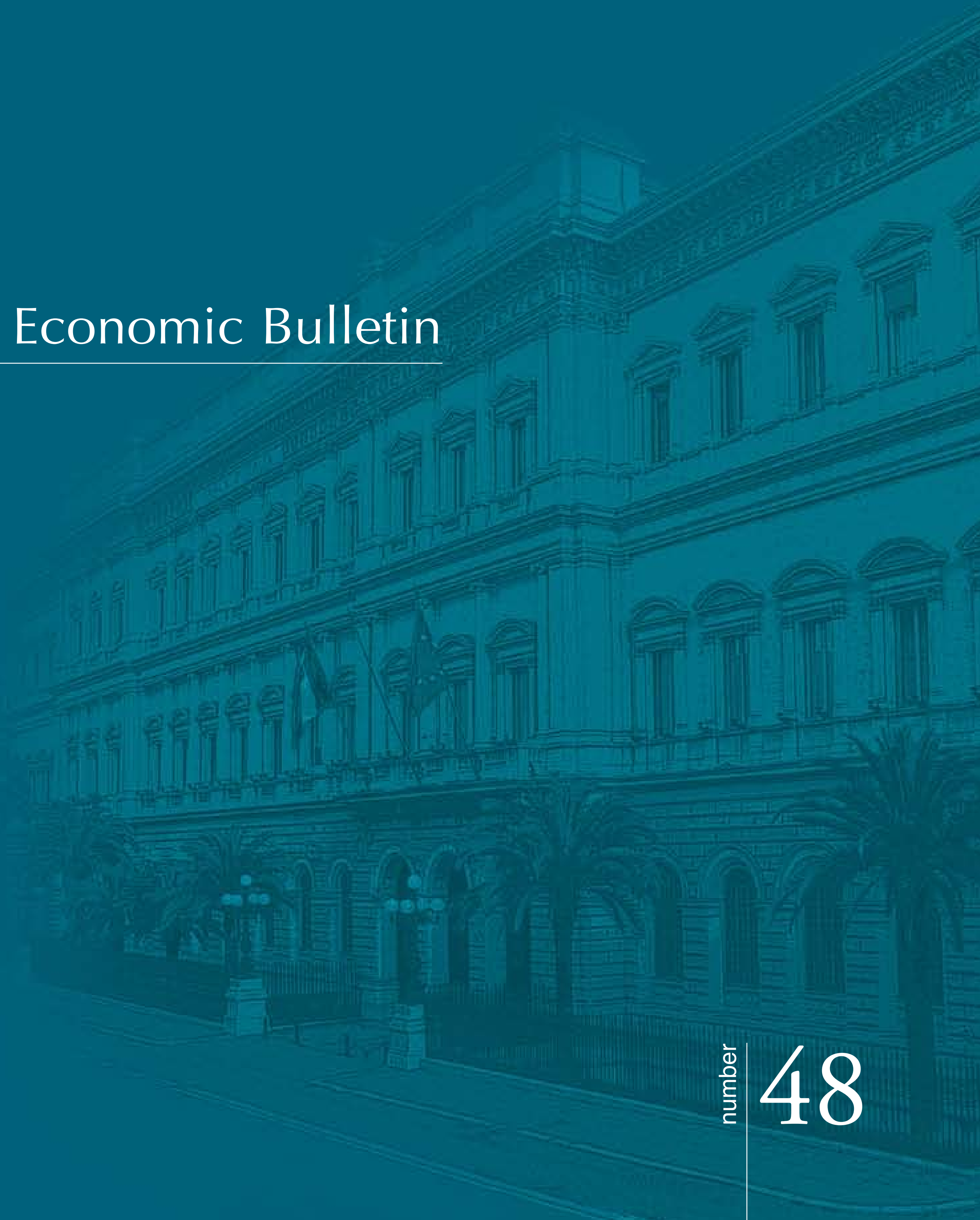
BANCA D'ITALIA
EUROSISTEMA

Economic Bulletin



April 2008

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SYMBOLS AND CONVENTIONS

Unless indicated otherwise, figures have been computed by the Bank of Italy.

In the following tables:

–	the phenomenon in question does not occur
....	the phenomenon occurs but its value is not known
..	the value is known but is nil or less than half the final digit shown
::	the value is not statistically significant
()	provisional; estimates are in italics

1 OVERVIEW

The world outlook worsens

International financial market strains have become more acute in the first part of 2008 and the world economic picture has worsened. In the United States economic activity has slowed sharply, as the effects of the housing market slump are compounded by those of more restrictive financial conditions for households and firms. The unflagging growth of the emerging economies continues to sustain the rapid expansion of world trade. The prices of energy and food commodities have recorded further substantial rises, fuelling inflation in the importing countries, influencing monetary policy stances and weighing on disposable incomes and consumption.

Growth slows and inflation picks up in the main euro-area countries ...

The European Central Bank forecasts released in March put the central estimate of euro-area GDP growth in 2008 at 1.7 per cent, lower than in December; and the latest IMF forecast pares that figure to 1.4 per cent. The €-coin indicator for the area suggests a possible pause in the deceleration in March, but the international picture remains unfavourable and highly uncertain. Consumer price inflation in the area has been gradually accelerating since the autumn, and it reached 3.5 per cent in March according to provisional estimates. In this context the ECB has kept its official rates unchanged at 4 per cent while working in concert with the other principal central banks to supply adequate liquidity to the financial system.

... including Italy

For Italy, a series of qualitative and quantitative indicators suggest that the phase of cyclical slackening that began in the fourth quarter will continue in 2008, holding output growth below the economy's potential, which is already low by international standards. The economy continues to suffer from the structural problems that have prevented satisfactory productivity increases for a number of years now, regardless of cyclical fluctuations. It is estimated that inflation reached a twelve-month rate of 3.6 per cent in March, with an increase since August in line with that of the euro area as a whole.

Household consumption and borrowing slow down

Italian household consumption expanded by 1.4 per cent in 2007, sustained by an analogous increase in disposable income after two years of stagnation. More than half the income gain stemmed from the expansion of employment, while gross per capita earnings remained unchanged in real terms. However, the second half of the year saw a deterioration both in the labour market (employment declined in the fourth quarter) and in consumption, and the subsequent trends in retail sales and consumer confidence suggest that this pattern has continued in recent months as well.

It is estimated that the major labour contract renewals concluded in late 2007 and early 2008 should result in an acceleration of de facto per capita earnings this year. In 2009 earnings growth is expected to return to the moderate levels of recent years. Households have continued to increase their debt, but at a slower pace. The cost of debt service has increased to about 8 per cent of disposable income. It is calculated that the quality of household credit remained unchanged in the second half of 2007.

Firms increase exports but not investment

Firms are slowing down their accumulation of material capital. Investment grew by just over 1 per cent in 2007, but that in machinery and equipment was flat. The broad *stagnation of investment has apparently continued into 2008, as is suggested by businesses' assessments of the outlook for demand and capacity utilization. According to the new data series released by Istat, Italian exports expanded by 5 per cent last year, confirming the signs of the recovery in industrial export capability that emerged in 2006; however, they grew by about 2 points less than world trade, in the presence of a similar deterioration in price competitiveness due to comparatively slow increases in productivity and the appreciation of the euro.*

It is estimated that firms' operating profits declined in the last part of 2007. Corporate self-financing diminished, resulting in an increase in the borrowing requirement despite the stagnation of investment. Bank lending to firms continues to grow rapidly.

Italy's public accounts improved in 2007

Italian general government net borrowing diminished by 1.5 percentage points in 2007 to 1.9 per cent of GDP, coming back down to the levels recorded in 1999 and 2000. This should allow the termination within the next few months of the excessive deficit procedure initiated against Italy in 2005. The primary surplus, which was practically eliminated that year, has been brought back up to 3.1 per cent of GDP. As in 2006 the improvement in the accounts stemmed essentially from the substantial increase in tax and social contribution revenue (to 43.3 per cent of GDP, just under the 1997 peak). Part of the increase reflects the transfer of the accruing severance pay entitlements of employees who did not elect to join supplementary pension funds to the social security administration, INPS. The incidence of primary current expenditure declined slightly to 39.6 per cent of GDP but remains near its highest level ever. Investment spending returned to growth, but at a slower rate than GDP, while interest payments increased from 4.6 to 5.0 per cent of GDP, largely reflecting the increase in interest rates over the last two years.

The public debt was reduced from 106.5 to 104.0 per cent of GDP, the same level as in 2004.

In March the Government revised its estimate of net borrowing for 2008 upwards, from 2.2 to 2.4 per cent of GDP. The cyclically adjusted deficit, net of the effects of temporary measures, is projected to deteriorate by 0.6 percentage points with respect to 2007. The planning framework confirms the objective of a balanced budget in 2011.

2 THE WORLD ECONOMY

2.1 ECONOMIC DEVELOPMENTS AND THE FINANCIAL MARKETS

World growth continues to suffer from the effects of the financial crisis

Although the world economy continued to grow at a rapid pace in 2007 (4.9 per cent), in the latter part of the year it began to feel the effects of the financial crisis that had broken out in the summer. To date economic activity has slowed in the United States and to a lesser extent in Europe, but according to the IMF the slowdown will spread not only to Japan but also to the emerging economies (Table 1). The latter are expected to go on recording high growth rates, however, and thus to support the expansion in world trade. There is still considerable uncertainty regarding the intensity and duration of the crisis.

Table 1

Projected values of some macroeconomic variables
(percentage changes on the previous year)

	IMF			Consensus Forecasts	
	2007	2008	2009	2008	2009
GDP					
World	4.9	3.7	3.8	–	–
Advanced countries					
Euro area	2.6	1.4	1.2	1.5	1.8
Japan	2.1	1.4	1.5	1.3	1.8
United Kingdom	3.1	1.6	1.6	1.7	1.9
United States	2.2	0.5	0.6	1.4	2.3
Emerging countries					
Brazil	5.4	4.8	3.7	4.6	4.4
China	11.4	9.3	9.5	10.2	9.6
India	9.2	7.9	8.0	8.0 (1)	8.4 (1)
Russia	8.1	6.8	6.3	7.0	6.7
Consumer prices					
Advanced countries					
Euro area	2.1	2.8	1.9	2.7	2.0
Japan	0.0	0.6	1.3	0.6	0.5
United Kingdom	2.3	2.5	2.1	2.5	2.0
United States	2.9	3.0	2.0	3.4	2.3
Emerging countries					
Brazil	3.6	4.8	4.3	4.4 (2)	4.2 (2)
China	4.8	5.9	3.6	5.0	3.6
India	6.4	5.2	4.0	5.8 (1)	5.1 (1)
Russia	9.0	11.4	8.4	10.4	8.8
World trade (3)	6.8	5.6	5.8	–	–

Sources: National statistics, IMF *World Economic Outlook*, April 2008; Consensus Economics, March 2008.
(1) Changes during the financial year beginning in April of the year indicated in relation to the preceding financial year. – (2) December on December. – (3) Goods and services.

Prices of basic commodities have recorded further large increases

Oil prices have undergone a further significant rise since the beginning of 2008 (Figure 1). In mid-March and again on 10 April they rose to over $106 per barrel, a level close in real terms to the all-time high recorded in 1979. Futures contracts indicate that the oil price is expected to remain high for the rest of the year, notwithstanding the slowdown in economic activity in the industrial countries (see the box "The factors underlying the recent rise in oil prices"). Large increases have also been recorded in the prices of foodstuffs (see the box "The recent rise in food commodity prices"). Concern about the impact of these trends on inflation, currently rising in most advanced and emerging countries, is influencing the stance of their monetary policies.

The strains in financial markets have grown more severe

Since the beginning of the year conditions in the international financial markets have deteriorated. The US subprime crisis has grown worse and spread to the market for prime mortgage loans and to the commercial construction sector. The leading international financial intermediaries have continued to announce, or

THE FACTORS UNDERLYING THE RECENT RISE IN OIL PRICES

According to data released by the International Energy Agency (IEA), in 2007 the demand for oil worldwide narrowly exceeded supply, leading to a significant decline in the private reserves of major countries; the supply-demand mismatch appears to have widened in the first quarter of 2008. Such a scenario has not been seen since 2002, when both the OPEC cartel and several non-OPEC exporting countries (including Russia, Norway and Mexico) agreed to cut supply by almost two million barrels a day.

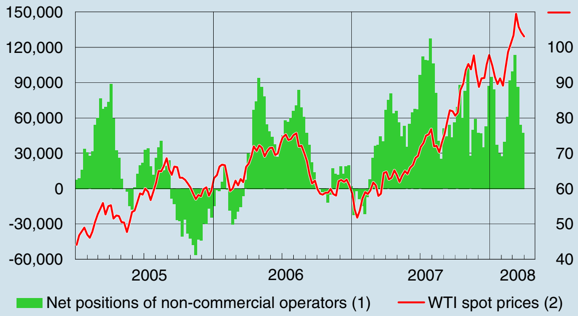
There are many factors behind the ongoing tensions in the oil market. First of all there is the surge in demand from emerging economies, whose energy intensity far exceeds that of advanced countries. Again for 2008 the IEA estimates indicate an increase in global oil consumption of around 2 per cent, almost entirely attributable to emerging countries, while the increase in supply (1.8 per cent) is wholly ascribed to non-OPEC producers. This situation has made the petroleum market even more vulnerable to geopolitical tensions and the risk of temporary interruptions of supplies, increasing price volatility.

A second factor of tension is the relative inelasticity of supply. The causes for this lie both in the policies of the OPEC cartel, whose current output target, even after the increase decided last November, is below the 2006 level, and in the difficulties non-OPEC producers must overcome to boost their productive capacity, because the construction of new wells entails increasingly high research and development costs and very long lead-times.

Figure A

Net speculative positions and spot oil prices

(weekly data; number of contracts and dollars per barrel)

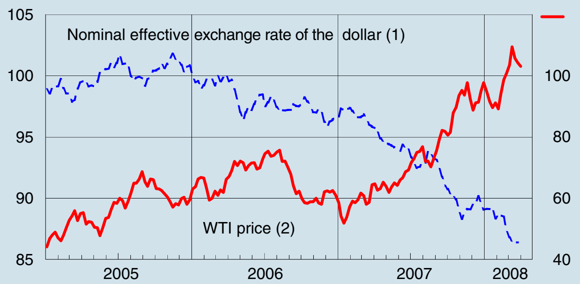


Sources: US Future Commodity Trading Commission, Thomson Financial Datastream.
(1) Net volumes of WTI futures contracts listed in the New York Mercantile Exchange. 1 contract = 500 barrels of oil. The figures refer to Tuesday of each week. – (2) Average weekly data; right-hand scale.

Figure B

Dollar exchange rate and spot oil prices

(average weekly data)



Source: Thomson Financial Datastream.
(1) Index, 2005 = 100. – Dollars per barrel; right-hand scale.

It has been suggested that oil prices may have been affected by developments in the financial markets. Some have noted the apparently strong correlation of the dollar spot price of oil both with the amount of net speculative positions in oil futures (Figure A)[1] and with the nominal effective exchange rate of the dollar (Figure B). In respect of the first correlation, the thesis is that an increase in net speculative positions, inducing a rise in futures prices, can be transmitted to spot prices through arbitrage; however, statistical tests show that the increase of futures positions cannot explain the increase in spot prices.[2] Regarding the second correlation, it has been suggested that exporting

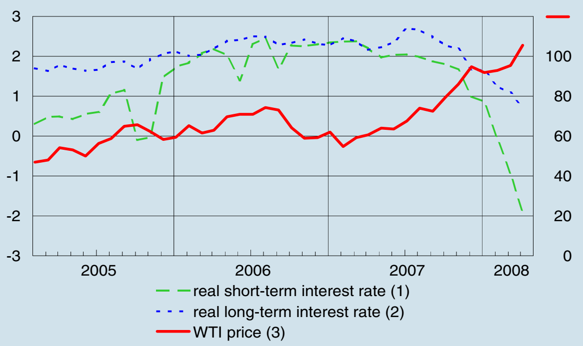
[1] These are measured by the difference between the long and the short positions of non-commercial traders operating on the New York Mercantile Exchange (NYMEX).
[2] See, for example, G. Gorton, F. Hayashi and K. G. Rouwenhorst, "The Fundamentals of Commodity Futures Returns", NBER

countries may seek to recoup the decline in terms of trade by increasing crude oil prices. This correlation is highly unstable over time and not statistically significant, however. A possible alternative explanation of the correlations observed most recently is that oil prices, dollar exchange rates and speculative positions have all reacted to a common factor. Since the end of last summer, the decline in real interest rates in the United States, determined by the reduction of nominal rates and by heightened inflation expectations, may have contributed to rising petroleum prices (Figure C). Lower real interest rates in fact reduce the opportunity cost of holding real assets. It therefore becomes less costly for oil producing countries to build up reserves underground and extract the oil later.[3] At the same time, the fall in dollar interest rates has most likely both weakened the dollar and encouraged the increase in net speculative positions, by reducing their cost.

Figure C

Real US interest rate and spot oil prices

(monthly data; percentage points and dollars per barrel)



Source: Thomson Financial Datastream.
(1) Calculated by deflating the 1-year swap rate with inflation expectations for the next 12 months reported in surveys conducted by the University of Michigan. – (2) Yield on 10-year index-linked government securities. – (3) Average monthly data; right-hand scale.

Working Paper No. 13249, 2007.

[3] The relationship between real interest rates and the commodities prices is analysed by J. Frankel, "The Effect of Monetary Policy on Real Commodity Prices" in J. Campbell (ed.), *Asset Prices and Monetary Policy*, University of Chicago Press, 2007.

recognize in their accounts, loan losses and writedowns of assets related to mortgage loans and other structured products. In total these have amounted to more than $230 billion since the beginning of the crisis. The weakening of the capital bases of monoline insurers (companies that provide protection against the credit risk associated with certain financial assets, including structured products) has fuelled the fear of a downward revision of these companies' credit ratings, which would be passed on to the instruments they guarantee, including many US municipal bonds.

Stock markets have recorded substantial falls ...

Since January 2008 share prices on the leading stock markets have fallen by between 7 and 15 per cent (Figure 2); for the most part the falls have been largest in the banking and financial company sectors. The volatility of share prices has risen again and exceeded the peaks recorded in August 2007 (Figure 3).

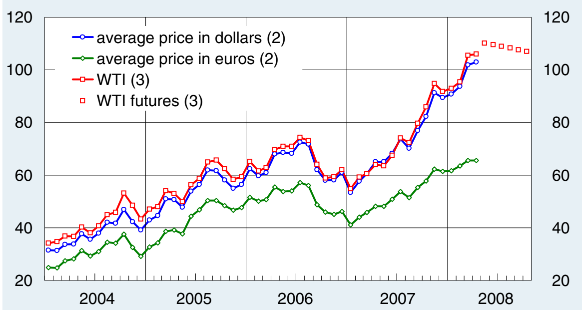
... bond spreads have widened

The yield differentials between corporate bonds and government securities in the United States and the euro area have widened further (Figure 4); for the highest grade securities (AAA) and for

Figure 1

Crude oil: spot prices and futures (1)

(dollars and euros per barrel)



Sources: IMF and Thomson Financial Datastream.
(1) Monthly averages for spot prices. The future data (dotted line) refer to 10 April 2008. – (2) Average price per barrel of the three main grades (Brent, Dubai and WTI). – (3) Dollars per barrel.

those issued by banks and other financial companies the risk premiums are at their highest level since these statistics became available in January 1997, both in the United States and in the euro area.

... and issue volumes have withered

In the United States the large contraction in gross issues of corporate bonds in the first quarter (by more than 50 per cent compared with the first quarter of 2007) was entirely due to the fall of 60 per cent in issuance by banks and of 80 per cent in that by other financial companies; in the euro area the contraction of 60 per cent was spread more evenly across categories of issuers. After a fleeting recovery in January, the volume of asset-backed commercial paper issued in the United States has fallen again.

The expectations of slower growth in the main areas and, above all, the shift in the composition of portfolios in favour of more liquid and less risky assets have led to a renewed decline in the yields on the public-sector securities of the industrial countries (Figure 5). In the United States, despite expectations of rising inflation, ten-year yields fell to 3.5 per cent at the beginning of April, the lowest level since the middle of 2003.

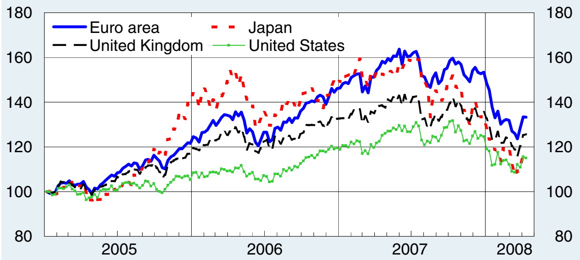
Central banks have intervened again to ease the strains in the money market

The turbulence in the interbank markets also gathered strength in March, when the differentials between rates on secured and unsecured interbank loans widened again. The G10 central banks announced a series of coordinated interventions to increase the supply of liquidity. The action taken by the Federal Reserve included the introduction of two new instruments aimed at primary dealers. The first – the Term Securities Lending Facility – allows primary dealers to obtain Treasury securities in exchange for private-sector securities, including AAA/Aaa-rated mortgage-backed securities (MBS). The second – the Primary Dealer Credit Facility – allows them to obtain very-short-term loans at the discount rate in exchange for eligible collateral; further details are available on the website of the New York Fed (www.ny.frb.org). On 14 March the US investment bank Bear Stearns met with serious difficulty in

Figure 2

Stock market indices (1)

(end-of-week data; first week of January 2005 = 100)

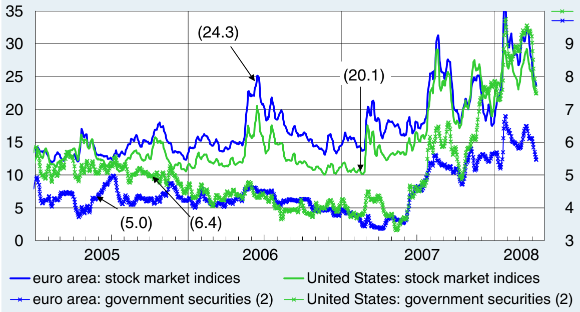


Source: Thomson Financial Datastream.
(1) Dow Jones Euro Stoxx for the euro area, Nikkei 225 for Japan, FTSE All Share for the United Kingdom and Standard & Poor's 500 for the United States.

Figure 3

Implied volatility (1)

(percentage points; averages for the period 1999-2006 in brackets)

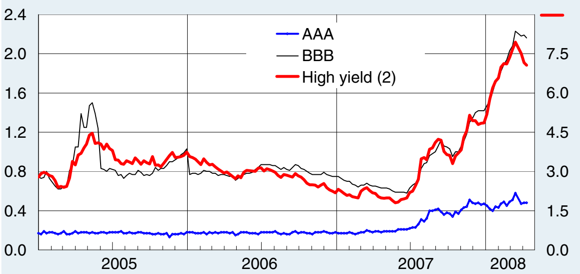


Source: Based on Bloomberg data.
(1) Moving averages over 5 days. Stock market indices: VSTOXX for the euro area and VIX for the United States. Government bonds: volatility implied by the prices of options on futures on the 10-year German Bund for the euro area and on futures on 10-year Treasury notes for the United States. – (2) Right-hand scale.

Figure 4

Yield differentials between euro-denominated bonds of non-financial corporations and government securities (1)

(end-of-week data; percentage points)



Source: Merrill Lynch.
(1) Yields on fixed-rate euro-denominated Eurobonds with a residual term to maturity of not less than one year issued by corporations resident in countries whose long-term foreign currency debt has a rating of not less than Baa3 or BBB- (investment grade). Yield differentials are calculated with respect to French and German government securities. – (2) Right-hand scale. Includes only bonds of companies with a rating of less than Baa3 or BBB- (high yield).

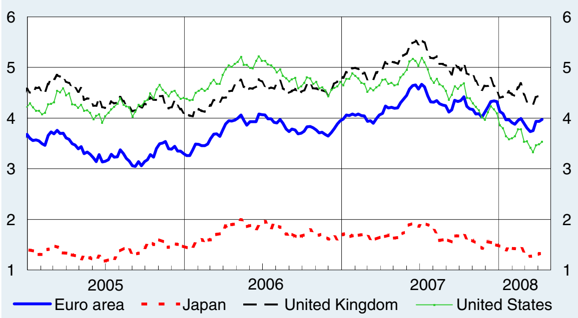
raising liquidity on the market. The bank's shares lost nearly 50 per cent of their value and this triggered falls on all the main stock markets that were especially large for financial companies. To avoid systemic consequences, the Federal Reserve used JP Morgan Chase to provide a 28-day loan to Bear Sterns, which was technically not eligible to receive central bank refinancing, and then approved JP Morgan Chase's proposal to buy Bear Stearns within 90 days.

In the middle of March risk premiums in the emerging countries, measured as the yield differentials between long-term dollar-denominated government securities and US Treasury notes, rose to their highest levels since 2005. The cost of raising funds in foreign currency for these countries is nonetheless still quite low by historical standards. Since the end of last year share prices have fallen by 14 per cent in the emerging countries of Asia and recorded modest gains in those of Latin America.

Figure 5

Yields on ten-year government bonds (1)

(weekly averages; percentage rates)

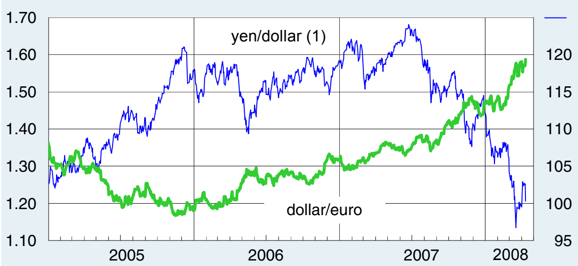


Source: National statistics.

Figure 6

Exchange rates

(daily data)



Source: ECB.
(1) Right-hand scale.

The decline in the dollar accelerates

Influenced by expectations of slower economic growth in the United States and reductions in US interest rates, at the beginning of April the dollar fell to a new low of $1.59 against the euro and in March fell to below 100 yen per dollar, its lowest level since 1995 (Figure 6). In nominal effective terms the depreciation since the end of last year amounted to 4 per cent.

Reflecting the comparatively more pronounced slowdown in economic activity in the United States and the effects of earlier declines in the dollar, the deficit on the current account of the US balance of payments shrank to 5.3 per cent of GDP in 2007, from 6.2 per cent in 2006. The same factors should contribute to a further contraction this year, to 4.3 per cent of GDP according to the IMF.

2.2 THE MAIN INDUSTRIAL AND EMERGING COUNTRIES

Economic activity is stagnating in the United States

The US economy nearly stalled in the fourth quarter, with annualized GDP growth down to 0.6 per cent, from 4.9 per cent in the third, reflecting the sharp contraction in residential investment, the reduction in inventories and a slowing of household consumption and non-residential fixed investment. Consumption appears to have slowed further in the first quarter of 2008, reflecting the drop in employment, slow growth of real disposable income and the fall in the prices of financial and real assets. Housing market indicators suggest that the decline in prices and the contraction in residential investment could continue in the coming months, and the fall in orders and the deterioration in business confidence (Figure 7) point to the likelihood of a further slowdown in non-residential investment.

Private analysts and the international organizations have pared their forecasts for US economic growth. The IMF has just released an estimate of 0.5 per cent for the current year, 1 percentage point lower than the forecast it published in January. The revised forecast implies that average quarter-on-quarter GDP growth during the year will be negative.

No clear signs yet of a sharp tightening of credit

The deterioration in banks' capital and liquidity position and the abrupt increase in risk premiums on all financial markets are fuelling concern that a pronounced tightening of credit supply could make the cutback in households' and firms' spending plans more severe. In the data that has come in up to now, however, there is only limited evidence that such a development is already under way (see box "Bank lending in the United States").

Fiscal policy and monetary policy have reacted rapidly

The US Congress approved temporary stimulus measures in February to counter the worsening of economic conditions. The measures include significant tax cuts for households ($117 billion) and incentives for investment in capital equipment that offer firms tax relief equivalent to $51 billion. However, it is estimated that the effect on demand could prove limited and short-lived if it were attenuated by an increase in households' saving rate.

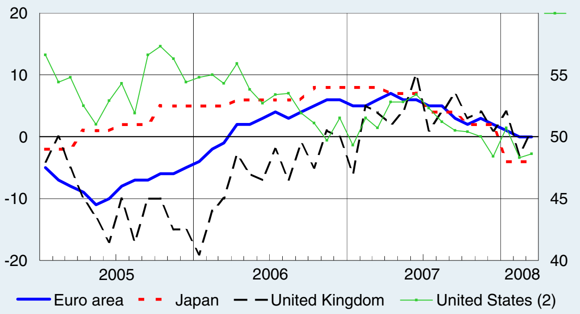
Monetary policy has also reacted swiftly. The Federal Reserve has lowered its federal funds target rate three times since January, reducing it by a total of 2 percentage points, to 2.25 per cent, in a span of less than two months; the prices of futures contracts incorporate expectations of further reductions totalling half a point by the end of the summer (Figure 8). However, the Federal Reserve has signalled worries about inflation. Although inflation as measured by the monthly private consumption deflator has eased slightly since the end of last year, it remains high (3.3 per cent in February), mainly owing to the steep increases in the prices of food and energy products.

A more moderate slowdown is expected in Japan ...

Japan recorded an unexpected pick-up in economic activity in the fourth quarter (to annualized growth of 3.5 per cent) led by exports, especially to

Figure 7

Indicators of manufacturing firms' confidence (1)

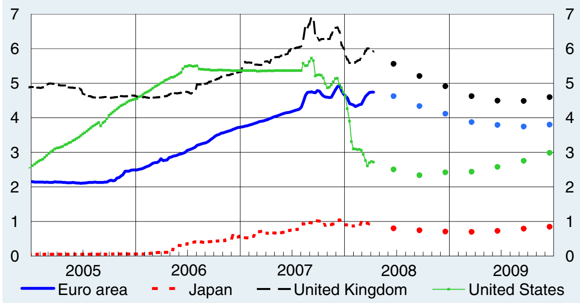


Sources: National statistics and European Commission.
(1) For the euro area, Japan, and the United Kingdom, percentage balance of firms' responses; for the United States, a value higher (lower) than 50 indicates an expansion (contraction) of economic activity. – (2) Right-hand scale.

Figure 8

Spot and forward three-month interest rates implied by futures on Euromarket deposits (1)

(average weekly data; per cent)

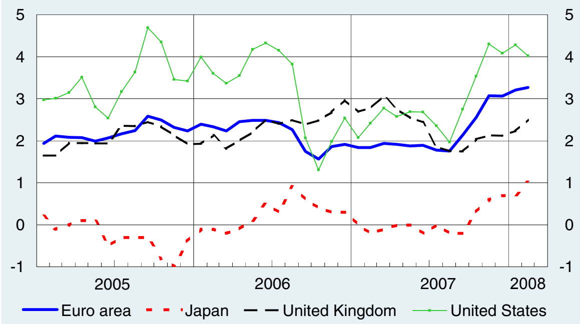


Source: Thomson Financial Datastream.
(1) For futures (dotted line), prices at 10 April 2008.

Figure 9

Consumer price inflation (1)

(monthly data; twelve-month percentage changes)



Sources: Thomson Financial Datastream and Bloomberg.
(1) For the United Kingdom, harmonized index of consumer prices.

the rest of Asia. However, the cyclical indicators signal a slackening in the first half of 2008; the international organizations and private analysts have revised their forecasts of growth down to below 2 per cent. The recent increase in consumer price inflation (to 1 per cent in February; Figure 9) is entirely ascribable to the energy and food components; if these are stripped out, the change in prices remained slightly negative. The Bank of Japan has held official rates unchanged and is expected to continue to do so for the rest of this year.

... and also in the United Kingdom

In the first half of 2008 the British economy appears to be continuing to slow moderately. A factor in this could be the tightening of lending conditions for both corporate loans and mortgages, which banks expect will continue in the coming months. House prices have been falling since November. Consumer price inflation rose to 2.5 per cent in February, but the Bank of England judged the increase to be temporary and lowered its reference rate by another quarter-point both in February and in April.

Though decelerating, growth in the main emerging economies remains vigorous

The main emerging economies continued to grow rapidly in the fourth quarter of 2007. The Chinese central bank tightened monetary conditions further with a view to braking the strong expansion in credit and countering inflation (which rose to 8.7 per cent in February, owing mainly to food prices). There are no indications so far of the restrictive measures having affected investment growth. By contrast, exports have showed signs of slowing in the first few months of 2008, reflecting the deceleration in demand. Although the renminbi has appreciated faster against the dollar (by 4.5 per cent since the start of the year), its nominal effective exchange rate has remained virtually unchanged.

The IMF forecasts indicate that the slowdown in the advanced countries will have a relatively minor impact on the growth of the emerging countries in 2008. GDP is forecast to expand by 9.3 per cent in

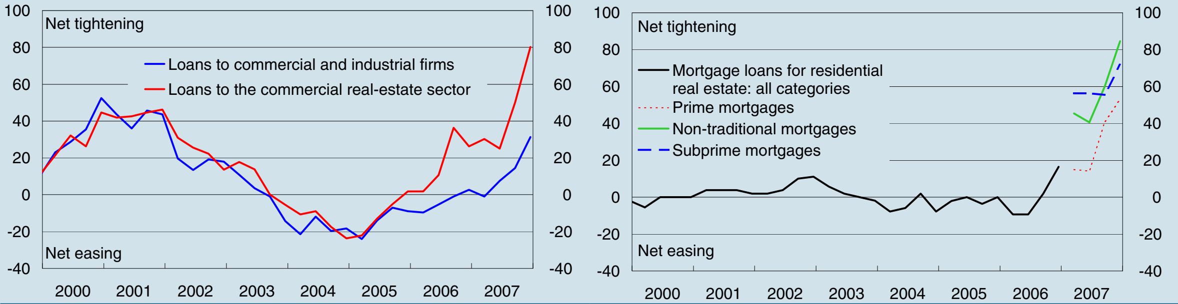
BANK LENDING IN THE UNITED STATES

The subprime mortgage crisis and consequent deterioration in banks' financial situation and liquidity could have serious repercussions on the supply of credit to firms and households, particularly in the United States. In the Fed's last Senior Loan Officer Opinion Survey, which refers to the fourth quarter of 2007, the banks reported that loan demand had slowed and that they had tightened access to credit for firms and households, particularly in the case of mortgage loans, home equity lines of credit, and consumer credit (Figure A). The tightening concerns both interest rates and other lending conditions,

Figure A

Main results of the Senior Loan Officier Opinion Survey (1)

(percentage points; quarterly data)



Source: Federal Reserve.
(1) Difference between the percentage of banks declaring they have tightened access to credit and those reporting they have eased it.

including the maximum amount and duration of loans as well as the collateral requested. The banks justify their decision by citing the unfavourable economic conditions, the lower propensity to take risk, and in some cases their own financial or liquidity situation.

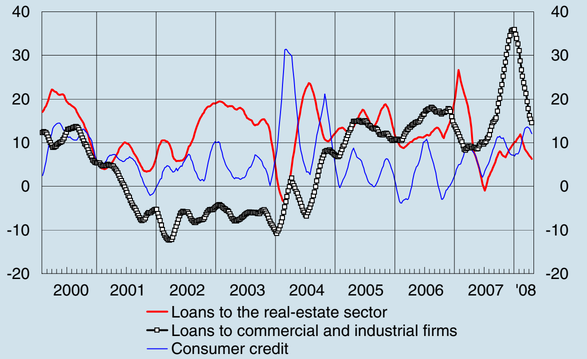
Available data provide only partial confirmation of these results. Since last summer, after the Fed had eased monetary conditions, the average rate of interest on loans to commercial and industrial enterprises and that on conventional mortgage loans (prime 30-year fixed-rate mortgages for less than $417,000) have decreased by 2.1 and 0.7 percentage points respectively, to 5.2 and 6 per cent. However, the rate reduction has been offset somewhat by a widening of the spread between lending rates and the average cost of banks' fund-raising; for both categories of loans this spread is now greater than on the eve of the 2001 recession.

In terms of volume, credit to commercial and industrial firms accelerated sharply in the second half of 2007 (Figure B), before suddenly slowing in the first three months of 2008. Households' consumer credit has been picking up slowly since the middle of last year, but the slowdown in lending to the real-estate sector, for which the breakdown into residential and commercial loans is not available, has been under way since the beginning of 2007.

Figure B

Lending to commercial and industrial firms and firms in the real-estate sector and consumer credit (1)

(percentage changes; seasonally adjusted weekly data)



Source: Federal Reserve.
(1) Change in the average for a 13-week period on the previous one, on an annual basis.

The unexpected growth in lending to firms in the second half of 2007 can probably be put down to the substantial financing accumulated in banks' balance sheets in connection with leveraged buy-outs, which the sudden, sharp cooling of the leveraged loan market last August prevented then from transferring to non-bank operators.[1] Professional forecasters estimate that at the end of January this year leveraged loans not placed on the market amounted to some $150 billion, a figure close to the total growth in lending to commercial and industrial firms in the previous six months. These effects make it difficult to assess the true underlying performance of lending to the corporate sector and to compare it with previous occasions. A lag of one or two quarters between signs of a credit crunch appearing in bank surveys and its effects becoming fully apparent in credit data does not contradict the evidence of history. There has been no decline in aggregate bond issues by non-financial companies since the start of the crisis, although the widening spread with government securities has pushed up their cost. On the other hand, issues of high-yield securities have contracted sharply and their spreads have widened considerably.

Recent trends in the two other categories of lending contrast markedly with those recorded in 2001, when the growth of consumer credit slowed brusquely and mortgage lending held more or less steady. There is probably a greater risk of repercussions on households' spending behaviour on this occasion, partly because mortgage loans now account for four times as much borrowing as consumer credit, and partly because with property prices falling and banks becoming more cautious, households will find it difficult to sustain expenditure by extracting equity from their homes as they did in the 2001 recession.

[1] This financing, which is connected with commitments banks entered into in the last two years, is in fact classified as lending to commercial and industrial firms and influences the aggregate's growth.

China, 7.9 per cent in India, 4.8 per cent in Brazil and 6.8 per cent in Russia, compared with 11.4, 9.2, 5.4 and 8.1 per cent respectively in 2007.

2.3 THE EURO AREA

Growth remained strong in 2007, with a slackening in the autumn

Euro-area GDP grew by 2.6 per cent in 2007 (2.8 per cent in 2006), sustained almost entirely by domestic demand. Investment expanded by 4.3 per cent in connection with high capacity utilization and easy financing conditions for most of the year. Household consumption increased by 1.5 per cent (1.8 per cent in 2006), reflecting the improvement in disposable income thanks to the good performance of the labour market. In Germany, the growth in GDP (2.5 per cent) was driven mainly by exports in spite of the appreciation of the euro, but consumption registered an abrupt slowdown triggered by the indirect tax measures at the start of the year.

GDP growth in the area slowed in the fourth quarter (to a quarterly increase of 0.4 per cent), reflecting the gradual increase in inflation and households' consequent prudent spending behaviour.

The economic situation in the euro area remained highly uncertain in the first few months of the new year. The €-coin indicator fell until March, when it reached 0.3 per cent, below the estimated growth in potential output (Figure 10). After an appreciable upturn in January, growth in industrial activity was modest in February, consistent with survey findings of widespread pessimism among firms and households over the short-term outlook.

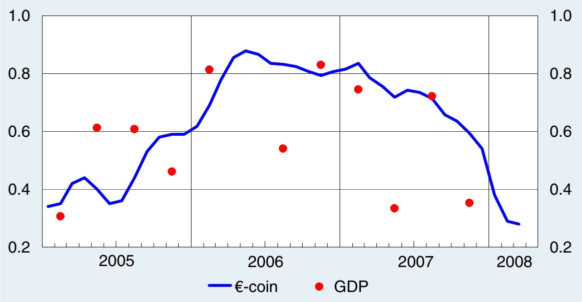
Inflation, fuelled by sharply higher food and energy prices, continues to rise ...

In the first quarter of 2008 the year-on-year increase in the harmonized index of consumer prices, based on preliminary data for March, came to 3.3 per cent (Figure 11). The acceleration reflected the rises in world prices of energy products and processed foods of 10.4 and 6.5 per

Figure 10

€-coin coincident indicator of the euro-area business cycle and GDP (1)

(percentage changes)

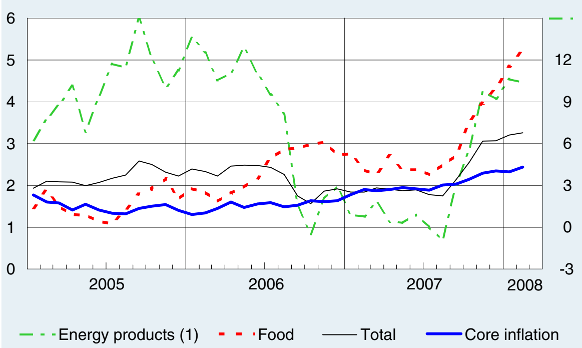


Sources: Eurostat and based on Thomson Financial Datastream data.
(1) For information on the construction of the indicator, see the box "€-coin, a real-time estimate of growth in the euro area" in Economic Bulletin No. 46. For GDP, quarterly data, change in relation to the preceding quarter. For €-coin, monthly data, change in relation to three months previously.

Figure 11

Inflation in the euro area

(twelve-month percentage changes)

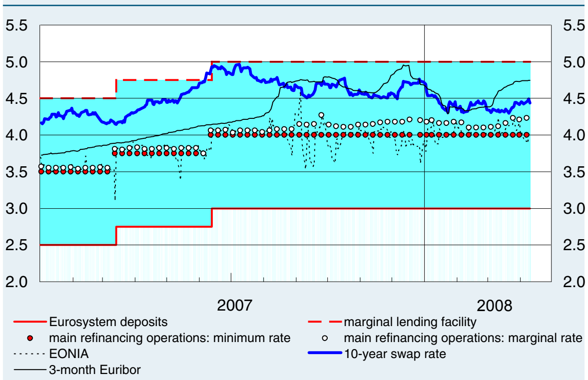


Source: Eurostat.
(1) Right-hand scale.

Figure 12

Official interest rates and money and financial market rates in the euro area

(daily data; per cent)



Sources: ECB, Reuters and Telerate.

cent respectively in the twelve months to February (see the boxes "The factors underlying the recent rise in oil prices" and "The recent rise in food commodity prices"). The high rate of increase in the producer prices of food products (8.8 per cent in February) signals that the tensions in this sector may not yet be fully played out. Core inflation (net of energy and fresh foods) remained at 2.3 per cent. This reflects the slowdown in non-food, non-energy industrial goods prices in connection with the moderate rise in unit labour costs and the easing of demand pressures.

... and short-term inflation expectations adjust accordingly

These developments resulted in a generalized upward adjustment of inflation forecasts for 2008. The professional forecasters polled by *Consensus Economics* in March expected average inflation of 2.7 per cent for the year, falling back to 2 per cent in 2009. The longer-term expectations implicit in the yields on indexed government securities in recent months are only slightly higher.

Bank lending to non-financial corporations continues to expand

Credit to the private sector continued to expand at a rapid pace (10.9 per cent in the twelve months to February), mainly reflecting the growth in lending to firms, while lending to households slowed again as the real estate market cooled off and mortgage rates rose. The rapid growth of M3 in recent months (11.3 per cent in February) may have been due in part to greater demand for low-risk instruments, in response to the performance of the financial markets.

The ECB keeps rates unchanged

In a context of great uncertainty over the possible impact of financial turmoil on economic activity and of the risk of higher inflation, the European Central Bank kept its minimum bid rate on main refinancing operations unchanged at 4 per cent (Figure 12). Interbank rates and spreads over the corresponding rates on secured deposits (Eurepo) turned back upwards at the start of March, signalling the resurgence of money market tensions. The ECB continued to supply abundant liquidity, in part by extraordinary operations in coordination with the main central banks. An agreement with the Federal Reserve made liquidity in dollars available to euro-area banks.

THE RECENT RISE IN FOOD COMMODITY PRICES

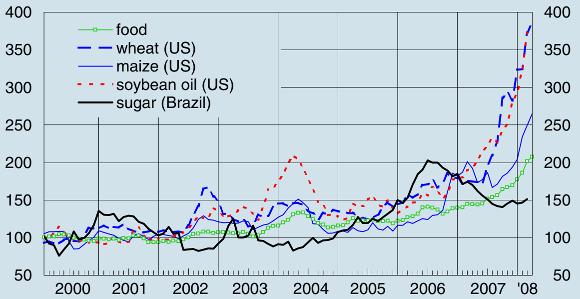
World food commodity prices began rising early this decade after a protracted decline in real terms. The overall index of food commodity prices in dollars has risen by nearly 120 per cent since the low of November 2001 (Figure A) and by 60 per cent in the last two years (in euros, the index has risen by about 30 per cent).

Although the price increases of the past two years have been due in part to exceptional factors, such as bad weather that limited harvests and reduced global stocks of food commodities, the overall increase since the turn of the decade stems mainly from structural changes. First of all, the growing consumption of animal proteins in the emerging countries has produced higher prices for meat, dairy products, and animal feed and forage, mainly consisting of cereals. Second, higher oil prices have put considerable pressure both on the cost side (for the energy and fertilizer used in farming) and on the demand side, by strengthening the incentive for the production of biofuel. According to recent

Figure A

World food commodity prices in dollars

(indices, 2000 = 100)



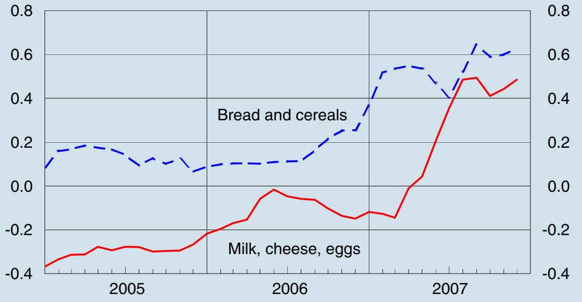
Source: IMF.

estimates by the UN Food and Agriculture Organization, world demand for grain for industrial uses, including biofuel, has increased by more than 25 per cent since 2000, while world food consumption has risen by 5 per cent. Biofuel enjoys highly favourable cost conditions in Brazil (the world's leading exporter of ethanol extracted from sugar cane), but in the main Western countries costs are high and its recent expansion has derived from very substantial tax incentives. Since 2005, in fact, vastly strengthened government subsidies for ethanol production from maize have been in effect in the United States, and in Europe subsidized projects are under way to increase the output of rapeseed biodiesel. Production of biofuel has had a direct price impact, especially on vegetable oils, wheat and maize, whose prices have risen the most in the last three years, by between 130 and 200 per cent. Owing to the high degree of substitutability between some food products and the relative ease of changing crops, the rises were quickly transmitted to other farm products.

The increase in food commodity prices affected consumer inflation in the euro area with a lag. Prices did not begin to accelerate until the last few months of 2007, as an effect of higher processed food prices. Figure B shows that despite the lag, the speed with which the consumer prices of some food products (dairy products and cereals in particular) react to world commodity prices, as measured by the correlation between the two indexes, has increased steadily. In the case of dairy products this can be ascribed to the Common Agricultural Policy's minimum price mechanism. As long as the world price of milk was below the CAP intervention threshold, European prices remained very close to that threshold, and hence relatively stable (Figure C). During that period, therefore, dairy product prices responded primarily to other factors. When world prices went above the CAP threshold, the price of milk in Europe adjusted quickly, inducing producers to raise the prices of dairy products.

Figure B

Correlations between food commodity prices and consumer food prices in the euro area (1)



Sources: Based on Datastream and ECB data.
1) Correlation over the previous 36 months between the monthly change in the sub-indices of the consumer prices shown and a 12-term moving average of monthly changes in the prices of the corresponding food commodities, in euros. The commodities are wheat for "bread and cereals" and milk for "milk, cheese, eggs".

Figure C

Price of non-fat dried milk, 1999-2007
(thousands of euros per ton)

Sources: FAO, EU Commission, IMF.

In the case of wheat (for which the world price was well above the CAP threshold as early as 2000), the recent sharp rise in producer prices can be blamed on bad European harvests in the summer of 2007 owing to poor weather, against a background of exceptionally limited world stocks.

The rapid adjustment of consumer prices to the higher cost of inputs suggests that producers see the latter as a permanent change in cost conditions, which has accordingly been passed on to consumers. In the future, uncertainty over the adjustment of world supply to the growing demand from the developing countries could be a factor in persistent tensions in food commodity markets and in keeping euro-area prices more sensitive than in the past to global shocks.

3 RECENT DEVELOPMENTS IN ITALY

3.1 THE CYCLICAL SITUATION

In 2007 GDP growth was slower than in 2006

On the basis of annual national accounts data, GDP in Italy increased by 1.5 per cent last year, compared with 1.8 per cent in 2006 (Figure 13 and Table 2). Growth was fuelled by domestic consumption and exports. Investment slowed and its contribution to growth decreased; the negative contribution of imports also diminished. In the absence of complete quarterly data, it is estimated that economic activity faltered in the second half of the year.

Employment continued to increase during 2007 as a whole; in the last few months of the year, however, the number in employment fell, with most of the contraction occurring in the Centre and South, and the unemployment rate stopped falling, although it remained at a historically low level.

The economic cycle remains weak

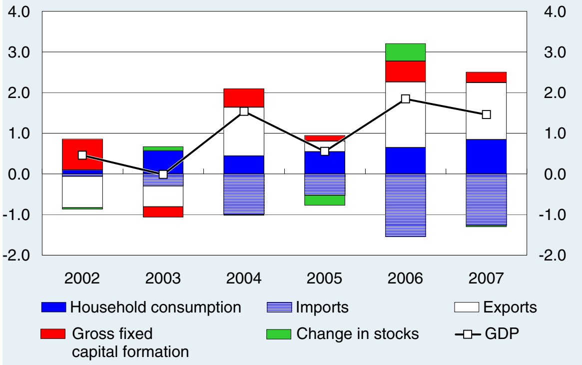
In the first two months of 2008 industrial production, partly estimated on the basis of electricity consumption, stopped its contraction. The forecasts for GDP growth in 2008 have gradually been revised downwards in recent months, owing largely to factors that also affected the other euro-area countries, such as the more uncertain outlook for growth in world trade, the recent worsening of the terms of trade and the strong appreciation of the euro (Table 3).

Inflationary pressures mount

Inflation continued to accelerate in the first quarter of this year, reflecting pressures in international markets in basic energy and food products that were only partly offset by the appreciation of the euro (see the boxes "The factors underlying the recent rise in oil pricel" and

Figure 13

Contributions of the main components of demand and imports to the growth in GDP (1)
(percentage points)



Source: Istat.
(1) The formula for calculating the contributions to real GDP growth in accordance with the new methodology for price deflation based on chain linking is available at www.istat.it.

Table 2

GDP and its main components
(chain-linked volumes; quarterly data adjusted for seasonal and calendar effects; percentage changes on previous period)

	2006	2007 (1) Q1	2007 (1) Q2	2007 (1) Q3	2007
GDP	1.8	0.3	0.1	0.4	1.5
Total imports	5.9	-1.2	-0.2	2.4	4.4
National demand (2)	1.8	-0.1	0.4	0.8	1.3
National consumption	1.0	0.5	0.4	0.2	1.4
households	1.1	0.7	0.5	0.2	1.4
other (3)	0.9	..	-0.1	0.2	1.3
Gross fixed capital formation	2.5	0.6	0.2	1.5	1.2
construction	1.5	1.6	-1.2	1.4	2.2
other goods	3.5	-0.4	1.5	1.5	0.2
Change in stocks and valuables (4)	0.4	-0.6	0.1	0.4	..
Total exports	6.2	0.2	-1.4	0.9	5.0

Source: Istat.
(1) Quarterly data on the components are not necessarily consistent with the annual accounts. – (2) Including change in stocks and valuables. – (3) Expenditure of general government and non-profit institutions serving households. – (4) Contribution to GDP growth over the previous period, in percentage points.

"The recent rise in food commodity prices"). On the basis of provisional data, consumer price inflation, measured in terms of twelve-month changes in the harmonized index, rose to 3.6 per cent in March, 1.9 percentage points above the level of last August. Excluding energy and food products, the rise in the index remained more or less unchanged at around 2 per cent.

3.2 FIRMS

Industrial production stagnates

After falling sharply in the fourth quarter of 2007, according to our estimates industrial production remained flat on average in the first three months of this year (Figure 14). Recent surveys of manufacturing firms continue to report widespread pessimism. The indices compiled from interviews with purchasing managers (PMI) and from surveys by ISAE fell to approximately the average level of the second half of 2005, preceding the start of the last upturn. The deterioration in assessments of the current level of both export and domestic orders (Figure 15) was accompanied by a worsening of short-term expectations about production and the general economic situation. The survey conducted by the Bank of Italy in conjunction with *Il Sole 24 Ore* at the end of March reveals a sharp decline in the expectations of firms in industry and services about the general economic state of the country.

Activity in the construction sector appears to have weakened again, as indicated by the fall in house sales and the further slowdown in property prices. These developments appear to be in line with the deterioration in confidence among firms in the sector, which was already signalled in the last number of this Bulletin and which continued in more recent months.

Investment weakens

Signs that investment plans are being pruned are evident from several indicators. Surveys of firms producing capital goods point to a worsening of assessments of levels of production and domestic orders. The capacity utilization rate fell at the beginning of this year to a level close to the average for the last decade. Half of the industrial firms interviewed for the Bank of Italy-Sole 24

Table 3

Forecasts for Italy

(percentage changes on previous year)

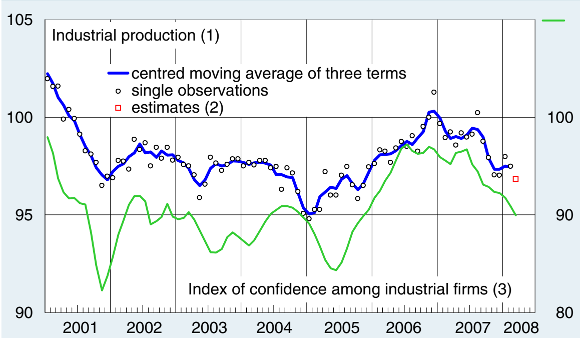
	GDP		Inflation (1)	
	2008	2009	2008	2009
OECD (2)	1.3	1.3	2.4	1.9
European Commission (3)	0.7	–	2.7	–
Consensus Forecasts (4)	0.8	1.2	2.6	2.0
Government (5)	0.6	1.2	2.7	2.1
IMF (6)	0.3	0.3	2.5	1.9

Sources: OECD, European Commission, *Consensus Forecasts*, Ministry of the Economy and Finance, IMF.
(1) Harmonized index of consumer prices; for government forecasts, consumption deflator. – (2) *Economic Outlook*, December 2007. – (3) Interim Forecast, February 2008. – (4) Survey of March 2008. – (5) *Relazione Unificata sull'Economia e la Finanza Pubblica*, March 2008. – (6) *World Economic Outlook*, April 2008.

Figure 14

Industrial production and index of business confidence

(monthly data; index, 2000=100)

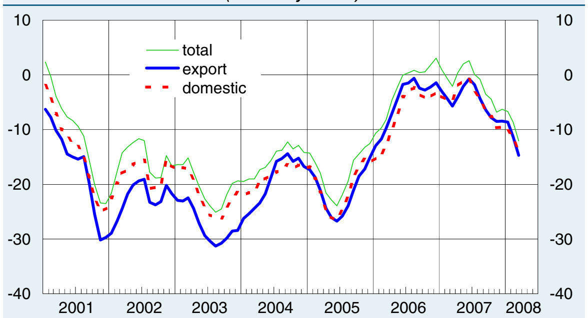


Sources: Based on ISAE, Terna and Istat data.
(1) Data adjusted for seasonal and calendar effects. – (2) Based on electricity consumption and the indicators of the ISAE surveys of manufacturing firms. – (3) Average of the seasonally adjusted percentage balances of the responses to questions regarding the level of demand, production expectations and stocks of finished products; moving average of three terms (right-hand scale).

Figure 15

Industrial order (1)

(monthly data)



Source: Based on ISAE data.
(1) Moving average for the three months ending in the reference month of the difference between the percentage of positive replies ("high", "increasing") and that of negative replies ("low", "decreasing") to the request to assess the level of orders. Seasonally adjusted. The replies are weighted by size, sector and location of firm.

Ore survey reported that in the first quarter of this year investment conditions were worse than in the previous quarter.

Price competitiveness deteriorates

In 2007 the price competitiveness of Italian firms, measured on the basis of producer prices, declined by around 2 per cent, more than in the other major euro-area countries (Figure 16). According to our estimates, there was a further slight deterioration in the first quarter of this year. The appreciation of the euro is depressing the price competitiveness of all the countries of the area. In Italy a further important factor is the rate of increase in unit labour costs, which have been raised by the unfavourable trend in productivity.

Productivity growth has halted

The cyclical weakening in activity again caused the productivity growth of industrial firms to stall last year, against the background of a modest increase in employment in the sector. Compensation per full-time employee rose by 2.4 per cent while unit labour costs increased by 2.5 per cent, the same as in 2006 (Figure 17).

Corporate profitability declines

According to estimates based on the national accounts, firms' operating profits declined in the final quarter of 2007; over the year as a whole they remained at an unchanged low level. Self-financing fell, owing partly to the increase in net interest charges; over the year as a whole it was lower in relation to value added than at any time during the last five years.

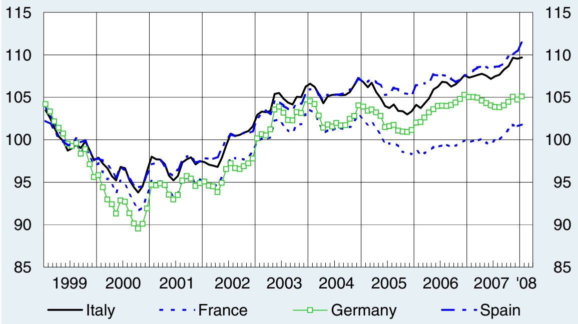
The borrowing requirement increases

Despite a contraction in investment, the decline in self-financing appears to have caused an increase in the borrowing requirement (defined as the difference between gross investment, including stocks, and self-financing). At the end of 2007 firms' financial debt rose to the equivalent of 73.3 per cent of GDP (Figure 18), three points more than in September and more than five points higher than at the end of 2006. Net bond issues amounted to €3 billion in the final quarter of 2007, whereas there had been net redemptions

Figure 16

Indicators of competitiveness for the major euro-area countries (1)

(indices, 1999=100)



Sources: Based on IMF, OECD and Eurostat data.
(1) Based on producer prices; an increase in the index indicates a loss of competitiveness. Indices calculated in relation to 61 competitor countries; latest available data refer to January 2008.

Figure 17

Labour costs and productivity in industry excluding construction

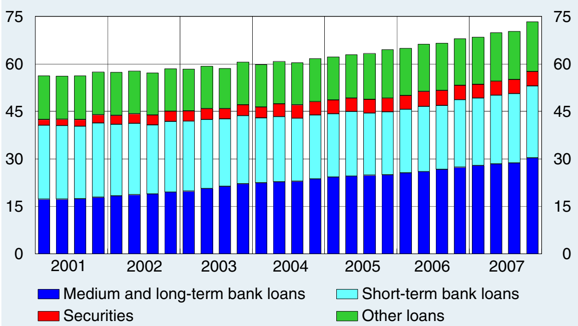
(annual data; percentage changes on previous period)

Source: Based on Istat data.

Figure 18

Corporate debt (1)

(as a percentage of GDP)



(1) The figures for 2007 are provisional.

in the preceding quarter and in the fourth quarter of 2006. Preliminary data on gross issues indicate, however, that there were no placements in the first quarter of 2008. In Italy bond issues by non-financial firms are almost exclusively the preserve of large listed companies, which make issues at irregular intervals and sometimes for large amounts. Capital increases were substantial in the final quarter of 2007 (just under €2 billion) and much smaller in the first two months of 2008.

In the fourth quarter of 2007 Italian firms announced 17 mergers and acquisitions, all of them small in scale. They acquired significant or controlling interests totalling about €2.5 billion, similar to the figure for the preceding quarter and below that recorded in the other leading European economies.

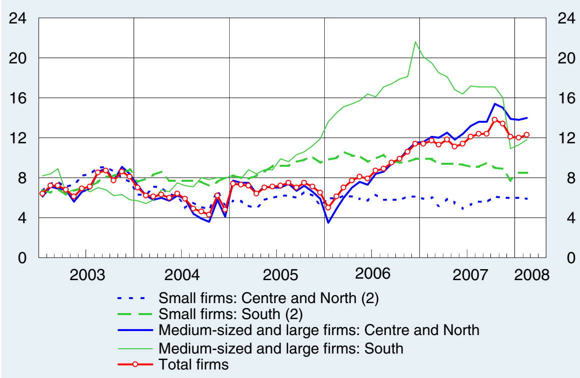
Credit growth remains rapid, credit quality stable

Bank lending to firms continues to increase rapidly, rising by 12 per cent in the twelve months to February (Figure 19). In relation to the volume of loans outstanding at the beginning of the period, new bad debts recognized in the twelve months ending in December 2007 came to 1.3 per cent in manufacturing and construction and 0.9 per cent in services, broadly the same as last June. Indices of debt risk remain lower than in the past.

Figure 19

Bank lending to firms by size and geographical location of firm (1)

(monthly data; twelve-month percentages changes)



(1) Loans exclude repos, bad debts and other, minor items included in the Eurosystem harmonized definition of the aggregate. The breakdown by geographical area is based on customer residence. The percentage changes are calculated net of reclassifications, exchange rate variations and other changes not due to transactions. – (2) Limited partnerships, general partnerships, informal partnerships, de facto companies and sole proprietorships with up to 19 workers.

3.3 HOUSEHOLDS

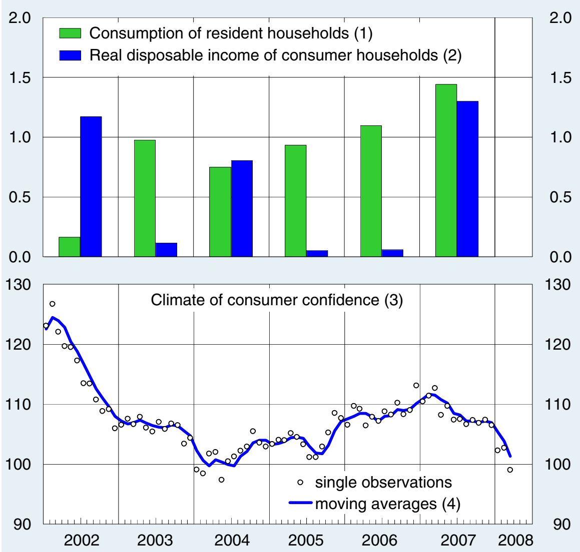
Disposable income sustained consumption...

In 2007 the growth of 1.4 per cent in household consumption reflected the increase in spending on services and, to a lesser extent, durable goods. Among the latter, purchases of transport equipment increased particularly strongly, encouraged partly by tax incentives introduced in the budget law for 2007. The growth in consumption was close to our estimate for the rise in disposable income, which recovered after two years of virtual stagnation (Figure 20). More than half of the increase in disposable income was ascribable to the rise in employment.

Figure 20

Household consumption and income and consumer confidence in Italy

(percentage rates of increase; indices)



Sources: Based on ISAE and Istat data.
(1) Chain-linked volumes; percentage changes in relation to preceding year. – (2) Obtained using the deflator of consumption of resident households; our estimates for 2007. – (3) Index: 1980=100, seasonally adjusted data. – (4) Moving average for the three months ending in the reference month.

...which nevertheless slowed during the year...

Consumer spending slowed sharply in the second half of the year. Data on retail sales in the fourth quarter indicate a marked fall in purchases of non-durable goods and food, which may have been affected by recent price rises.

...and stagnated in the first few months of 2008

In more recent months the index of retail sales has continued to fall. Consumer confidence has worsened noticeably (Figure 20); the deterioration affected all components of the index, but especially those relating to the present economic situation of the country and the future outlook for savings.

Household debt slows...

The slowdown in household debt that began in mid-2006 continued; it was entirely ascribable to medium and long-term credit. Data for February indicate a further slowdown both in loans for house purchases and consumer credit. At the end of 2007 the ratio of debt to disposable income stood at 50 per cent (Figure 21).

... but the cost of borrowing increases

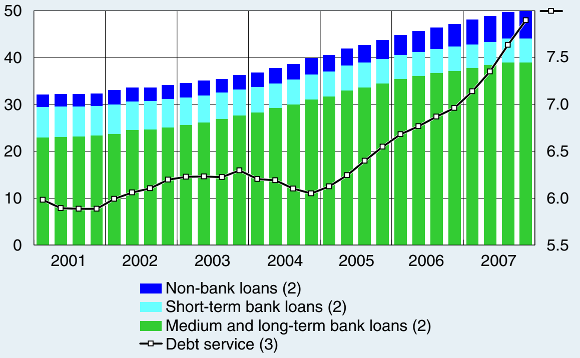
Households' debt servicing expenses continued to rise, reaching 7.9 per cent of disposable income in 2007, 0.9 points more than in 2006 (Figure 21). Around half of the increase can be attributed to interest payments, owing partly to the rise in mortgage interest rates up to the final quarter of the year (Figure 22). Evidence from sample surveys indicates that since 2004 the ratio of mortgage instalments to household income increased the most for households in the lowest income quartile, rising to 32 per cent, and that this level, although high, had previously been reached in the second half of the nineties. In the last decade the increase in the ratio affected mainly households with an income above the median, who hold more than three quarters of the sector's total debt (see the box "Household debt in Italy").

The quality of household credit remained stable in the second half of 2007. The flow of new bad debt recorded during the year equalled 0.8 per cent of loans outstanding at the beginning of the year, similar to the figure for 2006.

Figure 21

Household debt (1)

(as a percentage of gross disposable income)

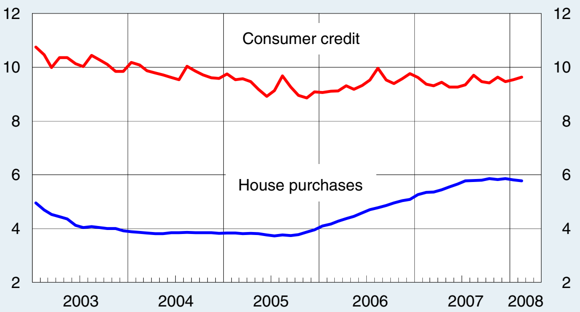


Sources: For gross disposable income, Istat and our estimates.
(1) Consumer households, non-profit institutions serving households and sole proprietorships with up to 5 workers. Disposable income and debt service are for the twelve months ending in the reference quarter. Our estimates for quarterly data on disposable income; data for 2007 are entirely estimated – (2) End-of-period stocks. – (3) Right-hand scale. Refers only to consumer households. Debt service includes payment of interest and repayment of principal.

Figure 22

Interest rates on bank loans to households: APRC on new business (1)

(monthly data; per cent)



(1) The data on bank lending rates refer to euro transactions and are gathered and processed using the Eurosystem's harmonized method. Contracts concluded during the reference period or contracts renegotiating previous terms and conditions. The annual percentage rate of charge (APRC) includes ancillary expenses (administrative expenses, loan examination fees and insurance) and is calculated as the average rate across all maturities, weighted by loan amount.

HOUSEHOLD DEBT IN ITALY

Lending to households in Italy has risen extremely rapidly since the beginning of the decade, with total loans increasing on average by 11.5 per cent annually and home mortgages by over 15 per cent. This is higher than the rate recorded for the euro area.

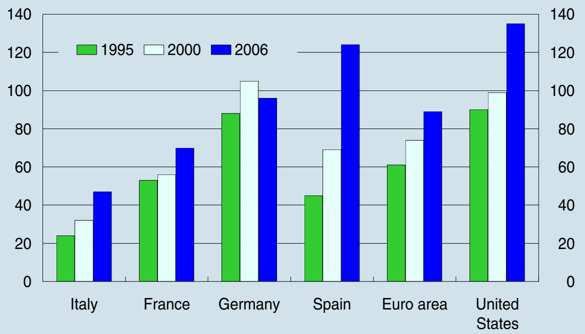
The growth in household debt has been fostered by low interest rates and accompanied by a sharp rise in property prices. The deregulation following the adoption of the 1993 Consolidated Law on Banking has also contributed by allowing banks to adapt their terms to households' requirements. Thus, in 2006 the average ratio between the amount of the mortgage and the value of the property reached around 70 per cent. [1] It also became possible to take out mortgage loans for larger amounts thanks to their longer duration, with those contracted in 2006 carrying an average maturity of over 20 years.[2]

Despite this growth, in 2007 the aggregate debt of Italian households amounted to about 50 per cent of disposable income, well below the average for the euro area (around 90 per cent) and for the majority of industrial countries (Figure A). The percentage of households with debts was also lower: according to the Bank of Italy's Survey on Household Income and Wealth [3] in 2006 12 per cent of households had a mortgage loan and 13 per cent some form of consumer credit. The corresponding percentages for both categories of loan were close to 20 per cent in Spain (on data for 2001) and to 30 and 50 per cent respectively in France and the United States (in 2004). [4]

Overall, the percentage of Italian households with some form of debt has fluctuated around the 20 per cent mark since the mid-1990s, showing a slight tendency to rise since 2002 (Figure B). The sharp growth in debt in recent years therefore mainly reflects an increase in the average individual debt of the households concerned rather than broader participation in the credit market.

Figure A

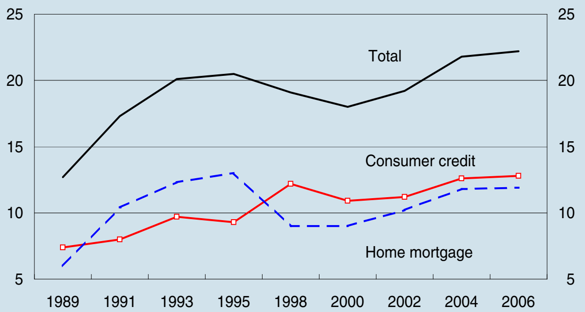
Households financial liabilities (1)
(as a percentage of disposable income)



Sources: Bank of Italy for data on Italy; Banque de France for France; Deutsche Bundesbank for Germany; Banco de España for Spain; Federal Reserve System Board of Governors, *Flow of Funds Accounts of the United States* for the United States; ECB for the euro area.
(1) Data refer to consumer and producer households and to non-profit institutions at the service of households. Gross disposable income refers to households with and without debts.

Figure B

Participation in the credit market (1)
(percentages)



Source: Bank of Italy, *Survey on Household Income and Wealth*.
(1) Percentage of households with debts in total households in the survey. Does not include loans contracted for professional reasons.

[1] In the 1970s the loan-to-value ratio could not exceed 50 per cent by law; in the 1980s it was progressively raised, reaching 80 per cent in 1995. Under present supervisory regulations it is possible, in certain conditions, for the LTV ratio to attain 100 per cent.
[2] Data on the loan-to-value ratio and mortgage duration were obtained from a questionnaire put to a sample of Italian banks accounting for more than 85 per cent of households' outstanding mortgages at the end of 2006. The survey was carried out by the Economic Research Units operating from the Bank of Italy's regional branches.
[3] The survey is carried out every two years on a sample of around 8,000 households. Only debts contracted for personal reasons are taken into account and therefore any loans for professional or business reasons are excluded. The survey can be found on the Bank's website at www.bancaditalia.it.
[4] See OECD, "Has the Rise in Debt Made Households More Vulnerable?", *Economic Outlook*, 80, 2006, p. 135-158. Although the data come from largely homogenous sample surveys they may not be perfectly comparable owing to differences in the definition of households and in the types of loans included in consumer credit.

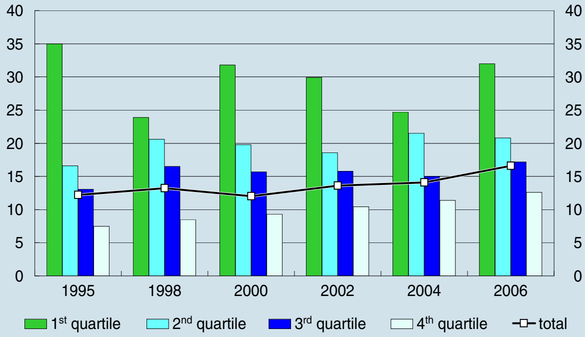
The proportion of households with a mortgage loan has thus followed the property market cycle, returning at the end of 2006 to a value close to that recorded in the mid-1990s. In contrast, partly as a result of deregulation, the proportion of households obtaining consumer credit has risen from 9 per cent of the total in 1995 to 13 per cent in 2006 (Figure B). Participation in this segment of the credit market has also increased among households in the lowest quartile of income, although the largest growth is recorded for households with income over the median.

During the decade the total debt of borrower households has increased in proportion to their disposable income. The median value of this ratio reached 37 per cent in 2006, compared with 27 per cent in 2000, while the average ratio rose from 60 to 95 per cent in the same period.[5] All income classes have been affected, although the ratio has increased most for households with a mortgage loan.

Figure C

Debt service on mortgage loans by income class (1)

(percentage of disposable income; median values)



Source: Bank of Italy, *Survey on Household Income and Wealth*.
(1) Instalments on home mortgages only and only for households with this type of loan. Households are divided into quartiles according to income (i.e. in increasing order of income). Loans contracted for professional reasons are not included.

As borrowing has increased so has the cost of debt service, i.e. households' expenditure on interest payments and repayment of principal. In 2007 the cost of debt service amounted to almost 8 per cent of aggregate disposable income of all households, both with and without debts, nearly 3 percentage points more than in 1996. According to the Survey on Household Income and Wealth, in 2006 the cost of servicing home mortgages alone amounted to 17 per cent of the disposable income of the median household with this type of loan, compared with 12 per cent in 1995 and 2000 (Figure C). Since 2004 this item of expenditure has increased most for households in the lowest income quartile, whose mortgage instalments amount to 32 per cent of their income. Although this seems high, a similar value was recorded in the 1995 and 2000 surveys. For households whose income is above the median, the cost of debt service is around 15 per cent; this represent an increase with respect to earlier surveys, particularly for households in the highest income quartile.

Households in the lowest income class with a mortgage loan represent 1 per cent of all Italian households (about 230,000). They account for 7 per cent of total mortgages and 8 per cent of total debt. Households whose income is over the median hold more than three-quarters of the sector's total debt.

[5] Values below the 1st percentile and above the 99th percentile of distribution are not included.

3.4 FOREIGN DEMAND AND THE BALANCE OF PAYMENTS

In 2007 exports increased at a sustained pace...

As a result of the recent revision of foreign trade statistics by Istat and the associated amendment of national accounts data, the growth in Italian exports and imports during the last decade now appears to have been greater than previously reported (see the box: "The recent statistical revision of the average unit values and the volumes of Italian exports and imports"). In 2007 as a whole the volume of exports grew by 5 per cent (Table 2), above the average for the five years from 2001 to 2005 but two points less than the growth in world demand. Merchandise exports to Russia increased particularly strongly, while those to the United States declined further, penalized by the exchange rate. Within the EU, a slowdown in exports to Germany, where domestic demand was sluggish, contrasted with an acceleration in exports to the other major countries. Above-average volume growth was recorded in refined petroleum products, means of transport and mechanical equipment; among the traditional branches of activity, exports by the textile and garment sector and the leather and leather goods sector began to contract again.

...and more than imports...

In 2007 imports increased by 4.4 per cent in volume. The growth was mainly in machinery and mechanical equipment and in means of transport, reflecting the good performance of production and foreign demand in those sectors.

...but both slowed towards the end of the year

The foreign trade data show that both exports and imports of goods decreased in volume between the third and fourth quarters, affected by the deterioration in the international economic climate and also by the strike by Italian lorry drivers in December, although the impact of the latter was probably largely offset in subsequent months.

Table 4

Italy's balance of payments (1)

(billions of euros)

	2006	2007	2007 January	2008 January
Current account	**-38.2**	**-36.6**	**-5.5**	**-5.6**
Goods	-10.2	2.0	-2.4	-2.5
non-energy products (2)	*37.5*	*46.9*	*1.4*	*2.3*
energy products (2)	*-47.7*	*-44.9*	*-3.8*	*-4.9*
Services	-1.2	-6.6	-1.4	-0.7
Income	-13.6	-18.8	-1.4	-1.7
Current transfers	-13.2	-13.2	-0.3	-0.8
Capital account	**1.9**	**2.7**	**0.2**	**0.3**
Financial account	**35.5**	**30.4**	**4.9**	**1.5**
Direct investment	-2.3	-41.5	-14.0	0.2
Portfolio investment	54.8	13.9	-7.4	20.3
Financial derivatives	-0.4	0.1	0.5	-0.1
Other investment	-17.0	59.4	26.7	-17.6
Change in official reserves	0.4	-1.6	-0.9	-1.2
Errors and omissions	**0.8**	**3.5**	**0.4**	**3.8**

(1) Provisional data for December 2007 and January 2008. – (2) Based on Istat data on foreign trade.

The current account deficit narrowed, thanks to an increase in the value of exports

In 2007 as a whole the deficit on the current account of the balance of payments (€36.6 billion, equal to 2.4 per cent of GDP) decreased slightly from the peak reached in 2006 (Table 4). The merchandise balance improved appreciably, from a deficit equal to 0.7 per cent of GDP to a small surplus, reflecting a larger surplus on non-energy products and a reduction in the energy deficit. The latter benefited from the sustained increase in exports of refined products and the appreciation of the euro, but it began to increase again towards the end of the year as a result of the sharp increases in oil prices. The increase in the deficit on services to €6.6 billion was caused mainly by sustained growth in imports of "other business services". The deficit in respect of "income" rose to €18.8 billion owing to a decrease in receipts in euros on dollar-denominated assets and an increase in interest on the banks' increased debtor position in the Euromarket.

In January the current account deficit was at the same level as a year earlier, but the deterioration in the trade balance that had begun at the end of last year continued and was attributable primarily to the increase in the energy deficit.

Italian direct investment abroad increased, and inward investment remained high

The financial account shows a net outflow of €41.5 billion in respect of direct investment in 2007; Italian investment abroad almost doubled, to €64.9 billion, owing to two large acquisitions in the banking and energy sectors; inflows were below the extremely high level of 2006, but still substantial. As regards portfolio investment, there were net sales of Italian equities by foreigners and of foreign equities by residents. The latter in particular appear to be related to the turmoil in international markets from the middle of 2007 onwards.

THE RECENT STATISTICAL REVISION OF THE AVERAGE UNIT VALUES AND THE VOLUMES OF ITALIAN EXPORTS AND IMPORTS

Average unit values (AUVs) calculated as the ratio between the value and the physical quantity of the goods exported (imported) are, in the absence of ad hoc surveys, an important indicator of the behaviour of Italian export and import prices.[1] Between the end of February and the middle of March 2008 Istat released the new monthly indices of Italian foreign trade (AUVs and volumes) for the period 1996-2007. The statistical revision, incorporating significant methodological improvements,[2] reduces the growth in AUVs substantially and consequently increases that in export and import volumes.

As a result of the revision the growth in AUVs between 1996 and 2007 falls from 61 to 32 per cent for exports and from 61 to 40 per cent for imports (Table A). Consequently, the expansion in volumes rises from 13 to 38 per cent for exports and from 40 to 62 per cent for imports. For the same period, Italy's share of the volume of world trade now shows a contraction of 38 per cent, compared with an estimate of 47 per cent based on the old export AUVs. Italy's loss of market share is attenuated by the revision but remains considerable, especially in the second half of the 1990s, when the shares of other European countries, such as Germany and France, were increasing or stabilizing (see the figure).

Table A

Exports and imports of goods: average unit values (old and new indices)
(percentage changes on the corresponding period, except as indicated)

	Export			Imports		
	Old indices	New indices	Difference	Old indices	New indices	Difference
1997	3.2	1.0	-2.2	1.7	1.1	-0.6
1998	3.4	1.2	-2.2	-1.6	-3.1	-1.5
1999	2.7	0.5	-2.2	1.7	0.6	-1.2
2000	8.0	5.3	-2.7	16.3	14.4	-1.9
2001	3.6	2.0	-1.6	2.7	0.8	-1.9
2002	1.4	0.9	-0.5	-0.5	-1.0	-0.6
2003	0.8	-0.3	-1.0	-0.3	-0.7	-0.3
2004	4.2	2.5	-1.7	4.8	3.3	-1.5
2005	6.3	4.8	-1.5	8.7	7.9	-0.9
2006	6.6	5.1	-1.5	10.5	9.6	-0.9
2007 (1)	8.6	4.9	-3.7	6.1	2.6	-3.5
Cumulative growth 1996-2007	60.6	31.5	-29.1	61.0	39.8	-21.2

Source: Based on Istat data.
(1) For the old indices, the figures for November and December 2007 are estimated.

The revision by Istat significantly improves the quality of the statistical information on Italy's foreign trade, and the dynamics of AUVs are now more consistent with the corresponding indicators for Italy calculated by Eurostat, with those for the other major euro-area countries and with the export prices recorded by the Bank of Italy's Survey of Industrial Firms.[3] However, it may not have eliminated all the problems involved in using AUVs as indicators of export and import prices.

If the AUVs calculated by Istat are compared with the simulated values obtained by applying a quantitative relationship that takes account of the behaviour of domestic producer prices of industrial products, demand in the outlet markets and the bilateral exchange rate, the rate of growth in Istat's new AUVs is higher by one percentage point per year for the period 2005 to 2007.[4]

[1] Average unit values are aggregations of indices constructed from customs documents and other administrative data on trade. Prices are calculated by aggregating the elementary prices recorded for a sample of exporters (importers) and for a predetermined basket of goods. Many countries, Germany and the United States among them, survey and publish not only the average unit values but also the prices of the goods they export (import).
[2] In particular: the classification of products is now at the highest level of detail available; a new method is used to treat anomalous data and measurement errors that eliminates the tails of the distributions; the AUVs of some goods are calculated using "supplementary units of measurement" (number of units, pairs, carats, etc.) instead of weight in kilograms; and the base year is moved up from 2000 to 2005. For a complete methodological description, see the informational note published by Istat on 25 February 2008, "I nuovi indici del commercio con l'estero (base 2005=100)", available at www.istat.it.
[3] See M. Bugamelli, "Prezzi delle esportazioni, qualità dei prodotti e caratteristiche di impresa: un'analisi su un campione di imprese italiane", Banca d'Italia, Temi di discussione no. 634, 2007, available at www.bancaditalia.it.
[4] See M. Bugamelli and R.Tedeschi, "Pricing-to-Market and Market Structure", *Oxford Bulletin of Economics & Statistics*, Vol. 70, No. 2 (April 2008), pp. 155-180.

A similar discrepancy emerges for the same period, again only for the manufacturing sector, from a comparison with the export prices at individual firm level found by the Bank of Italy's survey. The difference between the two indicators is very large in some outlet markets. For example, in 2006 the prices of Italian exports to the United States and China increased by about 4 per cent according to the survey data but by more than 7 per cent according to Istat. The latter result is hard to square with the appreciation of the euro against the dollar and the renminbi.

The residual divergence between the new Istat data and other price information may be due to the well-known limitations of AUVs as price indicators. As a proxy for export (import) prices, AUVs are less precise the more intense is the change in the composition of the basket of products exported (imported). In addition, their limitations are aggravated when there are improvements in the quality and an increase in the variety of products exported. Phenomena of this kind have been especially pronounced in the last decade, both because of the massive entry into the international markets of low-cost products originating from developing countries, which has intensified a process of selection among Italian exporters and forced product innovation, and because many new products, or products that were not previously exported, have reached the markets of other countries.

Direct surveys of the export prices of a fixed basket of goods would make it possible to take the qualitative improvement into account through hedonic adjustments. Adjustment for the distortion generated by the introduction of new varieties of products is less easy, requiring the application of methods and procedures that are the subject of an intense debate among academics.

Table B

Exports and imports of goods: volumes (old and new indices)

(percentage changes on the corresponding period, except as indicated)

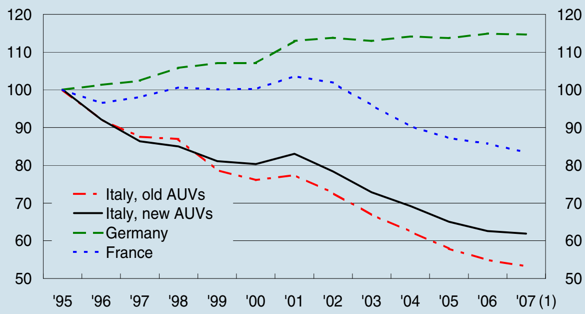
	Export			Imports		
	Old indices	New indices	Differ-ence	Old indices	New indices	Differ-ence
1997	2.0	4.2	2.2	9.5	10.2	0.6
1998	0.7	2.8	2.1	7.6	9.2	1.6
1999	-2.6	-0.5	2.2	3.9	5.1	1.3
2000	9.0	11.8	2.8	7.5	9.3	1.8
2001	1.5	3.0	1.6	-0.5	1.3	1.8
2002	-2.8	-2.3	0.5	-0.6	0.0	0.6
2003	-2.7	-1.7	1.0	0.7	1.0	0.4
2004	3.0	4.7	1.7	3.6	5.1	1.5
2005	-0.9	0.6	1.5	-0.1	0.7	0.8
2006 (1)	3.8	5.5	1.7	3.1	4.0	0.9
2007 (2)	1.4	5.0	3.6	0.1	3.5	3.4
Cumulative growth 1996-2007 (3)	12.5	37.7	25.2	40.0	61.2	21.2

Source: Based on Istat data.
(1) The variation in the final current values (release of 22 February 2008) deflated with the old average unit values replaces that in the old volume indices for the sake of homogeneity with the variation in the new indices, constructed by Istat using the final current values. – (2) For 2007, data adjusted by the estimate (at 19 February 2008) of the intra-EU transactions that since 2003 are no longer recorded monthly but annually following the change in the reporting threshold and taking account, based on past experience, of delays in submitting declarations. – (3) See note 1 for 2006 and note 2 for 2007.

Figure

Market shares of goods exports in volume

(indices, 1995=100)



Sources: Based on IMF and Istat data and national statistics.
(1) Partially estimated.

3.5 THE LABOUR MARKET

Employment increased on average in 2007...

Employment increased by an average of about 1 per cent in 2007, both according to the Labour Force Survey (Table 5) and on the basis of the national accounts, which include non-resident workers, illegal as well as legal. According to the survey, the increase was greatest in female employment (1.3 per cent, compared with 0.8 per cent for male employment); the number of non-Italian workers rose from 5.9 to 6.5 per cent of the total. The growth in employment was mainly in employees, whereas the number of self-employed workers declined. Among payroll employees, the number of part-time workers increased considerably; they now account for 14.1 per cent of the total, compared with 13.5 per cent in 2006. The annual average employment rate rose by 0.3 percentage points to 58.7 per cent; however, regional disparities widened further.

Table 5

Labour force status of the Italian population

(thousands of persons; percentage rates)

	Average 2006	Average 2007	Q4 2006	Q4 2007	Change in relation to year-earlier quarter (1)
Total persons in work	**22,988**	**23,222**	**23,018**	**23,326**	**1.3**
Employees	**16,915**	**17,167**	**16,961**	**17,350**	**2.3**
of which: fixed-term contracts	*2,222*	*2,269*	*2,313*	*2,282*	*-1.3*
part-time contracts	*2,290*	*2,422*	*2,339*	*2,504*	*7.1*
Self-employed	**6,073**	**6,055**	**6,057**	**5,976**	**-1.3**
Labour force	**24,662**	**24,728**	**24,727**	**24,981**	**1.0**
men	*14,740*	*14,779*	*14,720*	*14,856*	*0.9*
women	*9,922*	*9,949*	*10,006*	*10,124*	*1.2*
Population	**58,436**	**58,880**	**58,531**	**59,046**	**0.9**
Unemployment rate	**6.8**	**6.1**	**6.9**	**6.6**	**-0.3**
men	*5.4*	*4.9*	*5.6*	*5.3*	*-0.3*
women	*8.8*	*7.9*	*8.8*	*8.6*	*-0.2*
Participation rate (age 15-64)	**62.7**	**62.5**	**62.9**	**63.0**	**0.1**
men	*74.6*	*74.4*	*74.5*	*74.6*	*0.1*
women	*50.8*	*50.7*	*51.2*	*51.4*	*0.2*
Employment rate (age 15-64)	**58.4**	**58.7**	**58.5**	**58.7**	**0.3**
men	*70.5*	*70.7*	*70.3*	*70.6*	*0.3*
women	*46.3*	*46.6*	*46.7*	*46.9*	*0.3*
North	*66.2*	*66.7*	*66.4*	*66.9*	*0.4*
Centre	*62.0*	*62.3*	*61.7*	*62.0*	*0.4*
South	*46.6*	*46.5*	*46.6*	*46.7*	*0.0*

Source: Istat, labour force surveys.
(1) Percentage change for persons and change in percentage points for rates.

...but fell in the fourth quarter

On a seasonally adjusted basis, employment fell by 0.2 per cent between the third and fourth quarters, reflecting the slowdown in activity. The modest increase of 0.1 per cent in the North was outweighed by falls of 0.3 and 0.8 per cent in the Centre and South respectively. The number in employment in agriculture, industry excluding construction and in the construction sector decreased; it rose slightly in services.

The fall in the unemployment rate came to a halt

The labour supply also declined (by 0.3 per cent) between the third and fourth quarters. On a seasonally adjusted basis the unemployment rate remained unchanged at 6 per cent in the fourth quarter, thus bringing a long period of falling rates to an end. On average in 2007, the rate decreased by 0.7 points by comparison with the previous year (Table 5), reflecting primarily the fall in the South due to a reduction in labour market participation.

Wages remained stationary in real terms

According to the national accounts, in 2007 gross per capita earnings in the economy as a whole rose by 2.1 per cent, compared with 3 per cent in 2006, and remained broadly stationary in real terms, whereas in 2006 they had risen by 0.3 per cent on that basis. The slowdown occurred both in industry excluding construction (falling from 3.4 to 2.8 per cent) and more markedly in services (from 2.9 to 1.6 per cent), where earnings were affected by the sharp slowdown in the public sector.

The important wage agreements signed in late 2007 and early 2008 are likely to lead to an acceleration in actual per capita earnings this year, owing partly to the effect of lump-sum payments to cover the long periods before contracts were renewed. In 2009, however, the rate of increase should return to the moderate levels of the last few years.

3.6 PRICE DEVELOPMENTS

External pressures continue to determine price developments...

The rise in the world market prices of basic energy products and foodstuffs caused a significant acceleration in inflation in Italy as well from last summer onwards. According to the harmonized index of consumer prices (HICP), it reached a twelve-month rate of 3.6 per cent in March (Table 6), its highest level since 1996. The acceleration since August is comparable to that in the index for the euro area as a whole. The index of consumer prices for the entire resident population (CPI) recorded a similar increase to that in the HICP, rising by 3.3 per cent over the year to March (provisional data). The increases in air fares and in hotel and restaurant prices also contributed to the marked quickening of inflation in that month.

Table 6

Indicators of inflation in Italy
(twelve-month percentage change)

		HICP (1)		CPI (2)		PPI (3)
		Overall index	Excl. energy and food	Overall index	1-month	Overall index
2006		2.2	1.6	2.1		5.6
2007		2.0	1.8	1.8		3.5
2007 –	Jan.	1.9	1.5	1.7	0.1	4.0
	Feb.	2.1	2.0	1.8	0.3	4.0
	Mar.	2.1	2.0	1.7	0.2	3.8
	Apr.	1.8	1.8	1.5	0.2	3.3
	May	1.9	1.8	1.5	0.3	3.0
	June	1.9	1.9	1.7	0.2	2.7
	July	1.7	1.7	1.6	0.2	2.0
	Aug.	1.7	1.8	1.6	0.2	2.1
	Sept.	1.7	1.7	1.7	0.0	3.5
	Oct.	2.3	1.9	2.1	0.3	3.7
	Nov.	2.6	1.9	2.4	0.4	4.8
	Dec.	2.8	2.0	2.6	0.3	4.7
2008 –	Jan.	3.1	2.1	3.0	0.4	5.4
	Feb.	3.1	2.0	2.9	0.2	5.7
	Mar. (4)	3.6		3.3	0.5	

Sources: Based on Istat and Eurostat data.
(1) Harmonized index of consumer prices. – (2) Index of consumer prices for the entire resident population; it differs from the harmonized index primarily on account of the different method of recording the prices of pharmaceutical products and promotional sales. – (3) Index of producer prices of industrial products sold on the domestic market. – (4) Provisional data.

...especially those of energy...

The increase in the prices of petrol and fuels (13.9 per cent in the twelve months to February) reflected the rise in oil prices, which was only partly offset by the appreciation of the euro against the dollar (see the box: "The factors underlying the recent rise in oil prices"). Electricity and gas prices, which have a lagged response to changes in oil prices owing to indexation, have also risen since the beginning of the year.

...and food

The prices of processed food continued to accelerate, reaching 5.3 per cent in the twelve months to February. They appear to respond to changes in world commodity prices more quickly and strongly than in the past, both in Italy and in the euro area as a whole (see the box: "The recent rise in food commodity prices").

The increases of recent months have mainly been in the prices of frequently purchased products and have been accompanied by a pronounced rise in the indicators of perceived inflation, ascertained from surveys. Recent studies have shown that consumers' perceptions of inflation are especially influenced by increases in the prices of goods and services that are purchased regularly. Such increases cannot, however, be interpreted as an alternative measure of consumer price inflation, either for households as a whole or for those that are the less prosperous (see the box: "Consumer price inflation and inflation perceptions").

Excluding energy and food, consumer price inflation remained almost unchanged at around 2 per cent, owing partly to the smallness of the rise in the prices of industrial products other than food and energy (1.8 per cent in February), which reflected the continued moderation of domestic costs.

Producer prices are also accelerating

Producer price inflation, which began to accelerate last summer, is continuing to gather pace (5.7 per cent in the twelve months to February), driven essentially by energy prices. By contrast, the rise in the producer prices of food inputs stabilized, albeit at a high twelve-month rate of around 9 per cent.

Italy's terms of trade, which had improved in early 2007, have deteriorated again owing to the rapid increase in the prices of basic energy products, which was not entirely offset by the appreciation of the euro.

Inflation is likely to remain above 2 per cent throughout 2008

According to professional forecasters surveyed in March by Consensus Economics, consumer price inflation in Italy is likely to remain relatively high throughout 2008, averaging 2.6 per cent, and is not expected to fall back to around 2 per cent until the early months of next year. These expectations, which do not take account of the particularly high provisional figure for March, are based on a scenario of slowing world growth, which is likely to lead to a substantial stabilization of the prices of foodstuffs and oil.

According to the findings of the survey organized by the Bank of Italy and *Il Sole 24 Ore*, firms in the services sector and industry forecast consumer price inflation over the next twelve months to be 3.3 per cent, compared with predictions of 2.6 per cent in December. By contrast, their expectations of changes in their own prices over the same period are stable at 1.7 per cent.

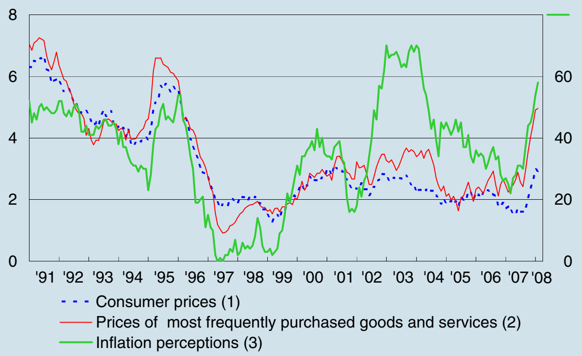
CONSUMER PRICE INFLATION AND INFLATION PERCEPTIONS

The last months of 2007 saw a significant increase in consumer price inflation in Italy and the euro area, driven by large increases in food and energy prices. Simultaneously, the inflation perceptions emerging from the monthly economic surveys of Italian households have also risen considerably, approaching the historic highs reached following the euro cash changeover in January 2002 (see Figure). The official inflation figures cannot be compared directly with the indicators of perceived inflation, which are strictly qualitative (respondents are asked if prices have risen a lot, moderately, etc.). However, recent studies have shown a connection between the indicators of perceived inflation and a series of factors, such as the frequency of purchase of the goods and services included in the basket used to calculate inflation.

This analysis shows that when perceptions are formed, the prices of infrequently purchased goods (e.g. motor vehicles and computers) are relatively unimportant (unless the respondent has bought one recently),[1] while the prices of frequently purchased goods play a more important role.[2]

Figure

Consumer price inflation and inflation perceptions of Italian households
(twelve-month percentage changes and balance of responses)



Sources: Istat and ISAE.
(1) Index of consumer prices for the entire resident population. – (2) Sub-index of consumer prices for goods and services purchased most frequently by Italian households and included in the index for the entire resident population. – (3) Qualitative index obtained as a balance of positive and negative responses in the monthly survey of Italian consumers conducted by ISAE; right-hand scale.

[1] See European Central Bank, "Measured inflation and inflation perceptions in the euro area", *Monthly Bulletin*, May 2007.
[2] Among the other factors that taken together explain the discrepancy between inflation perceptions and actual inflation we find the socio-demographic profile (e.g. educational level) and economic situation of the respondent (partly in relation to the modest growth in incomes registered in recent years, especially for some categories of households). In addition, there is a broad tendency to remember prices inaccurately, so that the changes registered over a time period longer than a year can be cumulated in a person's perceptions. For Italy, see P. Del Giovane, F. Lippi and R. Sabbatini (eds.), *L'euro e l'inflazione*, il Mulino (2005); for an expanded version in English, see P. Del Giovane and R. Sabbatini (eds.), *The Euro, Inflation and Consumers' Perceptions. Lessons from Italy*, Springer (2008, forthcoming).

Istat has released a breakdown of the consumer price index in which individual goods and services are grouped on the basis of how frequently households purchase them ("high", "medium", or "low"-frequency purchases).[3] An analysis of these components confirms the above thesis for the current period, in which the trend of consumer perceptions is very similar to that of the prices of high-frequency purchases (see Figure). On a longer time scale, the correlation between inflation perceptions and the increase in the prices of the high-frequency purchases is not very different from that between perceptions and average inflation, 0.65 and 0.56 respectively.

Table

Consumer prices by frequency of purchase of goods and services in Italy

(percentage changes on corresponding period)

	Goods and services with low frequency of purchase	Other goods and services	of which: Medium frequency	of which: High frequency	Total
Weights (1)	*19.8*	*80.2*	*41.4*	*38.8*	*100*
2006	1.3	2.3	2.2	2.5	2.1
2007	1.3	2.0	1.1	2.9	1.8
2008					
Jan.	1.6	3.3	1.8	4.9	3.0
Feb.	1.4	3.3	1.7	5.0	2.9

Source: Based on Istat data.
(1) 2008 weights.

Istat's price sub-indexes for goods and services based on frequency of purchase are useful in studying the trend of people's perceptions and inflation in general. Given that these indexes are obtained by summing a subset of items from the general basket, they cannot be interpreted as an alternative measure to the general consumer price index, which is based on the actual overall spending of households.

Nor does the sub-index of prices of the most frequently purchased goods supply any information about the impact of inflation on the least well-off households, because the weighting structure used to sum the single items is based on the consumption of the entire population taken as a reference in calculating the overall CPI. In the same way, this sub-index is not a true indicator of price rises for subsistence goods since it does not include numerous basic items, classified by Istat as medium-frequency purchases, such as electricity and water, waste collection and telephone services, which are not billed every month even if they are consumed daily, and some necessities, such as medicine. The index for medium-frequency purchases rose in the twelve months ending in February by 1.7 per cent (see Table) while the prices of low-frequency goods and services (essentially durable goods) had an even smaller increase of 1.4 per cent.

[3] For the definitions used for the classification, see the press release "Consumer prices" for January 2008, available at www.istat.it.

3.7 BANKS

Credit continues to expand

Bank lending in Italy continues to expand rapidly (by 9.9 per cent in the twelve months to February; Table 7), reflecting sustained growth in corporate demand for loans; by contrast, credit demand from households has slowed.

Securitizations have recovered, after falling sharply between August and November. A large proportion of the new securities issued in connection with such operations was subscribed by the banks of the groups that had assigned the loans. In some cases the securities were used by the acquiring banks to obtain liquid funds under Eurosystem refinancing operations, on relatively attractive terms given the continuation of tensions in the money markets. On average, the terms on which Italian intermediaries are being allocated funds by the Eurosystem are advantageous by comparison with those enjoyed by the banking system of the euro area; that advantage, while small, increased from the summer onwards, confirming that Italian banks are having less difficulty obtaining liquidity.

Slight tightening of credit to firms and an easing for households

The banks indicate that they have tightened their criteria for corporate lending; on the other hand, the terms of loans to households have been eased slightly (see the box: "Credit supply and demand in Italy"). Bank interest rates have continued to adjust gradually to movements in money market rates (Figure 23).

No signs of a deterioration in credit quality

In the twelve months ending in December the ratio of new bad debts to total lending remained broadly unchanged both at national level (0.8 per cent) and in the main geographical subdivisions (0.7 per cent in the Centre and North and 1.3 per cent in the South). The volume of substandard loans (exposures to borrowers in temporary difficulties) remained more or less stable in relation to total lending.

Domestic funding accelerates

After the slowdown in 2007, the growth in both deposits – especially those held by consumer families – and bond issues accelerated. The banks' net external liabilities remained essentially unchanged, however.

Profits have been only moderately affected by the subprime crisis

According to data from their consolidated accounts, the revenues of the main Italian banking groups grew more slowly in 2007. Profits have increased, benefiting from the measures to hold down operating costs and, above all, from income from extraordinary operations. The overall capital ratio of the large groups declined slightly. The liquidity of balance-sheet assets, which fell to a low last November, has risen again: at the end of February the ratio of liquid assets (cash and securities other

Table 7

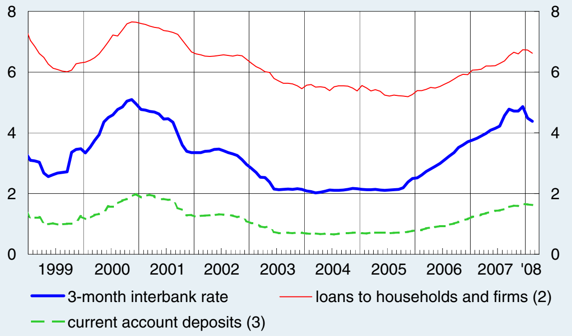
Main assets and liabilities of Italian banks (1)
(end-of-period data; 12-month percentage changes)

	2006	2007	February 2008	
				Stocks (2)
Assets				
Securities	5.3	9.9	18.7	262,057
Loans	11.5	10.1	9.9	1,696,941
of which:				
up to 12 months	*10.8*	*7.5*	*6.4*	*574,503*
beyond 12 months	*11.9*	*11.3*	*11.5*	*1,122,438*
External assets	19.8	12.6	14.9	387,320
Liabilities				
Domestic funding (3)	9.9	7.3	9.3	1,688,346
Deposits	8.3	4.2	6.2	1,038,994
of which: (4)				
current accounts	*6.7*	*2.9*	*3.6*	*625,907*
with agreed maturity	*9.8*	*14.3*	*28.0*	*53,538*
redeemable at notice	*-0.8*	*-0.5*	*3.0*	*231,892*
repos	*29.4*	*12.1*	*11.9*	*114,031*
Bonds (3)	12.5	11.9	14.4	649,351
External liabilities	25.6	22.9	17.0	511,070

(1) The figures for February 2008 are provisional. From October 2007 onwards the data include Cassa Depositi e Prestiti S.p.A. The percentage changes are calculated net of reclassifications, exchange rate variations and other variations not due to transactions. – (2) Millions of euros. – (3) Includes bonds held by non-residents. – (4)Does not include those of central government.

Figura 23

Short-term bank interest rates (1)
(monthly data; percentage rates)



Sources: Based on Bank of Italy and Interbank Deposit Market data.
(1) The data on lending and deposit rates refer to transactions in euros and are gathered and processed using the Eurosystem's harmonized method. – (2) Average rate on loans to households and firms with a maturity of up to one year. – (3) Average rate on current account deposits of households and firms.

than equities) to the sum of liquid assets and loans was 15.4 per cent for the Italian banking system, similar to the figure obtaining shortly before the turmoil erupted in the international financial markets.

CREDIT SUPPLY AND DEMAND IN ITALY

Based on the responses of the Italian banks interviewed in the Bank Lending Survey conducted in the first ten days of January,[1] in the last quarter of 2007 the turmoil in the financial markets led to a tightening of the criteria for lending to firms, especially in connection with corporate restructuring (Figure A). Caution in the granting of credit was reflected primarily in an increase in margins, especially those for more risky loans. For the first quarter of 2008 credit institutions forecast a further tightening of lending criteria to large firms (Figure B).

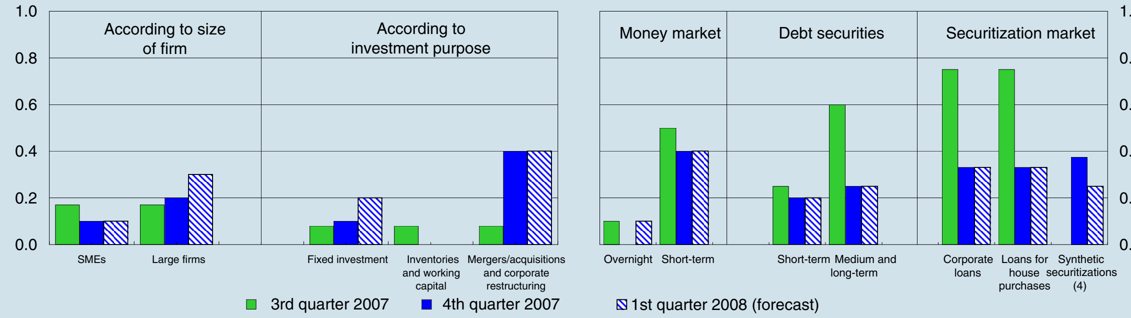
The banks reported a slight loosening of the criteria for lending to households (primarily due to competitive pressure), and signalled that they intended to leave their credit supply policies unchanged in the first quarter of 2008. However, the banks also indicated a sharp fall in demand for loans by households, both in the last quarter of 2007 and, looking ahead, in the first quarter of this year.

On the funding side the repercussions of the subprime crisis, which were at their most acute during the summer of 2007, are reported to have subsequently eased. It is widely agreed that the crisis will increase the costs of meeting capital adequacy requirements. Responding to some questions introduced in January's questionnaire, the banks said that tensions in the financial markets had significantly limited the scope for transferring credit risk off balance sheets using credit derivatives. Meanwhile recourse to credit lines by vehicle companies in connection with structured securities' issue programmes was quite modest and was not thought to have significantly restricted the overall supply of credit.

Figure A

Effects of the sub-prime mortgage crisis in Italy (1)

Index of tightening of the criteria for lending to firms (2) — *Index of the difficulty of obtaining funds in the wholesale market* (3)



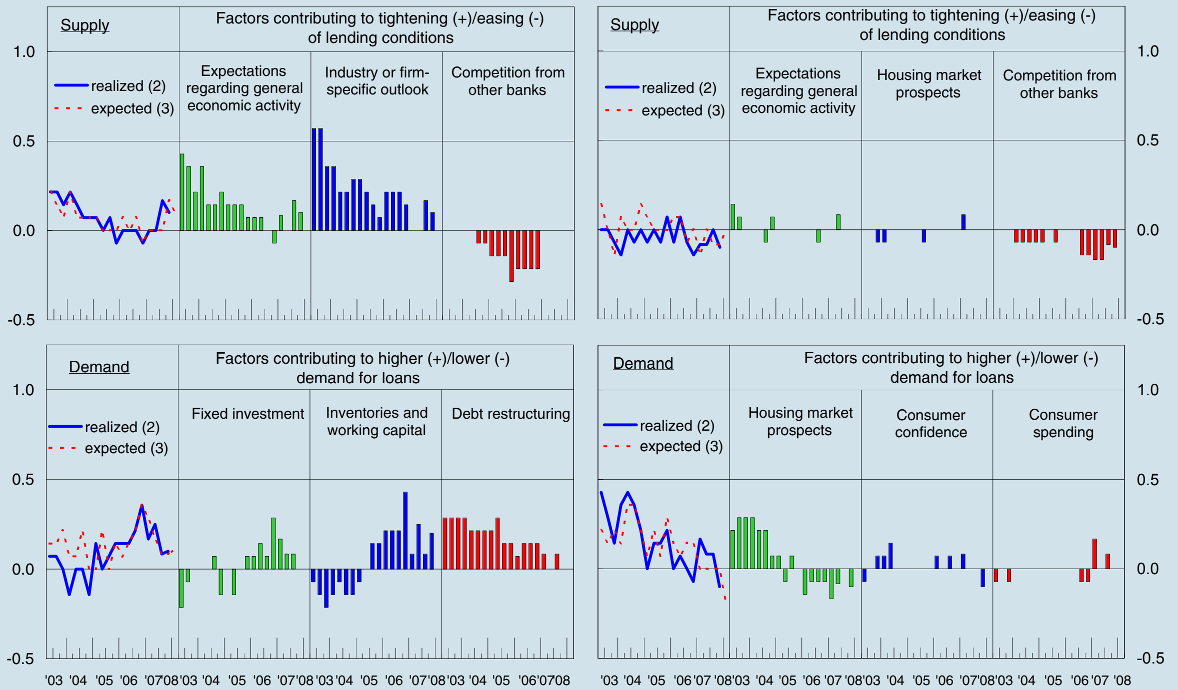
Source: Bank Lending Survey for the euro area.
(1) Diffusion indices constructed by aggregating the qualitative replies to the special questions on the effects of the subprime mortgage crisis added to the quarterly Bank Lending Survey. – (2) Weighted as follows: 1 = tightened considerably, 0.5 = tightened somewhat, 0 = remained basically unchanged, -0.5 = eased somewhat, -1= eased considerably. The range of variation of the index is from -1 to 1. – (3) Weighted as follows: 1 = considerable difficulty, 0.5 = some difficulty, 0 = basically no difficulty. The range of variation of the index is from 0 to 1. – (4) These imply recourse to credit derivatives. Data for the third quarter of 2007 are not available for this indicator.

[1] The five leading Italian banking groups participated in the survey; the results for Italy are available at www.bancaditalia.it and those for the euro area at www.ecb.int.

Figure B

Trends in lending conditions and credit demand in Italy (1)

A. *Lending to firms* B. *Lending to households for house purchases*



Source: Bank Lending Survey for the euro area.
(1) Diffusion indices constructed by aggregating the qualitative replies from the groups participating in the quarterly Bank Lending Survey, weighted as follows: for supply, 1 = tightened considerably, 0.5 = tightened somewhat, 0 = remained basically unchanged, -0.5 = eased somewhat, -1 = decreased considerably; for demand, 1 = increased considerably, 0.5 = increased somewhat, 0 = basically unchanged, -0.5 = decreased somewhat, -1 = decreased considerably. The range of variation of the index is from -1 to 1. – (2) In the quarter in which the survey was conducted. – (3) Forecasts made in the preceding quarter.

3.8 THE FINANCIAL MARKET

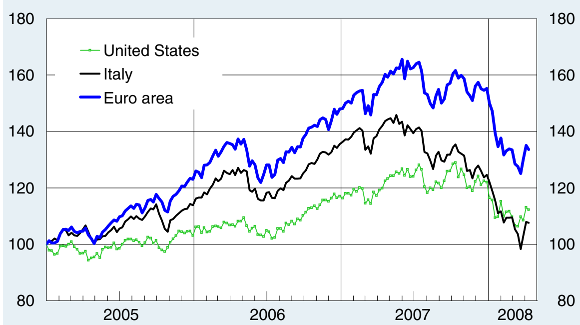
Share prices continue to fall

In the first quarter of 2008 the Italian stock market index fell by 18 per cent, in line with the average for the euro area (Figure 24). The decline was attributable mainly to an increase in the risk premium demanded by investors, but a slowdown in corporate profits was also a factor. All sectors were affected except those producing basic materials, which benefited from the rise in commodity prices; telecommunications shares fell much more sharply than the general index, punished by the downward revision of forecasts for Telecom Italia's turnover in 2008. The fall in the share prices of Italian banks since the beginning of the year was similar to that in both the general Italian index and the index for banks in the euro area.

Figure 24

Share prices (1)

(end-of-week data; indices, 31 December 2004=100)



Source: Bloomberg.
(1) MIB for Italy, Dow Jones Euro Stoxx for the euro area, Standard & Poor's 500 for the United States.

The earnings/price ratio is at a high level

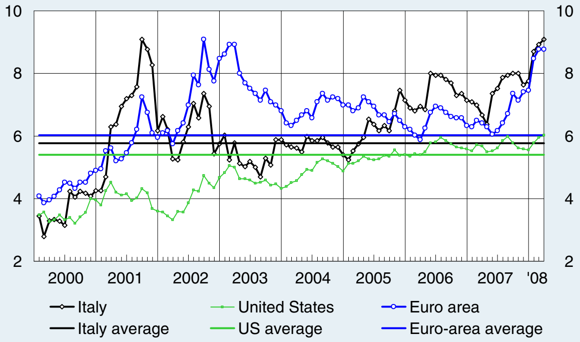
At the end of March the ratio of current earnings to price reached a level close to the peaks of 2003 (Figure 25). The share price volatility implicit in options prices continued to rise, exceeding the long-term average.

In the first quarter of 2008 two initial public offerings were carried out on the Italian Stock Exchange, compared with five in the corresponding period of 2007; in the euro area there were eight new listings, compared with twelve a year earlier. At the end of March 300 companies with a total market capitalization of €604 billion were listed in Italy; of these, three were listed on the Alternative Capital Market for the shares of small companies, which is open only to institutional investors.

Figure 25

Current earnings/price ratios for the main stock exchanges (1)

(monthly data; per cent)



Source: Based on Thomson Financial Datastream data.
(1) Averages are calculated from January 1986 onwards.

Bond issuance resumed...

In the last quarter of 2007 Italian companies made substantial net issues of bonds, following a pause in the wake of last summer's financial turmoil (Table 8). As in the past, a substantial part of bond issuance was by the financial sector, but a relatively large volume was also issued by non-financial firms, in particular the Eni and Enel groups, the latter being engaged in the acquisition of the Spanish electricity company Endesa. The considerable volume of bonds issued by other financial companies in the euro area partly reflects securitization operations by Spanish banks.

Table 8

Net bond issues (1)

(millions of euros)

	Banks	Other financial corporations	Non-financial corporations	**Total**
		Italy		
2006	60,371	15,906	4,561	**80,838**
2007	63,904	19,414	8,668	**91,986**
2006 – Q1	20 039	1,325	545	**21,909**
Q2	12,310	1,787	3,752	**17,849**
Q3	7,155	4 504	329	**11,988**
Q4	20,867	8,331	-57	**29,141**
2007 – Q1	21,619	3,452	-1,221	**23,850**
Q2	15,371	10,276	7,606	**33,253**
Q3	1,794	-2 386	-812	**-1,404**
Q4	25,120	8,072	3,095	**36,287**
		Euro area		
2006	346,468	238,720	29,243	**614,432**
2007	281,505	329,542	28,581	**639,628**
2006 – Q1	100,683	44,666	2,876	**148,225**
Q2	87,072	57,858	16,347	**161,277**
Q3	62,700	36,769	115	**99,585**
Q4	96,013	99,427	9,904	**205,344**
2007 – Q1	141,146	96,342	978	**238,466**
Q2	100,506	61,843	22,258	**184,608**
Q3	14,130	37,639	-96	**51,673**
Q4	25,724	133,717	5,440	**164,881**

Sources: Bank of Italy and ECB.
(1) Bonds with a maturity at issue of more than one year, at face value, issued by resident companies belonging to the sector indicated. The nationality and sector refer to the issuer and not to the company that controls it. Net issues are equal to the difference between the face value of the securities issued and that of the securities redeemed.

...and bond risk premiums rose

In the first quarter of 2008 yield differentials between government securities and bonds issued by non-financial companies increased by a further half percentage point, slightly more than the increase for the bonds of similar firms in other euro-area countries. The rating agencies downgraded the bonds of Enel, Telecom Italia and ASM Brescia. For Italian banks, the increase in premiums on credit default swaps was less than that for the sector in the euro area as a whole, amounting to 0.6 percentage points compared with 0.7 points.

Outflows from investment funds accelerate

In the fourth quarter of 2007 the outflows from Italian investment funds were almost twice as large as in the preceding quarter, affecting both funds operated under Italian law (€11.8 billion) and those established abroad (€11.5 billion) and all types of fund except money market funds and funds of hedge funds. Portfolio management services also recorded large net outflows. The average rates of return were negative in the case of equity and flexible funds (-3.8 and -1.6 per cent respectively) and just positive in that of money market and bond funds (0.7 and 0.5 per cent respectively).

The differential between BTPs and Bunds increased substantially

At the beginning of March the yield differential between Italian ten-year government securities and corresponding German Bunds widened to 65 basis points before narrowing again to 50 (Figure 26). Adverse reports about cyclical developments in the United States and the exposure of the major international banks to the financial crisis triggered portfolio adjustment in favour of highly liquid securities of the highest quality. Although the increase in the differential was larger for Italian securities, which have a lower rating, it affected all the leading European countries and hence does not appear to be attributable to national factors. This is also confirmed by the correlation between the yield differential for Italian securities and that for French and Spanish securities, which recently rose to more than 0.9. Demand for Italian government securities on the primary market remained strong in February and March.

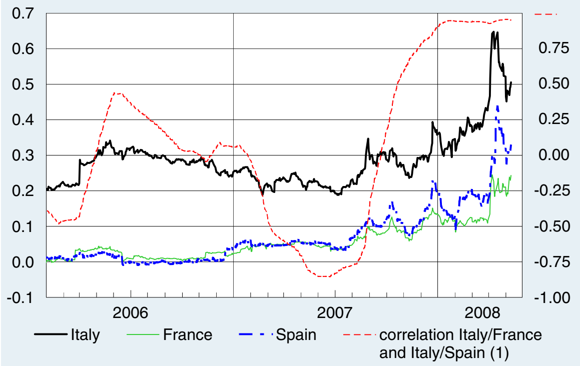
3.9 THE PUBLIC FINANCES

General government net borrowing has decreased further, to 1.9 per cent of GDP

In 2007 general government net borrowing fell to 1.9 per cent of GDP, a decrease of 1.5 percentage points (Table 9), thereby returning to the levels recorded in the two years 1999-2000 (excluding the proceeds of sales of UMTS licences). This result, which is attributable largely to the increase in the ratio of tax and social security contributions to GDP, should make it possible in the next few months to close the excessive deficit procedure launched against Italy in 2005. The primary surplus, which was close to zero in 2005, rose to the equivalent of 3.1 per cent of GDP (Figure 27).

Figure 26

Interest rate differentials between ten-year Italian government securities and corresponding German securities
(daily data; percentage points and indices)



Source: Based on Bloomberg data.
(1) Simple average of the moving 250-day correlations between the differentials on Italian securities and those on French and Spanish securities.

Table 9

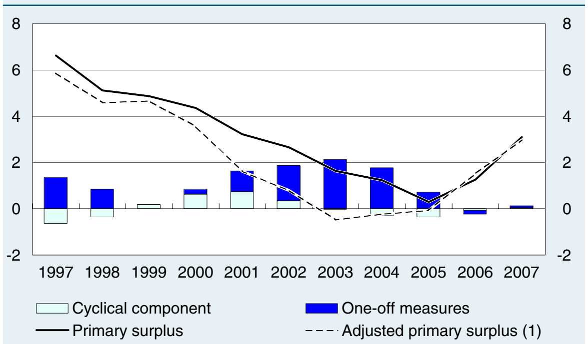
General government balances and debt (1)
(millions of euros and percentages of GDP)

	2004	2005	2006	2007
Net borrowing	48,312	60,428	49,634	29,179
% of GDP	*3.5*	*4.2*	*3.4*	*1.9*
Primary surplus	17,197	4,272	18,610	47,547
% of GDP	*1.2*	*0.3*	*1.3*	*3.1*
Interest payments	65,509	64,700	68,244	76,726
% of GDP	*4.7*	*4.5*	*4.6*	*5.0*
Debt	1,444,603	1,511,554	1,575,636	1,596,762
% of GDP	*103.8*	*105.8*	*106.5*	*104.0*

Source: Based on Istat data for items from the general government accounts.
(1) Rounding may cause discrepancies in totals.

Figure 27

Primary surplus and transitory effects
(as a percentage of GDP)



Sources: Based on Istat data and the state sector accounts.
(1) Net of the effects of the economic cycle and one-off measures; as a percentage of trend GDP.

Istat has revised the figures for net borrowing in 2006 downwards from 4.4 to 3.4 per cent of GDP, owing mainly to a change in the statistical treatment of the repayments made in compliance with the judgement on the deductibility of VAT delivered in 2006 by the European Court of Justice. By agreement with Eurostat, the full amount of the foreseen expenditure (around €16 billion) is no longer recorded as occurring in 2006 but will be spread over the years in which disbursements actually occur; €0.8 billion in 2007.

The structural budget balance improves by more than one point

The structural deficit (that is to say the deficit adjusted for the effects of the economic cycle and one-off measures) decreased by the equivalent of more than 1 per cent of GDP, to around 2 per cent; the improvement in the two years 2006-2007 was more than one percentage point larger than the objective of a reduction of 1.6 points that the Government had undertaken to achieve under the excessive deficit procedure. In 2005, when the structural deficit stood at just under 5 per cent of GDP, the economic cycle had an adverse effect on the public finances equivalent to almost half a percentage point, while the one-off measures improved the balance by almost one point; both of these effects were essentially absent in the two years 2006-2007.

As in 2006, net borrowing was lower than the official objectives and forecasts (Table 10), despite the increased expenditure equal to about 0.9 per cent of GDP decided in the summer and autumn (see the box "The measures decided at the end of June and September", in *Economic Bulletin*, No. 46, October 2007) and the abolition in December of the advance payment demanded of collection concessionaries (about 0.3 per cent).

Table 10

Public finance objectives and estimates for 2007

(billions of euros and percentages of GDP)

	General government			*Memo. item*
	Net borrowing	Primary surplus	Debt	GDP growth rate
Objectives				
July 2006 (1)	....	....	....	1.2
% of GDP	*2.8*	*2.1*	*107.5*	
September 2006 (2)	42.1	30.7	....	1.3
% of GDP	*2.8*	*2.0*	*106.9*	
December 2006 (3)	....	....	....	1.3
% of GDP	*2.8*	*2.2*	*106.9*	
Estimates				
March 2007 (4)	34.6	39.4	....	2.0
% of GDP	*2.3*	*2.6*	*105.4*	
June 2007 (1) (5)	38.3	35.5	....	2.0
% of GDP	*2.5*	*2.3*	*105.1*	
September 2007 (6) (7)	36.4	38.2	....	1.9
% of GDP	*2.4*	*2.5*	*105.0*	
November 2007 (3)	....	....	....	1.9
% of GDP	*2.4*	*2.5*	*105.0*	
Outturn (8)	29.2	47.5	....	1.5
% of GDP	*1.9*	*3.1*	*104.0*	

(1) Economic and Financial Planning Document. – (2) Forecasting and Planning Report. – (3) Stability Programme. – (4) Combined Report on the Economy and Public Finances. – (5) Including the effects of Decree Law 81/2007. – (6) Update to Economic and Financial Planning Document for 2008-11. – (7) Including the effects of Decree Law 159/2007. – (8) Istat press release of February 2008 for net borrowing, primary surplus and GDP growth.

The tax burden has increased further

The ratio of tax and social security contributions to GDP increased by 1.2 points to 43.3 per cent (Table 11), close to the high recorded in 1997. The rate of increase in revenue was due to the rapid growth in social security contributions and receipts of direct taxes. Social security contributions were affected by the budget measures for 2007, which provided for increases in contribution rates and the transfer of severance pay to INPS. The increase in direct tax revenue was due essentially to profit-related taxes, which reflected the recovery in economic activity in 2006 and the measures to combat tax evasion and avoidance and to broaden the tax base. Receipts of municipal and regional income surtaxes also increased significantly, owing, in the case of the former, to the introduction of a payment on account and, in that of the latter, to an increase in statutory tax rates in 2006 in the Regions with health service deficits. Despite a satisfactory increase in receipts from VAT and the regional tax on productive activities (IRAP), indirect taxes grew less rapidly because of the smallness of the increase in receipts of excise duties.

Table 11

General government expenditure and revenue

(millions of euros and percentage changes)

	2006	2007	Changes on previous year 2006	Changes on previous year 2007
EXPENDITURE				
Final consumption expenditure	299,074	303,950	2.8	1.6
of which:				
compensation of employees	*162,889*	*164,645*	*4.1*	*1.1*
intermediate consumption	*77,661*	*79,738*	*-1.2*	*2.7*
soc. sec. benefits in kind	*41,331*	*41,722*	*2.7*	*0.9*
Soc. sec. benefits in cash	252,119	265,284	4.0	5.2
Interest payments	68,244	76,726	5.5	12.4
Other current expenditure	36,029	38,972	0.8	8.2
Current expenditure	**655,466**	**684,932**	**3.5**	**4.5**
% of GDP	*44.3*	*44.6*		
Current expenditure, net of interest payments	**587.222**	**608.206**	**3.2**	**3.6**
% of GDP	*39.7*	*39.6*		
Investment (1)	34.792	36.134	3.2	3.9
Investment net of property disposals	*36.475*	*37.571*	*-1.1*	*3.0*
Investment grants	22.292	24.769	1.4	11.1
Other capital expenditure (2)	16.924	7.590	532.0	-55.2
Capital expenditure (1)	**74.008**	**68.493**	**26.8**	**-7.5**
Total expenditure, net of interest payments (1)	**661.230**	**676.699**	**5.4**	**2.3**
% of GDP	*44.7*	*44.1*		
TOTAL EXPENDITURE (1)	**729.474**	**753.425**	**5.4**	**3.3**
% of GDP	*49.3*	*49.1*		

	2006	2007	Changes on previous year 2006	Changes on previous year 2007
REVENUE				
Direct taxes	213,308	233,660	12.4	9.5
Indirect taxes	220,181	225,928	8.6	2.6
Social security contributions	189,683	204,772	3.4	8.0
Other current revenue	52,194	55,272	5.2	5.9
Current revenue	**675,366**	**719,632**	**8.0**	**6.6**
% of GDP	*45.6*	*46.9*		
Capital revenue	**4,474**	**4,614**	**-24.8**	**3.1**
of which:				
capital taxes	*225*	*300*	*-88.0*	*33.3*
TOTAL REVENUE	**679,840**	**724,246**	**7.6**	**6.5**
% of GDP	*45.9*	*47.2*		
of which:				
taxes and social security contributions	*42.1*	*43.3*		
NET BORROWING	**49,634**	**29,179**		
% of GDP	*3.4*	*1.9*		
Primary surplus	**18,610**	**47,547**		
% of GDP	*1.3*	*3.1*		
Memorandum item:				
Nominal GDP	1,479,981	1,535,540	3.6	3.8

Source: Based on Istat data.
(1) This item includes the proceeds of property sales entered with a negative sign. – (2) For 2006. includes the effects of the cancellation of the high-speed train company's debts to Infrastrutture S.p.A. (€12.950 million).

The ratio of primary current expenditure to GDP decreased slightly

The ratio of primary current expenditure to GDP decreased slightly for the second year in succession, to 39.6 per cent, but remained close to the peak of 39.8 per cent reached in 1993 and 2005. The increase in expenditure on final consumption slowed further, to 1.6 per cent, having been 5.3 per cent in 2005. The slowdown was due to the small growth in compensation of employees: the effects of contract renewals (government departments, schools and social security institutions, involving around one third of public sector employees) were partly offset in 2007 by the absence of the large arrears paid in 2006. Social security benefits in cash increased apace, owing partly to the payment of a bonus to persons whose gross tax liability is less than their tax credits and deductions, increases in

Table 12

General government financial balances and debt

(millions of euros and percentages of GDP)

	2004	2005	2006	2007
Borrowing requirement	49,778	69,441	54,380	30,520
% of GDP	*3.6*	*4.9*	*3.7*	*2.0*
Net borrowing requirement (1)	58,093	74,059	54,418	34,020
% of GDP	*4.2*	*5.2*	*3.7*	*2.2*
Debt	1,444,603	1,511,554	1,575,636	1,596,762
% of GDP	*103.8*	*105.8*	*106.5*	*104.0*
Memorandum item:				
Privatization receipts	8,316	4,618	38	3,500
% of GDP	*0.6*	*0.3*	*0.0*	*0.2*
Settlements of past debts	529	1,864	243	2,420
% of GDP	*0.0*	*0.1*	*0.0*	*0.2*

(1) Excluding privatization receipts.

Table 13

Estimated effects of the budget on the general government consolidated accounts (1)
(millions of euros)

REVENUE		EXPENDITURE	
Increase in revenue	**1,590**	**Decrease in expenditure**	**7,920**
Limitation of group offsets of VAT	450	Current expenditure	3,380
Tobacco excise duty	320	*Finance for local public transport*	*1,580*
Other measures affecting VAT and excise duties	290	*Intermediate consumption*	*1,170*
Other revenue	530	*Improvements in quality of expenditure and organization*	*390*
Decrease in revenue	**3,940**	*Other measures*	*240*
Tax relief for households	3,170	Capital expenditure	4,490
Irpef– deduction for rent of first home	*1,300*	*Lapsing of expenditure carryovers*	*1,640*
ICI – deduction for first home	*900*	*Business incentives*	*840*
Irpef – impact of deduction for first home	*390*	*Rationalization of property maintenance expenditure*	*700*
Tax relief for businesses (2)	770	*Property purchases by social security institutions*	*400*
of which: tax regime for small and marginal taxpayers	*210*	*Territorial protection*	*290*
NET DECREASE IN REVENUE	**2,350**	*Other measures*	*620*
		Other effects (3)	50
		Increases in expenditure	**11,650**
		Current expenditure	8,900
		Public employment	*2,300*
		Finance for local public transport	*1,750*
		Social Security, Labour and Competitiveness Agreement	*990*
		Intermediate consumption and expenditure of ministries and other public bodies (4)	*930*
		Abolition of charge for medical diagnostic tests	*830*
		Social and development policies	*610*
		Armed forces	*320*
		Domestic Stability Pact	*280*
		Other expenditure	*890*
		Capital expenditure	2,590
		Ministries & refinancing of economic support measures (5)	*1,110*
		Infrastructure	*420*
		Territorial protection	*420*
		Business incentives and research	*320*
		Other expenditure	*320*
		Other effects (6)	160
INCREASE IN NET BORROWING	**6,080**	**NET INCREASE IN EXPENDITURE**	**3,730**

(1) Based on official estimates. – (2) Includes the measures associated with the reform of corporate income tax (Ires) and regional tax on productive activities (IRAP) which generate an increase in revenue in 2008 (stemming from some withholding taxes introduced as part of the reform) and a reduction in subsequent years. It is estimated that the overall effect of the withholding taxes and the changes in Ires, IRAP and Irpef (for the latter, mainly in the taxation of dividends and shareholdings) will be to reduce revenue by €2.5 billion in 2009 (and by about €1 billion in 2010 owing to the expiry of some transitional tax reliefs and the automatic effect of self-taxation). In the draft law of September, the estimates of the decrease in revenue were about €1.5 billion and €0.5 billion in 2009 and 2010 respectively. – (3) Effects of the amendments contained in Table F of the Finance Law. – (4) Includes the amendments contained in Table A. – (5) Amendments contained in Tables B and D. – (6) Effects of the amendments contained in Tables C and E.

minimum pensions and the reform of family benefits laid down in the budget for 2007. The substantial rise in interest expenditure reflected mainly the rise in issue rates over the last two years; other factors were swap operations, which in previous years had reduced disbursements, and an accounting effect (the decline in the estimate of the cost of indirectly measured financial intermediation services (SIFIM), which in the national accounts is deducted from interest income and imputed to intermediate consumption). Investment spending, net of the proceeds of property disposals, rose by 3 per cent, after having contracted by 3.6 per cent overall in the two years 2005-2006.

The borrowing requirement decreased considerably

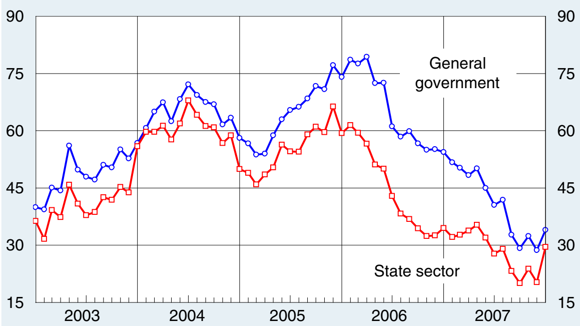
In 2007 the general government borrowing requirement net of privatization receipts fell from more than €54 billion to €34 billion; in relation to GDP it declined to the lowest level of the last four decades (2.2 per cent; Table 12 and Figure 28). The borrowing requirement of local government alone decreased from €18.4 billion to €3.7 billion, owing among other things to substantial increases in local tax revenues and transfers from central government to the Regions, partly in connection with the elimination of past health service deficits.

There was also a reduction in the gap between the general government borrowing requirement and net borrowing (0.3 per cent of GDP, compared with 1.2 per cent in 2006, excluding from net borrowing the effect of cancelling the debt of the high-speed rail project). The narrowing of the gap was due mainly to interest expenditure, which was lower on a cash basis than on an accruals basis (in 2006 disbursements on a cash basis were higher owing to significant redemptions of post office savings certificates, on which accrued interest is paid at redemption).

Figure 28

Rolling twelve-month borrowing requirement (1)

(billions of euros)



Source: Ministry for the Economy and Finance for the state sector borrowing requirement.
(1) Net of privatization receipts.

Public debt returns to the 2004 level

The ratio of general government debt to GDP fell from 106.5 per cent in 2006 to 104.0 per cent last year (see the box "General government debt").

The budget for 2008 reduces revenue and increases expenditure

The budget measures for 2008 increase net borrowing by €6.1 billion by comparison with the figure on a current programmes basis (Table 13). It raises €9.5 billion in fresh resources and allocates €3.9 billion to finance tax relief and €11.7 billion for increased expenditure. The amendments made during parliamentary debate of the draft law of September had only modest effects on the net figure (see the box "The budget for 2008", in *Economic Bulletin* No. 46, October 2007).

Table 14

Public finance objectives and estimates for 2008

(billions of euros and percentages of GDP)

	General government			*Memo. item:* GDP growth
	Net borrowing	Primary surplus	Debt	
Objectives				
June 2007 (1)	....	....	....	1.9
% of GDP	*2.2*	*2.7*	*103.2*	
September 2007 (2)	35.4	42.9	....	1.5
% of GDP	*2.2*	*2.7*	*103.5*	
November 2007 (3)	....	....	....	1.5
% of GDP	*2.2*	*2.6*	*103.5*	
Estimates				
March 2008 (4)	38.7	40.6	....	0.6
% of GDP	*2.4*	*2.6*	*103.0*	

(1) Economic and Financial Planning Document. – (2) Forecasting and Planning Report. The primary surplus is derived from Section II of the Report. – (3) Stability Programme. – (4) Combined Report on the Economy and the Public Finances.

Government Report estimates the 2008 deficit at 2.4 per cent of GDP

In March the Government's Combined Report on the Economy and the Public Finances revised upwards the estimate of net borrowing for 2008 from 2.2 to 2.4 per cent of GDP (Table 14). The revision takes account, on the one hand, of the better results achieved in 2007 and, on the other, of the deterioration in the outlook for economic growth and the deferment of the cost of some measures to this year. In relation to GDP, net borrowing is 0.5 percentage points higher than in 2007; excluding cyclical effects and transitional measures, the deterioration in the Government estimate amounts to 0.6 points (0.3 points excluding only cyclical effects). The ratio of primary current expenditure to GDP rises by 0.6 points; the ratio of tax and social security contributions to GDP decreases slightly, to 43.1 per cent.

In the first quarter of 2008 the state sector borrowing requirement was €20.3 billion, €0.9 billion less than in the corresponding period of 2007. The improvement reflects temporary factors on the revenue side.

GENERAL GOVERNMENT DEBT

At 31 December 2007 general government debt amounted to €1,597 billion. The nominal growth over the year of €21.1 billion was smaller than the borrowing requirement (€30.5 billion) owing to the reduction of €13.1 billion in the assets held by the Treasury with the Bank of Italy. The change in the debt was also influenced by the issue of securities below par and the rise in the exchange rate of the euro (see the table). As a ratio to GDP, the debt fell by 2.5 percentage points to 104 per cent (in 2005 and 2006 it had risen by 2 and 0.7 points respectively; see the figure). The change in the ratio of the debt to GDP can be broken down into two main components – primary net borrowing and the difference between the average cost of the debt and the nominal growth in GDP – and a residual component.[1] In 2007 the primary surplus reduced the debt ratio by 3.1 percentage points of GDP (1.3 points in 2006). The difference between the average cost of the debt and the nominal growth in GDP increased it by 1.1 percentage points (0.9 points in 2006). In fact, there was a large increase in the average cost of the debt (of 35 basis points to 4.9 per cent, calculated with reference to the initial stock), that was only partly offset by the acceleration in nominal GDP growth (from 3.6 to 3.8 per cent). The residual component reduced the debt ratio by 0.5 percentage points of GDP, after increasing it by 1 percentage point in 2006.

As for the breakdown by sub-sector, in 2007 central government debt grew by €17 billion to €1,485 billion; in relation to GDP it fell from 99.2 to 96.7 per cent. The debt of the social security institutions, which had been negligible in the two previous years, increased by €0.5 billion to €0.6 billion. Local government debt increased by €3.6 billion (€18.1 billion in 2006) to €112 billion, and remained unchanged in relation to GDP at 7.3 per cent. There was a small reduction of €0.8 billion in the stock of securities, accompanied by an

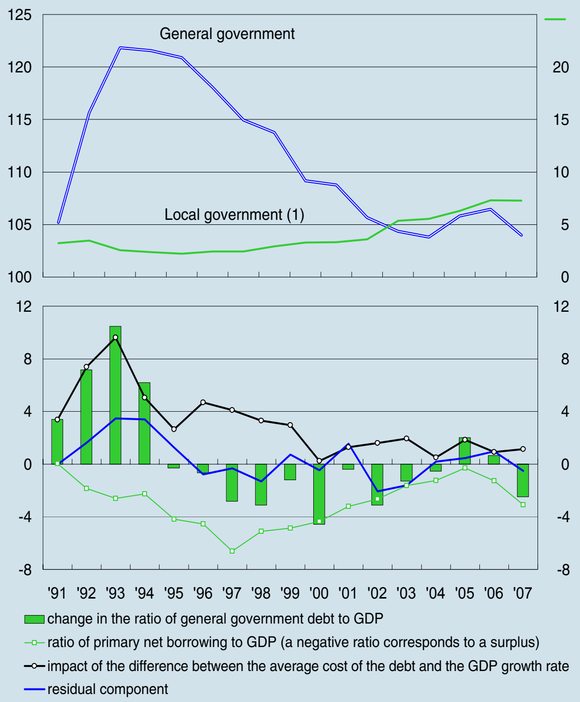
Table

Changes in general government debt and its components
(millions of euros)

	2004	2005	2006	2007
Change in the debt = (a)+(b)+(c)+(d)	**51,108**	**66,950**	**64,082**	**21,126**
(a) Total borrowing requirement	49,778	69,441	54,380	30,520
(b) Change in Treasury deposits with the Bank of Italy	2,578	-1,197	8,230	-13,142
(c) Issue discounts and premiums	-227	-2,444	2,274	4,083
(d) Change in foreign currency liabilities	-1,021	1,150	-801	-333

Figure

General government debt: trend and determinants of its changes and its components
(as a percentage of GDP)



(1) Right-hand scale. The increase in 2003 was mainly of an accounting nature in connection with the reclassification of Cassa Depositi e Prestiti S.p.A. outside general government.

[1] This is influenced by the different methods used to calculate net borrowing and the borrowing requirement (the former on an accrual basis and the latter on a cash basis), the net acquisition of financial assets (including the deposits held with the Bank of Italy), the effects of debt restructuring transactions, issue premiums and discounts, and movements in the exchange rate.

increase in loans (€2.5 billion) and other debt instruments, which mainly involved securitizations (€1.9 billion). The debt of the regions grew by 4.4 per cent (32.5 per cent in 2006) to €47.1 billion. The debt of the municipalities and provinces grew by 2.8 per cent (12.1 per cent in 2006) to €55.5 billion; that of the other entities, primarily producers of health services, remained basically stable (rising from €9 billion to €9.1 billion), after increasing by 15.3 per cent in 2006.

STATISTICAL APPENDIX

Additional tables are contained in the Statistical Appendix of the *Economic Bulletin* available on the Internet at www.bancaditalia.it/pubblicazioni

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Table A1

Sources and uses of income: United States (1)

(seasonally adjusted data; percentage changes on the previous period and contribution to growth, on an annual basis)

	GDP	Resident households' expenditure		General government expenditure		Investment		Domestic demand (2)		Exports	Imports	Net exports	Stocks
	Change	Change	Contri-bution	Change	Contri-bution	Change	Contri-bution	Change	Contri-bution	Change	Change	Contri-bution	Contri-bution
2004	3.6	3.6	2.6	1.4	0.3	7.3	1.1	4.1	4.3	9.7	11.3	-0.7	0.4
2005	3.1	3.2	2.2	0.7	0.1	6.9	1.1	3.1	3.3	6.9	5.9	-0.2	-0.2
2006	2.9	3.1	2.2	1.8	0.4	2.4	0.4	2.8	3.0	8.4	5.9	-0.1	0.1
2007	2.2	2.9	2.0	2.0	0.4	-2.9	-0.5	1.5	1.6	8.1	1.9	0.6	-0.3
2005 – Q1	3.1	2.4	1.7	1.3	0.3	4.0	0.7	2.6	2.8	6.0	2.1	0.3	0.2
Q2	2.8	3.5	2.4	1.2	0.2	7.9	1.3	1.9	2.0	9.5	0.8	0.8	-1.9
Q3	4.5	4.1	2.8	3.1	0.6	8.0	1.3	4.3	4.6	2.1	2.1	-0.1	-0.1
Q4	1.2	1.2	0.8	-1.9	-0.4	2.3	0.4	2.5	2.6	10.6	16.2	-1.4	1.7
2006 – Q1	4.8	4.4	3.0	4.9	0.9	7.9	1.3	4.5	4.7	11.5	6.9	0.1	-0.5
Q2	2.4	2.4	1.6	1.0	0.2	-1.9	-0.3	1.9	1.9	5.7	0.9	0.5	0.5
Q3	1.1	2.8	1.9	0.8	0.1	-4.7	-0.8	1.3	1.4	5.7	5.4	-0.3	0.1
Q4	2.1	3.9	2.7	3.5	0.7	-7.1	-1.2	0.8	0.9	14.3	1.6	1.3	-1.3
2007 – Q1	0.6	3.7	2.6	-0.5	-0.1	-4.4	-0.7	1.1	1.1	1.1	3.9	-0.5	-0.7
Q2	3.8	1.4	1.0	4.1	0.8	3.2	0.5	2.4	2.5	7.5	-2.7	1.3	0.2
Q3	4.9	2.8	2.0	3.8	0.7	-0.7	-0.1	3.3	3.5	19.1	4.4	1.4	0.9
Q4	0.6	2.3	1.6	2.0	0.4	-4.0	-0.6	-0.4	-0.4	6.5	-1.4	1.0	-1.8

Source: National statistics.
(1) Chain-linked volumes. Public sector investment is included in government expenditure. – (2) Includes change in stocks.

Table A2

Sources and uses of income: Japan (1)

(seasonally adjusted data; percentage changes on the previous period and contribution to growth, on an annual basis)

	GDP	Resident households' expenditure		General government expenditure		Investment		Domestic demand (2)		Exports	Imports	Net exports	Stocks
	Change	Change	Contri-bution	Change	Contri-bution	Change	Contri-bution	Change	Contri-bution	Change	Change	Contri-bution	Contri-bution
2004	2.7	1.6	0.9	1.9	0.3	1.4	0.3	1.9	1.9	13.9	8.1	0.8	0.3
2005	1.9	1.3	0.7	1.6	0.3	3.1	0.7	1.7	1.6	7.0	5.8	0.3	-0.1
2006	2.4	2.0	1.1	-0.4	-0.1	1.3	0.3	1.6	1.5	9.7	4.2	0.9	0.2
2007	2.1	1.4	0.8	0.8	0.1	-0.3	-0.1	1.0	0.9	8.8	1.7	1.1	0.1
2005 – Q1	2.9	1.4	0.8	4.9	0.9	7.6	1.7	3.0	2.8	-0.8	-0.9	..	-0.5
Q2	4.6	3.9	2.1	-2.1	-0.4	3.9	0.9	3.4	3.2	14.2	5.0	1.3	0.6
Q3	1.8	2.7	1.5	3.6	0.6	3.6	0.8	1.9	1.8	12.4	14.5	0.1	-1.2
Q4	2.4	2.1	1.2	-4.1	-0.7	-2.6	-0.6	0.1	0.1	15.5	-1.6	2.2	0.3
2006 – Q1	2.1	2.2	1.2	-1.6	-0.3	-0.7	-0.2	1.7	1.6	10.0	7.6	0.6	0.8
Q2	3.4	3.2	1.8	1.9	0.3	5.3	1.2	3.5	3.3	3.5	4.0	0.1	..
Q3	0.1	-3.0	-1.7	1.7	0.3	-1.5	-0.3	-1.4	-1.4	9.2	-1.0	1.4	0.4
Q4	4.4	4.2	2.3	-1.4	-0.2	8.1	1.8	4.0	3.7	3.3	0.4	0.4	-0.1
2007 – Q1	3.8	2.5	1.4	0.8	0.1	1.5	0.3	2.1	2.0	14.8	4.1	1.6	0.1
Q2	-1.5	0.6	0.4	1.2	0.2	-9.6	-2.3	-2.0	-1.9	4.6	2.1	0.5	-0.2
Q3	1.2	0.6	0.3	0.6	0.1	-3.9	-0.9	-0.9	-0.9	12.2	-0.5	1.9	-0.4
Q4	3.5	0.9	0.5	3.6	0.6	-0.1	..	1.6	1.6	13.2	2.2	1.7	0.5

Source: National statistics.
(1) Chain-linked volumes. – (2) Includes change in stocks.

Table A3

Sources and uses of income: euro area (1)

(percentage changes on the previous period)

	Sources			Uses					
	GDP	Imports	Total	Gross fixed capital formation			Resident households' expenditure (2)	General government expenditure	Exports
				Construction	Machinery, equipment, sundry products & vehicles	Total			
				Chain-linked volumes					
2002	0.9	0.4	0.8	-0.7	-2.1	-1.4	0.9	2.4	1.8
2003	0.8	3.3	1.4	1.4	1.3	1.4	1.3	1.8	1.2
2004	2.1	7.0	3.4	1.3	3.5	2.4	1.6	1.4	7.2
2005	1.6	5.5	2.7	1.8	4.2	3.0	1.6	1.5	4.7
2006	2.8	7.7	4.2	4.1	5.9	5.0	1.8	2.0	7.9
2007	2.6	5.2	3.4	3.7	4.8	4.3	1.5	2.2	6.0
2005 – Q4	0.5	2.0	0.9	0.8	1.1	1.0	0.1	0.1	1.0
2006 – Q1	0.8	2.4	1.3	-0.1	1.2	0.6	0.7	1.1	3.1
Q2	1.0	1.2	1.1	2.6	2.8	2.7	0.4	0.2	1.5
Q3	0.5	1.5	0.8	1.0	0.3	0.7	0.4	0.5	0.9
Q4	0.8	1.7	1.1	1.4	1.6	1.5	0.5	0.5	3.3
2007 – Q1	0.7	1.3	0.9	1.8	0.8	1.3	0.1	1.0	0.8
Q2	0.3	0.3	0.3	-1.1	1.1	..	0.6	0.2	0.9
Q3	0.7	2.5	1.2	0.9	1.3	1.1	0.5	0.6	2.0
Q4	0.4	-0.3	0.2	..	1.6	0.8	-0.1	-0.1	0.6
				Implicit prices					
2001	2.5	0.5	….	….	….	1.4	2.4	2.8	1.1
2002	2.6	-2.1	….	….	….	1.4	1.9	3.0	-0.4
2003	2.2	-1.8	….	….	….	1.1	2.1	2.4	-1.3
2004	1.9	1.5	….	….	….	2.4	2.1	2.2	1.0
2005	1.9	3.6	….	….	….	2.4	2.1	2.5	2.4
2006	1.9	3.8	….	….	….	2.7	2.2	1.9	2.7
2005 – Q4	0.7	0.9	….	….	….	0.7	0.5	1.6	0.9
2006 – Q1	0.3	1.7	….	….	….	0.7	0.5	-0.4	0.7
Q2	0.5	0.5	….	….	….	0.8	0.6	1.1	0.5
Q3	0.5	0.3	….	….	….	0.7	0.5	-0.3	0.5
Q4	0.4	-0.7	….	….	….	0.5	0.3	0.1	..
2007 – Q1	0.7	0.3	….	….	….	1.0	0.4	0.7	0.2
Q2	0.7	0.7	….	….	….	0.6	0.6	0.4	0.7
Q3	0.4	0.3	….	….	….	0.4	0.4	0.4	0.1
Q4	0.5	1.4	….	….	….	0.4	1.1	0.6	0.5

Source: Eurostat.
(1) Quarterly data are seasonally and calendar adjusted. – (2) Includes expenditure of non-profit institutions serving households.

Sources and uses of income: Italy (1)

(percentage changes on the previous period)

	Sources: GDP	Sources: Imports	Sources: Total	Uses: Gross fixed capital formation: Construction	Uses: Gross fixed capital formation: Machinery, equipment, sundry products & vehicles	Uses: Gross fixed capital formation: Total	Uses: Resident households' expenditure	Uses: General government expenditure (2)	Uses: Exports
				Chain-linked volumes					
2002	0.5	0.2	0.4	5.9	1.9	3.7	0.2	2.5	-2.9
2003	..	1.2	0.2	2.4	-4.6	-1.2	1.0	1.9	-2.0
2004	1.5	4.2	2.0	2.2	2.3	2.3	0.7	2.3	4.9
2005	0.6	2.2	0.9	0.5	0.9	0.7	0.9	1.9	1.0
2006	1.8	5.9	2.7	1.5	3.5	2.5	1.1	0.9	6.2
2007	1.5	4.4	2.1	2.2	0.2	1.2	1.4	1.3	5.0
2005 – Q3	0.4	..	0.3	1.0	2.1	1.5	0.5	0.4	0.6
Q4	-0.1	1.3	0.2	- 1.4	-2.1	-1.7	-0.3	-0.2	1.4
2006 – Q1	0.8	1.2	0.9	0.4	3.0	1.8	0.5	-0.3	2.2
Q2	0.6	0.4	0.6	1.1	0.7	0.9	0.5	-0.1	1.5
Q3	0.3	2.0	0.7	0.1	-2.0	-1.0	0.7	0.3	-1.9
Q4	1.1	1.8	1.2	2.9	1.6	2.2	0.2	-0.1	4.1
2007 – Q1	0.3	-1.2	..	1.6	-0.4	0.6	0.7	..	0.2
Q2	0.1	-0.2	..	- 1.2	1.5	0.2	0.5	-0.1	-1.4
Q3	0.4	2.4	0.9	1.4	1.5	1.5	0.2	0.2	0.9
				Implicit prices					
2002	3.3	-0.3	2.5	3.7	2.2	2.9	2.9	2.6	1.4
2003	3.1	-1.3	2.2	2.8	0.3	1.6	2.8	3.7	0.4
2004	2.6	2.7	2.6	4.0	1.4	2.7	2.6	2.7	2.6
2005	2.1	6.2	2.9	4.6	1.2	2.9	2.3	3.3	4.0
2006	1.7	7.6	3.0	3.2	2.0	2.6	2.7	2.0	4.5
2007	2.3	2.3	2.3	3.5	1.6	2.6	2.2	0.4	3.6
2005 – Q3	0.2	4.0	1.0	0.7	0.6	0.7	0.8	0.5	2.0
Q4	1.4	1.1	1.3	0.7	0.4	0.6	0.5	7.0	1.4
2006 – Q1	-0.5	4.2	0.5	0.5	..	0.3	0.7	-3.7	0.8
Q2	1.0	1.5	1.1	1.0	0.8	0.9	0.8	4.5	1.2
Q3	0.2	1.3	0.5	0.9	0.3	0.6	0.7	-2.7	1.5
Q4	0.5	-1.1	0.1	0.9	1.2	1.1	..	-1.0	1.4
2007 – Q1	0.9	2.7	1.3	1.2	1.5	1.4	0.4	1.1	2.3
Q2	0.7	1.3	0.9	0.7	0.6	0.7	0.6	0.4	1.8
Q3	0.5	1.0	0.7	0.9	0.6	0.7	0.8	0.9	0.9

Source: Istat.
(1) Quarterly data are seasonally and calendar adjusted. – (2) Includes consumption of non-profit institutions serving households.

Table A5

Unit labour costs, per capita compensation and productivity: euro area (1)

(percentage changes on the year-earlier period)

	Per capita compensation	Productivity	of which: Value added (2)	of which: Employees	Unit labour costs
			Total industry excluding construction		
2002	2.2	1.3	..	-1.2	0.9
2003	2.3	1.8	0.2	-1.5	0.5
2004	2.8	3.4	2.7	-1.3	-0.6
2005	1.6	2.5	1.0	-1.2	-0.9
2006	3.4	4.1	3.5	-0.4	-0.8
2007	1.8	2.6	4.1	1.5	-0.7
2006 – Q1	3.5	4.4	3.5	-0.9	-0.8
Q2	3.5	4.0	3.6	-0.4	-0.5
Q3	3.6	4.1	3.8	-0.2	-0.4
Q4	2.8	4.1	4.1	..	-1.3
2007 – Q1	1.5	2.7	4.2	1.5	-1.2
Q2	2.3	2.2	3.8	1.6	0.1
Q3	1.5	2.9	4.5	1.6	-1.4
Q4	2.1	2.5	4.0	1.5	-0.4
			Services		
2002	2.7	-0.1	1.4	1.5	2.8
2003	2.3	..	1.1	1.2	2.3
2004	2.0	0.3	1.9	1.5	1.7
2005	1.9	0.6	2.0	1.4	1.2
2006	1.8	0.4	2.4	2.1	1.4
2007	2.1	0.5	3.0	2.5	1.6
2006 – Q1	1.7	0.1	2.0	1.9	1.6
Q2	2.2	0.2	2.6	2.4	2.0
Q3	2.1	0.4	2.6	2.2	1.7
Q4	1.3	0.9	2.9	2.0	0.5
2007 – Q1	2.3	0.9	3.3	2.4	1.4
Q2	1.8	0.6	3.0	2.3	1.2
Q3	1.9	0.3	3.1	2.7	1.6
Q4	2.2	..	2.7	2.6	2.1
			Total economy		
2002	2.5	0.3	1.0	0.7	2.3
2003	2.3	0.2	0.7	0.5	2.1
2004	2.1	1.2	2.2	0.7	0.9
2005	1.8	0.8	1.6	0.9	1.0
2006	2.2	1.2	2.7	1.6	0.9
2007	2.1	0.8	3.2	2.4	1.3
2006 – Q1	2.1	1.0	2.3	1.3	1.1
Q2	2.4	1.1	2.8	1.7	1.3
Q3	2.4	1.2	2.9	1.6	1.2
Q4	1.7	1.6	3.3	1.6	0.2
2007 – Q1	2.1	1.2	3.7	2.4	0.9
Q2	1.9	0.7	3.1	2.3	1.2
Q3	1.9	0.7	3.3	2.6	1.2
Q4	2.2	0.5	2.8	2.4	1.7

Source: Based on Eurostat.
(1) Averages for countries belonging to the euro area at the date shown. – (2) Value added at base prices, volumes at chain-linked prices – reference year 2000.

Table A6

Unit labour costs, per capita compensation and productivity: Italy

(percentage changes on the year-earlier period) (1)

	Per capita compensation (2)	Productivity	of which: Value added (3)	of which: Employees (2)	Unit labour costs
			Total industry excluding construction		
2002	2.5	-1.0	-0.3	0.6	3.5
2003	2.8	-2.6	-2.7	..	5.6
2004	4.0	1.9	0.9	-1.0	2.0
2005	2.7	0.7	-0.4	-1.0	2.0
2006	2.6	0.1	1.2	1.0	2.5
2007	2.4	-0.1	0.8	0.9	2.5
2006 – Q1	3.5	2.1	2.8	0.8	1.4
Q2	2.3	..	2.0	2.0	2.3
Q3	2.4	0.7	2.3	1.5	1.6
Q4	2.5	3.4	4.2	0.8	-0.8
2007 – Q1	2.6	0.6	1.4	0.8	1.9
Q2	3.7	0.2	0.8	0.6	3.6
Q3	4.0	1.0	1.1	0.1	3.0
			Services		
2002	2.8	-0.9	0.9	1.8	3.7
2003	3.8	-0.7	0.4	1.1	4.5
2004	3.1	0.9	1.6	0.7	2.2
2005	3.6	0.7	1.1	0.4	2.9
2006	2.5	..	2.1	2.1	2.5
2007	1.6	0.7	1.8	1.1	0.9
2006 – Q1	3.6	-0.2	1.2	1.4	3.8
Q2	5.3	-1.0	1.5	2.5	6.3
Q3	3.7	-0.7	1.4	2.2	4.4
Q4	-2.2	0.6	2.3	1.6	-2.8
2007 – Q1	1.4	1.4	2.3	0.9	..
Q2	-0.9	1.3	2.0	0.7	-2.1
Q3	0.8	-0.3	2.0	2.3	1.1
			Total economy		
2002	2.7	-0.7	0.6	1.3	3.4
2003	3.7	-0.9	-0.3	0.6	4.7
2004	3.3	1.4	1.7	0.4	1.9
2005	3.2	0.6	0.7	0.2	2.6
2006	2.5	0.1	1.8	1.7	2.4
2007	1.9	0.6	1.6	1.0	1.4
2006 – Q1	3.4	0.5	1.6	1.1	2.9
Q2	4.3	-0.5	1.5	2.0	4.8
Q3	3.2	-0.5	1.4	1.9	3.7
Q4	-0.7	1.0	2.6	1.5	-1.7
2007 – Q1	1.9	1.5	2.2	0.7	0.4
Q2	0.6	1.1	1.7	0.6	-0.5
Q3	1.8	0.1	1.9	1.7	1.7

Sources: Based on Istat and Eurostat data.
(1) There may be discrepancies between the sum of quarterly results and the annual accounts. – (2) Standard labour units. – (3) Value added at base prices, volumes at chain-linked prices – reference year 2000. Value added of services is the sum of the sectors included in the aggregate.

Table A7

Harmonized index of consumer prices: main euro-area countries

(percentage changes on the year-earlier period)

	ITALY		GERMANY		FRANCE		SPAIN		EURO (1)	
	Total	Total excl. unprocessed food and energy products	Total	Total excl. unprocessed food and energy products	Total	Total excl. unprocessed food and energy products	Total	Total excl. unprocessed food and energy products	Total	Total excl. unprocessed food and energy products
2002	2.6	2.8	1.4	1.6	1.9	2.2	3.6	3.9	2.2	2.5
2003	2.8	2.7	1.0	0.9	2.2	2.2	3.1	3.0	2.1	2.0
2004	2.3	2.3	1.8	1.6	2.3	2.4	3.1	2.8	2.1	2.1
2005	2.2	2.0	1.9	1.0	1.9	1.2	3.4	2.7	2.2	1.5
2006	2.2	1.8	1.8	0.8	1.9	1.3	3.6	3.0	2.2	1.5
2007	2.0	1.9	2.3	2.1	1.6	1.5	2.8	2.7	2.1	2.0
2005 – Jan.	2.0	2.2	1.6	1.4	1.6	1.4	3.1	2.8	1.9	1.8
Feb.	2.0	2.1	1.9	1.3	1.9	1.2	3.3	2.8	2.1	1.6
Mar.	2.2	2.1	1.6	1.0	2.1	1.4	3.4	2.9	2.1	1.6
Apr.	2.1	2.0	1.4	0.7	2.0	1.3	3.5	2.7	2.1	1.4
May	2.3	2.1	1.6	1.1	1.7	1.3	3.0	2.6	2.0	1.6
June	2.1	2.0	1.8	0.8	1.8	1.2	3.2	2.5	2.1	1.4
July	2.1	1.8	1.8	0.8	1.8	0.9	3.3	2.5	2.2	1.3
Aug.	2.1	1.9	1.9	0.8	2.0	1.0	3.3	2.5	2.2	1.3
Sept.	2.2	1.8	2.5	1.1	2.4	1.2	3.8	2.6	2.6	1.4
Oct.	2.6	1.8	2.3	1.3	2.0	1.1	3.5	2.7	2.5	1.5
Nov.	2.4	1.9	2.2	1.2	1.8	1.1	3.4	2.8	2.3	1.5
Dec.	2.1	1.6	2.1	0.9	1.8	1.2	3.7	3.0	2.2	1.4
2006 – Jan.	2.2	1.6	2.1	0.6	2.3	1.3	4.2	3.0	2.4	1.3
Feb.	2.2	1.6	2.1	0.7	2.0	1.1	4.1	3.0	2.3	1.3
Mar.	2.2	1.8	1.9	0.8	1.7	1.2	3.9	3.1	2.2	1.4
Apr.	2.3	1.9	2.3	1.0	2.0	1.3	3.9	3.2	2.5	1.6
May	2.3	1.8	2.1	0.6	2.4	1.3	4.1	3.1	2.5	1.5
June	2.4	1.8	2.0	0.8	2.2	1.4	4.0	3.1	2.5	1.6
July	2.3	1.7	2.1	1.0	2.2	1.5	4.0	3.2	2.4	1.6
Aug.	2.3	1.6	1.8	0.8	2.1	1.4	3.8	3.1	2.3	1.5
Sept.	2.4	2.0	1.0	0.8	1.5	1.2	2.9	3.0	1.7	1.5
Oct.	1.9	2.0	1.1	1.0	1.2	1.3	2.6	2.8	1.6	1.6
Nov.	2.0	1.8	1.5	1.1	1.6	1.4	2.7	2.7	1.9	1.6
Dec.	2.1	1.9	1.4	1.0	1.7	1.5	2.7	2.5	1.9	1.6
2007 – Jan.	1.9	1.6	1.8	1.7	1.4	1.4	2.4	2.8	1.8	1.8
Feb.	2.1	2.1	1.9	1.8	1.2	1.4	2.5	2.8	1.8	1.9
Mar.	2.1	2.0	2.0	1.7	1.2	1.3	2.5	2.5	1.9	1.9
Apr.	1.8	1.8	2.0	1.9	1.3	1.4	2.5	2.5	1.9	1.9
May	1.9	1.9	2.0	2.1	1.2	1.4	2.4	2.5	1.9	1.9
June	1.9	1.9	2.0	2.1	1.3	1.4	2.5	2.5	1.9	1.9
July	1.7	1.8	2.0	2.1	1.2	1.4	2.3	2.4	1.8	1.9
Aug.	1.7	1.9	2.0	2.2	1.3	1.6	2.2	2.5	1.7	2.0
Sept.	1.7	1.8	2.7	2.3	1.6	1.6	2.7	2.6	2.1	2.0
Oct.	2.3	2.1	2.7	2.2	2.1	1.7	3.6	3.1	2.6	2.1
Nov.	2.6	2.2	3.3	2.4	2.6	1.8	4.1	3.3	3.1	2.3
Dec.	2.8	2.3	3.1	2.4	2.8	1.9	4.3	3.4	3.1	2.3
2008 – Jan.	3.1	2.6	2.9	2.1	3.2	2.2	4.4	3.2	3.2	2.3
Feb.	3.1	2.5	2.9	2.2	3.2	2.3	4.4	3.3	3.3	2.4

Source: Eurostat.
(1) Weighted average of the indices of the countries belonging to the euro area at the date indicated.

Table A8

Balance of payments (current account and capital account): Italy

(millions of euros)

	Current account						Capital account			
	Total	Goods	Services	Income	Current transfers		Total	Intangible assets	Capital transfers	
					Private	Public			Private	Public
2004	-13,077	8,854	1,179	-14,817	-1,477	-6,816	1,700	-38	-26	1,764
2005	-23,403	536	-523	-13,643	-1,451	-8,323	998	69	-66	994
2006	-38,204	-10,203	-1,161	-13,607	-5,251	-7,982	1,890	-100	-60	2,050
2007	(-36,571)	(2,002)	(-6,596)	(-18,769)	….	….	(2,675)	….	….	….
2006 – Q1	-12,646	-6,025	-1,444	-2,125	-1,275	-1,777	487	-106	65	528
Q2	-10,444	-2,856	1,740	-6,803	-1,012	-1,514	-27	-19	-139	131
Q3	-6,159	-1,464	237	-970	-1,469	-2,492	293	-2	1	294
Q4	-8,954	143	-1,695	-3,709	-1,495	-2,198	1,137	26	14	1,097
2007 – Q1	-12,508	-2,332	-3,201	-4,092	-1,247	-1,636	1,133	-1	30	1,104
Q2	-10,345	891	-1,118	-8,178	-1,728	-213	-32	-27	-14	9
Q3	-4,659	2,583	-842	-2,713	-1,580	-2,107	572	25	-30	577
Q4	(-9,058)	(861)	(-1,436)	(-3,786)	….	….	(1,003)	….	….	….
2006 – Jan.	-4,139	-3,007	-363	-605	-197	32	76	5	-42	113
Feb.	-3,265	-2,081	-336	-522	-240	-87	148	-8	101	55
Mar.	-5,242	-937	-745	-998	-839	-1,722	264	-103	7	360
Apr.	-3,881	-1,380	770	-2,367	-215	-689	-48	-9	-82	43
May	-3,819	-714	196	-2,183	-485	-633	65	3	19	42
June	-2,744	-762	775	-2,252	-312	-192	-44	-14	-76	46
July	69	1,264	664	-755	-538	-566	68	6	25	37
Aug.	-1,100	-863	-672	1,384	-368	-582	37	-1	2	37
Sept.	-5,128	-1,866	245	-1,599	-564	-1,344	188	-7	-25	220
Oct.	-3,214	168	-12	-2,209	-559	-603	106	23	2	81
Nov.	-2,787	-104	-736	-1,063	-507	-377	-83	2	-33	-52
Dec.	-2,953	78	-947	-437	-430	-1,218	1,114	2	44	1,068
2007 – Jan.	-5,524	-2,389	-1,358	-1,427	-515	165	242	-3	10	235
Feb.	-3,532	-978	-776	-1,231	-167	-380	249	-6	9	246
Mar.	-3,452	1,035	-1,066	-1,434	-565	-1,421	642	7	12	623
Apr.	-4,808	-753	-885	-2,087	-502	-582	23	-8	-1	32
May	-4,444	284	-276	-3,457	-543	-451	7	-18	-4	29
June	-1,094	1,360	44	-2,634	-683	820	-62	,,	-10	-52
July	2,349	3,037	344	-221	-527	-284	40	21	-20	39
Aug.	-3,042	130	-1,014	-1,110	-462	-586	35	,,	5	30
Sept.	-3,966	-584	-172	-1,382	-591	-1,237	496	3	-14	507
Oct.	-1,119	1,461	-9	-1,510	-621	-440	32	-47	2	77
Nov.	-2,690	632	-875	-1,331	-664	-451	123	-10	80	53
Dec.	(-5,250)	(-1,232)	(-552)	(-945)	….	….	(847)	….	….	….
2008 – Jan.	(-5,640)	(-2,522)	(-657)	(-1,672)	….	….	(328)	….	….	….

Table A9

Lending by Italian banks by geographical area and sector (1)

(12-month percentage changes)

	General govern-ment	Finance and insurance companies	Non-financial corporations (a)		Households		Firms = (a) + (b)				Total
				under 20 employ-ees (2)	Producer (b) (3)	Consumer		Manufac-turing	Construc-tion	Services	
						Centre and North					
2006 – Dec.	4.9	15.4	10.7	5.1	7.2	10.0	10.4	5.7	14.3	12.4	10.7
2007 – Mar.	4.8	13.7	11.1	4.1	6.3	8.6	10.7	4.7	14.4	12.1	10.3
June	4.8	9.8	11.5	4.2	5.5	8.1	10.9	5.7	14.7	10.5	9.8
Sept.	-0.1	7.7	12.7	5.5	5.7	8.5	12.1	7.1	15.3	12.1	10.1
Dec.	7.9	5.6	13.2	6.8	5.2	8.2	12.4	6.5	13.5	11.1	10.6
2008 – Feb.	5.9	8.1	13.2	6.4	5.4	7.3	12.5	..	..	..	10.7
						South and Islands					
2006 – Dec.	-3.0	-22.3	19.9	9.6	10.1	13.1	18.1	12.5	20.5	22.2	13.9
2007 – Mar.	-9.5	-1.7	17.2	9.0	9.6	12.7	15.8	13.8	21.2	18.1	12.9
June	2.5	4.4	15.4	9.4	9.2	12.0	14.3	11.3	20.9	16.2	12.6
Sept.	-3.8	-4.8	16.3	10.4	8.9	12.2	14.9	12.4	21.3	16.4	12.6
Dec.	-3.5	-7.0	10.8	9.8	6.6	10.5	10.1	7.3	18.5	9.7	9.2
2008 – Feb.	-3.8	-7.4	11.6	10.3	7.4	9.5	10.9	..	..	..	9.4
						ITALY					
2006 – Dec.	3.7	14.1	11.8	5.7	7.9	10.7	11.4	6.5	15.3	13.7	11.2
2007 – Mar.	2.5	13.2	11.8	4.8	7.1	9.4	11.3	5.8	15.5	12.8	10.7
June	4.4	9.7	12.0	5.0	6.4	9.0	11.4	6.4	15.7	11.2	10.2
Sept.	-0.7	7.4	13.1	6.1	6.5	9.3	12.4	7.7	16.3	12.7	10.4
Dec.	6.4	5.3	12.9	7.2	5.5	8.7	12.1	6.6	14.4	10.9	10.4
2008 – Feb.	4.5	7.7	13.0	7.0	5.9	7.8	12.3	7.7	13.6	10.6	10.5

(1) Statistics for February 200 are provisional; they include data for Cassa Depositi e Prestiti S.p.A., which has been classified as an MFI since October. Loans do not include repurchase agreements, bad debts and some smaller items included in the Eurosystem harmonized definition. The breakdown by geographical area is according to customers' place of residence. Net of the effects of reclassification, exchange rate changes and other modifications not due to transactions. – (2) Limited partnerships and general partnerships with fewer than 20 employees. Informal associations, de facto companies and sole proprietorships with 6-19 employees. – (3) Informal associations, de facto companies and sole proprietorships with up to 5 employees.

Table A10

Financing of the general government borrowing requirement: Italy

(millions of euros)

	Currency and deposits	of which: PO funds	Short-term securities	Medium and long-term securities	MFI loans (1)	Other operations (1)	of which: change in central bank current accounts	Borrowing requirement	of which: financed abroad
2005	20,743	-4,177	-924	39,968	5,593	4,061	1,197	69,441	3,986
2006	7,476	-4,957	4,867	33,116	63,596	-54,676	-8,230	54,380	-6,883
2007	-13,977	-28,447	5,542	22,348	1,750	14,857	13,142	30,520	-6,156
2005 – Q1	2,510	-516	11,204	45,940	1,198	-33,130	-34,293	27,721	1,293
Q2	12,725	149	9,287	20,745	1,952	-15,573	-14,842	29,137	3,536
Q3	2,758	-1,577	2,547	-19,414	346	29,464	28,813	15,701	424
Q4	2,751	-2,233	-23,963	-7,303	2,097	23,300	21,519	-3,117	-1,266
2006 – Q1	10,657	-891	18,406	13,053	2,479	-11,612	-16,246	32,983	-19
Q2	1,162	-1,615	7,154	28,758	-627	-25,553	-26,568	10,893	724
Q3	232	-1,210	-7,799	5,973	55,958	-39,101	12,948	15,263	1,294
Q4	-4,575	-1,240	-12,893	-14,668	5,787	21,590	21,637	-4,759	-8,882
2007 – Q1	-1,537	-3,474	20,664	7,520	2,340	-5,598	-5,753	23,388	-521
Q2	-16,496	-13,509	345	28,689	-632	-8,731	-8,936	3,175	2,490
Q3	-2,330	-8,550	3,074	-2,809	-1,099	7,094	5,459	3,930	-6,283
Q4	6,387	-2,914	-18,541	-11,052	1,140	22,093	22,372	26	-1,841
2006 – Jan.	7,154	-844	9,294	20,225	615	-31,497	-31,955	5,790	-68
Feb.	1,933	370	2,388	-1,681	319	5,547	2,941	8,506	-39
Mar.	1,570	-417	6,725	-5,491	1,545	14,338	12,768	18,687	88
Apr.	-651	-370	4,549	4,722	400	681	47	9,702	-1,832
May	550	-56	2,139	4,834	-1,129	9,452	8,401	15,846	1,187
June	1,264	-1,188	465	19,201	101	-35,686	-35,016	-14,655	1,368
July	-1,478	-601	-2,755	-4,529	-935	6,202	4,564	-3,496	-190
Aug.	1,440	-28	-2,960	7,915	-475	3,237	1,153	9,157	-1,225
Sept.	271	-582	-2,084	2,587	57,367	-48,540	7,232	9,601	2,709
Oct.	-330	-216	80	3,258	719	1,949	1,870	5,676	-7,105
Nov.	-1,964	-553	2,895	2,146	10	5,602	5,765	8,690	2,052
Dec.	-2,281	-471	-15,868	-20,073	5,058	14,040	14,002	-19,124	-3,829
2007 – Jan.	3,209	-263	12,347	-1,824	848	-11,536	-11,383	3,044	-759
Feb.	-2,029	204	3,027	5,059	1,082	-3,550	-3,489	3,589	-291
Mar.	-2,718	-3,415	5,290	4,285	410	9,488	9,120	16,756	528
Apr.	-4,256	-4,597	99	4,960	3,164	7,554	7,549	11,520	353
May	-3,081	-1,584	2,261	18,325	-2,062	-4,732	-5,066	10,711	505
June	-9,159	-7,329	-2,015	5,404	-1,734	-11,553	-11,419	-19,056	1,632
July	-203	-4,856	377	110	-241	-2,262	-3,963	-2,219	-2,646
Aug.	-1,558	-1,934	358	-728	-1,831	3,831	3,887	72	-448
Sept.	-569	-1,760	2,340	-2,191	972	5,526	5,534	6,077	-3,189
Oct.	-35	-580	5,213	5,094	412	-1,846	-1,859	8,840	70
Nov.	404	-1,152	-380	-5,385	1,656	8,712	8,860	5,007	419
Dec.	6,017	-1,182	-23,374	-10,762	-928	15,226	15,372	-13,821	-2,330

(1) As of September 2006 Cassa Depositi e Prestiti S.p.A. is included among MFIs; as of the same month its loans to general government bodies are included in the item “MFI loans”.

General government debt: Italy
(millions of euros)

	Currency and deposits	*of which:* PO funds	Short-term securities	Medium and long-term securities	MFI loans (1)	Other liabilities (1)	General government debt	*of which:* in foreign currencies	*of which:* medium and long-term	*Memorandum item:* central bank current accounts
2005	149,530	70,578	117,460	1,129,276	60,098	55,190	1,511,554	27,255	1,257,844	14,634
2006	157,006	65,622	122,327	1,163,873	123,687	8,743	1,575,636	10,740	1,303,558	22,864
2007	143,029	37,175	127,869	1,189,972	125,434	10,459	1,596,762	3,465	1,330,997	9,721
2005 – Mar.	131,297	74,239	129,589	1,136,070	55,698	53,489	1,506,143	29,260	1,264,274	50,124
June	144,021	74,388	138,877	1,156,976	57,655	52,759	1,550,288	26,844	1,283,042	64,966
Sept.	146,779	72,811	141,424	1,136,445	58,000	53,409	1,536,058	26,634	1,261,592	36,153
Dec.	149,530	70,578	117,460	1,129,276	60,098	55,190	1,511,554	27,255	1,257,844	14,634
2006 – Mar.	160,186	69,687	135,868	1,142,338	62,574	59,824	1,560,792	22,314	1,275,756	30,880
June	161,349	68,072	143,025	1,172,259	61,945	60,839	1,599,417	18,375	1,302,764	57,449
Sept.	161,581	66,862	135,224	1,178,470	117,902	8,790	1,601,967	15,116	1,312,091	44,501
Dec.	157,006	65,622	122,327	1,163,873	123,687	8,743	1,575,636	10,740	1,303,558	22,864
2007 – Mar.	155,469	62,147	142,994	1,172,608	126,027	8,898	1,605,995	5,020	1,314,927	28,616
June	138,972	48,639	143,349	1,203,506	125,394	9,103	1,620,323	4,908	1,344,776	37,552
Sept.	136,642	40,089	146,422	1,200,347	124,295	10,738	1,618,444	4,678	1,342,511	32,094
Dec.	143,029	37,175	127,869	1,189,972	125,434	10,459	1,596,762	3,465	1,330,997	9,721
2006 – Jan.	156,684	69,734	126,753	1,149,208	60,711	55,649	1,549,004	26,360	1,278,369	46,589
Feb.	158,617	70,104	129,141	1,148,334	61,032	58,254	1,555,378	23,446	1,279,368	43,648
Mar.	160,186	69,687	135,868	1,142,338	62,574	59,824	1,560,792	22,314	1,275,756	30,880
Apr.	159,535	69,317	140,421	1,146,825	62,974	60,459	1,570,213	19,509	1,280,185	30,834
May	160,085	69,261	142,561	1,152,342	61,844	61,510	1,578,343	17,673	1,285,872	22,433
June	161,349	68,072	143,025	1,172,259	61,945	60,839	1,599,417	18,375	1,302,764	57,449
July	159,870	67,471	140,268	1,167,827	61,010	62,477	1,591,452	18,101	1,299,023	52,885
Aug.	161,310	67,444	137,306	1,175,889	60,534	64,562	1,599,601	17,379	1,308,569	51,732
Sept.	161,581	66,862	135,224	1,178,470	117,902	8,790	1,601,967	15,116	1,312,091	44,501
Oct.	161,251	66,646	135,303	1,181,897	118,620	8,869	1,605,941	12,370	1,315,084	42,631
Nov.	159,287	66,093	138,199	1,183,896	118,630	8,706	1,608,718	10,813	1,319,788	36,866
Dec.	157,006	65,622	122,327	1,163,873	123,687	8,743	1,575,636	10,740	1,303,558	22,864
2007 – Jan.	160,215	65,358	134,674	1,162,776	124,535	8,591	1,590,791	6,968	1,303,783	34,247
Feb.	158,186	65,562	137,702	1,168,418	125,617	8,529	1,598,452	6,845	1,309,657	37,736
Mar.	155,469	62,147	142,994	1,172,608	126,027	8,898	1,605,995	5,020	1,314,927	28,616
Apr.	151,213	57,551	143,094	1,177,560	129,189	8,902	1,609,958	4,907	1,320,426	21,067
May	148,131	55,967	145,358	1,196,854	127,128	9,236	1,626,707	4,960	1,340,284	26,133
June	138,972	48,639	143,349	1,203,506	125,394	9,103	1,620,323	4,908	1,344,776	37,552
July	138,769	43,782	143,726	1,204,157	125,153	10,803	1,622,609	4,837	1,346,831	41,515
Aug.	137,211	41,848	144,084	1,203,528	123,323	10,747	1,618,893	4,847	1,345,287	37,628
Sept.	136,642	40,089	146,422	1,200,347	124,295	10,738	1,618,444	4,678	1,342,511	32,094
Oct.	136,608	39,508	151,631	1,205,520	124,706	10,752	1,629,216	4,591	1,347,928	33,953
Nov.	137,012	38,357	151,251	1,200,384	126,362	10,604	1,625,613	3,490	1,342,582	25,093
Dec.	143,029	37,175	127,869	1,189,972	125,434	10,459	1,596,762	3,465	1,330,997	9,721

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