BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1961

PRESENTED TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31st MAY, 1962

ROME

PRINTING OFFICE OF THE BANCA D'ITALIA

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REPORT OF THE GOVERNOR

I. *General Economic Conditions*

The strong cyclical upswing which the Italian economy has been enjoying since 1959 continued in full force last year, and indeed the pace of expansion quickened.

Gross national income in real terms rose by 7.9 per cent over the year, compared with 6.9 and 7.2 per cent, respectively, in 1959 and 1960. Contrary to the decline of agricultural output in 1960, the sector this time fully shared in the general advance.

All components of total demand again expanded sharply, and again foreign demand occupied a conspicuous place among them. At the same time, output and supply were able to develop strongly, thanks both to the growth of capacity resulting from the high investment of 1960 and to the increase in the employment of available manpower. Industrial production alone followed up its 8.5 per cent increase in 1960 with another large increase last year, when the December index stood 15 per cent above that of a year earlier.

On the other hand, the year 1961 was unlike its predecessor in that the rate of increase of imports slowed down after its quite exceptional spurt and that, therefore, the total of resources disposable for domestic uses expanded proportionately less than gross national income (see Table 1).

The latent imbalances and potential stress factors which had already been inherent in the price situation for some time, became more openly evident during the latter half of last year. What may be called institutional factors, such as the annual increase in controlled rents, and purely accidental ones, such

TABLE 1

Condensed National Accounts

(billion lire, at current prices)

Origin of resources	1960	1961	Use of resources	1960	1961
Agriculture, forestry and fishing	2,733	3,031	Consumption:		
Industry	6,513	7,200	— Private	12,235	13,194
Commerce, transportation and services	4,673	5,093	— Public	2,091	2,288
Net product of the public sector	1,872	2,045			
Adjustments	– 1,034	– 1,261			
Net domestic product at factor cost	14,757	16,108	Total consumption	14,326	15,482
			Gross investment	4,746	5,358
Taxes not included above in the value of goods and services	2,364	2,691			
Net domestic product at market prices	17,121	18,799	*Total domestic expenditure*	19,072	20,840
Net income from abroad	76	106	Exports of goods and services	3,357	3,886
Depreciation	1,881	2,070			
Gross national product	19,078	20,975			
Imports of goods and services	3,351	3,751			
Total	22,429	24,726	Total	22,429	24,726

as the short supply of vegetables owing to bad weather, exerted additional pressure on the price level, which has been rising since the early months of this year.

The value (at current prices) of private consumption rose last year by 7.8 per cent, and its volume by 6.8 per cent. The composition of the increment was much the same as the year before; again, the increase in food consumption was comparatively large, with 6.7 per cent in volume and 8 per cent in value, and again transport vehicles and durable household goods figured prominently, together with services.

Gross investment also expanded again, though less spectacularly than in 1960. The year's increase from 4,746 to 5,358 billion lire corresponds to 12.9 per cent, against 20.6 per cent the year before. Gross fixed investment showed a rise of 13.9 per cent in comparison with 17.5 per cent in 1960; new inventory investment, which had risen from 149 billion lire in 1959 to 305 billion in 1960, absorbed an almost identical amount last year. Gross fixed investment as a whole accounted for 25.5 per cent of gross national income in 1961, compared with 24.9 per cent the year before. The primary beneficiaries were the directly productive sectors with the exception of agriculture, but building construction and public works also took in some 8 per cent more (see Table 2). Industrial investment expanded just a little more than in 1960, when the year's increase had been 20.5 per cent; on the other hand, transport and communications received rather less than the exceptional investment increments of the preceding year.

TABLE 2

Gross Fixed Investment

Sectors	Value (billion current lire)		Percentage change in		
	1960	1961	volume	price	value
Agriculture	538	539	– *2.0*	*2.2*	*0.2*
Industry	1,309	1,590	*17.4*	*3.5*	*21.5*
Transport and communications	747	892	*20.1*	– *0.6*	*19.4*
Building construction	1,101	1,192	*5.0*	*3.1*	*8.3*
Public works	449	485	*4.7*	*3.2*	*8.0*
Others	297	360	*18.5*	*2.3*	*21.2*
Total fixed investment	4,441	5,058	*11.2*	*2.4*	*13.9*

Aggregate capital formation amounted to 5,701 billion lire and so exceeded the 1960 total of 4,955 billion by 15 per cent. Net domestic saving grew by 18.1 per cent from 3,074 to 3,631 billion. Of these, 3,288 billion were used to finance net domestic investment, which was 14.8 per cent higher than the year before.

The year 1960, it will be recalled, was one of strongly rising employment, flourishing foreign trade and expanding investment. In 1961 the pattern of expansion was much the same, but the emphasis differed here and there. This is particularly true of employment. In aggregate terms, the rate of increase of employment was, at 1.5 per cent, still very high, though rather less so than in 1960, when it was 2.1 per cent. But within that total, agricultural employment contracted by 5.1 per cent, while the increments in industrial and tertiary employment considerably exceeded those of 1960.

As in the preceding year, aggregate employment again grew much faster than the labour force, so that there was another reduction in available manpower.

Over the economy as a whole, output per head of person employed increased faster (by 6.3 per cent as against 5 per cent in 1960), which explains why the increase in real income in its turn exceeded that of the preceding year.

A major contributor to the improvement in productivity was the agricultural sector. In industry, output per person employed rose by only 3.2 per cent in comparison with 7.8 per cent in 1960, when output in industry and building construction together had risen by 12.2 and employment by 4.1 per cent; in 1961, output rose by 8.9 and employment by 5.5 per cent.

Although intersectoral and interregional labour movements were on a larger scale than before, the economy began to suffer at various points from more frequent and more serious labour shortages, especially in the skilled grades.

As regards industrial plant, the capacity increments resulting from investment in 1960 were not enough to prevent capacity reserves from dwindling away, especially in some sectors. Rising demand could, therefore, only be met by expanding employment, and industrial employment in fact did rise by 6.6 per cent, as against 5 per cent in 1960.

II. *Production*

Agriculture.— In striking contrast to 1960, when bad weather caused a considerable diminution of crops, agricultural output increased by 5.3 per cent last year. Indeed, in absolute terms last year's output exceeded the previous record of 1959, the index (1952-55 = 100) having reached 122.1 or 1.3 per cent more than two years ago.

As in 1960, it was largely the highly weather-susceptible grain crops that were responsible for the year-to-year fluctuations in agricultural output as a whole, only this time the wheat harvest, the failure of which had depressed the total in 1960, contributed conspicuously to the overall increase.

Among agricultural inputs, the use of technical means increased again, though rather less than the year before; in quantitative terms, the increase was 3.2 per cent last year, against 4.5 per cent in 1960. Agricultural investment, on the other hand, remained almost stationary after its 20 per cent spurt the year before; at current prices, the figure of 539 billion lire was all but identical with the 1960 one of 538 billion, and at constant prices it was actually a little lower.

Nevertheless, mechanization made some further, if modest, progress. Purchases of machinery, which had risen by almost 12 per cent in 1960, rose last year by a mere 3 per cent.

Overall investment in land reclamation, transformation and improvement increased only by 2.2 per cent. This figure masks a high increase, of 16.3 per cent, in the sums spent on land reclamation and a very sharp contraction, of 35 per cent, in the transformation expenditure of land reform agencies; land improvement on private account took up about as much as in 1960, but here again there were some internal shifts—projects financed with the help of capital grants by the *Cassa per il Mezzogiorno* took up far more and those relying on government contributions far less, while private investment financed by loans from special credit institutes was about equal in the two years.

As regards output, Italy had bumper crops of wheat and other cereals, fruit, citrus fruit, and olives; only the grape harvest and forage crops were poor. On the other hand, the considerable development of livestock production was not followed up last year, when indeed there was a slight contraction of 1.4 per cent. Thus the increase in overall output owed everything to field crops (9.9 per cent) and tree crops (9.1 per cent).

Among the former, the wheat harvest was outstanding. After its sharp fall in 1960, when the weather was so bad, it rose last year by 22 per cent from 67.9 to 82.9 million quintals. A spectacular increase of 55 per cent occurred in the crops of hard wheat, while the harvest of soft wheat was 16 per cent larger.

The increased cereal output is entirely attributable to higher yields per acre, given that the area under cultivation was 6 per cent less that in 1960, mostly because of heavy rain during the sowing season.

Vegetable production was some 4 per cent higher than in 1960, and industrial crops suffered a very sharp contraction—in the case of sugar beet 10 per cent and in the case of tobacco nearly 70 per cent.

Fruit crops, as has already been mentioned, were copious. Output was nearly one third higher, as a result partly of favourable weather conditions and partly of new orchards beginning to bear fruit. Citrus fruit crops were excellent, and about 20 per cent larger than the previous year.

On the other hand, the weather was unfavourable for forage crops, the 7 per cent diminution of which was largely responsible for the above-mentioned decline in the output of livestock products. Meat production actually fell by 1.8 per cent and the output of milk and milk products by 3.1 per cent.

Italy was again a net importer of food last year. It will be recalled that after a year of more or less balanced food exports and imports in 1957, the country developed a deficit of some 60 to 70 billion lire in 1958 and 1959, in spite of a strong expansion of domestic food production. The deficit then climbed steeply to 192 billion lire in 1960, and even though the terms of trade improved very considerably in the meantime, it was still 176 billion last year.

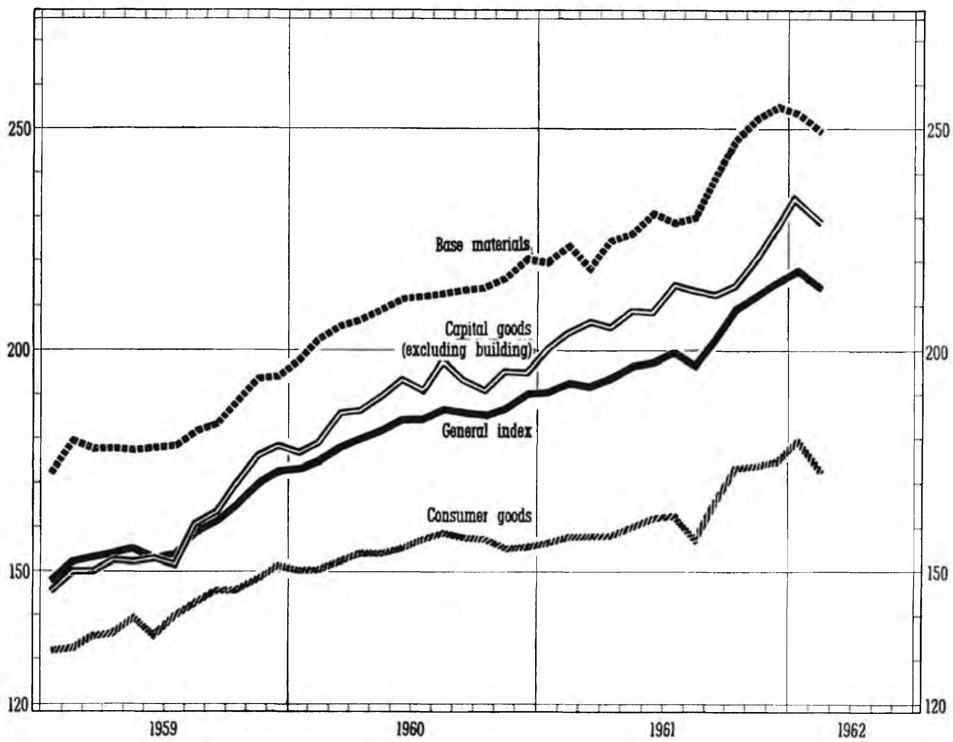
Domestically, the value of gross marketable product rose by 9 per cent over the year, thanks to the combined effect of larger output and higher prices. In absolute and aggregate figures, gross marketable product amounted to 3,712 billion lire, as against 3,406 billion in 1960.

Industry.— Industrial production made further big advances last year. The annual index calculated by the Central Statistical Institute for industrial production (including seasonal industries but excluding building) rose from 180.1 (1953 = 100) in 1960 to 196.0 in 1961, which corresponds to a rise of 9.1 per cent.

The building construction index, in its turn, shows rather similar developments, having risen by 92.9 per cent since 1953 and by 7.6 per cent over the preceding year. Consequently, the combined index for industry and building now stands at 195.6, having risen over the year by 8.9 per cent.

For purposes of comparison, there are now the corrected 1960 figures showing a 12.2 per cent rise in the combined index, made up of a rise of 13.4 per cent in industrial production proper and of 4.6 per cent in building construction. It will be seen, therefore, that while building picked up a little in 1961, other industrial production advanced rather less fast. Nevertheless, the pace was still brisk enough, especially in the light of the fact that this was the third successive year of strong expansion, and the year's production curve fits perfectly into the trend line of averages since 1953.

CHART 1



General index of industrial production and indices of production of base materials, capital goods and consumer goods

(1953 = 100; seasonally adjusted)

The production of capital goods and base materials rose last year by an almost identical 11 to 12 per cent, while that of consumer goods expanded by 4.5 per cent (see Chart 1 and Table 3). Although the rise in the indices fell short of 1960, it was fairly close to the average over the past eight years; the production curve was still above the trend line in the case of capital goods, coincided with it in the case of base materials and was a little below it in the case of consumer goods.

Within the capital goods sector, engineering stands out with the fastest growth rate of all industry; the overall increase was 15.2 per cent, and the best showing was made by calculating machines and typewriters, agricultural tractors, textile machines, steel structural work and electrical machinery. The automobile industry, stimulated by continued high demand at home and by a revival of foreign demand after the pause of 1960, was alone responsible for the good performance of the whole transport equipment branch and offset further contractions in shipbuilding and railway rolling stock. The iron and steel industry, which registered an increase in output of 9.9 per cent, was held back only by lack of capacity; although existing plant was fully utilized most of the year, the industry was unable to meet the rise in domestic demand and had to turn in larger measure to

Table 3

Percentage Changes in the Indices of Industrial Production

Indices	1958	1959	1960	1961	Annual compound rate of increase on the average over			1961 Index (1953=100)
					8 years 1953-61	5 years 1953-58	3 years 1958-61	
General index (including building)	4.5	11.4	12.2	8.9	8.8	7.5	11.0	*195.6*
General index (excluding building)	3.9	11.5	13.4	9.1	8.8	7.3	11.3	*196.0*
Base materials and fuel	10.1	14.6	14.2	10.9	11.0	9.9	13.2	*233.1*
Capital goods (including building)	2.5	9.0	14.7	10.5	9.5	8.3	11.4	*206.4*
Capital goods (excluding building)	—	8.0	19.3	11.6	9.8	8.1	12.9	*212.1*
Consumer goods	3.6	12.8	6.7	4.5	5.9	4.8	7.9	*158.6*
Mining and quarrying	2.3	7.1	5.3	7.4	8.7	10.0	6.6	*194.8*
Manufacturing industry	3.9	11.9	13.8	9.3	8.9	7.3	11.6	*197.9*
Electricity and gas	5.4	7.2	12.6	6.9	7.0	5.9	9.0	*171.4*
Building construction	8.5	11.2	4.6	7.6	8.5	9.0	7.8	*192.9*

Source: Central Statistical Institute, *Yearbook of Industrial Statistics*, 1961; some indices not contained in the Institute's series have been calculated on the basis of the original figures.

foreign sources of supply. At 144 billion lire, the value of net imports of iron and steel products was more than double the 1960 figure. Production of construction materials (up 10.2 per cent) benefited from the revival of building activity.

With the exception of electric power, all branches of the base materials and fuel sector advanced at the uniform rate of 11 to 13 per cent. The chemical industry went ahead chiefly in plastics and synthetic resins, and was able to offset the fall in the domestic use of agricultural fertilizers by larger foreign sales (up 24 per cent in terms of value). Growing domestic consumption of petrol and fuel oil kept the refineries busy, and the rubber industry again had the benefit of strong domestic and foreign demand both for tyres and other products.

Power generation increased by 8.1 per cent over 1960. As often happens, the exceptionally good rainfall conditions of 1960 were followed last year by unfavourable ones, so that less hydroelectric power was produced and thermal plants had to be drawn on to a greater extent.

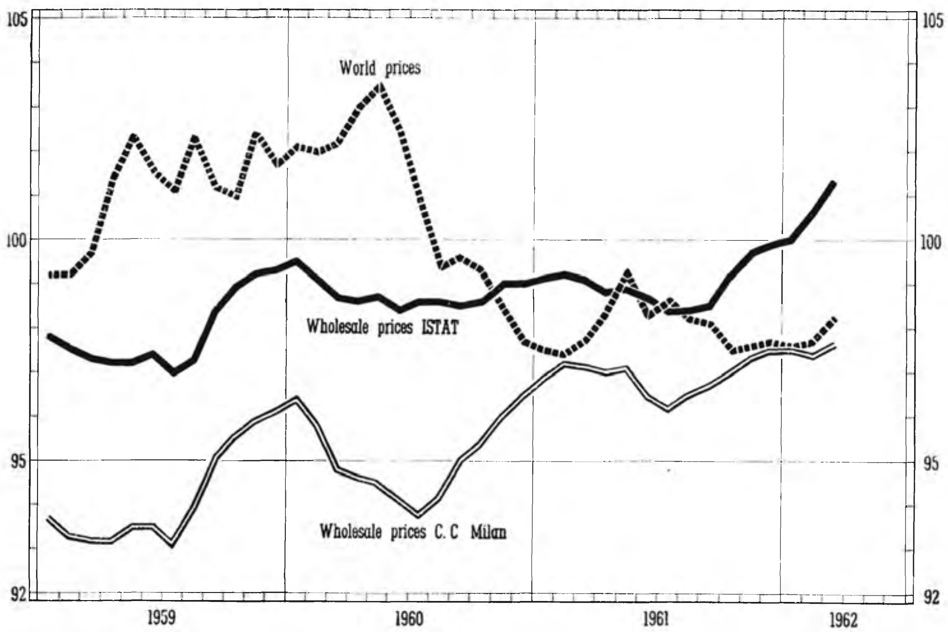
For the third year in succession, durables led the advance in the consumer goods sector with an increase in output of 8.4 per cent; much smaller increases were registered by semi-durables (4.1 per cent) and non-durables (3.6 per cent). These developments clearly reflect a change in consumer priorities connected with growing family incomes and hence a higher standard of living generally.

III. *Prices*

Wholesale prices.— The Central Statistical Institute's annual average index of wholesale prices, which had risen by 0.9 per cent from 1959 to 1960, last year was a mere 0.2 per cent higher than in the preceding year; however, the index for December 1961 was almost 1 per cent higher than that of December 1960, which in turn had been just a little lower (0.3 per cent) than the corresponding index for 1959.

The general wholesale price index remained almost stable during the first quarter of last year, then dropped a little during the second quarter and, in July, actually stood 0.6 per cent below its December 1960 level. But from September onwards the index began to climb and has continued to do so since the beginning of the current year. Between August 1961 and March 1962 there occurred a rise of 2.9 per cent (see Chart 2).

CHART 2



Indices of domestic wholesale prices
(Central Statistical Institute and Chamber of Commerce of Milan)
and of world market prices
(1953 = 100)

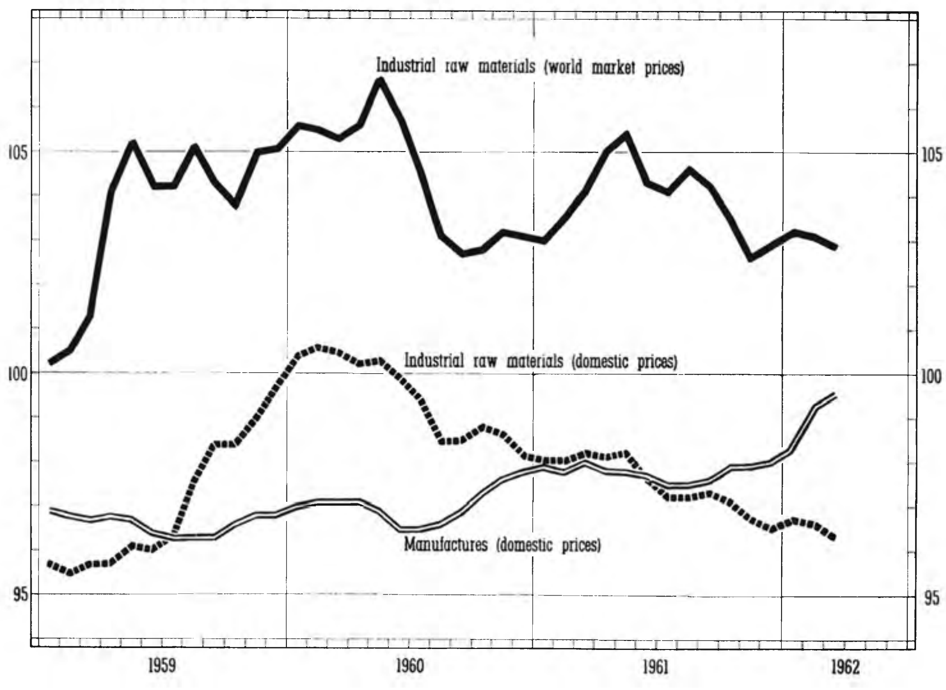
Generally speaking, it can be said that, contrary to what was the rule in the past, domestic wholesale prices have recently shown a certain tendency to diverge from world raw material prices.

Within general wholesale price movements, there was a marked difference in the behaviour of food and industrial prices; it was the former which were largely responsible both for the early dip in the general index and in its later rise. Poor crops in 1960 had pushed up food prices slightly between October 1960 and February 1961, when they began to diminish and dropped by altogether 0.9 per cent until August; at that point they began to pick up again in spite of last year's good harvest, though the continued rise in the early months of this year may perhaps in some part be ascribed to poor weather conditions. All in all, wholesale food prices had, by March 1962, risen by 5.5 per cent since last August.

By contrast, industrial prices remained remarkably stable throughout the year and the December indices show hardly any change at all; it was not until the first quarter of this year that a rise of 1.2 per cent helped to lift the general index of wholesale prices (see Chart 3).

The slight dip in the general level of industrial wholesale prices during the first half of 1961 is entirely attributable to auxiliary industrial materials and consumer goods; capital goods

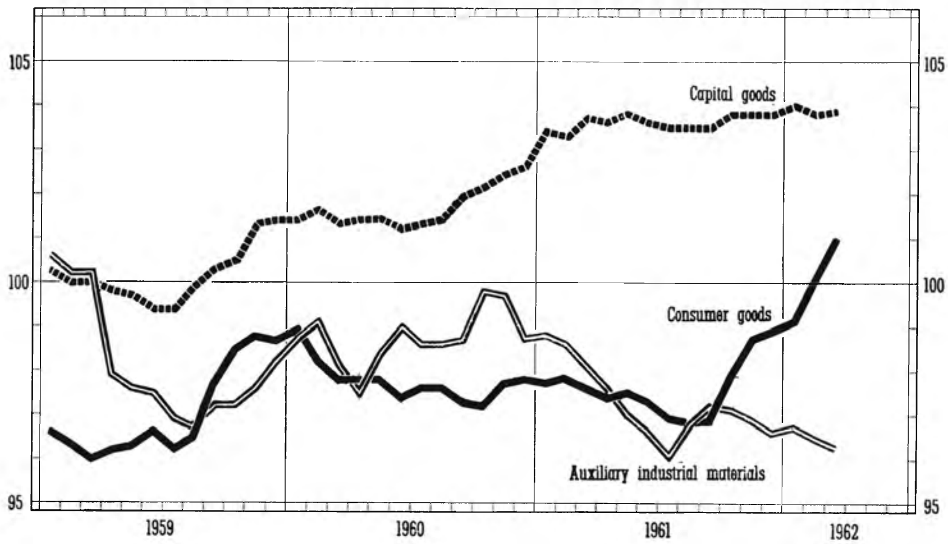
CHART 3



Indices of domestic wholesale prices for industrial raw materials and manufactures and of world market prices for industrial raw materials
(1953 = 100)

prices actually rose by 1 per cent over the same period and, in July last year, stood 4.1 per cent above their record low of July 1959, just before the current phase of expansion began (see Chart 4).

CHART 4



Domestic price indices for consumer goods,
capital goods and auxiliary industrial materials
(1953 = 100)

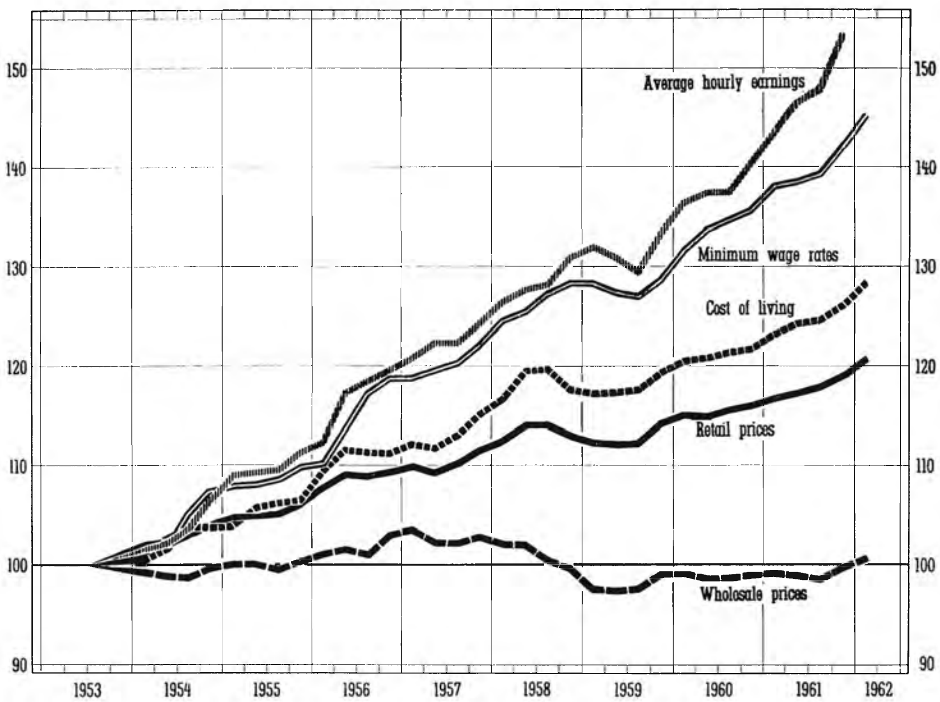
Retail prices, cost of living and wages.— At 2.1 per cent, the annual average rate of increase in retail prices last year was almost the same as in 1960 (2.3 per cent); however, while over the whole year the general retail price level went up by only 1.4 per cent in 1960, it rose by 2.8 per cent last year. Prices climbed almost uninterruptedly throughout the year and still continue to do so; between March 1961 and March 1962 the total rise amounts to 3.9 per cent.

Bad harvests had caused retail food prices to rise by 0.9 per cent late in 1960; during the first half of 1961 they fell back a little, only to start following wholesale prices up in August and to continue climbing until the end of the year by 2.5 per cent.

In recent months, the upward movement began to affect also some industrial prices. During the nine months ending last March the prices of textile products rose by 2.1 per cent and those of furniture and miscellaneous household goods by 9.6 per cent. Over the same period consumer prices for electricity, gas and other fuels went up by 3 per cent.

As regards the cost of living, the national index rose by 2.9 per cent over the average of last year; this was much the same as the year before (2.7 per cent), but more than the rise in the retail price index. The reason for the divergence resides mainly in the different weighting of the two indices, especially as regards food items, which are shown 1.7 per cent dearer on the average by the cost-of-living index, whereas the corresponding retail price index went up by only 0.4 per cent (see Chart 5).

CHART 5



Indices of wholesale and retail prices, cost of living and wages in industry
(1953 = 100)

The rise of the wage level in 1961 was due in part to the renewal of many wage agreements and to the growing practice for firms to negotiate their own agreements with their workers, and in part to the application of new agreements regarding interregional wage parity in industry and transport. Furthermore, as a result of changes in the special index relevant for the application of sliding wage scales, cost-of-living allowances in industry were raised by two points in the course of the year, one from February onwards and the other from August, and family allowances were raised in May.

IV. *The Balance of Payments*

Besides achieving a conspicuous growth of national income in 1961, Italy also earned a large balance-of-payments surplus (Table 4), which went to swell the country's foreign assets and reserves. The surplus was bigger than in 1960, and 234 million dollars of it came from the goods and services account, which had produced only 97 million dollars the year before.

Imports of goods and services were 15 per cent higher in real terms than in 1960; the expansion was so fast that the income elasticity of imports did not fall short of the average of the years 1950-60, a period when trade liberalization proceeded apace and when large-scale inflows of foreign capital and grants-in-aid also helped to push up imports (Chart 6). It is the export side, therefore, with its 17.3 per cent rise over the year, which provides the chief explanation for the higher surplus on goods and services account.

Another strong group of items was that of unilateral transfers, where higher emigrants' remittances more than offset larger disbursements for reparations and aid to developing countries. Taking unilateral transfers and the exchange of goods and services together, the total current surplus increased from 317 million dollars in 1960 to 503 million last year. About half the increment came from a reduction of the deficit in visible trade, and the other half from higher invisible earnings for services and from unilateral transfers.

The strong fluctuations in the current balance over the last five years are patently connected with visible trade, the deficit in which has shown itself highly sensitive to cyclical influences; invisibles were much steadier, and gradually pushed up their surplus until it passed the billion-dollar mark in 1961.

TABLE 4

Overall Balance of Payments (1)

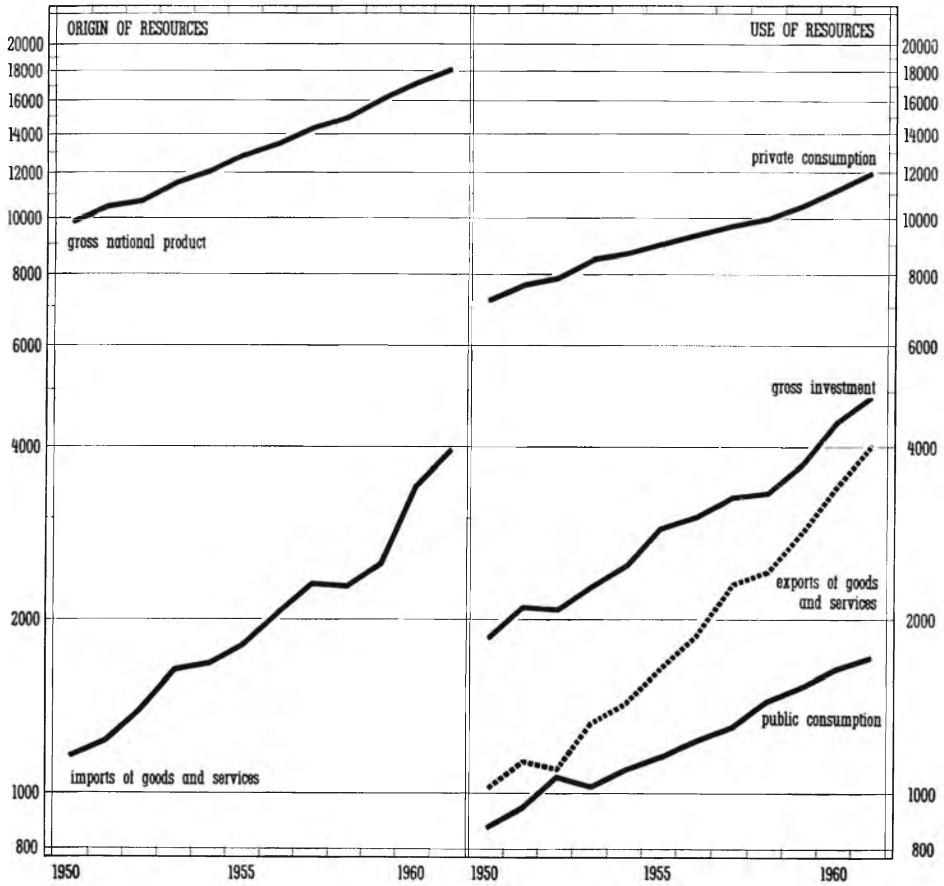
(*million dollars*)

Items	Credit 1960	Credit 1961	Debit 1960	Debit 1961	Balance 1960	Balance 1961
A. *Goods and Services*						
Goods (fob)	3,570.6	4,108.3	4,204.4	4,658.5	— 633.8	— 550.2
Transport	495.9	554.3	600.5	678.6	— 104.6	— 124.3
Insurance	38.8	67.8	40.9	65.6	— 2.1	2.2
Foreign travel	642.5	755.1	94.4	107.7	548.1	647.4
Investment income	83.7	88.8	113.5	140.3	— 29.8	— 51.5
Workers' remittances	171.7	214.8	21.0	24.1	150.7	190.7
Government services	49.9	62.4	77.3	71.4	— 27.4	— 9.0
Miscellaneous	317.8	347.4	208.9	277.6	108.9	69.8
Total . . .	5,370.9	6,198.9	5,360.9	6,023.8	10.0	175.1
Offshore procurements and military services	87.7	59.1	0.6	0.7	87.1	58.4
Total . . .	5,458.6	6,258.0	5,361.5	6,024.5	97.1	233.5
B. *Unilateral Transfers*						
Emigrants' remittances	214.0	260.7	—	—	214.0	260.7
Other donations	41.3	54.9	—	—	41.3	54.9
Reparations	—	—	10.8	17.1	— 10.8	— 17.1
Miscellaneous aid	—	—	24.6	29.3	— 24.6	— 29.3
Total . . .	255.3	315.6	35.4	46.4	219.9	269.2
C. *Total of* A + B (excluding extraordinary government transactions)	5,626.2	6,514.5	5,396.3	6,070.2	229.9	444.3
D. *Total of* A + B	5,713.9	6,573.6	5,396.9	6,070.9	317.0	502.7
E. *Capital Movements* (2)						
Foreign borrowing and lending:						
a) Public	82.9	85.0	16.2	37.8	66.7	47.2
b) Private	26.3	126.3	—	32.5	26.3	93.8
Contractual repayments:						
a) Public	18.8	19.4	38.0	34.6	— 19.2	— 15.2
b) Private	3.6	2.4	13.9	20.6	— 10.3	— 18.2
Investment abroad and from abroad:						
a) Public	—	—	12.0	—	— 12.0	—
b) Private	847.6	1,111.1	186.6	151.9	661.0	959.2
Total . . .	1,024.6	1,412.9	672.9	877.2	351.7	535.7
Disinvestment:						
a) Public	—	—	—	—	—	—
b) Private	45.4	68.7	406.2	599.8	— 360.8	— 531.1
F. *Monetary Movements* (2)						
a) Official gold and convertible currency holdings	—	—	127.2	339.5	— 127.2	— 339.5
b) Transactions with the IMF	—	—	—	175.3	—	— 175.3
c) Other official assets abroad	23.2	21.8	70.3	124.1	— 47.1	— 102.3
d) Bank assets abroad (net)	—	39.7	268.2	—	— 268.2	39.7
Total . . .	23.2	61.5	465.7	638.9	— 442.5	— 577.4
G. *Balancing items*	175.1	185.1	401.3	646.1	— 226.2	— 461.0

(1) The figures, which have been approved by the Committee for the Balance of Payments, have been adjusted in the light of new statistics and estimates during the last two months and therefore differ in certain respects from the provisional figures of the *Report on the Economic Situation in Italy*.

(2) The credit columns show changes in foreign assets; the debit columns indicate changes in foreign liabilities. If positive, the amounts indicate a reduction in foreign assets or an increase in foreign liabilities; if negative, they indicate an increase in foreign assets or a reduction in foreign liabilities.

CHART 6



Origin and final use of Italy's resources, 1950-61

(billion lire; semilogarithmic scale)

In turn, the fluctuations in the merchandise trade deficit are mostly due to deviations of imports from the trend line. Exports have been climbing steadily and, in recent years, expanded even faster than invisible earnings.

While visible trade had been losing ground in relation to invisible trade since the war, this tendency was recently reversed and, with merchandise exports providing 63 per cent of total export receipts (against 59 per cent in 1958), the situation is more or less back at what it was in 1938. But this is where the similarity ends; the composition of exports is now vastly different from the pre-war pattern. Two pairs of figures may serve to illustrate the advance of Italy's industrialization: in 1938, foodstuffs provided 21 and engineering products 6 per cent of total export receipts, in 1961 the share of food was 10 and that of engineering products 22 per cent of the total.

Conspicuous as the growth of current transactions was in 1961, that of capital movements was even stronger. The day is rapidly approaching when Italy finds her place in world capital markets as she has already largely found it in the world's markets for goods and services.

At the same time net capital inflows from abroad diminished to 75 million dollars, having already dropped from an average of 165 million dollars during 1957-59 to 125 million in 1960. As Italy began to earn current surpluses, therefore, she received less and less net capital inflows from abroad.

With these results of current and capital transactions at hand, the monetary authorities added 577 million dollars to Italian foreign assets, as against 442 million in 1960, and created a like amount of liquidity at home through an increase in the money supply, including bank money.

The Exchange of Goods and Services.— In Italy's merchandise trade with foreign countries, then, exports grew faster than imports and the balance improved. Comparing the two years 1960 and 1961, the value figures for cif imports are 2,953 and 3,264 billion lire, corresponding to an increase of 10.5 per cent, and for exports they are 2,280 and 2,617 billion lire, corresponding to an increase of 14.8 per cent. Consequently the deficit diminished from 673 to 674 billion lire, or, expressed in fob values, from 396 to 344 billion.

The Central Statistical Institute has calculated that both import and export prices fell by something like 3.5 per cent last year. This implies that in terms of volume imports increased by 14 and exports by 19 per cent (see Table 5).

As in 1960, the largest single increase (26 per cent) in imports occurred in industrial manufactures, which now account for more than 30 per cent of the total value of imports. There are two obvious reasons behind this development: one is the

TABLE 5

Changes in Imports and Exports, by Main Groups

Items	Percentage composition of				1961 Indices (1960 = 100)					
	imports		exports		imports			exports		
	1960	1961	1960	1961	value	price	volume	value	price	volume
Foodstuffs (1)	18	17	15	15	104	88	118	111	98	113
Industrial raw materials	22	19	3	3	97	95	102	110	103	107
Semi-manufactures	19	19	15	13	112	97	115	102	93	110
Manufactures	27	31	61	64	126	103	122	120	97	124
Auxiliary materials	14	14	6	5	107	94	113	106	96	110
Total . . .	100	100	100	100	111	97	114	115	96	119

(1) Including live animals.

intensive drive to extend and modernize industrial plant and equipment, and the other is the improvement in the general standard of living and the consequent growth of demand for consumer goods. Actually, capital goods accounted last year for 54 per cent of all imported manufactures and their imports expanded by 34 per cent, while the imports of consumer goods showed a rise of 13 per cent.

By contrast, the volume of imports of industrial raw and auxiliary materials expanded by only 6 per cent last year and, given the intervening price fall, they cost hardly more than in 1960. With stocks rebuilt, the rate of import of these goods now again closely follows domestic industrial production.

On the export side, there were some marked changes in comparison with the year before. In 1960, when capacity margins in certain industrial countries abroad were very low, Italian exports of manufactures and semi-manufactures expanded sharply, but the rate of increase slowed down somewhat in 1961; conversely, last year's good harvests led to a recovery of food exports. These two developments proved to be nearly offsetting in quantitative terms, so that the overall increase in the volume of exports, at 19 per cent last year, was almost the same as in 1960 (20 per cent). Export prices, on the other hand, rose in 1960 by 4 per cent and dropped by about as much last year, so that the value of exports increased by only 15 per cent as against 25 per cent in 1960.

Nothing happened last year to alter the basic tendency of Italian exports, which is for foreign sales of manufactures to expand more quickly than those of any other group of merchandise. In 1961, exports of manufactures expanded by 24 per cent in quantitative and 20 per cent in value terms, and their share in total exports was 64 per cent, as against 61 per cent in 1960. Within manufactures, capital goods were again in the lead, with an increase of 26 per cent in value terms, even though consumer goods exports, which clearly benefit from growing incomes and improving standards of living abroad, also showed a very respectable expansion of 15 per cent and still account for 54 per cent of total Italian exports of manufactures. Last year's developments also confirmed the tendency towards a relatively larger increase in the exports of goods incorporating a high proportion of value added.

The estimates for the balance on transport account put the final overall deficit at 124 million dollars for 1961. The deterioration with respect to the 1960 deficit of 105 million dollars was due entirely to overland transport, where the deficit increased by 27 million dollars, as a result partly of larger imports from European countries and partly of a diminution of transit traffic. Shipping, on the other hand, had a slightly smaller deficit last year, thanks to the fall in freight rates for liquid cargoes, and in air transport a relatively larger increase in services rendered improved the balance once more.

The rate of increase of foreign tourism, in terms of the number of visitors to Italy, slowed down for the second year in succession, owing largely to the almost complete drying up of the tourist flow from Austria and to stationary conditions in arrivals from the United States. In the event, the rate of increase, which had been 9.8 per cent in 1959 and 7.3 per cent in 1960, was only 5.1 per cent last year.

Foreign exchange receipts from tourism also failed to expand as sharply as in 1960 (the rates of increase for the two last years were 21.2 and 17.5 per cent), but, thanks to larger expenditure per head, they still expanded more than the number of foreign tourists.

The growth of foreign tourism in Italy has found its counterpart, these last few years, in conspicuously larger tourist flows in the other direction. As Italians gradually become better off, they spend more on foreign travel—to be precise, 82 million dollars in 1959, 94 million in 1960 and 108 million in 1961. This amounts to an annual average increase of about 15 per cent.

On the other hand, fewer Italians emigrated last year. Taking the net balance of migratory movements as an indicator of permanent emigration, there was a fall in the latter of 11 per cent. The chief reason for this was a further reduction of emigration to overseas countries, due to better employment possibilities at home and in the countries of the Common Market.

The outflow of migrant labour increased by around 12 per cent, with the Netherlands, Germany and Switzerland taking most of the additional seasonal workers and France taking rather fewer than before. Germany and Switzerland each employed some 80,000 seasonal workers from Italy last year.

Emigrants' remittances from abroad amounted to 476 million dollars in 1961, in comparison with 386 million in 1960. Of the total, 261 million dollars are shown in the balance of payments under unilateral transfers as remittances from emigrants permanently resident abroad, and the remaining 215 million under services as earnings by temporary emigrants.

Capital Movements.— The salient feature in the two-way movements of capital to and from abroad last year is the growing amount and flexibility of private foreign investment in Italy, especially in the form of equity investment. Foreigners invested 1,111 million dollars in Italy and disinvested 600 million, while the corresponding 1960 figures were 848 and 406 million dollars (see Table 6).

On the other hand, the net inflow of medium- and long-term loans from foreign public and private sources, while exceeding the 64 million dollars of 1960, still amounted only to a fairly modest 108 million dollars.

TABLE 6

Foreign Investment and Disinvestment in Italy

(million dollars)

Items	1960	1961
A. Investment under laws No. 211 of 1948 and No. 43 of 1956, according to:		
Article 1	50.9	32.3
Article 2	241.7	318.9
Increase in non-resident capital deposits and other investment	555.0	759.9
Total A . . .	847.6	1,111.1
B. Disinvestment under laws No. 211 of 1948 and No. 43 of 1956, according to:		
Article 1	—	0.4
Article 2	0.3	7.1
Reduction in non-resident capital deposits and other disinvestment	405.9	592.3
Total B . . .	406.2	599.8
C. Net investment (A — B)	441.4	511.3

At the end of 1961 Italy's long-term foreign indebtedness amounted to 4,094 million dollars, of which 2,731 million in the form of equity holdings in foreign hands (the figure includes appreciation since purchase and therefore exceeds the original inflow of foreign exchange), 764 million in government or government-guaranteed loans from abroad and 599 million of long-term private debts.

Net Italian investment abroad fell from 153 million dollars in 1960 to 83 million last year (see Table 7). Both figures exclude the Italian Exchange Office's purchases of World Bank bonds and its buying in of a certain amount of bonds of foreign public loans to Italy; these are shown in the balance of payments under monetary movements in a net amount of 82 million dollars in 1961.

Among further steps to liberalize capital movements, a provision of November 14, 1961 authorized Italian residents to purchase foreign-currency bonds issued by international financial institutions of which Italy is a member.

Table 7

Italian Investment and Disinvestment Abroad

(million dollars)

Items	1960	1961
A. Investment:		
1. Public:		
Subscription to European Investment Bank .	12.0	—
2. Private:		
Involving foreign exchange transfers	112.0	106.1
Through other means of transfer	74.6	45.8
Total A . . .	198.6	151.9
B. Disinvestment:		
Involving foreign exchange transfers	12.2	22.1
Through other means of transfer	23.4	29.5
War reparations	9.8	17.1
Total B . . .	45.4	68.7
C. Net investment (A — B)	153.2	83.2

A fortnight later, a Ministerial Decree of November 28, 1961, removed some of the restrictions still remaining under the regulations of July 1959. At that time, companies were authorized to buy shares or subscribe capital to foreign companies operating in the same field; now these provisions have been made to apply also to the purchase of bonds. Finally, in February of this year, the Interministerial Committee on Credit and Saving abolished the 20 per cent ratio between foreign security purchases and paid-up capital plus reserves, which had governed the foreign investments of specified medium- and long-term credit institutes and finance companies in Italy since February 22, 1961. This means that there is no longer any discrimination against foreign security investment on the part of these institutes and companies, though it does, of course, remain subject to the same laws and regulations as apply to investment in Italian securities.

A major item in the capital outflow from Italy last year was repatriation of Italian bank notes in the amount of 330 million dollars (as against 185 million in 1960); these are not shown separately in the balance of payments, but are included in the balancing item.

Aid to developing countries accounted for a sizeable part of the increase in medium-term credits for capital goods exports and in Italian capital outflow more generally. Gross resources made available to foreign countries on a bilateral basis rose from 275 million dollars in 1960 to 307 million last year—some of it for debt consolidation to relieve the balance-of-payments difficulties of countries like Yugoslavia, Egypt and Turkey.

Monetary Movements.— On balance, monetary movements last year increased Italy's foreign assets by 577 million dollars and contributed a corresponding amount of about 360 billion lire to domestic liquidity. However, these global figures do not adequately reflect the effects of these movements on international and domestic liquidity. The individual components of the total flows each have their own specific effects at home and abroad, and it is of course the very essence of monetary policy to modify the weight and distribution of these components in order to obtain certain desired results. Generally speaking, it may be said that last year the main purpose was to keep the domestic market liquid and at the same time to mitigate the harmful effects on international liquidity deriving from Italy's basic balance-of-payments surplus. Both lines of action were pursued both by autonomous measures and within the framework of international agreements and arrangements.

Among the numerous means of intervention some stand out as novel and original. Domestically, the Italian Exchange Office continued throughout the first six months of 1961 with its spot sales of foreign currency to Italian banks, accompanied by forward repurchasing commitments. The total amounts involved at any one time kept in the neighbourhood of 500 million dollars, as against some 400 million dollars in December 1960. From July onwards, the Exchange Office also deposited growing amounts of dollars with the banks, so that by the end of the year the latter had taken in about 671 million dollars under the facilities of the so-called spot-and-forward ceiling.

The Exchange Office either deposited the dollars outright with the banks, or else closed some of the banks' existing swaps, which meant repurchase and simultaneous deposit of part of the dollars sold to the banks for lire under the provisions of November 1959, when banks were authorized to build up their own foreign exchange holdings. These deposits, which bear interest at 3.5 per cent, gradually increased up to a level of 302 million dollars last December; thereafter they rapidly shrunk to about 115 million dollars with the reactivation of the original swaps.

All this led to considerable shifts in the composition of the overall monetary movements connected with the balance of payments, as shown in Table 8.

TABLE 8

Monetary Movements (Details to Table 4)

(million dollars)

Movements reflected in the balance sheets of the	1960	1961
a) Bank of Italy:		
Official holdings:		
gold	454.8	21.7
convertible currencies	— 327.6	317.8
Transactions with the IMF	—	175.3
Other official assets abroad	47.1	102.3
Total *a)*	174.3	617.1
b) Banking System:		
Bank assets abroad (net)	268.2	— 39.7
Total *a)* + *b)*	442.5	577.4

The differences between 1960 and 1961 are obvious. It will be seen that in the earlier year the monetary authorities had relied heavily on the banking system to finance the addition to currency reserves, thereby tightening the banks' lire liquidity. In 1961, by contrast, the central bank alone financed the balance-of-payments surplus. Furthermore, by paying with lire for the repurchase of foreign exchange previously sold against lire and then depositing the foreign exchange with the banking system, the central bank restored the banks' lire liquidity without detriment to their foreign exchange position *vis-à-vis* other countries.

Since September 1960, when Italian banks were authorized to finance short-term operations for non-residents, foreign exchange assets in the form of discounted bills and other commercial instruments have been growing and have enabled Italian banks to engage in some fairly large-scale operations on foreign money markets.

Dollar credits to Italian clients increased again last year, but at a much slower rate than in 1960. Sterling credits of the same kind expanded somewhat until August and then returned to their original level when the rate of interest went up, but concurrently Swiss franc credits, which in any case expanded more than dollar credits, were taken up in conspicuously larger amounts.

The Italian banks' forward transactions developed strongly last year in response to more active foreign business combined with arbitrage over third currencies. However, no increase took place in forward liabilities towards foreign countries (see Table 9), in so far as the banks were able to draw still further on spot-and-forward facilities. This became important after the Federal Reserve Bank of New York, acting for the U.S. Treasury, undertook in January 1962 to take over, within certain limits, the Exchange Office's forward dollar repurchasing commitments to the Italian banking system.

This gave more manoeuvring freedom to the Italian Exchange Office and enabled it to sell yet more spot dollars to the banks, still with an undertaking to repurchase at par. By March of this year, 782 million dollars had been taken up by the banks inder these spot-and-forward facilities. Now, these operations deplete official foreign currency reserves, raise the proportion of gold in official reserves and enable banks to extend more foreign exchange credit to their clients and to improve their foreign position; the cost to the banks equals the forgone yield on alternative lire assets and their international effect is to stop the flow of hot money from the United States, or for that matter from other European countries, to Italy. It follows that

TABLE 9

Forward Commitments of Italian Banks

(end-month figures in million dollars)

Items	1959 Dec.	1960 June	1960 Dec.	1961 June	1961 Dec.	1962 March
Forward claims						
— with foreign counterpart	390.7	414.2	331.6	498.3	454.0	596.3
— with domestic counterpart	2.7	1.1	5.9	5.8	3.3	1.9
Total . . .	393.4	415.3	337.5	504.1	457.3	598.2
Forward liabilities						
— with foreign counterpart	426.5	473.0	387.5	543.9	470.7	635.6
— with domestic counterpart	15.6	41.6	13.5	11.0	11.0	12.6
Total . . .	442.1	514.6	401.0	554.9	481.7	648.2
Net forward liabilities						
— with foreign counterpart	— 35.8	— 58.8	— 55.9	— 45.6	— 16.7	— 39.3
— with domestic counterpart	— 12.9	— 40.5	— 7.6	— 5.2	— 7.7	— 10.7
Total . . .	— 48.7	— 99.3	— 63.5	— 50.8	— 24.4	— 50.0

the measures taken to curb the quest for dollar credits abroad at the same time help to ease pressure on the U.S. gold stock.

Non-residents were given full discretion early this year to transfer their lire at will between ordinary and capital non-resident accounts. This has meant the disappearance of the lira's dual exchange rate and of the special bank note market, which existed for five years side by side with the ordinary foreign exchange market. The only disability suffered by bank notes now is that the banks make a small charge for transfer costs and loss of interest between the date of purchase and the date of the credit entry with the foreign correspondent.

There is now only one exchange rate for non-resident capital and ordinary accounts, foreign exchange accounts and bank notes, and the Italian Exchange Office has kept this single rate within the limits of 620.50 and 629.50 lire to the U.S. dollar, the former official limits for the ordinary foreign exchange market.

The measures so far described were not the only ones the Italian monetary autorities took to mitigate the adverse effects of the balance-of-payments surplus on international liquidity. Italy played a constructive part also in all the relevant international agreements and arrangements.

Thus at the monthly B.I.S. meeting in March 1961, representatives of the Bank of Italy joined with those of other central banks in the Basle agreement to counteract the harmful effects of speculative short-term capital movements, which at that time put sterling under severe pressure.

However, Italy's credits to the United Kingdom were on the whole temporary only, since they were soon replaced by I.M.F. credits on the basis of facilities accorded to the Fund in August 1961 by nine countries, including Italy. The total involved on this occasion, it will be remembered, was the equivalent of 1,500 million dollars, of which the equivalent of 120 million dollars was in Italian lire.

Nor was the United Kingdom the only country to borrow lire through the International Monetary Fund; many others did the same, so that in the course of the whole year the lire quota was drawn on to the extent of 175 million dollars.

Apart from stand-by credits at guaranteed rates, as agreed at Basle by central banks, new methods of open and systematic official intervention on foreign exchange markets were applied, especially in the United States. The U.S. Treasury's operations were essentially designed to protect the dollar against bear speculation through acting on the differential between the spot and forward rates.

V. *Government Finance*

As in 1960, only much more so, the various aspects of public finance showed a rather mixed appearance last year.

The deficit in the administrative budget seems to be settling down at a level which involves new government borrowing of some 400-500 billion lire (see Table 10). At any rate, figures of this magnitude are found not only in the outturn for 1960/61, but also in the provisional and supplementary estimates for the current year and for 1962/63.

TABLE 10

Budget Position for the Fiscal Years 1960/61, 1961/62 and 1962/63

(administrative budget; billion lire)

Items	1960/61 Initial estimates	1960/61 Subsequent variations	1960/61 Final results (1)	1961/62 Initial estimates	1962/63 Initial estimates
Current Section:					
Revenue	3,647	306	3,953	4,050	4,482
Expenditure	3,942	414	4,356	4,335	4,761
Surplus or deficit (—)	— 295	— 108	— 403	— 285	— 279
Capital Movements:					
Revenue:					
a) Issue of securities	—	264	264	—	—
b) Issues for various indemnities (2)	5	— 1	4	3	3
c) Issue of Treasury coin	—	14	14	—	—
d) Balancing items	12	—	12	16	11
e) Withdrawals from the 1966 Treasury Bonds Special Fund	—	6	6	—	—
f) Other	44	11	55	46	23
	61	294	355	65	37
Expenditure:					
a) Repayment of public debt (3)	203	— 4	199	361	267
b) Balancing items	12	—	12	16	11
c) Allocations to 1966 Treasury Bonds Special Fund	—	1	1	—	—
d) Other (4)	124	— 12	112	138	133
	339	— 15	324	515	411
Surplus or deficit (—)	— 278	309	31	— 450	— 374
Overall results:					
Revenue	3,708	600	4,308	4,115	4,519
Expenditure	4,281	399	4,680	4,850	5,172
Overall surplus or deficit (—)	— 573	201	— 372	— 735	— 653
Net result of public debt operations (5)	— 198	286	88	— 358	— 264
Net surplus or deficit (—)	— 375	— 85	— 460	— 377	— 389

(1) Provisional figures.
(2) Mainly compensation for confiscation of Italian property abroad.
(3) Including the withdrawal of Treasury currency, payments into the Amortisation Fund for Treasury Bonds and Green Plan bonds repayments.
(4) Comprising, in particular, new credits and equity subscriptions.
(5) Including, for 1960/61, transactions connected with the 1966 Treasury Bonds Special Fund.

This suggest that larger deficits have come to stay, after the relatively modest 200-billion levels of 1957-59. There was, it will be recalled, a big jump in 1959/60, largely as a result of additional appropriations for extraordinary economic expenditure. Since then, public investment expenditure has consistently been very high—not, in fact, far short of 1,000 billion lire (see Table 11)—so that the overall deficit, swelled also by growing current government spending, does not seem to be retreating from its 1959/60 level.

TABLE 11

Government Finance

(administrative budget; billion lire)

Fiscal years (a)	Net revenue (b)	Net expenditure (b)	Ratio of revenue to expenditure (per cent)	Net deficit			Public investment	Surplus of investment over deficit
				Current section	Capital movements	Total		
1	2	3	4=2 : 3	5	6	7=5+6=2—3	8	9=7+8
1958/59	3,292	3,466	*95.0*	— 124	— 50	— 174	624	450
1959/60	3,728	4,152	*89.8*	— 337	— 87	— 424	972	548
1960/61	4,008	4,468	*89.7*	— 403	— 57	— 460	966	506
1961/62	4,096	4,473	*91.6*	— 285	— 92	— 377	892	515
1962/63	4,505	4,894	*92.1*	— 279	— 100	— 389	933	544

(*a*) The figures for 1958/59 are in the course of being audited by the Court of Accounts; the figures for 1959/60 and 1960/61 are provisional, those for 1961/62 and 1962/63 are initial estimates.
(*b*) Current items plus the « other » capital items shown in Table 10.

The cash budget, on the other hand, was easily as favourable last year as in 1960. As a result, Treasury deposits with the Bank of Italy have been growing steadily, which indicates a real improvement in the Treasury's cash position to the extent that additional deposits do not represent proceeds from new government borrowing.

Considering only Treasury operations proper (in figures comparable to those of the administrative budget, as mentioned above), the cash deficit dropped further last year from its already fairly modest level of around 70 billion lire to a mere 30 odd billion (see Table 12).

TABLE 12

Treasury Cash Requirements and their Coverage

(billion lire)

Items	1960		1961	
	(Calendar years)			
Overall cash requirements				
1. Budget receipts *(a)*	3,786		4,052	
2. Budget payments *(a)*	3,892		4,189	
3. *Budget deficit* (1 — 2)		— 106		— 137
Treasury operations *(b)*:				
4. Current account with the Bank of Italy *(c)*	20		110	
5. Sundry transactions with the Bank of Italy *(d)*	15		— 7	
		35		103
6. *Adjusted cash deficit* (3 + 4 + 5)		— 71		— 34
Operations by Central Post Office Savings Fund and autonomous government agencies *(e)*:				
7. Loans and investments by the Central Post Office Savings Fund	— 226		— 268	
8. Expenditure by autonomous agencies of funds raised directly on the market *(f)*	— 35		— 31	
		— 261		— 299
9. *Overall cash requirements* (6 + 7 + 8)		— 332		— 333
Coverage of overall cash requirements				
10. *Foreign borrowing (g)*		— 11		— 12
Domestic borrowing:				
Medium- and long-term debts with:				
11. Bank of Italy *(h)*	6		21	
of which: government stock concerning Italian Exchange Office	*13*		*13*	
12. Other banks	— 15		63	
13. Private investors	196		76	
		187		160
of which: government stock sold on the market		*131*		*112*
Post Office Savings:				
14. Savings certificates	150		181	
15. Savings books	47		62	
16. Current accounts	14		29	
		211		272
Treasury Bills:				
17. Bank of Italy	— 104		— 25	
of which: compulsory bank reserves invested in Treasury Bills	— *108*		— *20*	
18. Other banks	48		92	
of which: bank reserves directly invested in Treasury Bills	*392*		*187*	
19. Private investors	— 3		5	
		— 59		72
Current accounts and other short-term debts with:				
20. Bank of Italy	— 32		— 159	
21. Other banks	11		— 8	
22. Private investors	9		— 2	
		— 12		— 169
23. Net new issue of Treasury coin		16		10
24. *Total borrowing* (10 to 23)		332		333
of which: short-term borrowing from domestic banking system:				
25. Bank of Italy (11 + 17 + 20)	— 130		— 163	
26. Other banks (18 + 21)	59		84	
		— 71		— 79
27. Other short-term borrowing (15 + 16 + 19 + 22 + 23)		83		104
28. Total recourse to money market (25 + 26 + 27)		12		25
29. Recourse to capital market (12 + 13 + 14)		331		320
30. *Total internal borrowing* (28 + 29)		343		345
31. (Bank of Italy's stockpiling bills)		*10*		*44*
32. (Bank reserves in cash)		— *99*		*104*

(a) Excluding public debt operations and 1966 Treasury Bonds Special Fund. — *(b)* Receipts (+) and payments (—): excluding public debt operations. — *(c)* Including *a* few adjustment items. — *(d)* Miscellaneous services on account of government, miscellaneous creditors and current account with the Italian Exchange Office to the extent that the Treasury is concerned. — *(e)* Net payments (—). — *(f)* State railways and National Road Agency. — *(g)* Proceeds of « surplus » and railway loans net of budgetary foreign debt redemption. — *(h)* Including Treasury bonds for extinction of debts with the Italian Exchange Office.

Adding to this loans and investments by the Central Post Office Savings Fund and debt-financed expenditure by autonomous government agencies, overall cash requirements worked out in both years at around 330 billion lire—though last year without the special benefit of the 1960 gold revaluation proceeds in the amount of 63 billion. This is in striking contrast with the years 1958 and 1959, when public expenditure of an economic nature was a good deal lower and yet the annual overall cash deficit was in the neighbourhood of 500 billion.

The divergence between the situation in the administrative and the cash budget is explained by the intervening changes in budgetary arrears. The balance of disbursments due over receipts due increased last year by some 395 billion lire, as against only 76 billion in 1960—when, however, the figure was depressed by some considerable rearrangement in the accounts. Nevertheless, even the 1960 figure fits in with the reversal of the previous tendency for the relevant balance to fall; the change began in 1959/60 and was sharply accentuated last year.

It should perhaps be made clear that the more than 2,300 billion lire of arrear payments due at the end of June 1961 were in large part for items not admittable to immediate disbursement for administrative reasons or else were offset by receipts due or disbursements already made. For this reason the potential incidence of payments arrears on the actual cash position is rather overstated by the above figures.

The government has lately been committing itself with growing frequency to large-scale expenditure to be spread over several years. The method of spreading expenditure in this manner is often conditioned by the nature of the projects to be financed and sometimes by the mere size of the overall amounts involved, but it has also had the advantage of enabling the government to repay some huge outstanding debts (for instance, to the Social Insurance Fund) and to put in hand the solution of some long-standing problems of great social and economic importance.

The major part of expenditure for projects of this kind takes the form of public investment. Given its growing importance, it has been thought right to set out, in Table 13, the details of the principal programmes decided upon since 1959—which means, in effect, roughly when the initial budget estimates for the last financial year were under preparation.

TABLE 13

The Principal Long-term Public Investment Programmes

Project	Duration (years)	Initial year	Public expenditure involved (billion lire) (1)	Chief source of finance	Estimated total investment (billion lire) (2)
Rural housing	10	1961/62	200	20-year loans from Credit Consortium for Public Works	200
Green Plan	5	1960/61	(3) 550		1,280
Schools Plan (4)	5	1960/61	(5) 661	Budget revenue	(6) 291
National Road Plan . . .	10	1961/62	(7) 478	Budget revenue and loans	1,150
Extension of telephone network	7	1961/62	100	Loans from Central Post Office Savings Fund . .	100
Flood and erosion control	5	1961/62	(8) 127	Budget revenue	127
Sardinian Recovery Plan	15	1960/61	395	Budget revenue	535
Railway Plan	10	1962/63	(9) 1,500	Miscellaneous loans	1,500
Workers' housing	10	1963/64	200	Budget revenue	1,000
Aid to mountain districts	5	1962/63	(10) 71	Budget revenue	71
		Total	4,282	Total	6,254

(1) Expenditure to be incurred by the government or autonomous government agencies for the period of duration, excluding the cost of debt service, if any.
(2) Direct and induced.
(3) Subsequent annual government expenditure will bring the total to 730 billion.
(4) As originally approved by the Senate, subject to later amendments.
(5) Including personnel costs.
(6) Cost of construction and equipment only.
(7) Subsequent annual government expenditure will bring the total to 1,163 billion.
(8) A 30-year general programme approved in 1959/60 involves overall expenditure of about 1,700 billion.
(9) 800 billion have already been appropriated for the first five years.
(10) Subsequent annual government expenditure will bring the total to 78 billion.

It will be seen that altogether these programmes commit the government and autonomous government agencies to a total expenditure of more than 4,000 billion lire between the beginning of the financial year 1960/61 and the end of 1974/75, involving mounting annual expenditures until 1964/65 and a gradual falling off later. Adding private investment induced by government contributions (which in turn are spread over several years), the total investment figure is well in excess of 6,000 billion lire, the chief beneficiaries being agriculture, transport (roads and railways) and building (housing and schools).

VI. *The Capital Market*

In 1959 and 1960, it will be recalled, the progressive liberalization of capital movements and the consequent adjustment of Italian interest rates to those prevailing in major financial centres abroad gave strong new impetus to the domestic capital market. There was lively activity on the stock exchange, prices were high especially in the equity section, yields diminished and large new bond and share issues were floated.

After the break late in 1960 more calm returned to the market and remained the dominant feature throughout 1961. Even so, the Italian stock market kept up a fairly high rate of expansion in comparison with the general tendencies to stagnation, not to say slight decline, in other European markets.

In the equity section the upward thrust became weaker and weaker last year until it finally spent itself in June, when there was a change in direction and prices generally retreated through a succession of alternating falls and rallies. At the end of the year, however, the average monthly index of share prices was still 8.6 per cent higher than in December 1960 (see Chart 7).

The pattern of price movements was not much different in the fixed interest security section. The strong rise of 1958 gave way to a gentler upward movement in June 1959, which was eventually reversed in October 1960. The decline did not last long, for in February 1961 bond prices reached a peak unequalled since 1953; subsequently, however, a renewed slight, but persistent, retreat of bond prices brought the average December index back to its level of a year ago.

Government securities did better than most, in so far as they rose steadily and continuously over the whole of the two years, with the exception only of the brief period between October 1960 and January 1961.

While the cost of market funds had been going down generally until 1960, it continued to do so last year only in the equity section (where average yields of 2.44 per cent compared with

CHART 7

Indices of stock exchange prices
(1953 = 100; semilogarithmic scale)

2.63 per cent in 1960) and for government stock (4.98 against 5.24 per cent in 1960); other bond yields tended to reverse course (see Chart 8).

Again, the capital market responded readily to high investment demand. Having almost doubled their claims on the market in 1960 with respect to the preceding year, companies last year maintained their bond and share issues at the new high level; the amounts involved during the last two years were almost identical, namely, 1,166 billion lire in 1961 and 1,160 in 1960. A relatively smaller proportion of the total was raised by equity issues last year, which amounted to 417 billion as against 496 billion in 1960; the proportion of bonds rose correspondingly from 664 to 749 billion lire.

The government directly or indirectly raised only 135 billion lire on the market last year, as against 162 billion in 1960.

CHART 8

Security yields
(per cent per annum)

Consequently, the total funds supplied by the capital market were much the same during the two years, showing a slight contraction from 1,322 to 1,301 billion lire (see Table 14).

Special credit institutes stepped up their new issues by a quarter from 412 to 514 billion lire last year, and among them the institutes concerned with building credit raised the conspicuous amount of 230 billion, nearly twice as much as the year before.

In their turn, I.R.I. and E.N.I. also nearly doubled their demands on the market; between them they raised 115 billion, but I.R.I. alone was responsible for the year's increment.

After an absence of many years foreign issues reappeared in 1961 on the Italian capital market. First on the spot was the International Bank for Reconstruction and Development with a bond issue of 15 billion lire, and in the early months of this year there followed bond issues of like amount by the European Investment Bank and the Inter-American Development Bank.

Table 14

New Security Issues (1)

(billion lire)

Types of security	1960			1961		
	Private investors and companies (2)	Banks (3)	Total	Private investors and companies (2)	Banks (3)	Total
Bonds:						
Industrial credit institutes	156.5	119.2	275.7	187.1	96.8	283.9
Other special credit institutes	68.6	67.8	136.4	166.6	63.5	230.1
IRI	13.5	− 0.4	13.1	60.3	9.2	69.5
ENI	20.3	26.0	46.3	34.7	11.2	45.9
Business companies	168.1	24.3	192.4	101.3	− 7.9	93.4
International credit institutions	—	—	—	3.4	11.6	15.0
Local authorities	− 0.2	− 0.1	− 0.3	11.5	—	11.5
Total bonds	426.8	236.8	663.6	564.9	184.4	749.3
Shares:			559.2			530.7
less Duplicated items			63.5			113.9
Total shares (net)	495.7	—	495.7	416.8	—	416.8
Total bonds and shares	922.5	236.8	1,159.3	981.7	184.4	1,166.1
Government securities:						
Bonds issued for Treasury account	35.9	3.5	39.4	77.8	65.4	143.2
Government stock	135.0	− 12.1	122.9	− 16.6	8.7	− 7.9
Total	170.9	− 8.6	162.3	61.2	74.1	135.3
Grand total	1,093.4	228.2	1,321.6	1,042.9	258.5	1,301.4

(1) Actual proceeds, net of redemption.
(2) Including insurance companies and social insurance funds.
(3) Including the Central Post-Office Savings Fund.

Structural Aspects.— Looking at the structural evolution of the Italian capital market over the last ten years or so, as shown in Table 15, it will be seen that, starting from an annual amount of around 300 billion lire in 1950 and 1951, security issues passed through stages of about 500 billion in 1953 and

1954 and 650 billion in 1958, to climb rapidly during the last two years to record levels of more than 1,300 billion annually.

The expansion is seen to be continuous, with the exception only of 1956 and 1957, when there was a cyclical retreat from already fairly high levels. The ratio of new issues to gross national income simultaneously went up from a three-year average of 3.4 per cent in 1950-52 to one of 6.2 per cent in 1959-61. It should be noted, however, that the rapid increase of the ratio, especially during the earlier years, was no doubt due to the reconstitution of financial assets after their drastic curtailment through devaluation during and after the war. In its turn, the ratio between new issues and gross fixed investment started out at around 20 per cent at the beginning of the period, touched a peak of 30 per cent in 1960, and dropped again to 25.7 per cent in 1961.

No spectacular changes occurred during the eleven-year period under consideration in the relative proportions of fixed-inteerst and other securities. With the exception of 1950 and 1952, when less than 20 per cent of all new issues were shares, equity issues accounted for between 24 and 37 per cent of the total; the average proportion of around 30 per cent has, if anything, shown a slight tendency to increase since 1959.

Within fixed-interest bearing securities, however, government has been taking up less and less of the total. Until 1956, government issues accounted for between 30 and 52 per cent of total new issues; since then, the proportion has been much smaller or, indeed, less than zero in 1958 and 1961. By contrast, bond issues by special credit institutes and business companies have been expanding strongly, if somewhat jerkily from year to year; starting with a share of 26 per cent in total new issues in 1950, they accounted for 58 per cent last year. The share of special credit institutes in total security issues fluctuated widely between a minimum of 11 per cent in 1957 and a maximum of 45 per cent in 1952.

As regards the source of investable funds for all these issues, the banking system has, over the last five years, been taking in around one fifth of total issues. The banks habitually

TABLE 15

New Security Issues, 1950 to 1961

Type of security	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
	Absolute figures in billion lire											
Government stock	174.9	113.6	119.7	184.8	213.2	216.4	180.6	88.6	− 9.1	287.7	122.9	− 7.9
Bonds issued for Treasury account .	20.3	0.3	36.3	35.9	− 3.9	71.0	− 5.4	− 6.5	− 7.2	51.0	39.4	143.2
Other bonds	87.9	56.1	163.7	158.3	127.6	159.5	196.5	241.3	438.7	380.5	663.6	749.3
Total bonds . . .	108.2	56.4	200.0	194.2	123.7	230.5	191.1	234.8	431.5	431.5	703.0	892.5
Shares	53.0	77.4	75.7	136.6	145.1	144.2	180.9	168.1	222.3	225.0	495.7	416.8
Total securities . . .	336.1	247.4	395.4	515.6	482.0	591.1	552.6	491.5	644.7	944.2	1,321.6	1,301.4
	Ratio of total new issues to:											
Gross fixed investment	*22.0*	*13.3*	*18.8*	*22.9*	*19.6*	*21.5*	*18.1*	*14.3*	*18.5*	*24.9*	*30.0*	*25.7*
Gross national income	*3.9*	*2.5*	*3.8*	*4.6*	*4.0*	*4.5*	*3.9*	*3.2*	*4.0*	*5.4*	*6.9*	*6.2*

TABLE 16

Ownership of Securities, 1949 to 1961

Items	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
	End-year figures in billion lire												
Owned by banks (1):													
Government stock (2)	124	207	252	322	406	491	591	816	853	854	986	974	1,055
Other bonds (3)	113	162	179	286	347	357	422	349	378	497	645	883	1,070
Total . . .	237	369	431	608	753	848	1,013	1,165	1,231	1,351	1,631	1,857	2,125
Total securities outstanding:													
Government stock (2)	465	681	782	962	1,198	1,432	1,750	1,951	2,058	2,067	2,425	2,613	2,768
Other bonds (3)	321	401	459	646	818	995	1,183	1,424	1,686	2,161	2,559	3,248	4,011
Total fixed-interest securities	786	1,082	1,241	1,608	2,016	2,427	2,933	3,375	3,744	4,228	4,984	5,861	6,779
Shares (4)	1,140	1,270	1,540	2,530	2,420	3,330	4,410	4,840	5,490	6,220	10,740	14,290	16,350
Grand total . . .	1,926	2,352	2,781	4,138	4,436	5,757	7,343	8,215	9,234	10,448	15,724	20,151	23,129
	Ratio of bank holdings to:												
Total of fixed-interest securities . . .	*30.2*	*34.1*	*34.7*	*37.8*	*37.4*	*34.9*	*34.5*	*34.5*	*32.9*	*32.0*	*32.7*	*31.7*	*31.3*
Total securities	*12.3*	*15.7*	*15.5*	*14.7*	*17.0*	*14.7*	*13.8*	*14.2*	*13.3*	*12.9*	*10.4*	*9.2*	*9.2*

(1) Including the Central Post Office Savings Fund.
(2) Including railway and agricultural bonds.
(3) Including World Bank bonds.
(4) Valued at market price, net of duplications through exchange of shares in interlocking companies (estimated at 20 per cent).

buy government stock and the bonds of special credit institutes; in periods of normal liquidity, they maintain a certain ratio between such investment and their loans, though when they are excessively liquid they often put into securities such monies as they cannot use elsewhere. Because they are forbidden by law to hold equity investments, the banks in this latter case only act on behalf of their clients, to whom, however, they may extend credit to meet outstanding commitments.

To sum up, the total of securities in circulation at the end of 1949 was made up of 24 per cent government stock, 17 per cent other bonds and 59 per cent shares (see Table 16). In the twelve years that followed, the composition changed considerably. By the end of 1961 government stock accounted for only 12 per cent of the total of securities outstanding, other bonds for 17 per cent as before, and shares for 71 per cent.

However, since shares are valued at market price, the figures take account not only of new equity issues, but also of self-financing through retained profits and of the companies' profit outlook. Of a total amount of 16,350 billion lire of equity issues outstanding at the end of 1961, about 45 per cent represent issues already existing at the beginning of the period under consideration and the remaining 55 per cent new equity issues during the twelve years; furthermore, actual cash subscriptions during these twelve years account for only 14 per cent of the shares' total value.

The great bulk of securities (more than 90 per cent at the end of 1961) is owned by private investors and companies, but banks (1) hold a persistent 30 per cent or so of fixed-interest securities. Of 6,779 billion fixed-interest securities outstanding at the end of 1961, the banks owned 2,125 billion; this corresponds to 31 per cent of the total, a proportion which is almost identical with that of 1949 and not far from the average over the whole period.

Institutional investors—that is, in Italy, exclusively insurance companies and social insurance funds—are seen to be re-

(1) Including the Bank of Italy, commercial and savings banks, special credit institutes and the Central Post Office Savings Fund.

latively unimportant in this context; with actuarial reserves of 1,332 billion lire at the end of 1960, they owned only 338 billion's worth of securities.

The banks' investment portfolios equalled about 14 per cent of their deposits at the end of 1961, a ratio which has remained fairly stable since 1953. Commercial banks habitually maintain a lower ratio of around 8 per cent, and savings banks and special credit institutes a higher one, which recently was around 33 per cent.

The Operations of Medium- and Long-term Credit Institutes.— With large private investment programmes and public works in progress, there was much demand for the types of medium- and long-term credit which special credit institutes provide.

To finance their growing activity, the institutes raised an additional amount of 987 billion lire in new funds last year, bringing their total to 5,055 billion (see Table 17). Conspicuous as the growth of the institutes' resources was in 1960, at 18.2 per cent, they easily beat their own record last year with an expansion of 24.3 per cent.

Again the bulk of the new finance for this credit sector was supplied through the typical sources of bonds, time deposits and interest-bearing certificates, which together provided more than three quarters of the total and 29.9 per cent more than the year before. The sums so raised amounted to 762 billion lire last year (as against 515 in 1960) and the rapid growth of resources of this kind is to be regarded as welcome progress towards making this credit sector self-supporting. Naturally, the institutes' ability to finance their activities through bond issues depends closely upon the financial capacity of the capital market.

In 1960, 54 per cent, or 470 out of 877 billion lire of total bond issues, were floated by special credit institutes; in 1961 the percentage rose to 75, and the amounts involved were 685 out of a total of 917 billion. There was a corresponding drop

TABLE 17

The Special Credit Institutes' Funds by Sources

(end-year figures, in billion lire)

Sources of funds	Institutes for: Industrial credit 1960	Industrial credit 1961	Land and building credit 1960	Land and building credit 1961	Agricultural credit 1960	Agricultural credit 1961	Total 1960	Total 1961
Bonds: issued for Treasury account	269.9	417.4	—	—	—	—	269.9	417.4
Bonds: others	1,295.3	1,591.3	676.3	916.1	62.6	64.2	2,034.2	2,571.6
Deposits and certificates	245.3	322.1	—	—	—	—	245.3	322.1
Rediscounts	—	—	—	—	211.1	238.8	211.1	238.8
Current accounts with banks	67.8	125.9	4.3	8.3	148.4	160.3	220.5	294.5
Current accounts with parent agencies	—	—	—	—	95.7	109.0	95.7	109.0
Government funds: Mediocredito	93.0	107.7	—	—	—	—	93.0	107.7
Government funds: other lire funds (1)	191.3	208.5	48.3	53.2	122.4	129.8	362.0	391.5
Government funds: foreign currency funds	122.5	105.0	—	—	—	—	122.5	105.0
Loans in foreign currencies	176.4	208.9	—	—	—	—	176.4	208.9
Capital and reserves	155.3	175.6	25.1	43.5	23.6	30.4	204.0	249.5
Miscellaneous	11.4	21.4	—	—	21.9	17.9	33.3	39.3
Total	2,628.2	3,283.8	754.0	1,021.1	685.7	750.4	4,067.9	5,055.3

(1) Including funds supplied by Regional Governments and by the *Cassa per il Mezzogiorno* from its own resources, but excluding direct medium- and long-term loans by the *Cassa* from its own resources (4.5 billion at the end of 1961) and from IBRD and European Investment Bank loans (70.2 billion).

from 22 to 10 per cent of the total in the bond and debenture issues of industrial companies, and the government, which had taken up 17 per cent of the total in 1960, made practically no direct claims on the market at all last year. Instead, part of the government's investment expenditure was financed through the Credit Consortium for Public Works, which placed 148 billion of its own bonds (40 billion in 1960); of these 118 were earmarked for public investment connected with the Green Plan and 30 billion for railway modernization.

This year the Treasury is to rely even more heavily on the special credit institutes for the finance of public investment. There is to be an issue for the first *tranche* of the loan for the recently approved ten-year railway modernization plan, in addition to the 20-billion bond issue for rural housing and the 114-billion second *tranche* of Green Plan bonds already floated early in 1962. However, the latter actually required only 10 billion lire of new money from the market, in so far as the rest of the issue was financed through the conversion of maturing Nine-year Treasury bonds.

Another development worth mentioning is that the amount of overdrafts conceded to special credit institutes by the commercial banking system increased by 87 billion lire last year as against only 18 billion in 1960. This is, of course, a reflection of the institutes' growing need of resources, but is important from the point of view of the general interrelations between ordinary and longer-term credit.

In 1961 nearly one third of the special credit institutes' new funds came from the banks, that is, the ordinary credit sector, in some form or another; more precisely, the banks furnished 315 billion lire (208 in 1960)—the bulk of them through bond purchases (201 billion against 169 in 1960), 87 billion through overdrafts, as mentioned, and the relatively small residual through capital subscriptions.

In their turn, the special credit institutes' operations expanded faster than ever before in 1961, witness the increase of 24.3 per cent, or 915 billion lire, in loans oustanding to a total of 4,678 billion lire at the end of the year; in 1960 the corresponding increments had been 19.7 per cent and 619 billion lire. More than two thirds of the new loans were granted during the second half of the year (see Table 18).

To assess these developments in their true significance, it must be remembered that last year's expansion started out from high levels, in so far as the growth of fixed investment in 1960 had already greatly accelerated and widened the scope of the institutes' activities. Since the end of 1957, the amount of loans outstanding has nearly doubled, and of the total increment of 2,303 billion lire, two thirds are attributable to the last two years alone.

To a large extent the recent rapid growth of medium- and long-term credit operations of this kind is a matter of deliberate policy on the part of the government. Not only has the Treas-

TABLE 18

Special Credit Institutes' Loans and Bonds Outstanding (1)

Type of institute and loan	End-year figures (billion lire)		Yearly increases (per cent)	
	1960	1961	1960	1961
Industrial credit institutes:				
Loans	2,160.2	2,622.6	*22.0*	*21.4*
of which: on special funds	210.1	189.5	*— 4.2*	*— 9.8*
Bonds	1,295.3	1,591.3	*28.2*	*22.9*
Land and building credit institutes:				
Loans	715.9	955.8	*24.8*	*33.5*
Bonds	676.3	916.1	*25.5*	*35.5*
Agricultural credit institutes:				
Land improvement credits	257.5	284.2	*15.3*	*10.4*
Bonds	62.6	64.2	*14.9*	*2.6*
Total:				
Medium- and long-term loans	3,133.6	3,862.6	*22.0*	*23.3*
Bonds	2,034.2	2,571.6	*26.9*	*26.4*
Additional operations:				
Short-term credits to agriculture	367.0	408.0	*3.8*	*11.1*
Operations for Treasury account	262.3	407.5	*17.7*	*55.4*

(1) Excluding loans to Treasury.

ury itself relied more heavily on special credit institutes to raise funds for public investment, but the government has also stimulated the demand for medium- and long-term credit by offering direct subsidies to prospective borrowers in the form of contributions to interest payments.

In these circumstances the medium- and long-term credit sector must clearly be expected to go on expanding vigorously. There is the normal growth of credit demand to consider, as well as the additional demand induced by the system of interest subsidies to medium- and small-scale industry, agriculture, shipping, the hotel and tourist industry and for purposes of southern industrialization generally, and finally also the financial resources needed for the government's own long-term programmes for agriculture, the railways, roads, etc. It seems reasonably certain that the rate of increase of the special credit institutes' lending operations this year will not fall short of last year's, and that in absolute figures the relevant order of magnitude will be that of the second half of 1961—provided, of course, the development is backed by an orderly growth of the capital market, from which the bulk of the necessary resources must be drawn.

VII. *Banking*

On December 31, 1961, there were 1,261 registered banking firms in Italy and between them they had 9,258 bank premises open to the public, as shown in Table 19.

TABLE 19

Banks and Bank Premises

(end-year figures)

Type of banking firm	No. of firms		Bank premises	
	1960	1961	1960	1961
Public-law credit institutes	6	6	1,372	1,382
Banks of national interest	3	3	737	737
Joint stock banks	147	149	2,085	2,099
People's co-operative banks	211	213	1,477	1,498
Limited-liability banks	1	1	1	1
Private banking firms	47	45	116	115
Savings banks	79	79	2,557	2,561
Pawn banks category I	10	10	69	69
Pawn banks category II	8	8	8	8
Rural and artisan savings banks	738	735	757	757
Foreign banks	1	1	1	1
Other banking firms	12	11	31	30
Total	1,263	1,261	9,211	9,258

The Sources of Funds.— At the end of last year, total bank deposits amounted to 11,914 billion lire. The year's increase of 1,738 billion or 17.1 per cent compares with 1,355 billion and 15.4 per cent in 1960 (see Table 20).

Savings deposits contributed rather more to the increment than current accounts, although both expanded. A total of 933 billion lire was newly deposited in savings accounts last year

TABLE 20

Bank and Post-Office Deposits

(end-of-period figures, in billion lire)

Period	Savings deposits: Commercial banks	Savings deposits: Savings banks	Savings books and postal certificates	Total savings deposits, savings books and certificates	Bank current accounts	Total bank deposits
	1	2	3	4=1+2+3	5	6=1+2+5
1959 - December	3,116.0	1,621.9	1,869.3	6,607.2	4,083.7	8,821.6
1960 - March	3,160.6	1,686.9	1,911.6	6,759.1	4,041.4	8,888.9
June	3,230.2	1,720.8	1,925.7	6,876.7	4,205.1	9,156.1
September	3,337.0	1,781.9	1,952.7	7,071.6	4,529.7	9,648.6
December	3,541.9	1,881.9	2,065.5	7,489.3	4,752.7	10,176.5
1961 - March	3,628.4	1,961.3	2,111.8	7,701.5	4,731.7	10,321.4
June	3,717.9	1,999.1	2,135.2	7,852.2	4,899.3	10,616.3
September	3,842.5	2,079.4	2,175.8	8,097.7	5,092.2	11,014.1
December	4,146.2	2,210.2	2,308.7	8,665.1	5,558.0	11,914.4

(686 billion in 1960) and the overall rate of increase was 17.2 per cent (14.5 per cent in 1960), with a marked acceleration in the second half of the year. Time deposits increased more than sight deposits, again especially during the latter half of the year.

All this clearly reflects certain salient aspects of general economic conditions in the last six months of 1961. Savings deposits obviously felt the impact of larger cash receipts in farming circles and, more generally, of a greater capacity to save on the part of a population enjoying growing incomes. These external factors added their effects to the larger banks' own fund-raising activities, which were greatly intensified late last year in view of the growing need for resources and of keen competition from small and, above all, medium-sized banks.

In their turn, current accounts reflected the cash needs of business during the last six months, and especially during the third quarter of the year, when both current production and investment speeded up. To meet these cash needs, firms deposited large amounts with the banking system, more especially in time deposits, which are the favourite repositories of funds raised through equity and bond issues, pending actual investment expenditure.

For some time, deposits at the largest banks have been expanding less fast than in other parts of the banking system and last year's developments strengthened this tendency. The gap widens with the growing size of other banking firms and is largest in the case of savings deposits. Part of the explanation is no doubt that the larger credit institutes can draw to a considerable extent on interbank deposits and foreign exchange funds. Another reason may well be that these banks' own commission business in the placing of security issues diverts some of their clients' money from bank saving into security investment. In the event, deposits at the big banks attracted relatively little new money throughout the first half of last year, though they picked up later and more especially in December.

Minor sources of funds provided altogether 340 billion lire of new bank resources, which compares favourably with a decline of 97 billion in 1960. Individually, the component flows had a mixed aspect. Accounts with the Italian Exchange Office, which had fallen by 3 billion in 1960, increased by 192 billion last year; cashiers' cheques in circulation furnished an additional 65 billion (16 in 1960), recourse to the Bank of Italy 59 billion (32 in 1960), and resident foreign-exchange accounts together with foreign borrowing 54 billion (after a contraction of 151 billion in 1960). On the other hand funds held in trust diminished by 30 billion, after an increase of 8 billion the year before.

Compulsory bank reserves, which of course are determined by the level of deposits, rose by 238 billion lire to a total of 2,237 billion at the end of 1961; of this total, 117 billion were attributable to savings banks (see Table 21). The liquidity-reducing effects of the growth of compulsory reserves were largely offset by operations with the Bank of Italy and the Italian Exchange Office.

On December 31, 1961, total compulsory reserves represented 22.8 per cent of total deposits, or just a little less than the year before. The slight proportionate fall and the divergence from the legal ratio of 25 per cent was due to capital changes which reduce the assessment base and to time lags in the constitution of reserves.

TABLE 21

Compulsory Reserves and Deposits

(billion lire)

Period	Commercial banks					Savings and pawn banks	
	Compulsory reserves			Deposits	Reserve/ deposit ratio	Compulsory reserves (govt. securities) (1)	Deposits
	Cash	Govt. securities	Total				
1959 - December	757.9	853.1	1,611.0	6,989.7	*23.0*	36.4	2,140.1
1960 - March	812.0	839.3	1,651.3	7,157.8	*23.1*	48.6	2,198.1
June	704.8	1,005.2	1,710.0	7,351.0	*23.3*	55.3	2,261.7
September	798.8	986.4	1,785.2	7,799.8	*22.9*	63.7	2,352.2
December	671.0	1,212.5	1,883.5	8,156.1	*23.1*	70.6	2,482.9
1961 - March	777.6	1,150.7	1,928.3	8,226.9	*23.4*	85.0	2,567.4
June	624.7	1,362.2	1,986.9	8,464.8	*23.5*	93.1	2,640.0
September	829.0	1,212.3	2,041.3	8,752.8	*23.3*	155.0	2,759.6
December	768.4	1,351.3	2,119.5	9,313.4	*22.8*	117.4	2,939.4

(1) Only to the extent that they are deposited with the Bank of Italy.

Security Investment.— In spite of the credit expansion and of the strain on bank liquidity, security holdings by banks and banking associations increased by 344 billion lire last year, compared with 264 billion in 1960.

The year's additional increment came almost entirely from commercial bank investment in government stock and in bonds issued for Treasury account; savings banks and savings bank associations added about as much to their portfolios as they did the year before and again replaced maturing government stock, especially Treasury Bills, by bonds of special credit institutes.

Commercial Lending.— The high credit demand connected with expanding current output and fixed investment caused bank assets to grow last year about as fast as the year before, although their rate of growth was neither uniform throughout the twelve months nor equally high for all types of credit institutes.

In line with general business conditions, new bank credit was taken up at a slower rate during the first nine months of the year, only to be drawn on so heavily later as to cancel most of the effects of the earlier slowing-down. Most types of banks actually lent out less new money than the year before, with the conspicuous exception of savings banks and the relevant banking associations, which stepped up their rate of credit expansion.

Bank deposits remaining disposable after the constitution of compulsory reserves were not sufficient to satisfy credit demand, so that the banking system not only had to make inroads into its own liquid funds but to turn in growing measure to the Bank of Italy throughout the year and especially so in December (see Table 22).

At the end of the year, total bank assets amounted to 8,902 billion lire, having risen by 1,492 billion or 20 per cent over twelve months; 166 billion of the increment were in foreign exchange assets.

Table 22

Main Items in the Consolidated Balance Sheet of the Banking System

(quarterly changes, billion lire)

Period	Cash and call money	Compulsory reserves		Government securities (1)	Bonds and shares (1)	Loans (2)		Deposits	Recourse to Bank of Italy (3)	Balance of minor items
		Cash	Securities			short-term	medium- and long-term			
1960 - 1st quarter	−48.5	54.1	−13.8	49.7	4.4	56.3	5.5	9.5	−1.3	99.5
2nd quarter	8.4	−107.2	165.9	−169.6	75.3	246.3	12.3	203.5	18.7	9.2
3rd quarter	0.2	94.0	−18.8	54.5	47.2	246.2	4.1	402.1	2.9	22.4
4th quarter	67.1	−127.8	226.1	−206.7	−65.7	495.2	8.8	397.6	−4.7	4.1
Total	27.2	−86.9	359.4	−272.1	61.2	1,044.0	30.7	1,012.7	15.6	135.2
1961 - 1st quarter	−77.6	106.6	−61.8	115.9	0.4	69.7	8.4	60.2	10.2	91.2
2nd quarter	5.5	−152.9	211.5	−183.3	52.7	234.3	2.7	222.2	33.2	−84.9
3rd quarter	−10.9	204.3	−149.9	176.5	−7.4	214.0	7.2	278.3	45.1	110.4
4th quarter	66.8	60.6	138.8	−94.9	26.6	595.5	16.2	720.7	148.9	−181.2
Total	−16.2	97.4	138.6	14.2	72.3	1,113.5	34.5	1,281.4	237.4	−64.5

(1) Excluding compulsory reserves.

(2) Including loans in foreign currencies and loans to foreign customers, but excluding parent banks' shareholding in affiliated special credit sections and current advances to them.

(3) Including loans granted by the Italian Exchange Office.

In relative terms, the increase was larger in the case of foreign currency assets which, besides representing credits for foreign trade movements, also to some extent are substitutes for lire credits. This type of business has been expanding sharply over the last few years and must be expected to continue to do so; it has a steadying influence on the Italian money market and tends to level out the interest cost of credits obtainable alternatively at home or abroad. The first to benefit from this development were firms which have access to international markets, but, directly or indirectly, the effects ultimately spread to all users of bank credit.

Overdrafts on current account are not only the most widespread form of bank credit, but also the most sensitive to cyclical influences; of a total 1961 increment of 848 billion lire (more than 200 billion in excess of the 1960 increment), 500 billion alone are attributable to the last quarter of the year.

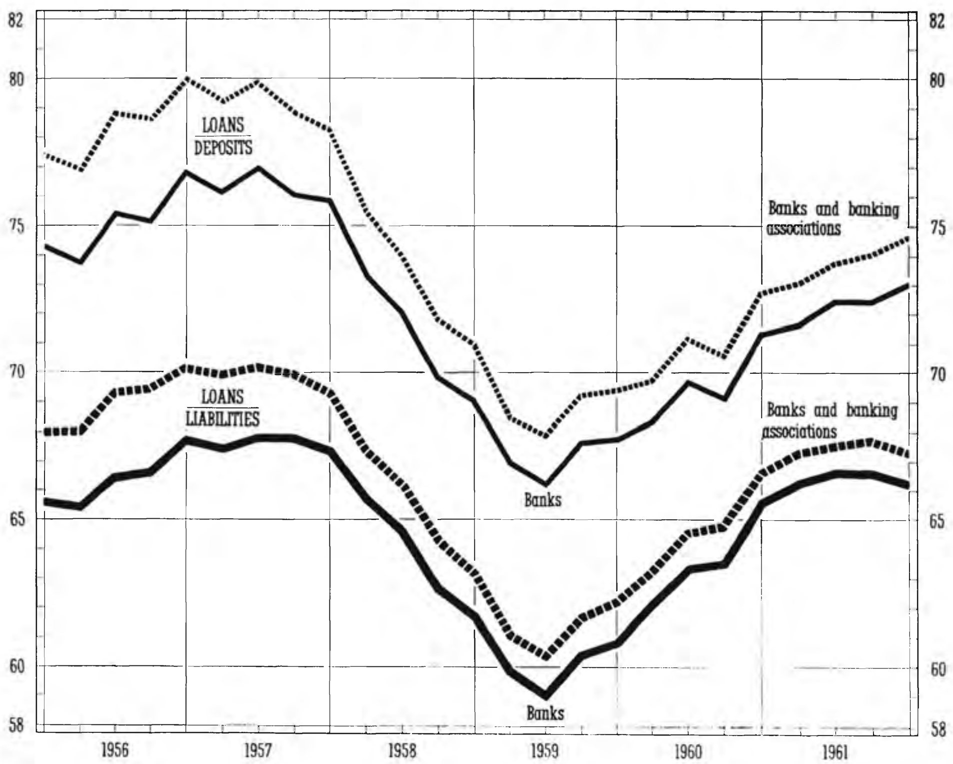
Second in quantitative importance are bill discounts; these expanded rather less, no doubt partly because of the incidence of fiscal charges on bills. The banking system's bill portfolio expanded by 337 billion lire in 1961, as against 390 billion the year before.

Medium- and long-term credits, which absorbed 7,1 per cent of total bank deposits and mainly took the form of savings bank loans to government agencies and the low-cost housing sector, expanded more than the year before (by 128 as against 98 billion lire) but less than short-terms assets.

The loan/deposit and the loan/liability ratios continued at an accelerated pace along the uninterrupted upward path on which they have been moving since the middle of 1959, thus providing yet further proof of the strain on bank liquidity evidenced by the scarcity of loanable funds.

In the event, the banks' loan/deposit ratio rose during the year from 71.3 to 73 per cent; the loan/liability ratio, which takes account not only of deposits but also of minor loanable funds like cashiers' cheques in circulation, trust funds, recourse to the Bank of Italy, credits from the Italian Exchange Office, resident foreign exchange accounts and the banks' net foreign indebtedness, was lower but still climbed from 65.5 to 66.1 per cent (see Chart 9).

CHART 9



Percentage ratio of bank loans to deposits and to total liabilities

Bank Liquidity. With assets rising more quickly than deposits, things were far from easy for the banks last year.

The excess liquidities which had been built up between September 1957 and June 1959 were nearing exhaustion and by June last year the situation had become very tight indeed. Thereafter greater recourse to the Bank of Italy (directly or through the Italian Exchange Office) eased the position, and although the banking system was less liquid at the end of the year than it had been before the phase of abundant liquidity began, liquidity reserves were adequate for the orderly conduct of credit business (see Table 23).

TABLE 23

Liquid Assets of Banks and Banking Associations, 1955-1961

(end-year figures in billion lire)

	1955	1956	1957	1958	1959	1960	1961
Cash	74.1	93.5	98.4	105.3	109.6	116.3	121.6
Deposits with the Bank of Italy . . .	35.3	27.0	47.9	77.4	49.6	46.6	45.8
Deposits with the Treasury, etc. . . .	33.3	12.2	17.9	17.1	10.7	32.1	16.4
Credit margin with the Bank of Italy	181.8	172.2	193.5	243.4	237.3	250.0	263.7
Free Treasury Bill holdings	42.3	17.0	32.4	371.2	580.2	221.4	93.8
Stockpiling bills	64.6	73.6	68.0	89.5	109.5	102.2	101.0
Convertible foreign currencies	—	—	—	—	—	—	40.7
Total . . .	431.4	395.5	458.1	903.9	1,096.9	768.6	683.0

At 683 billion lire, liquidity reserves equalled 5.7 per cent of deposits at the end of last year and were 86 billion lower than at the end of 1960, when in turn they had dropped by 328 billion over the course of the year. The most important changes took place in Treasury Bill holdings, which contracted by 128 billion, and in foreign exchange, which increased by 41 billion.

In computing liquidity reserves, any excess of foreign exchange assets over foreign exchange liabilities is now included, since the banks can convert it at will into lire.

The contraction of liquidity reserves was principally localized in the big banks, which habitually are almost alone in holding the type of liquidities which diminished most last year. But although the phenomenon was, therefore, actually limited to only a few credit institutes, it had its bearing on the whole banking system, in so far as the liquidity reserves of the big banks include some of those of the smaller banks. Small banks often pass on fairly large parts of their deposits to the big banks and then resolve their own liquidity problems by turning either to the latter or to the Bank of Italy. As a result of this practice the big banks have, for some years past, experienced much wider liquidity fluctuations than the small ones.

Policy instruments to regulate bank liquidity had not been much in evidence lately, because they were applied only to specific transactions or types of credit institutes. This has now changed. For the first time since compulsory reserves were introduced, the reserve ratio was altered on January 13, 1962. To be specific, it was reduced from 25 to 22.5 per cent, to give the banking system more elbow room in the fulfilment of its functions. The idea was to set free liquid resources uniformly throughout the whole banking system, but the relaxation would, of course, not have been possible without the improvement in the Treasury's cash position and without the foreign exchange reserves which have now been built up to a satisfactory level.

VIII. *The Economy's Total Supply and Use of Funds*

New funds furnished to the economy last year in the form of medium- and long-term credits by special credit institutes, the Central Post Office Savings Fund and insurance companies and funds between them amounted to 1,141 billion lire. This was a 24 per cent increase over the 1960 total of 920 billion. Business companies raised another 637 billion (as against 747 billion in 1960) through share and bond issues, so that the total of medium- and long-term funds channelled into productive activities last year works out at 1,778 billion lire. Even though the corresponding figure was, at 1,668 billion, a little lower in 1960, both years are in striking contrast to the recent past, not to speak of 10 or 12 years ago: 370 billion in 1949-51, around 640 billion in 1955-56, and 1,000 billion in 1959.

Excluding stockpiling bills, the commercial banks furnished the economy with 1,467 billion lire (as against 1,335 billion in 1960 and 760 in 1959), bringing their total supply of finance (including stockpiling bills but excluding minor banking firms and banking associations) to 8,728 billion lire at the end of last year—19.6 per cent above the end-1960 level. The special credit institutes raised their total supply of finance to the economy even more sharply, namely, by 21.9 per cent to an end-year figure of 4,212 billion lire (also including stockpiling bills).

Contrary to 1960, when industrial companies raised far more medium- and long-term funds than they needed for fixed investment beyond what could be covered from self-financing, 1961 was a year when financial requirements were in excess of disposable funds, and business liquidity returned to normal.

A special survey covering 408 joint stock companies (see Table 24) showed to what extent they drew, during the years 1958-60, on different sources of long-term finance, including all external funds in the form of equity and bond issues or loans, and the various sources of self-financing. A comparison of these figures with the companies' annual fixed-investment expenditure reveals the balance of their liquidity.

TABLE 24

Sources of Finance for Fixed Investment in 408 Joint Stock Companies

(billion lire)

Items	1958		1959		1960	
Self-financing		320.3		323.0		503.7
of which: allocations to reserves	18.2		2.7		73.8	
depreciation allowance	269.3		290.4		352.8	
allocations to staff provident funds	32.8		29.9		77.1	
External sources of finance		310.5		305.2		640.6
of which: shareholders' subscriptions	170.8		184.1		329.1	
bond issues	39.8		26.5		153.6	
long-term debt	99.9		94.6		157.9	
Total long-term funds at disposal		630.8		628.2		1,144.3
Fixed investment		588.4		562.0		637.4
Balance		42.4		66.2		506.9

Among the recipient sectors, building construction deserves particular mention this time. The special credit institutes dealing with building credit last year extended 248 billion lire in new loans, against only 142 in 1960. Bank credit to building firms also increased more than the year before, namely, by 178 billion as against 130; on the other hand the increment in bank credits to public corporations, also largely for construction work, was smaller than in 1960 (49 as against 79 billion lire).

In 1960 there had been a very considerable expansion of bank credit to private persons (189 billion lire as against 90 billion in 1959), mostly in the form of advances against securities deposited as collateral; there was another, less spectacular, but still strong expansion last year, with 158 billion lire, the bulk of it for purposes of house-building.

Including also funds made available by property companies and by the Central Post Office Savings Fund, the building sector in its widest sense (public works, public building construction and housing) received around 900 billion lire in new funds last year, as against 800 billion in 1960 and 550 in 1959.

All of last year's increment went into housing, largely through loans granted by building credit institutes. New finance for public works was probably a little less than the year before.

In the public utilities sector, transport received an additional 67 billion lire of medium- and long-term funds last year, against 58 billion in 1960. Telephones reduced their claims on the market from 66 to 46 billion (the largest reduction being in loans from special credit institutes) and the electric power sector likewise took in only 66 billion in new medium- and long-term funds, as against 83 billion in 1960.

Agriculture borrowed less for medium and long terms (40 billion lire in comparison with 60 in 1960) and for the short term (36 and 51 billion, respectively).

Among industries, petroleum and hydrocarbon gas companies raised 96 billion lire on the market through equity and bond issues (36 billion more than in 1960) and took 44 billion in new bank credits, more than twice as much as the year before.

The metallurgical industries took in 53 billion in new medium- and long-term funds; the reduction from the previous year's total new finance of 60 billion was largely due to a contraction of credits from special credit institutes. The same industries, however, simultaneously stepped up their fixed investment from about 75 to 140 billion lire, and also increased their short-term indebtedness to the banks by 53 billion, as against 42 billion in 1960.

In its turn, the engineering sector (including transport equipment) also took in less new medium- and long-term funds than the year before (137 and 171 billion lire, respectively), though in this case the diminution was due entirely to the contraction of share and bond issues from 133 to 78 billion lire. The change in the sector's financial position is well illustrated by comparison with investment in plant and equipment over the same period: it rose from 210 billion lire in 1960 to 270 billion last year. This sector, too, took up much more new bank credits than before, namely, 239 billion as against 174 in 1960.

The chemical industry last year raised 125 billion lire through share and bond issues—very much less than the spectacular 236 billion of 1960. Although the industry drew more heavily on loans from special credit institutes (59 as against 33 billion in 1960), the total of new medium- and long-term funds it absorbed decreased from 269 to 184 billion last year. Investment, on the other hand, increased from something like 210 to 260 billion lire.

Textile companies raised long-term funds of 55 billion lire on the market (67 billion in 1960) and borrowed an additional 83 billion from the banks (93 billion in 1960).

Finally, a remarkable development took place in retail trade and miscellaneous services, which together absorbed an additional 32 billion of long-term funds, having needed only 5 billion more in 1960.

IX. *Money Supply and Finance Funds*

In the course of 1961 the total of money supply and finance funds increased by 3,599 billion lire, of which 1,699 billion are attributable to short-term credits and 1,900 to medium- and long-term funds in the form of loans, mortgages and securities (see Table 25). The latter increased at a markedly slower rate (8.2 per cent) than short-term credit (13.5 per cent), and the combined rate of increase over the 1960 total of 3,272 billion (1,473 billion short-term and 1,799 billion medium- and long-term funds) was 10 per cent.

TABLE 25

Flow of Money Supply and Finance Funds

(billion lire)

	end-1961 position	Annual changes 1959	1960	1961
Public sector.				
Short-term credit (1):				
Bank of Italy	264.8	− 415.0	43.2	− 223.3
Banks	2,500.0	437.1	− 31.1	179.8
Private investors and companies (2)	1,031.3	27.0	3.5	9.0
Total . . .	3,796.1	49.1	15.6	− 34.5
Government securities:				
Banks	730.5	108.4	− 15.3	63.3
Central Post Office Savings Fund	96.6	4.6	1.1	2.5
Private investors and companies	1,713.0	215.7	170.7	61.2
Total . . .	2,540.1	328.7	156.5	127.0
Total public sector . . .	6,336.2	377.8	172.1	92.5
Private sector.				
Short-term credit:				
Bank of Italy	322.8	17.8	23.1	240.3
Banks	7,704.1	666.1	1,165.7	1,130.8
Total . . .	8,026.9	683.9	1,188.8	1,371.1
Loans and mortgages:				
Banks	841.1	86.7	98.6	128.4
Central Post Office Savings Fund	1,551.7	160.1	212.7	258.1
Special credit institutes	2,893.7	340.0	474.7	614.2
Insurance companies and Social Insurance Funds	1,010.7	103.4	94.4	103.9
Total . . .	6,297.2	690.2	880.4	1,104.6
Securities (3):				
Banks	1,156.4	187.1	253.0	209.5
Central Post Office Savings Fund	76.2	11.7	17.0	14.3
Private investors and companies	19,291.0	452.8	922.7	981.7
less issues by special credit institutes	2,571.6	279.0	430.6	537.4
Total . . .	17,952.0	372.6	762.1	668.1
Total private sector . . .	32,276.1	1,746.7	2,831.3	3,143.8
Foreign sector.				
Net position of the Bank of Italy and Italian Exchange Office	2,585.1	563.1	101.0	387.4
Net position of the banks	− 108.9	− 29.6	167.6	− 24.8
Total foreign sector . . .	2,476.2	533.5	268.6	362.6
Total credit and securities . . .	41,088.5	2,658.0	3,272.0	3,598.9
Primary liquidities.				
Notes and coin	2,744.6	183.9	196.8	360.0
Current accounts	5,790.6	610.8	685.8	795.4
Total . . .	8,535.2	794.7	882.6	1,155.4
Secondary liquidities	7,078.0	727.5	756.1	1,030.1
Other non-security assets:				
Banks	2,728.0	382.2	336.3	401.2
Central Post Office Savings Fund	1,724.5	176.4	230.8	274.9
Special credit institutes	322.1	61.0	44.1	76.8
Insurance companies and Social Insurance Funds	1,010.7	103.4	94.4	103.9
less surplus of gross liquid assets over short-term credit	1,314.0	255.7	165.7	486.3
Total . . .	4,471.3	467.3	539.9	370.5
Securities (4) .				
Government securities	1,713.0	215.7	170.7	61.2
Bonds by special credit institutes	1,787.0	172.9	225.0	353.7
Industrial, I.R.I. and E.N.I. bonds	1,154.0	54.9	202.0	211.2
Shares	16,350.0	225.0	495.7	416.8
Total . . .	21,004.0	668.5	1,093.4	1,042.9
Total liquid assets and securities . . .	41,088.5	2,658.0	3,272.0	3,598.9

(1) Compulsory bank reserves in cash and M accounts appear as an asset with the Bank of Italy (with reversed sign) and as an asset of banks.
(2) Including the Central Post Office Savings Fund's, insurance companies' and Social Insurance Funds' current accounts with the Treasury.
(3) Non-government securities.
(4) In private or company ownership. The figures are based on market values, not on book values, nominal values or estimates as may appear in other tables. Aggregate equity values are net of an estimated 20 per cent for duplications. Railway and Green Plan bonds are included under government securities.

With these additions, the economy had altogether 41,088 billion lire at its disposal in money supply and finance funds at the end of 1961, about half in each of the two categories. This was almost twice as much as gross national income; the ratio has been growing steadily over the last two years, not least as a result of the expansion of the capital market and the rise in equity prices.

Short-term credit to the public sector, which had expanded slightly during the two preceding years, contracted by 34 billion lire in 1961, the figure being the resultant of a reduction in short-term debts to the Bank of Italy in the amount of 223 billion and increases of 180 billion and 9 billion, respectively, in short-term Treasury debts to the banks and to private investors and companies.

The public sector's total new claims on the money and capital market were less than in 1960, namely, 92 billion lire as against 172 billion. The reduction in new government indebtedness reflects the improvement in the Treasury's cash position (see Chart 10).

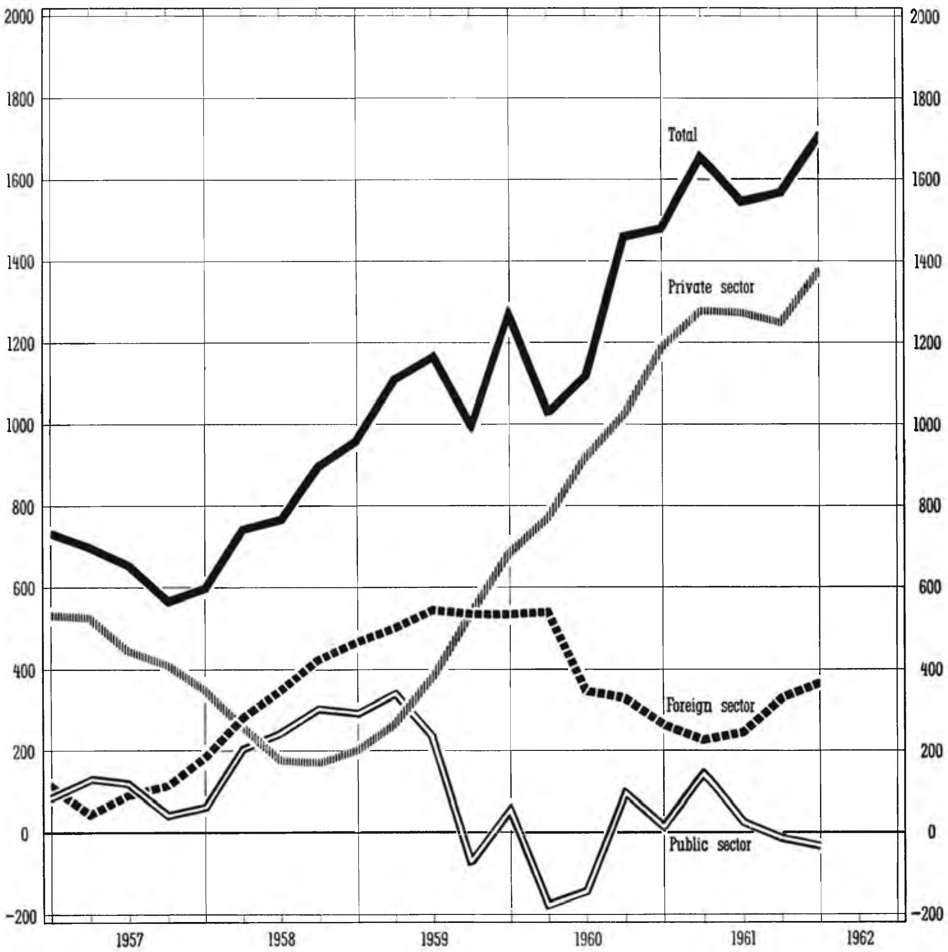
In its turn, the private sector took up 1,371 billion lire in new short-term credit last year, or about 200 billion more than in 1960, thanks to the Bank of Italy's help in refinancing more bank credit.

Bank credits themselves remained at their high 1960 levels and again provided the counterpart to the bulk of liquid asset formation on the market.

Medium- and long-term loans and mortgages to the private sector expanded by 1,105 billion lire, compared with 880 billion in 1960. Special credit institutes contributed proportionately more to last year's increment than any others, though all of them stepped up their mediunm- and long-term lending.

The private sector raised less new money through share and bond issues (excluding those of special credit institutes) than in 1960, when direct recourse to the capital market provided more funds than were needed for immediate fixed investment; the 1961 total of 668 billion lire compared with 762 billion in 1960.

CHART 10



Short-term credit

(12-month changes at quarterly intervals; billion lire)

Between them, short-term credit, loans, mortgages and securities furnished the private sector with 3,144 billion lire, as against 2,831 the year before.

Monetary movements connected with foreign transactions, which had played such an important part as a source of liquidity between 1956 an 1959 and then furnished only half as much in 1960 as in 1959, contributed rather more again; they provided 363 billion last year, about 100 billion more than in 1960.

The foreign exchange assets of the Bank of Italy and of the Italian Exchange Office increased by 387 billion lire, including

TABLE 26

Short-term Credit and Liquid Assets

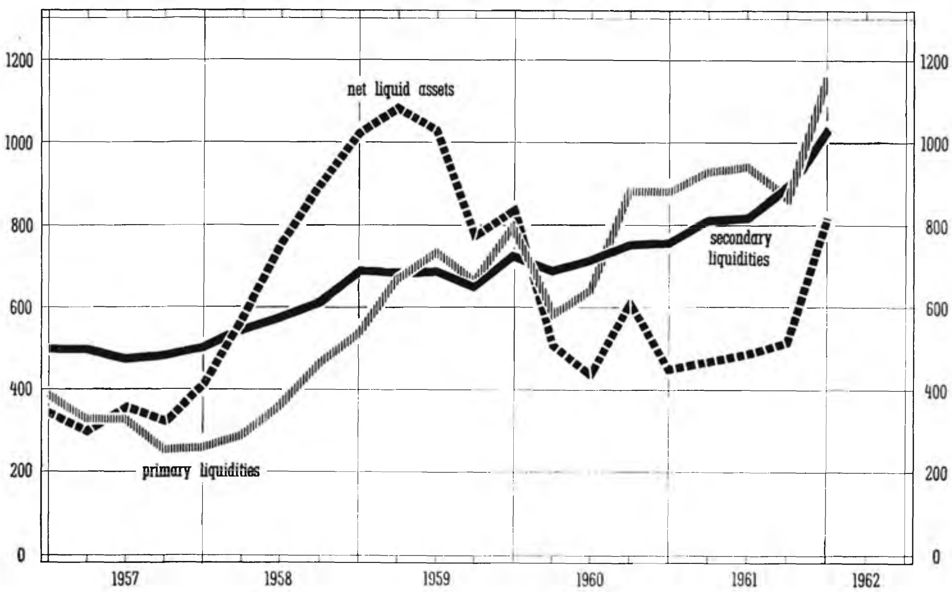
(end-year figures in billion lire)

Year	Credits to				Gross liquid assets			Surplus of		Net liquid assets
	Treasury (1)	Private sector	Foreign sector (1)	Total	Primary liquidities	Secondary liquidities	Total	Credits over primary liquidities	Gross liquid assets over credits	
1955 . . .	3,387.3	3,718.8	484.4	7,590.5	4,523.9	2,876.5	7,400.4	3,066.6	— 190.1	3,681.6
1956 . . .	3,476.7	4,251.8	593.9	8,322.4	4,911.1	3,371.7	8,282.8	3,411.3	— 39.6	4,031.0
1957 . . .	3,537.9	4,600.2	782.1	8,920.2	5,169.9	3,874.1	9,044.0	3,750.3	123.8	4,443.8
1958 . . .	3,828.7	4,801.3	1,248.7	9,878.7	5,702.5	4,564.3	10,266.8	4,176.2	388.1	5,465.5
1959 . . .	3,877.8	5,485.2	1,782.2	11,145.2	6,497.2	5,291.8	11,789.0	4,648.0	643.8	6,303.8
1960 . . .	3,830.6	6,658.4	2,113.6	12,602.6	7,379.8	6,047.9	13,427.7	5,222.8	825.1	6,769.3
1961 . . .	3,796.1	8,026.9	2,476.2	14,299.2	8,545.2	7,078.0	15,613.2	5,764.0	1,314.0	7,586.3

(1) Net of 62.8 billion resulting from the revaluation of gold reserves in February 1960.

the IMF drawing of 110 billion on the lire quota; but at the same time the banking system's foreign indebtedness, which had fallen by 168 billion lire in 1960, rose last year by 25 billion lire.

CHART 11



Liquid assets

(12-month changes at quarterly intervals; billion lire)

Gross liquid asset formation was well in excess of 1960. Of the total of 2,185 billion lire, rather more was attributable to secondary liquidities than in the past, mainly as a result of larger bank savings deposits. The increase in primary liquidities (currency circulation and current accounts), large though it was, is somewhat overstated in Table 25, because of the exceptional end-year peak.

The differential rates of increase of the two categories of liquidity is reflected in a change in the composition of liquid assets. At the end of 1955 primary liquidities accounted for 61.1 per cent of gross liquid assets, and at the end of 1961 for only 54.7 per cent.

Within primary liquidities, the share of the note and coin circulation, which largely reflects the requirements of consumption economies, dropped from 36.2 per cent at the end of 1955 to 32.2 per cent at the end of 1961. Over the same period the propor-

TABLE 27

Loans, Mortgages, Securities and Finance Funds

(end-year figures in billion lire)

	1956	1957	1958	1959	1960	1961
Loans, mortgages and securities:						
Treasury	1,770.1	1,852.8	1,875.5	2,214.5	2,400.3	2,540.1
Private sector	7,909.3	9,163.0	10,721.5	16,101.5	20,822.3	24,249.2
Total . . .	9,679.4	11,015.8	12,597.0	18,316.0	23,222.6	26,789.3
equals:						
Finance funds						
of which: Surplus of gross liquid assets over short-term credits	— 39.6	123.8	388.1	643.8	825.1	1,314.0
Other non-security assets (1)	2,669.0	2,889.0	3,111.9	3,579.2	4,103.5	4,471.3
Government securities (2)	1,135.0	1,205.0	1,213.0	1,439.0	1,639.0	1,713.0
Special credit institute bonds (2)	681.0	826.0	990.0	1,179.0	1,413.0	1,787.0
Other bonds (2)	394.0	482.0	674.0	735.0	952.0	1,154.0
Shares (2)	4,840.0	5,490.0	6,220.0	10,740.0	14,290.0	16,350.0

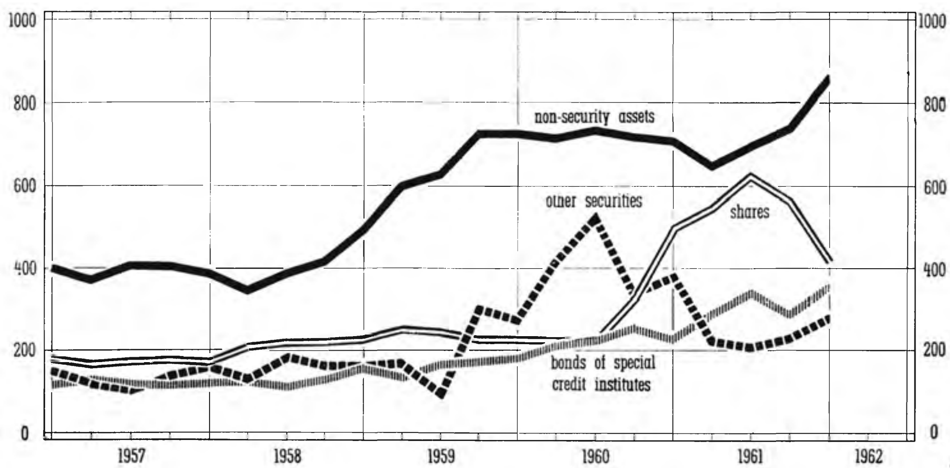
(1) Miscellaneous bank resources; time deposits at special credit institutes; Post Office savings certificates and actuarial reserves of insurance companies and Social Insurance Funds, excluding short-term credits and securities.

(2) In private or company ownership. The figures are based on market values, not on book values, nominal values or estimates as may appear in other Tables.

tion of currency circulation in gross liquid assets fell from 22.1 to 17.6 per cent.

The surplus of gross liquid assets over short-term credit, which had been falling since 1958, on the contrary increased sharply last year as a result of the growth of secondary liquidity. The movement of funds from the money market to the capital market amounted to 486 billion lire, compared with only 166 billion in 1960 (see Table 26).

CHART 12



Security assets and non-security assets other than liquid
(12-month changes at quarterly intervals; billion lire)

In spite of the expansion of short-term credit to the private sector, net liquid assets rose, because the banks received flows of funds from sources other than the economy's indebtedness to the banking system; the chief of these was foreign transactions. Consequently, market liquidity also rose (see Chart 11).

Finance funds, in the form mostly of time deposits and securities, rose by 1,900 billion lire last year, as against 1,800 in 1960. The increment was due to last year's large-scale flow of funds from the money to the capital market, given that security purchases by private investors and companies, though high in absolute terms, were less than the year before (Table 27 and Chart 12).

On comparison of the various kinds of liquid assets with gross national income over the last few years, currency circulation is seen to be in a more or less constant ratio to gross national income, whereas the ratios of secondary liquidities, and even more so of securities, to gross national income have been rising at a steady pace. The difference can be explained in terms of the comparative yields of the various forms of liquid assets, of the increase in transactions through the capital market, and of the growing ease with which securities representing fixed investment can be turned into money.

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

Gentlemen,

Hardly two months ago the government's Report on the Economic Situation in Italy laid before Parliament and the nation a broad picture of the course of Italy's economy in 1961. Since then, the government has, in a number of other documents and programmatic statements, made public its own considered view of the problems and priorities to which economic policy in general is to be directed.

In speaking to you today at our annual meeting I shall regard it as my duty to discuss more particularly the role incumbent upon exchange policy, international co-operation and domestic monetary policy in countercyclical as well as in more forward-looking action. In so doing, I shall dwell especially on the institutions and mechanisms by wich monetary flows are channelled into the public sector and private investment.

World Economic Conditions, Co-operation Between Central Banks and International Liquidity.— For the world's industrial countries generally, 1961 was another year of economic expansion, although individually many countries experienced pressure on prices or on the balance of payments, leading to considerable shifts in their competitive position beyond those following upon the currency revaluations of March 1961.

The United States overall balance-of-payments deficit, though somewhat smaller than in 1960, was still very large, because the current surplus was not enough to finance the net outflow of short- and long-term private capital, economic aid to other countries and military expenditures abroad. Canada and other primary-producing countries, on the other hand, had current deficits offset by large inflows of foreign capital. The United Kingdom and the rest of the sterling area were in deficit, though less so than in recent years.

The inflationary pressures experienced by several European countries were at least to some extent of outside origin. It stands to reason that in a system of large-scale foreign trade and generally fixed exchange rates inflationary pressures generated in any one country tend to spread to the rest of the world, while, conversely, their effect on the price level of the originating country tends to be mitigated by imports. It follows that international price movements and balance-of-payments disequilibria are the two principal means of adjustment for such inflationary or deflationary pressures as may appear in individual countries.

All through the 'fifties and still at the beginning of the 'sixties, economic policy everywhere was generally of an expansionary nature. By and large, the response was a growth of supply in real terms sufficient to allow the authorities to retain control over prices even in conditions of nearly full employment. In some countries, nevertheless, the policy of sustaining demand has tended more readily to generate inflationary pressures, and the monetary authorities then found themselves faced with the painful alternative of either applying restrictive measures which, in some circumstances, might be apt to lower the degree of capacity utilization and thereby to slow down economic growth, or else of accepting the erosion of money for a certain time, only to clamp on restrictions later.

In other, more favourable conditions it was somewhat easier to combine monetary stability with growth. From this point of view the experiences of the last ten years repay close study, in so far as they can teach us much on the basic conditions of success in this matter.

The first lesson is that in the countries most closely integrated in international trade the conditions of growth are most propitious when the necessary maintenance of a high level of aggregate demand does not conflict with the equally necessary maintenance of a high degree of competitiveness, which, in turn, depends among other things on a rise in productivity. Without that essential condition, foreign demand is unlikely to expand in the desired measure or, if it is stimulated artificially, cannot by itself ensure rapid and balanced growth. By contrast, a strong competitive position provides the means to finance an abundant flow of imports and, through its effects on the strength of the currency, makes it possible to avoid recurring restrictions on demand for the sake of the balance of payments. There is the warning example of the United Kingdom to show how such restrictions depress investment and with it the whole rate of expansion.

It is quite certain that during the 'fifties the prospect of strongly rising foreign demand was an important growth factor for many industrial economies. There is more than one reason for this. First of all, the incidence of exports on the net product of industry is relatively greater than that of any other component of global demand. Secondly, the expectation of rising exports has a decidedly favourable impact on the view one takes of the extent to which sustained and growing demand can be met with available resources. And thirdly, these expectations are, in their turn, encouraged by a high rate of expansion, just because of its effect on productivity and hence on competitive strength.

Experience has also confirmed the close correlation between a high rate of expansion and a rapid improvement of productivity, thus proving the conclusions of economic analysis to the effect that self-sustained growth can be generated by rising productivity and expanding export markets. Countries in an initially weak competitive position have had the greatest difficulties in containing money incomes within the limits of a slow improvement in productivity, and this has further weakened their ability to compete and has slowed down growth, thus inaugurating a downward spiral from which it is hard to escape. To try to expand demand in such a situation with the object of raising productivity to the extent that is necessary to keep costs stable is indeed exceedingly difficult in the short run, in view of the narrow margins of unutilized capacity and of weak foreign reserves. Conversely, countries in an initially strong competitive position have found it easy to absorb rising wage costs in periods of heavy pressure of demand for capital and labour and hence to maintain a high rate of growth, because a rapid increase in productivity has enabled them to defend or even to strengthen their competitive position.

Despite the greatest efforts, in fact, few countries succeeded during the last ten years in making the transition from a low to a high rate of growth. Nothing could provide better proof of the fact that, quite apart from the purposes and methods of economic policy, the creation and maintenance of competitive strength in international markets is quite indispensable in the conditions of the modern world.

It must be concluded, therefore, that one of the principal components of growth policy is the removal of foreign trade barriers, which encourage non-competitive activities and make it difficult to penetrate foreign markets. Another is the gradual elimination of those obstacles to the mobility of capital which disturb the international movement of monetary flows and savings. A third point to stress is the need to make every effort, both by autonomous measures and through international collaboration, to even out emergent balance-of-payments disequilibria, especially in the major countries.

Given the great importance which the solution of the growth problems of economically less developed countries has for the whole world, it is imperative that international collaboration be extended to all compartments of economic policy. The experience of the last ten years seems to suggest that the efforts of the developing countries to achieve rapid growth on a sound basis were most successful in cases when it proved possible to avoid inflation, thanks to a supply of savings sufficient to cover the large requirements of the public sector, and to go ahead with the realization of a detailed and concrete development programme.

Nevertheless, even the fulfilment of these two conditions does not appear to be enough to vouchsafe conspicuous progress in the absence of a propitious external situation. Developing countries need not only financial and technical aid, but also a system of international exchange in which they can expand their exports in a satisfactory manner.

As in industrial countries, only more so, the success of growth policy in developing countries is largely conditioned by the balance of payments. Without good export prospects, it becomes almost impossible for them to build expansion plans on economically rational projects or to mobilize the saving needed for projects requiring capital goods which must be paid for in foreign exchange.

All this points to the expediency of planning for economic growth in overall terms, so that limited physical and financial resources may be correctly allocated as between alternative uses of different degrees of priority and so that the extent of supplementary requirements to be met by foreign aid may be assessed. It should be added that whenever, in the past, development programmes were associated with a vigorous policy of monetary stability, they heightened business expectations of the future course of global demand, reduced margins of error and with them the losses which the economic system might otherwise have had to incur.

More even than in 1960, the size and direction of short-term capital movements—whether directly or indirectly connected with commercial and financial transactions or due to purely speculative motives—last year created serious disturbances in the economic relations among industrial countries.

To the extent that money rates are still rising in Europe and, for internal cyclical reasons, still falling in the United States, the conflict between domestic and external needs to which I drew your attention last year must be expected to become yet sharper. I can but repeat that the possibility of such conflicts calls for the creation of adequate compensatory machinery. In 1961 already, the monetary authorities of the industrial nations tried, through close bilateral and multilateral co-operation, to neutralize the effects of hot-money movements and to make advance arrangements to absorb the shock of foreseeable future movements of this kind.

Bilateral co-operation took the form of agreements between central banks, including the Italian, generally to the effect that some of them might hold in their reserves currencies other than those traditionally used for this purpose. More specifically, these agreements also enabled reserve centres to substitute some of the major convertible currencies for gold in spot and forward interventions on exchange markets. Reciprocal facilities between central banks have the advantage of speed, since they can be put into effect without cumbersome formal procedures; on the other hand, they are necessarily subject to certain quantitative limitations and, even when no definite time limit is set, can apply to the short run only and need to be refinanced with more stable resources in case the original disturbance should persist. Examples of effective central bank assistance are the facilities extended in the spring of 1961 to the Bank of England and, later that year and again in the early months of 1962, to the United States Treasury and Federal Reserve, who now propose to build up some foreign exchange balances of their own.

Multilateral co-operation between the industrial world's monetary authorities, again with full Italian participation, has furnished the International Monetary Fund with supplementary resources of 6 billion dollars, to be drawn on, if necessary, by countries embarrassed by large-scale and sudden movements of short-term funds. The credits which the participating countries may be called upon to put at the Fund's disposal by virtue of this agreement are repayable at the lender country's request in case it should run into balance-of-payments difficulties.

Another important result of international monetary co-operation are the agreements between several central banks and the Federal Reserve to lay down good-conduct rules for gold transactions and to co-ordinate gold purchases in London. The purpose of these agreements is clearly to mitigate the threats to international monetary equilibrium which derive from the existence of two channels through which monetary gold requirements can be met, namely, the Federal Reserve and the London market, which latter, incidentally, is the meeting place not only of central bankers but also of industrial users, private hoarders and speculators.

Italy's Balance of Payments.— The above general considerations are fully borne out by Italy's economic experiences over the last ten years. Without any doubt at all, productivity was the most important single factor to contribute to the rapid expansion of output in Italy. The same factor enhanced the competitive strength of Italian goods on foreign markets and thereby helped to increase exports at a pace fast enough to create a sound balance-of-payments position and to enable the country to escape at least one category of setbacks and uncertainties which might otherwise have handicapped domestic expansion.

The conspicuous rise in Italian productivity is attributable to the economies of scale which domestic growth and growing integration with world markets brought in their wake, in so far as they permitted the fuller utilization of existing plant and an increase in the size of firms. In the last analysis, that is, the rise in productivity was due to new investment and to the adoption of new and more efficient factor combinations.

Not all countries, of course, start out from the same position and it must be recognized that Italy was better placed in both respects than most other industrial countries, where for some time past firms have been bigger and the degree of capacity utilization higher.

Another factor to work in Italy's favour has been abundant labour supply, which helped to contain the rise in wages and provided durable support for such competitive advantages as Italian goods enjoyed abroad thanks to their quality and to energetic sales promotion.

Naturally, all these factors had the strongest impact on those sectors whose outlets were widened by steady foreign demand and where international competition, stimulated by import liberalization, called forth the modernization of obsolete plant and hence a cost reduction.

The view that successful foreign trade is the foundation of lasting domestic growth is certainly confirmed by the Italian experience. Throughout the period 1950-61 exports were the most dynamic component of global demand; they increased at an annual average rate of 13.3 per cent in real terms, whereas investment demand increased by 9.2, consumption demand by 4.8 and total domestic demand by 5.8 per cent on the average over the twelve years.

However, as Italy is gradually closing the gap between herself and the older industrial nations, we witness a diminution of those differences in the rate of increase of productivity and wages which, as we noted, were principally responsible for the rapid expansion of Italian exports.

Neither in 1960 nor in 1961 have the overall balance-of-payments surpluses given rise to corresponding changes in official gold and convertible currency reserves. Part of the surpluses were transferred from the accounts of the Italian Exchange Office and of the Bank of Italy to those of commercial banks, part of them were used to finance drawings on the IMF lire quota, and part of them to buy in Italian securities circulating abroad.

Of an overall surplus of 442 million dollars in 1960, 127 million went into official reserves, 268 million were transferred to the banking system and the rest was used to extinguish foreign debts or grant foreign credits.

In 1961 the overall surplus amounted to 577 million dollars and official reserves increased by 340 million; at the same time, 82 million dollars were spent on purchasing Italian securities circulating abroad, and other official assets abroad grew by 195 million dollars, principally as a result of the International Monetary Fund's lending out lire. These increases owe something also to the fact that, contrary to what happened in 1960, the net foreign indebtedness of the banking system rose by 40 million dollars.

During the first quarter of 1962, Italy ran an overall balance-of-payments deficit of 94 million dollars (according to foreign exchange statistics), or just about as much as during the corresponding period last year. However, official reserves fell by rather more than that, namely, by 140 million dollars. The main reason was that the Italian Exchange Office again transferred foreign exchange to the banking system.

The banks' net foreign position has hardly changed since the end of 1961. The monetary authorities have been anxious to prevent the banking system from becoming a channel through which hot money can flow into or out of the country, with all the disturbing effects such movements can have on international liquidity and on domestic liquidity formation. Nevertheless, the banks were still in a position to serve their clients with a considerable volume of credits for foreign transactions.

On March 31, 1962, outstanding credits of this kind amounted to 987 million dollars and they were to a large extent financed with foreign currency bought by the banks from the Italian Exchange Office against lire. Spot purchases from the Exchange Office and forward sales to it actually amounted to 664 million dollars at the same date, and the Exchange Office's foreign currency deposits with the banks to 113 million dollars. Adding to this another 5 million dollars of outright purchases by the banks, the Italian Exchange Office in one form or another contributed 782 million dollars to finance foreign exchange credits, the rest being financed by the banking system's own holdings.

But while the Exchange Office's sales of foreign currency to the banks enabled the latter to balance their foreign commitments, it also reduced their lire liquidity by a corresponding amount.

Realizing that some banks were getting into a rather tight liquidity position in the course of 1961, the Bank of Italy stepped in, through the Italian Exchange Office, to ease the strain. What was done was to buy back some of the foreign exchange previously sold to commercial banks and then to redeposit it with them. Transactions of this kind assumed their greatest volume towards the end of last year to relieve the seasonal pressure on bank liquidity; since then they have fallen off sharply.

The traditional methods by which the central bank increases or decreases bank liquidity were in this manner supplemented by a new device, which appears especially useful in the light of the fact that fiscal charges on commercial bills tend to restrict the use of this type of credit, so that the banking system does not always dispose of sufficient quantities of rediscountable paper.

It has been noted earlier that the Italian Exchange Office repurchased fairly large amounts of Italian securities circulating abroad. Altogether, the Exchange Office had in its portfolio on March 31, 1962, securities in the amount of 173 million dollars, 54 million Swiss francs and 19 million Dutch guilders, in addition to 12 billion lire's worth of lire securities optionally payable in foreign currencies.

In January 1962 new provisions entered into force by virtue of which non-resident ordinary and capital accounts became freely intercommunicating in both directions. The effect was to remove any possibility of an unofficial lire rate different from the rate on the official exchange market. Since Italian bank notes reimported from abroad can be freely accredited to non-resident capital accounts and, via transfer to ordinary non-resident accounts, transformed into foreign currency at the official rate, bank notes can no longer be quoted at any other but the official rate.

Other measures to give additional freedom to capital movements were taken in 1961, but it has not so far been possible to remove the restrictions on Italian residents' purchases of foreign shares, given the existing differences in fiscal assessment procedures applicable to Italian shares on the one hand, and to foreign shares on the other. Now that a new provision has been introduced under which income tax on dividends is withheld at the source, the extension of the applicability of this provision to foreign shares owned by Italian residents and duly deposited with the banks, may open the door to a further liberalization of equity investment.

During the second half of 1961 and the first quarter of this year large bond issues were floated on the Italian capital market by the International Bank for Reconstruction and Development, the European Investment Bank and the Inter-American Development Bank. We note with especial pleasure that this was the first issue made by the Inter-American Development Bank and we regard it as proof of the close ties of friendship which, beyond those of an economic nature, link Italy with the nations of the Latin American continent. Nor is it to be excluded that the provisions of the new law on export credits may in practice lead the special credit institutes to raise on the capital market funds to finance or refinance economic aid to developing countries.

Obviously, the possibility for the special credit institutes to finance both the so-called tied credits—tied, that is, to the export of Italian goods—and untied credits is limited by the need to distribute resources between domestic and foreign claimants. *Mediocredito* cannot provide more money than it has in its endowment fund, unless it were, itself, to turn to the capital market, where it would come up against the same limitations which the credit institutes also encounter.

As regards the cost of credits to foreign countries, it may, especially in the case of untied credits, seem expedient to keep interest charges lower than corresponds to the conditions of the capital market. But here again it must be stressed that, in case the government should consider such practices to be in the general interest, there is only one proper method suitable for the purpose, namely, adequate government subsidies either on capital or on interest account. It is incumbent upon the central bank to press home the point that to create means of payments cannot in any circumstances whatever be allowed to substitute for such subsidies; as the guardian of the currency, the Bank cannot evade its primary duty to maintain monetary equilibrium.

Prices, Production and the Sources of Finance.— Turning now to domestic monetary equilibrium, we note that although since the middle of 1960 world raw material prices have had a tendency to fall, domestic wholesale prices on the contrary have recently had a tendency to rise.

During the first quarter of 1961, wholesale prices were stationary; in the second quarter they declined a little and then they started to climb in a more and more pronounced manner.

The determinant influence in these movements has come from fluctuations in the prices of agricultural and food products. These prices have been rising steadily throughout the last quarter of 1961 and again since the beginning of this year, and while the increase may have owed something to a crop failure here or there and, occasionally, to bad weather in vegetable- and fruit-growing districts, it has for the most part taken place in response to high domestic and foreign demand.

Wholesale prices for raw materials and manufactures were subject to some minor fluctuations last year, but the price level as a whole was stable, thanks to the offsetting effects of slightly falling raw-material and slightly rising product prices. These conflicting movements go back to the middle of 1960, when the rise in manufacturing costs began to overtake the increase in productivity in some sectors. Between March 1960 and March 1962, raw material prices dropped by 3.6 per cent and the prices of manufactures rose by 3.1 per cent.

However, the stability of the general level of industrial prices throughout 1961 was followed, during the first quarter of this year, by a rise of 1.2 per cent, as a result of a certain slowing-down in the fall of raw material prices and a quicker advance of those of manufactures.

Retail prices and the cost of living have been climbing rather faster than wholesale prices. During the year ending on March 31, 1962, the wholesale price index rose by 2.2 per cent, the retail price index by 3.9 and the cost-of-living index by 5 per cent.

It has been the customary pattern for a long time for retail prices to rise by about 2.5 per cent a year even in the presence of a stable wholesale price index; but these, as it were, habitual causes were recently reinforced by the slight upward movement of wholesale prices. In the event, the rise in the indices of retail prices and of the cost of living between March 1961 and March 1962 was considerably in excess of the long-term trend.

It is true that food prices, in particular, recently felt the impact of some random causes; nevertheless, there remains an underlying strain in our price system, as a result of high domestic and foreign demand coupled with cost increases tendentially in excess of productivity improvements.

Our economic system again gave proof of its remarkable capacity to expand supply. It is common knowledge by now that the excellent results of 1961 raised Italy's national income by 7.9 per cent in real terms and her production curve well above the trend line over the last ten years of strong expansion. Furthermore, the rate of increase of output speeded up during the second half of the year and more especially during the last few months.

The index of industrial production, the annual average of which rose by 9.1 per cent last year in comparison with the annual average of 1960, stood about 15 per cent higher in December last year than twelve months earlier. During the last quarter of 1961 overall output was more than 5 per cent above the annual average.

Looking separately at the major components of global demand, in terms of current prices and with reference to the last quarter of 1960, export demand is seen to have risen by 22 per cent, domestic investment demand by 16 and consumption demand by 9 per cent.

The value of fixed investment in industry rose by 21.5 per cent between 1960 and 1961. Machinery purchases alone increased by 25.4 per cent over the year.

Nearly all branches of industry expanded their investment last year, but particularly so the iron and steel, engineering and chemical industries as well as petroleum refineries, which together were responsible for more than 45 per cent of total fixed investment in industry.

Although industrial companies, generally speaking, were engaged in large-scale programmes of plant extension, their financial position was on the whole satisfactory, although certain aspects of abundant liquidity, which had been so marked in 1960, began to disappear.

External sources of finance last year furnished industrial companies with 80 billion lire less new money than in 1960, namely, 726 billion as against 806. The contraction was wholly due to the companies' reduced direct recourse to the market in the form of bond and share issues; the drop from 627 billion lire in 1960 to 487 billion in 1961 was not fully offset by the special credit institutes' new industrial assets in the amount of 239 billion lire, as against 179 billion in 1960.

At the same time industrial investment expanded by 281 billion lire last year, as shown by the national accounts. The cumulative effect of the higher investment expenditure and the reduction in the flow of external funds to the industrial sector works out at something like 360 billion lire; if, in these circumstances, the liquidity position of industrial companies were to have remained the same as in 1960, they would have had to find an additional sum of like amount from self-financing.

This would have implied a further acceleration of the already very high rate of increase of self-financing, but instead the rate of increase slowed down a little. It follows that the investment requirements of industrial companies last year were met by a steady increase of short-term indebtedness to the banks.

This development was more pronounced in the case of the larger companies and those engaged in large-scale extension and modernization programmes. Our usual survey of major joint stock companies in fact shows their gross fixed investment last year to have been 35 per cent in excess of the 1960 figure and therefore well above average. These are the companies which are most sensitive to changes in the financial equilibrium and also those in which rising wages tend to push up labour cost. It is they which have suffered most from the slowing down of the rate of increase of profits available for self-financing.

Housing construction last year absorbed a total of 1,192 billion lire of investment, compared with 1,101 billion in 1960. As a result mainly of the reduction in INA-Casa investment, the public funds reaching the building sector fell off from 223 billion lire in 1960 to 176 billion in 1961. Housing investment financed from private sources correspondingly rose from 878 to 1,016 billion lire, to which the special credit institutes contributed mortgage loans in the amount of 248 billion, as against 142 billion the year before. In its turn, short-term borrowing from the banks increased considerably, especially in the form of credits to construction firms and prefinance for mortgage loans. In global terms, the inflow of market funds fully covered private investment demand, and private saving directly invested in housing remained roughly equal in the two years at around 600 billion lire annually.

After this brief review of the sources of finance for investment in the two broad sectors of industry and housing, last year's changes in the overall situation of private investment, and sources of finance therefor, will be understood more readily.

As in 1959 and 1960, investment financed from private sources again increased at a higher rate than investment financed with public funds. Private investment rose by 16.4 per cent last year, from 3,454 to 4,022 billion lire, and public investment by 3.4 per cent from 1,292 to 1,336 billion. In comparison with 1959, private investment was up 43.7 and public investment 17.6 per cent.

In 1960 the conspicuous investment increment was for the most part financed by exceptionally large direct issues on the market and loans from special credit institutes (which increased from 629 to 1,224 billion lire over the year); in addition self-financing by firms increased considerably.

In 1961 the situation was quite different. At 1,255 billion lire, external funds were only very slightly higher than the year before, and if the large increase in mortgage loans is excluded, there was even a slight contraction. On the other hand, direct investment of private saving in housing remained almost stationary and the slowly growing funds of self-financing could make but little contribution towards meeting the higher investment demand. As a result, the net short-term indebtedness of industry to the banks increased and this was in part reflected in the banking system's higher loan/deposit and loan/liability ratios; basically, however, the increased borrowing was backed by higher deposits as a result of an improvement in the income and liquidity position of the consumer public.

In fact, bank resources grew last year at an even faster rate than in 1960, thanks above all to the larger flow of funds into savings deposits, which increased by 14.5 per cent in 1960 and by 17.2 per cent in 1961; at the same time, the rate of increase of current accounts rose from 16.4 to 16.9 per cent.

In connection with the strong expansion of production requiring more working capital and also with the higher demand for funds to prefinance intensive investment, bank assets grew by 20.1 per cent—just a little less than the exceptional rate of 1960.

Notwithstanding the large increase in deposits, the banking system therefore experienced a growing strain, which was relieved, as we already noted, by liquidity injections from the Bank of Italy, mainly in the form of repurchase of foreign exchange against lire.

In this manner the banking system was kept liquid enough to meet the demands deriving from the system's own growing integration with the whole body of productive activity and trade.

The central bank's policy of sustaining and encouraging a balanced credit expansion found expression in yet another measure. In view of the persisting balance-of-balance surplus and of the satisfactory cash position of the Treasury, it was found possible a few months ago to ease bank liquidity all round by reducing the ratio of compulsory reserves to deposits from 25 to 22.5 per cent.

As in 1960, market liquidity was to a large extent provided by the expansion of short-term credits to the private sector. The foreign sector was responsible for liquidity creation in the amount of 363 billion lire as compared with 269 billion in 1960, while for the third successive year the liquidity effects of Treasury operations were negligible.

Total liquid assets at the disposal of the market, which consist for the overwhelming part of currency circulation, current accounts and savings deposits, increased by 16.3 per cent in 1961, compared with 13.9 per cent in 1960. Secondary liquidities in the form of quasi-money increased proportionately more than primary liquidities, monetary circulation and current accounts together having grown by 15.7 per cent, as against 13.6 per cent in 1960.

With the more rapid rise both of incomes and turnover in 1961, the monetary circulation also increased at the faster rate of 11.8 per cent during the year ending November 1961, as against 8.9 per cent during 1959 and 1960. The exceptional accumulation of holidays at the end of December led to a peak which then flattened out again in January.

By the end of 1961 the monetary circulation had risen by altogether 14.6 per cent, but since then the rate of increase has returned to normal and now keeps in step, at a slightly higher level, with the rate of expansion of output and turnover.

The increase in liquid assets of which we have spoken found its counterpart in a strong rise of the private sector's indebtedness, mainly to the banking system. Short-term credits to the private sector amounted in 1961 to 1,371 billion lire, as compared with 1,189 billion in 1960; the corresponding percentage increases in the two years were 20.6 and 21.7.

The market as a whole may be subdivided into the two broad categories of consumers and producers; the latter, as has already been noted, found themselves in a rather less liquid position last year than in 1960, with the result that their net indebtedness to the banking system increased. The liquidity increments of 1961 therefore accrued entirely to consumption economies, which indeed improved their liquidity position considerably.

The total of money supply and finance funds grew last year by 3,599 billion lire, of which 1,699 billion were attributable to the expansion of short-term credit and the remaining 1,900 to medium- and long-term credit in the form of bond and share issues, loans and mortgages.

Although liquid asset formation was well in excess of the expansion of short-term credit in 1961—to be precise, by 486 billion lire which were transferred to the capital market—last year's annual expansion of medium- and long-term credits fell short of the expansion of short-term ones.

The Capital Market, the Special Credit Institutes and Their Relations with the Banking System.— There was some change last year in the relative amounts raised by industrial companies directly on the capital market and those raised by special credit institutes. All in all, the capital market provided roughly 1,300 billion lire in both these last two years, but while equity issues accounted for 37 per cent of the total in 1960, their share dropped to 32 per cent in 1961. Bond issues by special credit institutes were very active and provided 685 billion lire, or 215 billion more than in 1960. Their share in total fixed-interest security issues, excluding Treasury Bills, rose from 54 per cent (470 billion out of a total of 877) in 1960 to 75 per cent (685 billion out of a total of 917) in 1961. Conversely, the share of industrial bonds and debentures dropped from 22 to 10 per cent. The government raised money for public investment through the special credit institutes, which placed bonds in the amount of 148 billion lire for this purpose last year, as against 40 billion in 1960.

The special credit institutes' increased claims on the market were a response, in part, to the credit demand of firms in connection with their investment programmes, but in part also to the credit demand induced by the progressive spreading of the system of government contributions to interest charges, as a means of promoting ventures regarded as deserving of public support. To some extent, of course, the institutes' increased fund-raising activity was also a matter of deliberate financial policy, in so far as greater responsibilities devolve upon them when the Treasury uses them as intermediaries.

All in all, the special credit institutes granted new credits in the amount of some 900 billion lire last year, which corresponds to an increase of 24.3 per cent over credits outstanding at the end of 1960. Two thirds of the increment are attributable to the second half of the year.

Privileged credits, that is, those eligible under Law No. 623 for government subsidies towards interest charges, rose considerably in 1961 and show every sign of continuing to do so this year. The figures were 50 billion lire in 1960, 128 billion in 1961, and at the end of March this year privileged credits outstanding amounted to 212 billion lire, while applications for a total of 435 billion worth of such credits had been approved; this left a balance of more than 200 billion still to be paid out, half of it by the three southern institutes.

The outlook for this year is that special credit institutes will again exercise a rising demand for capital funds, especially through bond issues. They will need these funds to meet the claims made upon them by public investment for economic and social purposes, by the foreseeable volume of privileged-credit demand induced by the government subsidies to interest charges, and by the expansion of credit to industry and to foreign countries in the various admitted forms.

The cross-currents between special credit institutes and the ordinary banking system have been assuming growing importance. During the last two years, when the activities of the special credit institutes expanded so fast as to raise their operations by more than 1,500 billion lire, banks and banking associations stepped up their supply of funds (by 208 billion in 1960 and by 315 in 1961) to about one third of the additional resources needed each year by the medium- and long-term credit institutes.

But there were some internal shifts last year, both as regards the type of funds provided by the banking system and the form in which it provided them. Bond issues for Treasury account increased, and so did the banking system's subscriptions to them. Furthermore, the banks furnished increased amounts through overdrafts on current account, thereby largely prefinancing bond issues, in so far as the overdrafts bridged the time gap between the date of issue and the moment when the proceeds can technically become available.

On the other hand, banks and banking associations provided a smaller share—31 per cent as against 37 in 1960—of the resources required for the special credit institutes' ordinary operations, excluding, that is, operations for Treasury account and stockpiling finance. Even so, the banks provided more for this purpose in absolute figures, namely, 254 billion lire as against 219 in 1960. In the aggregate, the funds transferred by the banks to the medium- and long-term credit sector amounted to almost one tenth of total bank resources at the end of 1961.

It may be of interest to note the growing tendency to extend the faculty to issue bonds against long-term loans to credit institutes and special bank sections so far lacking this faculty. The result is that, in spite of the increased absorption or short-term funds by the medium- and long-term credit sector, the separation of the latter from ordinary credit is ultimately reinforced. The wider and more functional structure of the special credit sector, which has grown so much since the war, contributes much to the interregional mobility of capital—to some extent also with the help of the branch network of the big banks which, together with their special credit sections, permeate the whole national territory.

The large bond issues of 1961 had a distinctly depressing effect on bond prices, which are now back to the level of late 1959. Only government bonds improved slightly; the rest declined and have still been giving way since the beginning of this year.

In the light of current prospects, what is needed above all else is clearly that the capital market should be flexible; in other words, it must be easy to transfer funds from one category of uses to another and to channel them to those uses which appear most in the general interest. We need measures, therefore, to heighten the response of the market and of market rates of interest to the lead given by the monetary authorities. This means in effect that we need to tie short rates more closely to medium and long rates and to create in our country a money market in which the Treasury, the central bank and the banking system interchange funds at variable prices, according to the balance of supply and demand. The purpose of such measures is to improve the machinery through which the money and capital markets interconnect and to enhance the interdependence of the respective rates of interest.

But ultimately security issues cannot be placed elsewhere than with savers. It follows that the size of new issues must be tailored to the foreseeable supply of new saving. The investigations which precede new issues will have to become more selective without, of course, any presumption of wishing to lay down the direction of total new investment—of which, after all, only about one quarter is financed through the capital market. The broader task of deciding upon the distribution of the country's whole resources will be incumbent upon those authorities which are responsible for general planning.

Security issues will, of course, be easier to place in the measure in which the dimensions of the capital market grow. Furthermore, even wide fluctuations in the volume and composition of the total of securities outstanding on the market will be more readily acceptable once the domestic capital market is in communication with capital markets abroad.

All this underlines the need for a policy to enhance the flexibility of the capital market, so as to fashion it into an efficient instrument of finance for a process of steady and self-sustained growth. It would not fit into such a policy to fall into the trap of believing that balanced growth can be promoted through a limitation of the public authorities' discretion to authorize or not to authorize new issues in the light of market conditions. Nor would it be right to expand the system of privileged credits unduly. In our view, credits of this kind are a proper policy instrument so long as the purpose is to even out certain unbalances; but we also believe that, just because privileged credits are a means to correct unbalances, they should be applied in a selective manner, that is, concentrated in the regions and sectors which need special incentives. Applied indiscriminately, they would fail to serve the purpose for which they were intended and would merely become a factor of rigidity on the market.

The need for a well-functioning and flexible capital market is underlined by considerations based on international comparisons, such as were conducted very thoroughly by the Bank last year.

It must be said that our—and, for that matter, the German—capital market have shown reserves of strength which have allowed them to grow more vigorously than the capital markets of other countries. If we measure the size of a capital market by the relevant flows, the expansion of ours over the last ten years was more than fourfold. In Italy, the ratio of security issues to fixed investment was 26.9 per cent during the three-year period 1959-61; in Germany, the ratio was 14.4 per cent, in France 11.3, in the United Kingdom 9.6, in the Netherlands 13.5 and in Belgium 31.9 per cent. It follows that in Italy the market in which security issues are placed has furnished far and away the largest proportion of the capital used for fixed investment, with the sole exception of Belgium, where government and other public agencies were responsible for the high level of security issues.

Similar conclusions can be reached by measuring the size of the capital market in terms of gross domestic product. Again it will be seen that during the period 1959-61 the proportion of the latter transformed into fixed investment by the capital market was larger in Italy than in any other country, namely 6.2 per cent, in comparison with 3.4 per cent in Germany, 2.0 in France, 1.3 in the United Kingdom, 3.3 in the Netherlands and 5.6 in Belgium. Time series of the same ratios show that the upward movement was strongest in Italy. All in all, our capital market has demonstrated singular vigour and has proved its worth as an effective instrument of a policy designed to expand investment.

International comparisons also show that the amount of funds passing through a country's capital market is highly sensitive to cyclical influences, tending to grow in periods of rising incomes and to contract in recessions.

Over the last ten years, all categories of issuers of bonds and shares have exercised a strong, if fluctuating, demand for funds. The total of issues has always been determined to a conspicuous extent by the claims made on the market by those categories which have no other way of raising funds except by the issue of fixed-interest-bearing securities. The latter, incidentally, have almost everywhere been the predominant instruments, with the sole exception of France, and have in most major capital markets accounted for 70 per cent or more of total issues.

All this, however, still leaves unimpaired the dominant position of shares in the composition of the total value of securities outstanding; on the contrary, thanks largely to the prevailing trend of stock market prices, the proportion of equities has risen in most cases. In any event, the distribution of security ownership differed widely from country to country at the end of the period under consideration.

A last important point that emerges from international comparisons is that in some countries the banks sustain the bond market with large funds. In Germany, for example, the ratio of bank investments in fixed-interest securities to bank deposits amounted to 12.1 per cent at the end of 1961. In the United Kingdom the banks' portfolio of government securities has been contracting in relative terms and amounted to 19 per cent of deposits at the same date.

All in all, in the international context the Italian capital market is seen as one whose part in financing investment and hence economic growth can well stand comparison with that played by the capital markets of the most advanced countries. Its expansion can therefore hardly be expected to proceed at the fast rate of the past. It is also true to say that the banking system's support of the stock market, calculated in terms of the ratio of bank investments in fixed-interest securities either to bank deposits or to total security circulation, is rather high in Italy in comparison with other countries.

Finally, we should learn the lesson that, just because the Italian capital market has become an efficient instrument, the monetary authorities cannot and must not evade the heavy responsibility of keeping it in sound condition or even of improving upon it. But no capital market in the world could ever provide hospitality for large bond issues unless the government's policy created confidence in monetary stability.

The Money Market and the Banking System.— Last January, as I have already recalled, we lowered the compulsory reserve ratio. This was fully consistent with a line of monetary policy which my predecessor, Dr. Menichella, defined as early as 1949, when he said: " The instruments which we have created and applied, at times, for certain purposes, must be ready to be applied also for opposite purposes "—a point which he drove home more than once in recent years. With this measure we have set free about 200 billion lire, and in our view these should allow bank credit to expand about two-and-a-half times as much. We took this step in the conviction that our balance-of-payments position will remain such as to permit an expansionary measure apt to enable the credit system to give further support to the economy's growth without pushing up interest rates. Given the rising tide of rates in other countries, it was our intention, among other things, to contain the rise of interest rates in the bond market.

The measures by which short-term rates can be controlled are more effective in regulating economic activity in general when they are seen to have an impact also on long- and medium-term rates. The money market must be so organized that this can happen, and only when it does will the changes in bank liquidity due to the change in the reserve ratio have their full effect.

Furthermore, it is only when money rates respond promptly to liquidity changes that it becomes possible to promote such flows of short-term capital towards or from foreign countries as may be required to compensate balance-of-payments disequilibria.

Suppose, for example, that some country has large balance-of-payments surpluses and that the monetary authorities create a corresponding volume of liquidity. When this additional liquidity comes to weigh on the money market, it immediately brings down money rates, with two results. Part of the excess liquidity is transferred abroad in search of higher money rates, and the reduction of interest rates spreads from the money to the capital market, where the resulting lower capital costs have an expansionary influence on investment decisions. But in the absence of prompt repercussions on long rates, fluctuations in the short rate would have an effect only on international monetary movements.

We believe it essential that we should bring every effort to bear on the maintenance of an efficient capital market on which to place new issues which, subject only to minor price fluctuations, provide the necessary capital funds for the large-scale investment programmes of both the public and the private sector. In pursuing this objective, we have in mind the experiences of others, especially in so far as they go to show that an increase in the quantity of easily monetizable securities often weakens the effectiveness of monetary controls.

Nor must it be overlooked, in planning for a sound money and capital market, that in the Italian banking system as it is at present there is no functional relationship between Treasury Bill issues and the Treasury's cash needs. Excess liquidity simply flows into the Treasury, and the balance of its current account with the Bank of Italy is apt to convey a false picture of financial ease.

It should be added that to issue Treasury Bills in unlimited quantities and at a rate of interest fixed for long periods, may, at times of abundant liquidity, reduce the incentive for the banks to look for productive employment of their resources, precisely because the banks can invest their liquid funds at will in a security which can always be transformed into money and from which they obtain a constant yield not immediately subject to the influence of changing market conditions.

The present system, therefore, reduces the incentive to adjust the rate of productive lending to the level of liquidity which the monetary authorities think it right to leave on the market; but it also prevents the Treasury from borrowing at interest rates in line with the balance of supply and demand on the money market.

In these circumstances, we believe it would be of advantage if the authorities responsible, together with banks and banking associations, were to consider some change in the present system of unlimited Treasury Bill issues, independent of the Treasury's cash needs. The present system might well be replaced by another, in wide use abroad, under which Treasury Bills are issued periodically and in quantities corresponding to the

Treasury's cash needs. If liquidity is abundant, rates of interest will fall; in the contrary case, they will rise. If the monetary authorities should wish abundant liquidity to bring down the yields of medium- and long-term securities, this will be facilitated by the fact that bank resources, no longer able to flow to the Treasury in unlimited quantity and at constant yield, will instead reach the current accounts of the central bank, where yields are minute. As a result, banks will have more immediate incentives to look for more fruitful employment of their funds, which may then well be channelled into medium- and long-term securities.

The best innovation to introduce might be to replace the present system of tap issues by monthly quotas. The issue price of each monthly quota would, as a general rule, be aligned to Bank Rate, and at that price the banks could obtain all the Treasury Bills they need to fill up their compulsory reserves. Anything left over could then be taken up by the banks either as investment for their own liquid reserves or on behalf of their clients. The quotas would be allocated to the highest tenders.

Our credit system is adequate to ensure the flow of funds from one part of the country to another; the big banks, which operate all over the country, move sizeable funds into the less developed areas. Excluding southern banks, the big banks' loan/deposit ratio in the mainland south was 76.7 per cent in 1960 and 77.7 per cent in 1961, whereas the same banks loan/deposit ratio over the country as a whole was 75.4 and 76.7 per cent, respectively. The divergence becomes even more evident if the islands are taken into account. The big banks' loan/deposit ratio in Sicily was 108.3 per cent in 1960 and 108.9 per cent in 1961; in Sardinia, it was 86.8 and 92.9 per cent, respectively. The ratios are lower if southern banks are included in the computation, but then they refer to the lending operations of the banks as such, without their special credit sections. Including these latter, it would seem that the southern banks generously fulfil their task of helping the economy of their own regions.

Another part of the country where loan funds tend to concentrate is, obviously, Lombardy, where the loan/deposit ratio of nation-wide banks was 86.5 per cent in 1960 and 88.0 per cent in 1961. However, the statistics of the geographical distribution of credit do not tell the whole story of the ultimate destination of the credits granted. Milan, for example, is the headquarters of a large number of nation-wide companies. The head office takes up the credit, but the borrowed funds may then be spread all over the country. We do not have the necessary statistical materials, as yet, to determine the geographical distribution of credit flows with a sufficient degree of approximation, but at least we know that we would go seriously wrong in interpreting these statistics as true indicators of the ultimate destination of the credits granted.

Apart from moving flows of money across the country, our banking system also has facilities for large-scale internal movements of funds through interbank accounts. The magnitudes involved are really large now. On December 31, 1961, the total of funds which all categories of banks except the six largest had deposited with other banks amounted to 1,077 billion lire; at the same date, the same banks, again without the six largest, had themselves 530 billion lire in interbank deposits. The rest had gone to the six largest banks.

Clearly the smaller banks, and especially those operating in only one province or one region (the former had deposited 255 billion and received deposits of 46, and the latter had deposited 291 billion and received deposits of 82) have more funds than they can employ directly, and the big banks, with offices all over the country, act as depositories for a sort of central cash pool for the smaller ones by lending out not only their own funds, but also part of those which the smaller banks collect.

This puts two heavy responsibilities on the shoulders of the big banks. One of them is that they must at all times maintain a sufficiently large and flexible cash reserve to discharge the tasks which the smaller banks seem to shift onto the big ones by such deposits. In this, we believe, the big banks have not failed. Liquid bank assets in the form of Treasury Bills are almost entirely in the hands of the six big banks. This explains why the central bank at times came to the rescue more particularly of these banks by recreating lire liquidity through the repurchase of foreign exchange. It was by no means a case of trying to bolster the big banks' competitive position *vis-à-vis* the small and medium ones, but of enabling the former to administer efficiently the cash pool entrusted to them by the latter.

The second responsibility is that the big banks must not pay for the smaller banks' deposits a rate of interest high enough to push up the cost of borrowing for the whole banking system. These interest rates should move parallel with money rates; if, then, the central bank wished abundant liquidity to bring down money rates in order to provide an incentive for the productive employment of bank resources, the big banks which administer the joint cash pool ought to follow suit.

All this suggests that it will become necessary to tighten control over interbank accounts if we are to create a well organized money market, in which money flows become more mobile and in which the conditions of borrowing and lending respond readily to the intentions of the monetary authorities. I do not mean that we wish to suppress the phenomena which come about through the intermediary of interbank accounts. But, should we ever become convinced that the flows moving through this channel carry with them the seeds of a general rise in the cost of borrowing in contradiction to the monetary authorities' intentions, then we shall not hesitate, among other measures, to insert ourselves into these flows.

Our policy with respect to interest rates, both for borrowing and for lending, has always been to prefer those types of restraint which work through agreements among the banks themselves. We have no intention of suddenly adopting the kind of intransigent attitudes for which we sometimes chide our colleagues in the banks, and we shall resist the proposals, which are often made to us, to adopt coercive controls which, in our view, are humiliating both for those who impose and for those who are subject to them. On the other hand, we shall not shrink from using the instruments which modern monetary policy puts into our hands, because we believe them to be more effective than admonishments and threats. In any event, we have every confidence in the reasonable behaviour of bank managers faced with narrow margins between cost and revenue.

The narrowing of the margin between borrowing and lending rates is bound, from time to time, to engage the attention of even the busiest bank manager, but it is also the most eloquent possible demonstration of the existing keen competition in the banking world. If we compare effective debtor and creditor interest rates in the case of some of our big banks and in that of comparable credit institutes in foreign countries reputedly more open to competition, the spread is probably narrower in Italy. We hope to carry this investigation further with the help of some other central banks and through the exchange of confidential information; but even such fragmentary material as we have at hand allows of some reasonably reassuring conclusions.

The further extension of the branch network of banks is another matter where we would wish some self-restraint to be introduced by agreement within the banking associations. We continue to believe that this is the method which can best protect the system against outside influences and ensure a balanced distribution of various categories of banking institutions, such as to make room for the coexistence of decision centres at differing removes from headquarters and thereby to avoid the drawbacks of excessive concentration. But should the banks, by ill fortune, fail to come to an agreement, we shall again not shirk our responsibilities, and the choices we shall be called upon to make will obviously not be uninfluenced by our judgement of the individual banks' willingness to tow the line.

Our economy is now much more mature than it used to be and this must eventually be reflected in the credit system. In common accord we shall have to fashion instruments of monetary and financial policy fit for a country intent on further progress and on making good use of the fruits of progress.

From what we have said before it will be evident that our success in creating a continuously expanding capital market, the banks' support of the capital market, our steady improvement in the organization of our banking system and credit institutes and their mutual collaboration, have given us what we may rightly call a modern credit system. It is, of course, still in evolution and certainly not free from elements of emulation, and we all want it to continue on the road of progress. On our part we count, as before, on your whole-hearted collaboration. Our preferred method is that of open discussion and, through it, of mutual persuasion. Even more than in the past we hope to avail ourselves of your counsel, but on occasion we shall have to call upon your good will in complying with a discipline not imposed, but freely accepted in view of its fitness to further the common weal.

We have outlined the developments which we believe to be apt to safeguard the proper functioning of the capital market and to create an efficient money market. We have done so because these objectives cannot be realised in practice without the full and deliberate collaboration of those who operate in the fields of credit and finance.

But a word of warning may be indicated. To say that valuable contributions can be made through the improvement of suitable instruments and through the search for every promising opening for their application does not mean that we may lose sight of the fact that these contributions as such can in no way make good any weakening or disappearance of the basic conditions of a continued high rate of growth.

Other countries' experiences go to show that one of the essential determinants of a high rate of growth is a strong competitive position in foreign markets, to be achieved primarily through notable productivity increases.

These lessons are confirmed by Italy's own experience, both as regards the conditions which have allowed our goods to establish themselves abroad and as regards the primary importance which foreign demand has assumed in the last decade as an element of support for the Italian economy.

At present there is a process afoot in our economy which tends to raise labour costs more than productivity. At stable price levels, this compromises our firms' self-financing capacity and ultimately heightens their dependence on outside sources of finance, as is clearly evidenced by their greater recourse to bank credit. The same tendency is apparent in the growing loan applications to special credit institutes.

At the same time, the volume of investment planned by the public sector in excess of its own saving tends to expand, so that the public sector, too, has to incur more debts. These again largely converge upon the special credit institutes, which cannot, in their turn, pay out more funds unless they float more bond issues in the capital market. If both company saving and public saving are insufficient for expanding investment, there is obviously only one way to re-establish equilibrium, and that is to raise private saving. This has in fact happened to some extent in 1961.

However much our capital market may have grown, it cannot gain immunity from the repercussions of large disparities between the rate of increase of investment, on the one hand, and of the rate of increase of self-financing funds, on the other. This holds especially in so far as the capital market is, for institutional and conventional reasons, qualitatively subdivided into several, and only partly intercommunicating, compartments.

Furthermore, changes in the composition of investment together with the nature of the investing agency may create sectoral imbalances on the capital market. The nature and size of some agencies lead them to look for funds primarily on the capital market, and to do so, moreover, by means of specific security issues; if investment by such agencies should grow relatively more, then the particular compartment of the capital market involved may experience serious difficulties even if the additional claims on it are not so large in the overall view.

I have described the means by which we propose to improve the flexibility of the capital market and to facilitate the transfer of funds from the money to the capital market; but these measures can obviously resolve only short-term problems and cannot make good any deficiency of real saving. Should inadequate saving fail to be compensated by a scaling down of investment, the measures we have in mind would simply impose a strain on monetary equilibrium. We do certainly have the intention of putting at the disposal of the economy an efficient market where capital circulates freely and can be channelled into the most productive uses or at any rate into uses in line with programmes considered to be in the public interest; on the other hand we shall do nothing which might interfere with the level of liquidity at the cost of blurring the dividing line between liquidity and saving.

To sum up, I would say that while the process of financing production and investment may derive great benefits from the existence of an efficient and flexible market capable of overcoming partial and sectoral disequilibria, this process is ultimately conditioned by real factors pertaining to the primary sources of the formation of saving. In the last analysis, the process remains in the safekeeping of the nation's willingness to save and of a sagacious apportionment of the private and the public sectors' needs with a view to containing them within the limits of disposable saving.

XI. *The Bank's Activities and Balance Sheet*

Anxious to be possessed of yet more precise information for the assessment of monetary developments, the Bank of Italy proceeded last year to a thorough reappraisal of the significance and composition of all items figuring in its own balance sheet and in that of the Italian Exchange Office. The purpose was to break down the accounts by sectors and to make them additive, so as to gain a full conspectus of the details of both institutes' transactions and combined position.

This has led to considerable refinement in the reclassification of the items in the Bank's balance sheet. The composition of all items is now rearranged by sectors and, what is more, rearranged in complete concordance with the new pattern of Italian Exchange Office accounts, which formerly reflected merely the broad division between advances to the Treasury and operations in gold and foreign exchange. It is especially useful that the consolidation of the balance sheets of the two institutes has furnished some missing elements for a full and systematic analysis of the changes in individual items, and particularly also of some additional ones which have displayed considerable variations in the course of 1961, so that we now have a complete and clear picture of all the interventions having a bearing on liquidity control (operations deriving from Italy's membership in the International Monetary Fund and the Exchange Office's transactions with the banking system). If the year's changes are considered sector by sector, it will be seen that of an additional 387 billion lire of foreign assets last year (101 billion in 1960), 110 billion are accounted for by IMF drawings on the lire quota (none in 1960). It will also be seen that of 260 billion lire (30 in 1960) of additional loans to banks, 192 (compared with a contraction of 3 billion in 1960) are attributable to credits by the Italian Exchange Office (see Table 28).

TABLE 28

Selected Items from the Consolidated Balance Sheet of the Bank of Italy and the Italian Exchange Office

(annual changes in billion lire)

Items	1960			1961		
	Credit	Debit	Balance	Credit	Debit	Balance
Public sector (1)	− 67.9	− 1.4	− 66.5	− 77.1	87.0	− 164.1
Foreign sector (1)	108.8	7.8	101.0	281.2	− 106.2	387.4
of which: IMF	—	—	—	—	− 109.5	109.5
Miscellaneous accounts	5.8	− 7.6	13.4	6.8	47.6	− 40.8
Note circulation	—	186.8	− 186.8	—	355.1	− 355.1
Special credit institutes	3.8	—	3.8	24.5	—	24.5
Banks	29.8	− 105.3	135.1	259.5	111.4	148.1
of which: Italian Exchange Office credits	− 3.4	—	− 3.4	191.7	—	191.7

(1) Net of 62.8 billion lire for gold revaluation in February 1960.

Brief sectoral analysis reveals that the net increase in disbursements last year, namely, 355 billion lire representing the expansion of the note circulation, is the resultant of additional credit entries in the amount of 671 billion lire (387 billion foreign assets and 284 billion lending to the credit system) and additional debit ones in the amount of 316 billion (164 from the Treasury, 111 from bank deposits and 41 miscellaneous accounts). The analogous net increase of 187 billion lire in 1960 was made up of credit entries of 253 billion (101 billion net lending to the foreign sector and 34 to the credit system, 105 billion bank deposits and 13 miscellaneous accounts) and debit ones of 66 billion (Treasury).

The Bank's balance sheet drawn up on the principles described above shows that, in line with a tendency dating back to 1958, advances to the Treasury contracted by 164 billion lire last year (66 billion in 1960 an 517 in 1959). To the extent of 104 billion this further contraction in the Treasury's debt to the central bank took place in the *Treasury current account*, which, at the end of 1961, showed a credit balance of 263 billion, as against 159 billion at the end of 1960. At the same time, *Advances to the Treasury* diminished by 64 billion lire (extinction of the Treasury's debt for temporary advances) and Exchange Office advances to Treasury for stockbuilding and machinery purchases from the sterling area contracted by 12 billion (thanks to further repayments).

The Bank's holdings of government stock increased by 16 billion lire (10 billion in 1960), half of them shown under *Government or government-guaranteed securities* and half as investment of reserves and miscellaneous funds in government securities, railway bonds and above all Green Plan bonds.

In the foreign sector, the net credit balance rose from 2,198 to 2,585 billion lire between the beginning and end of last year; the increase of 387 billion was well in excess of the 1960 increase of 101 billion, net of 62.8 billion for gold revaluation. The change reflects the balance-of-payments surplus which, in particular, contributed 260 billion lire to gold and foreign exchange reserves. Of the remaining 175 billion, 110 are accounted for by IMF drawings on the lire quota.

As regards the domestic credit system, gross lending to banks and special credit institutes passed the 800-billion lire mark on December 31, 1961, having risen by 284 billion in the course of the year, compared with 33 billion in 1960. This was in large measure a reflection of the Italian Exchange Office's expansion of credit to banks authorized to engage in foreign business. The new credits amounted to some 190 billion lire, about 54 billion (12 in 1960) of them rediscounts of bills presented by banks and special credit institutes.

The liquidity strain experienced by banks, especially towards the end of the second and fourth quarter of the year, and their consequent greater recourse to the central bank are most clearly reflected in the item *Advances,* which confirm the preference of banks for this particular source of funds. This item grew by 43 billion (18 in 1960) over the year to 107 billion lire.

Of the total of 801 billion lending to the credit system, 536 are attributable to banks, which, however, still have a credit balance with the central bank, if their compulsory and voluntary deposits with the latter are taken into account. At the end of 1961, net deposits by the banks (that is, the excess of deposits over debts) still amounted to 304 billion lire, as against 452 at the end of 1960 and 587 at the end of 1959. While the diminution in 1960 was due to the banks' withdrawals from deposit accounts and connected with the substitution of securities for cash in the compulsory reserve, the further drop in 1961 was mainly attributable to increased recourse to the central bank, in part for the purpose of fulfilling reserve requirements to the extent of an additional 100 billion in cash deposits.

In the group of miscellaneous accounts a debit balance of 327 billion lire is shown at the end of 1961, that is, 41 billion more than at the end of 1960. The change is due to positive and negative variations of minor importance.

Note circulation increased by 355 billion from 2,424 to 2,779 billion lire over the year. The percentage increase of 14.6 was conspicuously higher than those of 8.3 and 8.6, respectively, in the years 1960 and 1959.

The increase in the rate of expansion, measured in end-year figures, reflects two major circumstances: first, the greater incidence of the seasonal end-year peak, intensified last year by an exceptional accumulation of holidays and by the introduction of a five-day working week in banks; secondly, a consistent increase throughout the year, in connection with boom conditions in the economy.

As regards the first point, it will be recalled that both the Christmas and the New Year holidays were preceded last year by an extra two days on which the banks were closed. This naturally led business men to withdraw more cash than usual and also prevented the habitual reflux, during the last days of December, as a result of higher consumer spending.

The counterpart of the increased note circulation in 1961 consisted of 387 billion lire attributable to additional assets deriving from the balance-of-payments surplus and 173 billion attributable to transactions with the credit system, partly offset (to the extent of 104 billion) by a reduction in the Treasury's indebtedness. Taking account also of the contractive effect of 41 billion on miscellaneous accounts, all these changes resulted in an increase of the note circulation of 355 billion lire.

The composition of the note issue showed a further shift in favour of the largest denomination; the tendency was rather more marked than the year before, especially last December, when, on the 31st, 10,000-lire notes accounted for 79.1 per cent of the total (77.8 per cent on December 31, 1960). By contrast, the circulation of 5,000 and 1,000 lire notes contracted, as in 1960. It will clearly become necessary to adjust the structure of the note circulation to the larger volume of transactions and this might well be done by introducing a note of higher denomination than 10,000 lire.

Personnel Matters.— At the end of 1961, the Bank's staff consisted of 7,500 employees, 267 more than a year before—the resultant of 540 new appointments and 273 terminations. In 1960 the Bank's staff had increased by 429.

Capital, Reserves, and the Profit and Loss Account.— None of the Bank's shares changed hands in the course of the year under review. On December 31, the 300,000 shares and 796 voting rights were, therefore, distributed as before in the following manner:

72	Savings Banks	177,746	shares	with	468	votes
8	Public-law credit institutes .	54,500	»	»	141	»
3	Banks of national interest .	21,000	»	»	54	»
1	Social Insurance Fund . .	15,000	»	»	34	»
9	Insurance companies . . .	31,500	»	»	99	»
93	Shareholders	299,746	shares	with	796	votes

Shareholders with less than 100 shares:

5	Savings banks	254	shares
98	Shareholders	300,000	shares

Ordinary Reserves, which stood at 3,060.8 million lire on December 31, 1960, rose during the year to 3,755.3 million. This was the result of an appropriation of 107,15 million from 1960 profits, 635.0 million investment income from the reserve fund itself, and a diminution of 47.7 million, which represents distribution to shareholders of part of the 1960 investment income from the fund (under Article 56 of the Statute).

Extraordinary Reserves rose from 1,789.5 million lire on December 31, 1960, to 2,037.8 million at the end of 1961. This was the result of an appropriation of 107.15 million from 1960 profits, 171.5 million investment income from the reserve fund itself, and a diminution of 30.3 million, representing distribution to shareholders of part of the 1960 investment income (under Article 56 of the Statute).

In application of Article 54 of the Statute, the Board of Directors proposes, and the Treasury authorizes, the following appropriation of the Bank's net profit of Lit. 575 million for the year 1961:

	(million lire)
To Ordinary Reserve, 20 per cent	115
To shareholders, 6 per cent on capital	18
To Extraordinary Reserve, 20 per cent	115
To shareholders, a supplementary dividend of 4 per cent on capital	12
To the government, the residual of	315
Total net profit . . .	575

In accordance with Article 56 of the Statute, the Board of Directors further proposes a distribution to shareholders of another 28 per cent on capital, or 84 million lire, out of investment income from the ordinary and extraordinary reserve funds. This amount corresponds to 1.73 per cent of the overall reserves on December 31, 1960, and is, therefore, below the 4 per cent laid down in Article 56 as the upper limit of distribution under this heading.

THE GOVERNOR
G. CARLI

BALANCE SHEET

AND GENERAL PROFIT AND LOSS ACCOUNT

BALANCE SHEET AS

ASSETS

Gold	L.	1,000,000,000,000
Cash in hand	»	12,464,345,558
Domestic bills of exchange	»	499,592,203,089
Bills for collection	»	216,192,001
Advances	»	107,225,078,776
Deferred clearing house payments	»	6,044,697,500
Foreign exchange balances abroad	»	63,363,038,266
Italian Exchange Office—current account	»	1,810,184,825,250
Government or government-guaranteed securities	»	83,021,675,895
Premises	»	1
Miscellaneous debtors	»	123,195,308,620
Advances to the Treasury: extraordinary	»	485,000,000,000
Miscellaneous services for account of government	»	501,833,022
	L.	4,190,809,197,978
Securities and other valuables deposited	»	4,774,581,760,337
	L.	8,965,390,958,315
Items written off in past years	»	19,975,867
GRAND TOTAL	L.	8,965,410,934,182

Audited and found correct — Rome, 11th May, 1962

The Auditors

ALESSANDRO BACCAGLINI
BRUNO DE MORI
MARIO MAZZANTINI
FELICE PAPPALARDO
RAFFAELE PILOTTI

p. p. **The Accountant General**

ARNALDO FALSINI

OF DECEMBER 31, 1961

LIABILITIES

Note circulation	L.		2,779,229,266,000
Bank drafts, cashier's cheques and other sight liabilities	»		38,661,252,735
Current accounts	»		117,523,307,436
Time deposits (incl. compulsory reserves)	»		796,757,740,643
Miscellaneous creditors	»		189,055,064,679
Treasury current account	»		262,914,424,236
Net profit for 1961	»		574,966,883
			4,184,716,022,612
Capital	L.	300,000,000	
Ordinary reserves	»	3,755,344,177	
Extraordinary reserves	»	2,037,831,189	
			6,093,175,366
	L.		4,190,809,197,978
Depositors	»		4,774,581,760,337
	L.		8,965,390,958,315
Items written off in past years	»		19,975,867
GRAND TOTAL	L.		8,965,410,934,182

The Governor

GUIDO CARLI

GENERAL PROFIT

FOR THE

EXPENDITURE

Administration and contributions to staff retirement fund	L.	25,807,119,787	
Directors' emoluments	»	363,822,502	
Transport of notes, coin and other valuables	»	110,244,939	
Note printing	»	4,687,827,145	
Expenditure on premises	»	771,914,122	
			31,740,928,495
Circulation tax on notes and demand drafts	L.	5,117,000,894	
Income and company taxes	»	2,502,118,353	
Sundry taxes and dues	»	352,499,444	
			7,971,618,691
Amounts written off	L.		4,584,440,568
Interest payable	»		466,883,457
Charity and other contributions	»		75,394,365
	L.		44,839,265,576
Net profit for distribution	»		574,966,883
Total	L.		45,414,232,459

APPROPRIATION

To ordinary Reserve
To Extraordinary Reserve
10 % Dividend to shareholders
To the government
Total distributable

Audited and found correct — Rome, 11th May, 1962

The Auditors

Alessandro Baccaglini
Bruno De Mori
Mario Mazzantini
Felice Pappalardo
Raffaele Pilotti

p. p. **The Accountant General**

Arnaldo Falsini

AND LOSS ACCOUNT

YEAR 1961

RECEIPTS

Discounts	L.	15,652,940,810	
Interest on advances	»	3,724,787,444	
Interest on other assets	»	17,082,641,256	
Commissions and custody fees	»	1,334,883,859	
Profits on foreign transactions	»	2,141,123,119	
Sundry profits	»	482,399,123	
			40,418,775,611
Interest on government securities	L.	4.741,750,467	
Revenue from real estate	»	253,706,381	
			4,995,456,848
	Total . . . L.		45,414,232,459

OF NET PROFIT

	L.	114,993,377
	»	114,993,377
	»	30,000,000
	»	314,980,129
profit for the Year	L.	574,966,883

The Governor

Guido Carli

THE ADMINISTRATION OF THE BANK OF ITALY (1961)

BOARD OF DIRECTORS

CHAIRMAN: Guido **CARLI** * – GOVERNOR OF THE BANK

Paolo BAFFI * – GENERAL MANAGER

Ernesto BINDOCCI – DEPUTY GENERAL MANAGER AND SECRETRY TO THE BOARD

Paolo BLUMENSTIHL	Francesco MAILLER
Renato BRANZI	Paolo MONICO
Gaetano CARBONE *	Lucio MORODER
Gian Luigi DONES *	Eugenio VACCARI *
Antonio FONDA SAVIO *	Ernesto VACCARINO
Leone MAGLI	Giambattista VIRGA

* Member of the Executive Committee.

BOARD OF AUDITORS

Alessandro BACCAGLINI	Felice PAPPALARDO
Bruno DE MORI	Raffaele PILOTTI

Mario MAZZANTINI

ALTERNATE AUDITORS

Domenico AMODEO	Raffaele D'ADDARIO

THE CENTRAL ADMINISTRATION

MANAGERS

Ciro de MARTINO	Emilio RANALLI
Paolo VECCHIA	Tullio RICCIO
Vincenzo ONORATELLI	Salvatore GUIDOTTI