BANCA D'ITALIA
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New Research at the Bank of Italy

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Contents

Highlights

On 28 June the Bank of Italy's hosted the workshop on *"Assessing the impact of State aid to firms"*. In Italy, State aid to firms is substantial, amounting to 0.4 per cent of GDP, a share similar to that of other large European countries such as France and Spain. Governments use State aid to pursue a number of objectives - fostering regional development, promoting R&D, or supporting SMEs. Despite the widespread use of government sponsored programs, the evaluation of their effects is still in its infancy in Italy. This workshop, bringing together economists and policy makers, represent an initial attempt to bridge this gap. Overall, the results of the papers presented at the workshop cast many doubts on the effectiveness of the measures considered. The discussion highlighted that the evaluation is a key step to assist policy makers to design effective and non-distortionary measures.

The international conference "The Luxembourg Wealth Study: Enhancing Comparative Research on Household Finance" was held at the Bank of Italy on 5-7 July. Family assets are playing an increasing role in buffering life uncertainties, as rich economies have experienced a shift of risk from the State to the household, on account of greater job insecurity and reduced social expenditure. Population ageing is also shifting the weight in life-cycle income from labor earnings to capital income and pension transfers. These themes are often at the center of the policy debate. As aggregate information at the country level is seldom adequate to investigate these issues, there is a need for micro-data on household finance that can be compared across countries.

An important result towards this end has been achieved by the Luxembourg Wealth Study (LWS), a project launched in 2003 by central banks, statistical agencies and research institutes from ten countries. The LWS archive contains standardized household-level data on wealth holdings, family and adult characteristics, income and consumption data, derived from existing data sources. The conference marked the end of the experimental project. The database is to be released to the scientific community in November 2007. More information on the LWS project and how to access the data is available at: www.lisproject.org.
(workshop's proceedings)

Our working paper *No. 631*: "New Eurocoin: Tracking economic growth in real time" details the construction of a new coincident indicator for the euro area growth. The indicator, to be officially presented in London to the financial community on 20 September, will be made regularly available on the Bank of Italy webpage and updated at a monthly frequency.

From 16 to 17 October 2007, the Bank of Italy will host in its headquarters in Perugia the conference "Household wealth In Italy."

Latest working papers

No. 629: Monetary policy shocks in the euro area and global liquidity spillovers

João Sousa and Andrea Zaghini

We analyse the international transmission of monetary policy shocks with a focus on the effects of foreign liquidity on the euro area. We estimate two domestic structural VAR models for the euro area and then we introduce a global liquidity aggregate. The impulse responses show that a positive shock to foreign liquidity leads for the euro area to a permanent increase in M3 and in the price level, a temporary rise in real output and a temporary appreciation of the euro real effective exchange rate. Moreover, we find that innovations in global liquidity play an important role in explaining price and output fluctuations. (full pdf text)

No. 630: Endogenous growth and trade liberalization between asymmetric countries

Daniela Marconi

The paper presents a general equilibrium model of endogenous growth and trade between two countries, an advanced country (A) and a backward country (B). The development stage is summarized by the level of knowledge stock accumulated through R&D investments. The latter generates technological progress that intermediate goods producing firms, operating under increasing returns to scale and monopolistic competition, perform to obtain process innovations (reduction of production costs) when they are incumbents, or product innovations if they are new entrants. The model shows that convergence in long-run growth rates can be obtained even in absence of international technology spillover, in which case, under the assumption of no variety overlap, the gain from trade will be only static. Dynamic effects will be delivered instead in presence of an initial overlap in the varieties produced in the two countries, together with a wide gap in unit production costs. In this case it is shown that the impact of trade liberalization on firms' profits might generate a cumulative causation process which may lead to a polarization of innovative productions in the advanced country. (full pdf text)

No. 631: New Eurocoin: Tracking economic growth in real time

Filippo Altissimo, Riccardo Cristadoro, Mario Forni, Marco Lippi and Giovanni Veronese

This paper presents ideas and methods underlying the construction of an indicator that tracks euro-area GDP growth but, unlike GDP growth, (i) is updated monthly and almost in real time, and (ii) is free from short-run dynamics. Removal of short-run dynamics from a time series to isolate the medium to long-run component can be obtained by a band-pass filter. However, it is well known that band-pass filters, being two-sided, perform very poorly at the end of the sample. New Eurocoin is an estimator of the medium to long-run component of GDP that only uses contemporaneous values of a large panel of macroeconomic time series, so that no end-of-sample deterioration occurs. Moreover, as our dataset is monthly, New Eurocoin can be updated each month and with a very short delay. Our method is based on generalized principal components that are designed to use leading variables in the

dataset as proxies for future values of GDP growth. As the medium to long run component of GDP is observable, although with delay, the performance of New Eurocoin at the end of the sample can be measured.
(full pdf text)

No. 632: Oil supply news in a VAR: Information from financial markets

Alessio Anzuini, Patrizio Pagano and Massimiliano Pisani

This paper analyzes the macroeconomic effects on the U.S. economy of news about oil supply by estimating a VAR. Information contained in daily quotations of oil futures contracts is exploited to estimate the dynamic path of oil prices following a shock. Hence, differently from the VAR literature on oil shocks we do not need to rely on recursive identification. Impulse response functions suggest that oil supply disruptions have stagflationary effects on the U.S. economy. Historical decomposition shows that oil shocks contributed significantly to the US recessions of the last thirty years, but not all exogenous increases in oil prices induced a recession. Finally, the contribution of oil shocks to inflation fluctuations seems to have declined over time.
(full pdf text)

No. 633: The reliability of EMU fiscal indicators: Risks and safeguards

Fabrizio Balassone, Daniele Franco and Stefania Zotteri

The reliability of EMU's fiscal indicators has been questioned by recent episodes of large upward deficit revisions. This paper discusses the causes of such revisions in order to identify ways to improve monitoring. The computation of EMU's deficit indicator involves the assessment of accrued revenue and expenditure and the identification of transactions in financial assets. Both can open margins for opportunistic accounting. However, crosschecks between deficit and changes in gross nominal debt (the other fiscal indicator used in EMU) can reduce the scope for window dressing. Simple comparison of deficit and changes in debt can readily spotlight large inconsistencies in fiscal data. Nevertheless, consistency checks must go deeper than simple comparison, since different items in the reconciliation account between deficit and change in debt can offset each other. Econometric evidence suggests that such offset may indeed have been used to reduce the visibility of deficit-specific window dressing. Attention to the quality of statistics has increased in recent years, also in the context of the reform of the Stability and Growth Pact. In this context, the paper argues that detailed analysis of the reconciliation account between deficit and change in debt is crucial to the effectiveness of monitoring.
(full pdf text)

No. 634: Export prices, product quality and firms' characteristics: An analysis on a sample of Italian firms

Matteo Bugamelli

The unsatisfactory performance of Italian export volumes in the last decade has been attributed to three factors; the product specialization still centered around traditional sectors, the small firm size and the exceptional rise in export unit values. This paper analyzes the latter with the aim of testing three alternative hypotheses: i) measurement error; ii) composition effect: globalization forcing the exit of less productive firms producing low quality goods would have raised the average quality and thus prices of exported goods; iii) pricing strategies: Italian firms would have maximized profit margins sacrificing volumes. On the basis of sample data on price variations by destination market at the firm-level, we find that: a) in the last decade (1996-2005), export unit values have overestimated export price dynamics by 2 percentage points on average every year; b) on the basis of our new export prices, the Italian loss in world market share has been smaller, but still larger as compared to France and Germany; c) the composition effect has had a limited role. (full pdf text; in Italian)

No. 635: **Openness to trade and industry cost dispersion: Evidence from a panel of Italian firms**

Gianmarco I.P. Ottaviano and Marcello Pagnini

We use Italian firm-level data to investigate the impact of trade openness on the distribution of firms across marginal cost levels. In so doing, we implement a procedure that allows us to control not only for the standard transmission bias identified in firm-level TFP regressions but also for the omitted price bias due to imperfect competition. We find that more open industries are characterized by a smaller dispersion of costs across active firms. Moreover, in those industries the average cost is also smaller.
(full pdf text)

No. 636: **The weighting process in the SHIW**

Ivan Faiella and Romina Gambacorta

The design of a probability sample jointly determines the method used to select sampling units from the population and the estimator of the population parameter. If the sampling fraction is constant for all the units in the sample, then the unweighted sampling mean is an unbiased estimator. In the Survey on Household Income and Wealth (SHIW), units included in the sample have unequal probabilities of selection and each observation is weighted using the inverse of the proper sampling fraction (design weight) adjusted for the response mechanism (nonresponse weight) and for other factors such as imperfect coverage. In this paper we present the weighting scheme of the SHIW and assess its impact on bias and variance of selected estimators. Empirical evidences show that the increasing variability induced by using weighted estimators is compensated by the bias reduction even when performing analysis on sample domains. A set of longitudinal weights is also proposed to account for the selection process and the attrition of the SHIW panel component. These weights, giving their enhanced description of the "panel population", should be better suited to perform longitudinal analysis; nevertheless their higher variance implies that they wouldn't always be preferable in terms of mean square error.
(full pdf text)

No. 637: **Emerging markets spreads and global financial conditions**

Alessio Ciarlone, Paolo Piselli and Giorgio Trebeschi

In this article, we analyse how much of the reduction in emerging markets spreads can be ascribed to specific factors - linked to the improvement in the 'fundamentals' of a given country - rather than to common factors - linked to global liquidity

conditions and agents' degree of risk aversion. By means of factor analysis, we find that a single common factor is able to explain a large part of the co-variation in emerging market economies spreads observed in the last four years; on its turn, this common factor might be traced back mainly to financial markets volatility. Due to the particularly benign global financial conditions in recent years, spreads seem to have declined to levels lower than those warranted by improved fundamentals. As a consequence, EMEs do remain vulnerable to sudden shift in financial market conditions.
(full pdf text)

Latest Occasional Papers

No. 8: **Supplementary pension schemes in Italy: Features, development and opportunities for workers**

Riccardo Cesari, Giuseppe and Grande, Fabio Panetta

Participation in supplementary pension funds allows workers to exploit tax benefits and payroll employees to take advantage of employer contributions. The simulations reported in the paper show that these two components can considerably increase workers' retirement wealth. Data show that returns on supplementary pension funds may be greater than the revaluation rate of the so-called Trattamento di fine rapporto (Tfr, severance pay entitlements that also serve as provision for old age and are funded by workers' contributions). As for the liquidity of accrued positions, recent changes in the law give retirement wealth held in pension funds a degree of flexibility comparable to that of the Tfr. The paper shows that scale economies may be substantial. Cost moderation also requires transparency and comparability of charges and fees: they are also essential in stimulating competition and allowing workers to move freely from expensive retirement schemes to schemes charging lower fees. In this respect the limits on the portability of employer contributions discourage worker mobility across different pension schemes. Italian workers seem to overestimate the level of the future public pension. This result suggests the importance of strengthening public efforts aimed at providing workers with appropriate information, to make them aware of their retirement position.
(full pdf text; in Italian)

Forthcoming working papers

Di Giacinto V. and G. Micucci, *The producer services industry in Italy: Long term growth and its local determinants*

Iacoviello M. and S. Neri, *The role of housing collateral in an estimated two-sector model of the U. S. economy*

Maccheroni F., M. Marinacci, A. Rustichini and M. Taboga, *Portfolio selection with monotone mean-variance preferences*

Magri S., The financing of small innovative firms: The Italian case

Marconi D. and V. Rolli, *Comparative advantage patterns and domestic determinants in emerging countries: An analysis with a focus on technology*

Mistrulli P., Assessing financial contagion in the interbank market: Maximum entropy vs. observed interbank lending patterns

Moretti G., *Detecting long memory co-movements in macroeconomic time series*

Rosolia A. and R. Torrini, *The generation gap: Relative earnings of young and old workers in Italy*

Recently published working papers

No. 628 Kristian Behrens, Andrea R. Lamorgese, Gianmarco I.P. Ottaviano and Takatoshi Tabuchi, *Changes in transport and non transport costs: Local vs. global impacts in a spatial network* (April 2007)

No. 627 Giuseppe Ferrero, Andrea Nobili and Patrizia Passiglia, *The sectoral distribution of money supply in the euro area* (April 2007)

No. 626 Federico Cingano and Piero Cipollone, *University drop-out: The case of Italy* (April 2007)

No. 625 Monica Paiella, *The forgone gains of incomplete portfolios* (April 2007)

No. 624 Giovanna Messina, *A new measure of local endowments of transport infrastructures* (April 2007; in Italian)

No. 623 Andrea Brandolini, *Measurement of income distribution in supranational entities: The case of the European Union* (April 2007)

No. 622 Bronwyn H. Hall, Francesca Lotti and Jacques Mairesse, *Employment, innovation, and productivity: Evidence from Italian microdata* (April 2007)

No. 621 Maria Elena Bontempi, Roberto Golinelli and Giuseppe Parigi, *Why demand uncertainty curbs investment: Evidence from a panel of Italian manufacturing firms* (April 2007)

No. 620 Orazio P. Attanasio and Monica Paiella, *Intertemporal consumption choices, transaction costs and limited participation in financial markets: Reconciling data and theory* (April 2007)

Recently published occasional papers

No. 6: Chiara Bentivogli, Emidio Cocozza, Antonella Foglia and Simonetta Iannotti, *The bank-firm relationship after Basel 2: A survey of Italian firms* (February 2007; in Italian)

No. 7: Andrea Finicelli, *House price developments and fundamentals in the United States* (May 2007)

Selection of forthcoming or recently published articles by Bank of Italy's staff

(full list since 1990)

Angelini P., **A. Generale**, *On the evolution of firm size distributions*, Forthcoming, American Economic Review (WP No. 549)

Ascari G. and **T. Ropele**, *Optimal monetary policy under low trend*

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Busetti F., **L. Forni**, A. Harvey and **F. Venditti**, *Inflation convergence and divergence within the European monetary union*, Forthcoming, International Journal of Central Banking

Cipollone P. and **A. Rosolia**, *Social interactions in high school: Lessons from an earthquake*, Forthcoming, American Economic Review (WP No. 596)

Marchetti D. J. and F. Nucci, *Pricing behavior and the response of hours to productivity shocks*, Forthcoming, Journal of Money, Credit and Banking (WP No. 524)

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