a substantial inflow of base money from abroad associated with the operation of the lending ceiling and expectations of a stable exchange rate. Adding to this expansionary impulse to liquidity, in March, was that deriving from the large Treasury borrowing requirement and from restrained demand for government securities, especially those at medium and long term. The working out of these factors led to the gradual extinction of the banking system's temporary indebtedness to the central bank (see figure). From the end of March *onwards, the control of the monetary base was carried out primarily by means of temporary financing operations. Through the first quarter the market's demand for government securities continued to shift towards the shorter maturities. Net purchases of Treasury credit certificates were cut back in favour of purchases of bills and two-year bonds, the latter being first issued by the Treasury in March. The Bank of Italy facilitated this shift in preferences by outright open-market operations aimed at stabilizing the prices of credit certificates.*

In the first half of April *a large injection of liquidity resulting from the rapid expansion of Treasury borrowing was accompanied by a sizable outflow of foreign exchange reserves. The central bank mopped up liquidity on the open market with offers of repurchase agreements at rates approximating 12 per cent. The weakness of the market for Treasury credit certificates was also evidenced by the unsatisfactory results of the issue at the beginning of the month. The Bank of Italy responded, on the one hand, by continuing open market support for the certificates counterbalanced by offsetting operations in Treasury bills, and on the other, by acceding to a rise of 35 basis points in the rate on the twelve-month bills at the mid-April issue. The yield curve thus became positively sloped in the short-term segment. Despite the market's disinvestment of credit certificates, overall net subscriptions of government securities amounted to 11 trillion lire in the month, thanks to net demand for two-year bonds and ECU-denominated securities of about 8.6 trillion lire and for bills of about 3.8 trillion. By the end of the month average liquidity had come back down to about 4 trillion lire and the overnight deposit rate had exceeded 12 per cent (see figure).*

In May *the outflow of foreign exchange reserves slowed. Heavy spending by the Treasury and slack demand for new issues of government securities produced another surge in bank liquidity at the beginning of the month. The central bank intervened with temporary sales of about 2 trillion lire. The small volume of net purchases of new issues forced the Treasury to make full use of its current account overdraft, which exceeded the maximum indebtedness allowed by 500 billion lire at the end of the month.*

In June, *the Treasury cash borrowing requirement was seasonally less large, which facilitated a return to within the overdraft limit despite a further decline in net securities issues. The market's net demand focused mainly on Treasury bills (2.5 trillion lire) and to a lesser extent on two- and four-year bonds (1.8 trillion lire), while for credit certificates new acquisitions barely equalled redemptions. The destruction of monetary base resulting from these factors was offset by a creation of base money through the external channel, where after three months of steady outflow there was a foreign exchange inflow equivalent to 2.3 trillion lire. The Bank's open market operations were characterized by a reduction in repurchase agreements outstanding and by a continuation of market support for credit certificate prices via outright purchases accompanied by offsetting Treasury bill sales.*

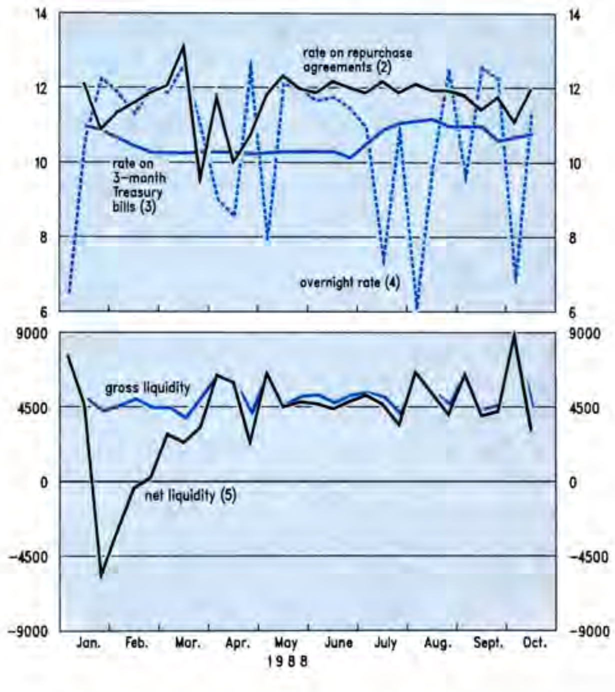
In the first half of July *renewed concern about the financing of the borrowing requirement led to a decision to raise yields on government securities across the board. The first coupon on the credit certificate issue at the start of the month was raised by 20 basis points, bringing it to 6 per cent on a six-month basis. The base rates on six- and twelve-month bills were raised by 23 and 35 basis points, respectively, and the yield on the mid-month issue of two-year bonds was increased by 20 basis points. Net subscriptions for the month amounted to over 5 trillion lire for bills and about 4.5 trillion for bonds. This helped, together with recourse to a foreign loan and the contribution of new PO deposits, to limit the creation of monetary base through the Treasury channel and to hold bank liquidity at an average of 4.6 trillion lire for the month.*

From the beginning of August, *however, the expansionary impulse coming from the Treasury borrowing requirement led to a new increase in liquidity, which rose to an average of 6.6 trillion lire for the first ten days of the month, while the overnight rate dropped to 6 per cent. As in the preceding months, the Bank of Italy responded with open market operations, selling securities in the amount of 7.4 trillion lire, of which 2.7 trillion lire (mainly Treasury bills) were outright sales. On the primary market for government securities, heavy disinvestment of credit certificates equivalent to 3.5 trillion lire during the month partially offset the success in placing bills and bonds, bringing net subscriptions to 6.0 trillion lire. Rates on repurchase agreements remained at around 12 per cent, and at the end of the month the overnight rate also moved to that level.*

In the first half of September *speculation based on expectations of a devaluation of the lira gave rise to a strong outflow of foreign exchange reserves, part of which returned in the second half of the month. Substantial redemptions of securities in the early part of the month together with large outlays by the Treasury again swelled liquidity, which the central bank neutralized by means of temporary open-market sales. Issue yields were raised simultaneously with the increase in the discount rate; those on Treasury bonds and credit certificates went up by 50 basis points and those on six- and twelve-month bills by 24 and 45 basis points, respectively. This eased the task of financing the Treasury's cash needs and facilitated the successful renewal of a substantial volume of maturing securities. Net demand was strong for both Treasury bills (8.4 trillion lire) and for two-year and four-year bonds (6.2 trillion and 4.5 trillion respectively), while disinvestment of credit certificates continued, amounting to 5.2 trillion lire in the month. The increase in yields enabled the Treasury to cover a particularly large monthly borrowing requirement (18.2 trillion lire) without exceeding the limit on its current account overdraft, which closed the month with an available credit line of just 700 billion lire.*

In October *market participants' preferences were again directed towards medium-term government securities. At the start of the month the demand for four-year bonds was especially heavy, owing in part to expectations of a scaling-down of applications. In short-term maturities, the strongest demand at the mid-month Treasury bill auction was for six- and twelve-month bills. Substantial net purchases of new issues made it possible to reabsorb the rapid expansion of liquidity that occurred in the first few days of the month in concomitance with payments made by the Treasury. Operations in repurchase agreements also helped towards this end. The volume of open market temporary sales by the Bank between April and mid-October exceeded 96 trillion lire.*

Money market rates and bank liquidity (1)



(1) Except for Treasury bills, ten-day averages of daily rates. — (2) Arithmetic mean of marginal rates on repurchase agreements during the ten-day period. — (3) Simple gross interest rate at auction. — (4) Arithmetic mean of asked prices. — (5) Net of fixed-term advances and repurchase agreements.

decline in the prices of Treasury credit certificates on the secondary market (in order to prevent trading from becoming too thin) and to absorb excess liquidity through repurchase agreements (Table a24).

The increase in very short-term rates was followed in April by a rise in yields on twelve-month bills. Then in July, by which time the acceleration of bank lending in the spring had become evident and the borrowing requirement appeared exceptionally large, yields on government securities rose across the board. The yield on credit certificates, gross of withholding tax, went up from 12.15 to 12.58 per cent, and the rates on bonds and bills were increased by corresponding amounts.

The interest rate changes of these months were accompanied by structural changes designed to improve the working of the primary and secondary markets in government securities. In May the screen-based trading system went into operation (see insert). In July the floor price in auctions of three-month bills was eliminated in order to encourage quicker adjustment of short-term rates to real market conditions. Also in July, the terms of the Treasury bonds issued at the start of each month and at mid-month were standardized, in order to reduce the number of different types of securities on the market and increase the volume of each type, thus fostering an expansion of trading on the secondary market.

However, the market's demand for securities continued to be weak. In July only the issue of two-year bonds, which was less than the volume required to meet the month's borrowing requirement, was fully subscribed. Market participants' uncertainty was increased in August by a strengthening in the rising tendency of interest rates in the principal countries abroad, followed by the raising of the US discount rate and the resulting appreciation of the dollar.

In view of the need to check the excessive expansion of credit and to ensure the financing of the borrowing requirement, which exceeded the forecast by an ever widening margin, the authorities raised interest rates at the end of August in accord with similar decisions taken in the leading European countries. The discount rate was raised from 12 to 12.5 per cent and yields on government securities increased to about the same extent.

Investor reaction was favourable thanks in part to renewed indications of the Government's commitment to restoring the public finances to soundness. Issues of four-year bonds in September were oversubscribed, requiring applications to be scaled down at both the beginning and the middle of the month, and Treasury bills were virtually all taken up. This enabled the Treasury to get through a month of especially heavy undertakings, which in addition to new borrowing of 18 trillion lire included the need to redeem some 37 trillion lire worth of maturing securities. The proportion of the borrowing requirement met by securities with maturities of over one year recovered to 45 per cent from the 17 per cent registered in the period July-August.

The demand for credit and the activity of credit intermediaries

The shift in the composition of bank assets towards loans following the lifting of the credit ceiling was a key feature of this period. Lira lending by the banks, which had grown slowly when the ceiling was in place, soared in April. The faster growth was maintained in subsequent months, but without provoking a rise in lending rates, and was accompanied by an expansion in foreign currency borrowing, which had declined in March and April after copious inflows at the beginning of the year. As noted above, it was not until the summer, after the rise in lending rates, that credit expansion slowed.

The distribution of loans by borrowing sector suggests that the growth in credit demand stemmed primarily from the expansion of real economic activity. With regard to firm size, a significant share of credit went to smaller private firms. As in recent years, consumer credit continued to account for a considerable share, some 30 per cent of the total in the twelve months to July. Borrowing from banks for financial operations, the category most directly affected by the ceiling (see *Economic Bulletin*, No. 6) and thus partly responsible for the acceleration of lending following its removal, was not as strong as it had been in 1987.

The reduced importance of "financial" lending is indirectly evidenced by the behaviour of loans at more than two points below the prime rate; though their share rose following the abolition of the ceiling, it nevertheless stabilized below the level of mid-1987. This interpretation is further strengthened by an examination of corporate financial balances, which deteriorated perceptibly over the first six months, reflecting the fact that the substantial growth in borrowing was not accompanied by an accumulation of financial assets.

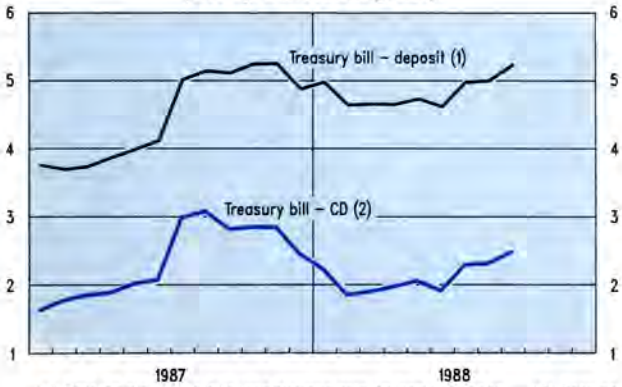
The overall growth in lending was not evenly distributed among bank categories. The popular and cooperative banks and the small and minor banks expanded their lending more than the average, the savings banks less.

The growth of deposits was relatively moderate. Over the first half of the year their twelve-month growth rate remained under 6 per cent, then rose by about one point in July and August. To bolster their profitability, banks continued to hold down the cost of fund-raising and accepted a progressive disintermediation from the liabilities side, accelerated by the increase in the withholding tax on deposit interest to 30 per cent. The differential between the rate on Treasury bills and the average deposit rate, both net of withholding tax, remained at about five percentage points in the first half of this year, virtually unchanged from the last half of 1987 but about one point wider than in the first half of that year (Figure 10).

Figure 10

Interest rate differentials

(net of withholding tax)



(1) Rate on six-month bills less average rate on bank deposits. — (2) Rate on six-month bills less rate on six-month CDs.

The banks' policy on CD interest rates was more aggressive. The differential between the rate on Treasury bills and that on CDs, which had also widened by a percentage point in mid-1987, was steadily brought back to its previous level. The consequent appreciable increase in issues was concentrated especially in CDs of 3-to-6 months, which more than doubled in volume in the twelve months to June 1988, and in those of 6-to-9 months. Following the revision of the rules governing banks' operations beyond the short term, banks also moved into the 18-to-24 month CD market. The increase in such certificates, which compete more directly with those of the special credit institutions, brought their share to 7.9 per cent of the outstanding stock.

The end result was that the fastest overall deposit growth was achieved by the categories of banks that already held a large share of the CD market, such as the banks of national interest, and those that had been particularly active in issuing CDs, such as the savings banks. The latter's market share expanded from 22.4 per cent in June 1987 to 26.5 per cent in June 1988.

These policy choices by the banking system resulted in a modest rise in profitability over the first half of the year. Net interest income was higher as a ratio to total resources than in the first half of 1987 or in the first half of 1986, when a lending ceiling was in effect. This gain was partly offset by a further decline in earnings on securities transactions, but a positive contribution came from a relative reduction in staff costs after the increase in 1987 stemming from the renewal of nationwide labour contracts in the banking industry.

Lending by the special credit institutions expanded strongly starting in the second half of 1987. Subsidized credit, however, decelerated steadily. In the twelve months to August total lending by special credit institutions increased by 15.3 per cent, with the subsidized components rising by about 10 per cent.

Real estate and building credit rose quite sharply (more than 20 per cent in the twelve months to August), thanks to the recovery in the housing market. The expansion was largely attributable to mortgages for home purchases, with households accounting for a more than proportional share of the increase in lending.

In line with the growth of investment in machinery and equipment, the industrial credit institutions also recorded an appreciable 14.9 per cent rise in lending in the twelve months to August. Their short-term lending expanded more slowly, by 11.1 per cent, as the tax advantage of their exemption from the tax in lieu of registration tax and stamp duty had diminished.

Reflecting investor preferences for shorter-term assets, fund-raising by the special credit institutions consisted principally in the issue of CDs, which expanded by over 11 trillion lire in the first eight months of the year, or by more than 50 per cent in relation to the stock outstanding a year earlier. The increase occurred chiefly in the first quarter and consisted largely of 18-to-24 month CDs, i.e. the shortest maturity among those the institutions are allowed to issue. Bond issues, by contrast, amounted to about 4.4 trillion lire in the first eight months of 1988, as against 7.0 trillion in the corresponding period of 1987. Fund-raising abroad brought in about 3.0 trillion lire, as in the same period last year.

The financial market

The growing public sector borrowing requirement and the shift in investor preferences affected the volume and the composition of new government security issues. Over the first three quarters, gross issues of government securities amounted to 388 trillion lire, 85 trillion more than in the same period of 1987. In line with the shift of investor preferences towards short-term and fixed yield securities, issues of Treasury bills and bonds increased to 306 trillion and 45 trillion respectively, as against 221 trillion and 18 trillion in the year-earlier period (Table 18). Issues of securities denominated in ECUs rose from the equivalent of 1.1 trillion to nearly 13 trillion lire, of which 6.5 trillion represented 12-month bills. By contrast, issues of Treasury credit certificates dropped off by 28 trillion lire, to just under 24 trillion.

There was a similar shift in the composition of net issues, which rose from 70.5 to 80 trillion lire. Of this amount, 44 per cent was made up of Treasury bills, as against 20 per cent in the same period of 1987, and 46 per cent of bonds, as against 20 per cent a year earlier. The share of credit certificates, which had been 49 per cent in 1987, actually turned negative. The shortening of the average life of the public debt thus continued. From almost four years in May 1987 and three and a half years in December, the average term to maturity had fallen to just over three years by September 1988.

Table 18

Government securities

(billions of lire)

	Bills (1)	Credit certificates	Bonds	Credit certificates in ECUs (2)	Total (3)
			Gross issues		
1985	256,281	97,209	17,288	3,367	384,553
1986	265,865	79,255	53,276	2,079	400,475
1987	316,110	55,480	19,020	590	404,116
1987 - 9 months	221,139	51,630	18,190	1,113	302,543
1988 - 9 months (4)	306,566	23,650	44,860	6,341	387,996
			Net issues		
1985	13,181	78,567	3,973	3,367	106,102
1986	9,697	53,534	35,025	2,079	97,153
1987	25,171	35,267	13,538	590	83,550
1987 - 9 months	14,372	34,434	13,981	1,113	70,440
1988 - 9 months (4)	34,979	−2,715	36,529	6,341	79,988

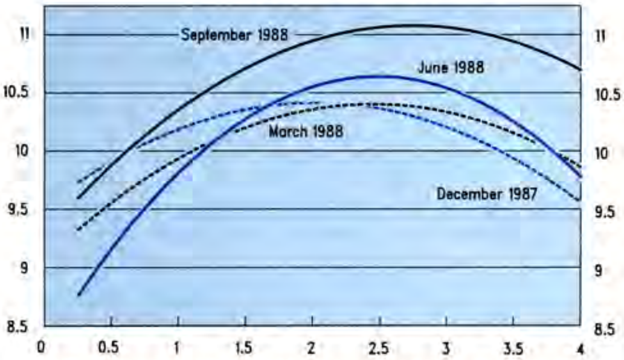
(1) Net issues of bills are defined as gross issues less redemptions. — (2) Net of those that may be sold to non-residents. — (3) The 1985 figures include the securities issued in settlement of debts amounting in net terms to 9,923 billion lire. Net issues of Treasury bills denominated in ECUs amounted to 2,311 billion lire in 1987 and to 6,519 billion in 1988. — (4) Provisional.

Uncertainties as to future interest rates were at first reflected in a progressive steepening of the slope of the time/yield curve, yields moving lower for the shorter maturities and higher in the longer term (Figure 11). Then, during the summer, the entire curve shifted upwards. Prices of Treasury credit certificates on the secondary market fell rapidly until June but recovered to some extent in the summer months.

On the demand side, the government securities market has been characterized this year by the unusually large purchases made by the general public, as described above, and by a sizable contraction of the banking system's portfolio, which declined by 25.6 trillion lire over the first eight months. This disinvestment by the banks, of which only 5.3 trillion lire was offset by purchases by the special credit institutions, consisted chiefly in sales on the secondary market, especially of Treasury credit certificates, bank holdings of which declined by over 18.5 trillion lire.

Figure 11

Time/yield curves (1)



(1) The curves were constructed by interpolating the effective yields on listed Treasury bonds in relation to their durations.

This heavy liquidation of credit certificates helps to explain the unsettled behaviour of their prices in the first part of the year. In large part the extent of the disinvestment reflects the importance that the certificates had assumed in the banks' balance sheets. The sales also testify to the continuing tendency of banks to sell tax-exempt securities to the public and to replace them with taxed ones. In the first six months of 1988, the share of exempt issues in banks' certificate portfolios declined from 60 to 54 per cent. This policy has probably also been influenced by a change in the perception of the risk of capital loss associated with the holding of such securities, whose prices had begun to decline in the second half of 1987.

The behaviour of the investment funds was similar to that of the banks. In the first nine months of the year the funds had to cover net redemptions of 10.5 trillion lire, and most of the resulting disinvestment consisted of Treasury credit certificates. The funds' holdings of other lira securities and Italian shares diminished only slightly, while they continued to increase their portfolios of foreign currency securities (Table 19).

Table 19

Portfolios of Italian investment funds

(billions of lire)

	Lira securities			Foreign currency securities		Total
	Govern-ment	Bonds	Shares	Bonds	Shares	
1986 — Dec.	35,844	5,153	17,887	1,422	2,305	62,611
1987 — Aug.	36,236	5,527	17,100	2,666	4,274	65,803
Sept.	34,533	5,486	17,861	2,775	4,382	65,037
Oct.	32,671	5,345	14,449	2,345	3,175	57,985
Nov.	32,128	5,326	14,787	2,618	2,811	57,670
Dec.	31,569	5,254	13,561	2,889	2,608	55,881
1988 — Jan.	30,773	5,204	12,670	2,804	2,631	54,082
Feb.	28,445	5,112	13,139	2,721	2,720	52,137
Mar.	27,930	5,046	13,440	3,225	2,874	52,515
Apr.	26,922	5,182	12,919	3,902	3,031	51,956
May	25,466	5,104	11,820	4,194	2,979	49,563
June	24,757	5,044	12,756	4,108	3,178	49,843
July	24,304	4,967	13,126	4,152	3,349	49,898
Aug.	23,923	4,980	12,686	4,371	3,284	49,244
Sept.	23,426	4,865	13,182	4,508	3,278	49,259

The reduction in the business done by investment funds in the Italian financial market, in a year when household investment in securities was considerable, suggests that investors' interpretation of the role of this type of intermediary has changed. The primary function of an investment fund is to enable savers to acquire a diversified, professionally managed portfolio with low transaction costs. The management of average portfolio risk, an essential component of such a strategy, is less important in Italy's domestic bond market, dominated by government issues. In this segment investors therefore appear to have opted for direct investment. The role of the funds assumes greater importance in the share market and in

The screen-based market for government securities: the first five months

On 16 May the screen-based market instituted by the Minister of the Treasury for block trading in government securities went into operation. (For a description of the system, see "Reform of the Secondary Market in Government Securities", Economic Bulletin *No. 6, February 1988.) The new market, which initially handled 16 issues of Treasury credit certificates and 4 of Treasury bonds representative of the securities in circulation (Table 1), got off to a satisfactory start, especially in view of the prevailing uncertainty regarding interest rates, which made it more difficult to match supply with demand and identify equilibrium conditions. The creation of the new market enhanced the transparency of trading and increased liquidity.*

On 14 October the face value of the Treasury credit certificates traded on the market amounted to 31 per cent of the value of all credit certificates outstanding; the comparable figure for bonds was 10 per cent. In relation only to the securities listed on the Milan Stock Exchange, the figures rise to 32 and 15 per cent, respectively; unlisted on that date were 8 issues of credit certificates having a total face value of 13.7 trillion lire and 12 of bonds with a face value of 46.8 trillion lire.

Of the 16 credit certificates traded on the screen-based market, eight have six-month coupons (four of these being linked to the yield on twelve-month Treasury bills) and eight have yearly coupons. As to their residual life, nine are medium-term and seven long-term. Seven are tax-exempt, while six are subject to a 6.25 per cent flat-rate withholding tax (proportionately nearly twice as much as that in relation to all credit certificates outstanding), and three subject to a 12.5 per cent withholding tax.

The operators authorized to trade on the market, which functions from 10 a.m. to 1 p.m. and from 3 p.m. to 4 p.m., now number 173, or 78 more than at the system's inception. Eighteen of these registered with the Bank of Italy as primary dealers, display the prices at which they are prepared to buy or sell specified securities in amounts of at least 5 billion lire face value on the Reuters network. The other participants act as counterparties to the primary dealers, finalizing trades with them by telephone. Execution of contracts via the screen-based system itself will be tested soon. Authorized operators in the system come for the most part from the credit system (97 banks, of which 4 are central credit institutions, plus 12 foreign bank branches and 6 special credit institutions). The other participants, apart from the Bank of Italy, comprise 56 financial companies (including investment fund management companies and stock exchange commission dealers) and one insurance company.

In the first five months of activity, securities with a face value of 25.6 trillion lire were traded, of which 23.3 trillion consisted of Treasury credit certificates (Table 2). Over the same period, trading of all quoted government securities on the Milan Stock Exchange amounted in face value to 6.5 trillion lire. Trading volume on the screen-based market, which is heaviest on Thursday and Friday, averaged 235 billion lire a day (214 billion in certificates and 21 billion in bonds), with a low of 65 billion on 16 August and a high of 595 billion lire on 25 August.

There has been a considerable difference in the marketability of various types of securities. From mid-May to mid-October, the total volume of trade in individual security issues ranged from 238 billion lire for the least traded credit certificate to 5,506 billion lire for the most heavily traded one. The turnover rate for different securities, or the ratio of trading to the volume outstanding, ranges from 4 to 65 per cent, averaging 21 per cent (Table 3).

The bid-asked spread, observed at 4 p.m. each trading day, has averaged 0.13 per cent, with peaks of over half a percentage point (Figure 1). The spread was larger the greater its variability over time and the slower the turnover of the security in question; moreover, credit certificates with annual coupons have tended to have wider spreads than those with

Table 1

Screen-based system and Milan Stock Exchange: Treasury credit certificates and Treasury bonds traded
(at 14 October 1988)

	Credit certificates			Bonds		
	Screen-based system	Milan SE	Total in circulation	Screen-based system	Milan SE	Total in circulation
Number of securities	16	75	83	4	42	54
under 18 months	0	0	0	3	17	17
18 mos.-5 years	9	38	45	1	25	37
over 5 years	7	37	38	0	0	0
tax-exempt	7	52	52	0	16	16
6.25% tax	6	17	17	3	18	18
12.5% tax	3	6	14	1	8	20
six-monthly coupon	8	30	37	4	42	54
of which: linked to 12-month bills	*4*	*16*	*23*	*0*	*0*	*0*
yearly coupon	8	45	46	0	0	0
Face value (billions of lire)	107,074	331,115	355,915	12,848	88,325	135,156

Table 2

Turnover on screen-based market and stock exchange

(16 May-14 Oct. 1988; in billions of lire)

		Screen-based system			Milan SE
		Treasury credit certificates	Treasury bonds	Total	Govern-ment securities
1988 —	May . . .	2,067	315	2,382	708
	June . .	3,090	668	3,758	1,487
	July . . .	4,698	366	5,064	1,208
	Aug. . .	6,047	334	6,381	1,105
	Sept. . .	4,844	362	5,206	1,271
	Oct. . .	2,563	285	2,848	681
	Total . .	**23,309**	**2,330**	**25,639**	**6,460**

six-month coupons. These three factors explain 85 per cent of the variance in average bid-asked spreads since the inception of the screen-based market (Table 3).

Treasury credit certificates have outperformed Treasury bonds in terms of prices. After a sharp, rapid drop in the last few days of May, certificate prices recovered and then trended upwards, while bond prices have remained essentially stable (Figure 2). Considering cum-coupon prices, i.e. including accrued interest, and assuming the reinvestment of coupons net of withholding tax, the securities traded in the secondary market gave an average yield over 5 months of 5.14 per cent (5.26 per cent for credit certificates and 4.09 per cent for bonds).

Between the end of May, when heavy sales of credit certificates abruptly raised their yields, and 14 October, the average differential between net yields on credit certificates and those on bills had narrowed, especially for the longer maturities.

Figure 1

Screen-based market for government securities: spread between best bid and asked prices

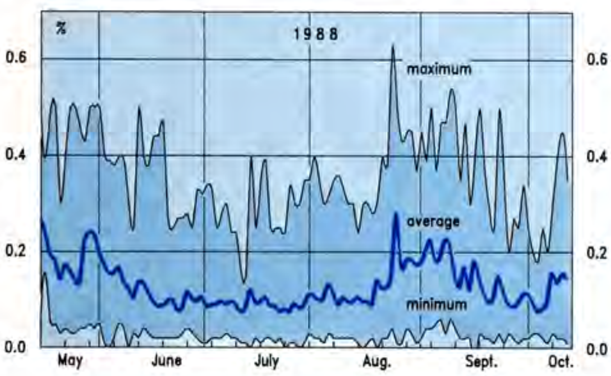


Table 3

Bid-asked spreads (1)

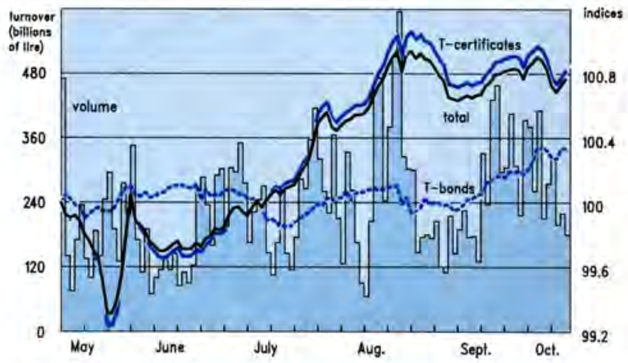
(16 May-14 October 1988)

SECURITY (2)	Spread mean	Spread standard deviation	Tur-over (bn lire)	Turnover rate	Coupon (months)
CCT 18.9.90 . . .	0.09	0.07	465	0.13	6
CCT 1.3.91 . . .	0.11	0.08	558	0.07	6
CCT 1.6.91 . . .	0.14	0.10	610	0.09	6
CCT 1.7.91 . . .	0.08	0.06	750	0.09	6
CCT 1.11.91 . . .	0.06	0.05	555	0.08	6
CCT 19.5.92 . . .	0.16	0.09	675	0.33	12
CCT 1.1.93 . . .	0.07	0.05	945	0.13	6
CCT 1.2.93 . . .	0.16	0.10	238	0.08	6
CCT 1.3.93 . . .	0.19	0.11	255	0.08	6
CCT 1.3.95 . . .	0.27	0.11	431	0.04	12
CCT 1.10.96 . . .	0.08	0.09	5,506	0.46	12
CCT 1.11.96 . . .	0.07	0.08	4,219	0.65	12
CCT 1.1.97 . . .	0.23	0.12	738	0.15	12
CCT 18.2.97 . . .	0.12	0.09	1.621	0.27	12
CCT 1.3.97 . . .	0.18	0.11	930	0.19	12
CCT 1.4.97 . . .	0.07	0.06	4,813	0.42	12
BTP 1.1.90 . . .	0.13	0.08	280	0.11	6
BTP 1.3.90 . . .	0.08	0.05	1,203	0.30	6
BTP 1.4.90 . . .	0.12	0.10	552	0.25	6
BTP 1.11.90 . . .	0.16	0.10	295	0.07	6

(1) Linear regression coefficients of the bid-asked spread over the standard deviation of the spread itself, the turnover rate, and the periodicity of the coupons (and preceded by the constant) are, respectively: −0.03 (−1.03); 1.52 (5.17); −0.19 (−4.03); and 0.01 (2.72). The t-statistics are given in brackets. R^2 was 0.85. — (2) CCT = Treasury credit certificates; BTP = Treasury bonds.

Figure 2

Screen-based market for government securities: price indices and volume of trading



foreign markets, where the number and variety of issuers and financial instruments demands greater experience and expertise. This analysis appears to be confirmed by the fact that many of the 24 new funds founded in the first nine months of the year have lower entry commissions, and many are more oriented towards investment abroad.

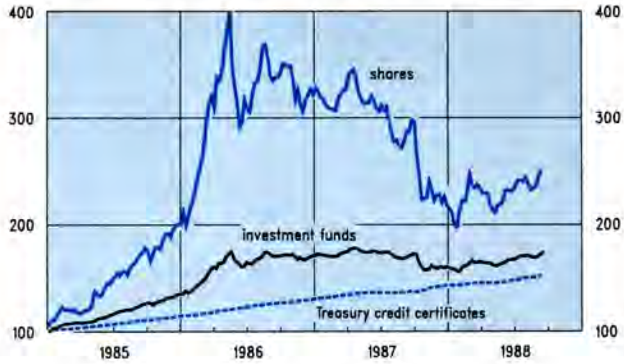
Foreign investors contributed appreciably to the relative success of issues of government securities denominated in ECUs. About one quarter of such securities this year have been sold to non-residents. According to first quarter data, foreigners also made net purchases of all the other types of Italian government securities, with a marked preference being shown for Treasury bills.

As in the other major industrial countries, share prices in Italy staged a strong recovery around the middle of 1988, regaining part of the ground lost in the crisis of October 1987 (Figure 12). The recovery in the Milan Stock Exchange index, which had hit a two-year low in February, was not without relapses. Nevertheless, by the end of September the index was 30.6 per cent above its February low. In recent months the rise in prices has been boosted by large-scale transactions aimed at acquiring control of some leading corporations. The capitalization of the Milan Stock Exchange rose to 162.6 trillion lire at the end of September, as against 140.7 trillion at the end of 1987. This increase reflects, in part, the listing of 17 new shares, which brought the total to 337.

Figure 12

Securities market indices of capitalization

(31 December 1984 = 100; end-of-month figures)



The recovery in share prices has not been strong enough to dissipate investors' uncertainties and to lower the cost of fund-raising via equity issues. Net share issues declined to 2.3 trillion in the first half of the year, the lowest figure of recent years, when issues have been substantial thanks to the largest industrial groups. Savings share issues in particular were very modest at just 100 billion lire.

Short-term prospects

Projections for 1988

In Italy, as in other industrial nations, the economy is expanding at a rapid pace this year; it has responded well to the stimulus of demand and, after six years of growth, the confidence of economic agents is now more firmly based. The latest data indicate that, after the slowdown in the second quarter, production picked up again in the summer. In July and August the seasonally adjusted index of industrial production rose by 1.4 per cent in relation to the preceding quarter. Figures on electricity consumption suggest that this upward trend continued in September. Further, information collected in recent months points to some improvement in merchandise trade. Looking ahead, business opinion surveys suggest that domestic demand will remain strong but point to a slight weakening in export orders.

The projections contained in the latest Government Forecasting and Planning Report indicate that GDP should rise by 3.6 per cent for 1988 as a whole. This would be almost one percentage point over the planning objective and the largest increase since the beginning of the decade. It is the consequence of an acceleration in export growth (5.8 per cent, compared with 3.6 per cent in 1987), coupled with a continuing buoyant increase in domestic demand (4.2 per cent as against 4.7 per cent last year).

The strong increase in exports has been fueled by the faster-than-expected growth of the international economy. Under the stimulus of domestic demand, imports are likely to increase at a very high rate, though at a slower pace than in 1987 (8.0 per cent as against 10.0 per cent). The narrowing of the energy deficit, caused by the contraction in the volume of imports and the fall in crude oil prices, will be offset by a larger deficit in other sectors resulting from the large increase in the prices of non-energy raw materials and the appreciation of the dollar. If these latter influences ease off later in the year, the balance of trade could improve in the second half of the year.

Table 20

Italian macroeconomic variables

	1987	1988 (1)	1989 (1)
	(percentage changes)		
Real variables			
GDP	3.1	3.6	3.0
Domestic demand	4.7	4.2	3.5
Real external balance (2)	−5.8	−2.0	−1.8
Prices			
GDP deflator	5.6	5.0	4.3
Private consumption deflator	4.8	4.8	4.0
Terms of trade (2)	2.6	—	0.2
	(percentages)		
Financial balances/GDP			
State sector borrowing requirement (net of settlements of past debts)	11.6	11.0	10.2
External current account balance (IMF)	−0.1	−0.4	−0.6

(1) *Relazione previsionale e programmatica sul 1989.* — (2) Percentage change in the index computed as the ratio between the index numbers of the volume (or the deflators) of exports and imports in the national accounts.

The deficit on merchandise trade will be coupled with a worsening of the invisible balance. The stagnation of net income on tourism means that it no longer offsets the net outflows of investment income and unilateral transfers. The current account deficit is expected to amount to around 5 trillion lire (as against 1.3 trillion in 1987).

Production has been sustained by the growth of exports and the impulse imparted by the public sector borrowing requirement, which will considerably overshoot the limits fixed in

November when the budget was revised. Investment has been the most dynamic component of domestic demand. The high rate of productive capacity utilization, which in the first part of the year was close to the peak levels reached in 1980, led firms to expand their plant and equipment again, with positive repercussions on employment. The numbers employed in the manufacturing sector rose by about 2 per cent in the first half of the year, after years of falling employment.

Demand for private consumption remains very buoyant. This chiefly reflects the rise in disposable income but is also attributable to the lagged effects of the improved terms of trade of recent years.

The implicit price deflator of household consumption is expected to be 4.8 per cent for the year, thus exceeding the planning objective by 0.3 percentage points. The faster rise in prices in the second half of 1987 (the cost-of-living index in October and November was 5.3 per cent higher than in the same period of 1986) was slow to be reabsorbed. At the end of the year the twelve-month rate could exceed the 4.3 per cent figure indicated in the Forecasting and Planning Report.

Besides reflecting the delayed effects of last July's fiscal package, price increases could also be influenced by the increase in the variable unit costs of manufacturing industry, which on an average annual basis has now risen to 5 per cent, compared with 2 per cent in 1987. Since the increases in these costs tend to exceed those in production prices, profit margins are likely to narrow slightly, after widening for four years.

In the private sector as a whole, the rise in unit labour costs is expected to be 4.7 per cent, while productivity should rise by about 3 per cent. Notwithstanding the wage increases arising from labour agreements, which took effect on 1 January 1988, the rise in public sector wages will be about 7.5 per cent, in line with that in the private sector. In 1987, however, the settlement of arrears in respect of 1986 had led to an increase in per capita earnings of more than 11 per cent.

In the first nine months of the year, the public sector borrowing requirement amounted to 94 trillion lire, an increase of 9 trillion over the same period of 1987. The Report on the economic situation of the public sector at 30 June 1988 estimated that the requirement for the year would total at least 118 trillion lire, compared with 114 trillion last year. This figure exceeds the limit fixed in November 1987 by about 15 trillion lire and is 4 trillion above the objective laid down in the economic and financial planning paper of 30 May. If the figure mentioned in the Report of 30 June is to be achieved, the borrowing requirement for the last quarter will have to be about 5 trillion lire below that for the corresponding period of 1987. Notwithstanding the restraining effects of the fiscal measures adopted in May and July, this appears unlikely.

Since revenues increased more than expected, the failure to achieve the objectives has to be ascribed to the rise in expenditure. Revenues were boosted by the strong growth in income, the continuing impact of the measures adopted in the summer of 1987 and the effect of decisions taken in 1988 (the Finance Law and the measures adopted in May and July).

The growth of revenues and economic activity will permit further progress in the slow reduction of the borrowing requirement in relation to GDP that started in 1984. In particular, net of interest payments, the state sector's financing needs should fall from 37 trillion lire in 1987 to little more than 30 trillion (from 3.8 to 2.9 per cent of GDP).

Expenditure net of interest payments is growing at a pace similar to that of the gross product. The cost of servicing the public debt is expanding much faster, as a result of its increased size and the larger proportion of Treasury bills in new issues. The demand for Treasury bonds began to recover in September, by which time further increases in interest rates were no longer expected and fears of higher inflation had subsided.

The increase in the public sector borrowing requirement and the very large demand for credit stemming from the strong growth of economic activity have posed problems for the control of financial flows. The heavy demand for credit, accentuated by the difficulties firms encountered in raising funds by share and bond issues, was satisfied by the banks through substantial sales of medium and long-term portfolio securities. In turn, this caused problems for the placing of new

Table 21

Financial flows

	Gross domestic product		State sector borrowing requirement (1)		Credit to the non-state sector (B)		Total domestic credit (A) + (B)			Non-state sector financial assets (2)				Money (M2)		
					flows		flows		ratio to GDP (3)	flows		ratio to GDP		flows		ratio to GDP (4)
	billions of lire	% change	total	domestic (A)	billions of lire	%	billions of lire	%		billions of lire	%	(3)	(4)	billions of lire	%	
1980	390,432	....	37,018	34,015	29,219	16.4	63,234	18.5	16.2	52,615	15.8	13.2	98.7	41,959	12.7	79.3
1981 (5) ...	468,049	19.9	53,293	45,239	28,098	13.5	73,336	18.1	15.7	65,410	17.0	14.0	96.5	30,932	10.0	72.8
1982 (5) ...	545,124	16.5	72,799	69,133	31,604	13.4	100,737	20.9	18.5	89,810	19.9	16.5	99.5	61,587	18.1	73.8
1983	631,575	15.9	88,260	85,197	35,432	13.2	120,629	20.7	19.1	111,545	20.6	17.7	103,8	49,432	12.3	71.5
1984 (6) ...	727,798	15.2	95,695	91,708	48,325	15.6	140,033	19.7	19.4	129,287	19.7	17.9	109,0	54,867	12.1	69.6
1985	815,630	12.1	110,036	107,281	46,441	12.9	153,722	18.1	19.1	138,280	17.6	17.2	114,9	55,805	11.0	69.0
1986	902,238	10.6	109,557	106,714	45,694	11.4	152,408	15.2	16.9	156,863	16.9	17.4	121,3	52,720	9.4	68.2
1987	982,596	8.9	113,962	105,834	45,667	10.3	151,500	13.1	15.4	152,764	14.1	15.5	126,1	51,099	8.3	67.8
1988 (7) ...	1,045,000	7.5	103,500	97,000	(8) 39,000	6-10	136,000	10.4	13.0	138,000	11.1	13.2	131.7	(8) 53,000	6-9	68.8

(1) From 1985 onwards, the total borrowing requirements do not include settlements of past debts in securities or cash; the latter are included, however, in the domestic borrowing requirement. — (2) Domestic, net of shares. — (3) Based on period flows. — (4) Based on end-of-period stocks. — (5) Net of the effects of the non-interest-bearing deposit on external payments. — (6) 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. — (7) Planning scenario. — (8) Equivalent to the central value of the target range.

issues, which were overcome by adjusting the structure of interest rates and accepting a shortening of the average life of the public debt. Within this framework, monetary policy sought to keep the money supply on a tight rein and avoid an excessively fast expansion of credit, which would have had adverse effects on the external current account and prices.

In the second quarter total credit to the non-state sector was above target, pushed up by the rapid acceleration of bank lending; the extent of the acceleration was accentuated by accounting effects connected with the lifting of the credit ceiling. The banks responded fully to the demand for credit, which until May was met at falling rates of interest.

The seasonally adjusted growth rate of bank lending through May exceeded 19 per cent on an annual basis, while the figure for loans in lire was over 24 per cent. The raising of interest rates helped to curb this trend, and in September the rate had fallen to 15 per cent, with that of lira lending down to 17 per cent. Special credit also expanded vigorously, even in the case of institutions whose lending is not directly related to investment activity, but followed a more regular path in the course of the year. Consequently, the growth rate of lending to the non-state sector, which in May had been 17.5 per cent, fell to 15 per cent in September.

For the growth rate in credit to the non-state sector to drop back by year-end to around 13 per cent, which is considered consistent with the estimated macroeconomic outturn, the slowdown in bank lending registered in the third quarter will have to continue for the rest of the year; in other words, the annualized rate of lending in the fourth quarter must not exceed 6-7 per cent.

In view of how credit to the non-state sector and the state sector borrowing requirement have developed, total domestic credit is also likely to overshoot. The increase in this aggregate should be of the order of 13 per cent, about the same as in 1987 but well above the initial estimate of 10.4 per cent. The non-state sector's domestic financial assets are expected to expand by about 14 per cent. The very large purchases of government securities by the public should make it possible to keep the growth in the money supply within the target range of 6-9 per cent.

The prospects for 1989

The international economy

According to the IMF's September forecast, economic activity will slow down in the coming year; the GDP of the industrial countries should grow by 2.8 per cent, more than 1 percentage point less than in 1988. The countries expected to slow down the most are the United States, the United Kingdom and Japan; while France, the United Kingdom and Germany are expected to record less than average GDP growth. The forecast growth rate for Germany is very low (1.9 per cent). Nonetheless, other international institutions have produced more optimistic forecasts. The slower expansion of domestic demand in the industrial countries is expected to slow the growth in world trade (5.6 per cent as against 7.5 per cent in 1988).

The slowdown in economic growth in the industrial countries can be ascribed to the effects of the improvement in the terms of trade having worked themselves out and investment to expand productive capacity having come to a halt. These two factors are not expected to be offset by fiscal policies, which appear to be fundamentally restrictive (in the United States and the United Kingdom as a complement to monetary policy aimed at curbing domestic demand and in Japan and Germany in the absence of new proposals for expansionary fiscal measures of the type that characterized the budgets of the last two years).

With regard to the developing countries, the growth of GDP is expected to reach 4 per cent, though the overall figure hides wide differences between groups of countries. Growth could fall below this average in the most heavily indebted countries and in those of sub-Saharan Africa, because of continuing stringent financial constraints. By contrast, GDP growth in the developing countries of Asia is expected to exceed 6 per cent, thanks to an uninterrupted expansion in the volume of their exports.

Maintaining price stability will again be one of the main strands of the strategy of the industrial countries in 1989. For these countries as a whole the change in consumer prices is expected to be slightly higher than last year (3.5 per cent against 3.3 per cent), reflecting both the high rate of productive capacity utilization — particularly in countries such as the United States, the United Kingdom and Canada — and the lagged effect of the rise in non-oil raw material prices. The expected flattening out of the latter should help to keep prices generally more stable. The price of crude oil is still subject to great uncertainty, even though the markets for petroleum products are still suffering from excess supply owing to the inability of the producer countries to agree on production quotas.

In the absence of a more effective coordination of economic policies, the progress achieved in adjusting current account imbalances within the industrial area will come to a halt. The shift to more uniform rates of growth of domestic demand and the wearing off of the effects of earlier changes in competitiveness will not help to remove the imbalances. Moreover, the very large net financial positions built up in recent years tend to aggravate the imbalances on invisible items, thus accentuating the differences in current account positions.

The orderly economic development of EEC countries is hindered by internal trade disequilibria, which are becoming very large. Germany's surplus vis-à-vis the other EMS countries is widening; a better distribution of growth rates within the Community would strengthen exchange rate stability.

As far as the developing countries are concerned, current account balances are expected to deteriorate, both because the rise in raw material prices has been interrupted and because domestic demand in the newly industrializing nations is expected to be higher than in the past, when development was only partly reflected in domestic consumption and gave rise to the accumulation of very substantial external financial assets.

Some improvement is foreseen in the economic and financial situation of the most heavily indebted countries, although in recent years international institutions have tended to overestimate these countries' capacity for recovery. Growth is not expected to be sufficient to bring any significant alleviation of the debt/GDP ratio, while high international interest rates will contribute to keeping the ratio between debt servicing and exports high.

Table 22

Forecasts of the main international macroeconomic variables

(% changes on previous year)

	1987	1988 (1)	1989 (2)		1987	1988 (1)	1989 (2)
GDP (2)				**Current balances** (4)			
Industrial countries	3.4	4.1	2.8	Industrial countries	−42.9	−56.0	−59.2
of which:				*of which:*			
United States	3.4	4.0	2.7	United States	−154.6	−138.9	−134.7
Japan	4.2	5.8	4.2	Japan	87.0	78.1	81.3
Europe (3)	2.7	2.7	2.2	Europe (3)	42.1	23.5	15.7
Germany	1.7	2.3	1.8	Germany	45.0	42.2	38.6
Non-oil LDCs	4.6	4.5	4.6	Non-oil LDCs	5.7	−1.1	−9.7
Oil-exporting LDCs	0.6	1.4	2.3	Oil-exporting LDCs	−5.4	−14.4	−11.0
Consumer prices				**Unemployment rate** (5)			
Industrial countries	3.0	3.2	3.5	Industrial countries	7.6	7.1	7.0
of which:				*of which:*			
United States	3.7	4.1	4.5	United States	6.2	5.4	5.3
Japan	0.1	1.1	1.6	Japan	2.8	2.6	2.5
Europe (3)	3.7	4.0	3.7	Europe (3)	10.5	10.2	10.2
Germany	0.2	1.2	2.3	Germany	7.9	7.9	8.1
World trade (2)	**5.7**	**7.0**	**5.4**				
Exports (2)				**Imports** (2)			
Industrial countries	5.1	6.8	5.0	Industrial countries	6.8	7.5	5.0
Non-oil LDCs	12.1	8.4	7.8	Non-oil LDCs	8.9	9.9	8.7
Oil-exporting LDCs	−0.5	3.5	2.9	Oil-exporting LDCs	−11.1	0	3.8

Source: IMF.
(1) As of October 1988. — (2) At constant prices. — (3) European OECD countries. — (4) Billions of dollars. — (5) Level.

The Italian economy

Thanks partly to the modifications over the past decade in productive structures and to intervening changes in markets and the behaviour of economic agents, the opportunities offered by favourable international developments in 1988 were fully seized by the Italian economy. The expansion of world trade prevented the external accounts from deteriorating excessively under the pressure of domestic demand. External and domestic circumstances presented a favourable occasion for incisive action on public sector finances, but this opportunity was not grasped; nor did efforts on the inflationary front record the progress planned. Thus, the urgent need to reduce the public sector borrowing requirement and curb inflation will carry over undiminished into 1989.

The Forecasting and Planning Report for 1989 sets growth objectives that take account of the changes under way in the international economy, and of the plans to put the public finances on a sound basis, in accordance with the guidelines set forth in the economic and financial planning paper. If these goals are to be met, it will be necessary for budget, incomes, foreign exchange and monetary policies to function as an integrated whole, in view of the narrower room for manoeuvre resulting from the more restrictive policies of Italy's principal trading partners. The main objectives, which assume a continuation of the current investment cycle and a stabilization of exchange rates and international raw materials prices, can be summarized as follows:

— a Treasury borrowing requirement of 117,350 billion lire, equivalent to 10.2 per cent of GDP;

— consumer price inflation averaging 4 per cent for the year;

The main proposals of the Finance Bill for 1989 and accompanying measures

The Government's financial strategy for 1989 is based on: a series of tax measures; a curbing of transfers to the social security sector and local government, offset respectively by increases in contributions and by the granting of greater discretionary taxation powers; and the containment of appropriations to the National Health Service, accompanied by a number of measures aimed at reducing expenditure. During the drafting of the budget based on existing legislation, a significant reduction was made in appropriations on an accruals basis, primarily in connection with expenditure on capital account. In conformity with the recent reform of budget procedures, the Finance Bill has been reduced to its basic elements and accompanied by a series of sectoral provisions.

According to official estimates these measures will keep the state sector borrrowing requirement within the target of 117,350 billion lire in 1989; the proposed measures should produce a reduction in the borrowing requirement of around 20 trillion lire compared with the trend forecast made in September. The tax and social security measures should bring in extra revenues of about 10 trillion lire and expenditure will be cut by a similar amount (including a reduction in the interest burden of around 4 trillion lire). The measures discussed below supplement those adopted between May and July, the financial effects of which should be fairly evenly distributed between 1988 and 1989 (over 5 trillion lire).

Tax revenue. — *The Government's fiscal measures should boost revenue by nearly 5 trillion lire; this figure comprises both the reduction implied by the reform of personal income tax and an extra 3 trillion to come from measures not yet finalized.*

The IRPEF income brackets and tax rates have been modified as well as the system of allowances. The consequent revenue loss for 1989 is estimated at 5,950 billion lire, and that for 1990 at 8,340 billion. The relief has nonetheless been made conditional (by means of the special negative funds mechanism) on the implementation of specific measures (including provisions designed to curb tax avoidance and increase the tax base, the new tax system for the self-employed and small firms, the introduction of a tax on the concession of VAT tax registration numbers, and the arrangements for taxpayers who had used the conventional system of assessing taxable income in previous years to present supplementary declarations on the basis of the new parameters). These measures are expected to boost revenue by around 7,700 billion lire in 1989 and by 9,150 billion in 1990.

The systems of conventional assessment for VAT and direct taxes have been reformulated, with the right to use them restricted to self-employed workers and small businesses with a turnover of less than 36 million lire. Such taxpayers will determine their tax liabilities by means of special coefficients. Taxpayers with turnover of between 36 and 300 million lire may opt to keep simplified accounts for the purpose of determining their direct tax liabilities. This system, which firms with a turnover of less than 36 million can also adopt, is based on new income "yardsticks" reflecting variables such as the sector of economic activity and location, etc. In the event of a divergence between a firm's income calculated in this way and the income it declares, the tax authorities are authorized to reassess the firm's income inductively using presumptive standards based on criteria similar to those adopted for the aforementioned income "yardsticks". Provision has also been made for the Government to regulate the establishment of private tax consultancy firms.

With the aim of wiping the slate clean, provision is made for taxpayers who used the conventional system in force in 1988 (Decree Law 853/1984) to present, for the years from 1983 to 1988, supplementary income tax and VAT declarations conforming to the new presumptive criteria. Taxpayers will be liable to pay 20 per cent of any excess taxable income (the rate rises to 25 per cent for firms' income tax liability). In addition, an upper and a lower limit are fixed on the liability for each year.

A reduction in the appropriations to communes and provinces is matched by an increase in their scope to raise taxes autonomously. The communal concession tax on the renewal of authorizations and licences (previously charged as a lump sum or in relation to the area of business premises) has now been related to turnover. Communes are empowered to impose a communal surtax equal to 50 per cent of the tax on overnight stays and a local consumption tax (at a rate of between 0.4 and 0.8 per cent) on the turnover of retail outlets and lodging and catering establishments. The tax in respect of urban waste disposal is also to take account of the cost of street cleaning, of the upkeep of public gardens and other environmental services. The minimum amount of costs to be covered by charges have been raised for some services.

Social security contributions. — *Taken together, the various measures regarding social security contributions should result in an increase in revenue of more than 5 trillion lire. To this amount another 1.2 trillion has to be added in connection with increases in contributions that have not yet been implemented but which have already been authorized by the Finance Law for 1988. These increases were foreseen to cover the rise in outlays associated with the change, as of 1989, in the index used to adjust pensions in line with earnings (including the minimum contractual levels in industry and the average earnings of employees in the public and private sectors).*

The relief currently provided in respect of social security is maintained for manufacturing industry and agriculture but not for non-manufacturing craft activities and commercial firms, apart from those considered to be regular exporters and lodging and catering establishments. The contributory relief offered to all firms that hire additional female workers *is increased from 30,000 to 56,000 lire per month. The same amount of relief is also offered to firms that hire persons under 29 years of age. Finally, the supplementary relief offered to manufacturing firms located in the South of Italy has been slightly increased.*

The earnings with reference to which social security contributions are calculated are now required to be not less than the corresponding minimum amount laid down in the relevant national labour contract. Voluntary continuation of the payment of social security contributions has been made more costly. Measures have also been adopted to make it easier for social security institutions to collect contributions owed to them, to shorten the time allowed and increase the cost of paying contributions by instalment, and to reduce the erosion of the contributory base.

Over the three years 1989-91 the rates applicable to the social security contributions of public sector employees will be gradually raised to bring them into line with those paid by employees insured by INPS (7.15 per cent); for employees in the state sector, this will involve an increase of 0.55 percentage points.

Social security.— *The total of budget transfers and treasury advances to INPS in 1989 has been fixed at 37.5 trillion lire. The Institute's deficit charged to the Treasury is forecast to amount to 38 trillion lire in 1988, compared with the target of 36 trillion fixed by the Finance Law for this year. To prevent overshoots in the future, provision has been made for INPS to propose appropriate increases in contributions if at 30 June the Institute's borrowing requirement exceeds 6/13 of the budget transfers and treasury advances foreseen by the Finance Law for the year as a whole.*

As of 1 January 1989, INPS will cease to disburse sickness benefits to industrial blue-collar workers or employees of commercial firms. These payments will be made, as they already are for industrial white-collar workers, by employers, who will simultaneously be relieved of the obligation to pay INPS the corresponding contribution, currently fixed at 2.22 per cent for industry, which is the source of a small surplus.

Health. — *The financing of the current expenditure of the National Health Service charged to the budget for 1989 is 59.6 trillion lire (including approximately 1 trillion lire deriving from the renewal of labour contracts and agreements covering private sector provision of medical services). Current official estimates of financing requirements for 1988 are above 58 trillion lire, against allocations for 52,650 billion contained in the Finance Law for the same year. In order to ensure that the financial targets are met it has been decided that in 1989, when the quarterly statements of account submitted by the regional health authorities exceed the corresponding allocation, the Regions in question must either cut services or raise prescription charges; further, if the overall total committed by the local health units as at 30 June exceeds half of the allocations provided in the Finance Law, the Ministers of Health, Labour and Social Security are authorized to adjust health service contribution rates, even where this means differentiating between regions, maintaining the existing proportions payable by the various categories of taxpayer.*

The principal provisions governing health issues are: the extension to 31 December of the freeze on prices of drugs listed in the Italian pharmacopeia; a limited increase in the number of drugs subject to the highest share charged to clients (40 per cent); restriction of the exemption from payment of the charges for drugs to pensioners (within specified income limits), the unemployed and the poor; restrictions on the use of non-Health Service specialists; recognition of the Ministry of Health's right to carry out inspections to monitor the management of individual local health units; the introduction of individual national health cards; a requirement that local health units' budget statements be approved by the State Audit Office before the relative deficits can be made good.

Personnel. — *The previous Finance Law had allocated 600 million and 1 trillion lire respectively for 1989 and 1990 to cover the renewal of labour contracts in central government departments. The subsequent conclusion of negotiations in the education sector alone gave rise to extra costs estimated at around 1, 5 and 6.5 trillion lire respectively for 1988, 1989 and 1990 (most of it financed by increased revenues). The current Finance Bill assigns an extra 2 trillion lire for 1989 and 3.1 trillion for 1990 to be available for other labour contract awards in central and local government services.*

The system of freezes and waivers applying to hiring in government departments is modified; limits on turnover have been introduced together with the principle of according priority to job mobility over new recruitment.

Transportation. — *The Bill includes a number of measures aimed at improving efficiency, cutting costs and reducing state funding in mass transit and in air, rail and sea transportation.*

The Bill provides for an annual 10 per cent reduction in government contributions to the Regions for local public transport, starting in 1989 and based on the allocations for 1988; it also makes these contributions dependent on passenger frequency. Regional and Municipal authorities will also be required to decide minimum and effective tariffs for each year and for each type of service in relation to cost-covering criteria fixed by the Ministry of Transport; any additional subsidies will have to be financed by the authorities concerned. It is also established that loss-covering subsidies for sea links considered essential should be calculated on the basis of the costs of non-subsidized services.

Financing of local authorities. — *Allocations to local government agencies are reduced and an overall limit is placed on their investment. The Special Statute Regions and the autonomous Provinces of Trent and Bolzano are given reduced allocations by comparison with previous legislation.*

— an increase in GDP of 3 per cent, in line with other economies moving to a slower growth path and based on the assumption of moderate growth in all the components of domestic demand, as well as exports and imports. Notwithstanding a further decline in the differential between the growth rates of imports and exports, the current account is expected to worsen slightly but the deficit to be kept within 0.6 per cent of GDP.

On the prices front, Italy needs to bring its inflation rate closer into line with that of its European trading partners, not only to exploit the advantages of integration to the full but also because basically stable exchange rates mean that efforts to maintain competitiveness must focus chiefly on the formation of costs and prices. The factors putting achievement of the planning objective at risk are the real scope for an effective deceleration of consumer prices in the latter part of this year (to the level indicated in the Forecasting and Planning Report) and the effects of the tax measures foreseen for 1989. The measures relating to indirect taxes are expected to affect prices by as much as 0.5 per cent; to this must be added the less immediate, but equally important impact of the increase in social security contributions in some sectors.

In view of these difficulties, it will be necessary to adhere strictly to the guidelines indicated for prices and costs if the objectives laid down in the Government's plans are to be realized. In particular, rises in public service charges and monitored prices will have to be kept below 3 per cent on average. Per capita wages and salaries in the private and public sectors must not rise more than 5.0 and 6.7 per cent respectively; in the public sector this increase takes into account the effects of the recently agreed labour contract for teachers and other school personnel, as well as salary increases in other areas of no more than one percentage point above the targeted inflation rate. Finally, benefits accruing from productivity gains and possible reductions in raw materials prices will need to be reflected in full in final prices.

The guidelines contained in the economic and financial planning paper are confirmed in the fiscal policy for next year as set out in the Finance Law and related measures. The strategic aim is to bring about a significant reduction in the deficit net of interest payments; excluding these, the state sector budget deficit on an accruals basis should fall from 70 to 56 trillion lire between 1988 and 1989, as a result of both the reduction in expenditure and the important steps taken to increase revenue. The decrease is less pronounced for the overall balance, which is expected to fall from 150 to 143 trillion lire.

The state sector borrowing requirement, net of interest, is expected to decline less than the budget deficit on an accruals basis, falling from 30 to 21 trillion lire. This is almost entirely due to revenue measures (involving both taxes and social security contributions), which should yield an additional 11 trillion lire. The reduction in the deficit on an accruals basis should make it possible to prevent an acceleration in disbursements compared with previous years, but not to reduce the total.

The strength of the action directed at the budget on an accruals basis is confirmation of the Government's commitment to the planning objective. Over the next few years it will permit greater control over state expenditure, particularly that on capital account. The deficit to be funded in the budget on an accruals basis is lower than the figure implicit in the economic and financial planning paper. It should nonetheless be borne in mind that this improvement is matched by a change in the composition of expenditure; a marked increase in current account allocations is coupled with an even larger reduction in capital appropriations than assumed in the Government's document.

In order to ensure the success of the budget adjustment process, action must be taken as from now to rectify the structural mechanisms that automatically generate current expenditure in the principal areas of policy intervention. In the absence of such action, and bearing in mind that the room for manoeuvre on the revenue side is tending to contract, the only alternative in the coming years would be to reduce capital expenditure. This would necessitate cutting back, in terms of both number and cost, the investment programmes that Italy — and in particular the South — requires if growth prospects are to be strengthened.

The interest burden will amount to about 96 trillion lire; on the one hand, this assumes an expansion of the debt and, on the other, a reduction in the average level of nominal interest rates and a lengthening of the average maturity of the debt, which is already in progress.

The Bank of Italy has prepared, and submitted to the Interministerial Committee for Economic Planning, a plan for the growth of monetary and credit aggregates in conformity with the macroeconomic objectives laid down by the Government. In view of the increases expected in nominal GDP and investment, and of the need to keep prices and exchange rates stable, the increase in financing to the non-state sector will have to be held within a range of 7 to 10 per cent. The deviation from the central value will depend on developments in the real economy, especially as far as fixed capital investment is concerned, and on the possibility for firms to have recourse to the financial markets; the slow recovery of share prices, supported by profit trends, should make it possible for issues of equity capital to exceed those of last year. In view of the size of the state sector borrowing requirement, total domestic credit is expected to expand by about 11 per cent compared with end-1988, the equivalent of more than 13 per cent of GDP. Taking account of forecast changes in the balance of payments, total financial assets are also expected to rise by 11 per cent.

The growth of the money supply will have to be slower than that of total financial assets, approximating the growth of nominal GDP; it will therefore be kept within a range of 6 to 9 per cent, as in 1988. In line with this target, other financial assets, which for the most part consist of government seurities held by the non-state sector, should expand by about 15 per cent, or almost double the rate of nominal GDP. The conditions prevailing on international financial markets, whose significance will increase as a result of the currency liberalization measures that became operative on 1 October, will permit interest rates to reflect the progress made in controlling inflation and in rehabilitating the public finances.

Based on information available at 28 October.

Articles

The Reform of Italy's Exchange Controls (*)

1. On 1 October 1988 Italy's new exchange controls came into effect. The system is no longer based on the general prohibition of Article 2 of Decree Law 476/1956, ratified with amendments as Law 786/1956, but on the principle of freedom of external commercial and financial relations.

The importance of the reform lies not only in the change in the underlying principle but in the fact that the entire juridical structure of Italy's exchange legislation is now conducive to liberalization, thus permitting a considerable degree of openness in dealings with other countries.

The reform clearly limits the powers of the exchange authorities to impose administrative restrictions, though the new legislation provides for:

- the retention of permanent restrictions that may be lifted at the discretion of the exchange authorities (Article 6 of Presidential Decree 454/1987); and
- the imposition, to counter exchange rate pressures, of temporary restrictions on external transactions (Article 13 of the same Decree).

Accordingly, monetary and balance-of-payments objectives will have to be achieved by non-administrative means.

The new exchange legislation is the product of a lengthy process that began in 1981 and was concluded this year. The reform process has been marked by extensive and thorough discussion of the various aspects of this delicate matter, which affects the entire sphere of Italy's foreign trade and financial relations and hence the country's economic policy.

2. In practice, the reform was enacted in four steps:

a) Parliament's approval of Law No. 599 of 26 September 1986 on the "Reform of exchange legislation", which, among other things, delegated to the Government the power to carry out the reform in conformity with a series of principles and guidelines set forth in Article 1;

b) The Government's issue of the new "exchange control law" (**Presidential Decree No. 454 of 29 September 1987**), which laid down the principle of freedom of external transactions, although this has been mitigated by allowing the retention or imposition of permanent or temporary restrictions, as noted above;

c) The Government's issue of the "Codified Exchange Control Law" (**Presidential Decree No. 148 of 31 March 1988**), which will also replace Decree 454/1987 by incorporating it as of 1 January 1989;

d) Parliament's approval on 21 October of Law no. 455, which depenalizes exchange violations as of 13 November by converting violations previously subject to penal sanctions under Law 159/1976, as amended most recently by Law 599/1986, into simple administrative offences. In accordance with Article 2 of the Penal Code, this Law is retroactive and applicable to pending

(*) *Prepared by the Foreign Department of the Bank of Italy.*

proceedings, which will be transferred to the Italian Foreign Exchange Office for the handing down of the administrative sanction, except in certain cases where the proceedings have to be completed in the penal courts.

The new legislative order was completed with Ministerial Decree No. 21 of 1 February 1988 ("Provisions for the application of Presidential Decree No. 454 of 29 September 1987 enacting exchange regulations under the powers conferred by Article 1 of Law No. 599 of 26 September 1986") and by Ministerial Decree No. 329 of 26 July 1988 ("External loan facilities with maturities of more than 18 months"). These measures were followed by the UIC's instructions to banks with respect to the foreign exchange monopoly and the new foreign exchange information system.

One of the key factors in the debate leading up to the Parliamentary reform of exchange legislation was Law 159/1976, which had made the exchange control contraventions that directly affect the external accounts (illegal exportation of capital and formation of foreign exchange deposits abroad, failure to give up foreign exchange to the UIC, etc.) into penal offences.

In particular, the discussion focused on the need to revise the regulations in order to provide:

- *greater clarity*, so as to avoid all uncertainty of interpretation, which is particularly harmful when penal sanctions are involved;
- *less cumbersome* administrative procedures for external transactions, especially in connection with imports and exports;
- *fewer restrictions*, to further the international integration of the Italian economy.

A number of administrative measures were introduced in the early eighties to clarify the controls and streamline the procedures. (1) As for the aim of relaxing the external constraint, the improvement of the balance of payments in the course of the decade has permitted a gradual removal of exchange restrictions, most of which were introduced during the seventies to deal with the payments crises engendered by the oil shocks, the abandonment of fixed exchange rates and domestic economic problems. (2)

The belief gained ground that Italy could gradually remove all its exchange controls and achieve complete freedom of external transactions and full financial integration within the EEC.

It then had to be decided whether this objective should be attained without substantial changes in the law or through a sweeping revision of Italy's foreign exchange legislation.

In favour of the former course it was argued that, even though the foreign exchange law of 1956 was based on the principle of a general prohibition of foreign transactions, it provided sufficient flexibility by conferring on the exchange authorities full discretionary powers to determine the degree of international openness of the economy and to impose restrictions and grant authorizations depending on the state of the nation's external accounts.

The opposing argument, namely that a radical reform of the exchange legislation was necessary in order to replace the principle of prohibition with that of freedom, held that it was precisely the "excess" of discretionary power under the 1956 law that obstructed Italy's full participation in international markets. Moreover, it was believed that even if Italian operators were granted a very high degree of freedom, they would still act cautiously, for fear that their expansion plans might be thwarted by a sudden reimposition of exchange controls.

3. On 21 April 1981 the Government submitted to Parliament a bill asking essentially for delegated powers:

a) to improve some of the procedural aspects of the penal provisions of the foreign exchange controls by raising the penally relevant threshold for violations from 500,000 to 15,000,000 lire and resolving several problems posed by inconsistent interpretations of the law by the courts and the exchange control authorities; and

b) to issue a codified exchange control law.

Though the bill was of considerable significance at that time, its approach was nonetheless aimed basically at rationalizing and reordering existing legislation. The bill lapsed with the early dissolution of Parliament without being discussed in committee.

In the meantime, Law No. 689 of 24 November 1981 ("Modifications of the penal system") had decriminalized a number of offences, including exchange contraventions involving less than 5 million lire.

For its part the Ministry for Foreign Trade appointed a group of experts to draft proposals for amendments to the above bill.

The group's findings were assessed and finalized in agreement with all the government departments concerned. On 17 November 1983 the Government presented a new bill seeking delegated powers to undertake a revision of Italy's exchange control legislation going well beyond that envisaged in the 1981 bill. At the time this action was under way Italy's external accounts were showing fundamental improvement.

The text of the 1983 bill provided not only for more extensive changes in the system of penal and administrative sanctions (3) but also for a general reform of Italian exchange controls based on the affirmation of the principle of freedom for external commercial and financial transactions. This latter aspect was the essential feature of the bill. Article 11 laid down the principles and guidelines to which the Government should adhere in revising the law. In substance, these criteria tended:

- to establish by law the scope of the exchange authorities' discretionary powers with the declared intent of reducing them. While the exchange authorities were to be allowed to impose exceptions and limits to freedom, such measures were to be used only "for purposes of monetary policy or else to prevent damage to the national economy or individual sectors thereof ...";
- to fix the capital controls that the exchange authorities could adopt in the future;
- to achieve the greatest possible clarity and comprehensibility in the new exchange regulations;
- to increase the scope for trade in gold bullion (ingots, etc.);
- to simplify the administrative procedures involved in external transactions.

The bill further envisaged the setting-up of a Committee to study and find solutions for problems concerning the reform of Italy's exchange control system. It also required that the implementing decrees be examined in advance by the Standing Committees of the Chamber of Deputies and the Senate; in this way Parliament would have an opportunity to express a final opinion on the action of the executive branch, although its judgement would not be binding.

This marked the start of the lengthy debate in the Commissions of the Senate and Chamber of Deputies during which the Ministers for Foreign Trade, of Justice and of Finance, the Governor of the Bank of Italy and high-ranking officials of the competent authorities were all heard.

On 20 June 1985 the Senate approved an amended version of Bill No. 316, which was then transmitted to the Chamber of Deputies on 28 June.

The main changes compared with the bill tabled by the Government were:

1) the promotion to the level of a basic principle of the obligation to reconfirm the exchange monopoly; (4)
2) the obligation to keep Parliament informed of both foreign exchange movements and any administrative measures adopted by the exchange authorities (Ministerial Decrees, etc.); (5)
3) the creation of a system within the Italian Foreign Exchange Office to collect data on external economic and financial transactions;
4) the obligation to issue provisions aimed at coordinating the foreign exchange activities of the Bank of Italy, the Italian Foreign Exchange Office and the Special Foreign Exchange Squad of the Finance Police; (6)
5) the recourse to the principle of tacit approval. (7)

The debate on the bill in the Chamber of Deputies, as in the Senate, focused on the appropriate role of exchange controls in Italy and, therefore, on the relationships between freedom in external dealings, exchange monopoly, administrative control of the flows of foreign currency into and out of the country, and the punishment of exchange offences.

On 12 June 1986 the Chamber approved a modified version of the bill it had received from the Senate. The changes left the structure of the original text virtually intact and chiefly concerned formalities and comparatively unimportant issues. (8) The new text nonetheless regulated, for the first time, foreign exchange dealers' fees.

On 17 June 1986 the bill was returned to the Senate, discussed briefly and given final approval on 26 September 1986, as Law 599/1986 on the "Reform of exchange control legislation".

In brief, the Law:

1) delegated to the Government the task of introducing, within one year, a reform of the exchange control system on the basis of the principles and criteria indicated in Article 1;
2) introduced, with immediate effect, a number of important modifications to the 1976 law governing currency offences (including the increase to 100 million lire over three years of the threshold above which currency infringements are criminal offences); and
3) introduced, with immediate effect, the possibility of opting to have exchange offences extinguished by paying a fine (fixed by the same law and proportionate to the seriousness of the offence).

4. In carrying out this authority, the Government submitted two delegated decrees to the Parliamentary committees. Parliament began its consideration of them in the sessions of 5 August 1987 and concluded on 17 September with a favourable opinion, which however was accompanied by several observations. Although the latter did not relate to essential aspects of the legislation, they included the suggestion that the two texts be unified.

After taking account of these observations, the Government issued the new exchange law, Presidential Decree No. 454 of 29 September 1987, which, as provided by Article 32, went into effect on 1 October 1988.

The new exchange legislation adheres closely to the liberalization guidelines laid down by the enabling law and has also dealt with the complicated issues raised by the coexistence of the different principles of market freedom, monopoly and administrative restrictions:

- on the one hand, it confirms the principle of freedom in external commercial and financial relations (Article 5 of Decree 454) and provides that limits to such freedom may be adopted only in the instances, e.g. foreign exchange pressures, and forms indicated in Article 13;
- on the other hand, in connection with the foreign exchange monopoly, Article 6 specifies several standing restrictions that may be lifted or imposed at the discretion of the exchange authorities. These include the obligation to surrender foreign exchange holdings, the ban on residents' holding deposits abroad, and the possibility of regulating the foreign currency positions and net external positions of banks authorized to deal in foreign exchange.

At the same time, the new regulations (Article 7) retain the "channeling" obligation relating to foreign currency and exchange market dealings. Accordingly, market participants are required to conduct their external transactions via authorized banks and to deal through and with such banks when buying and selling foreign exchange.

Furthermore, the same liberalization principles are embodied in Ministerial Decree No. 21 of 1 February 1988 (designated "Provisions for the implementation of Presidential Decree No. 454 of 29 September 1987, containing foreign exchange regulatory provisions under Law No. 599 of 26 September 1986, Article 1"), Ministerial Decree No. 329 of 26 July 1988 and the UIC circulars regulating authorized banks' foreign exchange trading and statistical reporting.

Pursuant to Article 1(3) of the enabling law (Law 599/1986), Presidential Decree No. 148 of 31 March 1988 laid down the codified law of foreign exchange regulations, which comes into effect on 1 January 1989. This codified law expressly abrogates the new exchange legislation itself (i.e. Presidential Decree 454, which thus remains effective only from 1 October to 1 January 1989), but incorporates all its provisions.

5. In June 1988 the Council of Ministers of the EEC approved a Community Directive to which the legislation of all member states should be adapted by 1990. Member states will therefore be obliged to eliminate all remaining restrictions on the transferability of capital, including those of a monetary nature. This means, for example, that residents will be free to hold deposits in foreign currency with banks abroad, thus rendering the foreign exchange monopoly, as reaffirmed by Italy's new exchange legislation, inoperative. The change in question could be accomplished administratively, because existing legislation provides for the possibility for the monetary authorities to remove restrictions and prohibitions in connection not only with the implementation of the Single European Act but also with the progressive monetary unification of Europe, in which this Directive marks a key step.

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(1) Specifically, with the Ministerial Decrees of 12 March 1981 ("Provisions concerning foreign exchange regulations and external financial transactions") and of 18 July 1985 ("Foreign exchange provisions concerning merchandise imports and exports"), the Minister for Foreign Trade, in concert with the other Ministers concerned, carried out a general revision of the system of rules relating to foreign financial transactions and foreign trade, respectively.

(2) In differing degrees, depending on the case, the removal of these restrictions affected both the household sector and bank and non-bank operators. For example: the liberalization of time limits for settling foreign transactions; the abolition of requirements relating to financing in foreign exchange; the greater freedom allowed to operators and banks in managing their foreign exchange liquidity; the scope given for external credits to be transferred between residents; the freedom allowed for investment in foreign securities; the possibility for operators to hold accounts abroad; permission for direct investment abroad; the abolition of the foreign currency allowance for Italian tourists; and the elimination of non-interest-bearing deposits in respect of Italian investment abroad.

(3) Incorporation of the principles of Law 689; raising of the threshold for penal sanctions from 5 million to 100 million lire; provision for pecuniary settlement of administrative offences; solution of some interpretative matters (access of UIC inspectors, finance police, etc., to banks); checking the appropriateness of external transactions; the function of foreign exchange operators' statements; penal responsibility of bank managers; summary trial for exchange violations; admissibility of administrative sanctions imposed by criminal courts; compulsory confiscation; statute of limitations; etc.

(4) The Government's draft of the bill made no express reference to the foreign exchange monopoly.

(5) The definitive text of Law 599/1986, Article 1(g), was to specify that such notifications were to be made every six months.

(6) The first legislation designed to deal with the coordination problem was the penal foreign exchange legislation of 1976 (Law 159) and the Ministerial Decree of 11 November 1976. The latter conferred a special mandate on the finance police's Special Foreign Exchange Unit, which it instituted at that time for purposes of foreign exchange control.

(7) The principle had already been introduced, administratively, by an order of 15 December 1983.

(8) For example: making wilful intent and negligence equivalent with regard to administrative foreign exchange violations in conformity with the principle of Law 689/1981, Article 3.

Speeches

Cooperation and Conflict in Monetary and Trade Policies

Speech given by the Director General, Lamberto Dini, at a Roundtable organized by the International Management and Development Institute

Milan, 19 February 1988

Some general remarks

In dealing with the issues raised by our panel discussion, I have chosen to exploit my "comparative advantage" and focus on the macroeconomic aspects. I will devote the first part of my remarks to a brief interpretation of the eighties, from which I will draw some useful lessons for the discussion, in the second part, of the prospects for international cooperation.

Interpreting historical experience requires a conceptual framework. I find it useful in this regard to distiguish between cooperation and coordination. Cooperation basically involves information exchange, consultation among authorities, and possibly common assessments of the international repercussions of national policies. Coordination means that policymakers in a number of countries agree on common objectives and together take joint policy decisions that differ from those they would have taken on their own. Conflict is, in a sense, the opposite of coordination. It may arise from time to time when no consideration is given to the international dimension of national policies. In sum, we can view international cooperation as a continuum ranging from coordination, the highest level of cooperation, to conflict, when cooperation breaks down.

In most situations, simple cooperation is sufficient to guide economic policy: the exchange of information and assessments improves decision-making in each country, and national objectives are mutually consistent or at least in the main not in conflict. In some cases, however, policy coordination becomes both necessary, because indepedent domestic objectives are incompatible, and possible, in that all sides can improve their performance by making policy bargains that sacrifice some goals but entail a smaller loss than would be incurred in the absence of agreement. Clearly, in this framework cooperation is the general condition, while coordination may occur sporadically, usually as the response to potential or actual conflict.

Within this continuum, the situation at any given time will also depend on the rules governing international economic relations and the degree of consensus concerning the causes and possible solutions of current economic problems. For instance, the Bretton Woods regime can by and large be described as a system of (semi)-automatic coordination, since the exchange rate constraint set definite limits to national economic policies and countries were basically willing to respect it. The priority assigned to the exchange rate constraint reflected a basic consensus on the role of macroeconomic policies in ensuring domestic and external stability. Since the advent of free floating in the early seventies, we have witnessed a variety of situations ranging from coordination to conflict. For the most part, however, in this regime the national policy objectives of the major players have not been coordinated, while the burden of reconciling them has been placed on exchange rates. When conflict has arisen, it has often also been clear that the basic consensus on the role of macro-policies was, to say the least, much weakened.

The early eighties: lack of coordination leading to conflict

In the first half of this decade the three leading countries did not coordinate their domestic economic policies in the common pursuit of disinflation. The prevailing conviction was that policies "to put one's own house in order" would also ensure the smooth functioning of the international economy. Advocates of this approach argued that floating exchange rates would grant sufficient "insulation" from international disturbances. Accordingly, the United States adopted a very restrictive monetary policy and an expansionary fiscal stance, while Germany and Japan preferred a restrictive fiscal stance and relatively easier monetary policies. The dollar appreciated sharply. Though all the major industrial countries did manage to bring inflation under control, the fallacy of this approach has been thrown into sharp relief by sustained exchange rate misalignments, the build-up of enormous trade imbalances and the attendant increase in protectionist pressures. It is precisely in the sphere of trade that the threat of conflict has been felt most acutely, to the point of calling into question the entire architecture of the multilateral trade system organized within GATT.

Restoring international cooperation: from the Plaza agreement to the Louvre accord

Recognition that the non-cooperative approach was endangering trade and even the realization of national objectives eventually led to a shift along the continuum, away from conflict and towards coordination. The report by the Group of Ten Deputies issued in June 1985, while recognizing that a return to a system of fixed parities was premature, stressed the need for close and continuing cooperation among the major countries to promote convergence of economic performance and thereby enhance exchange rate stability. It should be noted, however, that coordination was initially limited to two specific episodes and that it was more in the nature of crisis management than a return to continuous collaboration.

The first episode came at the end of February 1985, when the leading central banks conducted massive concerted intervention in the exchange market to halt the appreciation of the dollar. The second was at the end of September, with the Plaza agreement, which was designed to speed up the depreciation of the dollar. Again, the coordinated action was limited in time and scope, with most of the effect being achieved by the announcement of the common goal of bringing the dollar down; interventions in foreign exchange markets were substantial only for a short period; monetary policies also played a role, since interest rates were coming down more rapidly in the United States than elsewhere.

The dollar did turn downwards and a "crash landing" was avoided. The reason for this success was that the common goal was consistent with economic fundamentals, while an easing of monetary policies, which was more pronounced in the United States, was also clearly consistent with national objectives. It was thus possible to produce a lasting change in market participants' expectations.

In the ensuing months the situation reverted to loose cooperation; the dollar continued to depreciate and monetary policies to ease; what was not done, however, was to restore a less unbalanced pattern of fiscal policy. The failure to use this instrument to foster the required redistribution of domestic demand from deficit to surplus countries and the impact effect of the dollar's depreciation on trade values led to a further widening of payments imbalances. Some of the problems deriving from this inability to coordinate fiscal policies were explicitly recognized at the Tokyo Summit in May 1986. This led to the decision to strengthen the procedures for multilateral surveillance, mainly through a more binding system of indicators designed to make national policies more consistent with the needs of external adjustment.

Since the summer of 1986 resistance to further depreciation of the dollar grew in the appreciating-currency countries, where the authorities were increasingly worried about the loss of competitiveness of their exports. The US attitude was less clear, although fears of a resurgence of inflation were spreading.

At their September 1986 meeting, the Group of Seven Finance Ministers declared their conviction that their policies "should help stabilize exchange rates ... so that imbalances can be reduced sufficiently without further significant exchange rate adjustment". This announcement, which was not followed by any action whatsoever, unsettled the markets and thus proved counterproductive.

It was only after a further depreciation of the dollar, and with current account imbalances still widening, that policymakers decided to sit down together again to halt the slide and restore some order to foreign exchange markets. The Louvre accord reached in Paris at the end of February 1987 provided for coordinated changes, clearly detailed for each individual country, not only in monetary but also in fiscal policies.

The aftermath of the Louvre accord

Subsequently, Japan did adopt a package of expansionary fiscal measures and the United States took steps to cut the budget deficit. Germany, on the other hand, did not accept the view that a greater fiscal stimulus would be appropriate. The brunt of dollar stabilization fell once again on monetary policy. Heavy intervention in foreign exchange markets led to a sharp acceleration of monetary growth outside the United States. The lack of support from the German authorities, the perception that the US budgetary position would not improve in 1988 and the evidence of still growing trade imbalances, all led market participants to consider the fiscal manoeuvre insufficient. The authorities in the appreciating-currency countries became uneasy about the pace of monetary expansion. The United States appeared increasingly concerned about the lack of progress on the external front, and was not ready to accept a slowdown of domestic demand. After a short period of calm, in May-June 1987, pressure on the dollar resumed.

Towards the end of the summer the markets perceived that cooperation was breaking down and a situation of conflict was emerging, with interest rates in all the major countries creeping upward. This market sentiment unleashed fears of recession in the United States and contributed to the October stock market crash. The Federal Reserve's response gave priority to the stabilization of national financial markets with the explicit abandonment, for the time being, of the objective of a stable dollar, as was made clear in a public statement by Secretary Baker at the beginning of November.

The current debate on coordination

Against this background, there has recently been an upsurge of pronouncements against international coordination and in favour of the pursuit of enlightened self-interest by sovereign nations, notably in the United States. This has been authoritatively argued by Martin Feldstein in a recent article in the Wall Street Journal (10 November 1987). The United States, he maintains, "should now in a clear but friendly way end the international coordination of macroeconomic policy. We should continue to cooperate with other countries by exchanging information about current and future policy decisions but we should recognize explicitly that Japan and Germany have the right to pursue the monetary and fiscal policies that they believe are in their own best interests". And he goes on to say that the conventional claims about the gains from international coordination are not justified by the degree of interdependence among the leading industrial economies; the expansion of domestic demand in Japan, Germany and the other industrial countries would have a limited impact on trade imbalances. The United States should therefore be prepared to accept a further decline of the dollar to the extent necessary to eliminate the trade deficit. Stabilization of the exchange rate at its current level would require higher interest rates and consequently would heighten the risks of a recession. At the same time Japan and Europe should recognize the inevitability of the dollar decline and provide the required offsetting stimulus to their economies through an increase in domestic absorption.

Objections to this view can be raised on a number of grounds. Let me mention two.

First, while Feldstein and others recognize that a fiscal correction is necessary, there is the attendant risk that in practice exchange rate adjustment may come to be seen as a substitute for required policy changes. Second, lack of supportive policy action may in turn induce a tendency for the exchange rate to overshoot, possibly setting in motion "vicious circles" of inflation and depreciation in the United States, of deflation and appreciation in Germany and Japan.

One has to recognize, however, that we are confronted here not only with the difficulties of reconciling inconsistent national priorities, but also with basic differences of view about the contribution that can be expected from exchange rates and macro-policies to the correction of trade imbalances.

Why is closer cooperation so difficult?

Although I have objected to the emerging anti-cooperative view of international adjustment, it is clear that there are numerous obstacles in the way of closer cooperation.

Since we are dealing here with sovereign countries and domestic policy objectives are decided upon by national parliaments, it is difficult to bring about mutually compatible policies. The domestic political process is so complicated that international considerations cannot be expected to be more than a small factor in policy-making. Only at times of "crisis" is a common interest in coordinated action more clearly recognized, thus permitting international policy agreements to be reached. In addition, since international cooperation is a "public good" any country participating in it will tend to be more conscious of the costs to itself — particularly the perceived loss of national sovereignty — than of the prospective benefits.

There is no shared view or accepted supranational authority to decide what policies are needed to deal with existing imbalances in the world economy. Empirical evidence from econometric models is not very helpful in this regard since it shows that, while there may be gains from systematic cooperation, these gains are on average not large. Furthermore, these results are based on the assumption that the authorities in the different countries "all use the same model", or in other words hold broadly similar views on the functioning of the world economy. If this condition is not satisfied, it is easy to show that it is far from certain that the gains from cooperation will be achieved or even recognized. Moreover, in certain circumstances the credibility effect of announcing coordination may be counter-productive on other fronts. For instance, the announcement that exchange rates will be stabilized, without adequate support from fiscal action, may convince private agents that monetary aggregates will run out of control and lead to a resurgence of inflationary expectations.

Are there realistic prospects for improved cooperation now?

In general terms, coordination is viable and useful insofar as it enables the countries concerned to make gains that they would not achieve by acting separately. Furthermore, these gains must be visible and exceed the cost of sacrificing domestic objectives, so that a deal is possible. I believe that this is true in the present situation, in which the world economy confronts the simultaneous objectives of adjusting large external imbalances and avoiding the twin dangers of inflation and recession. Clearly, however, we must take a realistic view of the scope for coordination and of the possible gains. We must recognize that external imbalances will persist for a long time, regardless of the policy approach adopted, and that their correction will be neither painless nor smooth.

It is also clear that the sheer size of the divergences in "fundamentals" in the leading countries is not consistent with a return to fixed exchange rates. Exchange stabilization agreements can only be seen as "holding" operations. They are necessary because the effects of exchange rate changes on trade flows are powerful but slow to come adout, so that exchange rates have a tendency to overshoot.

This view of stabilization operations is also consistent with another important lesson of recent experience: with divergent "fundamentals" countries will only be willing and able to adhere to exchange rate stabilization agreements for limited periods, that is for the time that it takes for fundamental inconsistencies to show up in conflicts with domestic objectives. The clearest example is the stock market crash putting an end to the Louvre accord, but others could be mentioned. This is not to say, however, that no constraint on national policy should be involved in stabilization agreements: indeed, these will be useful only if they succeed in gradually bending domestic policies and priorities to the requirements of international adjustment. A difficult middle way will have to be found here between discipline and flexibility; the policy judgements will have to be made on the basis of conditions in foreign exchange markets, domestic developments, and the progress made on the external front in the leading countries.

This realistic view of cooperation should also be reflected in public statements. It is essential to avoid creating excessive expectations, notably any implication that cooperation is either "everything forever" or nothing. By the same token, however, the public airing of disagreements should also be avoided.

A further feature of any cooperative strategy is that it should not continue to rely only upon the three leading actors. Other groups of countries should participate in the concerted efforts for adjustment. The size of the external surpluses accumulated by the Asian NICs and, in particular, the role of restrictive trade practices and "competitive" management of their exchange rates in generating these surpluses single out this group as one deserving special attention in identifying the requirements for adjustment.

Turning to the contents of coordination, any strategy will, of course, have to be based on the correction of the savings-investment imbalances in the leading countries. Since the room for manoeuvre on the monetary side is limited, fiscal policy will have to contribute more, both in the United States and in Germany. The role of Germany is crucial because its cautious fiscal posture greatly influences the other European countries participating in the exchange rate mechanism of the EMS. A more courageous growth-oriented approach in Germany, aiming at exploiting in full the potential of the economy, would therefore help set in motion a virtuous mechanism permitting Europe as a whole to contribute to worldwide growth and adjustment.

Europe must realize that it cannot expect the United States or Japan to help much in pulling it out of the present predicament of slow growth and high unemployment, since trade interdependencies between the two areas are small. Indeed, while Europe has quite a lot to lose from a lower dollar it does not have much to offer to the United States in exchange for participation in the dollar stabilization effort.

Japan finds itself in quite a different position, in view of its high interdependence with the United States. Since the US deficit and debtor position and the Japanese surplus and creditor position are, to a considerable extent, mirror images of each other, the benefits from cooperation between the two are greater and more evident to national authorities in both countries.

Would the United States have an incentive to cooperate in a coordinated strategy?

The proposed fiscal policy correction has so far proved politically difficult to implement. On the other hand, if the Federal government does not reduce its net absorption, the external deficit is bound to be adjusted by a decline in investment or a surge in private savings in response to higher real interest rates or a further slide in equity prices.

Finally, the discussion on international policy coordination is often confined to the macroeconomic sphere. This is an oversimplification since there is at least one other area of policy where collective action is relevant, i.e. trade policies.

The "gains" from coordination might prove larger if the scope for coordination were broadened to the trade arena or, for that matter, defence and foreign policy, because the range of possible policy bargains and improvements would thus be broadened. Trade and macroeconomic policies cannot be divorced since the viability of a free-trade system depends on a reasonable configuration of exchange rates.

The prevention of a protectionist backlash should be a chief imperative of international cooperation; it is clear from recent experience that trade-restrictive legislation is fostered by the persistence and exacerbation of external imbalances and exchange rate misalignments. When discussing whether payments imbalances are "sustainable" or not, we should not belittle this element of "political sustainability" represented by an increase in protectionism. There is an urgent need to insulate trade policy from the effects of persistent macroeconomic imbalances.

The Blurring of Financial Frontiers: in Search of an Order

Speech given by the Deputy Director General, Tommaso Padoa-Schioppa, to the Conference on Financial Conglomerates, Commission of the European Communities

Brussels, 14-15 March 1988

1. Introduction and summary

The calling of this Conference is a sign that the Commission is becoming increasingly aware that the creation of a unified financial market in Europe involves not only dismantling national frontiers but also managing a period of change in markets, institutions, and supervisory bodies. This attitude is to be welcomed.

To be in tune with the Conference and well briefed about the Commission's thinking I have carefully read the "Third Commission Working Paper on Financial Conglomerates". Let me say that while the subject of the Conference is exceptionally stimulating and topical, the paper does not fully render the scale of the change under way or the extent to which some long-standing features of our financial systems are now being challenged. The expression "blurring of frontiers" conjures up the idea of changes in the man-made administrative superstructures of an immutable physical geography. But what we are witnessing are important earth tremors, if not earthquakes. And, to describe what is happening, an analogy has even been drawn with the cosmic event of a "Big Bang".

I shall not offer you yet another description of the rapid financial changes that are taking place worldwide. Inflation, uncertainty, progress in information technology and attempts to circumvent regulations have frequently been identified as the driving forces. New instruments and new intermediaries have emerged. Many of us have the impression that a similar intensity in the parallel and interconnected changes in financial markets and regulatory frameworks has not been seen since the thirties. Indeed, some of the pillars that were erected then are now being seriously questioned for the first time. Enthusiasm about deregulation has cooled among market participants. Almost universally, the search is on for regulatory principles consistent with the new shape of financial markets.

The approach followed so far by the Commission in drafting proposals for new Community legislation concerning financial markets is based on the organization of regulatory functions that has traditionally characterized most industrial countries: the tripartition between securities, banking, and insurance in both financial institutions and contracts.

However, recent events and various aspects of the blurring of financial frontiers reveal the inadequacy of this traditional approach and highlight the need for a re-examination of the very foundations of our financial systems and regulatory frameworks. The combined impact of financial innovation and globalization are forcing us to undertake the extremely demanding task of revising our regulations in a coherent manner. In performing this task, we should not allow the diversity of national systems to divert us from inquiring into the *objectives* that satisfactory regulation is expected to achieve.

The analysis I shall develop has two main policy implications. The first is that we should no longer refer to financial markets in the plural for regulatory purposes. Official reports issued in the aftermath of last October's stock market crisis warned against the danger of having different markets supervised by different bodies at a time when integration among markets is proceeding apace. Both financial stability and market "transparency" are indivisible social goods: supervision of "the" financial system as a whole should avoid the risk of disparities in regulatory provisions leading to undesirable arbitrage between various parts of the market.

The second implication is that we should no longer limit the domain of stability controls to the banking system, because banks are now only one component of a larger category of institutions, whose common denominator is a mandate by savers to manage their funds on a discretionary basis. The growing complexity of the financial market, and the application of new technologies to centralized information processing, have considerably enhanced the role of this type of institution. Unit trusts, pension funds and portfolio management companies, to mention but a few examples, wield a delegated investment power very similar to that of banks and to a varying extent, perform a transformation function comparable to that traditionally associated only with bank-type institutions.

In practice, this involves a sharper distinction than is currently made between regulation aimed at the *market* as such and requirements applying to *institutions* that, in the normal course of their activity, operate in the securities market predominantly on behalf of final investors. The former is the area of "market making" or "market transparency" regulation; the latter, of stability and prudential controls.

A clear demarcation of the two areas seems highly desirable at the level of first principles, although it may pose some problems in practice. Systemic stability is best protected when the oneness of the financial system is matched by a coherent and graduated set of prudential controls, encompassing all institutions that act as delegated investors. Moreover, as a general rule, the authority responsible for prudential supervision should not be the same as that in charge of market transparency. However, the desirability of a system of "checks and balances" should not obscure the basic complementarity of the two goals and the need for consistency in the actions of the authorities to which they are entrusted.

In Section 2 I review basic financial contracts and institutions as well as the various ways in which traditional distinctions are blurring. A binary scheme, based on the distinction between market makers and delegated investors, is proposed. In Section 3 a regulatory framework is outlined, based on a distinction between the two objectives of market transparency and financial stability. Finally, in Section 4, I examine four selected issues that appear particularly important in the present condition of financial markets.

2. The conceptual framework

2.1 *Contracts and institutions*

If there were no uncertainty about the future, the specific contractual form in which financial markets channel funds from savers to investors would not matter. However, since uncertainty is everywhere and agents take decisions on the basis of incomplete or unevenly distributed information, every financial transaction involves some risk. Thus, the various financial contracts not only act as a vehicle for the transmission of savings but also provide agents with alternative risk-sharing mechanisms.

Fundamentally, contracts signed on financial markets fall into three broad categories: insurance, equity, and debt.

In principle, insurance is the most efficient way of dealing with risk, since the pooling of uncorrelated risks by a specialized institution results in an overall risk reduction thanks to the law of large numbers. For various reasons — among which moral hazard is prominent — not all risks can be insured against. In particular, in view of the importance of private information in establishing new firms or launching new projects, the risks involved cannot usually be insured against.

Broadly speaking, equity lies at the opposite extreme of the spectrum, since the flow of income accruing to the holder is dependent on the firm's performance. Its distinguishing feature is that it allows the risks involved in investment projects with uncertain returns to be shared, while providing holders with both the possibility and an incentive to foster profit maximization on the part of managers.

Debt, in its more general form, differs from equity in that it has a fixed nominal value and a predetermined rate of return. As a result, it places a lesser burden on the holder, who can disregard the actual performance of the firm he has financed, except in the extreme contingency of bankruptcy. Debt usually provides a good risk-sharing mechanism precisely in circumstances, such as an information asymmetry between creditor and debtor in favour of the latter, in which equity fails to meet the investor's needs.

If we now turn from financial contracts to financial institutions and markets, we have to consider negotiability and transformation. Not all assets can be easily negotiated. In some cases the intermediation of a financial institution is logically needed for the contract to be viable. Insurance and loans (non-negotiable debt) have to pass through the balance sheet of an institution because of the very nature of the underlying contract. Insurance contracts need an institution because their profitability for the insurer ultimately depends on the law of large numbers. Loans, on the other hand, are a type of debt contract that requires lenders to have skills and credit-evaluation procedures. The costliness and confidentiality of the information-gathering process acts as a barrier to the development of a truly impersonal market for loans. Without institutions specialized in appraising final borrowers' creditworthiness, lending would never grow beyond the stage of an occasional activity. Historically, this function has been performed by banks, which draw on the technical expertise and confidential information acquired in making payments on their customers' behalf. Thus, both insurance and lending require specialized institutions, whose ability to meet their commitments to customers depends crucially on numbers being large — on each institution intermediating a substantial volume of funds.

2.2 *The blurring of financial frontiers*

If insurance, debt and equity exhaust the taxonomy of basic contracts, insurance companies, banks and the capital market represent the three traditional institutions or channels of intermediation. The regulatory framework and the legislation of most countries is based on this double tripartition and on a large degree of correspondence between contracts and institutions. Now, the problems we are discussing in this conference arise from the fact that technological progress and operators' efforts to devise more flexible and efficient mechanisms have gradually blurred the frontiers between these different categories. The blurring occurred in several ways: the development of complex contractual forms, the "unbundling" of certain types of risk into separate financial claims, the extension of negotiability and the globalization of financial markets.

Financial products variously combining the features of the different basic contractual forms have always existed. In recent years, however, their variety and market share have increased to the point of giving a new shape to financial markets. Indexed bonds, NIFs and FRNs, for example, combine insurance and debt features. Convertible bonds, by contrast, stand mid-way between debt and equity financing. The common denominator of these products is the partial insurance they provide investors against specific adverse contingencies for which no insurance market exists.

The recent wave of financial innovation has taken a second direction. Thanks to technological advances, it is now possible to "unbundle" the components of financial contracts: the resulting parts are then priced explicitly and circulate separately. Currency and interest rate swaps were the first instruments designed for this purpose. More recently, financial futures, options and forward rate agreements have considerably enlarged the menu of instruments performing an insurance function. As a result of this trend, one financial operation may now give rise to several transactions, carried out on different markets.

Risk unbundling does not necessarily improve the ability of financial markets to perform their primary task of channelling savings towards those investments that offer the "best" combination of risk and return. From this point of view, financial innovation may even prove harmful since, by enhancing the liquidity of assets, it may lead operators to concentrate on short-term profits and neglect the "true" long-run prospects of investment projects.

The increase in negotiability of financial assets has been a third and related direction of financial innovation. Negotiability has never been an exclusive feature of equity contracts. For certain types of risk, the divisibility and

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negotiability of the basic insurance contract in the reinsurance market has been the very condition for profitability. Similarly, negotiable bonds have existed since the early stages of the evolution of financial markets and their market has been further enlarged by the standardization service provided by rating agencies.

On the other hand, the recent growth of securitization has given new impetus to negotiability and shifted a significant proportion of credit flows away from traditional bank lending. For our purposes, two aspects of securitization are worth stressing. First, the transformation of non-negotiable assets — notably mortgages — into negotiable instruments, through a complex process involving the combination of individual loans into large packages that can subsequently be divided and negotiated in small lots. Second, the outright sale of bank loans — traditionally a non-negotiable asset — on newly-created secondary markets. Behind securitization lie both the increased efficiency of securities markets in assessing credit risk and the "insurance" role played by banks themselves in connection with certain instruments, such as NIFs and RUFs.

Financial frontiers have also been blurred by the increasing tendency to market different financial instruments through one and the same retail organization. A financial institution that possesses a network of relationships with a large number of households or corporate customers is in a good position to exploit its name to market a wider menu of financial instruments, outside its original field of specialization. Banks selling insurance policies and pension schemes, securities firms offering payments services as a by-product of their portfolio management and re-insurance companies marketing mutual funds are but some examples.

Finally, information technology. Besides influencing all the above changes, the evolution of telematics has been the decisive factor behind two other important manifestations of the blurring of financial frontiers. First, the shift in market making from pure brokers to dealers as a result of the possibility of matching buy and sell orders by computer in continuous dealing. This change is epitomized by London's "Big Bang" and has also transformed the business both of American investment banks and of Japanese securities houses. The second change is the globalization of financial markets. This has meant going beyond not only geographical frontiers but also systems of regulation and specialization that history and governments had traced out very differently from one country to another. It is globalization that allows the London subsidiary of an American commercial bank or Japanese securities firm to provide international customers with services the parent company is precluded from supplying by its domestic legislation.

One general conclusion that can be drawn from the foregoing considerations is that the usual way of approaching the financial sector by splitting it into three components reflecting the basic contractual forms is no longer adequate, since it overlooks the new intersections between contracts, institutions and markets.

2.3 *Market makers and delegated investors*

It does not follow from what I have been saying that any attempt to identify different activities within the broad area of financial intermediation is bound to be analytically fruitless. It all depends on the definitions we adopt. The weakness of the traditional approach, as we saw, lies in the identification of functions with the basic contractual forms. Once this assumption is dropped, it becomes possibile to identify two types of activity that are both clearly distinguishable and vital for the orderly working of the market as a whole. For reasons that will be made clear, they can be labelled "market making" and "delegated investment".

First, market making. The efficiency of the market for negotiable assets primarily depends on the ability of the pricing system to give the appropriate signals to all participants. In this regard, the importance of the specialized operators who supply market-making services cannot be overstated, since they provide the financial system with their professional expertise in establishing the "right" prices of assets, thereby facilitating the completion of trades by individual investors. Such specialists are an essential component of an impersonal capital market, but cannot be considered intermediaries in quite the same sense as banks. They contribute to the overall efficiency of the market process, but do not receive a direct or indirect mandate from final lenders to choose either assets or final borrowers, nor do they transform the nature of the funds received from investors, who remain entirely responsible for their investment choices and bear all the associated risks.

Second, delegated investment. Several categories of financial institution participate in the market, not with the task of smoothing transactions and pricing assets, but rather to select and manage — on other agents' behalf — a portfolio of assets with the aim of maximizing its return for a given level of risk. The archetypal version of such institutions is the bank, to which depositors entrust the final decision as to where their funds should be placed, confident as they are of the banker's superior credit-evaluation ability. Banks, however, are no longer unique in this regard. Unit trusts, pension funds and portfolio management companies share the same economic rationale, i.e. the economies of scale in gathering and handling information and the scope for risk diversification offered by large portfolios.

The growing complexity of financial markets and the application of new technologies to the centralized management of information considerably enlarge the role of institutions of this type. At the same time the combining of basic contracts into innovative assets and the process of unbundling make it more difficult, not only for individual investors but also for institutions themselves, to assess the risks involved in their activity. For our purposes, what matters is that all institutions that collect funds for discretionary investment wield a delegated investment power very similar to that of banks. Like banks, they are entrusted with the task of channelling final investors' funds towards the most profitable uses the market can offer, performing in various degrees the transformation function that used to be the exclusive domain of banks.

This is not to deny that fundamental differences remain between banks and other delegated investors in other respects. On the assets side, the most obvious is that banking in the traditional sense implies bilateral, and therefore personal, relationships between bankers and debtors, while unit trusts and the like invest savings through the impersonal capital market. As a result, the information-collection process the bank undertakes is deeper, more costly and debtor-specific than that of other institutions. However, I would argue that the difference is one of degree and not of nature: by transforming savers' funds into assets that would otherwise have been neglected, any institution that produces information has an impact on the overall allocative process. Depending on how far financial transformation is pushed and the contractual form it takes, this process may considerably change the risk esposure of the institution concerned, but not the nature of the service. Moreover, real-world banks have long ceased to restrict their business to banking as defined here; lending is now but one component of a modern bank's activity.

Market making and delegated investment services are conceptually distinct activities that require different skills and involve different risks. In particular, the activity of a market maker is directed at searching for the "right" market price, no matter whether this searching process entails holding a portfolio that is non-optimal on the basis of the information available to individual investors on the market. Conceptually, commissions are the main source of income for a market maker, not the yield of a portfolio.

A market maker should be "neutral" with respect to the level at which prices are actually set. And this neutrality may be threatened if the same institution also acts as an investor, whether on its own or customers' account, since in this case the institution concerned is committed to choosing a portfolio composition that ensures, at each point in time, the best combination of risk and return. An institution acting in both fields could, for example, try to influence prices so as to facilitate the liquidation of assets whose true value, concealed to the market, had turned out to be inferior to that originally estimated. Conflicts of interest between the institution's management, its customers and the "market" may ensue. Needless to say, a clear demarcation line between the two fields may prove difficult to draw in practice. Indeed, institutions engaged in both market making and delegated investment are to be found in several domestic financial markets. However, the analysis outlined above provides useful guidance in understanding the evolving nature of financial activity and has major implications for the regulatory system. In particular, it suggests that the time-honoured distinction between insurance, banking and securities institutions — based on the now questionable assumption that the underlying contractual forms can be neatly and rigorously identified — should perhaps be treated as subsidiary to the more general distinction between market makers and delegated investors.

3. The regulatory framework

3.1 *The objectives of regulation*

In a growing economy based on the division of labour, the financial sector not only ensures the transmission of funds from surplus to deficit units; it is also responsible for selecting the projects and firms to be financed among a vast array of alternatives and for redistributing the risks arising from the production process.

Both the allocative efficiency and the stability of the economy are closely related to the efficiency and stability of the financial sector. An "ideal" financial system would minimize search and transaction costs, select the projects and firms that carry the highest social return and minimize the risk of instability stemming from the fiduciary nature of financial assets. However, the very nature of financial contracts and market imperfections, especially in the production and distribution of information, tend to keep real-world financial systems far from this target.

Thus, the primary requirement, and hence the first task of regulation, is to make the market efficient in managing information and pricing financial assets. This is the basic aim of all forms of intervention regarding the market as such, the behaviour of its participants, the procedures for matching supply and demand, disclosure requirements and the setting of contractual standards. This is why this kind of regulation, which predominantly consists of "rules of conduct", could be termed market-making regulation.

However, even a properly designed system of standards and rules of conduct would be unable to remove all sources of instability. To some extent, market imperfections are unavoidable because some trading occurs outside the market, some agents produce incorrect information, some relevant information is simply not available or retrievable, and so on. If the "fundamental" values of assets, regardless of their contractual form, are not perfectly known, rumours and misleading or false information may distort the allocative process at the best of times and, in the worst contingencies, lead to "manias, panics and crashes", i.e. generalized financial crises. Financial innovation can even aggravate this problem, since both the opening of new markets and the process of risk unbundling may shorten the time-horizon of agents, thereby making it harder to evaluate credit risk correctly, while increasing the speed at which local shocks are transmitted to other parts of the financial system.

Accordingly, regulations are needed both to reduce the risk of sudden breakdowns of the public's confidence in the trustworthiness of financial intermediaries and also to limit the consequences of crises that follow such breakdowns. The ultimate public interest is to let the economy benefit from the services of a money and credit system, while averting the risk of its imparting potentially uncontrollable shocks to the real economy. Such provisions usually go under the name of prudential regulation.

3.2 *The attribution of regulatory responsibilities*

In most countries, financial regulation has historically been based on the division of the financial system into the three sectors of securities, banking and insurance. At the level of both contracts and institutions each sector was assumed to be sufficiently segmented from the others to call for specific regulation and to permit a low degree of coordination between the various controlling agencies.

Financial innovation has weakened the foundations of this approach and appears to have seriously undermined its effectiveness. The basic contractual forms of financial activity are no longer easily distinguishable at either the production or the distribution levels. Consequently, securities, banking and insurance markets have simply ceased to have separate identities.

In recent years, the adaptation of the regulatory system to the blurring of financial frontiers has followed two approaches, neither of which seems entirely satisfactory. The first is the "functional" approach, whereby each "function", or type of financial service or product, is put under a particular supervisor, independently of the type of financial institution that offers it. It is doubtful, however, whether this is going to be an effective response in the present context of highly integrated markets and unbundled risks. The danger implicit in the functional approach is that of looking at individual parts of a complex reality without catching the whole. In the last instance, it is institutions that go bust, and not the single functions they perform.

The second is the "institutional" approach, whereby each class of institution is placed under the control of a different supervisory authority for the entire range of its operations. This approach may prove equally misleading, not only because it is no longer easy to tell in what way a bank differs from other institutions endowed with a mandate to invest other people's funds, but — and more importantly — because it entails the danger of applying disparate regulatory provisions to the same operations executed by different institutions. The institutional approach can be useful in countries, such as Germany and Switzerland, in which banks cover the whole spectrum of financial intermediation; it makes much less sense when they are but one component of a larger category of intermediary.

This is why I would argue that the need to adapt our regulatory framework to a changing financial system is better met by relating and organizing the instruments and responsibilities of control around the primary objectives regulation is meant to achieve. In the light of the foregoing analysis, this means that we should proceed according to a binary scheme that orders regulatory functions and interventions into the two main domains outlined above: market transparency and the stability of the financial system, respectively safeguarded by rules of conduct and prudential controls. The growing complexity characteristic of financial markets and intermediation thus leads, somewhat paradoxically, to greater generality and simplicity in the conceptual basis of the regulatory framework.

Four considerations should be taken into account when reflecting on the correct way to organize regulatory functions along the lines of this binary scheme. First, the concept of delegated investment is crucial if the domain of prudential controls is to be appropriately defined. Second, transparency and stability are indivisible social goods. Third, two different authorities should preside over these social goods. Fourth, some overlaps in regulation may be unavoidable, in view of the vast range of activities institutions perform. Let us briefly consider these points.

The concept of delegated investment is crucial insofar as it identifies the class of institution whose activity affects the allocation of resources and may give rise to systemic instability. From this standpoint, the crucial difference is not whether the institution submitted to prudential regulation is a bank or a mutual fund. Ultimately, what matters is whether that particular intermediary does or does not have the power to allocate and transform funds on behalf of depositors or investors. As will be argued below, banks continue to hold a special place in this broader category by virtue of their nature of financial intermediaries with debt-type liabilities and as producers of payments services, and it is this that poses specific regulatory problems.

Stability and transparency are indivisible social goods. As to the former, the danger of contagion would be greatly increased if the oneness of the financial system were not matched by a coherent regulatory framework, but also because the blurring of financial frontiers means that any segmentation or loophole in the system of prudential controls could have dangerous consequences. Mosaic-type supervisory arrangements — under which each company in a conglomerate may be supervised by a different authority — are undesirable. As to transparency, it may be necessary have just one responsible authority if we are to increase market efficiency through general rules of conduct and avoid the risk of differences in contractual information and trading standards leading to undesirable arbitrage between the various parts of the financial market.

While indivisibility implies that each of the two domains should ideally be covered by a single authority, separation implies that the authority responsible for prudential supervision should not be in charge of market transparency as well. The task of ensuring the stability of the financial system and preserving the public's confidence requires confidentiality and discretion in making interventions. The latter need to be both administrative and operational and entrusted to an institution able to discern the links between the two facets and exploit the scope for synergy. On the other hand, confidentiality and discretion could actually be counterproductive when the transparency of financial operations and investor information are the primary objectives. However, the desirability of a system of "checks and balances" in no way implies that the two goals are in conflict; quite the contrary, they are basically complementary and must be pursued consistently by the authorities to which they are entrusted.

Lastly, adoption of the suggested binary scheme implies that institutions could be subject to both supervisory agencies. For example, the need for transparency of contractual clauses and for general rules of conduct applies not only to market makers but also to delegated investors. Similarly, market making may also involve, depending on professional habits and the breadth of securities markets, risks for stability, which fall under the responsibility of the agency responsible for prudential controls. However, the possibility of overlaps need not be a matter of concern, as long as the respective responsibilities are clearly differentiated and supervisory duties are carried out in a cooperative way. To this purpose, it is essential that there should be no ambiguity as to the instruments to be used for the different purposes.

3.3 *Regulatory instruments*

It goes beyond the scope of this paper to dwell on the complex issue of regulatory instruments. Further work is needed to explore the extent to which each instrument could and should be assigned in line with the binary scheme suggested above.

Tentatively, one can envisage a small set of basic instruments — such as licensing and fit and proper criteria — that would apply to all institutions. This common framework would be supplemented by other provisions reflecting the specific functions performed by each class of institution and related to the primary public interest (transparency, stability) that needs protection. For instance, actuarial reserves cannot reasonably be applied to anything except insurance companies; on the other hand, deposit insurance, discretionary supervision and lending of last resort would naturally be limited to banks. At a more general level, all institutions with a mandate from their customers to choose either assets or final debtors should be subject to a consistent set of prudential controls: authorization based on criteria of managerial competence and integrity, solvency and capital requirements, appropriate provisions against risk concentration and so on. Conversely, market-making institutions, such as brokers and dealers, should be subject above all to disclosure requirements, anti-fraud provisions, regulations governing selling practices, investor protection rules and others specifically designed to regulate activities not involving the allocation and transformation of funds on behalf of investors. In the event of these operators being subjected to stability controls, in the form of capital ratios for example, their implementation should be entrusted to the authority normally responsible for such supervision.

4. Selected issues

The analysis of financial activities and regulatory functions developed in the preceding sections has the advantage of offering a simple and comprehensive framework that can cope with the growing complexity of the financial operations and institutions of modern financial systems. The actual regulatory systems of industrial countries are nonetheless still generally based on the traditional tripartition of securities, banking and insurance services and do not easily lend themselves to sweeping change. Rather than revolutionary, the change is likely to be evolutionary. And the foregoing analysis may be of use in managing the process.

Some specific regulatory principles can be identified that may help reduce the risk of systemic instability while financial innovation takes its course. The following is by no means an exhaustive list. Four main issues have been selected in the light of the main practical problems addressed by this Conference, but the choice was also influenced by work under way at the Community level and institutional features specific to Italy.

4.1 *Banking as a special case*

The particular combination of non-negotiable assets and monetary liabilities typical of banks makes banking "special" in two ways. Firstly, this loan-deposit combination results in the banking system being the principal channel for the transmission of monetary policy, not only because deposits happen to be the main component of monetary aggregates but also because the low short-term substitutability of bank loans with other channels of financing implies that fluctuations in the volume of bank lending have a strong impact on economic activity. Secondly, it results in banks playing a key role in the payments system, since the book-keeping nature of deposits requires that banks themselves should handle the complex process set in motion by their customers' payments.

The unique role of banks in the credit, monetary and payments systems gives rise to special systemic risks. In particular, it exposes banks — alone among financial institutions — to the risk of "runs", that is to sudden and massive withdrawals of funds as a result of depositors losing confidence. Besides threatening the solvency of the institution concerned, runs tend to be contagious, so that if the bank in trouble is large enough, the run may spread to other banks, with the risk of a general disruption of banking activity and a deflationary impact on the real economy. Moreover, even without a collapse in depositor confidence, the failure of a bank to meet its payments obligations, whatever the ultimate cause, may trigger a chain reaction, leading to widespread disruption in the payments system as a whole.

Recognition of the special nature of banking implies that banks have to be subject to more thorough controls than other institutions with delegated investment powers. It also requires general prudential controls to be supplemented with more flexible methods of intervention. In this respect, lending of last resort is of fundamental importance since it not only provides monetary authorities with an effective tool for imparting macroeconomic impulses to the banking sector in normal times, but also enables them to inject liquidity into the financial system in the event of a crisis.

Relatively new types of finance, such as leasing and factoring, are based on a case-by-case assessment of borrowers' credit-worthiness and really belong to the field of bank loans, regardless of whether they are supplied directly by banks or by other institutions that raise funds by issuing bonds or borrowing from a bank. Such institutions are involved in "banking activities" and are thus exposed to the risk of illiquidity, which increases with the amount of maturity transformation undertaken. This is why legal provisions and supervisory procedures currently applicable to banks and designed to promote stability should be extended to all such institutions, as the new French banking law has done. This does not rule out graduating regulatory provisions according to the basic characteristics of each category of intermediary.

4.2 *Finance and commerce*

The autonomy of banking is an essential condition, both for the efficient allocation of resources and for the stability of the financial system. Too tight a link between banking and industrial or other non-financial activities ("commerce" in the current terminology) could give rise to instability and cause a potential conflict of interest between banks and their depositors. Historical evidence supports this general conclusion.

The separation between banking and commerce has been enforced in the majority of industrial countries through provisions, either informal or embodied in banking laws, regarding investment links or connected lending, or both. To mention but a few examples of the former: the US Bank Holding Company Act which classifies as a bank any company that has control over a bank; the Dutch law, enabling bank supervisors to limit the voting rights of certain bank shareholders; and the Belgian "Protocol on the autonomy of the banking function", which requires the directors of a bank to undertake to ensure its autonomy vis-à-vis the interests of the controlling shareholders. The second type of regulation exists in almost every country, although it takes different forms: a typical example is the German provision requiring a loan to a shareholder of a bank to be unanimously approved by the Board of Directors.

In Italy, recent decisions taken by the competent Interministerial Committee have strengthened the regulations concerning the separation between banking and commerce. Non-financial companies will not be allowed to acquire, directly or indirectly, a dominant stake in the share capital of newly founded banks and the restrictions on connected lending have been tightened.

The blurring of financial frontiers has two consequences for the relationship between banking and commerce.

The first concerns the often informal procedures followed by bank supervisors when control in a bank changes hands. Such procedures are crucial to maintaining the separation between banking and commerce, and derived their strength from the desire of all the parties concerned to comply with the behavioural rules of the "club". Today's blurring of national boundaries could undermine the effectiveness of such unwritten rules and may make it necessary to transform informal provisions into formal regulations. In so doing these provisions will have to be harmonized if we are to avoid creating a serious source of distortion within the unified European market.

The second consequence, which is not related to the process of internationalization, stems from the emergence of non-bank institutions as major delegated investors of savings. Such institutions may face the same conflicts of interest as banks. Accordingly, the issue of "banking versus commerce" becomes one of "finance versus commerce".

4.3 *Banking and insurance*

The banking and insurance sectors are by far the oldest components of our financial systems. Operations, customs, and prudential controls differ in the two sectors as a result of a historical process spanning several centuries.

The legislation of most countries makes a clear distinction between insurance companies and credit institutions. However, the practical effect of this distinction has traditionally been diminished by the development of products combining insurance and financial features and by the establishment of ownership links between banks and insurance companies. While neither of these developments is new, both have acquired new impetus in the recent wave of financial changes.

The grafting of financial contracts onto insurance contracts is almost as old as insurance business. Recently, the share of mixed products in households' portfolios has grown and the marketing networks of insurance and financial products have increasingly overlapped.

The ownership link has its rationale in the analogies between the two categories of institution: both produce information about their customers, both have liabilities expressed in nominal terms, both act as financial intermediaries with highly diversified portfolios.

The product and ownership links pose similar problems. When a bank enters into a commitment that does not result in a specific balance-sheet entry, it becomes difficult for depositors and supervisors (and sometimes even for bank managers) to assess the riskiness of the bank's overall position. Similarly, the unrestricted production of financial instruments could distract insurance companies from their core business. On the other hand, the establishment of ownership links between banks and insurance companies may weaken certain prudential regulations concerning banks. For example, limits on banks' large exposures could be circumvented by a conglomerate in which the insurance company supplies the loans that the bank is not allowed to make. Thus, if not adequately monitored and regulated, the blending of insurance and traditional banking could accentuate instability.

It would be unwise to make radical changes in institutional and regulatory frameworks merely as a reaction to a market trend that is not yet consolidated. It may be preferable to reinforce the existing apparatus, by giving appropriate powers of intervention to the public agencies already operating in the two sectors and providing for closer coordination of their activities.

In Italy, the links between banking and insurance have recently been reviewed by a special Ministerial Commission and in a statement by the Governor of the Bank of Italy before Parliament. The emerging view is that there are no objections in principle to banks acquiring controlling interests in insurance companies and viceversa, as long as adequate provision is made for the managements of the two sets of firms to be kept separate, and provided the relative size of the two companies is such that the link does not alter the nature of their businesses. The acquisition of controlling interests in banks should be avoided when the insurance company in question has substantial links with non-financial groups.

4.4 *The securities market*

In the aftermath of the October 1987 stock market crash, the regulation of the securities market has become the main cause of concern. It is now widely agreed that the matter needs to be reassessed, both because the present legislation governing securities markets is generally more fragmented and heterogeneous than that applying to other forms of financial activity, such as banking and insurance, and because this lack of uniformity may be particularly costly in a segment of the financial system that is becoming "global" more rapidly than any other.

In the past, the regulation of the securities market was framed with the primary aim of protecting investors, i.e. of averting fraudulent practices on the part of issuers and market professionals. However, this approach reflects too restrictive a view of the regulatory needs arising from a large and complex securities market.

First of all, as was suggested above, a sharper distinction should be made between regulation aimed at the *market* as such and prudential requirements applying to *institutions* that, in the normal course of their activity, operate in the securities market predominantly on behalf of final investors who have delegated the management of their savings. Regulating the narrowly-defined securities market should be seen as quite different from regulating institutions involved in securities business.

Secondly, within the context of regulation aimed at the market, we have to make sure that two different sets of issues are properly addressed: on the one hand, the impersonal price-setting mechanism on which the market's proper functioning depends; on the other, the publicizing of information regarding financial assets and the setting of standards. Market-making regulation should be seen as encompassing both areas, although it is of the utmost importance that the distinction should be retained, since only the latter promotes the objective of protecting investors, the former being mainly directed at ensuring the efficiency of the market process. Let me elaborate on this point.

The process whereby the price of a negotiable asset is set is a complex one that requires technical infrastructures, proper procedures and specialized operators. To clear demand and supply effectively, and thereby perform their allocative function, prices should continuously reflect all the available information about the assets traded in the market. Consequently, there is a public interest in promoting the efficiency of the price-formation mechanism. Achieving efficiency, however, does not mean that prices will never jump, nor that the expectations of economic agents will always be fulfilled, even less that "widows and orphans" will never lose their money, nor even that those to whom they entrust their savings will always prove worthy of their confidence. There will always be events about which information is simply not available, or is withheld from the market, so that it cannot be discounted in the formation of prices. In principle, the regulations and supervisory authorities governing the price-setting mechanism should be neutral with respect to the interests of final borrowers and lenders, and aim exclusively at enhancing the overall efficiency of the process itself.

One of the aims of regulation should be to ensure that specialized market operators are also neutral. To this end, rules should be designed that will prevent firms involved in the price-setting process from exploiting their privileged position to pursue aims that could conflict with their primary function.

The risk of conflicting interests may be increased by the tendency for large brokerage houses to function increasingly as investment banks as well, by offering their customers securities in the form of mutual funds and other accounts. Securities companies of this type, which in the United States and Japan have acquired a considerable market share, provide their customers with both market-making and delegated investment services. As a result, the appropriate regulation to be adopted could be a matter of dispute. To advocate a total ban on institutions engaging in both types of business to overcome the potential conflicts of interest would be unrealistic. But it would be unwise to ignore the risk of instability resulting from an unregulated blurring of market-making and delegated investment functions. Thus, in the present situation, the rules that company managers must adhere to in their daily business should be carefully spelled out, and the activities of the various supervisory bodies effectively coordinated.

The second task of securities market regulation is to grant access to the market only to financial assets about which an adequate amount of information is disclosed to the general public. The ultimate aim of this kind of regulation is to make sure that individual investors have access to sufficient information on the risk-return combination of all traded assets, so that they can really choose the type and the amount of risk to accept. What matters from a regulatory standpoint is not that investors be protected from all risks, but only from *unintended* risks, i.e. those that lack of information made it impossible to consider and discount when the investment decision was taken. Thus, regulation aiming at investor protection should also be basically neutral with respect to the quality and value of the assets exchanged, provided always that the transparency of the contractual terms offered to investors is safeguarded. Its basic instruments comprise setting standards for the kinds of security that may be issued and drawing up rules of conduct and disclosure requirements that issuers and other traders must adhere to once a security has been issued.

5. Conclusions

The creation of a single market for financial services in Europe is taking place in a period in which most countries are experiencing intense change in both financial techniques and regulations. This coincidence represents both a complication and an opportunity. A complication because it is always difficult to draft new "laws" capturing and regulating a reality undergoing a sea change: the emerging regulatory framework of the Community's integrated financial market does not have a firmly tried body of widely accepted ideas and approaches on which to draw. But it is also an opportunity, because our regulatory framework would have had to be adapted regardless of the Community integration programme, and because the globalization of financial markets makes attempts to deal with financial innovation exclusively at the national level utterly inadequate.

The task of drafting Community legislation is further complicated by the need to reduce rather than increase the problems of consistency and coordination with the leading non-European financial centres, notably New York and Tokyo.

The approach followed so far by the Commission in drafting proposals for new Community legislation relies primarily on the regulatory arrangements that traditionally have characterized most industrial countries. In this area, as in many others concerning the completion of the internal market, the Commission's aim of making national systems converge on the common ground provided by Community legislation is based on a sort of "status quo" assumption, as if national systems — in our case regulatory principles and institutional arrangements — were given, and basically static. An important aspect of this approach is the notion of "competent authorities", whereby the Commission has so far taken a neutral attitude to the attribution of regulatory responsibility for different segments of the financial system to different national agencies.

This conference marks an important change, because it brings the Community's legislative initiatives to the frontiers of the regulatory problem. It reveals the need to harmonize not only the stock of inherited national norms but also the future. The timely opportunity provided by the conference would be wasted, however, if the debates of these two days and the questioning of the existing set up in our countries failed to reconsider the underlying rationale and ground rules of financial regulation.

The regulatory frameworks of most countries were designed for a system of specialized financial institutions in which the bulk of intermediation was carried out by banks. They are no longer appropriate because the formation of conglomerates, coupled with the emergence of non-bank institutions managing large amounts of savings on the basis of customer mandates make it increasingly difficult to ensure the stability of the whole financial system by controlling only one category of institution, however important this may be. Moreover, the various parts of the financial system have become so interlinked that the mere fact of considering them as separate is a threat to effective control and stability.

The reflections developed in this paper are intended as a contribution to the extensive debate opened by the Commission. For the author they are in part carefully weighed conclusions, in part simply "working hypotheses". Both have grown at the intersection between sets of national and international regulatory concerns and problems. They are submitted in the hope of both offering and receiving a contribution in a common cause.

Economic Policy and European Unemployment

Opening address by the Director General, Lamberto Dini, to the Third Annual Congress of the European Economic Association

Bologna, 27-29 August 1988

1. Introduction

I am honoured by your invitation to address this distinguished meeting at a particularly challenging time for Europe's economy. The construction of the internal market is under way and there is a strong momentum in the direction of further real and monetary integration; but difficult decisions will have to be taken if the ambitious objective of 1992 is to be met. Large budget deficits in some EC countries increase the risk of a rekindling of inflation; current account imbalances pose a threat to the stability of exchange rates and financial markets; and unemployment is still unacceptably high in too many countries.

I have chosen to talk about European unemployment for two reasons. First, it is a serious economic and social problem, especially because it is concentrated in some areas and some age groups. In Italy, for instance, it exceeds 20 per cent in the South and over 60 per cent of the unemployed are less than 24 years old. Second, policymakers have failed to tackle European unemployment satisfactorily, since they have lacked clear guidance in their search for effective solutions. Academic economists are still debating whether unemployment is demand or supply determined; and we are still not sure which supply-side measures would be appropriate or what monetary and fiscal policy mix would reduce unemployment without refueling inflation. Indeed, the very effectiveness of monetary and fiscal policies has been questioned.

The specificity and severity of the unemployment problem emerge clearly when one compares labour market developments in Europe with those in the US and Japan. Four main differences emerge. First, the unemployment rate in the European Community is much higher than in the US or Japan and is not expected to fall significantly. At the end of 1987 the EC rate was above 11 per cent, more than four times the Japanese rate and nearly twice that of the US. Second, the unemployment rate has declined substantially in the US from its peak in 1982, while it has continued to rise in the EC. Third, since 1973, the US economy has created a very large number of jobs, while total employment has fallen slightly in Europe (Tables 1 and 2). Fourth, long-term unemployment (12 months and over) is significantly higher in Europe than in the US and Japan. In the four largest European countries the proportion of long-term unemployment increased on average from 26 per cent of the total in 1980 to about 44 per cent in 1986 (Table 3); in the US it was below 9 per cent in 1986. In some European countries the proportion of the young in the long-term unemployed is particularly high (in 1985 about 64 per cent in Italy and 57 per cent in Spain, as opposed to 22 per cent in Denmark, 30 per cent in Germany and 34 per cent in France).

I shall review some of the factors underlying the unsatisfactory employment performance in Europe, and then discuss the policies that could be adopted to alleviate the problem. I do not claim to be exhaustive, to identify precisely the relative importance of the various explanations of unemployment or to know what policy measures stand most chance of success in coping with it. My purpose is rather to animate the debate by raising questions and to express reservations about the indiscriminate use of expansionary aggregate demand policies.

2. Supply of and demand for labour

In comparing labour market developments in the EC, the US and Japan, one is immediately struck by the rapid growth of both supply and demand of labour outside Europe; by contrast, supply in the EC has grown much more moderately, yet the growth of labour demand has been insufficient to prevent a large increase in unemployment.

In the 1979-86 period the total supply of labour rose by 1.7 per cent a year in the US, by 1.0 per cent in Japan and by only 0.7 per cent in the EC. The largest contribution to the expansion of the labour force in the US and Japan came from population growth (Table 1). In the EC, changes in the age structure were the main factor, with the participation rate exerting a negative effect, possibly indicating the existence of a material number of discouraged workers.

During the same period the demand for labour grew by 1.5 per cent a year in the US and 0.9 per cent in Japan but fell by 0.3 per cent in the EC. These figures show that in the 1980s the shortfall of labour demand in the EC with respect to supply has been substantial, with the average annual growth rate of the supply of labour exceeding that of demand by 1 percentage point (Table 1).

It should be noted that these aggregate numbers hide large differences between EC countries. From 1973 to 1986 the labour supply recorded the lowest cumulative growth in Germany (3 per cent) and Spain (5.8 per cent), and the highest in the Netherlands (21.6 per cent) and Italy (14.2 per cent). The demand for labour fell in Germany, Spain, Belgium and the UK, while it grew by 8.5 per cent in the Netherlands and Italy (Table 3) and remained broadly unchanged in France.

One can therefore say that the rise in unemployment in Italy and the Netherlands resulted from the inability of the demand for labour to grow fast enough to match the substantial increases in supply; in the other European countries rising unemployment was associated with negligible or negative changes in the total number of jobs.

The inability of labour demand in the EC to expand in line with supply is often attributed to severe and persistent negative forces. Between 1979 and 1985 the negative repercussions on the demand for labour of the second oil shock, restrictive fiscal policies and high real interest rates were particularly pronounced in Europe.

The oil price hike squeezed profitability in manufacturing and firms started shedding labour in order to restore their profit margins. The substantial shift in purchasing power to the OPEC countries was not accompanied by a sufficient increase in their final expenditure. At the same time as the incentives to invest became weaker, aggravating the initial fall in demand, the re-emergence of the external constraint in the EC led to the widespread adoption of restrictive policies that had a further negative impact on member countries' economies.

Starting in 1981, the restrictive monetary stance of the Federal Reserve was accompanied by substantial cuts in US federal taxes and increases in spending, especially for defence. This policy mix led to very high real interest rates worldwide and a sharp appreciation of the US dollar between 1981 and 1985. Although Europe would in any case have followed a restrictive monetary policy with the aim of bringing inflation under control, there is little doubt that the US policies caused it to be even more restrictive than it would otherwise have been.

In the immediate aftermath of the oil shock built-in fiscal stabilizers led to a worsening of public sector deficits in many EC countries, but subsequently fiscal policy turned restrictive as public deficits and debts came to be judged excessive. This further depressed aggregate demand.

We still do not have a sufficient understanding of the relative importance of these negative factors affecting the demand for labour in the period under study. However, unemployment in the EC increased from under 6 per cent in 1979 to above 11 per cent in 1986. The biggest increase occurred between 1979 and 1983. Subsequently, it came down in a number of EC countries, particularly in Belgium, Denmark, the UK and the Netherlands, but it continued to rise elsewhere, leading to a further slight increase in the EC average.

In the period 1979-85 the factors affecting the demand for labour pulled in opposite directions in the US, but they were all contractionary in both Europe and Japan, where they were probably stronger, since the oil shock was more severe and the fiscal stance more restrictive. However, some of these negative influences have reversed since 1985 with the depreciation of the dollar and the fall in oil prices. Why did Japan not develop major labour market disequilibria, despite the more rapid growth in its labour supply? What has prevented the EC labour market from returning to equilibrium?

3. Downward real-wage rigidity and rigidities in regional and sectoral wage differentials

To understand the causes of high unemployment in the EC, it is crucial to examine the evolution of real wages and investigate whether they have been insufficiently flexible and, if so, why. Negative demand shocks coupled with a downward rigidity of real wages may lead to permanently higher unemployment, since it may well be that today's unemployment levels are influenced by the history of actual unemployment and hence by the history of negative shocks to the demand for labour.

International comparison shows that real wages in the EC increased much more than in the US or Japan between 1973 and 1986 (Table 4). As a matter of fact, real hourly wages in US manufacturing remained stationary from 1973 to 1979 and fell by 0.5 per cent a year on average between 1979 and 1986. In the EC they grew by 2.9 per cent a year on average in the first period and by 1.3 in the second, despite the large excess supply of labour.

Several reasons have been advanced to explain why real wages did not re-equilibrate labour markets in Europe. These reasons are complementary in nature, so that each one may contain important elements of truth. First, to the extent that unemployment destroys the human capital of the unemployed, there is a possibility that the long-term unemployed stop exerting downward pressure on wages as if they had dropped out of the labour force. In other words, long spells of unemployment may corrode workers' skills as well as their attitudes to work. Second, the influence the unemployed exert on firms' wage bargaining is likely to be much less than that of workers in employment, because the former are left out of the bargaining process and trade unions are more concerned with the well-being of their members.

Finally, income taxes and social security contributions in the EC were increased very sharply, to a much greater extent than in Japan or the US. As a consequence the wedge between firms' labour costs and after-tax wages widened rapidly. Between 1980 and 1985, the wedge increased as a proportion of gross earnings in industry by a maximum of 7.6 points in Belgium and a minimum of 1.4 points in Spain (Table 5). A larger wedge may make it more difficult to bring about a fall in real gross wages in view of workers' unwillingness to bear the full burden of the higher taxation. The result, compounded in some countries by wage indexation, was that gross earnings fell in real terms only in Belgium, Denmark and Portugal (Table 6). In the same period the purchasing power of net earnings fell in all the EC countries except the UK and Greece. In some countries the fall was substantial: about 18 per cent in Portugal and 15 per cent in Belgium.

It is difficult to say whether the resistance to greater reductions in real after-tax earnings is due mainly to the presence of strong labour unions or to the fact that workers value the benefits they obtain from larger government expenditure less than the costs they are asked to bear. Be that as it may, it is an open question how much the increased taxation needed to finance higher government expenditure and the often poor quality of the services provided may have contributed to real wage rigidity.

Other cost components, such as the social security contributions paid by employers, payments for days not worked and training costs, also influence firms' demand for labour. A 1988 study by the Commission of the European Communities estimates that for workers in manufacturing such costs increased in Germany by 19 per cent in real terms between 1978 and 1984, as opposed to less than 7 per cent in Japan. The study shows that in general European non-wage labour costs are a much larger proportion of total labour costs than in the US.

Several other aspects of the wage determination process in Europe are worth mentioning, since they may have had important consequences for employment: firstly, wage agreements tend not to reflect regional labour market disequilibria and, secondly, their scope tends to extend to sectors beyond the ones in which they were originally negotiated. Furthermore, in several high-inflation countries above average indexation of wages at the lower end of the salary scale narrowed the wage differential between skilled and unskilled workers. This has at times resulted in leap-frogging behaviour, which may have led to a sharper rise in real wages. These rigidities may have contributed to decoupling salaries from productivity and thus hindered the creation of jobs.

It is illuminating to consider employment growth in services and industry separately. The fall or slow growth of employment in industry is common to all countries (Table 2). However, most of the employment created in the US since 1973 has been in the services sector, which is less unionized than the manufacturing sector. This development was favoured by a drop in wages in services relative to those in manufacturing. By contrast, there is evidence that in Europe wages in the services sector have fallen much less relative to wages in manufacturing and that less employment has been created in the services sector. The sectoral capital/labour ratio consequently increased more than in the US. In Germany, for instance, this ratio has almost doubled since 1973, while in the US it remained virtually unchanged. The institutional link between wage settlements in manufacturing and services may therefore have prevented the price mechanism from eliminating the existing economy-wide excess supply of labour.

If the negative employment effects generated by the downward rigidity of real wages and the lack of flexibility in regional and sectoral wage differentials are important, it follows that there may well be substantial structural unemployment in Europe.

4. Other rigidities and unemployment benefits

There are other rigidities and distortions in the EC labour market that may have played a role in preventing a larger increase in employment and in making unemployment more persistent. They include high severance payments, rigid hiring and firing rules, opposition to part-time employment in some countries, high real minimum wages, imperfections in the housing market, and unemployment benefits. One effect of these factors is to reduce labour turnover. The percentage of employees holding jobs for less than two years is much smaller in the EC than in the US (19 per cent as opposed to 39 per cent); the average number of new recruits and separations as a percentage of employees is also much smaller (Table 7). Italy, France and Belgium are the countries where, according to this evidence, labour mobility is lowest.

EC firms may indeed be discouraged from hiring by the higher costs connected with the firing of redundant workers. A 1986 survey by the Commission of the European Communities found that in all the EC countries except Ireland and the United Kingdom about half or more of the surveyed firms judged that shorter periods of notice for redundancies and simpler legal procedures would have a positive employment impact (Table 8). Italy emerges as the country in which rules about periods of notice for firing and legal restrictions seem to be most severe, followed by Greece, Belgium and Germany. The same survey shows that a large percentage of firms also believed that removal of restrictions on part-time jobs and measures facilitating temporary contracts would boost employment (Table 9).

Distortions in the housing market tend to reduce the geographical mobility of workers, because rent controls reduce the supply of housing in high growth areas and increase rents in the free segment of the market. In some countries local authorities or regional governments even contribute to the payment of the interest on workers' mortgages when they become unemployed. Language barriers, cultural differences, the importance of family ties and higher transport costs are other factors that contribute to lower mobility within the EC compared with the US.

There is some evidence that a part of the blame for high unemployment can be attributed to the level of unemployment benefits, although it is difficult to say how much. They often reduce the incentive to look for a new job or to move from declining to expanding regions. Leisure may have some value for the worker, but probably less than the forgone income. In addition, in many European countries it is possible to work in the hidden economy. This is especially true in regions and sectors where the number of small firms is particularly high. Taking into account the value of leisure and the possibility of (untaxed) earnings in the hidden economy, workers receiving unemployment benefits may not be much worse off than those in official employment.

In 1983 unemployment benefits, thirteen months after the loss of employment, were still between 90 and 96 per cent of workers' previous earnings in the Netherlands, Denmark and Ireland, and above 80 per cent in Italy and France. The lowest values were recorded in Germany and the UK, 61 per cent and 54 per cent respectively (Table 10). Despite the fact that the ratio in Germany is low by European standards, it is nonetheless high when compared with the US, where it averaged 37 per cent in 1979-81 for the first 26 weeks of unemployment and zero afterwards (Table 11). The percentage of all unemployed workers receiving unemployment insurance was also much smaller in the US than in Germany: about 45 per cent as opposed to about 75 per cent.

We still do not know enough about the actual importance of these rigidities in Europe's segmented labour markets. It is, however, difficult to escape the conclusion that they may have been very relevant.

5. Policy options to reduce European unemployment

The high and persistent unemployment observed in the EC is a serious problem whose solution necessarily requires actual and potential output to grow for a number of years at rates higher than the current ones. However, the combination of aggregate demand stimuli and supply-side measures needed to achieve this higher growth rate and the blend of demand and supply incentives to be adopted are widely debated issues.

While it is difficult to deny that fiscal contraction, the anti-inflationary monetary policies of the 1980s and the second oil shock had negative effects on employment in Europe, it does not necessarily follow that expansionary macroeconomic policies can be used indiscriminately to fight an unemployment problem deeply rooted in structural and regional imbalances. Unemployment among skilled workers in the most dynamic regions of Europe is now at a low level. This seems to be the case for instance in Northern Italy and Southern England and Germany. It should be kept in mind that inflation in each country may be influenced more by the rate of unemployment in the more dynamic regions than by the average national rate, to the extent that relative wage rigidities and imitative behaviour spread the higher wage increases in high productivity sectors and regions to those with slower productivity growth. We do not know what is the lowest rate of unemployment of skilled workers in the more dynamic regions that is compatible with a non-accelerating national inflation rate.

Reducing the rigidities that characterize the European labour markets by means of supply-side measures, essential as it is, risks being a long process: it will take time to convince governments, unions and workers to agree on the appropriate measures and to implement them. The lags between the introduction of these measures and the time when their effects materialize may also be long. This means that we should not waste time; but it also means that, while there are limits to the effective use of demand policies, Europe cannot renounce them if it is determined to fight low economic growth rates and rapidly reduce unemployment.

In this endeavour, European macroeconomic policy cannot be looked at in isolation from the rest of the world. We all agree that external constraints considerably reduce the room for manoeuvre, and this is especially true for monetary policy, which has to be geared on the one hand to price stability and on the other to maintaining stable exchange rates within the EMS.

Fiscal policy, by contrast, has a greater chance of making a lasting contribution to the solution of the problem at issue. Appropriately designed fiscal measures directed at increasing employment and growth in Europe could also promote the international adjustment process and enhance stability within the EMS without refueling inflation. International coordination is essential in this regard, both at the Community level and in the wider context, because fiscal policy also influences current account developments and exchange rates. The required fiscal measures should be differentiated by country and, above all, be "supply-side friendly", such as income tax cuts, which are likely to reduce labour costs.

Since no European country can afford to jeopardize the state of its public finances, a crucial issue is the effect of a discretionary fiscal stimulus on the economy. The experience of Japan in 1987 is interesting in this respect since it shows that a large fiscal stimulus may have only a small negative effect or even a positive one on the budget deficit. The increase in Japanese public investment in 1987 played an important role in re-establishing business confidence after the sharp appreciation of the yen. By contrast, in Germany the public deficit rose in 1987 mainly because growth was slow.

There can also be little doubt that the German current account surplus is a significant factor restraining overall growth in the EC. It represents a constraint on other European countries' ability to use macroeconomic policies to accelerate growth. A reduction of this surplus cannot be hoped for in the short run without a sizable acceleration of domestic demand; the latter, in turn, is difficult to achieve without stimulative fiscal action. In reality, there seems to be room for larger income tax cuts than those envisaged at present, and for public investment in, for example, environmental projects and transportation, all of which could have a high political and economic payoff without endangering price stability or the public finances. While it should be accepted that in the medium term Germany's economic growth will be slower than the Community average, because its population is no longer growing, at present there appears to be scope for tackling Germany's high unemployment and labour market rigidities with more determination.

Other European countries with small budget deficits and good current account positions and inflation performances may be able to follow the German lead. Those with large budget deficits and weak current account positions have less room for manoeuvre, but could help to improve the European outlook with energetic supply-side measures, a reduction in government expenditure and income tax cuts. In this fiscal policy scenario Europe could gradually take over the role of stimulating world aggregate demand in view of the need for fiscal contraction in the United States.

The scope for fiscal policy will probably increase as real-wage and other supply-side rigidities are reduced, because more flexible labour markets raise the real component of nominal income growth. This reinforces the need to tackle the structural labour market rigidities I discussed earlier. The reduction of these distortions is likely to bring Europe large gains in employment. In many countries there is an obvious need to reduce government expenditure in order to make room for lower marginal and average taxes on labour income and to reduce the wedge between gross and after-tax earnings. There is also room to improve the quality of government services in order to reduce worker resistance to reductions in real after-tax wages.

As to the insufficient dispersion of wages, the procedures for setting them should be modified to allow regional and sectoral differences in productivity and unemployment to be reflected to a greater extent. The flexibility of labour costs might be enhanced by forms of profit sharing, such as those that have recently been adopted by some European companies. While the effects of more widespread adoption of such contractual arrangements remain to be seen, profit sharing may well be one of the reasons why employment in Japan suffered much less than in Europe from the negative shocks of the 1970s and 1980s.

Consideration could also be given to reviewing the rules on hiring and firing and part-time employment and to reforming the system of unemployment benefits with a view to increasing labour market flexibility. Some deregulation of the housing market in countries where it is controlled might also help to increase the geographical mobility of labour; the possibility of giving subsidies to help workers cover moving and housing expenses could be considered and retraining programmes for displaced workers could be expanded.

The completion of the internal market by 1992 may, by itself, make a significant contribution to the reduction of unemployment in Europe. It will bring benefits in terms of lower border control costs, more competition between firms, the opening up of public procurement markets, possibly major economies of scale and gains from increased competition in the financial and transportation sectors.

The group of experts set up by the Commission of the European Communities to study the economic effects of the internal market estimated that in the long run the total benefits could amount to as much as 4.5 percentage points of the Community's GDP and 1.5 per cent of total employment. The overall gain in terms of lower consumer prices could be of the order of 6.0 per cent, and there would be improvements in the average government budget and the external balance. This study also estimates that the positive growth and employment effects would be substantially larger if the "room for manoeuvre" created by lower inflation, smaller budget deficits and improved external positions is fully exploited. Of course, these estimates have to be taken with some caution, especially since it is by no means certain that all the measures foreseen to complete the internal market will actually be implemented.

I conclude this intervention on a moderately optimistic note: the unemployment problem is not completely intractable if we attack it with determination. It is not an easy task, however, and much needs to be done. Appropriate measures to reduce rigidities in the labour market and complete the internal market have to be introduced at the national as well as the European level. It is worth noting in this regard that while a long list of internal market measures has already been prepared by the Commission, there is not enough consensus on the appropriate initiatives to reduce labour market rigidites and the political will to act appears rather weak. I think academic economists should further investigate the supply-side measures needed in each country and fuel the debates that generally precede legislation. Moreover, Germany, a key actor in any strategy to sustain growth in Europe, is reluctant to implement a more expansionary and supply-side friendly fiscal policy, which would also help reduce unemployment. The academic profession, especially the German one, could also make a major contribution in this respect.

Table 1

The supply of labour in the US, Japan and the EC

(yearly average growth rates) (1)

	1973-1979			1979-1986		
	US	Japan	EC	USA	Japan	EC
Total labour force (1)	2.6	0.8	0.6	1.6	1.0	0.7
Total population	1.0	1.1	0.4	1.0	0.7	0.3
Population 15-64 as a percentage of total population	0.7	−0.3	0.3	0.1	0.2	0.7
Residual (2)	0.9	0.0	−0.1	0.5	0.1	−0.1
Labour force participation:						
— male	0.2	0.1	−0.5	0.0	0.1	−0.1
— female	1.2	−0.1	0.8	0.8	0.4	0.8
Total employment	2.5	0.7	0.1	1.5	0.9	−0.3

Sources: OECD, *Labour Force Statistics 1965-1985*, Paris 1987; OECD, *Historical Statistics 1960-1986*, Paris 1988.

(1) The labour force (LF) has been divided into 3 components: $LF = Pop \cdot \frac{Pop\,(15\text{-}64)}{Pop} \cdot \frac{LF}{Pop\,(15\text{-}64)}$ where Pop = Total Population and Pop (15-64) = Population in the 15-64 age bracket and the first ratio shows changes in the age structure of the population and the second changes in the participation rate among the population of working age. — (2) Labour force as a percentage of population in the 15-64 age bracket.

Table 2

Growth of the labour force and of employment by sector

(% changes 1973-1986)

	Total labour force (1)	Employment (1)				Standardized unemployment rates		
		Total	Industry	Services	Agriculture	1973	1979	1986
Germany	3.0	−4.2	−17.6	13.8	−44.4	0.8	3.2	6.5
France	9.0	0.3	−20.3	25.1	−34.5	2.7	5.9	10.4
United Kingdom	8.4	−2.1	−28.7	19.6	−16.7	3.0	5.0	11.2
Italy	14.2	8.5	−8.5	43.1	−35.6	6.2	7.6	10.9
Belgium (2)	7.1	−3.5	−29.2	16.8	−27.1	2.7	8.2	11.2
Denmark (2)	12.5	5.2	−12.0	21.6	−25.5	0.9	6.0	7.2 (3)
Netherlands (2)	21.6	8.5	−21.0	29.6	−8.8	2.2	5.4	9.9
Spain	5.8	−14.2	−25.2	14.2	−43.2	2.5	8.5	21.0
EC-12 (2)	8.6	−0.9	−17.9	21.0	−28.2	2.7	5.7	11.2 (3)
US	31.1	30.5	7.5	42.5	−6.2	4.8	5.8	6.9
Japan	13.0	11.3	3.1	28.6	−29.8	1.3	2.1	2.8

Sources: OECD, *Labour Force Statistics, 1965-1985*, Paris 1987; OECD, *Quarterly Labour Force Statistics*, No. 2, Paris 1988.
(1) Armed Forces included. — (2) 1973-1985. — (3) 1985.

Table 3

Proportion of long-term unemployment (12 months and over)

(as a percentage of total unemployment)

	1980	1986
US	4.3	8.7
Japan	16.0	17.2
Canada	3.3	10.9
Sweden	5.5	8.0
Germany	17.0	32.0
United Kingdom	19.2	41.1
France	32.6	47.8
Italy	37.1	57.9
Netherlands	25.9	56.3
Belgium	57.9	68.9
Spain	34.5	56.6

Source: OECD, *Employment Outlook*, Paris, September 1987.

Table 4

Growth of real hourly wage rates in manufacturing

(period averages)

	1968-73	1973-79	1979-86
US	1.2	0.0	−0.5
Japan	9.7	1.6	1.5
Germany	5.2	2.5	0.9
France	5.3	3.7	1.2
United Kingdom	3.7	0.9	2.6
Italy	9.0	5.2	1.2
Belgium	6.5	3.4	−0.4
Denmark	....	3.0	−0.5
Netherlands	....	2.1	−0.4
Greece	4.1	6.9	1.6
Total EC	....	2.9	1.3

Source: OECD, *Historical Statistics, 1960-86*, Paris 1988.

Table 5

Derivation of net earnings from gross earnings

(as a percentage of gross earnings)

(manual worker in industry, single, male, average salary)

	Germany		France		Italy		Netherlands		UK	
	1980	1985	1980	1985	1980	1985	1980	1985	1980	1985
Gross earnings	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Social security	15.7	17.6	12.8	15.3	7.8	8.7	21.5	28.0	6.8	9.0
Taxes	22.3	23.8	6.7	6.7	11.7	16.1	16.2	13.7	22.6	22.4
Net earnings	62.0	58.6	80.5	78.0	80.5	75.2	62.3	58.3	70.6	68.6

	Belgium		Denmark		Grecee		Spain		Portugal	
	1980	1985	1980	1985	1980	1985	1980	1985	1980	1985
Gross earnings	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Social security	10.5	13.9	0.8	1.6	15.0	15.0	5.8	6.4	10.5	11.5
Taxes	22.6	26.9	40.9	43.8	3.7	9.1	11.3	12.1	5.3	8.0
Net earnings	66.9	59.3	58.3	54.6	81.3	75.9	82.9	81.5	84.2	80.5

Source: Eurostat, Rapid Reports, Population and Social Conditions, *Net earnings of manual workers in industry in the Community*, No. 1, Table 5, Luxembourg 1987.

Table 6

Changes in gross and net real earnings of manual workers in industry (1)

(single male, average salary)

	Germany		France		Italy		Netherlands		UK	
	gross	net	gross	net	gross	net	gross	net	gross	net
1980	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1985	98.6	93.2	101.6	98.5	104.4	97.6	98.3	92.1	112.4	109.2

	Belgium		Denmark		Grecee		Spain		Portugal	
	gross	net	gross	net	gross	net	gross	net	gross	net
1980	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1985	96.6	85.5	95.5	89.6	110.5 (2)	104.5 (2)	101.9	100.2	85.9	82.1

Source: Eurostat, Rapid Reports, Population and Social Conditions, *Net earnings of manual workers in industry in the Community*, No. 1, Table 4, Luxembourg 1987.
(1) The deflator of net earnings is the consumer price index, while the deflator of gross earnings is the GDP deflator. — (2) 1984.

Table 7

Labour turnover

	Percentage of employees holding jobs for less than two years (1)	Percentage annual average of new recruits and separations (2)
Italy	13	11
Belgium	18	....
France	18	14
Germany	19	25
Japan	19	18 (1983)
EC average	19	18
Ireland	22 (1979)	....
UK	24 (1979)	20 (1984)
Denmark	27	....
Netherlands	28 (1979)	....
US	39 (1983)	40 (1981)

Sources: OECD, *Labour Market Flexibility*, Paris 1985 and Michael Emerson, "Regulation or Deregulation of the Labour Market", *European Economic Review*, Vol. 32, April 1988.
(1) 1978 except where otherwise indicated. — (2) As a percentage of employees; 1982 except where otherwise indicated.

Table 8

Percentage of firms judging that there would be a positive employment impact from shorter periods of notice for redundancies and simpler legal procedures

(1985)

Italy	88
Greece	76
Belgium	74
Germany	63
EC average	58
Luxembourg	54
France	48
Netherlands	47
Ireland	35
United Kingdom	28

Sources: Commission of the European Communities, "Results of a Survey of Labour Market Flexibility", *European Economy*, No. 27, July 1986, Brussels; and Michael Emerson, "Regulation or Deregulation of the Labour Market", *European Economic Review*, Vol. 32, April 1988.

Table 9

Percentage of firms expecting a positive employment impact from measures facilitating temporary contracts

(1985)

Germany	74
Luxembourg	69
Italy	63
Belgium	63
EC average	55
France	53
Greece	50
Ireland	47
Netherlands	32
United Kingdom	27

Source: Michael Emerson, "Regulation or Deregulation of the Labour Market", *European Economic Review*, Vol. 32, April 1988.

Table 10

Replacement rates (1) of unemployed male (married, 2 children with wife earning an income) after 13 months of unemployment

(1983; percentages)

Germany	61
France	81
United Kingdom	54
Italy	46 (2)/88 (3)
Belgium	74
Netherlands	90
Denmark	92
Ireland	96

Source: Commission of the European Communities, *Medium-Term Projections of Expenditure on Social Protection and their Financing*, Report of the Commission to the Council, COM (85) 119 final, Brussels, April 1985.

(1) Ratio of unemployment benefits divided by earnings he would have received if he had been employed. — (2) Standard unemployment benefits. — (3) Special unemployment benefits in industry related to sectoral crisis or financial problems of the firms.

Table 11

Unemployment insurance in Germany and the US, 1979-1981

(percentages)

	Coverage ratio (1)	Replacement rate (2)		Duration of benefits (3)
		Year 1	Year 2	
Germany	74-80	66	56	1 year to indefinite
US	41-50	37	none	26 weeks

Source: Burda and Sachs, "Institutional Aspects of High Unemployment in the Federal Republic of Germany", *NBER Working Paper, No. 2241*, May 1987.

(1) Average number of recipients of unemployment insurance divided by total number of unemployed, 1979-81. — (2) Net replacement rate in first and second years of unemployment for average age worker who is married to dependent spouse and is without children. — (3) Potential duration of unemployment insurance and follow-up unemployment assistance.

Legislating for Banking Transparency

Statement by the Governor, Carlo A. Ciampi, before the 6th Standing Committee of the Chamber of Deputies

Rome, 29 September 1988

In the midst of changes that are transforming the financial sector, in Italy as in all other industrial countries, a combination of factors is increasing both the demand for transparency in bank customer relations, that is for further information and clearer contractual conditions, and the possibility of satisfying it.

Customers' desire for transparency is the natural correlate of an advanced society. Sustained by a high propensity to save, the volume of financial assets and liabilities has expanded remarkably. New instruments and financial operators have appeared on the market. High and variable interest rates have drawn the attention of all economic agents to the opportunities provided by the financial sector and to the information and contractual forms making it possible to take advantage of them.

On the supply side, the application of EDP and telematics enables financial intermediaries to gather and process information for distribution to customers not only more effectively and promptly but also at a lower unit cost. At the same time, intermediaries are feeling a sharpening of competition, both domestically and internationally and they are aware that their response must extend also to the quality of customer relations.

Nonetheless, knowledge of the conditions actually governing banking business and the understandability of contracts entered into with credit institutions are still unsatisfactory. This state of affairs transcends national boundaries. The lack of specific transparency rules for various types of banking operations, the unilateral preparation of contracts that the counterparty can only accept or reject as a whole and the reference to standard market practice even to determine the contractual conditions most important in economic terms: these are but some of the factors preventing customers from understanding the financial aspects of contracts, both when they are drawn up and during their implementation.

The problem is aggravated when banks are in a strong bargaining position, as in their dealings with small and medium-sized customers.

Germany and the United States have had legislation promoting transparency since 1969, though as this does not apply only to banking contracts it falls within the broader framework of consumer protection. Both the French Banking Act of 1984 and the 1987 Spanish law liberalizing interest rates contain provisions on banking transparency, while in the United Kingdom the provisions of the 1974 Consumer Credit Act have been supplemented by the sections of the 1987 Banking Act governing invitations to make deposits.

The aim in each case is to protect the weaker party. In the United States all credit transactions up to $25,000 come under The Truth in Lending and Fair Credit Reporting Act as well as the Federal Reserve Board's Regulation Z. This latter administrative regulation implements, in considerable detail, the general principles laid down in the Act for the protection of borrowers. The disclosure requirements imposed on banks in the United Kingdom are also more stringent in the case of loans of limited size. In Germany the law on standardized contractual terms applies only to business with final consumers.

One common feature of the legislation in the United States, France, Spain and, at least as regards the Banking Act, the United Kingdom is that the general principles are laid down in statute law, with the detailed specification of banks' obligations delegated to administrative provisions issued by the authorities responsible for the regulation and control of banking. This ensures that regulations are sufficiently flexible.

Publicity regarding the costs of services, disclosure of the way interest rates are calculated, specification of ancillary costs, standardization of the most frequently used contracts and clarification of how to withdraw from contracts are the basic objectives of the foreign legislation mentioned above, though there are naturally different degrees of detail and emphasis.

Implementation of the Community Directive on consumer credit will require loan contracts involving the "household sector" to be regulated by law before the end of 1989. This is an additional stimulus for Italy to introduce comprehensive legislation on the transparency of banking contracts.

The Italian credit authorities have refrained from regulating this matter by way of administrative measures, since these would have had to be based on a questionable interpretation of the provisions of Article 32 (1b and 1c) of the Banking Law on the regulation of interest rates and other contractual conditions.

Encouragement has been given to the steps taken by the Italian Bankers' Association, acting in a private capacity, to promote voluntary agreements among its members enhancing the transparency and publicity of the conditions offered to customers. The Association has recently drawn up standard notices for banks to use to inform the public of the terms of their principal operations as well as standard forms for bank statements and separate interest statements. These steps should not be underestimated.

The basic need to protect citizens in their capacity as consumers of banking services is increasingly recognized, especially when their bargaining position is weak. The efficiency and stability of the banking system are nonetheless just as important goals as equity. Transparency at every stage, from the conditions banks offer individual clients to their annual accounts, is both a cause and an effect of competition and operational efficiency. The latter is a pre-requisite for the long-term stability of the banking system; but also in the short term, clarity of information and transparency in bank/customer relations can eliminate not only dissatisfaction but also misunderstandings and doubts about banks' conduct, thereby strengthening their competitive position.

Experience in other countries also suggests the desirability of a solution combining the force of a clearly-defined legislative framework with self-regulation by the banking system, to ensure that transparency rules remain technically applicable and to safeguard the entrepreneurial nature of banking.

Acceptance of this view implies resisting the temptation to adopt detailed and all-encompassing primary legislation laying down precise rules for every conceivable circumstance. The diversity of the products and services offered by banks and the rapid development of new operational techniques would create gaps in such legislation, entail difficult problems of interpretation and make it largely unworkable.

Even less credible is the idea of a dirigiste approach, of the kind that would fix the economic conditions of contracts by fiat. Bureaucratic requirements would adversely affect the flexibility and cost of operations, and in the end the additional burden would be passed on to the consumers of banking services. The ensuing rigidity and distortions would be incompatible with efficiency and with the entrepreneurial nature of banking that has recently been reaffirmed both in Italy and in the ambit of the EEC. Such legislation, moreover, would place Italian banks at a disadvantage vis-à-vis foreign competitors.

From a technical standpoint, all these considerations suggest that a law stating basic principles would be the most appropriate: one that, rather than establishing a detailed and inflexible system of statutory rules, would create a framework with a limited number of articles defining the objectives of state intervention and the fundamental requirements for effective transparency. Such a law should lay down the guiding principles and criteria and then delegate to the competent authorities — the Inter-ministerial Committee for Credit and Savings and the Bank of Italy — the task of issuing the necessary implementing regulations and specifying technical procedures that would both reflect the varied nature of operations and be adaptable.

The flexibility of such secondary legislation would also make it easier to bring the provisions on banking transparency into line with those due to be adopted to implement EEC Directive 87/102 on consumer credit.

In drawing up directives and orders, the Credit Committee and the Bank of Italy could usefully consult the Italian Bankers' Association, in view of the role the latter plays in interpreting the banking system's technical needs and in simplifying, modernizing, and standardizing operational procedures.

Satisfactory transparency in banks' dealings with their customers can be achieved through a series of measures designed to ensure full information concerning the conditions offered by banks, clarity about the substance of individual transactions, protection against unilateral changes in conditions and adequate information on standing arrangements.

In the first place, the proposed law should establish the scope of the exercise. This could cover both banks and special credit institutions, with account being taken of the differences between them, and embrace all basic lending and fund-raising operations as well as the main banking services, to be specified subsequently in administrative provisions.

The intention of protecting the weaker party through the regulation of publicity would be underscored by restricting its scope to contracts below a certain limit.

Accordingly, the regulations governing publicity should not apply to highly complex arrangements, which in any case normally involve large corporate customers and are too specific and variable to lend themselves to standardization.

The primary legislation regarding publicity could identify the basic aspects of the obligation to publicize information, for which two levels of detail appear desirable on practical grounds.

Credit institutions could be required to post notices in premises open to the public setting out the interest rates and other costs and charges payable for basic banking products and the most popular services.

These notices should both use readily understandable terms and be the same throughout the system. They should provide an at-a-glance summary of a bank's basic charges and interest rates that would guide potential customers towards the contracts best suited to their needs, as well as enable a comparison of the conditions offered by different credit institutions.

The concise nature of such notices means that they cannot fully satisfy customers' information needs. Special take-away leaflets could both provide more details about the conditions displayed and illustrate products and services not included in the notices but nonetheless current.

The primary legislation should delegate to the credit authorities the tasks of specifying the operations and services for which information must be supplied and of devising standardized forms for its presentation.

The conditions offered by individual credit institutions would have to be publicized in the same terms over the country as a whole.

It would obviously be necessary to avoid the publicity of conditions constituting an "offer to the public", with the consequent obligation on banks to conclude contracts.

Moreover, some restrictions on the freedom to negotiate contracts should be contemplated, both to promote the understandability and completeness of individual contracts and to ensure that their substance conforms with the information given to the public. The following requirements might be introduced: all contracts to be written; explicit indication of all interest rates and charges with no reference to "standard practice"; automatic application of the most favourable publicized conditions in the event of failure to specify any such items; and the nullification of any contracted conditions less favourable than those publicized.

The proposed law should also require credit institutions to notify their customers of any worsening of interest rates or other contractual conditions, without prejudice to the right of customers to withdraw from contracts. The notification procedures, to be defined administratively, should be appropriately diversified (e.g., announcements in the press, information printed on bank statements and special notices). This would permit account to be taken not only of the scope of changes but also of the special features of individual contracts (e.g. bearer savings books).

Lastly, the primary legislation should establish the principle that banks must provide customers with sufficient, regular information about standing arrangements.

After defining the ways and means of publicizing information and identifying the products and services to which they are to be applied, the credit authorities would proceed in conformity with the provisions of the primary legislation to issue regulations on:

— the content and form of presentation of notices and leaflets;

— the standardization of the calculation of interest rates and the other economic conditions of contracts;

— the procedures for notifying customers of changes in interest rates and other contractual conditions;

— the content, form of presentation and frequency of bank statements and similar communications to customers, as well as the time that must elapse before customers are considered to have tacitly approved the figures therein.

Banks will incur organizational expenses as a result of the changes required by transparency regulations, so they will have to be introduced gradually.

Once the regulations have been drawn up, publicity via notices and leaflets could be possible almost at once. The next step, which should be taken without excessive delay, would be to adjust existing contracts to the new regulations and standardize the contents of bank statements and the methods of calculating interest throughout the banking system.

Contravention of transparency provisions should be punished by administrative fines, which could be fitted into the existing system of Banking Law sanctions. The task of verifying compliance would be entrusted to banking supervisors. In disputes between a bank and an individual customer, the rights of the latter would be protected by the competent organs designated by the law.

The regulations envisaged take account of and partially anticipate the provisions of the EEC directive on consumer credit regarding the transparency of banking. The full implementation of the Community directive may nonetheless require some adjustments. As noted earlier, these will be made easier by allowing most of the regulations to be formulated by administrative bodies.

Address by the Governor, Carlo A. Ciampi,

to the 31st National Congress of the Italian Forex Club
Santa Margherita di Pula, 29 October 1988

1. The world economy

When we met a year ago the shock of the collapse of the world stock markets only a few days before was still vivid in our minds. There was widespread concern that the sequence of events that had provoked the crisis of 1929 might be repeated and it was predicted in many quarters that financial instability would cause a pronounced slowdown in the growth of the world economy.

I considered these fears to be exaggerated. The reference I made to the primacy of the real economy was a way of expressing that belief and providing guidance to a market that was in danger of becoming seriously disorientated. Apart from turbulence in the financial markets, what new factors were there that could jeopardize a consolidation of the growth in the industrial countries' national income, which reflected the substantial improvement in their terms of trade in the previous two years? I pointed out that the productive sectors of these countries were on the road to recovery, that many countries had either corrected or begun to correct the disequilibria in their public finances and that inflation was low and gave no cause to fear that it would be rekindled.

It is true that the balance-of-payments disequilibria among industrialized countries were proving difficult to eliminate and that no progress was visible with regard to developing countries' debt. There was a danger that in the short term the stock market crisis would undermine the confidence of corporate investors, which, though difficult to quantify, is a decisive factor in economic growth. However, the central banks' prompt declaration that they were prepared to meet the markets' liquidity needs reassured operators and prevented the deterioration in expectations from spreading.

Today, estimates for 1988 indicate growth of 4 per cent in the gross national product of the seven major industrialized countries, more than a point higher than the rate forecast by international organizations in the immediate aftermath of the stock market crash and considerably higher than their earlier predictions. World trade is now picking up strongly, following a long period of slow growth. Even after allowing for a slight deceleration in recent months, the rate for 1988 as a whole should be 7 per cent higher than last year.

The improvement in the terms of trade, which has now been accentuated by a further fall in the price of oil, has increased households' disposable incomes and reduced companies' costs in all countries importing primary products. The rise in consumption has improved the outlook for aggregate demand, and capital expenditure has increased in view of the need to adjust plant capacity to the level of expected growth.

The depreciation of the dollar from February 1985 onwards has restored the competitiveness of American industry; fiscal measures first in Japan and then in the Federal Republic of Germany have stimulated domestic demand in these two countries.

Improved corporate profitability has been reflected in share prices, which have recovered significantly from the low points of last October. The stock exchange indices in New York and London have returned to the levels recorded at the beginning of 1987, recouping respectively one-half and one-third of their previous losses. The Tokyo Stock Exchange made good the entire loss and in August reached a new peak, fuelled not only by the growth in the Japanese economy but also by investors' abundant liquidity. On 18 October of this year the general index of the Milan Stock Exchange stood only 9 per cent lower than a year earlier and was 40 per cent higher than the low point to which it had fallen on 9 February.

Recent experience has confirmed that credible and prompt action by the monetary authorities is decisive in transmitting signals that will allow the financial markets to interpret the real state of the economy correctly.

The lessons taught by the stock market crisis have still to be fully assimilated, however. International financial integration makes it imperative to assess events in the capital market in the light of its links with the money and credit markets and the macroeconomic implications. Destabilizing influences should be counteracted by appropriate technical adjustments in the determination of securities prices, in the regulation of securities trading and in coordination among supervisory institutions. It must be stressed once again that regulation increases the stability of the financial markets and thus enables them to perform their role of supporting economic activities of all kinds more efficiently.

The fall in interest rates in the United States and the other major countries in the wake of the stock market crash of 19 October continued in the first few months of this year and affected both short and long-term rates. In the spring, however, signs of a possible rekindling of inflation began to appear, owing to the expansion in demand, an acceleration in raw material prices and, in some countries, a more rapid increase in labour costs. In the summer monetary policy became less expansionary everywhere and caused interest rates to rise once again. This dampened down inflationary expectations, leading in some markets to an immediate fall in medium-term rates.

The dollar, which remained stable for several months after the substantial depreciation in the second half of 1987, appreciated by 10 per cent against the Deutschemark and 7 per cent against the Japanese yen between April and June. Its exchange rate was influenced mainly by signs of a reduction in the US trade deficit. Fearing that the dollar would continue to rise, thus jeopardizing the restoration of balance-of-payments equilibrium, the European central banks and the US Federal Reserve intervened to hold it in check. The recent depreciation of the dollar reflects the easing of expectations of a rise in US interest rates and the deterioration in the trade deficit in August.

All in all, the figures for the first six months of this year are evidence that the disequilibria in merchandise trade are declining. The US trade deficit contracted by 32 billion dollars on an annual basis and Japan's surplus came down by 9 billion; the desired movements in opposite directions reflect both the more viable exchange rate relationship and the change to an expansionary fiscal policy stance in Japan and a moderately restrictive one in the United States. The US trade balance vis-à-vis EEC countries improved by 15 billion dollars, of which 3 billion was due to higher net German imports. However, Germany's overall trade surplus increased, leaving the other members of the Community to bear the brunt of adjustment between the EEC countries and the United States.

Current account adjustment is proceeding much more slowly. Servicing foreign debt amounting to more than 400 billion dollars meant that in the first six months of 1988 the US current account deficit was only 10 billion dollars less than in the second half of 1987 on an annual basis. Japan's current account surplus declined by a similar amount, whereas Germany's increased by 6 billion dollars.

The disequilibria in the external accounts of the major countries are still huge; more rapid progress must be made in correcting the imbalance in merchandise trade and reducing international interest rates.

Monetary policies did much to prevent the stock exchange crisis from becoming an economic crisis. Subsequently, they sought to counter the dangers constantly present on the inflation front, which are all the greater in prolonged periods of strong demand. However, the cost of such action is reflected in the persistence of high interest rates.

Internationally, fiscal policies must be coordinated more closely and implemented with greater determination with a view to influencing demand in the various countries in a way consistent with the objective of restoring fundamental equilibrium. If it were freed from tasks for which it was not designed, monetary policy would be better able to aim at price stability with lower interest rates and in this way reduce and eventually eliminate the disparity between interest rates and the rate of growth in national income.

The reduction in interest rates takes on even greater importance in the light of the exceptional scale of the developing countries' foreign debt. Despite the improvement in world economic activity, the situation of the fifteen most heavily indebted countries has deteriorated this year. According to recent estimates, their GNP is increasing at a rate of less than 2 per cent, inflation remains high and their per capita income is falling in real terms.

These countries are having difficulty raising new loans, especially from private sources, and some are having problems implementing adequate adjustment programmes. A study being carried out by the Alternates of the Group of Ten countries on the role of the Bretton Woods institutions in the strategy for tackling the debt problem may provide further food for thought and suggestions on ways of improving the policies pursued hitherto. Other initiatives, such as Japan's announcement at the recent Annual Meeting of the International Monetary Fund and the World Bank that it intended to provide additional loans to debtor countries in parallel with the IMF in order to support economic restructuring programmes, may make a further contribution.

The sustainability of the developing countries' debt burden depends crucially on their growth potential and opportunities. However, much will also hinge upon the economic policies of the major industrialized countries, their ability to trigger the virtuous circle of balance-of-payments adjustment, falling interest rates and strong, sustained growth, which is necessary to reduce the causes of instability that still persist throughout the international economy.

2. The Italian economy

The Italian economy has also benefited from the momentum generated by the improvement in the terms of trade and the upswing in international commerce. Gross domestic product should grow by 3.6 per cent this year, the highest figure of the decade. This will be due partly to an expansion of 4 per cent in household consumption and a further sharp increase in investment, with expenditure on plant and machinery rising by 8 per cent.

For many years Italian industrial companies, especially large ones, have directed investment towards rationalizing production facilities and reducing unit costs. Peaks of demand have been met partly by expanding imports but also by rapidly increasing plant utilization rates, something they were able to do because of their regained flexibility in the organization of production. The acceleration in growth has now made such a response inadequate and is encouraging firms to enlarge their plant, a development confirmed by the increase in investment in factory premises in 1988.

The growth in output and investment led initially to a substantial increase in the number of hours worked, but it is now beginning to have a positive impact on employment in industry.

Whereas a continued rise in investment is both an effect of and a prerequisite for a steady improvement in output and employment, the behaviour of household consumption deserves closer examination.

Between 1986 and 1988 private consumption grew by nearly 4 per cent a year, almost twice the rate recorded in the preceding five years. The rise in real incomes as a result of the improvement in the terms of trade was augmented by the stimulus from the budget deficit, which did not fall below the equivalent of 11 per cent of GDP.

With domestic demand growing faster than the average for the other main European countries, almost two-thirds of the exceptional amelioration of 18 trillion lire in merchandise trade in 1986 as a result of the improvement in the terms of trade has been eroded in the space of two years. The inflation rate is still 3 percentage points higher than the average for the other European countries participating in the exchange rate mechanism; despite low oil prices and the low dollar exchange rate, internal factors are making it difficult to bring inflation below 5 per cent.

Above all, full advantage has not been taken of the opportunity offered by the present world economic climate to restore better balance in the public finances.

In 1988 the borrowing requirement of the state sector as a whole will not be less than 118 trillion lire, 4 trillion more than last year. The target set a year ago will be exceeded by around 15 trillion lire, the same as the overshoot recorded in 1987. The faster growth in the economy and the bringing forward of tax receipts as a result of the measures taken in July have increased the expected rate of growth in tax revenues. However, the rise in expenditure has been greater.

In the first nine months of the year the state sector borrowing requirement was 9 trillion lire above the figure for the corresponding period of 1987. Not only did this give domestic demand a stimulus that, had it not been for the revival in world trade and the renewed decline in oil prices, would have adversely affected the external accounts, but it also made control of the monetary aggregates very difficult.

Bank lending began to accelerate in the spring. The boost to credit demand caused by the more rapid expansion in output and investment coincided with the bulge in lending associated with the expiry of the credit ceiling and the difficulties firms were having raising equity capital.

For cyclical reasons it was therefore necessary to keep tight control over the money supply in order to regulate the growth in the monetary and credit aggregates and ensure the non-inflationary financing of the Treasury's borrowing requirement and the renewal of a substantial volume of maturing government debt.

On several occasions the Bank of Italy had to conclude securities repurchase agreements for substantial amounts in order to regulate liquidity. By drastically reducing their securities portfolios, the banks were able to accommodate the increased demand for credit and thus to make up for the disappointing results they had recorded in 1987. The investment funds also met the heavy demand for redemptions by selling securities from their holdings. It was therefore left to households to subscribe directly for an even larger proportion of government securities than in the past.

The fall in yields on government securities that had begun in October 1987 came to an end in March, in an atmosphere dominated by the uncertain prospects with regard to public finances and the difficulties surrounding approval of the Finance Law. The upward movement in rates affected all maturities, but at different times; despite a steepening of the yield curve, the authorities had to resign themselves to a shift in investor preference towards short-term securities.

In July and August less than a quarter of the public sector borrowing requirement could be covered by sales of securities with maturities of longer than a year. In the first nine months the proportion of total gross issues of government securities in the form of Treasury bills was almost 50 per cent, more than twice as high as in the same period of 1987.

The difficulties of financing the public sector deficit were compounded by those encountered in curbing the expansion in credit. In July the raising of interest rates on securities at issue was supplemented by greater central bank recourse to securities repurchase agreements with the object of using interest rates to curb bank lending, especially at rates below prime rate. In August the official discount rate was raised from 12 to 12.5 per cent and yields on all new issues of government securities were increased by a similar proportion in view of continuing difficulties in the credit market and in Treasury financing.

The market responded positively. Expectations rapidly improved, owing partly to the general approval with which the announcement of the Government's fiscal stance for 1989 was greeted. The growth in lending slowed down and the October issues of two and four-year Treasury bonds were heavily oversubscribed. The market has given further proof of its readiness to support trenchant measures to reform the public finances. It is vital that the authorities take advantage of the opportunity so provided.

Macroeconomic equilibrium requires that bank lending continue to slow down for the rest of the year, even if this will not be sufficient to bring the expansion in credit to the non-state sector back within the target range set a year ago, when forecasts of the growth in demand and output were lower. Including the public sector borrowing requirement, the increase in total domestic credit is likely to work out at around 13 per cent at the end of the year, a rate of growth similar to that recorded in 1987. The money supply is growing within the limits set.

In the international context that I described at the outset, Italian economic conditions are on the whole favourable, but the causes of weakness have not been eradicated. The state of the public finances remains the most serious obstacle to sustained, non-inflationary growth, not only in the Centre and North but also in the South of Italy, where unemployment always tends to be concentrated; although a slight easing is apparent, unemployment remains at 12 per cent of the labour force in the country as a whole.

It came as a shock to public opinion when the public debt exceeded the figure of one thousand trillion lire in September. It is the substantial and continuous increase in the debt owing to successive annual borrowing requirements and the resulting allocation of a large part of domestic saving to non-productive uses that should leave a strong impression on the mind of the public, rather than the surpassing of thresholds considered to have symbolic significance.

The policy for the coming year, as laid down in the Finance Law and associated legislation, re-affirms the stance described in the economic and financial planning paper approved in May.

The Government has estimated the state sector borrowing requirement at 117,350 billion lire; in relation to gross domestic product it should come down to 10.2 per cent.

The severity of the measures to reduce expenditure on an accruals basis testifies to the Government's determination to keep borrowing on target. In the next few years they will allow better control over expenditure, especially capital outlays. However, eliminating the deficit in a country whose infrastructure still presents serious shortcomings, especially in the South, means that action should be taken without delay to correct the built-in mechanisms that generate current expenditure. It is here that more incisive measures are needed, not to dismantle the institutions of genuine social solidarity but to eliminate waste and improve the standard of services while meeting recipients' actual needs.

The declared aim of reducing the state sector borrowing requirement from 30 to 21 trillion lire net of interest payments should be achieved and exceeded in a single stride, given the knowledge that efforts to reform the public finances will have to continue for many years. The current state of the economy both permits and demands such action. Only in this way will it be possible to keep domestic demand in line with that in our trading partners, lengthen the maturity of public debt and reduce interest rates; it is on assumptions regarding the last two aspects that the forecast of the interest component of the total planned borrowing requirement is based.

Reducing the deficit net of interest payments will facilitate the conduct of monetary policy, which will have to continue to be used to curb credit expansion. An increase of between 7 and 10 per cent in lending to the non-state sector appears to be compatible with the growth in national income and investment indicated for 1989. Money supply growth will be kept between 6 and 9 per cent, in keeping with the forecasts of an increase of 3 per cent in real output and one of 4 per cent in consumer prices.

According to available estimates, industrial unit costs are around 5 per cent higher this year than last, with both the raw material and labour components rising in line. As far as budgetary receipts are concerned, the policy laid down for next year in the Finance Law is based partly on the initial results of the measures to curb tax evasion and partly on the assumption of an increase in indirect taxation. In order to keep inflation under control, the increase in tax revenues will have to be accompanied by an effective incomes policy for earnings from both capital and employment.

Holding inflation down to 4 per cent is a modest objective but an arduous task. However, success in this regard is essential if we wish to avoid jeopardizing competitiveness and to limit the current account deficit. The external constraint gave cause for concern in the first few months of this year but has been eased by the expansion in world demand, especially in Europe. However, between 1984 and 1987 the annual growth in the volume of Italy's imports was on average 3.5 percentage points higher than the rise in exports; preliminary data for this year indicate that the growth in the volume of exports is continuing to lag behind that of imports.

It is all the more important for merchandise exports to be competitive in view of the deficit now being recorded on trade in services. Net receipts from tourism are stagnating and are no longer sufficient to cover the rising outflows of investment income and transfer payments. The current account is likely to show a deficit of around 5 trillion lire this year, despite the fact that the deficit on the energy account is around 4 trillion lire less than in 1987 owing to the fall in the prices and volume of energy imports.

In the first nine months of the year the balance of payments as a whole showed a surplus of 1,878 billion lire, an improvement of 3,400 billion on the figure for the same period of 1987, which was affected by the foreign exchange crisis in the summer.

The improvement in the overall balance-of-payments position, which was confirmed by the substantial inflows of foreign exchange in October, can be attributed entirely to capital movements, with net inflows being more than sufficient to finance the current account deficit.

The foreign exchange reserves stood at 29.8 trillion lire yesterday evening, 9.5 trillion more than at the end of 1987. This is a historically high level that it was prudent to reach at the time of the full implementation of the reform of the foreign exchange regulations.

The inflows of capital were occasioned by loans and both direct and portfolio investment, with the net inflow of funds approaching 10 trillion lire between January and September, more than twice the amount recorded in the whole of 1987. It is significant that such a large surplus on capital account should have been generated in the year in which the effect of the adjustment in residents' financial assets to the removal of exchange controls was likely to be greatest.

That process of adjustment is now under way. Since May 1987 residents' portfolio investment abroad, net of disinvestment, has been running at an average of 500 billion lire a month. If the outflows in respect of residents' direct investment and lending abroad are also included, the total outflow of Italian capital was in excess of 10 trillion lire in 1987; the figure for the first nine months of this year was 9.7 trillion lire.

Foreign borrowing was sufficient to offset these outflows in 1987 and again this year. The scale of borrowing and the favourable terms testify to the high credit rating granted to individual Italian borrowers and to the country as a whole.

The need to reduce the cost of debt servicing might suggest that greater recourse should be made to international markets to cover part of the public sector borrowing requirement, but a policy of public debt management that significantly increased the amount raised abroad would risk undermining Italy's standing as a first-class borrower in international markets. The situation might be assessed differently once the country's creditworthiness had been enhanced by progress towards the restoration of sound public finances.

The overall picture of external capital flows in the course of this year confirms the favourable trends that had already begun to emerge in 1987, namely a gradual and sustainable adjustment in Italian savers' portfolios made possible by the liberalization of exchange controls, increasing flows of financial assets in both directions as a sign of progress in the integration of the Italian financial market with its counterparts abroad and heightened interest on the part of foreign savers in the investment opportunities Italy can offer.

Two points must be made with regard to these positive developments; first, that the increase in the scale of capital movements increases the volatility of flows, and secondly that inward investment in Italy is generally less stable than that made abroad by residents.

Today's gathering gives me an opportunity to summarize the terms in which, in my opinion, the question of the relationships between banking and industry is posed, a matter that has recently become the subject of a wide-ranging debate to which many valuable contributions have been made.

Above all, action should be taken to close the gap in our legislation that allows residents or non-residents to gain control of banks without being subject to any procedure whatsoever; they are not even obliged to notify or inform the monetary authorities.

The participation of financial enterprises in the ownership of banks has never posed any problem at all. The policy that the Bank of Italy has been pursuing for years, encouraging banks to amend their statutes and proposing legislative changes on subjects ranging from the transformation of the public banks into joint stock companies to the creation of multi-functional groups, is aimed at enhancing the capital strength and entrepreneurial spirit of the credit system via the entry of private capital.

The central issue concerns participation in the ownership of banks by non-financial companies, which now have more funds available as a result of the capital strength of Italian companies and growing international integration.

The Bank of Italy has repeatedly expressed the view that non-financial companies should be permitted to hold such participations but that they should not in any way occupy a dominant position in institutions collecting public savings and granting credit.

Given the importance of defining all aspects of this issue clearly, there is an urgent need for legislation laying down criteria, limits and procedures for the acquisition of substantial shareholdings in credit institutions, with a view to strengthening the credit system and safeguarding its autonomy.

3. Exchange rates and the European Monetary System

Exchange rate developments since the last Forex Club Convention have been marked not only by greater capital mobility but also by the change in the central banks' overall response in this regard following the understandings reached within the Group of Seven and the European Economic Community, especially as a result of the Basle-Nyborg agreements.

The agreements proved effective even before they had been ratified, when the repercussions of Black Monday in the stock markets made themselves felt at the end of last October. At that time it was widely felt in the market that there was a lack of coordination among the monetary authorities of the major countries as regards interest rates and exchange rates. In the absence of serious divergences within the Community, the tensions that developed in the European Monetary System were the almost mechanical consequence of forecasts of a further sharp depreciation of the US dollar. The situation was therefore precisely the one for which the Basle-Nyborg agreements cater, having been concluded in order to cope better with speculative movements not justified by the fundamental conditions of the economies concerned.

Concerted action was taken, using all the instruments for which the agreements provide. The interest rate differential between weak and strong currencies was widened, exchange rates were managed more flexibly within the band of fluctuation and intramarginal interventions financed by the EMCF were carried out. The stabilizing effect of this coordinated action was immediate; not only did the package of measures make speculation less profitable, it also made the expected realignment improbable by demonstrating a united resolve on the part of the monetary authorities.

The experience of November 1987 provided valuable indications for the management of exchange rates within the EMS in the months that followed. The holding of presidential elections in France in the spring of this year gave the market a further opportunity to infer from previous experience that a realignment was inevitable. Pressure on the French franc spread to the lira, which was allowed to decline against the Deutschemark. In mid-May the non-realignment of currencies after the French elections induced a reflow of funds and a recovery in the lira exchange rate. Similar movements of the lira, first downwards and then upwards, occurred before and after the informal meeting of EEC ministers and central bank governors in Crete in the middle of September. The lira has been largely unaffected by the recent tensions due to the renewed depreciation of the dollar.

In all of these instances the policy of the Bank of Italy has been not to fight against the trend but to be ready with measures designed to counteract excessive fluctuations in short-term capital movements and with complementary operations to manage liquidity in the money market. Cooperation with other central banks has caused the market to interpret the greater day-to-day exchange rate flexibility positively, as an indication of a concerted strategy and not as an omen of crisis. The fact that exchange rate variability has operated in both directions has greatly helped to reinforce this view, leading to a more widespread market perception of the symmetry of exchange risks, one of the prerequisites for smooth functioning of the markets.

The more orderly operation of the market aided the transition to the new foreign exchange regulations, which came fully into operation on 1 October of this year. The changeover was also eased by the fact that some of the more important liberalizing provisions of the new Law were gradually put into effect by changes in regulations over the preceding months.

By introducing the new foreign exchange legislation, Italy has fulfilled the commitments made at Community level, initiating a reform that goes beyond the minimum requirements laid down by the EEC. For years we have followed a monetary policy that relies heavily on control of the exchange rate as a means of maintaining price stability. When the reform of public finances on which the Government has embarked begins to produce results it may become possible for the lira to join the narrow band of fluctuation of the EMS.

The reform of foreign exchange legislation gives intermediaries new opportunities for growth and profits. It broadens the banks' scope for transactions in foreign currencies at home and abroad as well as in lire abroad, for operations in both the spot and forward markets and for dealing in securities denominated in foreign currencies and in the new instruments for covering exchange and interest rate risks. They will now be able to manage their cash positions in lire and foreign currencies as a single entity and thus invest their liquidity on the best terms available in either the domestic or the international market. Upon the expiry of exchange controls, the banks will have to adopt operating rules to keep their exchange risks in due proportion to their own funds. The supervisory authorities' prudential regulations are moving in the same direction.

The increased efficiency, viability and security of Italian banks' international activities will enable them to continue to be the main channel for residents' foreign exchange transactions, even after this ceases to be a requirement in July 1990.

The full liberalization of short-term capital movements within the Community will usher in a period of heightened risk for the European Monetary System, and in particular for the eight countries participating in the exchange rate mechanism. Under the new arrangements the markets will be able to punish economic policy inadequacies severely and swiftly. The overall framework determined jointly by the economic policies of all the member countries will become increasingly important for exchange rate stability as well as for prudent day-to-day operations in the money and foreign exchange markets.

The liberalization of short-term capital movements will be a positive development only to the extent that it is accompanied by other steps towards the harmonization of legislation and market integration. Otherwise it will potentially destabilize the EMS and will expose it to speculative movements that might prevail over economic policies and distort their effects. Progress on the capital front alone would be too unbalanced and would leave the countries of the exchange rate mechanism in mid-stream.

An awareness of the dangers inherent in a period of transition and the need to overcome them swiftly by means of institutional change underlie the renewed commitment to advance towards economic and monetary union. The Committee for the Study of Economic and Monetary Union set up by the European Council in Hanover has begun its work, which it is legitimate to suppose will produce not only a blueprint for European monetary union but also an indication of the concrete steps required to achieve it. These are bound to involve the ex ante coordination of monetary policies, setting common growth paths for monetary aggregates and establishing both a commitment to react to deviations from the planned path and the means of doing so. However, the other components of economic policy, both fiscal policy and incomes policy, will also have to become increasingly compatible within the Community.

The decision to move towards an area of fixed exchange rates and completely free capital movements in Europe was a difficult one for those who, while agreeing with it, are aware of the risks of instability to which the entire Community system is exposed if definite progress towards economic and monetary union is not achieved.

The duties member countries are required to fulfil jointly within the Community presuppose that each of them will fully meet their obligation to promote growth with stability within their own countries. As far as Italy is concerned, reform of the public finances, consolidation of the progress in the productive sector and completion of the restructuring of the credit system and financial markets are fundamental objectives and constitute the contribution we are both obliged and able to make to the construction of an increasingly integrated European economy.

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)*			
1982	−2.5	3.1	−1.0	2.5	1.1	0.2	−3.2
1983	3.6	3.2	1.9	0.7	3.5	1.1	3.2
1984	6.8	5.1	3.3	1.3	2.1	3.2	6.3
1985	3.4	4.9	2.0	1.7	3.9	2.9	4.6
1986	2.8	2.4	2.5	2.2	2.9	2.9	3.2
1987	3.4	4.2	1.7	2.4	4.2	3.1	4.0
1987 — 1st qtr.	1.1	1.5	−0.5	0.2	1.0	0.5	1.6
2nd "	1.2	—	0.7	0.9	0.3	1.2	1.3
3rd "	1.1	2.0	1.4	0.8	1.9	1.0	1.5
4th "	1.5	1.8	0.7	0.7	1.0	0.2	1.6
1988 — 1st qtr.	0.8	2.7	1.4	1.2	0.7	....	0.8
2nd "	0.8	−1.0	—	0.5	0.5	....	1.0
				GNP deflator (1) *(% changes on previous period; seasonally adjusted data)*			
1982	6.5	1.8	4.4	11.7	7.6	16.2	8.7
1983	3.9	0.8	3.2	9.8	5.3	15.0	5.1
1984	3.7	1.2	2.0	7.4	4.3	11.3	3.1
1985	2.9	1.4	2.2	5.9	5.8	8.9	2.9
1986	2.7	1.9	3.1	5.0	3.7	7.5	2.5
1987	3.3	−0.2	2.1	2.6	4.8	5.6	4.4
1987 — 1st qtr.	0.9	−0.4	0.8	0.9	0.5	1.0	1.2
2nd "	0.8	−0.2	0.2	0.5	0.5	1.8	1.3
3rd "	0.8	0.6	−0.2	0.3	1.9	1.1	0.6
4th "	0.6	−0.2	0.8	0.8	1.6	1.4	1.2
1988 — 1st qtr.	0.4	0.1	0.5	1.0	0.1	....	0.9
2nd "	1.2	−0.2	0.4	0.7	0.2	....	0.9
				Current account balance (2) *(billions of dollars)*			
1982	−8.1	6.8	4.8	−12.1	7.8	−5.5	2.3
1983	−46.6	20.8	5.2	−4.9	4.9	0.8	2.5
1984	−107.0	35.0	9.5	−0.8	2.7	−2.9	2.0
1985	−115.1	49.2	17.0	0.1	4.4	−4.1	−1.4
1986	−138.8	85.8	38.9	2.9	−0.2	2.2	−7.6
1987	−154.0	87.0	44.6	−4.8	−4.3	−1.0	−8.0
1987 — 1st qtr.	−37.6	20.9	11.9	—	1.4	0.9	−1.4
2nd "	−40.9	22.7	11.5	−1.2	−0.6	0.5	−1.9
3rd "	−42.0	21.3	10.9	−1.0	−1.8	−1.2	−2.1
4th "	−33.5	22.1	10.3	−2.6	−3,3	−1.2	−2.6
1988 — 1st qtr.	−36.9	18.5	9.2	1.0	−5.2	−1.7	−1.3
2nd »	−33.3	19.3	14.7	....	−5.4	0.4	−1.9

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
1982	−7.1	0.3	−3.2	−0.4	1.9	−3.1	−9.8
1983	6.0	3.3	0.6	0.3	3.6	−3.2	6.5
1984	11.4	9.3	3.0	1.9	1.4	3.4	14.1
1985	1.6	3.7	4.5	0.7	4.6	1.2	5.2
1986	1.1	−0.2	1.9	0.7	1.5	2.7	1.3
1987	3.7	3.1	0.4	2.0	3.1	4.0	3.7
1986 — 2nd qtr.	−0.7	0.1	—	1.0	1.0	0.1	—
3rd "	0.3	−0.3	0.9	1.3	0.7	0.3	−0.7
4th "	1.0	−0.1	−0.9	−1.3	0.2	1.9	0.6
1987 — 1st qtr.	0.8	1.0	−0.9	0.3	0.5	0.1	0.4
2nd "	1.0	0.2	1.9	1.6	1.0	2.7	1.6
3rd "	2.1	3.4	—	0.6	1.5	−0.9	2.6
4th "	1.7	3.2	0.9	1.0	1.1	2.6	2.5
1988 — 1st qtr.	0.9	3.3	—	0.6	0.3	1.6	1.3
2nd "	1.2	−0.5	0.9	0.3	1.3	−0.6	0.9
1987 — July	1.2	0.8	−0.9	−1.0	0.6	0.3	0.4
Aug.	0.4	—	2.8	—	1.6	−1.5	2.1
Sept.	−0.2	1.5	−0.9	1.0	−1.2	2.9	0.4
Oct.	1.2	1.7	0.9	—	1.1	2.4	1.0
Nov.	0.6	0.3	—	—	0.3	−1.4	0.7
Dec.	0.5	1.2	—	1.0	—	−0.8	0.3
1988 — Jan.	0.4	0.4	—	—	1.2	5.9	0.8
Feb.	—	2.7	0.9	—	−2.1	−4.2	0.1
Mar.	0.2	0.2	—	—	1.6	−0.9	−0.1
Apr.	0.6	−0.8	−0.9	−0.9	0.6	2.9	—
May	0.5	−2.4	0.9	1.0	0.9	−2.8	1.2
June	0.4	2.6	1.8	1.9	−0.9	1.2	0.2
July	0.8	—	—	....	—	2.6	....

Sources: National bulletins and OECD.

Table a3

Consumer prices

(% changes on corresponding period)

	US	Japan	Germany	France	UK	Italy	Canada
1982	6.2	2.7	5.3	11.8	8.5	16.5	10.8
1983	3.2	1.9	3.3	9.6	4.6	14.7	5.8
1984	4.3	2.2	2.4	7.4	4.7	10.8	4.4
1985	3.5	2.1	2.2	5.8	6.4	9.2	3.9
1986	1.9	0.4	−0.2	2.7	3.3	5.9	4.2
1987	3.7	−0.3	0.2	3.1	4.1	4.7	4.4
1986 — 2nd qtr.	1.6	0.7	−0.2	2.4	2.6	6.1	3.9
3rd "	1.6	—	−0.4	2.1	2.4	5.5	4.2
4th "	1.3	−0.4	−1.1	2.1	3.3	4.4	4.3
1987 — 1st qtr.	2.2	−1.2	−0.5	3.2	3.9	4.3	4.0
2nd "	3.7	−0.2	0.1	3.4	4.2	4.4	4.6
3rd "	4.2	0.1	0.6	3.4	4.4	4.9	4.5
4th "	4.5	0.4	1.0	3.2	4.1	5.4	4.2
1988 — 1st qtr.	3.9	0.6	0.8	2.4	3.3	5.1	4.1
2nd "	3.9	—	1.1	2.5	4.3	5.0	4.0
1987 — July	3.9	−0.3	0.7	3.4	4.4	4.7	4.7
Aug.	4.3	0.1	0.8	3.5	4.4	4.8	4.5
Sept.	4.3	0.5	0.4	3.2	4.3	5.2	4.5
Oct.	4.6	0.4	0.9	3.2	4.5	5.5	4.3
Nov.	4.5	0.4	1.0	3.2	4.2	5.4	4.2
Dec.	4.4	0.4	1.0	3.1	3.6	5.2	4.2
1988 — Jan.	4.1	0.7	0.7	2.4	3.3	5.2	4.1
Feb.	4.0	0.6	0.9	2.4	3.3	5.0	4.1
Mar.	4.0	0.4	1.0	2.5	3.4	5.2	4.1
Apr.	3.9	—	1.0	2.5	4.0	5.1	4.0
May	3.9	−0.1	1.1	2.5	4.3	5.0	4.1
June	4.0	—	1.1	2.6	4.7	5.0	3.9
July	4.1	0.4	1.0	2.7	4.9	5.0	3.8
Aug.	4.0	0.5	1.2	2.8	5.7	....	4.0

Sources: National bulletins and OECD.

Table a4

Wholesale prices

(% changes on corresponding period)

	US	Japan	Germany (1)	France (1)	UK (1)	Italy	Canada (1)
1982	1.8	1.8	4.8	10.7	7.8	13.9	6.7
1983	1.8	−2.2	1.5	8.9	5.5	9.7	3.5
1984	1.8	−0.2	2.8	8.9	6.1	10.4	4.5
1985	—	−1.2	2.0	4.8	5.5	7.3	2.8
1986	−2.6	−9.1	−2.4	−2.6	4.5	−0.9	0.8
1987	1.8	−3.8	−0.4	—	3.8	2.6	2.7
1986 — 2nd qtr.	−3.5	−9.5	−2.5	−3.2	4.5	−1.4	0.2
3rd "	−2.6	−10.8	−3.0	−3.9	4.4	−2.2	0.5
4th "	−3.5	−9.0	−3.0	−3.3	4.2	−2.4	0.4
1987 — 1st qtr.	−0.9	−7.8	−2.1	−2.0	4.1	−0.4	−0.2
2nd "	2.7	−5.1	−0.7	−0.7	3.6	2.4	2.7
3rd "	3.6	−1.2	0.3	0.7	3.6	4.1	3.8
4th "	4.5	−0.6	0.9	2.7	3.9	4.6	4.3
1988 — 1st qtr.	4.5	−1.0	0.8	2.7	3.9	4.1	5.0
2nd "	4.4	−0.6	1.4	....	4.3	4.4	4.4
1987 — July	3.6	−2.1	0.3	....	3.6	3.8	3.7
Aug.	4.5	−1.0	0.3	....	3.6	4.1	3.9
Sept.	3.6	−0.6	0.2	....	3.6	4.3	4.0
Oct.	4.5	0.1	0.8	....	3.9	4.5	3.9
Nov.	4.5	−0.7	0.9	....	3.9	4.6	4.4
Dec.	4.5	−1.1	1.0	....	3.9	4.7	4.9
1988 — Jan.	3.6	−1.0	0.6	....	3.8	3.9	5.1
Feb.	4.5	−1.0	1.0	....	3.9	4.2	4.8
Mar.	3.5	−1.0	1.0	....	4.0	4.3	4.9
Apr.	4.4	−0.7	1.1	....	4.2	4.4	4.6
May	4.4	−0.5	1.3	....	4.2	4.5	4.3
June	4.3	−0.6	1.7	....	4.7	4.5	4.1
July	4.3	−0.9	1.6	....	4.6	4.7	3.7
Aug.	....	−1.0	....	....	4.9	5.0	....

Sources: National Bulletins and OECD.

(1) Total producer prices for Germany; producer prices of intermediate goods for France; producer prices of manufactures for the UK and Canada.

Table a5

Short-term interest rates

	US	Japan	Germany	France	UK	Italy	Canada
			Official reference rates (1) *(end-of-period data)*				
1982 — Dec.	8.5	5.5	5.0	9.5	10.1	18.0	10.3
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 — Dec.	7.5	5.0	4.0	9.5	11.5	15.0	9.5
1986 — Dec.	5.5	3.0	3.5	9.5	11.0	12.0	8.5
1987 — Aug.	5.5	2.5	3.0	9.5	10.0	12.0	9.2
Sept.	6.0	2.5	3.0	9.5	10.0	12.0	8.6
Oct.	6.0	2.5	3.0	9.5	9.5	12.0	8.3
Nov.	6.0	2.5	3.0	9.5	9.0	12.0	8.5
Dec.	6.0	2.5	2.5	9.5	8.5	12.0	8.7
1988 — Jan.	6.0	2.5	2.5	9.5	8.5	12.0	8.6
Feb.	6.0	2.5	2.5	9.5	8.5	12.0	8.6
Mar.	6.0	2.5	2.5	9.5	8.0	12.0	8.8
Apr.	6.0	2.5	2.5	9.5	8.0	12.0	9.1
May	6.0	2.5	2.5	9.5	7.5	12.0	9.1
June	6.0	2.5	2.5	9.5	9.5	12.0	9.4
July	6.0	2.5	3.0	9.5	10.5	12.0	9.5
Aug.	6.5	2.5	3.5	9.5	12.0	12.5	10.0
			Money market rates (2) *(monthly averages)*				
1982 — Dec.	7.9	7.1	6.6	12.7	10.6	19.1	9.8
1983 — Dec.	9.0	6.3	6.5	12.2	9.4	17.0	9.7
1984 — Dec.	8.1	6.3	5.8	10.7	9.8	14.7	9.8
1985 — Dec.	7.1	8.0	4.8	9.0	11.8	13.1	9.2
1986 — Dec.	5.5	4.4	4.8	8.1	11.4	10.3	8.2
1987 — Aug.	6.0	3.7	3.9	8.0	10.0	10.9	9.0
Sept.	6.4	3.8	4.0	8.0	10.2	11.8	9.4
Oct.	6.1	3.8	4.7	8.3	10.0	12.0	7.8
Nov.	5.7	3.9	3.9	8.8	8.9	12.1	8.3
Dec.	5.8	3.9	3.6	8.6	8.8	11.7	8.4
1988 — Jan.	5.8	3.8	3.4	8.3	9.0	11.4	8.4
Feb.	5.7	3.8	3.3	7.7	9.2	10.8	8.3
Mar.	5.7	3.8	3.4	8.0	8.9	10.8	8.5
Apr.	5.9	3.8	3.4	8.1	8.3	10.8	8.9
May	6.3	3.9	3.5	7.9	8.0	10.8	8.9
June	6.5	3.9	3.9	7.4	8.9	10.6	9,2
July	6.7	4.0	4.9	7.4	10.6	11.1	9.3
Aug.	7.1	4.1	5.3	7.7	11.4	11.1	9.5

Sources: National bulletins, IMF, BIS and OECD.
(1) UK: base rate; all other countries: discount rate. — (2) For the US, the 3-month Treasury bill rate; for Japan, the rate on 2-month private sector securities; for Germany, France and the UK, the 3-month interbank rate; for Italy, the auction rate on 6-month Treasury bills; for Canada, end-of-period rate on 3-month Treasury bills.

Table a6

Long-term interest rates and share price indices

(monthly averages)

	US	Japan	Germany	France	UK	Italy	Canada
				Bond rates (1)			
1982 — Dec.	9.9	7.5	7.9	14.8	11.3	19.6	11.7
1983 — Dec.	11.1	6.9	8.2	13.3	10.3	17.7	12.0
1984 — Dec.	10.6	6.3	7.0	11.8	10.5	14.5	11.7
1985 — Dec.	8.4	5.8	6.5	10.5	10.4	13.7	10.1
1986 — Dec.	6.4	4.6	5.9	8.7	10.7	10.1	9.2
1987 — Aug.	8.0	4.5	6.0	9.8	9.9	11.3	10,4
Sept.	8.7	5.5	6.2	10.3	10.0	11.3	10.1
Oct.	8.7	4.7	6.5	10.7	9.9	11.4	10.2
Nov.	8.0	4.5	6.0	10.0	9.2	11.3	10.5
Dec.	8.1	4.3	6.0	10.0	9.6	10.5	10.3
1988 — Jan.	7.9	4.1	6.0	9.9	9.6	10.3	9.7
Feb.	7.4	4.1	5.8	9.1	9.4	10.3	9.6
Mar.	7.5	4.0	5.7	9.2	9.1	10.3	10.1
Apr.	7.8	3.9	5.8	9.2	9.1	10.4	10.4
May	8.2	4.2	6.1	9.2	9.4	10.5	10.4
June	8.2	4.5	6.1	8.9	9.5	10.5	10.1
July	8.4	4.5	6.4	9.0	9.7	10.6	10.4
Aug.	8.8	4.8	6.5	9.1	9.8	10.7	10.6
				Share price indices (1975 = 100) (2)			
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 — Dec.	243.8	322.5	283.9	347.2	507.5	441.1	290.0
1986 — Dec.	291.4	498.4	314.0	555.5	615.8	820.4	306.6
1987 — Aug.	386.6	676.3	304.2	567.3	862.4	732.9	399.4
Sept.	373.9	668.5	296.7	582.7	882.3	720.2	390.2
Oct.	331.6	650.2	271.4	498.0	773.6	717.2	301.9
Nov.	284.9	594.5	203.7	403.9	618.2	584.7	297.8
Dec.	283.1	583.5	199.2	385.8	636.7	575.6	316.0
1988 — Jan.	294.1	584.0	190.2	367.3	677.3	556.3	305.7
Feb.	303.1	636.5	200.0	389.2	673.5	532.4	320.4
Mar.	311.9	677.4	212.0	403.4	697.1	601.2	331.4
Apr.	308.3	695.8	210.5	409.4	690.2	611.1	334.0
May	300.4	696.5	203.1	428.3	691.7	573.3	324.9
June	318.7	702.6	217.6	475.8	719.8	594.2	344.2
July	316.1	698.8	224.9	487.3	725.2	637.2	337.7
Aug.	309.5	702.9	223.9	481.8	713.1	664.0	328.6

Sources: National bulletins, IMF, BIS and OECD.
(1) Rates on government bonds. — (2) Italy: 1958 = 100.

Table a7

Interest rates on international markets and US dollar premium/discount

(period average)

	US dollar	Japanese yen	Deutsche-mark	Pound sterling	Lire	US dollar	Japanese yen	Deutsche-mark	Pound sterling	Lire
	Rates on 3-month Eurodeposits					**Rates on 12 month Eurodeposits**				
1983	9.56	6.47	5.45	10.04	18.10	10.00	6.52	5.88	10.25	18.88
1984	10.74	6.28	5.71	9.88	15.62	11.60	6.40	6.18	10.24	16.56
1985	8.28	6.55	5.25	12.16	13.77	8.97	6.42	5.47	11.61	14.24
1986	6.71	5.03	4.51	10.88	12.69	6.79	4.91	4.55	10.63	12.06
1987	7.07	4.15	3.92	9.64	10.79	7.49	4.20	4.13	9.74	11.03
1987 — Nov.	7.42	4.26	3.84	8.87	11.81	7.81	4.31	4.08	8.96	11.73
Dec.	7.87	4.39	3.59	8.69	11.19	8.06	4.39	3.78	9.12	11.55
1988 — Jan.	7.12	4.17	3.30	8.86	10.67	7.64	4.24	3.67	9.42	11.25
Feb.	6.73	4.16	3.29	9.18	10.31	7.12	4.18	3.50	9.62	10.70
Mar.	6.74	4.26	3.30	8.82	10.69	7.27	4.24	3.53	9.26	10.92
Apr.	7.07	4.02	3.31	8.22	10.44	7.65	4.23	3.61	8.87	10.88
May	7.41	4.08	3.44	7.97	10.14	8.06	4.29	3.92	8.95	10.85
June	7.61	4.23	3.79	8.85	10.20	8.16	4.47	4.23	9.57	10.90
July	8.07	4.65	4.75	10.44	10.77	8.53	4.83	5.09	10.68	11.30
Aug.	8.48	4.76	5.14	11.32	10.79	9.01	4.88	5.56	11.40	11.47
Sept.	8.31	4.96	4.89	12.07	11.24	8.77	4.98	5.29	12.10	11.39
	3-month US dollar premium (−) / discount (+)					**12-month US dollar premium (−) / discount (+)**				
1983		3.09	4.11	−0.48	−8.54		3.48	4.12	−0.25	−8.88
1984		4.46	5.03	0.86	−4.88		5.20	5.42	1.36	−4.96
1985		1.73	3.03	−3.88	−5.49		2.55	3.50	−2.64	−5.27
1986		1.68	2.20	−4.17	−5.98		1.88	2.24	−3.84	−5.27
1987		2.92	3.15	−2.57	−3.72		3.29	3.36	−2.25	−3.54
1987 — Nov.		3.16	3.58	−1.45	−4.39		3.50	3.73	−1.15	−3.92
Dec.		3.48	4.28	−0.82	−3.32		3.67	4.28	−1.06	−3.49
1988 — Jan.		2.95	3.82	−1.74	−3.55		3.40	3.97	−1.78	−3.61
Feb.		2.57	3.44	−2.45	−3.58		2.94	3.62	−2.50	−3.58
Mar.		2.48	3.44	−2.08	−3.95		3.03	3.74	−1.99	−3.65
Apr.		3.05	3.76	−1.15	−3.37		3.42	4.04	−1.22	−3.23
May		3.33	3.97	−0.56	−2.73		3.77	4.14	−0.89	−2.79
June		3.38	3.82	−1.24	−2.59		3.69	3.93	−1.41	−2.74
July		3.42	3.32	−2.37	−2.70		3.70	3.44	−2.15	−2.77
Aug.		3.72	3.34	−2.84	−2.31		4.13	3.45	−2.39	−2.46
Sept.		3.35	3.42	−3.76	−2.93		3.79	3.48	−3.33	−2.62

Source: BIS.

Table a8

Lira exchange rates and the price of gold

(period average)

	Lire per unit of currency								Gold (dollars per ounce) (1)
	US dollar	Japanese yen	Deutsche-mark	French franc	Pound sterling	Swiss franc	SDR	ECU	
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	1,939.0	1,447.8	327.00
1986	1,489.6	8.8749	686.98	215.07	2,185.5	830.61	1,747.5	1,461.9	390.90
1987	1,296.8	8.9827	721.65	215.74	2,123.7	870.44	1,676.9	1,495.0	484.10
1986 — 3rd qtr.	1,436.9	9.2194	688.50	211.85	2,141.3	851.35	1,728.3	1,454.4	423.20
4th "	1,389.5	8.6728	692.53	211.42	1,985.8	835.44	1,675.6	1,442.5	390.90
1987 — 1st qtr.	1,306.2	8.5358	710.62	213.32	2,016.2	845.55	1,647.0	1,469.3	421.00
2nd "	1,300.2	9.1145	719.80	215.69	2,135.0	871.92	1,682.6	1,494.5	447.30
3rd "	1,330.9	9.0530	723.63	216.95	2,151.9	872.47	1,699.1	1,501.4	459.50
4th "	1,249.3	9.2136	732.13	216.88	2,187.9	891.02	1,676.7	1,513.4	484.10
1988 — 1st qtr.	1,236.4	9.6667	737.37	217.97	2,222.2	898.59	1,691.4	1,524.4	456.95
2nd "	1,269.3	10.0960	742.88	219.49	2,334.6	893.99	1,736.5	1,543.3	436.55
3rd "	1,385.9	10.3570	742.30	219.21	2,348.5	885.63	1,797.4	1,542.2	396.70
1987 — Aug.	1,345.8	9.1193	724.26	216.99	2,149.0	874.49	1,708.2	1,501.8	453.40
Sept.	1,310.3	9.1509	722.84	216.46	2,154.5	872.49	1,692.0	1,499.6	459.50
Oct.	1,303.1	9.0922	723.03	216.37	2,164.5	871.32	1,687.9	1,500.4	468.80
Nov.	1,239.4	9.1601	736.91	216.96	2,199.7	896.82	1,672.4	1,520.0	492.50
Dec.	1,202.9	9.3944	736.88	217.35	2,200.6	905.85	1,663.7	1,520.4	484.10
1988 — Jan.	1,215.0	9.5392	735.54	217.93	2,190.2	903.61	1,673.3	1,519.2	458.00
Feb.	1,250.3	9.6745	736.42	217.98	2,196.3	897.81	1,694.8	1,521.0	426.15
Mar.	1,241.4	9.7648	739.75	218.01	2,272.4	895.16	1,702.5	1,531.9	456.95
Apr.	1,242.2	9.9368	742.61	218.79	2,330.4	898.07	1,716.7	1,541.6	449.00
May	1,258.7	10.0910	743.28	219.51	2,352.8	892.18	1,731.9	1,545.8	455.50
June	1,303.4	10.2380	742.72	220.09	2,320.1	892.27	1,755.1	1,542.3	436.55
July	1,366.5	10.2630	740.84	219.77	2,329.2	891.48	1,783.4	1,539.9	436.80
Aug.	1,397.9	10.4460	740.21	218.65	2,371.5	882.31	1,800.8	1,540.9	427.75
Sept.	1,392.5	10.3580	745.78	219.24	2,343.9	883.37	1,796.9	1,545.9	396.70

(1) End-of-period data.

Table a9

Nominal effective exchange rates (1)

(indices, 1980 = 100)

	US	Canada	Japan	Germany	France	UK	Italy	Switzerland
1982	119.8	100.1	106.8	102.6	86.9	98.4	85.1	110.9
1983	122.9	101.6	117.0	106.5	80.5	91.2	82.0	115.8
1984	130.9	98.4	124.2	106.1	77.7	87.5	78.6	114.7
1985	135.1	93.9	126.8	106.2	78.4	87.1	74.2	113.5
1986	110.3	87.2	159.1	113.5	79.4	78.8	74.4	122.3
1987	97.5	88.6	171.0	119.1	78.7	77.0	73.7	127.4
1986 — 3rd qtr.	106.2	86.7	168.6	114.3	78.3	77.5	74.8	126.1
4th "	106.4	86.8	162.6	116.7	79.1	72.9	75.6	125.6
1987 — 1st qtr.	100.7	88.6	163.5	119.2	79.0	74.0	75.0	126.2
2nd "	97.3	88.1	173.2	118.6	78.6	77.2	73.6	127.5
3rd "	98.7	89.2	169.7	118.6	78.6	77.3	73.2	126.8
4th "	93.3	88.5	177.3	120.1	78.4	79.1	73.0	129.3
1988 — 1st qtr.	90.1	91.0	185.9	119.9	78.2	79.6	72.5	129.4
2nd "	89.2	93.8	190.2	119.0	77.7	82.5	71.4	126.5
3rd "	93.9	96.2	186.4	117.8	76.9	81.4	70.7	124.0
1987 — Aug.	99.4	89.1	169.8	118.4	78.4	76.9	73.2	126.9
Sept.	97.2	89.3	173.0	118.7	78.6	77.7	73.3	127.0
Oct.	96.9	89.6	171.8	118.9	78.6	78.2	73.3	126.9
Nov.	92.9	88.0	176.8	120.6	78.2	79.4	72.7	129.7
Dec.	90.2	88.0	183.3	120.8	78.4	79.7	72.9	131.3
1988 — Jan.	89.9	89.6	185.5	120.3	78.6	79.1	72.8	130.8
Feb.	90.9	91.2	185.5	119.8	78.2	78.6	72.4	129.3
Mar.	89.5	92.3	186.7	119.8	77.8	81.1	72.1	128.0
Apr.	88.5	93.1	189.5	119.5	77.6	82.8	71.7	127.5
May	88.8	93.0	190.7	119.1	77.6	83.3	71.4	126.1
June	90.3	95.2	190.4	118.5	77.7	81.4	71.1	125.9
July	93.1	96.9	186.1	117.8	77.3	81.0	70.8	125.2
Aug.	94.4	96.0	187.2	117.4	76.7	82.2	70.7	123.4
Sept.	94.4	95.7	185.9	118.1	76.7	81.1	70.5	123.4

(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.*

Table a10

Real effective exchange rates (1)

(indices, 1980 = 100)

	US	Canada	Japan	Germany	France	UK	Italy	Switzerland
1982	121.0	103.6	94.0	96.5	94.4	99.8	98.2	103.5
1983	122.3	107.1	99.4	97.2	92.2	94.2	100.7	104.5
1984	128.6	105.7	101.8	94.4	91.7	91.8	102.0	102.1
1985	130.4	102.7	100.8	93.1	95.5	93.9	100.4	100.1
1986	104.3	99.4	123.3	99.8	99.7	91.3	103.1	104.9
1987	94.3	101.5	126.3	103.5	100.3	92.0	105.2	106.1
1986 — 2nd qtr.	105.0	99.5	124.0	98.4	98.7	95.8	101.5	103.4
3rd "	99.7	99.4	130.7	100.7	99.2	90.9	103.7	107.9
4th "	100.7	99.9	123.5	102.4	100.7	86.3	105.9	106.2
1987 — 1st qtr.	96.6	101.1	122.3	104.0	100.7	88.1	106.0	105.6
2nd "	93.9	100.8	128.0	103.2	100.4	92.4	104.7	106.1
3rd "	96.0	102.2	124.9	102.8	100.4	92.3	104.7	105.1
4th "	90.7	102.0	130.2	104.1	99.7	95.1	105.4	107.6
1988 — 1st qtr.	87.7	105.5	135.2	103.8	99.2	96.7	105.6	107.7
2nd "	87.6	108.1	136.1	102.9	98.6	100.8	104.5	105.3
1987 — June	95.0	100.6	126.5	103.0	100.3	92.3	104.3	105.4
July	96.8	102.1	122.2	103.1	100.6	92.4	104.1	105.1
Aug.	96.8	102.0	124.8	102.6	100.3	91.7	104.5	105.1
Sept.	94.3	102.7	127.6	102.7	100.2	92.9	105.5	105.2
Oct.	94.3	102.9	126.3	102.9	99.9	93.7	105.6	105.7
Nov.	90.3	101.4	129.8	104.5	99.5	95.5	105.0	108.0
Dec.	87.7	101.6	134.4	104.7	99.7	96.2	105.6	109.2
1988 — Jan.	87.4	104.1	135.3	104.2	99.6	95.8	106.0	108.7
Feb.	88.6	105.5	134.8	103.6	99.1	95.4	105.7	107.3
Mar.	87.2	106.8	135.4	103.5	98.9	98.8	105.2	107.1
Apr.	86.7	107.4	136.2	103.3	98.5	101.2	104.9	106.1
May	87.3	107.3	136.4	102.9	98.6	101.6	104.5	104.6
June	88.9	109.5	135.8	102.4	98.5	99.6	104.0	105.0
July	91.7	111.5	132.5	101.9	98.3	99.0	103.6	104.3
Aug.(2)	93.3	110.0	133.0	101.2	97.5	100.5	103.7	102.3

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

External position of the Italian credit system (1)

(end-of-period outstanding claims in billions of lire)

Vis-à-vis (2)	1987 December	1988 March	1988 June (3)
Industrial countries	128,393	127,724	141,982
OPEC countries	3,280	3,349	3,736
Other developing countries	9,056	9,468	10,535
of which: Latin America	*5,703*	*6,062*	*6,318*
Africa	*1,383*	*1,339*	*1,447*
Asia	*1,207*	*1,302*	*1,905*
Middle East	*763*	*765*	*865*
Eastern Europe	7,255	7,740	8,400
Offshore centres	13,760	12,539	14,440
International organizations	954	1,062	1,228
Total	**162,698**	**161,882**	**180,321**
Memorandum item:			
"Baker Plan" countries:			
Argentina	1,533	1,586	1,642
Bolivia	1	1	3
Brazil	1,118	1,187	1,260
Chile	198	370	241
Colombia	217	213	216
Ivory Coast	49	67	45
Ecuador	166	114	145
Philippines	130	145	143
Yugoslavia	434	407	426
Morocco	423	431	466
Mexico	1,700	1,738	1,874
Nigeria	152	155	184
Peru	249	241	253
Uruguay	27	24	28
Venezuela	538	534	612
Total	**6,935**	**7,213**	**7,541**
Bulgaria	260	289	320
Czechoslovakia	156	177	162
Poland	1,400	1,402	1,499
German Democratic Republic	1,064	1,214	1,233
Romania	143	109	94
Hungary	452	430	709

(1) For the purposes of this table, the Italian credit system comprises the operational units of banks and special credit institutions (branches in Italy and abroad) and the Italian branches of foreign banks; the claims are those in respect of loans granted directly to non-residents excluding those granted by branches abroad in the currency of the country in which local operators are resident. — (2) The country grouping is that adopted by the BIS. — (3) Provisional data.

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Table a12

Sources and uses of income

(% changes on previous period)

	SOURCES			USES					
				Gross fixed investment					
	GDP	Imports	Total	Building	Machinery, equipment and vehicles	Total	Household consumption	Other domestic uses (1)	Exports
				At 1980 prices					
1983	1.1	−1.6	0.6	1.1	−1.5	−0.1	0.7	−1.1	2.3
1984	3.2	11.0	4.6	—	11.3	5.3	2.4	8.1	7.6
1985	2.9	4.7	3.2	−0.6	5.7	2.5	3.0	4.4	3.8
1986	2.9	4.7	3.2	0.7	2.0	1.4	3.5	4.3	3.4
1987	3.1	10.0	4.5	−1.3	11.5	5.2	4.3	5.1	3.6
1985 — 3rd qtr.	0.6	−1.4	0.2	−1.1	−0.1	−0.6	0.9	−2.0	0.5
4th "	0.9	4.8	1.6	1.6	0.4	1.0	0.7	1.4	5.1
1986 — 1st qtr.	−0.2	2.1	0.2	—	−2.6	−1.3	0.7	4.9	−3.1
2nd "	1.9	−2.7	1.0	0.4	5.3	2.8	0.8	−7.0	6.1
3rd "	1.0	6.1	1.9	0.6	−0.3	0.1	1.2	10.5	−0.3
4th "	0.3	−4.9	−0.7	−2.0	3.0	0.5	1.3	−2.8	−5.8
1987 — 1st qtr.	0.5	6.8	1.7	−0.7	4.1	1.8	1.2	3.8	1.2
2nd "	1.2	3.5	1.6	1.2	6.2	3.9	1.2	−1.3	3.0
3rd "	1.0	1.4	1.1	−0.7	−3.0	−2.0	0.5	−1.9	8.1
4th "	0.2	4.4	1.1	0.1	2.1	1.2	0.4	9.0	−2.9
				Implicit price deflators					
1983	15.0	5.1	13.1	12.9	8.7	11.1	15.1	14.8	8.6
1984	11.3	11.1	11.2	10.2	8.3	9.0	11.3	13.3	10.4
1985	8.9	7.5	8.6	8.6	8.0	8.1	9.3	7.9	8.0
1986	7.5	−15.2	3.3	3.9	3.3	3.6	5.6	2.4	−4.4
1987	5.6	−0.3	4.4	3.8	2.8	2.8	9.1	6.4	2.3
1985 — 3rd qtr.	1.9	−1.7	1.2	1.6	1.1	1.4	1.8	−1.0	1.6
4th "	0.9	−2.0	0.4	1.1	1.5	1.3	1.7	−3.3	−1.2
1986 — 1st qtr.	2.1	−5.9	0.6	0.5	0.8	0.7	1.3	1.2	−2.8
2nd "	2.4	−7.2	0.9	1.0	−0.3	0.2	1.1	6.3	−2.5
3rd "	1.8	−7.3	0.1	0.6	0.6	0.7	1.2	−4.4	−0.5
4th "	1.0	2.2	1.5	0.8	0.1	0.3	0.9	4.5	1.1
1987 — 1st qtr.	1.0	0.8	0.6	0.6	0.5	0.4	1.0	−0.5	0.3
2nd "	1.8	3.8	2.0	1.0	0.7	0.7	1.3	5.8	2.8
3rd "	1.1	0.8	1.0	0.8	1.5	1.2	1.7	2.0	−1.0
4th "	1.4	−0.9	0.8	3.1	2.4	2.7	1.2	−4.6	1.8

Source: Istat, seasonally adjusted data.
(1) Government consumption and change in stocks.

Table a13

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)*				
1983	92.3	94.2	92.6	90.9	−51.2	−43.8	−49.0	−8.5	13.0
1984	95.4	96.3	94.4	95.2	−27.4	−26.7	−24.1	7.5	7.8
1985	96.5	97.5	99.2	94.9	−22.7	−29.7	−21.1	7.7	6.1
1986	99.2	101.1	103.1	96.5	−18.8	−23.9	−18.0	11.2	4.9
1987	103.1	104.9	105.2	101.1	−8.3	−25.3	−9.1	10.9	0.8
1983 — 1st qtr....	91.7	95.9	91.1	89.0	−57.0	−52.3	−57.7	−17.2	15.3
2nd " ...	91.0	93.4	90.8	89.4	−55.1	−42.9	−52.4	−11.7	17.7
3rd " ...	92.5	93.6	93.5	91.3	−49.7	−46.0	−46.0	−5.1	13.3
4th " ...	94.2	93.9	95.1	94.0	−42.9	−34.0	−39.8	−0.1	5.7
1984 — 1st qtr....	93.2	93.1	91.9	93.8	−34.7	−30.4	−31.4	5.5	11.3
2nd " ...	95.2	96.8	91.9	95.3	−28.7	−21.8	−24.7	9.6	6.7
3rd " ...	97.0	98.0	96.7	96.5	−25.0	−25.4	−21.4	7.7	8.7
4th " ...	96.2	97.3	97.0	95.2	−21.2	−29.3	−18.8	7.2	4.7
1985 — 1st qtr....	96.1	96.7	98.4	94.9	−23.0	−29.3	−21.5	7.3	6.0
2nd " ...	96.6	97.9	98.6	95.0	−26.1	−30.2	−23.4	6.1	8.3
3rd " ...	96.5	97.8	99.2	94.7	−20.0	−29.4	−18.7	8.9	5.3
4th " ...	96.9	97.7	100.6	95.0	−21.6	−30.0	−20.7	8.4	4.7
1986 — 1st qtr....	98.6	100.4	101.5	96.2	−24.7	−26.2	−22.2	9.0	4.3
2nd " ...	98.4	100.1	102.7	95.8	−16.4	−24.0	−18.0	11.6	8.7
3rd " ...	98.8	100.4	103.1	96.3	−18.3	−23.6	−16.8	11.7	4.0
4th " ...	100.8	103.4	105.0	97.6	−15.6	−21.8	−15.0	12.6	2.7
1987 — 1st qtr....	101.0	103.6	103.1	98.5	−12.0	−25.4	−12.2	13.2	4.0
2nd " ...	103.3	104.7	105.8	101.4	−9.8	−27.5	−11.4	9.7	1.7
3rd " ...	102.7	104.8	103.5	101.0	−7.9	−26.0	−8.1	10.1	−4.3
4th " ...	105.4	106.6	108.4	103.5	−3.6	−22.3	−4.6	10.6	−4.3
1988 — 1st qtr....	107.0	107.7	113.0	104.8	−2.3	−17.2	−1.9	9.6	−2.7
2nd " ...	106.4	106.4	112.7	103.3	0.2	−9.8	—	14.9	−7.0

Source: Based on Istat and Isco data.

(1) Industrial production data are also adjusted for variations in the number of working days. — (2) Raw data.

Table a14

Labour market statistics (1)

(seasonally adjusted data; thousands of units and percentages)

	EMPLOYMENT					Unem-ployment	Labour force	Unemployment rate (%)		Partici-pation rate (%)
	Agricul-ture	Industry excluding construc-tion	Construc-tion	Other	Total			(2)	(3)	
1983	2,525	5,290	2,062	10,680	20,557	2,263	22,821	9.9	11.8	40.6
1984	2,426	5,087	1,956	11,179	20,648	2,304	22,933	10.0	12.0	40.7
1985	2,297	4,975	1,921	11,550	20,742	2,382	23,117	10.3	12.1	40.9
1986	2,242	4,940	1,883	11,795	20,860	2,611	23,468	11.1	12.8	41.5
1987	2,169	4,867	1,849	11,952	20,837	2,832	23,669	12.0	13.3	41.8
1984 — 1st qtr.	2,463	5,141	1,974	10,996	20,573	2,338	22,911	10.2	12.1	40.7
2nd "	2,410	5,082	1,962	11,149	20,602	2,292	22,894	10.0	11.9	40.6
3rd "	2,390	5,032	1,939	11,362	20,724	2,272	22,996	9.9	12.0	40.8
4th "	2,326	4,993	1,943	11,438	20,700	2,304	23,004	10.0	12.1	40.8
1985 — 1st qtr.	2,283	4,972	1,959	11,471	20,685	2,328	23,012	10.1	12.2	40.7
2nd "	2,316	4,966	1,919	11,586	20,787	2,364	23,151	10.2	12.0	41.0
3rd "	2,312	4,977	1,885	11,627	20,801	2,434	23,235	10.5	12.0	41.1
4th "	2,307	4,952	1,906	11,662	20,826	2,497	23,323	10.7	12.3	41.3
1986 — 1st qtr.	2,265	4,961	1,901	11,733	20,859	2,564	23,423	10.9	12.6	41.4
2nd "	2,213	4,954	1,872	11,777	20,817	2,589	23,406	11.1	12.7	41.4
3rd "	2,220	4,919	1,867	11,857	20,863	2,655	23,519	11.3	12.7	41.5
4th "	2,230	4,920	1,853	11,919	20,923	2,734	23,657	11.6	13.0	41.8
1987 — 1st qtr.	2,219	4,865	1,850	11,928	20,862	2,759	23,621	11.7	13.0	41.7
2nd "	2,185	4,852	1,859	11,925	20,822	2,852	23,673	12.0	13.4	41.8
3rd "	2,121	4,868	1,849	11,975	20,812	2,904	23,716	12.2	13.5	41.8
4th "	2,086	4,887	1,819	12,087	20,879	2,884	23,762	12.1	13.2	41.9
1988 — 1st qtr.	2,107	4,940	1,826	12,235	21,108	2,898	24,005	12.1	13.1	42.3

Source: Based on Istat data.

(1) The annual data are the averages of the raw quarterly data and therefore do not necessarily coincide with the averages of the seasonally adjusted data. — (2) Ratio of unemployment to the labour force. — (3) Corrected for workers on wage supplementation.

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		
1982	14.8	14.8	12.9	13.9	16.4	15.7	17.5	16.5	16.4	16.0
1983	11.3	13.0	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	13.2	10.8	10.6	11.1
1985	8.4	7.8	6.5	7.3	8.7	8.6	10.4	9.2	8.6	8.4
1986	3.0	5.7	−5.4	−0.9	5.5	3.7	8.9	5.9	6.1	5.9
1987	3.4	6.1	1.2	2.6	4.3	4.5	5.6	4.7	4.6	5.4
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	6.1	6.4	5.5
3rd "	2.2	5.6	−7.4	−2.2	4.9	3.1	8.9	5.5	5.9	6.0
4th "	1.9	4.9	−7.5	−2.4	3.8	2.0	8.1	4.4	4.7	5.6
1987 — 1st qtr.	2.5	5.2	−4.0	−0.4	4.1	2.9	6.2	4.3	4.3	5.6
2nd "	3.3	5.9	0.8	2.4	4.2	3.8	5.4	4.4	4.2	5.3
3rd "	3.7	6.2	3.9	4.1	4.0	5.2	5.4	4.9	4.6	5.2
4th "	4.1	7.0	4.4	4.6	4.8	5.9	5.2	5.4	5.2	5.6
1988 — 1st qtr.	4.2	6.1	3.6	4.1	3.7	5.3	6.1	5.1	4.9	5.2
2nd "	4.7	5.4	3.9	4.4	3.6	5.1	6.2	5.0	4.9	5.0
3rd "									4.9	5.5
1987 — July	3.7	5.8	3.4	3.8	4.0	4.7	5.5	4.7	4.4	5.2
Aug.	3.3	6.1	4.4	4.1	4.0	5.0	5.4	4.8	4.5	5.0
Sept.	4.1	6.7	4.0	4.3	4.1	5.8	5.5	5.2	5.0	5.4
Oct.	4.1	6.9	4.2	4.5	5.1	5.8	5.4	5.5	5.3	5.6
Nov.	4.1	7.0	4.6	4.6	4.8	5.9	5.2	5.4	5.2	5.7
Dec.	4.2	7.2	4.5	4.7	4.6	5.9	4.8	5.2	5.1	5.6
1988 — Jan.	3.9	5.8	3.4	3.9	3.8	5.4	5.9	5.2	5.0	5.3
Feb.	4.4	6.6	3.5	4.2	3.7	5.3	6.1	5.0	4.9	5.1
Mar.	4.3	5.8	3.8	4.3	3.6	5.4	6.3	5.2	4.9	5.1
Apr.	4.8	5.4	3.6	4.4	3.7	5.3	6.3	5.1	5.0	5.0
May	4.6	5.4	3.9	4.5	3.4	5.1	6.1	5.0	4.9	5.0
June	4.6	5.3	4.3	4.5	3.6	4.8	6.2	5.0	4.9	5.0
July	4.6	5.5	4.4	4.7	3.9	4.6	6.1	5.0	4.9	5.2
Aug.	5.3	5.1	4.7	5.0					5.0	5.6
Sept.									4.8	5.7

Source: Istat.

Table a16

Italy's real exchange rates

(indices, 1980 = 100)

	With respect to:							
	Germany	France	UK	Belgium	Netherlands	US	EEC countries (1)	13 industrial countries (2)
1983	103.1	108.9	102.2	122.9	103.5	72.2	106.2	100.7
1984	106.6	110.8	104.4	128.0	105.2	67.4	109.1	102.0
1985	106.5	105.8	101.1	126.5	106.4	66.4	107.1	100.4
1986	103.7	104.3	109.4	126.2	114.9	88.6	107.0	103.1
1987	102.7	105.6	112.3	126.8	115.7	102.6	107.3	105.2
1986 — 1st qtr.	103.6	102.2	105.8	124.9	110.9	81.1	105.5	101.1
2nd "	103.3	103.8	102.3	124.9	114.2	85.4	105.7	101.5
3rd "	103.5	105.4	110.6	126.9	116.9	92.4	107.6	103.7
4th "	104.2	106.0	119.1	127.8	117.7	95.8	109.1	105.9
1987 — 1st qtr.	103.0	105.9	117.8	126.1	116.5	101.8	108.2	106.0
2nd "	102.4	105.1	111.2	126.0	115.3	102.3	106.9	104.7
3rd "	102.8	105.1	111.0	127.0	115.1	99.5	107.1	104.7
4th "	102.4	106.3	109.2	127.9	116.0	106.7	107.2	105.4
1988 — 1st qtr.	102.8	107.0	107.5	129.0	117.4	108.4	107.5	105.6
2nd "	102.5	106.6	101.9	129.1	117.2	105.5	106.6	104.4
1987 — Jan.	103.1	106.2	120.0	126.4	116.4	101.5	108.6	106.3
Feb.	102.9	105.8	119.6	126.0	117.0	102.3	108.3	106.2
Mar.	103.0	105.7	113.9	125.9	116.1	101.7	107.7	105.5
Apr.	103.0	105.6	112.5	126.5	116.4	102.8	107.6	105.3
May	102.0	104.9	110.2	125.7	115.2	103.1	106.5	104.4
June	102.2	104.9	110.8	125.9	114.3	100.9	106.6	104.3
July	102.1	104.4	110.4	126.1	114.4	98.8	106.4	104.1
Aug.	102.8	105.0	111.4	126.9	115.2	98.2	107.1	104.5
Sept.	103.5	105.9	111.1	128.1	115.8	101.6	107.8	105.4
Oct.	103.5	106.3	110.4	128.4	116.0	102.0	107.8	105.6
Nov.	101.7	106.1	108.6	127.2	115.3	107.3	106.7	105.0
Dec.	102.1	106.6	108.6	128.1	116.8	110.9	107.2	105.6
1988 — Jan.	102.8	106.9	109.0	128.9	117.4	110.1	107.7	106.0
Feb.	102.9	107.1	108.7	129.1	117.6	107.1	107.8	105.7
Mar.	102.6	106.9	104.8	129.0	117.2	108.0	107.1	105.2
Apr.	102.5	106.9	102.2	129.1	117.5	107.8	106.8	104.9
May	102.5	106.5	101.2	129.0	116.6	106.3	106.5	104.5
June	102.5	106.2	102.2	129.3	117.3	102.4	106.6	104.0
July	102.6	106.1	102.0	129.2	118.7	97.7	106.7	103.6
Aug. (3)	103.3	107.0	100.4	130.0	119.7	95.5	107.1	103.7

(1) Germany, France, the UK, Belgium, the Netherlands, Ireland and Denmark. — (2) The seven EEC countries plus the US, Canada, Japan, Switzerland, Sweden and Austria. — (3) Provisional and partly estimated data.

Table a17

Balance of payments on a settlements basis (1)

(billions of lire)

	Goods (2)	Services and transfers: Foreign travel	Services and transfers: Income from capital	Services and transfers: Other	Services and transfers: Total	Balance on current account	Non-bank capital flows plus errors and omissions	Balance of non-monetary transactions	Bank capital flows (3)	Change in official reserves (3)
1982	−17,189	8,928	−5,815	4,028	7,141	−10,048	7,527	−2,521	−3,062	5,583
1983	−9,177	10,954	−6,418	5,347	9,883	706	3,087	3,793	4,995	−8,788
1984	−18,352	11,412	−7,554	7,240	11,098	−7,254	7,311	57	5,138	−5,195
1985	−18,685	12,362	−8,496	7,058	10,924	−7,761	−591	−8,352	−5,299	13,651
1986	−4,716	10,353	−10,259	3,311	3,405	−1,311	−1,654	−2,965	6,454	−3,489
1987 (4)	−8,186	9,902	−9,873	5,013	5,042	−3,144	4,346	1,202	5,573	−6,775
1986 — May	−136	1,127	−802	344	669	533	1,022	1,555	2,182	−3,737
June	−345	1,240	−928	564	876	531	133	664	−378	−286
July	415	1,666	−778	406	1,294	1,709	−250	1,459	−567	−892
Aug.	1,375	1,120	−453	672	1,339	2,714	−2,011	703	−1,464	761
Sept.	−212	1,248	−683	450	1,015	803	−2,500	−1,697	−331	2,028
Oct.	340	920	−986	336	270	610	−1,261	−651	1,953	−1,302
Nov.	−258	481	−747	−292	−558	−816	683	−133	−550	683
Dec.	−1,435	528	−1,399	236	−635	−2,070	1,614	−456	20	436
1987 — Jan.	44	209	−716	1,071	564	608	−988	−380	619	−239
Feb.	−750	260	−949	673	−16	−766	2,208	1,442	2,377	−3,819
Mar.	−582	572	−627	−93	−148	−730	1,656	926	273	−1,199
Apr.	−526	886	−688	685	883	357	1,222	1,579	−883	−696
May	−1,565	942	−1,226	335	51	−1,514	−1,351	−2,865	1,011	1,854
June	−1,450	1,543	−876	1,061	1,728	278	−2,781	−2,503	788	1,715
July	26	1,664	−1,098	53	619	645	−535	110	−2,019	1,909
Aug.	−32	1,156	−502	398	1,052	1,020	−2,031	−1,011	−3,214	4,225
Sept.	−895	1,049	−653	520	916	21	1,151	1,172	2,973	−4,145
Oct.	−478	829	−847	270	252	−226	463	237	1,769	−2,006
Nov.	−1,394	417	−727	74	−236	−1,630	3,286	1,656	1,815	−3,471
Dec.	−617	377	−789	−182	−594	−1,211	2,050	839	64	−903
1988 — Jan.	−340	128	−746	842	224	−116	1,820	1,704	1,450	−3,154
Feb.	−1,195	171	−649	210	−268	−1,463	576	−887	−1,802	2,689
Mar.	−1,430	446	−755	−44	−353	−1,783	1,490	−293	−1,194	1,487
Apr.	−1,393	505	−947	−61	−503	−1,896	−1,146	−3,042	903	2,139
May	−2,074	982	−1,172	−241	−431	−2,505	1,652	−853	130	723
June	−783	1,222	−1,108	1,043	1,157	374	174	548	1,775	−2,323
July								3,581	161	−3.742
Aug.								3,049	−1,485	−1,564

(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 total does not coincide with the sum of the monthly totals because of the provisional nature of the data.

Table a18

External position of BI-UIC (1)

	Short-term position: Assets: Gold	Convertible currencies	ECUs	SDRs	Reserve position in the IMF	Liabilites	Balances (2)	Medium and long-term position	Total official reserves (2)
	(billions of lire)								
1984 — Dec.	41,887	23,794	13,159	1,346	2,079	−263	82,002	−189	81,813
1985 — Dec.	39,530	16,536	7,139	879	1,946	−205	65,825	−616	65,209
1986 — Dec.	35,203	14,340	10,158	1,085	1,713	−285	62,214	−803	61,411
1987 — Aug.	36,300	10,201	11,235	1,294	1,793	−159	60,664	−830	59,834
Sept. . . .	37,646	20,403	5,142	1,293	1,790	−87	66,187	−830	65,357
Oct.	37,646	16,211	12,193	1,286	1,718	−110	68,944	−839	68,105
Nov.	37,646	19,379	12,240	1,277	1,668	−117	72,093	−834	71,259
Dec.	39,812	20,307	12,220	1,253	1,691	−127	75,156	−859	74,297
1988 — Jan.	39,812	23,823	11,154	1,267	1,658	−35	77,679	−651	77,028
Feb.	39,812	24,260	11,167	1,260	1,668	−98	78,069	−195	77,874
Mar.	38,115	22,551	11,285	1,252	1,636	−120	74,719	215	74,934
Apr.	38,115	20,712	10,928	1,255	1,676	−180	72,506	238	72,744
May	38,115	20,521	10,939	1,279	1,693	−511	72,036	275	72,311
June	37,499	22,680	10,896	1,214	1,792	−143	73,938	314	74,252
July	37,499	26,866	10,895	1,232	1,818	−132	78,178	346	78,524
Aug.	37,499	28,499	10,906	1,245	1,751	−93	79,807	317	80,124
	(millions of dollars)								
1984 — Dec.	21,637	12,291	6,797	695	1,074	−136	42,359	−98	42,261
1985 — Dec.	23,558	9,855	4,254	524	1,160	−122	39,228	−367	38,861
1986 — Dec.	26,055	10,614	7,518	803	1,268	−211	46,047	−594	45,453
1987 — Aug.	27,366	7,762	8,549	985	1,364	−121	45,905	−632	45,273
Sept. . . .	28,387	15,385	3,877	975	1,350	−66	49,908	−626	49,282
Oct.	28,387	12,680	9,537	1,006	1,344	−86	52,868	−656	52,212
Nov.	28,387	16,031	10,125	1,056	1,380	−97	56,883	−690	56,193
Dec.	34,050	17,368	10,451	1,072	1,446	−109	64,278	−735	63,543
1988 — Jan.	34,050	19,292	9,032	1,026	1,343	−28	64,715	−527	64,187
Feb.	34,050	19,495	8,974	1,013	1,340	−79	64,793	−157	64,637
Mar.	30,965	18,321	9,168	1,017	1,329	−97	60,703	175	60,877
Apr.	30,965	16,677	8,799	1,010	1,349	−145	58,656	192	58,847
May	30,965	16,033	8,546	999	1,323	−399	57,467	215	57,682
June	27,741	16,778	8,061	898	1,326	−106	54,697	232	54,930
July	27,741	19,379	7,858	889	1,311	−95	57,082	250	57,331
Aug.	27,741	20,473	7,835	894	1,258	−67	58,135	228	58,362

(1) Data for the last 2 months are provisional. — (2) The dollar values may not coincide with the sum of the single components because of rounding.

Table a19

State sector borrowing requirement (1)

(billions of lire)

	Budget revenues			Budget disbursements							
	Fiscal	Other	Total	Current expenditure	Capital expenditure	Total	Deficit (–)	Other transactions (2)	Borrowing requirement (–)	Borrowing requirement net of debt settlements in securities	of which: settlements of past debts in cash
1982	114,047	38,142	152,189	–173,474	–35,440	–208,914	–56,725	–16,074	–72,799	–72,087	–1,298
1983	143,554	34,014	177,568	–199,549	–50,842	–250,391	–72,823	–15,436	–88,260	–88,260	—
1984	160,627	39,082	199,709	–243,884	–48,761	–292,645	–92,936	–2,759	–95,695	–95,695	—
1985	177,645	43,945	221,590	–279,239	–54,988	–334,227	–112,637	–9,990	–122,627	–112,224	–2,188
1986	202,090	51,779	253,869	–307,338	–63,681	–371,019	–117,150	6,987	–110,163	–110,163	–606
1987	224,676	56,858	281,534	–334,017	–67,252	–401,269	–119,735	5,523	–114,212	–113,791	–132
1986 — 1st qtr.	42,727	6,972	49,699	–62,457	–1,650	–64,107	–14,408	–11,951	–26,359	–26,359	–337
2nd "	55,143	10,592	65,735	–68,946	–14,814	–83,760	–18,025	–1,952	–19,976	–19,976	–79
3rd "	37,669	10,794	48,463	–86,615	–17,475	–104,090	–55,627	19,415	–36,212	–36,212	–127
4th "	66,552	23,421	89,973	–89,320	–29,743	–119,063	–29,090	1,474	–27,616	–27,616	–64
1987 — 1st qtr.	44,612	10,613	55,225	–68,048	–11,776	–79,824	–24,599	–287	–24,886	–24,886	–41
2nd "	59,020	9,552	68,572	–95,363	–12,683	–108,046	–39,474	17,584	–21,890	–21,890	–31
3rd "	43,265	11,815	55,080	–70,762	–17,195	–87,957	–32,877	–5,585	–38,462	–38,319	–33
4th "	77,778	24,879	102,657	–99,844	–25,598	–125,442	–22,785	–6,190	–28,974	–28,696	–27
1988 — 1st qtr.	50,455	6,959	57,414	–64,976	–1,558	–66,534	–9,121	–17,773	–26,894	–26,894	–40
2nd "	66,509	10,177	76,686	–83,865	–14,222	–98,087	–21,401	–3,058	–24,459	–24,398	–19
3rd " (3)	49,263	18,533	67,796	–112,892	–17,302	–130,194	–62,399	19,626	–42,773	–42,773	–4
1987 — Oct.	19,339	4,304	23,643	–25,590	–3,598	–29,188	–5,546	–3,173	–8,719	–8,719	–15
Nov.	18,441	2,684	21,125	–29,032	–2,127	–31,159	–10,034	–2,313	–12,347	–12,347	–3
Dec.	39,998	17,892	57,890	–45,222	–19,873	–65,095	–7,205	–703	–7,908	–7,630	–9
1988 — Jan.	18,383	1,949	20,332	–16,357	–216	–16,573	3,759	–4,059	–300	–300	–9
Feb.	15,092	2,339	17,431	–17,554	–248	–17,802	–372	–10,709	–11,081	–11,081	–25
Mar.	16,979	2,672	19,651	–31,065	–1,094	–32,159	–12,508	–3,006	–15,514	–15,514	–6
Apr.	16,107	3,056	19,163	–20,828	–3,716	–24,544	–5,381	–6,758	–12,139	–12,139	–17
May	21,907	4,018	25,925	–30,638	–6,637	–37,275	–11,350	–20	–11,370	–11,309	–2
June	28,495	3,103	31,598	–32,400	–3,868	–36,268	–4,670	3,720	–950	–950	—
July	16,689	3,012	19,701	–23,679	–8,980	–32,659	–12,958	–766	–13,724	–13,724	—
Aug.	18,135	11,051	29,186	–46,775	–5,015	–51,790	–22,605	11,801	–10,804	–10,804	—
Sept. (3)	14,439	4,470	18,909	–42,438	–3,307	–45,745	–26,836	8,591	–18,245	–18,245	–4

(1) Rounding may cause discrepancies in totals. — (2) Minor Treasury operations and those of the Deposits and Loans Fund, the autonomous government agencies, the State Railways and the Southern Italy Development Agency. — (3) Provisional and partly estimated data.

Table a20

Financing of the state sector borrowing requirement (1)

(billions of lire)

	Medium and long-term securities: Total	Medium and long-term securities: of which: floating rate Treasury credit certificates	Treasury bills	BI-UIC financing other than securities purchases: Total	BI-UIC financing other than securities purchases: of which: Treasury overdraft with BI	PO deposits	Foreign loans	Other	Borrowing requirement	of which: creation of monetary base (2)
1982	23,473	27,378	32,604	8,883	6,598	3,683	2,570	1,586	72,799	12,676
1983	69,315	66,652	11,071	−1,125	−8,622	4,939	1,259	2,801	88,260	4,514
1984	62,763	56,738	9,300	13,288	18,555	6,365	2,271	1,709	95,695	10,027
1985	93,207	78,567	13,181	3,689	6,340	9,067	2,937	545	122,627	27,519
1986	87,073	53,534	9,697	1,673	4,525	11,271	856	−407	110,163	10,994
1987	56,090	35,268	27,482	10,224	9,274	12,879	6,067	1,470	114,212	9,240
1986 — 1st qtr.......	17,909	11,345	−2,039	9,572	8,266	1,311	−114	−279	26,359	11,084
2nd "	31,584	19,888	400	−12,839	−10,806	271	313	248	19,976	−10,802
3rd "	15,519	7,517	10,352	9,367	9,126	1,216	252	−494	36,212	3,229
4th "	22,061	14,785	984	−4,427	−2,061	8,474	406	118	27,616	7,484
1987 — 1st qtr.......	22,637	16,410	−6,986	7,632	6,596	2,045	475	−917	24,886	1,682
2nd "	21,588	8,425	1,562	−2,015	−1,490	975	421	−641	21,890	2,501
3rd "	12,158	9,600	19,795	3,255	3,452	2,022	541	690	38,462	9,403
4th "	−293	833	13,110	1,353	715	7,837	4,630	2,338	28,974	−4,346
1988 — 1st qtr.......	11,638	7,519	6,468	5,698	5,843	2,607	748	−264	26,894	475
2nd "	13,151	−534	13,025	−1,553	−1,626	247	256	−668	24,459	−451
3rd " (3) ...	12,064	−9,701	22,004	2,547	3,522	1,167	1,917	3,074	42,773	3,465
1987 — Oct.	376	891	7,723	−2,344	−2,703	85	1,395	1,484	8,719	−3,489
Nov.	291	445	5,897	2,156	2,279	971	2,912	120	12,347	−2,012
Dec.	−960	−503	−509	1,541	1,140	6,781	322	734	7,908	1,155
1988 — Jan.	3,954	4,965	−1,362	−4,971	−4,237	2,983	308	−612	300	490
Feb.	1,456	2,077	4,899	4,132	3,400	507	359	−272	11,081	−3,505
Mar.	6,228	478	2,931	6,537	6,680	−883	81	620	15,514	3,489
Apr.	7,726	−408	6,637	−1,656	−2,342	−187	−117	−264	12,139	586
May	4,995	−15	2,386	4,136	4,675	337	252	−736	11,370	2,204
June	430	−111	4,001	−4,032	−3,959	98	121	332	950	−3,241
July	2,971	−1,762	7,581	331	1,280	559	1,542	740	13,724	2,812
Aug.	1,033	−3,657	7,129	1,041	1,161	650	439	513	10,804	−4,297
Sept. (3)	8,061	−4,282	7,294	1,175	1,080	−42	−64	1,821	18,245	4,950

(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 27.9.1974. — (3) Provisional and partly estimated data.

Table a21

The domestic public debt (1)

(face value; billions of lire)

	Medium and long-term securities excluding BI portfolio	Treasury bills in lire and ECUs 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
1981 — Dec. . . .	55,802	98,357	35,639	18,420	1,779	209,997	66,555	276,552	261,178
1982 — Dec. . . .	80,895	127,395	39,322	23,613	1,938	273,164	78,670	351,834	332,540
1983 — Dec. . . .	149,876	137,772	44,261	29,312	2,147	363,369	79,630	442,999	421,238
1984 — Mar. . . .	165,970	134,604	45,867	30,616	2,196	379,252	82,914	462,166	439,658
June . . .	182,600	140,249	45,970	32,570	2,246	403,634	80,740	484,374	459,893
Sept. . .	194,492	149,936	46,440	34,314	2,290	427,472	83,208	510,680	484,483
Dec. . . .	207,892	152,691	50,626	38,024	2,379	451,611	92,863	544,474	516,215
1985 — Mar. . . .	230,724	146,955	52,141	38,837	2,429	471,086	102,991	574,077	545,794
June . . .	251,003	159,816	52,409	37,357	2,434	503,018	102,664	605,682	577,457
Sept. . .	273,513	165,217	52,399	35,940	2,457	529,526	106,015	635,540	609,645
Dec. . . .	294,961	150,814	59,693	35,925	2,451	543,843	120,286	664,130	639,266
1986 — Mar. . . .	306,585	153,075	61,004	34,931	2,384	557,978	131,536	689,514	666,148
June . . .	335,811	154,261	61,274	35,712	2,399	589,458	120,596	710,054	686,204
Sept. . .	359,336	163,507	62,490	34,723	2,457	622,514	123,504	746,017	722,491
Dec. . . .	374,454	159,187	70,964	37,444	2,475	644,524	130,954	775,478	750,716
1987 — Mar. . . .	402,094	154,059	73,009	36,788	2,515	668,465	132,528	800,993	776,419
June . . .	419,910	156,222	73,985	37,639	2,566	690,322	135,268	825,590	799,298
Sept. . .	429,284	172,444	76,007	36,302	2,628	716,664	144,447	861,111	837,509
Dec. . . .	429,742	191,427	83,843	40,847	2,619	748,479	137,968	886,447	861,895
1988 — Jan. . . .	427,337	193,045	86,826	40,795	2,655	750,658	136,513	887,171	862,036
Feb. . . .	433,060	201,130	87,333	40,371	2,648	764,543	132,890	897,433	872,839
Mar. . . .	442,742	204,162	86,450	40,036	2,650	776,040	136,233	912,273	888,359
Apr. . . .	450,020	209,131	86,263	40,484	2,666	788,563	136,795	925,358	901,110
May . . .	456,910	211,902	86,600	40,488	2,714	798,614	138,791	937,404	912,300
June . . .	456,145	216,430	86,697	40,729	2,722	802,723	135,603	938,327	913,118

(1) Rounding may cause discrepancies in totals.

Table a22.1

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: undrawn overdraft facility*	Refinancing	Other sectors
1984 — Dec.	22,691	91,271	40,245	41,842	*1,282*	2,882	−6,569
1985 — Dec.	9,013	118,774	64,019	48,182	*2,960*	8,763	−7,199
1986 — Dec.	12,557	129,728	73,285	52,707	*5,054*	4,429	−8,163
1987 — Sept.	12,885	143,313	77,884	61,266	*702*	3,260	−14,559
Oct.	14,927	139,825	76,765	58,562	*4,330*	3,363	−11,754
Nov.	18,361	137,813	72,585	60,841	*2,093*	4,052	−12,796
Dec.	19,313	138,548	71,781	61,981	*1,101*	3,699	−9,064
1988 — Jan.	22,455	139,038	77,221	57,744	*11,568*	5,197	−9,089
Feb.	23,191	135,534	69,584	61,144	*8,219*	5,032	−9,910
Mar.	21,610	139,023	66,540	67,824	*1,773*	3,745	−10,698
Apr.	19,563	139,610	68,775	65,482	*4,180*	4,038	−11,382
May	18,828	141,813	66,818	70,157	*−449*	3,690	−11,801
June	21,033	138,572	67,605	66,198	*3,522*	3,724	−9,638
July (2)	24,775	141,384	70,086	67,478	*2,291*	3,765	−10,954
Aug. (2)	26,339	137,087	64,741	68,639	*1,682*	3,534	−10,142
Sept. (2)	24,388	142,037	68,516	69,719	*723*	3,523	−10,985

	USES						
	Non-state sector		Banks				TOTAL MONETARY BASE
	Total	of which: notes and coin	Compulsory reserves	Deposit against overshoots of lending ceiling	Liquidity	Total	
1984 — Dec.	41,225	41,195	63,872	—	5,178	69,050	110,275
1985 — Dec.	45,227	44,997	76,086	—	8,038	84,123	129,351
1986 — Dec.	48,371	48,197	85,107	—	5,072	90,180	138,551
1987 — Sept.	47,776	47,573	92,515	—	4,608	97,123	144,899
Oct.	47,826	47,666	93,414	648	4,473	98,535	146,361
Nov.	48,132	47,966	94,233	328	4,738	99,299	147,430
Dec.	52,757	52,640	93,847	657	5,235	99,739	152,496
1988 — Jan.	50,276	50,176	102,382	1,205	3,737	107,324	157,600
Feb.	48,980	48,831	99,540	1,622	3,704	104,866	153,846
Mar.	50,078	49,966	97,617	1,588	4,396	103,602	153,680
Apr.	49,618	49,465	97,152	1,686	3,373	102,212	151,829
May	49,535	49,430	97,878	3	5,114	102,995	152,530
June	51,164	51,036	97,536	1	4,990	102,527	153,691
July (2)	54,810	54,724	99,793	1	4,367	104,161	158,971
Aug. (2)	51,404	51,312	101,064	1	4,349	105,415	156,819
Sept. (2)	52,108	51,995	100,991	—	5,865	106,856	158,964

(1) Rounding may cause discrepancies in totals. — (2) Provisional.

Monetary base (1)

(changes in billions of lire)

	Foreign sector	Treasury	Refinancing	Other	Total	Non-state sector	Banks: Compulsory reserves	Banks: Deposits against ceiling overshoots	Banks: Liquidity
1984	5,141	10,027	−218	−1,103	13,847	3,861	8,855	−2	1,133
1985	−13,677	27,519	5,881	−647	19,076	4,002	12,213	—	2,860
1986	3,543	10,994	−4,334	−1,004	9,200	3,143	9,022	—	−2,965
1987	6,756	9,240	−730	−1,321	13,946	4,386	8,740	657	162
1987 — Sept.	4,130	1,045	−770	−3,871	535	209	−531	—	857
Oct.	2,042	−3,489	103	2,805	1,462	50	899	648	−135
Nov.	3,434	−2,012	689	−1,043	1,069	306	819	−321	265
Dec.	952	1,155	−353	3,313	5,066	4,626	−385	329	496
1988 — Jan.	3,142	490	1,497	−25	5,104	−2,481	8,535	548	−1,498
Feb.	736	−3,504	−165	−821	−3,755	−1,297	−2,842	417	−33
Mar.	−1,581	3,489	−1,287	−788	−167	1,098	−1,923	−34	692
Apr.	−2,047	587	293	−684	−1,851	−461	−465	98	−1,023
May	−735	2,203	−348	−419	701	−82	726	−1,684	1,741
June	2,205	−3,241	34	2,163	1,161	1,629	−342	−2	−124
July (2)	3,742	2,812	41	−1,316	5,279	3,645	2,257	—	−623
Aug. (2)	1,564	−4,297	−231	812	−2,152	−3,406	1,271	—	−17
Sept. (2)	−1,951	4,950	−11	−843	2,145	704	−74	−1	1,516

Monetary base financing of the Treasury

(billions of lire)

	Borrowing requirement	Net sales of securities: Primary market (3): Treasury bills	Primary market (3): Treasury credit certificates	Primary market (3): Other	Open market (3): Total	Open market (3): of which: repurchase agreements	Total	Other forms of non-monetary financing	Monetary financing
1984	95,695	−13,187	−54,436	−2,796	−5,012	2,661	−75,431	−10,237	10,027
1985	122,627	1,802	−68,695	−14,504	−1,480	4,933	−82,877	−12,231	27,519
1986	110,163	−6,455	−47,664	−31,522	−1,823	1,913	−87,463	−11,706	10,994
1987	114,212	−19,353	−31,207	−20,160	−13,936	4,140	−84,657	−20,316	9,240
1987 — Sept.	15,073	−5,896	−1,165	−1,214	−4,800	−6,088	−13,075	−952	1,045
Oct.	8,719	−5,070	−837	−475	−2,835	−1,729	−9,217	−2,991	−3,489
Nov.	12,347	−4,615	−878	−991	−3,884	−1,920	−10,369	−3,990	−2,012
Dec.	7,908	492	−219	−303	1,115	1,609	1,086	−7,839	1,155
1988 — Jan.	300	2,174	−5,041	−478	6,194	9,172	2,849	−2,659	490
Feb.	11,081	−4,846	−2,004	−541	−6,601	−5,216	−13,992	−593	−3,504
Mar.	15,513	−1,997	−9	−6,306	−3,891	−5,131	−12,203	179	3,489
Apr.	12,139	−2,876	366	−8,614	1,003	50	−12,127	575	587
May	11,370	−1,174	−162	−4,666	−3,338	−3,425	−9,340	174	2,203
June	950	−2,459	−59	−2,109	982	2,525	−3,645	−546	−3,241
July (2)	13,724	−5,241	2,353	−5,317	134	33	−8,071	−2,841	2,812
Aug. (2)	10,804	−4,043	3,731	−5,756	−7,439	−4,761	−13,507	−1,594	−4,297
Sept. (2)	18,245	−8,428	5,238	−11,991	3,601	3,719	−11,580	−1,715	4,950

(1) Rounding may cause discrepancies in totals. — (2) Provisional. — (3) Open market sales of securities excluding those made in connection with advances granted under the Ministerial Decree of 27.9.1974.

BI-UIC operations in government securities (1)

(billions of lire)

	Primary market		Open market				Variations in BI-UIC portfolio
				of which: repurchase agreements			
	Subscriptions	Redemptions	Total	Financing subscriptions	Other purchases	Sales	
			Treasury bills				
1984	12,597	16,484	–5,947	636	—	780	–9,834
1985	25,547	10,565	35	–386	1,075	–1,200	15,018
1986	24,420	21,177	–1,841	1,797	–320	—	1,402
1987	31,838	26,021	–10,332	–1,035	–501	—	–4,515
1987 — Sept.	4,800	2,804	–473	–338	–231	—	1,523
Oct.	4,197	1,960	–3,210	–979	—	—	–973
Nov.	4,090	3,943	–2,895	–265	—	—	–2,748
Dec.	486	1,263	–1,109	–721	254	—	–1,886
1988 — Jan.	—	326	–2,398	454	–166	—	–2,724
Feb.	872	1,959	–2,258	–623	38	—	–3,345
Mar.	5,000	4,066	–982	–831	–126	—	–48
Apr.	4,831	2,614	–355	1,300	—	—	1,862
May	1,889	676	–1,576	–1,462	—	—	–363
June	—	—	–272	1,176	—	—	–272
July (2)	3,733	1,393	–266	282	—	—	2,074
Aug. (2)	2,230	300	–3,192	–670	—	—	–1,262
Sept. (2)	1,331	2,465	–862	–225	—	—	–1,996
			Treasury credit certificates				
1984	6,993	4,691	1,128	—	—	–2,805	3,430
1985	9,963	92	749	—	2,551	–455	10,620
1986	8,051	2,182	–174	—	–136	—	5,696
1987	5,868	2,108	–2,590	—	–2,415	—	1,169
1987 — Sept.	966	—	–3,875	—	–4,652	—	–2,909
Oct.	54	—	1	—	–645	—	55
Nov.	151	584	–1,356	—	—	1,655	–1,789
Dec.	18	739	1,962	—	—	–1,655	1,241
1988 — Jan.	4	81	7,631	—	7,988	—	7,554
Feb.	106	43	–3,768	—	–3,660	—	–3,705
Mar.	479	17	–2,907	—	–3,023	1,000	–2,445
Apr.	56	98	–432	—	–1,305	–250	–474
May	16	188	–1,803	—	—	2,000	–1,975
June	60	280	1,262	—	126	–1,200	1,042
July (2)	584	10	410	—	–5	234	984
Aug. (2)	91	10	–4,150	—	10	4,101	–4,069
Sept. (2)	988	—	4,424	—	–42	–4,036	5,412

(1) Final figures are given at book values. The portfolio variations differ from those given by the BI-UIC accounts since they do not include sales of securities made to supply collateral for advances granted under the Ministerial Decree of 27.9.1974. — (2) Provisional.

BI-UIC operations in government securities (1)

(billions of lire)

	Primary market		Open market				Variations in BI-UIC portfolio
				of which: repurchase agreements			
	Subscrip-tions	Redemptions	Total	Financing of subscriptions	Other purchases	Sales	
			Other government securities				
1984	5,806	2,578	–193	—	—	—	3,036
1985	3,912	3,496	–2,264	—	38	—	–1,847
1986	6,638	4,620	191	—	572	—	2,209
1987	5,704	2,429	–1,013	—	–189	—	2,261
1987 — Sept.	540	—	–452	—	–867	—	88
Oct.	67	641	375	—	–105	—	–199
Nov.	—	10	367	—	—	—	357
Dec.	—	—	261	—	421	—	261
1988 — Jan.	—	352	962	—	896	—	610
Feb.	1,025	1,037	–575	—	–971	—	–587
Mar.	80	629	–2	—	–151	—	–551
Apr.	1,064	—	–216	—	–195	—	848
May	1,344	1,004	40	—	37	—	380
June	24	—	–7	—	23	—	17
July (2)	353	920	–10	—	–10	—	–577
Aug. (2)	83	—	–97	—	—	—	–14
Sept. (2)	320	—	39	—	....	....	359
				TOTAL			
1984	25,396	23,753	–5,012	636	—	–2,025	–3,368
1985	39,423	14,153	–1,480	–386	3,664	–1,655	23,790
1986	39,109	27,979	–1,823	1,797	116	—	9,307
1987	43,410	30,558	–13,936	–1,035	–3,105	—	–1,084
1987 — Sept.	6,306	2,804	–4,800	–338	–5,750	—	–1,298
Oct.	4,318	2,601	–2,834	–979	–750	—	–1,117
Nov.	4,241	4,537	–3,884	–265	—	1,655	–4,180
Dec.	504	2,002	1,114	–721	675	–1,655	–384
1988 — Jan.	4	759	6,195	454	8,718	—	5,440
Feb.	2,003	3,039	–6,601	–623	–4,593	—	–7,637
Mar.	5,559	4,712	–3,891	–831	–3,300	1,000	–3,044
Apr.	5,951	2,712	–1,003	1,300	–1,500	–250	2,236
May	3,249	1,868	–3,339	–1,462	37	2,000	–1,958
June	84	280	983	1,176	149	–1,200	787
July (2)	4,670	2,323	134	282	–15	234	2,481
Aug. (2)	2,404	310	–7,439	–6.70	10	4,101	–5,345
Sept. (2)	2,639	2,465	3,601	–225	–92	–4,036	3,775

(1) Final figures are given at books values. The portfolio variations differ from those given by the BI-UIC accounts since they do not include sales of securities made to supply collateral for advances granted under the Ministerial Decree of 27.9.1974. — (2) Provisional.

Repurchase agreements

(billions

Temporary purchases (2)

	Amount offered	Amount taken up	Maturity (days)	Yields: Minimum	Yields: Weighted average
1987					
5 Jan.	1,000	1,000	7	13.50	13.58
14 "	1,250	1,250	6-19	13.25	13.37
15 "	4,000	4,000	15-18	12.00	12.19
23 "	3,750	3,750	5-10	11.85	12.13
26 "	7,000	7,000	4-8	11.50	11.78
30 "	3,000	3,000	17-28	11.90	11.96
2 Feb.	1,500	1,500	18-25	12.35	12.40
4 "	3,750	3,750	5-23	11.00	11.03
13 "	2,000	2,000	3-17	10.75	10.78
20 "	3,500	3,500	3-10	10.75	10.88
25 "	3,500	3,500	2-22	10.70	10.82
27 "	1,250	1,250	17-31	10.90	11.14
19 May	750	750	13	12.05	12.20
25 "	3,500	3,500	2-7	10.50	10.62
29 "	1,000	1,000	17-24	11.50	11.92
5 June	2,000	2,000	13-14	12.15	12.35
8 "	1,500	1,500	3-8	11.55	11.84
25 "	2,000	2,000	6-7	11.80	11.84
23 July	2,250	2,250	7-12	10.55	10.71
27 "	2,000	2,000	3	11.05	11.28
30 "	2,000	2,000	4-5	12.15	12.15
5 Aug.	750	750	6	12.55	12.84
11 "	1,000	1,000	7-13	12.85	12.92
13 "	2,750	2,750	6-18	12.55	13.13
25 "	5,500	5,500	7-17	12.55	12.89
31 "	1,000	1,000	8	12.65	12.80
24 Sept.	1,500	1,500	5-7	12.65	12.87
1 Dec.	1,000	1,000	20-29	11.05	11.15
4 "	10,000	10,000	4-14	11.30	11.63
7 "	2,750	2,750	2-9	10.75	11.24
15 "	1,000	1,000	15-20	10.90	11.28
1988					
22 Jan.	8,000	8,000	1-9	10.90	11.48
25 "	5,500	5,500	2-4	10.85	11.13
28 "	7,000	7,000	3-10	10.95	11.46
2 Feb.	2,000	2,000	21	11.55	11.55
3 "	2,000	2,000	7-15	11.25	11.53
8 "	3,500	3,500	2-11	11.25	11.32
23 "	1,000	1,000	7	11.90	11.90
25 "	4,000	4,000	4-5	11.85	11.93
4 Mar.	2,750	2,750	2-7	12.05	12.19
17 "	1,500	1,500	15	13.10	13.13

(1) Purchases at Treasury bill auctions by the syndicate of Bank of Italy is prepared to finance. — (2) Repurchase agreements based on

Table a24

by the Bank of Italy

of lire)

Financing of purchases at Treasury bill auctions (3)

	Maximum amount (1)	Actual amount	Maturity (days)
1987			
15 Dec.	994	316	15
30 "	7,740	1,577	5
1988			
13 Jan.	2,652	911	16
29 "	9,931	1,626	5
15 Feb.	3,397	1,081	14
29 "	7,016	1,173	2
15 Mar.	446	741	16
30 "	4,028	675	2
29 Apr.	5,536	1,642	3
16 May	1,334	300	1
30 "	3,642	180	2
15 June	1,476	270	6
30 "	7,863	1,356	1
15 July	1,661	391	5
29 "	7,528	1,638	4
16 Aug.	2,072	—	2
30 "	6,250	968	1
15 Sept.	2,193	379	6
30 "	8,462	743	3
14 Oct.	1,889	453	6

Temporary sales (2)

	Amount offered	Amount taken up	Maturity (days)	Yields	
				Maximum	Weighted average
1988					
1 June	3,000	3,000	5	11.30	11.05
9 "	1,000	1,000	21	11.80	11.51
10 "	1,500	1,500	34	12.50	12.16
13 "	2,000	2,000	17	12.45	12.31
14 "	1,500	1,500	13-16	12.40	12.27
16 "	1,000	1,000	11-14	12.05	11.92
17 "	1,500	1,500	10-13	12.00	11.74
20 "	1,250	1,250	7-10	11.95	11.71
21 "	1,500	1,500	9	12.00	11.52
1 July	4,000	4,000	24-28	11.05	10.71
4 "	2,500	2,500	22-25	12.10	11.89
6 "	1,750	1,750	20-23	12.40	12.22
7 "	1,000	1,000	18-22	11.90	11.76
13 "	2,500	2,500	6-16	12.15	11.92
19 "	1,250	1,250	6-10	12.20	12.06
21 "	1,500	1,500	4-8	11.75	11.41
27 "	1,750	1,750	8-34	12.00	11.85
4 Aug.	4,500	4,500	12-26	12.10	11.85
5 "	1,000	868	11-25	12.10	12.00
16 "	2,750	2,750	9-14	11.95	11.55
19 "	1,500	1,500	6-11	11.90	11.72
23 "	1,500	910	2-8	12.10	12.02
30 "	3,000	3,000	16-31	12.00	11.81
31 "	2,750	2,750	15-30	11.65	11.55
2 Sept.	4,000	4,000	28	10.90	10.71
6 "	1,000	1,000	20-24	12.00	11.82
7 "	1,500	1,500	19-23	12.25	12.01
8 "	500	500	18-22	12.05	11.97
13 "	1,750	1,750	13-17	12.10	11.96
16 "	1,000	1,000	7	10.75	10.42
21 "	1,000	1,000	2-9	12.50	12.04
28 "	750	750	28-33	11.50	11.29
29 "	1,000	1,000	27-32	11.30	11.19
3 Oct.	8,500	8,500	22-28	10.55	10.32
4 "	4,000	4,000	21-27	10.75	10.49
6 "	1,000	1,000	19-25	12.00	11.79
14 "	1,000	1,000	3-17	11.95	11.41

competitive bid auctions. — (3) The rate applied is that of the auction corresponding to the date of transaction.

9

Treasury bill auctions

(face value; billions of lire)

	Bills offered	Maturity (days)	Demand for bills from banks and the private sector	Bills allotted at auction: To banks and the private sector: Competitive bid	Other	Subscribed by BI-UIC	Total
3-month							
1988 — mid- Mar. . .	1,250	92	1,055	1,050	4	—	1,054
end- Mar. . .	6,500	92	5,729	5,720	9	—	5,729
mid- Apr. . .	2,500	91	1,990	1,988	1	500	2,489
end- Apr. . .	8,500	91	8,169	8,161	8	331	8,500
mid- May . .	2,000	92	1,940	1,940	—	—	1,940
end- May . .	8,500	92	5,941	5,939	2	300	6,241
mid- June . .	1,000	92	1,069	1,000	—	—	1,000
end- June . .	5,500	92	7,150	5,495	5	—	5,500
mid- July . . .	3,250	91	4,470	2,545	5	700	3,250
end- July . . .	10,500	94	12,748	9,828	5	667	10,500
mid- Aug. . .	3,250	91	5,413	3,226	24	—	3,250
end- Aug. . .	8,000	92	15,517	7,998	2	—	8,000
mid- Sept. . .	2,500	91	5,188	2,500	—	—	2,500
end- Sept. . .	8,250	91	14,603	8,248	2	—	8,250
mid- Oct. . .	4,000	94	2,975	2,845	—	1,155	4,000
6-month							
1988 — mid- Mar. . .	3,000	184	1,989	1,984	5	600	2,589
end- Mar. . .	11,500	184	9,617	9,600	16	1,750	11,366
mid- Apr. . .	3,000	182	1,996	1,996	—	800	2,796
end- Apr. . .	12,000	185	10,465	10,454	11	1,000	11,465
mid- May . .	2,500	183	2,054	2,054	—	446	2,500
end- May . .	9,500	184	8,807	8,801	6	500	9,307
mid- June . .	1,500	183	2,593	1,500	—	—	1,500
end- June . .	10,000	183	12,966	9,987	13	—	10,000
mid- July . . .	3,500	185	3,037	3,034	3	400	3,437
end- July . . .	11,500	185	11,234	11,228	6	226	11,460
mid- Aug. . .	3,000	182	2,543	2,539	3	300	2,842
end- Aug. . .	11,000	182	9,332	9,328	4	1,200	10,532
mid- Sept. . .	2,750	181	2,364	2,364	—	386	2,750
end- Sept. . .	12,000	181	11,055	11,052	3	945	12,000
mid- Oct. . .	2,000	182	2,490	2,000	—	—	2,000
12-month							
1988 — mid- Mar. . .	2,750	365	1,412	1,406	6	900	2,312
end- Mar. . .	10,500	365	7,913	7,901	12	1,750	9,663
mid- Apr. . .	3,000	364	1,610	1,609	—	1,200	2,809
end- Apr. . .	9,000	364	7,392	7,382	10	1,000	8,392
mid- May . .	1,500	364	1,207	1,207	—	293	1,500
end- May . .	6,500	365	5,906	5,899	7	350	6,256
mid- June . .	1,000	365	1,071	1,000	—	—	1,000
end- June . .	7,500	365	7,136	7,129	7	—	7,136
mid- July . . .	1,500	364	1,428	1,427	1	—	1,428
end- July . . .	10,000	367	8,006	7,997	9	1,700	9,706
mid- Aug. . .	1,750	365	1,413	1,413	—	300	1,713
end- Aug. . .	7,500	366	7,070	7,066	4	430	7,500
mid- Sept. . .	2,250	365	2,268	2,250	—	—	2,250
end- Sept. . .	9,000	364	10,472	8,991	9	—	9,000
mid- Oct. . .	2,000	367	3,160	2,000	—	—	2,000

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-month				
1988 — mid- Mar.	97.46	97.48	10.34	10.26	10.05	10.75	10.66	10.43
end- Mar.	97.46	97.47	10.34	10.30	10.09	10.75	10.70	10.48
mid- Apr.	97.50	97.50	10.28	10.28	10.07	10.69	10.69	10.46
end- Apr.	97.50	97.51	10.28	10.24	10.03	10.69	10.64	10.42
mid- May	97.47	97.47	10.30	10.30	10.09	10.70	10.70	10.48
end- May	97.47	97.47	10.30	10.30	10.09	10.70	10.70	10.48
mid- June	97.47	97.47	10.30	10.30	10.09	10.70	10.70	10.48
end- June	97.47	97.51	10.30	10.13	9.92	10.70	10.52	10.30
mid- July	—	97.36	—	10.88	10.66	—	11.33	11.10
end- July	—	97.23	—	11.06	10.86	—	11.52	11.30
mid- Aug.	—	97.29	—	11.17	10.96	—	11.65	11.42
end- Aug.	—	97.31	—	10.97	10.76	—	11.43	11.20
mid- Sept. ...	—	97.34	—	10.96	10.75	—	11.42	11.19
end- Sept. ...	—	97.43	—	10.58	10.37	—	11.01	10.78
mid- Oct.	—	97.30	—	10.77	10.57	—	11,21	10.99
				6-month				
1988 — mid- Mar.	94.96	94.98	10.53	10.48	10.37	10.80	10.76	10.64
end- Mar.	94.96	94.97	10.53	10.51	10.40	10.80	10.78	10.66
mid- Apr.	95.01	95.01	10.53	10.53	10.42	10.81	10.81	10.69
end- Apr.	94.93	94.93	10.54	10.54	10.43	10.81	10.81	10.70
mid- May	94.98	94.98	10.54	10.54	10.43	10.82	10.82	10.70
end- May	94.95	94.95	10.55	10.55	10.44	10.83	10.83	10.71
mid- June	94.97	94.99	10.56	10.52	10.41	10.84	10.80	10.68
end- June	94.97	95.07	10.56	10.34	10.23	10.84	10.61	10.49
mid- July	94.80	94.83	10.82	10.76	10.65	11.11	11.04	10.93
end- July	94.80	94.82	10.82	10.78	10.67	11.11	11.06	10.95
mid- Aug.	94.88	94.89	10.82	10.80	10.69	11.12	11.09	10.98
end- Aug.	94.88	94.89	10.82	10.80	10.69	11.12	11.09	10.98
mid- Sept. ...	94.79	94.80	11.08	11.06	10.95	11.39	11.37	11.25
end- Sept. ...	94.77	94.78	11.13	11.11	10.99	11.44	11.42	11.30
mid- Oct.	94.75	94.78	11.11	11.05	10.93	11.42	11.35	11.23
				12-month				
1988 — mid- Mar.	90.45	90.45	10.56	10.56	10.50	10.56	10.56	10.50
end- Mar.	90.45	90.45	10.56	10.56	10.50	10.56	10.56	10.50
mid- Apr.	90.15	90.15	10.96	10.96	10.89	10.96	10.96	10.89
end- Apr.	90.15	90.15	10.96	10.96	10.89	10.96	10.96	10.89
mid- May	90.15	90.15	10.96	10.96	10.89	10.96	10.96	10.89
end May	90.10	90.10	10.99	10.99	10.93	10.99	10.99	10.93
mid- June	90.10	90.10	10.99	10.99	10.93	10.99	10.99	10.93
end- June	90.10	90.15	10.99	10.93	10.86	10.99	10.93	10.86
mid- July	89.80	89.85	11.39	11.33	11.27	11.39	11.33	11.27
end- July	89.70	89.70	11.42	11.42	11.36	11.42	11.42	11.36
mid- Aug.	89.75	89.75	11.42	11.42	11.36	11.42	11.42	11.36
end- Aug.	89.70	89.70	11.45	11.45	11.39	11.45	11.45	11.39
mid- Sept. ...	89.30	89.35	11.98	11.92	11.86	11.98	11.92	11.86
end- Sept. ...	89.35	89.40	11.95	11.89	11.83	11.95	11.89	11.83
mid- Oct.	89.35	89.45	11.85	11.73	11.67	11.85	11.73	11.67

(1) Calendar year. From September 1986 interest payments were subject to a flat-rate withholding tax at the rate of 6.25 per cent, raised to 12.50 per cent in September 1987.

Interest rates

	Rates on BI-UIC loans: Base	Rates on BI-UIC loans: Actual on fixed term advances (1)	Yields: Treasury bill 3-month (2)	Yields: Treasury bill 6-month (2)	Yields: Treasury bill 12-month (2)	Yields: Treasury bill average (2) (3)	Yields: Treasury bonds	Yields: Bonds of industrial credit institutions
1984 — Dec.	16.50	17.48	14.82	14.69	14.68	14.70	14.53	13.84
1985 — Dec.	15.00	16.17	13.23	13.10	13.14	13.14	13.67	13.27
1986 — Dec.	12.00	13.03	10.81	10.25	10.01	10.21	10.05	9.05
1987 — Sept.	12.00	13.53	12.07	11.78	11.45	10.98	11.30	11.02
Oct.	12.00	—	11.84	11.98	12.09	11.96	11.41	11.01
Nov.	12.00	12.00	11.93	12.06	12.14	12.01	11.25	11.31
Dec.	12.00	12.37	11.64	11.66	11.39	11.56	10.50	11.19
1988 — Jan.	12.00	12.17	11.36	11.37	10.63	11.07	10.29	10.76
Feb.	12.00	12.28	10.72	10.78	10.50	10.66	10.30	10.84
Mar.	12.00	13.40	10.69	10.78	10.56	10.74	10.29	10.84
Apr.	12.00	12.12	10.65	10.81	10.96	10.84	10.39	10.80
May	12.00	12.17	10.70	10.83	10.98	10.89	10.49	10.75
June	12.00	12.02	10.55	10.63	10.94	10.74	10.47	10.85
July	12.00	12.45	11.48	11.06	11.41	11.45	10.61	10.88
Aug.	12.50	12.33	11.49	11.09	11.45	11.34	10.74	10.93
Sept.	12.50	—	11.11	11.41	11.90	11.43	10.88	11.08

	Bank rates (4): ABI prime rate (5)	Lending in lire: Minimum	Lending in lire: Average	Deposit rates: Maximum	Deposit rates: Average	Certificates of deposit: 6-month	Certificates of deposit: 12-month	Interbank rates
1984 — Dec.	18.00	17.68	—	15.96	—	—	—	17.31
1985 — Dec.	15.88	15.29	16.86	13.43	10.11	13.21	13.61	14.93
1986 — Dec.	13.00	12.54	13.93	10.69	7.62	10.69	10.34	11.51
1987 — Sept.	"	12.24	13.69	9.67	6.77	9.84	10.06	12.12
Oct.	"	12.52	14.15	9.77	6.83	10.04	10.22	11.54
Nov.	"	12.40	14.01	9.80	6.91	10.14	10.28	10.77
Dec.	"	12.34	13.79	9.81	6.94	10.18	10.29	10.76
1988 — Jan.	12.63	12.22	13.67	9.79	6.94	10.15	10.22	10.54
Feb.	"	11.97	13.55	9.53	6.70	9.98	10.13	10.61
Mar.	"	11.94	13.43	9.46	6.69	9.91	10.09	10.87
Apr.	"	11.90	13.35	9.50	6.74	9.85	10.07	10.74
May	12.50	11.84	13.24	9.40	6.64	9.75	9.96	10.45
June	12.63	11.84	13.26	9.39	6.56	9.72	9.90	10.51
July	"	12.00	13.46	9.41	6.57	9.70	9.89	10.60
Aug.	12.87	12.12	13.69	9.41	6.58	9.71	9.88	10.72
Sept.	13.00	12.40	13.90	9.47	6.64	9.85	9.97	10.93

(1) Average rate weighted according to the premiums charged. — (2) Annual rates, calendar year, compound interest formula. From September 1986 interest payments were subject to a flat-rate withholding tax at the rate of 6.25 per cent, raised to 12,50 per cent in September 1987. — (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 centred monthly average. For the definition of bank interest rates, see *Supplemento al Bollettino sulle aziende di credito.* — (5) Rates recorded by the Italian Banker's 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 a27

Principal assets and liabilites of banks

(billions of lire)

	ASSETS								
		Credits						Interbank accounts	
		Loans							
	Bank reserves (1)	In lire (2)	In foreign currency	Treasury bills (3) (10)	Other securities (4) (10)	Shares and equity participation	Bad debts (5)	Total	of which: special credit institutions
1984 — Dec.	67,807	185,066	30,531	42,292	144,745	8,600	14,570	102,789	8,278
1985 — Dec.	82,747	220,053	24,171	25,646	173,610	9,422	17,800	106,014	9,141
1986 — Dec.	88,474	238,584	27,451	29,827	181,329	11,717	20,963	116,636	8,879
1987 — Aug.	95,211	249,339	27,372	17,490	179,388	13,371	23,539	83,999	7,299
Sept. ...	95,562	239,060	29,187	16,233	189,307	13,499	23,756	88,854	7,198
Oct.	96,820	241,457	31,924	21,883	189,438	13,659	23,979	89,119	8,056
Nov.	97,482	246,729	32,446	22,457	193,389	13,627	24,186	97,835	9,318
Dec.	97,979	256,034	32,782	25,168	193,417	13,076	24,043	111,310	9,301
1988 — Jan.	105,504	258,557	34,447	17,221	181,186	13,293	24,677	84,543	7,718
Feb.	103,271	253,556	35,029	16,537	175,969	13,364	24,843	84,365	7,502
Mar.	101,680	253,759	34,473	15,176	175,700	13,574	24,846	85,419	7,873
Apr.	100,063	265,411	33,973	19,197	175,994	13,742	25,018	82,743	7,813
May	101,332	268,426	35,031	18,570	175,768	13,745	25,294	87,175	7,786
June	101,016	269,576	36,808	19,398	173,642	13,877	24,947	90,907	7,635
July	102,126	278,601	37,789	20,260	168,456	14,270	25,157	85,172	6,829
Aug. (11)	103,983	273,360	37,060	20,970	171,986	14,165	25,466	88,544	6,882

	LIABILITIES								
	Deposits (6)				Interbank accounts				
	Total	of which: current accounts	Other domestic funds (7)	Loans from BI-UIC	Total	of which: special credit institutions	Equity capital	Net foreign position (8)	Banker's acceptances issued (9)
1984 — Dec.	415,581	227,668	4,949	2,864	93,751	4,512	36,895	27,716	609
1985 — Dec.	457,743	250,282	6,467	8,740	94,338	4,459	43,166	25,806	377
1986 — Dec.	498,685	281,612	4,815	4,407	103,313	5,338	51,585	32,108	307
1987 — Aug.	488,684	270,419	4,234	4,003	82,567	5,720	61,344	33,566	235
Sept. ...	494,650	275,769	3,546	3,229	86,414	5,227	61,729	34,487	682
Oct.	497,816	278,821	3,549	3,279	88,011	4,844	61,791	37,654	1,081
Nov.	496,588	276,553	3,753	6,078	93,262	4,771	61,721	37,772	1,206
Dec.	532,697	302,862	3,209	5,711	103,761	5,887	61,828	36,691	1,066
1988 — Jan.	516,895	287,980	3,215	9,226	85,450	7,148	61,846	38,078	993
Feb.	508,064	281,994	3,320	9,068	80,286	6,822	62,018	40,261	1,109
Mar.	509,191	283,203	3,324	7,731	78,901	6,322	64,693	39,386	1,142
Apr.	514,416	288,296	3,528	7,668	77,271	5,668	67,256	42,489	897
May	512,615	286,372	3,786	7,755	80,201	4,750	67,342	40,830	788
June	519,370	291,977	3,445	7,782	83,874	5,933	67,153	37,581	750
July	523,646	294,464	3,919	7,821	76,397	5,494	67,357	38,082	784
Aug. (11)	523,130	292,000	3,805	7,592	81,265	5,500	68,095	36,921	780

(1) Comprises lira liquidity (excluding deposits with the PO and the Deposits and Loans Fund), compulsory reserves, collateral in respect of banker's drafts, and the non-interest-bearing deposit against ceiling overshoots. The data for December 1985 have been reworked to correct for suspended accounting entries due to strikes by Bank of Italy personnel. — (2) Includes investment in banker's 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) Includes protested bills. — (6) Lira deposits by non-bank resident customers. — (7) Government funds under administration 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 sale. — (11) Provisional.

Table a28

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	
1984 — Dec.	4,257	4,964	15,023	125,302	66,144	32,927	4,585	9,193	−7,917
1985 — Dec.	3,575	4,601	16,441	135,988	72,323	36,096	3,781	8,593	−8,238
1986 — Dec.	3,826	4,567	14,511	152,813	82,890	40,823	3,187	8,057	−10,298
1987 — Aug.	5,917	6,745	12,902	161,669	86,625	45,373	4,260	7,019	−12,591
Sept. ...	5,320	6,381	12,527	163,222	86,893	46,327	4,191	7,019	−11,427
Oct.	5,277	6,351	10,402	166,816	89,208	47,353	4,320	7,019	−11,296
Nov.	4,918	5,798	10,178	169,180	90,232	48,363	4,215	7,231	−10,734
Dec.	4,313	5,159	10,411	173,533	93,542	48,913	4,361	7,291	−8,090
1988 — Jan.	6,804	7,877	12,752	173,702	93,389	49,313	4,367	6,745	−11,995
Feb.	7,473	8,519	14,529	175,939	94,343	50,118	4,406	6,744	−12,459
Mar.	6,694	7,662	15,536	179,044	96,185	51,158	4,570	6,744	−11,249
Apr.	6,508	7,376	16,206	179,870	96,063	51,963	4,567	6,744	−10,732
May	5,366	6,173	16,149	182,326	97,192	53,002	4,639	6,724	−10,245
June	5,345	6,264	17,292	181,162	96,656	52,939	4,701	6,248	−6,141
July (3) ..	4,353	5,330	16,949	184,441	98,908	53,810	4,725	6,998	−10,686
Aug. (3) .	4,841	5,903	15,672	186,458	99,647	54,469	4,758	7,000	−10,635

	LIABILITIES								
	Certificates of 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				
1984 — Dec.	23,480	89,554	35,871	33,605	8,159	4,912	4,771	2,422	17,852
1985 — Dec.	25,549	95,022	37,736	36,192	7,145	5,513	5,365	2,521	20,051
1986 — Dec.	28,258	102,193	41,234	39,693	6,089	5,359	6,522	2,538	21,878
1987 — Aug.	28,044	109,102	44,436	43,096	5,048	3,395	6,886	2,754	24,775
Sept. ...	27,794	110,503	44,817	43,962	5,044	3,529	7,259	2,789	24,995
Oct.	28,190	111,472	45,651	44,391	5,043	4,019	7,066	2,822	25,000
Nov.	28,896	112,235	46,285	44,718	5,038	4,930	7,132	2,874	24,763
Dec.	30,878	113,681	46,137	45,944	5,036	5,634	7,537	3,038	26,861
1988 — Jan.	33,599	114,208	46,303	46,402	4,474	3,907	7,288	2,925	27,047
Feb.	36,720	114,761	46,110	47,213	4,468	3,822	7,535	3,042	27,330
Mar.	39,277	115,824	46,268	48,013	4,466	4,351	7,568	3,096	27,725
Apr.	40,092	116,477	46,939	48,186	4,454	4,441	7,351	3,143	28,073
May	40,353	117,452	47,467	48,597	4,432	4,373	7,464	3,197	28,495
June	42,037	118,389	47,824	49,125	4,402	4,478	7,930	3,238	29,052
July (3) ..	42,071	117,441	48,110	48,331	3,995	3,793	7,701	3,270	29,486
Aug. (3) .	41,887	118,127	48,205	48,836	4,000	3,732	7,872	3,357	30,181

(1) Excluding financing of compulsory stockpiling. — (2) Gross of exchange rate variations. — (3) Partially estimated data.

Table a29

Loans by branch of economic activity and type of enterprise

(billions of lire; % changes)

	BANKS				SPECIAL CREDIT INSTITUTIONS			
	Total as of July 1988	% change in the 12 months ending			Total as of July 1988	% change in the 12 months ending		
		Dec. 87	Mar. 88	July 88		Dec. 87	Mar. 88	July 88
General government	9,490	9.9	7.7	13.2	23,482	3.7	2.1	1.0
Credit and insurance institutions	18,751	4.2	−9.9	9.5	8,128	15.4	−21.8	−13.5
Non financial firms	252,270	8.3	8.6	12.9	130,525	12.9	17.4	16.9
Agriculture, forestry and fisheries	9,790	6.3	6.5	8.5	8,966	12.0	13.7	13.3
Industry	148,873	5.8	6.1	10.8	68,375	8.2	9.7	9.0
Mining and quarrying	1,808	−5.6	−11.6	−16.0	1,128	13.0	2.3	0.4
Food and related products	15,046	7.3	10.9	14.6	6,741	10.8	13.6	13.4
Textiles	11,809	16.0	17.3	13.0	2,543	8.2	7.8	7.3
Clothing, footwear, hides & leather	10,751	12.7	9.3	11.9	1,349	13.8	14.6	14.3
Wood, wooden furniture & fittings	6,397	9.5	8.5	9.9	1,345	7.4	4.5	6.5
Basic metals	7,858	−6.7	8.0	10.5	4,130	16.9	24.6	20.3
Engineering	32,575	4.9	4.6	14.2	14,148	6.7	7.9	7.9
Vehicles	6,375	−0.9	−10.0	3.9	3,699	−3.8	2.2	4.8
Non-ferrous mineral products	5,144	3.8	4.9	4.5	2,583	8.0	11.0	5.3
Chemicals, oil coal products	11,342	5.9	8.4	9.5	4,498	0.6	4.1	−0.1
Rubber and plastic	4,337	15.9	15.5	18.5	1,265	8.8	9.2	3.7
Paper, printing, publishing and related products	5,573	14.9	14.4	19.2	1,789	1.6	2.6	14.8
Still and motion picture equipment, sundry manufactures	1,165	12,7	6,6	16,6	585	34,2	35,0	69,6
Costruction and plant installation	27,338	6.0	6.8	10.3	19,458	9.6	9.0	9.9
Production and distribution of power, gas and water	1,355	−37.4	−54.8	−33.0	3,114	15.5	19.2	4.5
Distributive trades, other commercial activities and miscellaneous services	71,799	15.9	13.6	17.2	24,916	31.8	32.8	28.7
Lodging and catering	3,401	18.2	14.5	17.8	2,862	25.8	27.8	26.8
Transport and communications	8,428	6.1	17.1	17.4	15,100	5.4	7.4	6.5
Coordination and financial services to enterprises	9,979	−1.4	7.2	14.3	10,306	25.6	86.3	95.4
Non-profit, institutions, households and unclassifiable	14,316	13.0	15.6	16.2	5,984	61.0	50.6	47.5
TOTAL (RESIDENT CUSTOMERS)	294,827	8.2	7.7	12.9	168,119	12.5	13.3	13.3
of which: public enterprises	21,753	−5.9	−9.9	−3.2	29,046	7.8	12.6	10.3
of which: state controlled	17,205	−9.0	−12.5	−4.9	22,862	3.9	8.0	6.9
leading private sector firms	44,830	−7.5	−8.2	1.4	33,627	5.2	5.1	6.5
other	204,438	14.9	13.9	17.6	75,980	19.7	20.3	20.3

Source: Bank of Italy, Central Risks Office.

Table a30

Net issues of securities

(billions of lire)

	ISSUERS			Total bonds and govern-ment securities	INVESTORS					Shares
	Public sector	Special credit insti-tutions	Public agencies and firms		BI-UIC	Deposits and Loans Fund	Banks	Investment funds	Other	
1982	23,626	8,147	4,570	36,343	−273	−91	19,744	—	16,963	6,004
1983	69,942	7,640	2,374	79,956	1,948	562	29,975	—	47,471	10,899
1984	63,693	4,315	2,035	70,043	6,792	256	11,190	912	50,893	9,774
1985	94,074	5,178	2,195	101,447	8,910	510	27,336	11,656	53,035	12,220
1986	87,762	6,805	6,071	100,638	7,911	830	6,209	27,701	57,987	18,872
1987	56,505	11,012	4,037	71,554	1,420	485	11,690	−3,872	61,831	10,433
1986 — 3rd qtr.	15,702	−92	977	16,587	−7,380	−38	5,943	4,202	13,860	5,026
4th "	22,271	4,209	1,868	28,348	6,484	100	8,248	1,850	11,666	6,800
1987 — 1st qtr.	22,849	1,385	1,278	25,512	−3,881	61	−7,609	2,388	34,553	2,909
2nd "	21,819	3,786	238	25,843	4,950	567	6,915	493	12,918	1,769
3rd "	12,249	2,987	1,179	16,415	2,542	1	8,175	−3,633	9,330	3,556
4th "	−412	2,854	1,342	3,784	−2,191	−144	4,209	−3,120	5,030	2,199
1988 — 1st qtr.	11,852	2,140	−251	13,741	−1,137	−134	−17,745	−3,635	36,392	1,169
2nd "	13,456	2,125	447	16,028	−158	298	−1,578	−3,664	21,130	1,115
1987 — Sept.	3,917	1,486	395	5,798	−2,822	17	10,386	−1,308	−475	2,456
Oct.	369	957	452	1,778	−156	−9	−41	−2,569	4,553	506
Nov.	446	483	887	1,816	−3,551	−37	3,974	−489	1,919	325
Dec.	−1,227	1,414	3	190	1,516	−98	275	−62	−1,441	1,368
1988 — Jan.	4,045	497	−394	4,148	6,122	−51	−13,025	−894	11,996	153
Feb.	1,471	616	443	2,530	−4,295	−13	−5,561	−2,287	14,686	614
Mar.	6,336	1,027	−300	7,063	−2,964	−70	841	−454	9,710	402
Apr. (1)	7,766	669	−194	8,241	326	−6	168	−922	8,675	310
May (1)	5,206	735	557	6,498	−1,594	−6	139	−1,346	9,305	404
June (1)	484	721	84	1,289	1,110	310	−1,885	−1,396	3,150	401
July (1)	2,336	−251	−247	1,838	423	−22	−5,124	−1,033	7,594	366
Aug. (1)	1,165	416	−108	1,473	−3,929			−1,058		35

(1) Provisional data.

Issue conditions of government securities

Treasury credit certificates

ABI number	Maturity	Date of issue	Price at issue	Yield at issue (1) gross	Yield at issue (1) net	Amount taken up (lire bn.)	Spread	First coupon gross	First coupon net
13001 (2)	1.10.94	1.10.87	99.00	12.36	10.82	900	0.75	12.00	10.5000
13005 (3)	2.11.92	2.11.87	99.75	12.84	11.20	1,950	0.30	6.20	5.4250
13007 (3)	1.12.92	1.12.87	99.75	12.84	11.19	1,000	0.30	6.20	5.4250
13009 (3)	1.1.93	1.1.88	99.50	12.13	10.58	7,000	0.30	6.00	5.2500
13011 (3)	1.2.93	1.2.88	99.25	11.49	10.02	3,100	0.30	5.80	5.0750
13013 (3)	1.3.93	1.3.88	99.25	11.40	9.94	3,000	0.30	5.80	5.0750
13015 (3)	1.4.93	1.4.88	99.25	11.49	10.02	1,100	0.30	5.80	5.0750
13017 (3)	1.5.93	2.5.88	99.25	12.23	10.67	2,000	0.50	5.80	5.0750
13019 (3)	1.6.93	1.6.88	99.25	12.23	10.67	1,400	0.50	5.80	5.0750
13020 (3)	1.7.93	1.7.88	99.25	12.19	10.63	1,650	0.50	6.00	5.2500
13022 (3)	1.8.93	1.8.88	99.25	12.65	11.04	900	0.50	6.00	5.2500
13023 (3)	1.9.93	1.9.88	99.10	12.78	11.14	3,500	0.50	6.25	5.4685

Treasury bonds

ABI number	Maturity	Date of issue	Price of issue	Yield at issue gross	Yield at issue net	Amount taken up (lire bn.)	Coupon gross	Coupon net
12626	1.10.90	1.10.87	99.50	12.03	10.49	830	5.75	5.0312
12627	1.2.92	1.2.88	99.00	11.62	10.13	3,041	5.50	4.8125
12628	1.3.90	1.3.88	98.75	11.53	10.06	3,988	5.25	4.5935
12629	15.3.90	15.3.88	98.85	11.47	10.00	2,000	5.25	4.5935
12630	1.4.90	1.4.88	99.25	11.21	9.78	3,500	5.25	4.5935
12631	1.4.92	1.4.88	98.00	11.97	10.44	3,000	5.50	4.8125
12632	15.4.90	15.4.88	98.85	11.43	9.98	1,000	5.25	4.5935
12633	1.5.90	2.5.88	99.00	11.37	9.92	3,191	5.25	4.5935
12634	1.5.92	2.5.88	97.50	12.12	10.58	1,684	5.50	4.8125
12635	18.5.90	18.5.88	99.00	11.37	9.92	1,000	5.25	4.5935
12636	16.6.90	16.6.88	99.00	11.34	9.90	600	5.25	4.5935
12637	1.7.90	1.7.88	99.15	11.80	10.29	4,500	5.50	4.8125
12638	1.7.92	1.7.88	98.35	12.38	10.80	1,456	5.75	5.0310
12639	1.8.90	1.8.88	99.15	11.81	10.31	2,800	5.50	4.8125
12640	1.8.92	1.8.88	97.40	12.70	11.08	2,100	5.75	5.0310
12641	1.9.90	1.9.88	99.10	12.35	10.77	6,500	5.75	5.0310
12642	1.9.92	1.9.88	98.80	13.30	11.60	4,500	6.25	5.4685

Treasury certificates in ECUs

ABI number	Maturity	Date of issue	Price at issue	Yield at issue gross	Yield at issue net	Amount taken up (ECU mill.) (4)	LIRA/ECU exchange rate at issue	Coupon gross	Coupon net
13014	21.3.92	21.3.88	100	8.48	7.42	750	1,536.90	8.50	7.4375
13016	26.4.92	26.4.88	100	8.49	7.43	500	1,544.11	8.50	7.4375
13018	25.5.92	25.5.88	100	8.49	7.43	1,000	1,545.18	8.50	7.4375
13021	25.7.93	25.7.88	100	8.74	7.65	1,000	1,542.02	8.75	7.6563
13024	28.9.93	28.9.88	100	8.74	7.65	1,000	1,544.67	8.75	7.6563

(1) Expected yield in the months the first coupon matures on the assumption that rates are unchanged over the period. — (2) Annual coupon determined on the basis of 12-month Treasury bill rate. — (3) Half-yearly coupon based on the 12-month Treasury bill rate. — (4) Domestic market only.

Table a32

Treasury credit certificates, Treasury certificates in ECUs, index-linked Treasury certificates, Treasury bonds and investment funds

	Expected yields (1)			Total return indices (2)							
					Treasury certificates in ECUs (3)						
	Treasury credit certificates	Treasury certificates in ECUs	Index-linked Treasury certificates	Treasury credit certificates	Interest	Price	Exchange rate	Total	Index-linked Treasury certificates	Treasury bonds	Investment funds
1982	20.78			130.51							
1983	19.82	13.11		159.09	105.81	101.93	102.08	110.21		100.00	
1984	16.98	11.51	3.40	191.33	118.89	106.57	104.59	132.51	97.63	109.39	93.29
1985	14.68	9.88	4.61	226.18	132.42	111.76	109.64	162.52	101.12	126.89	117.10
1986	12.41	8.54	4.49	259.08	144.98	115.52	110.84	185.60	117.76	146.91	161.60
1987	10.66	8.43	4.57	289.14	161.33	113.45	113.26	207.26	132.34	163.44	169.68
1986 — 4th qtr.	10.63	8.59	3.95	271.73	147.96	114.56	109.34	185.33	127.09	155.07	169.47
1987 — 1st qtr.	10.22	8.45	4.36	280.27	155.72	114.11	111.32	197.70	128.21	159.56	170.93
2nd "	9.89	8.15	4.62	288.33	159.36	114.92	113.24	207.38	130.39	162.30	175.04
3rd "	10.92	8.29	4.41	290.82	163.12	113.71	113.80	211.07	135.04	163.56	170.78
4th "	11.60	8.85	4.90	297.15	167.11	111.07	114.70	212.90	135.71	168.35	161.98
1988 — 1st qtr.	10.71	8.18	5.03	306.51	170.82	113.45	115.49	223.83	139.13	174.75	160.20
2nd "	11.13	7.86	5.38	310.82	174.69	114.29	116.97	233.53	140.72	178.78	163.73
3rd "	11.52	8.08	5.25	319.50	178.78	113.06	116.88	236.24	142.84	182.53	169.68
1987 — Sept. . .	11.33	8.52	4.29	291.58	164.42	112.60	113.66	210.42	137.28	164.61	168.83
Oct. . . .	11.58	8.90	4.59	292.88	165.85	110.93	113.66	209.09	136.49	165.81	167.93
Nov. . . .	11.91	8.98	4.97	296.24	167.11	110.55	115.19	212.79	135.21	167.78	158.52
Dec. . . .	11.30	8.67	5.15	302.32	168.36	111.73	115.26	216.81	135.42	171.30	159.50
1988 — Jan. . . .	10.92	8.26	5.24	305.18	169.59	113.25	115.15	221.15	136.35	173.42	158.95
Feb. . . .	10.62	8.19	4.82	305.88	170.75	113.42	115.28	223.26	140.51	174.68	157.96
Mar. . . .	10.58	8.09	5.04	308.46	172.11	113.69	116.05	227.08	140.52	176.16	163.68
Apr. . . .	10.86	7.89	5.33	310.26	173.39	114.33	116.82	231.59	140.13	177.43	164.53
May . . .	11.21	7.82	5.55	310.20	174.67	114.44	117.16	234.18	140.21	178.69	162.26
June . .	11.33	7.87	5.26	311.99	176.02	114.11	116.92	234.83	141.83	180.23	164.40
July . . .	11.41	7.92	5.20	315.51	177.37	113.79	116.71	235.56	141.93	181.34	168.19
Aug. . .	11.45	8.10	5.20	320.00	178.78	112.99	116.79	235.91	143.15	182.53	170.40
Sept. . .	11.69	8.22	5.35	323.00	180.18	112.40	117.15	237.25	143.45	183.72	170.45

(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 deflator of GDP at factor cost; the yield so obtained makes the sum of the present values of the real payments foreseen equal the security's deflated cum-coupon price. — (2) These indices are based as follows: Treasury credit certificates, 31 December 1980; Treasury certificates in ECUs, 26 January 1983; index-linked Treasury certificates, 2 May 1984; Treasury bonds, 30 December 1983; and investment funds, 31 December 1984. — (3) The breakdown of the index into its interest, price, and exchange rate components is multiplicative.

Table a33

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
1982	100,737	31,604	69,133	—	20.9	—	13.4
1983	120,629	35,432	85,197	—	20.7	—	13.2
1984	144,033	52,325	91,708	—	20.4	—	17.1
1985	153,722	46,441	107,281	—	18.1	—	12.9
1986	152,407	45,693	106,714	—	15.2	—	11.4
1987	151,500	45,666	105,834	—	13.1	—	10.3
1986 — July	26,600	12,851	13,749	2.9	16.1	2.9	12.1
Aug.	3,949	−3,734	7,683	2.5	16.0	2.2	12.0
Sept.	16,005	1,948	14,057	4.7	15.9	3.5	12.2
Oct.	17,838	10,861	6,977	4.1	16.3	3.6	12.9
Nov.	20,876	6,324	14,552	4.8	16.1	4.0	13.0
Dec.	17,912	12,757	5,155	3.7	15.2	3.4	11.4
1987 (5) — Jan.	4,540	3,930	610	3.0	15.9	3.2	13.2
Feb.	12,462	1,793	10,669	2.8	15.7	3.5	13.9
Mar.	11,809	—884	12,693	3.2	15.3	2.9	13.1
Apr.	20,471	5,288	15,183	4.1	15.0	2.1	12.5
May	13,269	3,809	9,460	4.2	15.0	2.6	13.1
June	−2,108	2,093	−4,201	3.1	15.5	3.6	14.1
July	23,214	9,467	13,747	2.9	14.8	3.5	12.9
Aug.	4,568	−4,621	9,189	2.4	14.8	2.2	12.8
Sept.	8,058	−6,407	14,465	3.3	13.9	0.5	10.7
Oct.	15,466	8,248	7,218	2.8	13.5	0.8	9.8
Nov.	18,764	9,377	9,387	3,1	13.0	1.7	10.4
Dec.	20,987	13,573	7,414	3.0	13.1	2.9	10.3
1988 — Jan.	3,663	3,671	−8	2.6	13.0	3.5	10.1
Feb.	8,821	−1,674	10,495	2.4	12.5	2.6	9.3
Mar.	18,259	2,912	15,347	3.1	12.9	2.9	10.2
Apr.	23,498	11,328	12,170	4.1	13.0	3.2	11.4
May	17,209	6,344	10,865	4.7	13.1	4.9	11.8
June	1,785	1,264	521	3.6	13.5	5.0	11.6
July	25,085	12,924	12,161	3.3	13.4	4.2	12.1
Aug.	6,232	−4,131	10,363	2.7	13.5	2.8	12.3

(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, bank's 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 a34

Monetary aggregates and their counterparts

(changes in billions of lire)

	1985	1986	1987		1988			
			Year	Jan.-June	Apr.	May	June	Jan.-June
A) BI-UIC								
ASSETS								
Foreign sector *(a1)*	–13,651	3,489	6,775	2,384	–2,139	–723	2,322	1,872
State sector *(a2)* (1)	27,482	10,891	6,897	4,363	184	2,281	–3,074	–1,845
Banks *(a3)*	5,674	–3,360	327	–1,017	1,123	–1,337	–400	1,698
Special credit institutions *(a4)*	–273	458	90	–12	–6	12	–171	–152
Other *(a5)*	–400	–909	–1,479	–1,107	1,127	–1,559	2,719	–609
LIABILITIES								
Non-state sector *(a6)*	3,967	3,036	4,171	–1,025	–834	12	1,796	–1,369
Banks *(a7)*	14,865	7,532	8,439	5,635	1,123	–1,337	–400	2,333
B) Banks								
ASSETS								
BI-UIC *(b1=a7)*	14,865	7,532	8,439	5,635	1,123	–1,337	–400	2,333
Foreign sector *(b2)*	5,299	–6,454	–5,573	–4,185	–903	–130	–1,774	–4,695
State sector *(b3)* (1)	11,624	7,575	6,496	–7,834	4,354	1,086	329	–17,578
Non-state sector *(b4)*	30,126	28,166	25,798	10,478	11,211	3,712	1,864	15,744
Special credit institutions *(b5)*	1,123	6	1,446	–550	638	80	–1,836	–5,460
Other *(b6)*	–15,400	345	–1,757	–8,092	–9,576	–5,871	9,069	1,627
LIABILITIES								
Non-state sector:								
current accounts *(b7)*	22,296	29,808	19,983	–8,499	5,400	–2,090	5,452	–11,164
savings deposits *(b8)*	13,777	1,474	2,193	–7,252	–783	–1,599	–301	–17,661
repurchase agreements *(b9)*	3	199	1,460	2,573	284	393	878	2,900
bank CDs *(b10)*	5,753	8,128	10,492	9,279	917	1,726	1,448	15,222
BI-UIC *(b11=a3)*	5,674	–3,360	327	–1,017	1,123	–1,337	–400	1,698
State sector *(b12)*	134	921	393	367	–94	447	175	977

(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)

	1985	1986	1987 Year	1987 Jan.-June	1988 Apr.	1988 May	1988 June	1988 Jan.-June
C) State sector								
DOMESTIC BORROWING REQUIREMENT *(c1)*	114,848	109,307	108,146	45,880	12,256	11,118	829	50,349
LIABILITIES TOWARDS:								
Non-state sector								
PO savings:								
current accounts *(c2)*	2,221	−479	702	−1,288	−1,000	−962	434	−1,632
savings deposits *(c3)*	7,788	10,553	12,099	3,418	487	424	395	3,856
Treasury bills and other government securities *(c4)*	60,126	57,757	86,684	47,159	7,968	9,960	2,988	68,019
BI-UIC *(c5=a2)*	27,482	10,891	6,897	4,363	184	2,281	−3,074	−1,845
Banks *(c6=b3−b12)*	11,490	6,654	6,102	−8,201	4,448	−638	154	−18,554
Other *(c7)*	5,741	23,931	−7,338	430	170	−1,223	131	506
D) Monetary aggregates and their counterparts *(consolidated account of liquidity-creating bodies)*								
MONETARY AGGREGATES								
M1 *(d1=a6+b7+c2)*	28,484	32,365	24,856	−10,811	3,565	−3,040	7,682	−14,165
Savings deposits *(d2=b8+c3)*	21,565	12,027	14,292	−3,834	−296	−1,175	95	−13,806
Repurchase agreements *(d3=b9)*	3	199	1,460	2,573	284	393	878	2,900
M2A *(d4=d1+d2+d3)*	50,051	44,591	40,607	−12,073	3,553	−3,823	8,655	−25,070
Banks' CDs *(d5=b10)*	5,753	8,128	10,492	9,279	917	1,726	1,448	15,222
M2 *(d6=d4+d5)*	55,805	52,720	51,099	−2,793	4,470	−2,097	10,103	−9,848
SOURCES								
Foreign sector *(d7=a1+b2)*	−8,352	−2,965	1,202	−1,801	−3,042	−853	548	−2,823
State sector *(d8=c1−c4−c7)*	48,981	27,620	25,800	−1,709	4,119	2,381	−2,090	−18,176
Non-state sector *(d9=b4)*	30,126	28,166	25,798	10,478	11,211	3,712	1,864	15,744
Special credit institutions *(d10=a4+b5)*	850	464	1,535	−562	632	93	−2,007	−5,612
Other *(d11=a5+b6)*	−15,799	−564	−3,236	−9,199	−8,450	−7,429	11,788	1,018

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
1982 — Dec.	216,640	402,324	402,324	475,341	16.7	18.1	18.1	18.0
1983 — Dec.	244,629	448,498	451,755	540,084	12.9	11.5	12.3	13.6
1984 — Dec.	275,052	499,090	506,623	616,264	12.4	11.3	12.1	14.1
1985 — Dec.	303,536	549,141	562,427	687,652	10.4	10.0	11.0	11.6
1986 — July	294,071	531,662	548,916	686,672	8.8	6.9	7.6	7.3
Aug.	291,463	531,145	548,638	686,528	8.8	6.9	7.6	7.0
Sept.	298,055	538,451	556,744	693,512	9.5	7.3	8.2	7.0
Oct.	302,077	543,943	563,426	698,838	10.6	8.1	9.1	7.8
Nov.	304,475	548,355	568,636	702,517	11.3	8.7	9.9	8.2
Dec.	335,901	593,732	615,147	744,198	10.7	8.1	9.4	8.2
1987 (5) — Jan.	321,228	580,558	606,186	737,559	10.0	7.8	9.6	7.7
Feb.	314,238	571,470	599,339	731,943	10.1	8.3	10.4	7.7
Mar.	316,450	573,014	602,319	736,387	9.8	8.5	10.8	7.6
Apr.	319,728	576,843	606,947	741,862	10.5	9.3	11.6	8.6
May	319,187	576,569	607,248	743,255	10.6	9.8	12.0	9.0
June	325,090	581,660	612,354	747,090	11.5	10.2	12.4	9.4
July	328,026	585,681	614,923	755,458	11.5	10.2	12.0	10.0
Aug.	324,196	583,400	612,093	757,880	11.2	9.8	11.6	10.4
Sept.	328,584	587,768	616,881	771,490	10.2	9.2	10.8	11.2
Oct.	332,258	591,775	621,504	779,138	10.0	8.8	10.3	11.5
Nov.	330,374	590,637	621,517	786,191	8.5	7.7	9.3	11.9
Dec.	360,757	634,340	666,247	829,574	7.4	6.8	8.3	11.5
1988 — Jan.	344,230	614,628	651,675	823,063	7.2	5.9	7.5	11.6
Feb.	336,346	601,265	641,833	821,191	7.0	5.2	7.1	12.2
Mar.	338,385	600,885	643,923	827,549	6.9	4.9	6.9	12.4
Apr.	341,951	604,438	648,393	830,974	7.0	4.8	6.8	12.0
May	338,910	600,615	646,296	832,241	6.2	4.2	6.4	12.0
June	346,592	609,270	656,398	844,009	6.6	4.7	7.2	13.0
July	352,412	618,224	666,267	858,111	7.4	5.6	8.3	13.6
Aug.	346,927	614,189	663,450	....	7.0	5.3	8.4	....

(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.

Table a36

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			
1982	90,345	11,351	13,461	4,412	11,592	4,551	2,230	3,756	59,079	−10,048	−10,039
1983	123,013	21,462	11,549	2,422	14,139	8,645	3,000	2,094	71,867	706	−12,871
1984	138,758	35,930	14,469	1,925	10,780	6,365	3,300	2,075	82,507	−7,254	−11,340
1985	147,318	33,338	11,409	1,694	11,837	7,719	4,192	5,271	97,339	−7,761	−17,720
1986	168,487	23,463	16,896	5,334	9,215	14,888	5,092	3,695	97,484	−1,311	−6,269
1987	164,604	22,136	19,877	3,653	8,489	6,798	4,876	1,670	102,239	−3,144	−1,986
1986 — July ..	11,614	10,605	856	1,390	364	1,239	−213	157	13,184	1,709	−17,677
Aug. ..	7,034	−4,351	614	3	718	2,674	428	−1,067	7,258	2,714	−1,957
Sept. .	16,283	955	1,401	−409	263	2,762	493	−1,103	13,868	803	−2,750
Oct. ..	17,948	8,495	2,442	−76	618	3,789	62	−509	6,465	610	−3,948
Nov. ..	11,000	3,846	1,802	677	659	931	297	989	13,953	−816	−11,338
Dec. ..	46,771	8,388	3,601	769	462	703	283	579	4,956	−2,070	29,100
1987 (6) — Jan. ..	4,748	3,889	63	−22	555	710	1	−252	−97	608	−707
Feb. ..	8,292	−183	1,654	322	616	−799	884	1,285	10,673	−766	−5,394
Mar. ..	13,376	−3,827	2,122	822	1,014	68	527	2,630	11,809	−730	−1,059
Apr. ..	14,211	4,017	1,154	116	669	−454	150	1,160	14,653	357	−7,611
May ..	6,500	2,874	1,057	−121	541	−140	257	−537	9,073	−1,514	−4,990
June ..	10,157	1,789	145	159	482	1,979	785	−1,465	−4,736	278	10,741
July ..	19,273	6,306	2,555	607	1,391	1,927	−231	−575	12,406	649	−5,762
Aug. ..	6,781	−4,991	390	−20	557	1,055	522	−1,034	8,850	1,020	432
Sept. .	13,928	−8,477	1,676	393	727	2,026	822	1,254	13,486	21	2,000
Oct. ..	12,969	5,187	2,601	461	841	−380	551	408	7,688	−226	−4,162
Nov. ..	7,746	6,011	2,463	903	795	−213	480	−64	11,182	−1,630	−12,181
Dec. ..	46,623	9,542	3,997	33	302	1,018	127	−1,139	7,252	−1,211	26,702
1988 — Jan. ..	3,746	3,621	470	−420	507	−821	381	1,708	−97	−116	−1,487
Feb. ..	13,334	−4,378	2,339	365	609	−183	776	1,104	10,392	−1,463	3,773
Mar. ..	19,662	−338	3,178	72	2,758	−1,136	331	2,670	12,789	−1,783	1,121
Apr. ..	14,610	10,955	511	−138	1,438	−657	−128	790	10,731	−1,896	−6,996
May ..	8,988	3,790	2,476	78	1,128	−910	185	1,163	9,917	−2,505	−6,334
June ..	14,249	2,485	−1,171	−50	584	−909	135	843	−353	374	12,311
July ..	....	9,767	3,412	−255	655	....	−239	....	11,835	....	....
Aug. ..	....	−6,045	2,017	−103	....	....	3	....	9,028	....	....

(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 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 funding of debts of health and security institutions. — (5) Current account balance on a settlements basis. — (6) Provisional data.

Economic policy provisions

Monetary and credit policy

On 25 August the discount rate was raised from 12 to 12.50 per cent.

Tax measures

Law 67 of 11 March laid down the provisions for the state annual and multi-year budgets (1988 Finance Law). With regard to direct taxes, the preliminary payment of IRPEG and ILOR by corporate bodies was raised from 92 to 98 per cent; the flat-rate withholding tax on interest receipts from bank deposits and bank and postal current accounts was increased from 25 to 30 per cent; indirect taxes on private insurance schemes, government registration fees, methane gas, fuel oils and beers and spirits were also raised. In the field of social security, the contribution by agricultural employers for insurance against accidents at work was brought up to 9 per cent. The Health Service contribution for all wage and salary earners was fixed at 10.65 per cent, of which 9.60 per cent is payable by employers.

Decree Law 173 of 30 May laid down more restrictive criteria for eligibility for civil disability allowances and provided for increases in the rate of excise tax on electricity as well as in company registration fees (subsequently modified with Law 291/1988). It also raised from 92 to 95 per cent the preliminary payment of IRPEF and ILOR for individuals and brought forward the VAT payment deadlines for some categories of taxpayer.

Decree Law 303 of 30 July raised to 19 per cent the VAT rate previously set at 18 per cent.

Decree Law 307 of 30 July increased prescription charges.

Law 362 of 23 August established new regulations on the budget and government accounts. Specifically, the government is required to submit to the Senate and Chamber of Deputies: a) by 15 May of each year, the Economic and Financial Planning Paper, describing the public finance strategy for the period covered by the multi-year budget; b) by 31 July, the bill for approval of the annual and multi-year budget based on existing legislation; and c) by 30 September, the Finance Bill, the Forecasting and Planning Report and the multi-year planning budget.

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 banks' 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 market 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

— *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)

Labour force

— *employed persons (excluding conscripts) plus job seekers (unemployed workers, first job seekers and other job seekers).*

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.*

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.*

Unemployed workers

— *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.*

Under-employed persons

— *persons working less than 26 hours in the survey week owing to lack of demand for labour.*

Unemployment

— *Unemployed workers + First job seekers + Other job seekers.*

Unemployment rate

— *ratio of unemployment to the labour force.*

Unemployment rate adjusted for Wage Supplementation

— *ratio of unemployment plus equivalent full-time workers on Wage Supplementation to the labour force.*

Scala mobile

— *various Italian systems of wage indexation. The mechanism introduced in 1986 is based on the trade union cost-of-living index and half-yearly adjustments. It provides:*

1) 100% indexation of a minimum wage of 580,000 lire for all workers;

2) 25% indexation of a second wage component equal to base pay plus cost-of-living allowance less 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.

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 cover long-term layoffs (normally limited to two years).*

List of abbreviations

ABI	—	*Associazione bancaria italiana* Italian Bankers' 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 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
EAGGF	—	*European Agricultural Guidance and Guarantee Fund*
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
INAIL	—	*Istituto nazionale per l'assicurazione contro gli infortuni sul lavoro* National Industrial Accidents Insurance Institute
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
UIC	—	*Ufficio italiano cambi* Italian Foreign Exchange Office

MANAGEMENT OF THE BANK OF ITALY

at 31 October 1988

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
Vincenzo DESARIO	— Central Manager for Banking Supervision
Antonio FINOCCHIARO	— Secretary General
Pierluigi CIOCCA	— Central Manager for Economic Research
Luigi GIANNOCCOLI	— Accountant General
Giorgio MAYDA	— Inspector General
Luigi SCIMIA	— Central Manager for Bank Property and Special Projects
Alfio NOTO	— Central Manager with responsibility for the Milan Branch