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Excerpts from the Governor's Concluding Survey

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X. *Excerpts from the Governor's Concluding Survey*

Gentlemen:

In 1956 the Bank of Italy increased its loans by 124 billion lire, represented by an increase in rediscounts of 93 billion lire and a larger outlay for advances on securities, deferred payments and miscellaneous items of 31 billion.

This increase of 124 billion lire is in sharp contrast to the reduction of 3 billion in the same items in 1955.

The Central Bank, then, acted to ease the financial strain on the credit system in 1956, and especially at the end of the year by extending loans in an amount about 30 per cent higher than the volume outstanding for these items at the end for the preceding year (a total of 431 billion lire, which rose to 555 billion).

However, demand and time deposits at the Bank of Italy increased on the whole by only 11 billion lire, those made by credit institutions actually having decreased by 8 billion, since, on the one hand, they met their reserve requirements not in cash but with deposits of Treasury bills already in their portfolios or newly subscribed, and, on the other, decreased their liquidity under the pressure of the demand for credit.

The increase in loans granted by the Central Bank therefore produced its full effect on currency in circulation, which also reflected the increase in credits connected with the foreign exchange system. These credits rose by 84 billion lire, principally in response to the increase in foreign exchange reserves during the year, equivalent to 109.8 million dollars.

Holdings in gold and convertible currencies (US dollars, Canadian dollars and free Swiss francs) rose in an amount equivalent to 123.6 million dollars, and indebtedness within the EPU decreased by the equivalent of 22.8 million dollars; on the other hand, non-EPU currencies decreased by the equivalent of 36.6 million dollars.

Thus, during the year, there was not only an increase in the foreign exchange reserves, but a decided improvement in their composition.

A reduction in the volume of Bank of Italy advances to the Treasury acted to decrease the impact of the increased loans and foreign exchange financing on currency in circulation.

Disregarding minor items, it should be noted that the current account for Treasury services, in which are entered the collections and payments made by the Bank of Italy for the Treasury's account, recorded repayments of 45 billion lire during the year, while withdrawals of 79 billion had been made in 1955.

As the final result, allowing for the effect of the Bank's minor investment and disinvestment operations, note circulation increased by 147 billion lire during the year, against 133 billion the preceding year.

The larger expansion from December 1955 to December 1956 was entirely reabsorbed in the first months of 1957.

However, the fact that the increase in currency in circulation in 1956 was covered substantially if not formally by an increase in the foreign exchange reserves for more than 46 per cent, i.e., in a proportion considered satisfactory even in times of full convertibility, does not in itself warrant a favorable conclusion—nor would it have done so even then—in respect to monetary normality.

For a correct appraisal, it is necessary to go deeper and examine at least the most important actions and reactions of the market to the financial stimuli emanating from or flowing to the Central Bank.

This is the task that has been attempted, with the support of ample details, in this Report, which I shall try to summarize and comment upon in these concluding remarks.

Credit to the Private Sector and Monetary Policy.— Loans of credit institutions amounted to 4,785 billion lire at the end of 1956, increasing during the year by 667 billion, or 16.2 per cent

of the volume at the end of the preceding year, against an increase of 7.2 per cent in the gross national product at market prices.

The increase in the credit system's loans exceeded by 104 billion that of 1955, which had been 563 billion, or 15.8 per cent of the volume outstanding at the end of 1954.

Although international comparisons are difficult in this field, an examination of the statistics of the principal countries shows that in 1956 Italy's percentage of increase in bank credit to the private sector was exceeded among European countries only by France.

It also appears that in most of the other countries the expansion of bank credit to the private sector was appreciably less in 1956 than in 1955; France is also an exception here. Where there was any increase, as in the United Kingdom and Sweden, it was a question of easing the effect of heavy reductions in the volume of credit during 1955.

There is no doubt that the smaller expansion of bank credit in 1956, and its contraction in absolute value in some countries the year before, were in most cases the result of measures adopted by the Government and monetary authorities to halt or prevent inflationary pressures.

In 1955, the impact of the investment boom had appeared in the prices of capital goods, which rose 13 per cent during the year, while prices on the consumer goods market were still declining as a result of the dull situation in the cereals sector, the persistent textile crisis, and the drop in prices of coffee, tea, cocoa and similar goods from the high levels previously attained.

In 1956, the expansion of investment having been checked by monetary or other measures and the supply of consumer goods having been reduced by bad weather and the policy of agrarian land reparceling, the inflationary pressure appeared predominantly in the consumer goods market. In fact, while prices of capital goods increased only 2.5 per cent, those of consumer goods rose 11 per cent.

The inflationary process shown in these trends had serious negative repercussions on the volume of exchange reserves in some countries, and is not considered to have entirely worked itself out everywhere.

To combat it, or at least to slow its pace, monetary measures were mainly used. These consisted of tightening money and curbing the expansion of bank credit in general or of those special credits granted for sales of durable consumer goods. To these were frequently added measures of a different nature, such as the abolition or reduction of credit facilities for building, and taxation.

As the range of remedies adopted against the boom is extensive, so the controversy that has surrounded the adoption of one or another measure, the intensity of the action or the time selected to apply it has been broad, vigorous, and sometimes harsh.

Special interests, economic and monetary theories, and political creeds have confronted each other in this controversy.

It seems, at any rate, that in this field opposing schools of thought are gradually converging toward middle ground in recognizing that forms of intervention of various types—from restrictive measures of a general nature to those of a specific nature, from fiscal manipulation to direct manipulation of investment in the public and private sectors—can usefully coexist and be integrated.

Moreover, the recent experience of several foreign countries has demonstrated once more that the effectiveness of measures designed to check inflation hinges upon their timeliness, as their adoption hinges upon the capacity of the central bank authorities to face and withstand the unpopularity frequently attached to such measures.

The virtues of thrift and essential respect for contracts have been promoted to a large extent by the courage shown by these men.

In Italy measures to restrict bank credit were not adopted: the figures already given show in fact, to limit these remarks to the year 1956 alone, that it was expanded to a larger extent than in the preceding year.

Moreover, additional credits exceeding those granted in 1955 flowed to economic activities not only through the ordinary credit system, but a larger volume of money also reached these activities from other sources, such as the medium- and long-term credit institutions and the capital market, the Central Post Office Savings Fund, the social-security and insurance institutions (for investment of reserves and other operations) and other institutional investors.

These sources provided about the same amount as the credit system, i.e., 697 billion lire against 650 billion in 1955, representing an increase of 47 billion in addition to the increase of 104 billion from the credit system.

On the whole, then, the private sector received appreciably larger new funds from the market last year, the amount having risen from 1,213 billion lire in 1955 to 1,364 billion in 1956, an increase of 151 billion. This trend remains valid even considering that part of the increased funds was used to finance wheat stockpiles, of which special mention will be made later.

At this point, a question must be answered that arises spontaneously with the realization that in Italy, unlike most other countries of the Western World, not only were no deterrents applied to the increased flow of new funds to productive activities, but this flow was also abetted by direct action of the Central Bank.

Did not credit policy favor the creation of an inflationary climate in Italy as well, and thus imperil the economic system?

And if such a climate had in some way been created by other causes, would monetary measures have been appropriate for combating it, or would the consequences of their application have been serious and disproportionate to the desired end?

To answer this question adequately, it is necessary to stop and consider briefly, within the limited scope of these concluding remarks, prices, the growth of industrial output, the balance of payments and the monetary impact of Treasury operations, through an examination of the events of the year from the monetary and credit angle.

Wholesale Prices.— It is well known that monetary policy, if brought into action by the behavior of the cost of living index, should in particular not lose sight of the wholesale price index, especially when the former index is influenced by factors beyond the reach of monetary policy or when such a severe use of monetary instruments would be required to dominate these factors as to provoke profound repercussion throughout the economy of the country.

An examination of the general wholesale price index in the last four years, a period which roughly coincides both at home and abroad with the economic expansion that got its start after the Korean cycle had played itself out, shows that, from December to December, after having remained stable in 1953, it rose 1.8 per cent in 1954, dropping to 0.3 per cent in 1955 and stopping at 1.1 per cent in 1956, with an annual average increase for the four-year period of 0.6 per cent—a rather slight rise, then, in a four-year period of high economic progress.

The index of October 1956, equal to 101.9 with 1953 as base (100), was exactly the same as that of December 1954 and, let it be added, slightly below that of December 1955 (102.2).

Bearing in mind that the most reliable international indexes show increases in the average level of raw material prices in foreign markets of 2 per cent for the 22 months preceding the military crisis of Suez, that maritime freight rates, which affect the costs of imported raw materials, rose more than 50 per cent in the same period, and, in particular, that heavy increases in vegetable and fruit prices were recorded in the first months of 1956, the absolute stability of Italy's wholesale price index in the period preceding the Suez crisis and its slight drop from

December 1955 to October 1956 could not in any way have suggested the adoption of restrictive monetary measures but rather justified an increased expansion of bank credit.

In the last part of the year, plainly influenced by the closing of the Canal—which caused some price increases in Italy also—credit policy undoubtedly had to be made more vigilant principally to check any abuses that might have appeared in the use of credit to finance inventory accumulation. But it did not become necessary to adopt any particular control in that connection, because such financing occurred only incidentally and in the slightest degree.

Development of Industrial Production.— The contrast between Italy and many other countries in regard to the climate in which economic activity has been pursued may be cause for some astonishment when one considers that the rate of growth of industrial output in Italy in recent years has not been below that of the other Western countries, but rather, with only a few exceptions, has exceeded it.

This is true also for 1956. Notwithstanding the impression one could draw from a comparison between the average yearly data (7.1 per cent in 1956 against 8.8 per cent in 1955), the movement of monthly indexes brings into evidence that the total index rose from 188 in December 1954 to 199 a year later (an increase of 5.9 per cent), and to 219 in December 1956 (an increase of 10.1 per cent). The growth has been still greater until September-October 1956, i. e., before the closing of the Suez Canal (an annual rate of 12.8 per cent).

The high rate of increase in production per worker is certainly not extraneous to the absence of the monetary tensions that have appeared elsewhere. From a table of international comparisons contained in the study on the economic situation of Europe in 1956 published by the Economic Commission for Europe, it appears that this rate of increase was the highest among those of the countries of Western Europe, including Germany, whether the comparison is made on the basis of the pre-war or the post-war period.

There is no doubt that in recent years Italy has put to work the idle productive capacity still existing in several sectors, such as the ship-yards, which were already in full production abroad, while signs of saturation in this field appeared only recently in Italy. In addition, the iron and steel industry, at least in secondary and tertiary processing, and some branches of the heavy mechanical industry, had and still have some unused capacity.

And if it is true that there is a scarcity of trained and skilled labor in Italy, it is no less true that in this field our situation is different from that of the industrial countries of Western Europe, in which workers are frequently not available even for training and specialization.

It should be remembered that a large part of the American aid received under the Marshall plan had been used in particular to increase industrial potential, especially in the mechanical, iron and steel, and electrical sectors; thus, savings originating abroad were added to the portion of the national income devoted to productive investments, something that not all the other countries of Western Europe could do, since some of them had invested a large part of their available resources in overseas territories or for various reasons had had to defray heavy charges for military expenses. The use of foreign aid for investments was facilitated by the action, in the postwar, of autonomous factors that improved the current accounts of the balance of payments, especially in the sector of sources of energy through the exploitation of national hydrocarbon resources, and in the invisibles sector through the expansion of the tourist movement.

In more recent years, Italy's economic development has been aided directly by loans from the International Bank for Reconstruction and Development and other loans, contracted especially on the Swiss market, in a total amount higher than that obtained from the same sources by other European countries with few exceptions.

This postwar period has been characterized in addition by a profound structural reform of the Italian iron and steel indus-

try, which in the past had not adequately supported the mechanical industry's possibilities of growth.

Italy's industrial equipment has also been strengthened by the use of large Government holdings of sterling accumulated before the devaluation of that currency and thereafter used largely for loans under favorable conditions for the import of machinery and ships.

Finally, a very strong direct and indirect incentive to plant renewal and in general to reduction of costs had been provided in October 1951 by the well-known liberalization measures and the generosity with which the necessary foreign exchange was granted for importing machinery and working tools in general.

These reasons as a whole are perhaps sufficient to explain why it was possible for the recent process of expansion to develop at a high rate without encountering obstacles arising from the limited availability of factors of production.

International Trade.— Not even the development of foreign trade could have suggested, at any rate not before the Suez crisis, the adoption of special restrictive measures.

Given Italy's economic structure, an excess monetary demand reveals itself, when trade is conducted at fixed exchange rates and import restrictions are not applied, through an excessive increase of imports in comparison with the rate of growth of domestic production.

The increase of 98 billion lire that occurred in 1956 in Italy's trade balance deficit might at first glance suggest that the process described was operative in Italy as well.

But upon closer examination, it is noted that a considerable part of the increase of about 286 billion lire in expenditure for import goods reflects the higher prices paid at the source and above all the very high freight rates by which the year was characterized.

The increase in receipts from exports was 188 billion lire, against an increase of 136 billion the preceding year; this rel-

ative improvement and the fact that total exports receipts in 1956 exceeded those of 1955 by upwards of 16.2 per cent are also strong indications that the attitude of business was not influenced last year by inflationary factors.

In fact, according to OEEC statistics, against increases in 1955 and 1956 of 12.0 and 9.9 per cent in the exports of all other member countries, there were increases in Italian exports of 13.3 and 16.2 per cent, respectively. Italy's lead is even more outstanding if one considers that the group of other countries includes Western Germany, which caused not a little astonishment with percentage increases in exports of 16.7 in 1955 and 19.9 in 1956, exceeding those of Italy by not more than 4 points.

It can be added, to prove that the movement of exports was not hampered by domestic currency deterioration, that the increase that occurred was especially high with respect to hard currency countries; the percentage of increase in exports to the United States and Canada having been 32 per cent in 1956, or twice the general average of 16.2 per cent.

However, the objection could be made that the increase in the deficit occurred, and that monetary measures to counteract it might therefore have been useful in Italy also. It is well to remember, however, that while the trade deficit was growing worse, the yield of foreign tourist trade, freight earnings and emigrants' remittances was improving considerably, so that the year closed with a definite though small reduction of 15 billion lire in the deficit on current account of the balance of payments.

The improvement was even greater in the first nine months of the year; but part of it was then lost through the impact of the Suez crisis on the balance of payments.

Cost of Living.— To complete the answer to the question posed, some remarks must now be made on the behavior of the cost of living.

Here things went less well; the increase in the index from December 1955 to December 1956 was 4.2 per cent, and the aver-

age increase for the year was 5 per cent. These percentages are the highest recorded in the last five years and also among the highest in Europe.

However, it should not be forgotten that the average variation in prices for all domestic private consumer goods was only 3.1 per cent between 1955 and 1956.

From December to May, a period in which the rise in the cost of living was greater than for the entire year, increases occurred in the food sector, which rose 4.7 per cent, and in the sector including officially controlled housing rents. The other sectors showed insignificant increases, that of clothing even declining.

The increase in controlled rents was certainly not a manifestation of an inflationary state on the market, nor fortunately, although it was used in the functioning of the escalator clauses, is its effect entirely price-stimulating, since the increases derived from it are transferred to house-owners, who are largely savers.

The behavior of retail prices of foodstuffs in turn was conspicuously dominated by heavy increase caused by the shortage of olive oil and by frosts.

Not many words are needed to show that the sudden increases in olive oil, vegetable and fruit prices arising from a very heavy but temporary scarcity of commodities, not all of primary importance, were not manifestation of a swelling of monetary demand; in any case, they had no connection with credit problems, nor could they be hindered or counteracted by measures to restrict credit.

In fact, the increases were as unexpected as they were temporary, intended by their nature to work themselves out in a few months, after which the final increase in the cost of living index would not have occurred, or would have been very limited.

Unfortunately things went differently because of the sliding scale, to which reference has been made in past years and of which no mention would be made now if these increases had not produced lasting results on the cost of everything Italy produces, fully shown in the course of the period under review.

In the sectors bound by labor contracts with escalator clauses, there were wage increases of about 6 per cent last year because of the rise in the union cost of living index, and these were frequently added to increases in base wages arising from the renewal of contracts.

Therefore considerable increases in wages and salaries were recorded during the year, with or without the application of the escalator clauses. The level of contract wages in December 1956 exceeded that of December 1955 by 7-8 per cent; between the annual averages, the change was 6-7 per cent.

It is evident that, even when productivity is improving, general wage increases such as those that occurred last year, which in addition were largely concentrated in the space of a few months, cannot be borne without disadvantages by any economy. Frequently caused by the increase in the cost of living index, which sets off the escalator mechanism, these pay increases in turn push it up again in an alternation that may become accelerated and, to be arrested, requires measures that cannot fail to be reflected in the volume of production and of employment.

Things did not come to such a state of affairs in Italy because the factors that had heavily increased some prices then disappeared, and the drop in the second half of the year reduced the effects of the price rise that had been spread to other goods by increased purchasing power in the hands of consumers.

Nevertheless, the damage derived principally from the spring frosts and the consequent increases in pay has been serious.

It would surely have been less severe if the modification introduced toward the end of the year in the union agreements on the escalator clauses, which were thereby made somewhat less incisive in their operation, had been made before the effects of the adverse weather conditions at length proclaimed their absolute necessity.

So, even on the basis of the investigation conducted on the actual amount of the increase in the cost of living and on the causes that led to the rise in the index, it can be stated that the

year under review was not dominated by inflationary pressures resulting from a basic disequilibrium in the productive process.

Governments and monetary authorities have in budget policy and credit policy valid weapons which can be made to prevail in the fight to maintain monetary stability; but these weapons, precisely because of the planned and unautomatic character of their application, cannot be used in the same way to combat a large, precipitous inflationary movement, as was the case of Italy in the autumn of 1947, or a movement originating in a scarcity of goods or in a round of wage increases, as has been the experience practically everywhere in recent years.

If last year, under the influence of the rise in the cost of living index, Italy had had recourse to monetary measures of a restrictive character, this therapy, given the reasons why a large part of the increase occurred, would have been wrong and would have seriously affected the growth of industrial production, leading in all likelihood to serious consequences, especially on the employment of labor, and impairing the process of expansion which has been going on for four years in Italy and which must be safeguarded by every effort.

The National Treasury.— As has been seen, it was possible for the credit system to pay out a higher volume of new funds to the private sector in 1956 than in 1955. To this, the favorable operations of the National Treasury contributed both directly and indirectly.

Directly, because the Treasury reduced its demands on the money market, which had been rather high in the preceding years; indirectly, because the Treasury, despite the decreased recourse to the market, was in a position to reduce its indebtedness to the Bank of Italy for the first time in several years, permitting the latter to increase its assistance in the financing of wheat stockpiles and to aid the credit system, especially in its year-end requirements, without excessive and persistent forcing of the note issue.

The National Treasury, including the operations of the Central Post-Office Savings Fund and the extraordinary expenditures of the Railways financed with the well-known bond issues, required a good 241 billion lire less in 1956 than in 1955.

This fact, new indeed, is due to a number of reasons, of which only the most important will be examined to try to separate the lasting improvements from those of an incidental nature.

In 1955, receipts accruing to the budget, net of the proceeds of borrowing, exceeded those of 1954 by 169 billion lire; in 1956, on the other hand, the increase in receipts was 290 billion, an amount which in turn exceeded by 117 billion the increase in budget payments made by the Treasury during the year.

The other operations administered by the Treasury recorded expenditures of 15 billion lire less in 1956 than in 1955.

Finally, to achieve the decrease of 241 billion in total Treasury requirements, an appreciable contribution was made last year by the net result of so-called minor Treasury operations. There was a balance of 109 billion arising from the movement of items awaiting entry in budget accounts and from changes in deposits at the Treasury originating largely from budget appropriations credited to the recipients on Treasury accounts and temporarily unused; items of this kind contribute in an incidental fashion toward easing or aggravating the Treasury requirements as shown in the administrative budget accounts.

If, as a result of the decrease in requirements due to the reasons indicated above, the Treasury appreciably reduced its recourse to borrowing, on the other hand, taking budget receipts and recourse to the market together, it appears that in 1956 the Government had drawn off a total 171 billion more than it had absorbed in 1955; this figure exceeds, though but slightly, the figure of 164 billion by which the amounts absorbed by the Government in 1955 had exceeded those in 1954.

Because the increase in 1956, expressed as a percentage (6.2) of the total requirements in 1955 is only slightly below the increase in national income for the year (7.2 per cent, in monetary

terms), the pressure exerted by Government requirements on the private sector, which had to be pointed out in preceding reports, was not substantially reduced.

It was accompanied by growing investment requirements in productive activity, shown, among other things, by the deterioration of the ratio between primary reserves and deposits of banks, and by the increase in recourse to the capital market through the issue of bonds by medium- and long-term credit institutions, the Institute for Industrial Reconstruction (IRI) and the National Hydrocarbon Agency (ENI), and through the issue of bonds and shares by enterprises.

The ratio between primary reserves and deposits of banks shifted from 7.4 per cent at the end of 1955 to 6.0 per cent at the end of 1956; the indicated recourse to the market by institutions and corporations, which amounted to 304 billion lire in 1955 net of obligations due and redeemed, rose to 387 billion in 1956.

The increased requirements of the private sector were not met without effort by the market; from December 1955 to December 1956 the prices of both debentures and, to a small extent, shares dropped, despite the increase in dividends for the latter. Debentures yields rose from 6.9 per cent to 7.2 per cent, and the yield of shares from 4.6 to 5.0 per cent.

As far as Government securities are concerned the average annual yield climbed from 6.9 per cent to 7.2 per cent, although the multi-year Treasury bonds issue in 1956 absorbed 35 billion less than in the preceding year and there was no issue of National Railways debentures.

The falling prices of Government securities and the fact that the 1955 improvement in Treasury conditions was partly of an impermanent nature, but especially the approaching maturities of the nine-year Treasury bonds issued as from 1955 are to be considered among the principal reasons that have led to some important Government decisions, one being to reduce the 1957/58 budget deficit by 67 billion lire «above the line» and by 30 billion in the capital accounts, a total of 97 billion, and another one being to limit the issue of nine-year Treasury bonds

to 100 billion lire in 1957 and to forego further issues of this kind in the forthcoming fiscal years.

The latter decision is plainly connected with the Government's announced intention of eliminating the deficit within the two fiscal years succeeding 1957/58.

The goal of a balanced budget does not seem to be unrealizable in the light of the most recent results of its execution, which show that actual receipts have been considerably higher than estimated ones.

However, that goal still requires firm decisions not only to avoid saddling the budget with heavy new charges, but also to cope adequately with charges from the past which are proving to be a great deal higher than one might have believed.

In fact, an increasing need is appearing to round out the appropriations made heretofore to cover the losses of certain extrabudgetary operations and in particular those resulting from the wheat stockpiles.

As of last December 31, the credit system (and in particular the savings banks and agrarian credit institutions and sections) had put more than 489 billion lire into financing the obligatory stockpiles of wheat, rice, hemp, and other products. A large part of these credits, with peaks at harvest times and in relation to the liquidity situation of the banks, is supported by means of rediscounts at the Bank of Italy.

The system of wheat stockpiling has undergone a gradual process of transformation.

Created for the purpose of avoiding the sudden afflux to the market at harvest time of a large part of the crops in order to distribute them through the year, it assumed in times of underproduction in the war and postwar period the task of assuring the population of a supply of bread and « pasta » at prices not aggravated by the limited supply.

When production and the supply from abroad returned to normality, the system resumed its original function of equilibrating prices throughout the year.

But very recently, on the one hand because of the heavy increase in domestic production and on the other as a result of purchases abroad of soft wheat against industrial exports, the stockpiles have served to withdraw a huge quantity of production from the market, not merely temporarily, but rather in a way that is becoming permanent.

The purchases abroad have also related to large quantities of hard wheat, of which there has been and still is insufficient home production.

The new problem that is now being posed, therefore, is to sell off the surplus stocks of soft wheat, and this appears to be difficult to solve in the presence of an increasingly abundant production, which by this time exceeds consumption requirements.

Since the price obtainable will necessarily be appreciably below the present mill price, there will be large new losses both for sales abroad and for the portion of the wheat that goes into domestic uses other than ordinary ones, and, in any case, for the additional charges arising from prolonged storage. These losses, not considered at the beginning, and therefore not payable with the ordinary and extraordinary appropriations hitherto made, will fall upon the Treasury.

Therefore, despite the effort made this year to reduce the deficit, the test to which Government finances will be put is still serious, if only for wiping out charges from the past that are now beginning to materialize to a much higher extent than could have been anticipated.

The Suez Crisis and the Present Phase of Economic Development.— In the latter part of 1956, especially in connection with the Suez crisis, the conditions under which expansion took place in Italy were naturally less easy.

The rate of growth of industrial output slackened in November-December. The downward movement, fortunately of modest proportions, affected investment goods principally, while

output of consumer goods remained at the notable level already achieved.

Of more importance were the repercussions on the domestic prices of materials for use in production and investment goods, particularly because of the spurt of fuel and freight prices; consumer goods prices, however, rose very slightly.

The major impact of the changed situation is shown in the balance of payments accounts.

In particular, the increase in freight rates caused by the Suez crisis affected goods arriving in the first quarter of 1957; for the three principal bulk commodities (scrap-iron, coal and oil) the increase in freight rates, despite the heavy contraction in shipments of oil, amount to about 30 billion lire.

On the export side, the increase was less than that of the first quarter of the preceding year, but this seems to have been attributable to the higher than normal level of the corresponding period of 1956.

At any rate, the fact remains that the trade deficit of the first quarter of 1957 increased by 18 per cent over that of the preceding year.

In the foreign exchange sector, which felt the change with more immediacy, the months of November to January marked a considerable deterioration. Since February, the situation has become normal. However, in the six months from the end of October 1956 to the end of April 1957, the reserves deteriorated, decreasing approximately 90 million dollars in comparison with the corresponding period one year earlier.

The rate of increase in industrial production recovered briskly in the new year, so that the index for the first quarter exceeded that of the corresponding period of 1956 by 8.9 per cent.

Wholesale prices, finally, have dropped appreciably in the last few months. This drop, if it reabsorbed only in small part the rise that had taken place in the last two months of 1956 in the prices of materials for use in production and investment

goods, eliminated the entire increase in the consumer goods sector. The index of consumer goods prices, in particular as a result of the drop in farm prices, has declined further, falling below the level of September 1955, which, with the pronounced increase in olive oil prices, marked the beginning of the upward movement that reached a peak in May of last year as a result of adverse weather conditions.

The cost of living index also has dropped somewhat, returning in April to the level of April 1956.

Thus, in a climate less threatening to monetary stability, it appears that the upward movement begun toward the end of 1952 was resumed in Italy after the brief interruption due to the Suez crisis.

The Development of Savings.— The funds raised on the money market have not changed in size in the last two years; the savings of the public collected there amounted to 1,435 billion lire in 1955 and 1,433 billion in 1956.

There was a slight drop in the total funds flowing to the credit system, consisting of the increase in savings and current-account deposits and of bonds of medium- and long-term credit institutions, and a considerably smaller accumulation of funds through the sale to the public of Government securities; conversely, the money raised by means of the issue of shares exceeded that of the preceding year by about 50 billion lire.

Finally, the accumulation of new postal savings remained substantially unchanged, while the increase in the reserves of the social-security and insurance institutions was somewhat higher.

The figures given, while corroborating the increased need for new funds shown by business enterprises, nonetheless indicate that the process of formation of money savings is continuing.

Fortunately, then, the problem is not to correct a tendency of money savings to decrease, but rather to increase the rate of growth.

It appears that economic equilibrium in 1956 was safeguarded, on the one hand, by the shifting of available savings to the more directly productive investments, and on the other, by a drop in the rate of increase in total investments while consumption, even in the presence of a smaller increase of national income, maintained a growth approximately equal to that of the preceding year.

The still very rapid rate of technical progress, especially in some industrial sectors most concerned with the process of automation, the need in numerous types of industry to increase productive capacity by now almost completely utilized, and the demand for rapid application of technical improvements made by the ever-increasing integration of the Italian economy in the international economy, show that the pressure of financing needs in these fields is destined to increase rather than decrease. That poses a very serious problem for the near future of adjusting new formation of savings to increased requirements, since a diversion of savings of the magnitude that occurred in 1956 can no longer be expected.

Thus, while there are indications that the economic picture may remain bright, the basic questions of Italy's economy still requires the most careful consideration.

In the years immediately ahead, however, the rate of income growth seems destined to undergo an appreciable slowing down almost everywhere. In fact, the OEEC, in a study published as the second part of its Eighth Report, estimates that the gross national product, after having increased for the member countries as a whole at an annual rate of about 5 per cent in the five-year period 1951-55, will increase at a rate only slightly above 3 per cent in the five-year period 1956-60. This expected decline is attributable to the anticipated decrease in the availability of new labor forces and to the tendency that nonetheless is shown toward a reduction of working hours and a slackening of the rate of increase in productivity.

In fact, the process of postwar reconstruction having come to an end, it is believed that the rate of growth of productivity

ought to realign itself with that recorded in Western Europe between the two wars and with that experienced in recent years in the United States.

However, there are conditions that might allow Italy to maintain that more rapid rate required by her specific development requirements.

In the presence of the limiting factor created elsewhere by the scarcity of manpower, the existence in Italy of unemployment or underemployment might form the basis for a differentiation in the future development of income between Italy and the other major countries of Western Europe, if the necessary volume of savings, which must be relatively greater than required elsewhere, can be put into the productive process.

That savings represents a big limitation in Italy is clearly written in the working out of the ten-year plan for the first four years, in which an effort has been made to measure the quantity of savings necessary for attaining the desired objectives. Therefore, no further proof is required of the urgent necessity to save more than Italy is doing today.

In affirming this need it is not intended to disregard the improvement that has taken place in the distribution of the national product between consumption and investment during the years following the arrest of inflation. The portion invested has in fact increased from 19.4 per cent in 1948 to 22.7 per cent in 1955. This has required the allocation to investment of approximately 27 per cent of the annual increase of the national product during the period. Although the portion of the additional income going to investment dropped in 1956, the fact remains that in the entire period from 1948 to 1956, slightly more than 26 per cent of the annual increase in national product has on the average been allocated to investment.

While this was going on, the related broad expansion of the national product provided capacity for an appreciable increase in consumption.

However, it should not be forgotten that the large expansion of consumption along with the concurrent increase in the percentage of national income allocated to investment was made possible by a complex of favorable factors which, as has already been noted, have worked themselves out or are now in the process of termination, and that greater efforts will be necessary for the future if the rate of expansion of the last four years is to be kept unchanged and the basic problems of the Italian economy are to be solved.

In short, the endeavor to follow a different course from that of the European countries with manpower shortages might not seem unrealizable if only the necessary sacrifices can be made to achieve the purpose and channel the efforts in the right direction. Any attempt to make further investments without providing the necessary savings and using them in the best way would succeed only in creating inflation.

These things are obvious; if they have been repeated once more it is only because the increasingly abundant and elaborate data available have provided the opportunity for measuring, together with the progress made in these recent years, the order of magnitude of the problems facing Italy.

Those that may arise from the establishment of the Common Market are not insignificant.

In this connection, it must be noted with satisfaction that Italy's position at the discussion table that led to the agreement would have been quite different if five years ago she had not had the courage to set aside the quotas and other restrictions on imports from OEEC countries and if she had not thus attained a high percentage of liberalization.

However, the circumstance cannot be overlooked that among the countries participating in the projected common market Italy belongs to those with the highest customs tariffs.

It is clear, therefore, that the proportional reduction of tariffs will require of Italy, especially in the industrial sector, a greater capacity to withstand competition than is required of

other countries. For this reason, costs in Italy will have to improve in the years immediately ahead in comparison with costs in countries within and outside the Common Market. This is all the more necessary because our balance of payments still depends on aid and capital to be obtained from abroad, for more than 200 million dollars a year, and thus the deficit is still the most important deterrent to further investment.

The situation has improved in comparison with 1952 and 1953, in which the deficits were approximately 600 and 450 million dollars respectively; nonetheless the road to equilibrium is still long and can be made perilous by the expected lower rate of economic growth in the Western World.

The task will not be easy because to be really meritorious and produce lasting results, it must be accomplished by maintaining, or rather, by promoting a growing and ever more extensive liberalization of Italy's payments with foreign countries. In this field some progress has also been made this year toward eliminating bilateral arrangements or at any rate reducing them to the minimum.

This progress has been added to that made in past years, in which no backward steps have ever been taken, a course that has greatly favored the process of orderly economic expansion which stands to Italy's credit and which these concluding remarks have attempted to illustrate.