

BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1957

PRESENTED TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31st MAY, 1958

Excerpts from the Governor's Concluding Survey

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

Gentlemen,

This meeting, at which I am submitting for your approval the balance sheet of the Bank for the year 1957, is being held just over ten years after the memorable events that brought Italy's postwar inflation to an end.

It was on 4th August 1947 that the Interministerial Committee for Credit and Savings, passing its first resolution since its reconstitution, decided to rearrange the system of statutory bank reserves — a measure designed to check excessive credit creation made possible at that time by the high liquidity position of the banks after the war.

The meeting of bank representatives, to whom I had the honor to explain this measure and on whom I called for full and ready co-operation in restoring monetary stability, was held in this room on 20th August.

At our meeting on 31st March 1948 we were able to confirm that the operation had been successful. Many prices had fallen in the meantime; in general, they had at least stopped rising. Currency was once more being saved to meet future requirements or deposited in ever-increasing quantities with institutions for the collection of savings—a sure sign that confidence in it had been restored—and, to use technical terminology, its velocity of circulation had been considerably reduced.

We are convinced that it was largely due to the stabilisation of the currency that the sacrifices made by the people during the past ten years yielded the results which we see before us to-day and on which we have commented from this Chair each year.

According to official estimates, the national income of Italy, in real terms, increased during the last decade as follows: by approximately 7 per cent in 1948, the first year of monetary stabilisation; by between 6 and 7.5 per cent in 1949, 1950 and 1951, years reflecting to a remarkable degree the benefits of

the rapid termination of postwar reconstruction which had been facilitated by generous American aid; by only 2 per cent in 1952; by between 5 and 7 per cent in 1953, 1954 and 1955; and in the past two years by 4 and 5.6 per cent respectively.

In the Report which we are submitting to you and in this « Concluding Survey » a record is given of the progress made in the last ten years in the collection and utilisation of monetary savings by the banks and the capital market; this is also intended to show the close relationship that exists between the good use of credit and the development of the national product, which has never been greater in any other period of similar duration in Italy's economic history.

In commenting on the events of last year and the more recent period we have thus considered it worthwhile to give a brief survey of the financial history of the past decade; for we are convinced that contemplation of past events can help us to find guiding principles for future action.

In recalling the measures adopted to save the lira in the summer and autumn of 1947, I believe that I am interpreting the thoughts of all those present at this meeting when I express —also in the name of the Board of Directors of the Bank—our most profound gratitude to the man who conceived and tenaciously held to them: *Prof. Luigi Einaudi*.

World Economic Situation.— In last year's Report we noted the first signs of a slowing-down of the development of the western economies. It is now our difficult task to comment on a year in which the conflict between the equally desirable objectives of expansion and stability became more pronounced, without, however, taking on an acute form in Italy. This survey, having sketched the international situation in which they evolved, will be confined to a study of the problems arising from this conflict, and in particular to their monetary aspects.

At the beginning of 1957 the development of foreign trade in Italy, as elsewhere, was influenced by the events of the summer and autumn of 1956 — and primarily by the Suez crisis. The upswing of raw-material prices that resulted from this crisis

was reflected in a contraction of foreign exchange reserves in several European countries; it thus also led to a deterioration in their monetary equilibrium, especially as the greater absorption of national currencies for the purchase of foreign exchange caused a drain on internal liquid reserves.

The rise in raw-material prices, which was particularly marked in certain cases, and the sudden substantial increase in freight rates put monetary stability to a severe test, especially as it was already being undermined by inflationary processes nearly everywhere—sometimes scarcely perceptible, sometimes plainly evident—strengthened, particularly in some countries, by the fact that the accelerated rate of increase of wages was greater than the average growth in productivity in those countries.

Nor did Italy remain immune from inflation, as we pointed out at this meeting last year. In particular in 1956 Italy suffered manifestly from inflation, owing primarily to the rapid functioning of the escalator clause; for the sliding wage scale reacted to the rise in the cost-of-living index brought about by the increase in the prices of fruit and vegetables (which became scarce as a result of the frosts in the early months of the year).

The task of the monetary authorities who were called upon to deal with this difficult situation was rendered all the more arduous and unpopular because people were becoming increasingly convinced—and were even finding support for their belief in the writings of eminent proponents of monetary theory—that a slight inflation, measurable in terms of a rise of 2-3 per cent per annum in the general level of prices, was an essential part of any process of productive expansion, especially when this is combined with full employment.

Aware of the serious difficulties which monetary authorities everywhere were encountering in defending stability in these circumstances, we held that the trade unions should also co-operate to this end; otherwise, measures of monetary policy would not have succeeded in checking the inflationary process without at the same time running the risk of halting expansion and bringing about a recession.

A few months later the expansive phase in the US economy, which had been going on since the beginning of 1955, came to an end. Throughout this period the Federal Reserve had tried to limit the supply of money by raising, in successive stages, the official discount rate and carrying out open-market operations intended to tighten the liquidity position of the banks. As a result, there was a more modest increase in the total money supply in 1956 and no increase at all in 1957. This did not, however, prevent a further expansion in the volume of current monetary transactions, and financial requirements for investment purposes were, for the most part, covered, because at the beginning of the expansive phase the commercial banks and businesses still possessed a margin of elasticity, on which they were able to draw. In fact, these banks and productive enterprises sold large quantities of Government securities; the turnover of deposits gradually increased and the ratio of bank credits granted to deposits received rose.

Certain signs of monetary tension became apparent when the productive boom was already tailing off. Whereas the peak of industrial production, the highest rate of investment and the largest volume of orders on hand in industry had been recorded by the end of 1956, capital market and bank loan rates continued to rise until August 1957.

The slight fall in investment activity seemed to indicate that the American economy could come out of the boom without entering a recession; but though the pressure of demand on resources was eased, this was not adequately reflected in price movements. The behavior of prices was still determined by increases in the cost of labor and by the persistence of what is now a radical inflationary psychosis. With the decline in domestic demand for investments, there was also a falling-off in foreign demand, since there was no longer any exceptional stimulus, such as derived from the Suez crisis, and Government defence orders were reduced half-way through the year.

Then came the European monetary crisis of August-September. After Suez the United Kingdom had suffered a considerable loss of gold reserves, owing both to the utilisation

of sterling reserves by India and other sterling account holders and to the flight of capital through some gaps in its system of exchange control. During the summer a further flight from the pound took place, probably because wages and prices were still found to be rising particularly fast in that country and expectations of a revaluation of the German mark and perhaps the dollar were heightened by the devaluation in the meantime of the French franc.

The reduction in the United Kingdom's gold reserves, although not deriving from a balance-of-payments deficit on current account, prompted the monetary authorities there to adopt extremely severe measures in September; in particular, Bank rate was raised by two points, which brought it up to 7 per cent — a level at which it had only stood once before, namely in 1921, when a disinflationary policy was being pursued after the first world war.

This step met with warm approval at the meeting of the International Monetary Fund held in Washington shortly afterwards. By intervening with considerable financial assistance, the Fund and the Export-Import Bank supported the United Kingdom's move to bring the speculative movement of funds under control and its courageous determination to defend the parity of sterling without introducing import restrictions and without impeding the outflow of non-speculative funds. Finally, the German representatives declared—and the German authorities took steps to prove—that movements of « hot money » to their country were not welcome; Germany lowered its discount rate and adopted other measures designed to improve the international liquidity position.

It was clear, in short, that the most important countries of the western world were joining in the battle against inflation and were being fully and promptly supported in their action by the institutions for international financial co-operation. It was particularly clear that, faced with a choice between the risk of seeing inflation rendered more acute by unforeseeable circumstances and that of halting economic expansion, the Governments of the two main Anglo-Saxon countries would decide in

favor of the latter alternative; for they were convinced that to delay would only extend, when the time came, the recessive phase that was bound to come after the inflation.

This would, in our opinion, be sufficient to cause the sense of optimism that had prevailed in business for a long time (when less control was kept over the choice of investments and over costs) to give way to a more reflective attitude, and for producers and consumers to re-examine their positions in an atmosphere no longer veiled in the mists that inflationary processes always produce.

It thus became plain that both investment activity and production had been excessive in some countries and in some branches of industry during the last years of the expansion; and it was evident that, even if sale prices fell, it would not be easy for these sectors to bring consumption into line with the higher level of production and, above all, with the increased capacity of factory plant. In the case of the American automobile industry, which alone absorbs one quarter of total steel production in the United States, the imbalance between productive capacity and consumption was rendered more acute by certain changes in consumer tastes; in the case of other durable goods, there seems to have been a saturation of the market there and a slowing-down of new technological developments likely to create new mass consumption needs.

From this it was a short step to a fall in the rate of growth of investment and certain consumer products. The prices of imported raw materials, which had already dropped as a result of the fall in freight rates after the end of the Suez crisis, declined still further. The fall was rendered greater by the reduction in purchases, many industries being content to use up stocks accumulated previously at high prices.

In short, a recession set in in the United States and a phase of re-adjustment began elsewhere. Industrial production in the United States, which had recovered in 1955 from the depressed level of the preceding year and risen to the exceptional rate of 11 per cent, fell in the period from August 1957 to March 1958 by the equivalent of 19 per cent per annum.

Germany and Italy may be taken as examples of the re-adjustment that occurred in other countries.

In Germany industrial production had shown the highest rate of increase in western Europe up to 1955, when it rose by 15 per cent; the first signs of a slowing-down appeared towards the end of 1956, and by the middle of that year the rate was 8 per cent; during 1957 the slackening-off became more marked and in the first quarter of 1958 industrial production was only 3.6 per cent above its level a year earlier.

In Italy industrial production, which had been rising steadily and appreciably from the beginning of 1956 to September 1957, subsequently fluctuated at around the level attained in the summer of 1957; in the first quarter of 1958 it was 2.1 per cent higher than in the corresponding period of 1957.

This is not the first time that there have been rather long interruptions in the growth of industrial production in Italy, even in the recent years which have been characterised, on the whole, by a pronounced expansive tendency. Such a pause in expansion occurred from the middle of 1955 to February 1956 (as was recorded in our Report at the time), when the index fluctuated around the level reached in June 1955, after having risen rapidly in the first half of the year.

The present phase might have occurred, then, even without the international developments that have taken place, considering, *inter alia*, that it was preceded by a period (December 1955 to September 1957) in which iron and steel output increased at the high rate of 14 per cent per annum and that in the two-year period from 1954 to 1955 the rate of growth was even higher (20 per cent).

Recent Monetary Developments.— At the end of March 1958 the primary liquidity reserves (1) of the banks amounted to 8.9 per cent of deposits, whereas a year earlier (end of March 1957) the ratio had been 5.4 per cent. The increase of 3.5 points contrasts with a decrease of 0.9 points between March 1956 and

(1) This expression is taken to mean total cash on hand, demand deposits at the Bank of Italy, Treasury bills in portfolio, deposits with the Treasury and postal savings banks and unutilised balances of overdrafts (see table 24).

March 1957. In absolute figures, the reserves, which had fallen from 326 to 319 billion lire between March 1956 and March 1957, rose by 268 billion to a total of 587 billion at the end of March 1958.

A level of nearly 9 per cent of deposits for the primary liquidity reserves, though high, cannot be considered excessive; in the first five years after the stabilisation of the currency (1948-1952) this level was, in fact, always widely exceeded, with the sole exception of certain brief periods of the Korean cycle. Nevertheless, it must not be forgotten that in the past five years, when deposits with the banks were always used to a very considerable extent, the liquidity level was generally lower than it is at present; moreover, the transition in the past few months from very limited reserves to very high ones has been so rapid as to make necessary an analysis of the origins of the change and its significance.

At first sight, an increase in the liquidity of a banking system may be considered as evidence of an economic recession; for greater liquidity is normally attributed to a reduction of bank loans caused by a contraction of productive activity, or to a marked propensity towards monetary saving on the part of the public.

If this holds true as a rule for economies that are clearly self-sufficient, it may not be true—or may be only partly true—in the case of economies in which international trade plays an important rôle, since balance-of-payments fluctuations and, in particular, changes in the prices of imported raw materials may be reflected to a large extent in the degree of liquidity of the economic system, even if there is no considerable change in the rate of development of the country in question.

Such changes prompt producers to alter the volume of their stocks of raw materials, enlarging them when prices are rising and reducing them when prices are falling. In both cases the financial effects resulting from the change in the volume of the stocks are widened by price movements in the same direction and by alterations in freight rates, which generally also move in line with fob prices of raw materials.

Needless to say, the liquidity of an economic system also feels the impact of changes in the national budget, when a deficit or surplus leads to the issue or sterilisation of money.

In the case of Italy monetary equilibrium seems to have been greatly influenced towards the end of 1956, during 1957 and particularly in the early months of 1958 by the balance of transactions with foreign countries, which is reflected in the movements of the foreign exchange reserves held by the Italian Foreign Exchange Office, these movements being largely determined by the behavior of prices of imported raw materials and by adjustments made by businessmen in the volume of their stocks of these materials.

Monetary equilibrium was also influenced by changes in the national budget.

Finally, the study which we shall devote to the capital market and to loans by medium and long-term credit institutions will show that a greater amount of funds was applied to investment in 1957 and the first quarter of 1958 than was the case a year ago. We may, therefore, conclude that observation of financial facts does not allow us to call the present economic trend a recession; it is rather, as we have said above, a period marked by a pause at a still high level of production.

After the usual growth in foreign exchange holdings due to the summer tourist season, the outbreak of the Suez crisis caused a decrease equivalent to 138 million dollars between November 1956 and January 1957. The five months from February to June witnessed a resumption, though to a modest extent, of the upward movement; from June onwards, however, this rise assumed sizable proportions and did not cease or diminish with the end of the tourist season, but continued throughout the winter and is still operative.

Italy has thus experienced, though to a considerably lesser extent, the same expansion of its foreign exchange holdings that has characterised the German economy in the last few years, where, too, it gave rise to important problems of monetary policy.

In 1957, foreign exchange holdings increased by 286 million dollars, against 109 million in 1956. Mainly as a result of this increase, the net disbursement of the Bank of Italy for the financing of foreign exchange movements reached 196 billion lire in 1957 — a figure which was 128 billion higher than in 1956. The consequent improvement in market liquidity was also accentuated by the reversal of the position of the Bank of Italy in its relations with the Treasury.

In 1956 the current account for Treasury services, in which the Bank of Italy records its collections and payments for the account of the State, had shown a reduction of 45 billion lire in the Treasury's indebtedness to the Bank.

In last year's Report we said that this occurrence, which was quite unusual, had resulted not only from the improvement of the situation of the national budget, but also because there was a rise upwards of 90 billion lire in deposits with the Treasury of funds paid out under the budget but not yet used.

In 1957, although the position of the national budget continued to improve, the increase in such budget appropriations re-deposited at the Treasury was only 13 billion lire and, in contrast to 1956, the credits of the Central Post-Office Savings Fund for its institutional operations exceeded the savings received, with the result that there was a final charge of 30 billion lire on this account — something that did not happen in 1956. Moreover, the Treasury's borrowing on the market was more limited in 1957.

On balance, the Treasury's current account showed an increase in its indebtedness to the Bank of Italy of 39 billion lire compared with the beginning of the year — a figure which is not in itself very substantial, but which is superimposed on the large figure for new credits to the Italian Foreign Exchange Office.

The afore-mentioned increase in the money supply arising from the Bank's financing of foreign exchange holdings and its operations vis-à-vis the Treasury was only partly offset by the trend of other lending transactions, rediscounts and advances and the deposits with the Bank of counterpart funds derived from surplus American commodities received in Italy.

The portfolio of rediscounted bills was reduced during the year by 23 billion lire and advances on securities were lower by 26 billion. The reduction in rediscounts was connected—as will be seen better later on—with the decline in bank financing of wheat stockpiles. The account for American surplus counterpart funds showed an increase of 24 billion lire on the year.

In correlation with the increases in foreign exchange holdings, there was a marked increase in the creation of liquidity by the central bank during the early months of 1958. Up to March the amount involved was a further 90 billion lire; in the corresponding months of 1957, which were still influenced by the Suez crisis, there was a contraction of about 1 billion lire.

The first three months of 1958 also differ from the corresponding months of 1957 in regard to relations between the Treasury and the Bank. This year the Treasury's indebtedness to the Bank was reduced by 3 billion lire, whereas in the corresponding months of 1957 it was reduced by 54 billion.

A closer look at the position of the banks reveals that in the twelve months from June 1956 to June 1957, in which the Suez crisis began and ended, their liquidity reserves fell from 5.3 to 4.7 per cent of deposits.

The pressure on reserves arising from the demand for new financing was kept within bounds by the limitation of the usual issue of 9-year Treasury bonds in the first quarter of 1957 to almost one half of the issue in the corresponding quarter of 1956 (100 billion lire instead of 194 billion).

A contribution was also made in this direction by the large use made by the Italian banks in this period of credit lines opened in their favor by correspondents abroad and of foreign exchange deposited with them.

The monetary authorities did not hold it necessary to restrict such transactions, nor to modify the decision to limit Treasury borrowing from the market; it was not even felt that monetary measures should be adopted, as was being done in other countries, to check the tendency to make greater purchases abroad and enlarge inventories at home that develops when an international crisis arises and price increases are feared.

Above all it was considered that any disturbance of the process of absorption of unemployment then in progress should be avoided, as far as possible.

Restrictive measures were also made inadvisable by the behavior of prices of foodstuffs; these fell in the first half of 1957 by about 5 per cent, reaching their lowest level for three years.

Lastly, although production costs in 1956 had felt the full impact of the rapid increase in wages resulting from the operation of the escalator clause, the sliding wage scale having leapt up by 7 points in the first nine months of the year, the rise up to the summer of 1957 was limited to one point.

In the three months from July to September industrial production continued to develop at the same vigorous rate as in the preceding six months; nevertheless, there were no signs of monetary strain. The supply of money by the central bank increased by about 90 billion lire as a result of the financing of foreign exchange derived especially from the favorable development of the tourist trade; this not only neutralised any pressure on the banking system arising from the growth of production, but led to an increase in the primary reserves of the banking system.

Thus, at the outbreak of the international monetary crisis, Italy had not taken the restrictive measures that had been adopted nearly everywhere else to arrest inflation or check international capital movements prompted by the fear that such restrictions would spread.

In the last quarter of 1957 and the first quarter of this year the supply of money by the central bank continued, as already mentioned; for the most part, however, this was reflected in an increase in bank liquidity.

Turning now to examine the development of loans and advances of banks and banking associations, it appears that these increased in 1957 by the substantial sum of 425 billion lire. This figure was certainly lower than the increase in 1956 (662 billion), but it still represents a rise of 8.9 per cent over the volume outstanding at the end of the preceding year. Moreover, the dif-

ference from one year to the other is largely explicable by circumstances not directly related to industrial production.

In 1956, as we recorded in our Report last year, loans and advances had increased considerably as a result of the financing of stockpiles of agricultural commodities, especially wheat, the increase in unsold stocks and the accumulation of storage expenses and interest charges; in 1957, however, stocks were not enlarged and the position of the credit system was eased by the high payments made by the Treasury in respect of losses on old accounts.

If operations of agricultural credit institutions are included, the financing of stockpiling in 1956 led to an increase of 92 billion lire in total loans, despite the repayment of 23 billion by the Treasury towards the end of the year in respect of losses on old accounts. In 1957, however, Treasury repayments rose to 93 billion and credits during the year, though limited on account of the smaller amount of wheat stockpiled from the new crop, came to 73 billion, so that the total amount of bank credit outstanding was reduced, if only to a small extent (20 billion).

Sales abroad of large stocks of sugar last year also served to reduce bank loans and credits, which, however, had previously been increased to finance these same stocks.

As to the first quarter of 1958, it can be said that bank loans are usually well restrained in the first months of each year, and frequently the volume by the end of March is below that of the preceding December. This happened in 1954 and 1955, when decreases of 29 billion lire and 28 billion lire occurred. In 1956 and 1957, however, there were increases of 28 billion lire and 45 billion lire, respectively (the 1957 figure takes into account repayments of 41 billion lire made by the Treasury in respect of losses on stockpiles). In 1958 there was again a decrease, but in the rather high amount of 76 billion lire. It should be noted, however, that the effects of the profound change in Italy's terms of trade and the adjustments in the volume of inventories of imported raw materials have been felt particularly in recent months.

It has been estimated that if the 14 principal raw materials of foreign origin were imported in the first quarter of 1958 in the same quantities as those imported in the first quarter of 1957, this would mean a decrease in expenditure, at the present cost level, of more than 60 billion lire.

In particular, in the first quarter of 1958 there was a marked fall in the cif prices of petroleum, scrap iron and iron ores, and textile materials, which have been arriving at a rate sufficiently in line with the tendency in recent years. The decrease in expenditure has certainly had a direct repercussion on bank loans and advances, especially in the case of the banks that mainly finance industries engaged in the processing of imported raw materials.

A further reduction in expenditure has resulted from the decreased stocking of other raw materials caused by the desire to bring the volume of existing inventories back to a normal level. The recent slackening of purchases abroad of some materials and products, which has been evidenced by customs statistics, does not, however, appear to result from a contraction in economic activity, but rather from the caution that normally accompanies a decline in prices at origin of imported raw materials and products.

If there had been no other factors to consider, this growth in bank liquidity, not derived from a contraction of productive activity, would have obliged the monetary authorities to adopt measures for the absorption of excessive liquid funds.

Even without resorting to a raising of the banks' minimum reserve requirements, the central bank could have sold Government securities held by it; the banking system could have been asked to restrict its utilisation of credit lines opened by foreign banks, or even not to grant new finance with foreign exchange received on deposit; and, of course, banks could also have been required to reduce their existing foreign exchange advances.

It must be borne in mind, however, that the management of monetary policy cannot consist in the adoption, with almost automatic synchronisation, of measures to expand or restrict

the liquidity of the market, to be put into operation whenever the statistical indexes show a contraction or an expansion of liquidity.

This automatism would preclude the consideration of all the objective data that determine the actions of entrepreneurs and would not take into account their expectations, in which those relating to the probable policies of the monetary authorities play a prominent part.

Technical measures of restricting bank liquidity, even if necessitated by an excess of liquidity, are, however, always a presage that difficulties will probably be encountered in developing a larger volume of production.

It was therefore felt that measures designed to absorb a part of the liquidity, even if technically justified, would have been ill-advised during recent months, in view of the fears that the American recession might spread to the Italian market also and in view of the fact that Italy's industrial production was no longer expanding rapidly.

The task to be accomplished in the months ahead will certainly be connected with what will take place in the field of production. If, as is to be hoped, the rate of expansion rallies, the degree of liquidity in the banking system will be determined by the need to buttress the expansive trend without losing sight of the equally important need to counter possible speculative movements.

And, above all, it will be necessary to see that the relatively easy credit position does not lead us to overlook the fundamental requirements of economic development in Italy, namely that costs here should rise less than elsewhere, so that we may, as is necessary, further increase our exports, attract a greater number of tourists to this country and benefit from the opportunities that are being unfolded with the opening of the Common Market or the creation of a wider Free Trade Area.

Watchful waiting would naturally have to give way to bold action if pathological symptoms appeared; in that regrettable event, the most appropriate measures would have to be brought

into operation to absorb any liquidity that exceeded the sound requirements of the market.

This, essentially, is what can reasonably be demanded of monetary policy: to act at the right time and in a measure appropriate to the circumstances, without fear and without running into excesses.

Money Savings.— Money savings (1), as recorded by the statistics of the Bank of Italy, had amounted to 1,064 billion lire in 1955 and to 1,144 billion in 1956; in 1957 they were somewhat higher, being equivalent to 1,162 billion lire.

Considering these figures, it cannot be overlooked that while the advance was appreciable in 1956, and certainly in line with the increase in national income, it was barely discernible in 1957.

Taking into account the fact that the two years differ also because the collection of savings in the first half of 1957 was lower than that in the first half of 1956, while the opposite was the case in the second half, it may be warranted to believe that the benefit of favorable crops in 1955 was felt to some extent in 1956, and that there was not only no such benefit in 1957 but the adverse conditions derived from the Suez crisis were experienced during the first half of the year.

Money savings, which amounted to approximately 1,200 billion lire in 1957, represented about 8 per cent of gross national income, as shown in the « General Survey of the Economic Situation of Italy ».

With the qualification that international comparisons on this subject are very difficult and of little significance, because the volume of money savings is especially influenced by the state of economic development and by the degree of tax pressure in various countries, it can be said that Italy's percentage of money savings appears to be among the highest in the western world.

(1) This term is taken to include deposits and other funds collected by the banking system (excluding correspondence current accounts with customers, ordinary current accounts, checks and cashier's checks); postal savings books and interest-bearing bonds; the increase in policy reserves of social security and insurance institutions; issues of Government bonds and of Government, quasi-Government and private debentures, and shares, net of securities held by credit institutions.

The portion of money savings that was deposited in banks (excluding, of course, ordinary and correspondence current accounts with customers and minor items) amounted to 371 billion lire in 1955, to 438 billion in 1956 and to 484 billion in 1957.

There has thus been a steady growth from year to year in new savings flowing to the banks, even though the annual percentage increase was slightly smaller in 1957 than in 1956 (16.7 per cent, as against 17.8 per cent).

An increase in the formation of savings deposited at banks in comparison with 1956 occurred mainly in the last quarter. In the first three months of 1958 this savings formation was clearly higher than that of the first quarter of 1957 (156 billion lire, as against 111 billion).

Thus, while the formation of savings in the nine months from July 1956 to March 1957, a period influenced by the Suez crisis, amounted to 379 billion lire, that of the nine months from July 1957 to March 1958, a period characterised by increasing liquidity, was clearly higher, i.e. 469 billion.

Should one rejoice at this greater formation of savings, or should one consider that it is in some way an expression of a tendency to contract consumption?

Though recent developments are very difficult to interpret fully, it may already be observed that receipts in agriculture were higher in the last part of 1957 than they had been a year before and that the changes in the liquidity of many medium and small enterprises is reflected also in savings deposits, of which these enterprises avail themselves to draw higher interest allowances.

The rates of interest paid on savings did not undergo significant changes in 1957. Before the monetary developments of last year, they had been somewhat higher than those prevailing in the principal countries, in view of the need here in Italy to encourage the formation not only of savings for long-term investments, but also of savings deposits in banks, despite the fact that the latter enjoy the greatest mobility.

The increase in interest rates for borrowers undertaken abroad with the intention of combating the dangers of inflation and in line with increases in the official discount rates has caused the average interest rate level in some countries to be higher than that in Italy; but the fall which has already begun nearly everywhere is restoring, at least in part, the margins that had previously existed between borrowing rates in Italy and those elsewhere.

Thus, Italy was able to avoid the sudden movements in rates—rapid increases and abrupt reductions—which are not without inconvenience for the majority of depositors, especially from the psychological point of view; this was probably the consideration that prompted savings institutions in some countries, such as the United Kingdom, for many decades to keep their interest rates almost unchanged.

Italy has been able to carry out this policy of limiting interest rate fluctuations also because it has been relatively less exposed to the destabilising influence of international movements of short-term funds which have occurred on several occasions with sterling, the Deutsche Mark, the Netherlands guilder and other currencies. This stability of policy naturally does not prevent the Italian rate system from tending to adapt itself to the internal state of affairs.

Savings invested direct by the public in Government securities and in bonds and shares were respectively 431, 437 and 409 billion in the last three years. Thus the funds raised on the capital market were smaller, though only slightly, than in the two preceding years.

Disregarding funds arising out of issues of Government bonds—which were deliberately limited and which yielded, excluding subscriptions by the banks, 154 billion lire in 1955, 74 billion in 1956 and 51 billion in 1957—funds invested direct by the public in bonds and shares totalled 277 billion in 1955, 363 billion in 1956 and 358 billion in 1957. Thus this source of medium and long-term funds for the private sector was less animated in 1957 than in the preceding year.

A more complete picture of the private sector's requirements of medium and long-term capital in 1957 is obtained by totalling the funds raised on the capital market direct by enterprises, by their holding companies and by the special credit institutions, those obtained by these special institutions from banks and those granted by the Central Post-Office Savings Funds — in a word, by examining all « loans and advances » other than those made directly by banks, which are mentioned in the first part of this « Concluding Survey ».

Resources acquired by business firms as a result of share issues were not smaller in 1957 than they had been in 1956. Net of duplications that occur when the increase in the capital of a company is undertaken, wholly or partly, by another company which is also increasing its capital, the amount involved in 1957 was 208 billion, as against 202 billion in 1956. The total afflux of funds to businesses through the direct issue of bonds was higher in 1957 (31 billion) than in 1956 (17 billion).

The net increase in loans of the special institutions for credit to industry and public works, financed in the main by bond issues, was—at 137 billion lire—also slightly higher last year than in 1956 (133 billion); the increase in 1957 represented 11.5 per cent of the loans outstanding at the end of 1956. The change from one year to the other reflected the growth in credits to the electrical, mechanical-engineering and chemical industries.

Funds raised by the IRI and ENI through the issue of long-term bonds, net of funds invested in shares of dependent companies and already included in the volume of share investments mentioned above, also showed an increase in 1957 (32 billion lire, as against 25 billion).

The volume of land improvement credits of the special credit institutions showed practically the same net increase as in 1956 (30 billion lire, as against 29 billion); the increase in 1957 was equal to 23.4 per cent of the volume of loans of these institutions outstanding at the end of 1956.

The volume of outstanding loans of land and building credit institutions rose by 72 billion lire in 1957, compared with 64

billion in 1956; this increase represented 22 per cent of the loans outstanding at the end of 1956.

Altogether, the total increase in medium and long-term loans and share issues worked out at 510 billion lire, or 40 billion more than the comparable figure at the end of 1956.

Finally, it is comforting to note that the increase in medium and long-term loans and advances of the special credit institutions was also greater in the first quarter of 1958 than it had been in the corresponding period of 1957 and that the same holds true for fresh funds raised by means of share issues.

To judge by the volume of funds which flow from abroad to enterprises to be used in the process of creating new instruments of production, there were no signs in 1957 or in recent months of a tendency on the part of enterprises to slow down investment in progress.

Lastly, it should be pointed out that investments made by the Cassa per il Mezzogiorno amounted to 145 billion lire in 1957, compared with 130 billion in 1956, and that the volume of loans of the Central Post-Office Savings Fund increased by 140 billion lire in 1957, as against 110 billion in 1956.

Moreover, Italy cannot presume to be free from the ups and downs that are characteristic of any process of economic development, especially when it is carried out with great intensity.

For instance, although the amount of unfilled orders, as a result in part of orders received during the Suez crisis, assures lively activity in Italy's shipyards for some years yet, it has been noted that with the changed situation in regard to ocean freights the flow of new orders has been interrupted. Therefore, it seems that it can be said of Italy, too, that forces are not lacking that might lead to a certain slackening in some industrial sectors in the future, independently of any impact that might be exerted on the economy by a decrease in the rate of development of other economies closely linked with Italy's.

To gain a better idea of the present situation, however, it may be worthwhile to review the great efforts made in the past ten years in the formation and employment of money savings by the banks and the capital market.

In 1947 savings deposits with the banks rose by 134 billion lire; in 1957 the increase of 484 billion was about 3.5 times as great. In 1947 funds raised on the capital market (Government securities, bonds and shares taken up by the private sector) amounted to 122 billion lire; in 1957 the figure was 409 billion and thus also 3.5 times greater. If investments in Government securities in these two years are left out of account, it appears that, whereas 73 billion lire's worth of bonds and shares were taken up by the public in 1947, in 1957 the amount was 358 billion, i.e. five times as much. These coefficients of development are only slightly reduced if account is taken of the slight depreciation of the lira over the ten-year period.

It must then be noted that, in contrast to the quite remarkable growth in share and bond investments, there was very little change, between 1947 and 1957, in investments by the private sector in Government securities (49 billion in 1947 and 51 billion in 1957) and in post-office savings deposits (59 billion in 1947 and 107 billion in 1957). These two items amounted, together, to 108 billion in 1947 and 158 billion in 1957.

This fact appears more significant if it is borne in mind that, whereas there was a steady rise in savings deposits with banks during the decade and whereas the same was true for bonds and shares acquired by the private sector, funds raised from this sector by the State (including the railways), by means of security issues and through post-offices, rose from 108 billion lire in 1947 to 271 billion in 1953 and then gradually dropped to 158 billion in 1957.

Thus the results of the policy pursued in the past ten years in regard to the raising of funds from the private sector are quite clear: the Treasury has relied increasingly on the growth of tax receipts to satisfy its requirements and has deliberately restrained its direct calls on private savings, with the result that gradually, and particularly in the last five years, the collection of savings by banks and subscriptions to bonds and shares by the public have been facilitated; the banks, in their turn, encouraged such subscriptions, which, as we have seen, increased fivefold during the decade.

Government requirements have, however, always been greater than tax receipts and savings obtained by the Treasury direct from private individuals, so that it has been necessary for the banking system to help by subscribing for Government securities; bank reserves have had to be invested partly in Treasury bills and sometimes, too, direct intervention by the central bank has been required.

Such practices have fortunately been limited in recent years by the Government's firm resolve first to reduce the deficit and then finally to balance the budget. Nevertheless, in deciding which instrument of indebtedness it should use less as a result of the diminished requirements, preference had to be given to the one which has been most widely employed since the war — the 9-year Treasury bond, the price of which was too strongly influenced by the substantial volume of bonds in circulation.

The creation of a system for the annual amortisation of these bonds led to an improvement in the price and it was thus possible to make a renewal offer more than a year in advance in respect of the largest series of bonds — the 314 billion lire's worth issued in 1950 and maturing on 1st April 1959.

The renewal operation is meeting with the success expected; according to the latest available data, bonds to the value of 200 billion have already been renewed. Our warm thanks go out to the banks which have been carrying out this operation and doing so with the greatest care.

The Government's decision to stop raising funds by new issues of 9-year Treasury bonds makes it all the more necessary to balance the budget, as it is essential that short-term indebtedness vis-à-vis the private sector and the banking system should reassume its real function of providing only for temporary lags between Treasury expenditure and receipts and not for structural deficits in the budget.

And the present liquid position of the market (which has been causing subscriptions to Treasury bills to rise in the last few months) should not lead us to overlook this necessity. This is clearly a transitory phase; when it comes to an end, the Treasury may be confronted with an inverse trend.

In assessing the pressure of official needs on private savings, not only the requirement deriving from the Government budget but also the no less important one—and one that has increased considerably in the last few years—arising from deficits in the provincial and municipal budgets should be taken into account.

Moreover, there remains the problem of the financing of losses on wheat stockpiles.

Finally, the stepping-up of many public works as an anti-cyclical measure will inevitably raise Treasury requirements in the near future.

Achievements and Problems of Currency Stabilisation.— At the end of a decade in which reconstruction was accomplished with surprising rapidity, and a long-term phase of productive development at an unprecedented rate set in—a phase characterised by the decisive orientation of international trade on principles of the broadest trade and currency liberalisation—Italy is confronted with the need to continue and possibly increase its efforts to solve its fundamental problems in an international climate which will be less propitious, perhaps for some time.

The anti-cyclical instruments now known inspire confidence that, where wise men and the spirit of international co-operation are present, the slowdown now in progress may yield in the near future to a renewal of productive development. One can certainly count on that spirit of co-operation after the many proofs which have been given in the western world in the postwar period, and by which Italy has also benefited.

No one can say, however, whether the high rates of increase of production that marked the decade just ended can be reached again, and reached soon. This will depend on cautious and appropriate economic policies, as well as on the rapidity of technical progress, the future extent of which is unpredictable.

Italy is making ready to cope with the new tasks in an adequately balanced monetary situation; in addition, the trials undergone heretofore impart confidence that when any difficulties

occur, the lessons learned from experience will stand the country in good stead.

A comparison of the monetary conditions at the beginning of the decade with those of the present day shows conspicuous progress. From a broad inflation, which caused a 50 per cent increase in prices in the few months from March to September 1947, we advanced to a condition in which we could successfully withstand the devaluation of sterling in September 1949, the violent expansion of prices caused by the Korean war, the disturbances caused by the Suez events, and, finally, the international monetary crisis of last September.

We have never had to have recourse to the International Monetary Fund, and the gold and dollar reserves, which had practically been wiped out in the autumn of 1947, reached a total of about 1,450 million dollars at the end of March 1958. This amount represents 51 per cent of the currency circulation of the Bank of Italy and is sufficient to cover five months of imports, which in the meantime have increased two and one-half times since 1947.

Therefore, Italy can face calmly enough any temporary phase in which an increase in imports is not accompanied by a parallel movement of exports.

And it must be added that the credit Italy enjoys in international circles is solid and will certainly be maintained if the economic policy of the country continues to be based on respect for the fundamental balances which are a prerequisite of any sound development. It is up to Italy to safeguard the asset of monetary stability from new attacks.

It should be remembered that inflation, which is the crafty enemy of any progress, can reappear on the scene at any moment, both when the economy is growing at a rapid rate and when it is stagnating.

Many policies of the American authorities are now dictated, despite the recession, by the existence of certain symptoms which suggest the possibility of a new spurt of inflation. And the monetary policies of the United Kingdom and Germany are

cautious in abandoning those measures which have had to be adopted to check the inflationary tendencies of production costs.

Italy, too, is in a position in which vigilance against the dangers of inflation cannot be relaxed. It still has the advantage of recording a general level of wholesale prices not higher, but rather slightly lower than the average level of 1948, the first year of the recovery of monetary stability. This level is the result of slightly higher prices of foodstuffs and lower prices of industrial products. In the very recent period from July 1957 to March 1958 as well, there was a slight reduction in the general wholesale price index, also resulting from a drop in industrial prices and an increase in agricultural prices, which have recovered almost entirely the loss of the first part of 1957.

The behavior of the cost-of-living index is not so satisfactory: between 1948 and 1957 it rose by more than 30 per cent. More recently, although the months from September 1956 to June 1957, which marked the beginning and end of the Suez crisis, had elapsed without substantial variations in the index, there was a further increase of 4.1 per cent from June 1957 to March 1958.

There are many explanations for this development. To mention a few, in the last decade, there were: the influence exerted on the index by legal increases in controlled rents, arbitrarily held for too long a time at very low levels, as well as the adjustment of prices of other public services, also kept low by law; the repercussions of the increase in indirect taxes on consumer prices; failure to consider, or inadequate consideration of, the improved quality of goods consumed and services enjoyed in the computation used as a base for the index. Finally, devoid of the causes of variation indicated above, the cost-of-living index is still influenced by the weight of foodstuffs, which is more than proportional to the relative importance of foodstuffs in the composition of domestic production.

As to the very recent period, it is noted that the increase is derived from the poor fruit crop, scanty wine production, and an increase in meat consumption not offset by an increase in supply, in addition to the last increase in controlled rents.

The supply of high quality foodstuffs is becoming increasingly inadequate in relation to demand for export and for internal consumption, so that the measures that are being adopted and will have to be adopted to bring about changes in agriculture to end this inadequacy are understood.

There are many reasons to explain the increase in the cost-of-living index. It must be said, however, that while some of these are not, or only slightly, related to the conditions governing the development of Italy's economic growth, the increases in the cost of living are fully reflected in the cost of labor. This prevents the realisation of more moderate prices for the materials used in domestic investment and at the same time makes exports more difficult.

This fact assumes particular importance in the present economic situation, in which the slowing-down of production that has occurred to some extent everywhere sharpens the conditions of international competition and requires that nothing be done within the country that might shift those incentives that should remain in the area of investment to the area of consumption.

On the other hand, consumption of goods other than food, and especially of industrial goods which can be mass-produced at decreasing costs, is not so well developed in Italy as to cause fear that it will contract substantially, so that it is primarily through a decline in the volume of investment or foreign demand that a pronounced slowing-down of production might originate and continue.

A stimulus to consumption, when not derived from natural reductions of the prices at which consumption is satisfied, would therefore be harmful rather than beneficial; it would not be a way to get out of a weak cyclical situation as rapidly as possible, but a way to aggravate the difficulties that obstruct a clear and lasting recovery.

Therefore, it is not without serious concern that we have recently witnessed the increase of four percentage points in the sliding scale; and the most recent data confirm the cause of

our concern, since the cost-of-living index, for the reasons indicated above, is still rising.

The edifice of monetary stability, even if it has solid foundations, must be safeguarded each day not only from open attacks but also from the many insidious attacks that are capable of undermining it, however slowly.

If this is true in the short run, not many words are needed to point out that monetary stability is indispensable for continuing the savings drive we have been making in recent years, and it is all the more necessary for strengthening this effort, as required in the « Plan for Development of Employment and Income in Italy in the Decade 1955/64 » linked with the name of the late Minister Vanoni. The present abundance of the money supply is in fact only the framework within which that effort can produce more rapid and firm results, but this framework cannot take the place of new capital formation to be used for investments.

If it were permissible to compare stages of economic development that are widely separated in time, one comment would be spontaneous on comparing the progress made in the last ten years with that of the first decade of this century, which was also a period of strong expansion in the formation of national income. Although the rate of increase in income in that period was certainly lower than the rate Italy has been able to record in the last ten years or even in the last five years, on the other hand the portion of income then allocated for capitalisation in new instruments of production was higher.

The achievement of higher quotas of savings to be used for productive investment therefore does not appear impossible for Italy, on the basis of its own experience. The setting of this goal seems necessary, moreover, to make our productive equipment in agriculture and industry not only more capable of keeping pace with the increase in food consumption, but also of coping better with the changes that will take place in Italy's international trade as a result of the establishment of the Common Market.

And let us think also of the effort the State in particular can make, in equipment and endowment, to enlarge the base of scientific research and to promote widespread vocational training, which alone can assure final success in the battle against unemployment.

The experience of the last ten years tells those of us who have followed economic developments closely that, thanks to the saving effort made by the citizens, on many occasions in the course of the development process the inadequacy of capital for carrying out new projects has been felt less than the lack of men to execute them at all levels.