BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1963

PRESENTED TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 30th MAY, 1964

ROME

PRINTING OFFICE OF THE BANCA D'ITALIA

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REPORT OF THE GOVERNOR

I. *General Economic Conditions*

By and large, 1963 was a good year for the economy of the Western world. Expansion continued, though it was accompanied, in some countries, by inflationary pressures of varying origin and strength.

The growth rate of GNP in real terms slackened in countries where it had previously been highest and quickened where it had been slow, with the result that the international range narrowed from between 0.5 and 6.3 per cent, in 1962, to between 3.2 and 4.8 per cent last year. While this greater uniformity in the rates of expansion of various countries is no doubt an expression of certain basic factors common to all, it also masks differences in the development of aggregate supply and of the components of demand.

One general and, in some cases, very pronounced feature of economic conditions was the cyclical weakness of demand for investment goods. Economic activity was sustained chiefly by private consumption demand, which was fed, in some countries, by a redistribution of incomes to the benefit of wages and the detriment of profits. This process, which began in 1962 and still continues, last year worked to the advantage of countries where wages and prices rose less fast than elsewhere and which therefore attracted particularly strong foreign demand.

The beneficiaries of expanding trade flows included, among others, also developing countries, which were able to export more raw materials at rising prices.

At the turn of the year economic conditions appeared to have entered a phase of rapid change nearly everywhere, for a number of reasons. Among Common Market countries, some kept losing competitive strength and in some cases a pause in the growth of production now seems inevitable; Switzerland suffered from overheated boom conditions and similar signs in the United Kingdom portended renewed strains; in the United States, by contrast, stable costs and prices kept the upswing in orderly conditions.

The Present Outlook.— The cyclical problems with which the governments and monetary authorities of the Western nations have to deal at present are much the same as those which we already had occasion to discuss in last year's Annual Report. In the Anglo-Saxon countries the chief problems are to maintain economic expansion and to equilibrate the balance of payments, in the Common Market countries to stop cost inflation and to trigger off renewed expansion.

The United Kingdom, having solved some of its problems with signal success, is now having to face opposite ones and is already taking steps to meet them. The United States still have an unsolved unemployment problem on their hands, but have made much headway in stepping up the pace of economic expansion and in balancing their external payments position. In Switzerland, on the other hand, the current deficit continues to be very high in relation to GNP and the intensity of the boom is without precedent; here, as also in all EEC countries with the sole exception of Western Germany, the imbalances appear greatly aggravated and any prospect of their elimination further removed.

The inflationary tendencies which engulfed Italy and France and later appeared in the Netherlands and also in Belgium, now threaten to spread to Western Germany and to weaken the competitive strength of the whole EEC to a very considerable extent—so much so that there is a danger of expansion coming to a halt and economic integration being delayed.

There can be no doubt that the ultimate origin of these tendencies lies in foreign demand and the consequent increase in domestic money supply; but in the current cyclical phase they are, equally without doubt, sustained chiefly by the rise of wage costs per unit of product. There have, of course, been other causes, the combined impact of which is certainly not negligible, such as poor harvests, imperfect competition, insufficient mobility of labour, sliding wage scales, real estate speculation, higher prices for imported raw materials, etc.; but it was the rise of average labour costs which did more than anything else to push up prices. This remains true even though the wage-price spiral occasionally made cost rises appear not so much a cause as an effect, intensified in some cases by the existence of sliding wage scales based on the cost of living. In any event, demand inflation came to be superimposed upon cost inflation, so that now we have a situation where price and cost rises and inflationary pressures are clearly attributable to domestic factors.

Western Germany is in a peculiar position all its own: domestic price and cost stability has attracted so much foreign demand that there is now a danger of inflation being propagated to that country as well.

In this preoccupying situation, the Council of Ministers of the EEC, acting on the advice of the Commission, made a series of specific recommendations to member governments last April and requested them to report back within two months on their decisions; these recommendations concern measures by which to achieve, or consolidate, price and cost stability not later than the end of this year. The Ministers were at pains to stress that this objective is to take priority over all other at the present stage of the business cycle, and that the proposed anti-inflationary measures should in no way impair a liberal import policy.

For Italy, the Ministers made a number of specific as well as more general recommendations; one of the latter was to introduce a balanced incomes policy.

Incomes Policy.— It was already pointed out in last year's Annual Report that the governments of most major industrial countries had come to recognize the need for an incomes policy, given the proven inadequacy of counter-cyclical policies in a phase of cost inflation. Experience suggests that incomes policy should be applied in an indicative rather than in too rigid a manner, since a certain amount of flexibility is necessary to safeguard the market incentives which make for a transfer of human and material resources from static to dynamic sectors. In so far as exceptions to the general rule are allowed for this purpose, the benefits accruing to any one sector in the shape of higher wages or profits should be offset by sacrifices imposed upon other sectors of the economy. If, for instance, some particular group of workers is given wage increases in excess of the national average for justifiable economic or social reasons, then other groups of workers should get less-than-average wage increases; the same applies to profits in particular branches of industry, where above-average and below-average movements should also offset each other to the extent possible. Deviations of both wages and profits from the national average are obviously a matter to be referred to an independent agency, which should, above all, weigh the advantages or otherwise of sanctioning a collective agreement conferring more benefits on one group of workers than on others. Other points on which it is important to have an independent opinion is the practice of specific firms to attract workers by offering higher wages (wage drift may often be the consequence of productivity rises in some sector), and the conduct of firms or whole branches of industry which keep to themselves the full benefit of their own productivity rises without passing it on to the rest of the economy in the shape of lower prices. The idea that the fruits of higher productivity should accrue solely to the entrepreneurs and workers of the original branch of industry is incompatible with a well-informed incomes policy.

The above considerations underline another feature of incomes policy which has come to be recognized as essential in all countries where the problem has been under discussion, and that is that incomes policy must be comprehensive. It must be applied, with substantially uniform intent, not only to wage incomes, but to all other categories of incomes as well—that is, independent labour incomes (which include agricultural earnings), annuities, interests and dividends, and undistributed profits.

Uniform intent does not, of course, imply uniform standards of application; on the contrary, the standards of application must vary precisely because income categories themselves are different as regards their nature and the process of their formation.

The principle of profit control has by now been accepted, albeit with certains reservations, both by the Federation of British Industries in the United Kingdom and by the *Patronat* in France, which latter insists on the condition of sufficiently generous standards and a long reference period. Those who say, in these two countries, that incomes policy must cover also profits, argue that profits and other non-wage incomes, whether they rise autonomously or in consequence of wage increases, can be an important factor in price rises; in any event, profits are protected by price agreements, high trade mark-ups and restrictive practices, all of which tend to prevent increased productivity being reflected in lower prices.

However, all the discussions turning on this problem have also made it abundantly clear that the application of incomes policy to company profits raises some very complex issues. Profits, after all, depend on prices, and to control profits one must, therefore, either directly influence prices, which might unduly disturb the market mechanism, or else directly influence profits at the stage when they are formed, which might weaken the incentives to produce and invest.

In practice, profit control is feasible only if entrepreneurs themselves accept a commitment to keep prices stable and indeed to reduce them in certain circumstances, and also agree to abide by the verdict of an independent agency. This agency should regularly publish such facts and figures as are apt to help public opinion arrive at a free judgement on the relative movements of profits and wages.

As regards the actual methods by which to control profits, this is at present a matter of sharp controversy.

In some countries, notably in Western Germany and Switzerland, it is felt that, in present economic conditions, it would be neither easy nor indeed wise to exercise any direct influence on the formation of incomes and prices. Government, it is argued, already disposes of ample means to tackle the problem by fiscal and budgetary policy, by tariff reductions and by direct intervention in the form of subsidies, administrative and legislative provisions, price control, rate-fixing for public services, and so on. Once wage increases are regulated on the basis of the economy's average productivity, the monetary authorities should have no difficulty in influencing the profit level *via* money supply and the balance of payments.

Other countries have embarked, or seem about to embark, on direct action on profits, either through price policy, as in France, the Netherlands and Denmark, or through control of profits at the source. Price policy may be applied in different degrees, ranging from official price-fixing through checks, supervision and procedures for the notification of violations, but no-one—not even the trade unions of the Western countries—seems to think that general price control would be either expedient or, for that matter, efficacious. Direct control of profits at their source has been exercised from time to time by certain governments since the war, and more recently its systematic application has been discussed in France and the United Kingdom. Even there, however, it is realized that the chances of success depend upon prior agreement of all parties concerned to an overall economic plan; given the political difficulties of such a solution, the idea has not yet progressed beyond purely exploratory studies.

If there is one thing that discussions both in separate countries and on the international plane have made clear beyond doubt, it is that a number of fundamental conditions need to be fulfilled before an incomes policy can be launched in a climate of confidence between government, business men and trade unions. Two conditions have already been mentioned, namely, that the general standard of reference must be average productivity in the economy as a whole, and that incomes policy must be comprehensive in the sense that it must apply to all incomes, whatever their nature and the process of their formation.

Paramount among the other conditions is that, in accordance with the principles of a democratic society and its free political and economic institutions, incomes policy must be formulated in terms which are easily intelligible to the public. Incomes policy must, furthermore, be freely accepted and backed by the moral force of well-informed public opinion, which, too, retains ultimate judgement over such deviations as may appear necessary.

Another major condition is that incomes policy must rest upon full statistical information which, to safeguard it against doubt and attack by any interested party, should be collected by an independent agency of experts. This is important, in so far as the debate on this subject has made it clear that one of the reasons why labour opposed an incomes policy was precisely that not enough was known about the process of income formation and about the actual size of profits.

Acceptance of an incomes policy should also imply the recognition that price rises are not in all circumstances a valid reason for wage rises, and that wages should be allowed to go up only when average productivity in the economy as a whole improves. It follows that any sort of sliding wage mechanism is incompatible with a rational incomes policy within the framework of a general economic plan.

Italy. The Italian economy last year followed a course that was clearly visible already in 1962. Fundamentally, there was not much difference between the two years, although the disturbances from which our economy suffered increased in 1963 and the strains and imbalances got worse.

The upward movement of wages, costs and prices gained added impetus, our balance of payments on goods and services account got deeply into the red, and the growth of our national product slowed down.

Gross national product in real terms rose by 4.8 per cent— a sharp drop in comparison with the 1962 rate of expansion of 6.7 per cent. What is more, the rise last year was the smallest since 1959 and fell far short of the long-term (1950-1962) average of 6.1 per cent.

Nevertheless, the results still look respectable enough for a year in which adverse weather conditions depressed agricultural output and for the cyclical phase in which Italy found herself.

Industrial output (including building) expanded by 7.7 per cent over the average of 1963, which is not so much less than the 9.3 per cent of 1962. While, moreover, industrial production was stationary over large parts of 1962, it climbed steadily throughout 1963 until the last few months, when it settled at high levels.

Wages, which in 1962 had risen much more than productivity, went up even faster last year. At the same time the increase in output per person employed slowed down, so that the rise in labour costs per unit of product was much sharper than before.

Wage-earners' incomes in the aggregate went up by 21.6 per cent in 1963. Seeing that real GNP rose by 4.8 per cent, the increase in labour costs per unit of product amounted to 16 per cent. The corresponding figure was 10.3 per cent in 1962, when labour incomes rose by 17.7 and GNP by 6.7 per cent.

Wage and cost increases lifted consumption and imports and, by depressing investment and exports, held back national income.

The real rate of investment (at 1954 prices) dropped from 11.3 per cent in 1961 through 8.2 per cent in 1962 to 4.1 per cent in 1963; similarly, the real rate of expansion of exports fell from 17.2 through 10.7 to 6.8 per cent in the three years, respectively. Gross national product, finally, grew by 8.6 per cent in 1961, 6.7 per cent in 1962 and 4.8 per cent last year—though some allowance must here be made for fluctuations in agricultural output.

The volume of consumption, which had risen by 7.3 per cent in 1961, grew faster than GNP in 1962 (7.4 per cent) and even more so in 1963 (9 per cent). Taking the two last years together, a real rise in GNP of less than 12 per cent compares with an increase in consumption of nearly 17 per cent.

The rise in the volume of imports of goods and services, which had been 15 per cent in 1962 as in 1961, last year was 20 per cent.

The strong increase in monetary wage incomes also gave rise to an exceptional expansion of monetary consumption demand, which, during these last two years, rose by almost one third. No economy in the world can withstand such an onslaught without a price rise.

Although investment demand increased far less last year than in 1962 and exports of goods and services no more than the year before, aggregate monetary demand expanded very sharply. Last year's increase of 15 per cent was well in excess of the 13.2 per cent of 1962.

The upsurge of total domestic monetary demand which resulted from the exceptional expansion of consumption demand, pushed up prices at home and at the same time greatly widened the deficit in our balance of payments on goods and services account. The domestic price rise extended to practically all sectors, and in its turn pushed wages even higher through the mechanism of the sliding scale.

The general level of prices—including the prices of imported goods and services—rose by 7.2 per cent, the value of the total supply of resources having risen by 15.0 per cent at current prices and by 7.3 per cent at 1962 prices. In 1962 the rise in the general price level had been 4.7 per cent.

There can be no plainer proof of the progress of cost inflation over the last two years.

Figures on the supply and use of resources given in the Government's Report on the Economic Situation in Italy in 1963, convey a picture of vigorous expansion of total demand in the face of a decelerating increase in supply; investment expenditure growing by about as much as the year before, but consumption expenditure growing much more; very strong pressure of demand for domestic uses on disposable resources; a large deficit on current foreign transactions; a contraction of net domestic saving, and, finally, a price rise well in excess of that of the preceding year.

At current prices, gross national product in 1963 amounted to 26,930 billion lire (Table 1). This is an increase of 13.4 per cent over 1962 in monetary terms, but in real terms, that is, at 1962 prices, the increase was only 4.8 per cent. It follows

TABLE 1

Condensed National Accounts

	Billion lire at current prices (1)		Composition per cent	Percentage change 1963/62 at		Annual average rate of increase at 1954 prices		
	1962	1963	1963	current prices	1962 prices	1950-58	1958-62	1950-62
Origin of resources:								
Value added in agriculture, forestry and fisheries	3,668	3,797	*11.7*	*3.5*	..	3.3	1.4	2.8
Value added in industry	9,559	10,948	*33.8*	*14.5*	..	9.0	10.6	9.5
Value added in tertiary activities	6,323	7,266	*22.5*	*14.9*	..	4.0	7.0	4.9
Value added in public administration	2,409	2,934	*9.1*	*21.8*	..	3.5	3.5	3.5
Adjustments	−1,373	−1,710	*− 5.3*	*24.5*	..	8.6	3.2	6.7
Gross domestic product at factor cost	20,586	23,235	*71.8*	*12.9*	..	5.5	7.4	6.2
Taxes not included above in the value of goods and services	3,064	3,579	*11.1*	*16.8*	..	4.0	9.2	5.7
Gross domestic product at market prices	23,650	26,814	*82.9*	*13.4*	..	5.3	7.7	6.1
Net income from abroad	104	116	*0.4*	*11.5*	..	18.7	16.4	17.9
Gross national product	23,754	26,930	*83.3*	*13.4*	*4.8*	5.4	7.6	6.1
Imports of goods and services	4,365	5,410	*16.7*	*23.9*	*20.7*	8.8	18.8	9.4
Total	28,119	32,340	*100.0*	*15.0*	*7.3*	5.8	9.4	7.0
Use of resources:								
Exports of goods and services	4,314	4,800	*14.8*	*11.3*	*6.4*	11.5	16.0	12.9
Resources disposable for domestic uses	23,815	27,540	*85.2*	*15.7*	*7.4*	5.0	8.2	6.1
Consumption	17,659	20,768	*64.2*	*17.6*	*8.6*	4.4	6.8	5.2
of which: private	15,006	17,543	*54.2*	*16.9*	*9.2*	4.3	6.9	5.0
public	2,653	3,235	*10.0*	*21.6*	*5.2*	5.7	5.8	6.3
Gross investment	6,146	6,772	*21.0*	*10.2*	*4.0*	7.6	12.5	9.2

(1) Source: Report on the Economic Situation in Italy.

that the relevant prices rose by 8.2 per cent in the course of last year.

With the value of the gross product of agriculture actually having slightly declined in real terms, GNP owed the whole of its increase to sectors other than agriculture. The real value of the gross product of industry in fact rose by 7.3 per cent.

Real income rose more last year in Southern Italy than elsewhere in the country. Thanks to good crops of some typically southern products, real income in the Mezzogiorno went up by about 7 per cent, whereas the average for North and Central Italy was roughly 4 per cent.

Imports of goods and services provided resources worth 5,410 billion lire last year, compared with 4,365 billion in 1962. The increase of 23.9 per cent in the value of these imports compares with a quantitative increase of 20.7 per cent, and both were much higher than in 1962 and 1961.

Food and other agricultural products contributed conspicuously to the increase in imports.

The total supply of resources last year amounted to 32,340 billion lire. At current prices, this was an increase of 15 per cent over the preceding year, but even the real increase of 7.3 per cent was well in excess of the rise of GNP.

Exports of goods and services amounted to 4,800 billion lire in 1963, or 11.3 per cent more than the 4,314 billion of the preceding year. In volume terms, the increase was only 6.4 per cent, and as such much less than the 1962 increase, let alone that of the previous years since 1959.

As a result, the deficit on goods and services account rose from 51 billion lire in 1962 to 610 billion last year. Apart from pushing up prices at home, the pressure of domestic monetary demand thus created a large current deficit in foreign transactions.

All in all, resources disposable for domestic use amounted to 27,540 billion lire last year, compared with 23,805 billion in 1962. The increase was 15.7 per cent at current and 7.4 per cent at 1962 prices, and the real increment was much larger than the increment of GNP.

Consumption absorbed 17,659 billion lire's worth of resources in 1962 and 20,768 billion in 1963. The increase of 17.6 per cent in the value of consumption compares with an increase of 8.6 per cent in its volume (at 1962 prices), the price level having gone up by 8.3 per cent in the meantime. In real terms, consumption went up nearly twice as much as GNP and in any event very much more than in recent years.

Private consumption expenditure as a whole rose by 16.9 per cent, and food expenditure not much less, namely, by 15.3 per cent. Quantitatively speaking, the increase in total private consumption was 9.2 and that in food consumption 7.3 per cent, and both are far in excess of the large increases of 1962 and without precedent in recent years.

Gross investment, finally, absorbed 6,772 billion lire, that is, 10.2 per cent more than the 6,146 billion of 1962.

Gross fixed investment accounted for 6,537 billion, compared with 5,846 billion in 1962; the increase was 11.8 per cent in value terms and 5.5 per cent in terms of volume (Table 2).

TABLE 2

Gross Fixed Investment

Sectors	Value (billion current lire)		Percentage change in		
	1962	1963	volume	price	value
Agriculture	587	614	— 0.5	*5.1*	*4.6*
Industry	1,848	2,093	*6.8*	*6.1*	*13.3*
Transport and communications	973	1,057	*7.6*	*0.9*	*8.6*
Housing	1,541	1,821	*8.4*	*9.0*	*18.2*
Public works	457	468	— *3.3*	*5.9*	*2.4*
Others	440	484	*2.7*	*7.1*	*10.0*
Total fixed investment	5,846	6,537	*5.5*	*6.0*	*11.8*

Source: Report on the Economic Situation in Italy.

In real terms, the increment of gross fixed investment fell far short of the 1962 figure of 9 per cent; it was hardly more than a third of the increment during the record years 1959-1961, and not much more than half the long-term average.

The labour force, excluding persons employed abroad and occasional workers, declined last year by 0.2 per cent in comparison with 1962. Total employment (allowing for the same exclusions) rose by 0.4 per cent, the rate of increase thus being close to that of 1962, but short of the 1.5 and 1.0 per cent rates of 1960 and 1961, respectively.

The combined effect of the slight decline in the labour force and the slight rise in employment was an appreciable drop in unemployment.

The total wage bill, including employers' contributions to the social security system, amounted to 12,885 billion lire in 1963, having risen by 21.6 per cent over the 1962 figure of 10,597 billion lire (Table 3).

TABLE 3

Dependent Labour Incomes (1)

Sectors and Branches	Billion lire		Composition per cent		Index 1963 (1962=100)
	1962	1963	1962	1963	
1. *Private sector*	*8,264.9*	*10,040.4*	*78.0*	*77.9*	*121.5*
Agriculture, forestry and fisheries	571.1	664.3	*5.4*	*5.2*	*116.3*
Industry	5,037.8	6,227.1	*47.5*	*48.3*	*123.6*
Tertiary activities	2,656.0	3,149.0	*25.1*	*24.4*	*118.6*
2. *Public sector*	*2,332.1*	*2,844.4*	*22.0*	*22.1*	*122.0*
Total . . .	10,597.0	12,884.8	*100.0*	*100.0*	*121.6*

(1) Including gross wages and remunerations in kind to workers, employees and managing staff, as well as employers' social insurance contributions; excluding mixed capital-and-labour incomes earned by artisans, share farmers, etc., as well as the incomes of family helpers.
Source: Report on the Economic Situation in Italy.

Since wage labour at the same time increased by 2.0 per cent, the increase in the level of dependent labour incomes works out at 18.2 per cent for 1963. This was much more than in 1962, when wage labour rose by 2.5 per cent, the total wage bill by 17.7 per cent, and the level of dependent labour incomes, therefore, by 14.8 per cent.

Net national product at factor cost, at current prices, was 20,670 billion lire in 1963, or 12.9 per cent more than the preceding year's 18,388 billion. With dependent labour incomes rising so much faster than national income at current prices, there was a further shift in income distribution last year to the benefit of wage earners, whose share rose from 57.6 to 62.1 per cent of the total.

Other incomes, that is, independent labour incomes, profits, investment incomes and annuities, rose together by 1.1 per cent, but, given the intervening price rise of 8.2 per cent, they actually declined by 6.6 per cent in real terms (Table 4).

TABLE 4

Distribution of Income

(billion lire at current prices)

	1959	1960	1961	1962	1963
Net national product at factor cost	13,525	14,833	16.287	18,388	20,760
Increase	(853)	(1.306)	(1,454)	(2,101)	(2,372)
Percentage increase	*6.7*	*9.7*	*9.8*	*12.9*	*12.9*
Dependent labour incomes (1)	7,415	8,178	9,006	10,597	12,885
Increase	(429)	(763)	(828)	(1,591)	(2,288)
Percentage increase	*6.1*	*10.3*	*10.1*	*17.7*	*21.6*
Other incomes (2)	6.110	6.655	7,281	7,791	7,875
Increase	(424)	(545)	(626)	(510)	(84)
Percentage increase	*7.5*	*8.9*	*9.4*	*7.0*	*1.1*

(1) As indicated in Table 3.
(2) Income from independent labour, profits, interest, rent, transfer payments, etc.
Sources: Statistical Yearbook of the Central Statistical Institute and Report on the Economic Situation in Italy.

It is worth recalling, in this context, that in Italy independent labour is far more common than in other developed countries and in fact accounts for something like one third of total employment. Except for agricultural incomes, independent labour incomes must be assumed to have risen last year, even though less than wage incomes; it follows that the remaining incomes, including especially profits and interests, must have fallen quite sharply.

II. *Production and Prices*

Agricultural Production.— The gross marketable product of Italian agriculture, valued at 1962 prices, was 1 per cent higher in 1963 than the year before. Taking average output over the four years 1952-1955 as a reference base, the index of agricultural production (including livestock and forestry) was the same as in 1962, when it had risen by 1 per cent.

Weather conditions had been bad enough in 1962, but were worse still during the first half of last year. Many crops, especially wheat and spring vegetables, suffered widespread damage in Northern and Central Italy from the exceptionally severe winter. Later in the year the weather improved and abundant summer rains helped the fruit, vegetable and forage crops, though they were bad for the vineyards.

In these circumstances, there was a sharp drop in the output of wheat and wine, whereas vegetables, citrus and other fruit, and olives were produced in appreciably larger quantities than before. There was some decline in the output of livestock products.

The failure of agricultural production to rise more than negligibly last year is largely attributable to the poor wheat harvest.

While agricultural output remained practically stationary during the last two years, food consumption, in quantitative terms, expanded by 5.4 per cent in 1962 and by 7.3 per cent in 1963. As a consequence, the value of food and other agricultural imports, which amounted to 569 billion lire in 1961, rose through 626 billion in 1962 to 965 billion last year. Import prices having risen by 13 per cent, last year's increase of 54 per cent corresponds to an increase of 37 per cent in the volume of imports.

Exports, on the other hand, contracted. Having risen to 451 billion lire in 1962 from the preceding year's 393 billion, they fell by 3 per cent to 436 billion last year. In terms of volume, the decline was 8 per cent. Consequently, the deficit on food and agricultural trade, which had been 176 billion lire in 1961 and 175 billion in 1962, came to as much as 529 billion lire last year.

Given the strong influence of weather conditions, the results of these last two years do not justify any conclusions about the capacity of Italian agriculture. Food consumption, on the other hand, is likely to remain high, so that imports must be expected to become larger than in the recent past. Exports are less predictable, except to the extent that the foreign trade deficit in food products will doubtless be appreciably larger from now on than it was before 1963.

While agricultural output remained stationary owing largely to weather conditions, further good progress was made in such matters as modernization of farming techniques, mechanization, farm management and factor combination, and this in spite of the difficulties which the outflow of labour and growing obsolescence of fixed capital are creating for agriculture.

Nothing happened last year to lessen the imbalance between *per caput* incomes in agriculture and other sectors of the economy. Hired agricultural labourers, it is true, earned conspicuously more along with all the rest of wage earners; but the gap widened between their incomes and those of independent farmers, who, too, derive most of their income from labour rather than capital.

One definitely positive development was the growth of Southern Italy's agricultural production, even though some of it is attributable to the random effect of annual crop fluctuations.

Industrial Production.— Industrial output went on expanding steadily last year, though at a somewhat slower pace than of late. The annual average index calculated by the Central Statistical Institute for industrial production (excluding building) reached 235.2 (1953=100), which corresponds to a rise of 8.1 per cent over the 1962 level. Including building, with its rate of 4.6 per cent, overall industrial production increased by 7.7 per cent.

In 1962 the combined annual rise had been 9.3 per cent, made up of an increase of 7.8 per cent in building and of 9.5 per cent elsewhere in industry.

The rate of increase was lower last year than at any time since 1959, the year when the upswing began. During 1960 the expansion gathered speed, thanks to the initial margins of unused capacity and abundant labour supply; thereafter it continued at a decreasing rate, which, however, even last year still exceeded the average of the pre-recovery five-year period 1954-1958.

The slowing-down of industrial expansion in recent years after its exceptional spurt in 1959-1960, takes its place in the general cyclical pattern. The initial upsurge in industrial production originated in a vigorous expansion of exports and of investment to extend and renew plant and equipment, which latter was subsequently further stimulated by the growth of foreign demand. These two factors and the cumulative effect of their mutual interaction pulled the whole of industrial production forward at a rapid pace, in so far as increased employment raised consumption demand and the boom was thus propagated to all sectors.

During the last two years, however, and more especially in 1963, both exports and, even more so, investment expanded at a much slower rate and the growth of industrial output lost its impetus.

Broadly speaking, the main features of the course of industrial production were the same in the Common Market as a whole as they were in Italy, abstraction made of certain aspects and tendencies which differed from one country to another according to its special situation.

In Italy the rate of increase in gross fixed investment in industry began to slow down in 1962 after two years of great expansion. Last year the deceleration was even more pronounced. In real terms, the rate of investment dropped from 18 per cent in 1960 and 1961 through 9.3 per cent in 1962 to 6.8 per cent in 1963 (Table 5).

TABLE 5

Gross Fixed Investment in Industry

Sector	Billion lire at current prices			Percentage change over preceding year at			
				current prices		constant prices	
	1961	1962	1963	1962	1963	1962	1963
Machinery and engineering products (other than electrical)	668	773	889	*15.7*	*15.0*	*10.2*	*7.5*
Electrical machinery and apparatus .	186	207	236	*11.3*	*14.0*	*7.5*	*9.2*
Metallurgical products, plant and equipment, industrial construction .	173	868	968	*15.3*	*11.5*	*9.0*	*5.6*
Total . . .	1,607	1,848	2,093	*15.0*	*13.0*	*9.3*	*6.8*

Source: Report on the Economic Situation in Italy.

There were a number of reasons behind this development. Growing production cost was squeezing profit margins and thereby diminished the self-financing capacity of firms; outside finance became more difficult to raise, and many companies already had on their hands investment programmes decided upon or begun during the preceding boom years. All this, together with the rise in prices, stood in the way of new investment decisions. At the same time the need to reduce costs and raise productivity caused new investment to be directed to rationalization rather than to extension of plant.

The last two years' tendential changes in the weight of the different components of total demand were clearly reflected in the composition of industrial output. The difference in the rates of growth in the sector producing goods which strengthen industrial equipment and in the consumer goods sector has all but disappeared.

The index of industrial production for capital goods, including building, rose by 7.3 per cent last year as against 7.8 per cent in 1962; without building, the rise of 8.4 per cent, was just a little higer than in 1962.

Consumer goods production rose by 6.9 per cent, and this is the only sector which, while expanding less than in 1962 (8.8

per cent), stayed at least above the trend line. The output of producer goods regularly grows at a faster rate than aggregate production and did so last year as well, but the rate fell from 11.6 per cent in 1962 to only 9.6 per cent.

Outstanding in last year's pattern of generally slow expansion was the persistent dynamism of the motor vehicles industry, where output increased by 20.4 per cent. This rate owed much to motor cars, which may to some extent be regarded as durable consumer goods and in part as capital goods; industrial motor vehicles took second place.

Elsewhere in the base metals and engineering industries development was much slower, though both sectors did better than in 1962. However, the comparison does not mean very much, because of the production losses due to recurrent strickes in 1962.

In producer goods industries, the biggest increase took place in rubber manufactures (19.2 per cent), thanks largely to automobile tires. The industry was in a phase of recovery after a year of setbacks due to disturbances in the normal rhythm of production, and also benefited from increased export demand.

Growing domestic consumption and exports of petroleum products raised the output of refineries by 15.2 per cent, but actually expansion here had been still more vigorous in 1962 (19.3 per cent).

The chemical industry's rate of growth of 8.6 per cent was well below the last five-year average. The reasons included a deceleration—though still at high levels—of the recent years' exceptional rates of expansion in synthetic resins and plastic materials, sluggish growth in many user industries, and scant progress in the use of fertilizers in agriculture.

Electric power generation increased by 9.4 per cent, compared with only 6.9 per cent in 1962. Abundant rainfalls after two years of adverse weather conditions enabled hydro-electric power plants to meet all the additional user demand as well as to reduce recourse to thermal plants.

Consumer goods once more got their strongest boost from durables (+ 14.2 per cent), and especially from transport vehicles and electric household appliances. Apart from the expansion of motor car production, motor cycles and scooters also picked up again after a period of contraction.

In semi-durables and non-durables, the rates of expansion were much slower (6.8 and 4.2 per cent, respectively). Export difficulties and keener competition from foreign products on the home market kept the natural fibres industries as a whole back to just above the preceding year's levels; a slight improvement in the cotton industry was offset by slight setbacks in wool, silk and hard fibres. Only artificial and synthetic fibres as well as knitwear and hosiery registered good progress, thanks, in the latter case, to appreciable export growth.

The reasons why expansion in the non-durables sector slowed down were, first, a slight setback in tobacco manufacture and, secondly, that food processing industries expanded rather slowly in spite of increased domestic demand. The poor sugar beet harvest and lower milk production made further inroads into the output of sugar refineries and cheese factories, with the result that the respective imports leapt forward. Other food processing sectors, on the other hand, made better progress than the year before, with beverages, oilseed oils and confectionery in the lead.

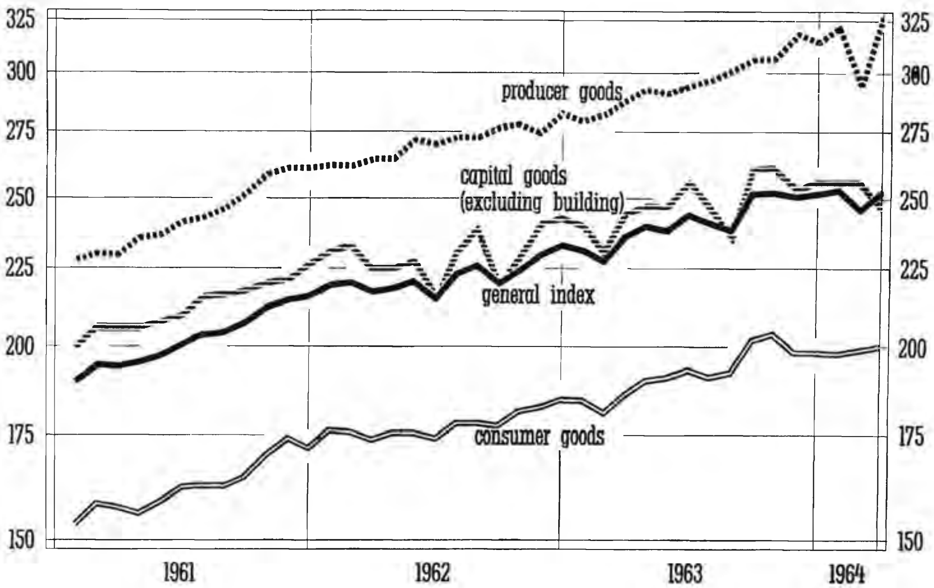
It is interesting to compare the time path of industrial production over the course of the last two years. In overall terms, industrial production increased a little less in 1963 than in 1962; but monthly indices, adjusted for the number of days and seasonal variations, show that, apart from building, the upward tendency last year was no less strong than in 1962, though the time distribution was very different.

The index of industrial production, excluding building, stood at 232.2 in December 1962, 7.8 per cent higher than in December 1961; at the end of December 1963, the index had risen by as much again (7.9 per cent) to 250.6. Including building, the percentage rise of the index was 8.6 in 1962 and 7.6 last year.

In 1962, industrial activity was stationary over large parts of the year, with dips in June and September due to the metal and engineering workers' strikes. In the last quarter of the year production picked up strongly, partly because it was possible to make good the previous losses of working time.

In 1963, by contrast, the whole of the year's expansion took place during the first nine months, though there were some fluctuations due to random factors, like the exceptional cold wave in January and February, and the sharper incidence of the holiday period in July and August. During the last quarter of the year output remained stationary at the high September levels; nor did it undergo significant changes in the first few months of 1964 (Chart 1).

Chart 1



General index of industrial production
and indices of production of producer goods, capital goods and consumer goods
(1953 = 100; seasonally adjusted, logarithmic scale)

Wholesale Prices.— The upward movement of wholesale prices gathered further momentum last year. The Central Statistical Institute's general index, which had risen by 4.6 per cent between the end of 1961 and the end of 1962, registered a further increase of 5.5 per cent in December 1963. In annual average terms, a rise of 3.0 in 1962 compares with 5.2 per cent last year (Table 6).

TABLE 6

Index of Domestic and International Wholesale Prices

(1953 = 100)

Index	1962	1963	1962 Dec.	1963 March	1963 Dec.	1964 March	Percentage change 1963 / 1962	Dec. 62 / Dec. 61	Dec. 63 / Dec. 62	March 64 / March 63
a) DOMESTIC PRICES:										
Central Statistical Institute:										
General index	102.0	107.3	104.5	106.2	110.2	110.7	*5.2*	*4.6*	*5.5*	*4.2*
Foodstuffs	105.5	113.0	110.0	111.9	116.7	115.5	*7.1*	*7.3*	*6.1*	*3.2*
Industrial raw materials and manufactures (1)	99.7	103.4	100.7	102.3	105.7	107.4	*3.7*	*2.7*	*5.0*	*5.0*
Industrial raw materials (1)	95.3	95.8	94.3	95.4	97.1	97.4	*0.5*	*− 2.3*	*3.0*	*2.1*
Manufactures	100.3	104.7	102.0	103.4	107.0	109.3	*4.4*	*4.1*	*4.9*	*5.7*
Consumer goods	101.9	107.7	105.0	106.7	110.7	111.0	*5.7*	*6.2*	*5.4*	*4.0*
Capital goods	104.6	109.1	105.9	107.4	112.0	112.8	*4.3*	*2.0*	*5.8*	*5.0*
Producer goods	96.4	100.3	97.7	99.6	102.0	103.4	*4.0*	*1.1*	*4.4*	*3.8*
Chamber of Commerce, Milan:										
General index	97.7	101.8	98.8	101.1	104.8	105.2	*4.2*	*1.3*	*6.1*	*4.1*
Foodstuffs	102.6	110.0	105.0	108.3	114.0	111.5	*7.2*	*4.1*	*8.6*	*3.0*
Industrial raw materials and manufactures	95.7	98.5	96.2	98.3	101.1	102.7	*2.9*	*0.1*	*5.1*	*4.5*
b) INTERNATIONAL PRICES:										
Volkswirt:										
General index	97.6	100.4	97.6	99.1	103.1	103.5	*2.9*	*− 1.1*	*5.6*	*4.4*
Foodstuffs	90.2	95.7	90.5	93.0	99.9	99.3	*6.1*	*− 0.7*	*10.4*	*6.8*
Industrial raw materials	101.8	103.1	101.6	102.6	104.7	105.8	*1.3*	*− 1.3*	*3.1*	*3.1*

(1) In our re-elaboration of the Central Statistical Institute's indices construction timber, lignite, crude petroleum and quarrying products are not included in the index of industrial raw materials, but are included in the combined index of industrial raw materials and manufactures.

Early this year wholesale prices tended towards more stability. In March the general index stood 4.2 per cent above its March 1963 level.

In 1962, the wholesale price level owed its rise between the beginning and the end of the year in roughly equal parts to agricultural and non-agricultural products, allowing for the relative weight of the two categories. The rise between December 1962 and December 1963, on the other hand, was attributable to an extent of more than five sixths to non-agricultural products. In 1962, agricultural prices went up by 10.1 per cent, in 1963 by only 3.7 per cent. By contrast, non-agricultural prices rose almost twice as much last year than in 1962, namely, by 5.9 as against 3.1 per cent.

Generally speaking non-agricultural prices climbed steadily and uninterruptedly throughout the year, whereas agricultural prices were subject to considerable fluctuations.

Retail Prices and the Cost of Living.— Retail prices, in their turn, rose much more last year than in 1962 in annual average terms, the two figures being 7.5 and 4.7 per cent. The December indices, on the other hand, registered almost equal rises over the preceding twelve-month period, the 1963 increase of 6.9 per cent only slightly exceeding the 1962 figure of 6.5 per cent. Like wholesale prices, retail prices too slowed down their advance in the early months of this year, so that the March index stood only 5.2 per cent above the March 1963 level (Table 7).

Food prices rose by 6.8 per cent over the course of last year, as in 1962. All the major foodstuffs became more expensive, with the conspicuous exception of eggs, where the development of the poultry industry brought down prices by almost 10 per cent. The biggest increases took place in the price of meat and dairy products, both wholesale and retail; but strong demand pushed up the price of all other foodstuffs as well, including olives and olive oil, in spite of a very good harvest.

Retail prices for non-food products went up by 5.7 per cent between December 1962 and December 1963, with textiles and furniture in the lead. Services generally also became dearer,

TABLE 7

Index of Retail Prices and the Cost of Living

Index	1962	1963	1962 Dec.	1963 March	1963 Dec.	1964 March	Percentage change 1963 / 1962	Dec. 62 / Dec. 61	Dec. 63 / Dec. 62	March 64 / March 63
Retail price index (1953 = 100)										
GENERAL INDEX	*123.3*	*132.5*	*127.4*	*131.0*	*136.2*	*137.8*	*7.3*	*6.5*	*6.9*	*5.2*
Food products	118.8	128.6	123.8	127.8	132.2	132.4	*8.2*	*6.7*	*6.8*	*3.6*
Non-food products and services	128.2	136.8	131.3	134.5	140.6	143.7	*6.6*	*6.2*	*7.1*	*6.8*
Textiles and related products	107.1	113.8	110.3	112.2	117.0	119.3	*6.3*	*7.0*	*6.1*	*6.3*
Electricity, gas and other fuels	102.6	106.0	103.5	104.9	108.8	110.7	*3.3*	*2.5*	*5.1*	*5.5*
Housing	242.6	265.6	246.7	259.7	270.3	280.6	*9.5*	*9.1*	*9.6*	*8.0*
Miscellaneous (1)	132.1	140.8	135.1	138.3	144.8	148.0	*6.6*	*5.7*	*7.3*	*7.0*
Cost-of-living index (1953 = 100) (2)										
GENERAL INDEX	*131.8*	*143.4*	*136.0*	*141.7*	*147.4*	—	*8.8*	*7.3*	*8.4*	—
Food	120.6	130.6	124.7	130.0	134.0	—	*8.4*	*6.9*	*7.5*	—
Clothing	110.9	117.8	114.1	116.2	121.1	—	*6.5*	*6.9*	*6.1*	—
Electricity and fuels	101.4	105.6	102.3	103.9	109.9	-	*4.1*	*1.9*	*7.4*	—
Housing	407.2	461.1	415.3	445.9	473.8	—	*13.2*	*11.9*	*14.1*	—
Miscellaneous expenditure	127.9	139.3	133.3	135.6	145.8	—	*8.9*	*7.1*	*9.4*	—
New cost-of-living index (1961 = 100) (3)										
GENERAL INDEX	—	*112.4*	—	*111.1*	*115.6*	*117.6*	—	—	—	*5.9*
Food	—	113.2	—	112.6	116.1	116.5	—	—	—	*3.5*
Clothing	—	110.5	—	109.1	113.7	115.8	—	—	—	*6.1*
Electricity and fuels	—	103.0	—	101.4	107.2	109.5	—	—	—	*8.0*
Housing	—	119.6	—	115.6	122.9	129.8	—	—	—	*12.3*
Miscellaneous expenditure	—	107.6	—	104.7	112.6	116.3	—	—	—	*11.1*

Source: Central Statistical Institute.

(1) Hygienic and medical articles; furniture and other household goods and appliances; private vehicles; domestic and similar services; transport, communications and public services; miscellaneous services (Bank of Italy's re-elaboration of Central Statistical Institute indices).

(2) Original national index (1938 = 1) converted to the base year 1953 = 100.

(3) The new index applies as of January 1964; the 1963 figures were obtained by modifying the January 1964 index according to the changes shown by the 1938 (= 1) index.

and under the added impact of a further relaxation of rent control and the rise of some utility rates, the index went up by 8.3 per cent over the year.

Taking account of the weight of the different categories in the general price index, it may be said that a little more than half last year's rise of 6.9 per cent is attributable to food products, about one fifth to non-food products, and the rest to services.

The Central Statistical Institute's cost-of-living index (1938 = 1) rose by 8.8 per cent over the average of last year. This followed an annual average increase of 2.8 per cent between 1953 and 1961, and a 5.8 rise in 1962.

At the end of last year the index was 8.4 per cent higher than the December 1962 figure, which in turn stood 7.3 per cent above the level of December 1961. All the separate headings of the general index went up, at the following percentages: food 7.5, clothing 6.1, electricity and fuels 7.4, housing 14.1, and miscellaneous expenditures 9.4 (Table 7).

These figures are all based on the reference year 1938. Since January 1964, the Central Statistical Institute uses a new cost-of-living index with the base year 1961. Apart from the change of the base year, a number of other important innovations have been introduced. This new index shows an annual average rise of 12.4 per cent in 1963 in comparison with the base year (1961), with the following percentage increases for separate headings: food 13.2; clothing 10.5; electricity and fuels 3.0; housing 19.6; miscellaneous expenditure 7.6.

The Central Statistical Institute also recalculated the 1963 indices on the new basis, adopting the expedient of retroactive changes derived from the simultaneous variations in the 1938-based index numbers. From this it would appear that during the twelve months ending March 1964 the cost of living in Italy went up by 5.9 per cent. A little more than one third of this increase is attributable to food prices, which went up by 3.9 per cent; the percentage increases for other items are: clothing 6.1, electricity and fuels 8.2, housing 12.3 and miscellaneous expenditure 10.6.

Wages.— The level of minimum contractual wages in all sectors except transport rose last year more sharply even than in 1962. The most spectacular increase took place in the gross wage rates for industrial workers, excluding family allowances: the relevant index, which had gone up by an annual average of 4.2 per cent between 1953 and 1961, jumped up by 11.3 per cent over the course of 1962 and by another 14.3 per cent last year.

Transport workers were at the lower end of the range of increases, with 8 per cent; at the upper extreme, civil servants got 25 per cent. Some part of the rise was due to concessions obtained by workers in particular branches, some part to the automatic mechanism of the sliding wage scale based on the cost of living.

During the first quarter of 1964, minimum contractual wages went up once more, under the combined impact of a further three-point rise in the cost-of-living allowance for February-April, and the renegotiation of collective agreements in building, some industrial branches, trade and, above all, transport. From May onwards the cost-of-living bonus went up another two points.

Internationally speaking, labour costs went up far more in Italy last year than in any other country of the Western world, as can be seen from a comparison of average hourly earnings in industry (Table 8); Italy stands out with a rocketing 17.0 per cent.

TABLE 8

Index of Average Hourly Earnings in Manufacturing Industry in Selected Countries

(1953 = 100)

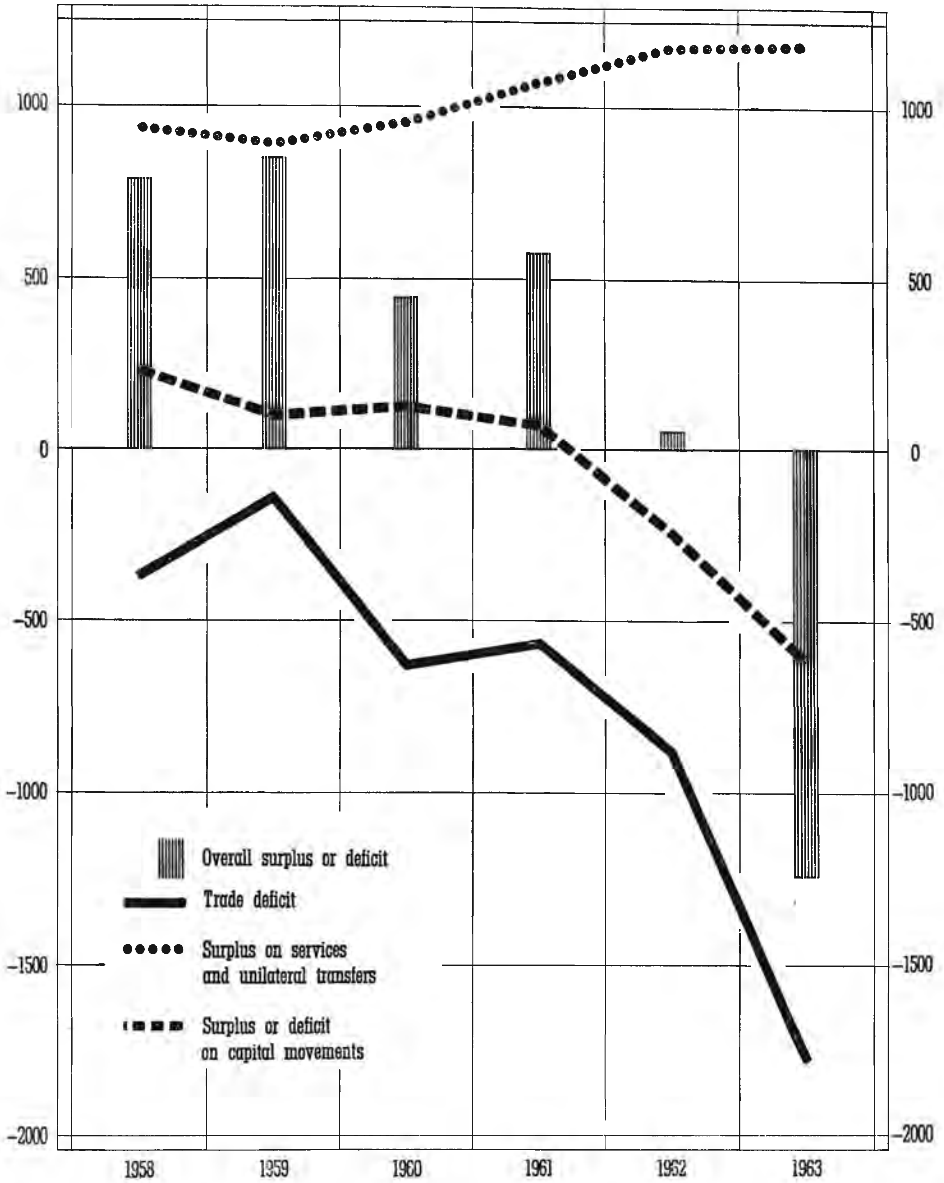
Country	1962	1963	1962 Dec.	1963 March	1963 Dec.	Percentage change 1963/1962	Percentage change Dec. 62/Dec. 61	Percentage change Dec. 63/Dec. 62
Italy	(1) *168*	(1) *197*	(2) *180*	*192*	(2) *205*	(3) *17.0*	*19.5*	(4) *13.8*
France	198	215	202	207	219	*8.6*	*8.6*	*8.4*
Sweden	174	189	179	185	193	*8.6*	*8.6*	*7.8*
Belgium	154	167	159	160	172	*8.4*	*8.9*	*8.2*
Netherlands	183	198	191	196	200	*8.2*	*11.0*	*4.7*
West Germany	194	209	200	201	214	*7.7*	*9.9*	*7.0*
Austria	175	187	174	177	193	*6,9*	*7.4*	*10.9*
Switzerland	129	137	130	134	139	*6.2*	*4.8*	*6.9*
United Kingdom	152	157	155	155	161	*3.3*	*4.0*	*3.9*
United States	137	141	140	140	144	*2.9*	*2.2*	*3.6*

(1) First 11 months.
(2) November.
(3) First 11 months of 1963 over first 11 months of 1962.
(4) November 1963 over November 1962.
Source: Statistical Bulletin of the OECD.

III. *The Balance of Payments*

After its consistently large surpluses during the years 1958 to 1961 and near-equilibrium in 1962, Italy's balance of payments got into deficit last year to the tune of 1,252 million dollars (Chart 2).

CHART 2



The Italian balance of payments
(million dollars)

The current account turned from a 276 million dollar surplus in 1962 to a 657 million dollar deficit, thus losing more than 900 dollars almost entirely in the trade balance, given that hardly any change occurred in the balance on services and unilateral transfers. In the capital account, there was a net outflow of 559 million dollars—a deterioration of 250 million in comparison with the net outflow of 309 million dollars in 1962. Finally, the " errors and omissions " item, which yielded a surplus of 83 million dollars in 1962, last year showed a deficit of 35 million (Table 9).

TABLE 9

Overall Balance of Payments (1)

(million dollars)

Items	Credit		Debit		Balance	
	1962	1963	1962	1963	1962	1963
1. Goods (fob)	4,589.2	4,968.9	5,469.6	6,776.6	– 880.4	–1,807.7
2. Services	2,336.1	2,719.6	1,538.7	1,904.5	797.4	815.1
3. Offshore procurements	69.2	45.9	—	—	69.2	45.9
4. Unilateral transfers	343.6	321.0	53.4	31.5	290.2	289.5
5. Total current items (1+2+3+4)	7,338.1	8,055.4	7,061.7	8,712.6	276.4	– 657.2
6. Capital Movements	932.5	1,407.1	1,241.4	1,966.3	– 308.9	– 559.2
7. Errors and omissions	82.9	—	—	35.8	82.9	– 35.4
8. Balance of payments (5 + 6 + 7)					50.4	–1,251.8
9. Monetary movements	1,027.3	1,663.3	1,077.7	411.5	– 50.4	1,251.8
9. 1 Central monetary institutions	88.1	960.2	568.8	358.2	– 480.7	602.0
9. 2 Other monetary institutions (banks)	939.2	703.1	508.9	53.3	430.3	649.8

(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.*

The adverse movement in the balance of payments began in the capital account in 1962 and in the last quarter began to spread to the current account, mainly under the impact of enormous merchandise imports, especially food and other consumer goods. The same factors exercised growing pressure on the balance of payments last year. Apart from the net capital outflow of nearly 560 million dollars, the gap between the import and export of goods widened owing to sharply divergent rates of increase: imports rose at an annual average rate of 24 per cent over the preceding year, exports at 8 per cent. Thus the trade deficit, in fob terms, more than doubled from 880 million dollars in 1962 to 1,808 million last year (Table 9).

Services earned 815 million dollars on balance, a little more than the 797 million of 1962. But in earlier years, the services account brought in rapidly rising surpluses; that it was so nearly stationary last year was due to the heavy increase in debit items (23.8 per cent) as against the more modest rise of 15 per cent in credit items. Unilateral transfers, which consist almost entirely of emigrants' remittances, yielded identical surpluses of 290 million dollars in 1962 and 1963.

In the capital account (Table 10), foreign investment in Italy, net of disinvestment, increased last year from 773 to 934 million dollars. Loans, net of reimbursements, increased even more spectacularly from 59 to 270 million dollars. Since, at the same time, Italians invested less abroad and extended fewer foreign loans, the surplus on long-term capital movements increased by 476 million dollars, from 474 million in 1962 to 950 million last year. However, capital outflow in the shape of bank note exports (1) practically doubled last year (1,470 million dol-

TABLE 10

Capital Movements

(million dollars)

Items	Credit		Debit		Balance	
	1962	1963	1962	1963	1962	1963
1. Net investment abroad and from abroad	773.1	933.9	213.8	178.7	559.3	745.2
2. Net loans to and from abroad	59.3	269.9	77.8	32.4	− 18.5	237.5
3. Other long-term capital movements	—	10.2	66.4	42.8	− 66.4	− 32.6
4. Total long-term capital movements (1 + 2 + 3)	832.4	1,214.0	358.0	263.9	474.4	950.1
5. Repatriation of Italian bank notes	—	—	765.9	1,470.4	− 765.9	−1,470.4
6. Short-term trade credits	63.0	153.6	85.8	188.4	− 22.8	− 34.8
7. Public capital movements	37.1	39.5	31.7	43.6	5.4	− 4.1
8. Total capital movements (4 + 5 + 6 + 7)	932.5	1,407.1	1,241.4	1,966.3	− 208.9	− 559.2

(1) Clandestine exports of Italian bank notes are recorded in the balance of payments as a capital outflow at the moment of their repatriation in the form of non-resident bank accounts, which may be used either for domestic investment by Italians under a foreign name, or for Italian investment abroad.

lars as against 766 million in 1962), so that the balance on capital movements as a whole worsened to the extent mentioned above.

The monetary movements in which the overall balance-of-payments deficit was reflected, indicate also the manner in which it was financed. Bank indebtedness abroad increased by 650 million dollars, first- and second-line reserves dropped by 409 million dollars, and the Bank of Italy's and the Exchange Office's other official foreign assets contracted by 193 million dollars.

For the first time this year we show the global balance of payments summary in a new form (Table 11), according to the schedule adopted by the International Monetary Fund, the Organization for Economic Co-operation and Development and the European Economic Community, at a meeting in Paris in February 1964.

A break-down of the various balance-of-payments items by geographical distribution (Table 12) shows a further intensification of Italy's relations with the other Common market countries. Among current transactions, a surplus of 256 million dollars with the EEC in 1962 gave way to a deficit of 190 million dollars, and this deterioration alone accounts for close to 47 per cent of the total deterioration on current account. With imports rising by about 32 per cent and exports by only 10 per cent, it was the trade balance with the EEC that suffered most, but the usual invisible surplus also declined by about 10 per cent. Trade with the United States and other developed countries, on the other hand, expanded at a good deal less than average rates, with imports up some 17 per cent and exports 4 per cent. Steady trade flows with developing countries turned out, on balance, more favourable to the latter than before, Italy's deficit having increased by 81 per cent from 234 to 423 million dollars. Taking the whole of the current account, the deficit vis-à-vis developing countries rose from 153 million dollars in 1962 to 369 million last year and so accounted for more than half the total current deficit.

TABLE 11

Global Balance of Payments Summary

IMF-OECD schedule

(million dollars)

PART I

Item	Credit 1962	Credit 1963	Debit 1962	Debit 1963	Balance 1962	Balance 1963
A. Goods and Services (1)	1,994.5	7,734.4	7,008.3	8,68.1	— 13.8	— 946.7
1. Merchandise (fob)	4,589.2	4,968.9	5,469.6	6,776.6	— 880.4	—1,807.7
2. Freight and insurance on international shipments	273.5	318.6	468.9	602.6	— 195.4	— 284.0
2. 1 Freight	267.2	311.8	461.9	594.0	— 194.7	— 282.2
2. 2 Insurance	6.3	6.8	7.0	8.6	— 0.7	— 1.8
3. Other transportation	333.9	370.0	238.3	258.2	95.6	111.8
3. 1 Passenger fares	175.4	191.5	33.8	38.7	141.6	152.8
3. 2 Other	158.5	178.5	204.5	219.5	— 46.0	— 41.0
4. Travel	847.3	931.6	123.6	182.8	723.7	748.8
5. Investment income	109.9	128.0	200.6	241.7	— 90.7	— 113.7
6. Government, not included elsewhere	125.3	136.7	92.5	97.3	32.8	39.4
6. 1 Military transactions	69.2	45.9	—	—	69.2	45.9
6. 2 Other transactions	56.1	90.8	92.5	97.3	— 36.4	— 6.5
7. Other services	715.4	880.6	414.8	521.9	300.6	358.7
7. 1 Workers' earnings	284.0	337.2	27.2	38.4	256.8	298.8
7. 2 Other	431.4	543.4	387.6	483.5	43.8	59.9
B. Transfer Payments	343.6	321.0	53.4	31.5	290.2	289.5
8. Private transfers	343.6	321.0	—	—	343.6	321.0
8. 1 Emigrants' remittances	298.4	282.9	—	—	298.4	282.9
8. 2 Other	45.2	38.1	—	—	45.2	38.1
9. Public transfers	—	—	53.4	31.5	— 53.4	— 31.5
9. 1 Reparations	—	—	23.0	10.0	— 23.0	— 10.0
9. 2 Other	—	—	30.4	21.5	— 30.4	— 21.5

(1) Including military services and offshore purchases.

TABLE 11

Global Balance of Payments Summary

IMF-OECD schedule

(million dollars)

PART II

Item	ASSETS						LIABILITIES					
	Credit		Debit		Balance		Credit		Debit		Balance	
	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963
C. Capital and Monetary Gold	139.3	1,131.8	1,589.9	999.9	−1,450.7	131.9	2,283.4	2,593.4	1,192.6	2,032.7	1,091.3	560.7
10. Private long-term (including all direct investment)	66.0	138.6	509.8	590.9	− 443.8	− 452.3	1,235.9	1,816.9	340.5	449.3	895.4	1,367.6
10. 1 Direct investment	24.9	56.4	250.0	214.7	− 225.1	− 158.3	378.9	372.7	23.7	34.4	355.2	338.3
10. 2 Other common stocks	10.1	10.3	9.9	46.7	0.2	− 36.4	657.2	877.6	256.0	292.2	401.2	585.4
10. 3 Other securities .	12.5	12.6	1.4	6.6	11.1	6.0	27.0	42.1	10.3	31.9	16.7	10.2
10. 4 Loans	5.2	44.1	83.0	76.5	− 77.8	− 32.4	109.8	349.3	50.5	79.4	59.3	269.9
10. 5 Long-term trade credits	13.3	15.2	79.7	58.0	− 66.4	− 42.8	....	21.6	—	11.4	....	10.2
10. 6 Short-term trade credits	—	—	85.8	188.4	− 85.8	− 188.4	63.0	153.6	—	—	63.0	153.6
11. Repatriation of Italian bank notes	—	—	—	—	—	—	—	—	765.9	1,470.4	− 765.9	−1,470.4
12. Local government	—	—	—	—	—	—	—	19.1	—	1,470.4	—	19.1
13. Central government . .	19.1	25.9	50.8	69.5	− 31.7	− 43.6	74.4	61.4	37.3	—	37.1	20.4
13. 1 Long-term loans .	19.1	25.9	47.3	66.0	− 28.2	− 40.1	74.4	61.4	37.3	41.0	37.1	20.4
13. 2 Other long-term assets and liabilities	—	—	3.5	3.5	− 3.5	− 3.5	—	—	—	41.0	—	—
14. Central monetary institutions	54.2	790.2	551.1	335.8	− 496.9	454.4	33.9	170.0	17.7	—	16.2	147.6
14. 1 Accounts with IMF	40.0	—	—	22.9	40.0	− 22.9	—	—	—	22.4	—	—
14. 2 Gold	—	—	18.4	99.7	− 18.4	− 99.7	—	—	—	—	—	—
14. 3 Other reserves . .	—	591.8	90.2	207.5	− 90.2	384.3	—	—	—	—	—	—
14. 4 Liabilities to official institutions .	—	—	—	—	—	—	33.9	170.0	17.7	—	16.2	147.6
14. 5 Other foreign assets and liabilities	14.2	198.4	442.5	5.7	− 428.3	192.7	—	—	—	22.4	—	—
15. Other monetary institutions	—	177.1	478.2	3.7	− 478.2	173.4	939.2	526.0	30.7	49.6	908.5	476.4
15. 1 Foreign assets . .	—	177.1	478.2	3.7	− 478.2	173.4	—	—	—	—	—	—
15. 2 Foreign liabilities	—	—	—	—	—	—	939.2	526.0	30.7	49.6	908.5	476.4

TABLE 11

Global Balance of Payments Summary

IMF-OECD schedule

(million dollars)

PART III

Item	Credit 1962	Credit 1963	Debit 1962	Debit 1963	Balance 1962	Balance 1963
16. Goods and Services (1 through 7)	6,994.5	7,734.4	7,008.3	8,681.1	− 13.8	− 946.7
17. Transfers Payments (8 plus 9) . .	343.6	321.0	53.4	31.5	290.2	289.5
18. Foreign Assets and Monetary Gold 10 through 15, assets)	139.3	1,131.8	1,589.9	999.9	−1,450.6	131.9
19. Foreign Liabilities (10 through 15, liabilities)	2,283.4	2,593.4	1,192.1	2,032.7	1,091.3	560.7
20. Total Net Transactions (16 through 19)	—	—	—	—	− 82.9	35.4
21. Net Errors and Omissions	—	—	—	—	82.9	− 35.4

In capital movements, the total of 559 million dollars was made up of capital outflows in the amount of 436 million dollars to developed and of 139 million to developing countries, with a small offsetting net inflow from international organizations and the Sino-Soviet area.

Looking, finally, at the balance of payments from the point of view of its development over time (in seasonally adjusted figures), it will be seen that the current account, which turned from a surplus of 276 million dollars in 1962 to a deficit of 657 million in 1963, began to deteriorate in the first quarter of 1962 and come under heavy pressure from the trade deficit in the third quarter. Until the first few months of 1963, invisible earnings were just enough to keep the current account in rapidly dwindling surplus, but during the second and third quarters of last year the excess of imports over exports pulled the current account into growing deficit. The trade gap alone, always in seasonally adjusted figures, was more than 400 million dollars in the second and almost 550 million in the third quarter, while invisibles still brought in a steady surplus of a little less than 300 million. The deterioration in the current account then practically came to a halt in the fourth quarter, thanks to a parrallel development in merchandise trade. The

TABLE 12

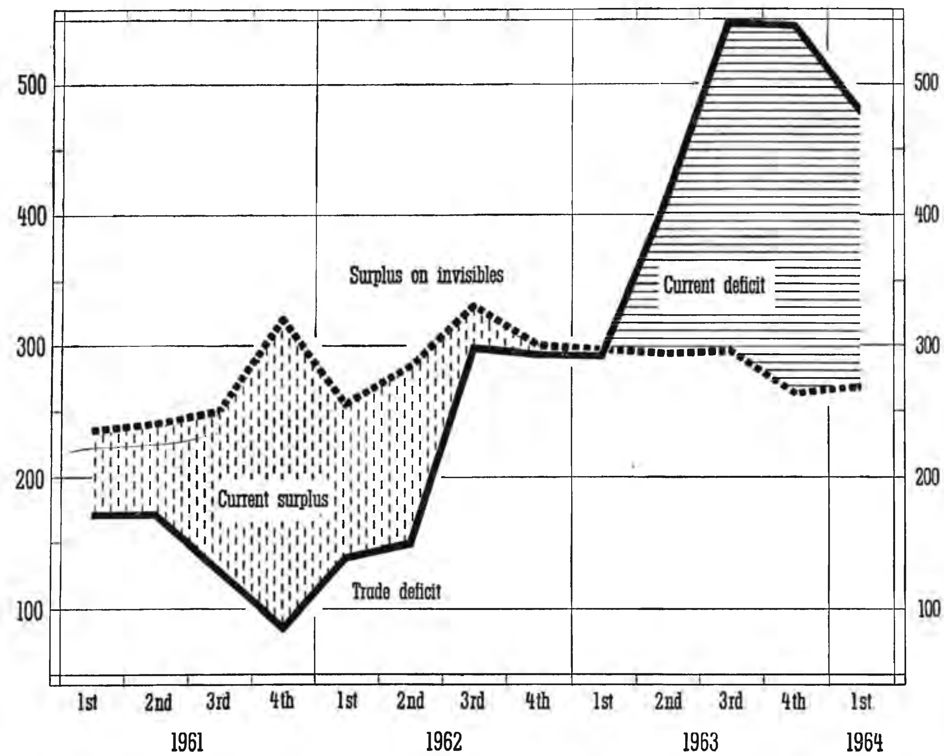
Regional Balance-of-Payments Summary

(million dollars)

Items	Developed countries								Developing countries		Sino-Soviet area		International organizations and unallocated		Total	
	U. S.		EEC countries		Others		Total									
	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963	1962	1963
Goods:																
Debit	806.5	905.9	1,790.5	2,359.3	1,270.4	1,522.2	3,867.4	4,787.4	1,330.4	1,634.0	269.2	350.5	2.6	4.7	5,469.6	6,776.6
Credit	441.0	475.6	1,633.4	1,800.6	1,148.7	1,176.1	3,223.1	3,452.3	1,096.9	1,211.1	257.1	291.9	12.1	13.6	4,589.2	4,968.9
Services:																
Debit	262.0	341.5	322.7	367.3	475.0	572.6	1,059.7	1,281.4	345.6	430.5	38.5	51.5	94.9	141.1	1,538.7	1,904.5
Credit	559.0	651.1	663.9	673.1	661.6	708.5	1,884.5	2,032.7	407.7	464.7	43.0	51.4	70.1	216.7	2,405.3	2,765.5
Unilateral Transfers:																
Debit	—	—	—	—	—	—	—	—	34.7	24.8	2.6	2.1	16.1	4.6	53.4	31.5
Credit	129.9	122.7	71.6	63.0	88.8	91.1	290.3	276.8	53.3	44.1	—	0.1	—	—	343.6	321.0
Current Account:																
Debit	1,068.5	1,247.4	2,113.2	2,726.6	1,745.4	2,094.8	4,927.1	6,068.8	1,710.7	2,089.3	310.3	404.1	113.6	150.4	7,061.7	8,712.6
Credit	1,129.9	1,249.4	2,368.9	2,536.7	1,899.1	1,975.7	5,397.9	5,761.8	1,557.9	1,719.9	300.1	343.4	82.2	230.3	7,338.1	8,055.4
Capital Movements:																
Debit	113.0	116.6	114.4	125.1	1,079.0	1,897.7	1,306.4	2,139.4	258.2	269.0	25.3	4.4	114.4	208.3	1,704.3	2,621.1
Credit	111.3	286.7	128.8	176.2	953.9	1,240.4	1,194.0	1,703.3	63.4	130.2	2.5	13.1	135.5	215.3	1,395.4	2,061.9
Monetary Movements:																
Debit	762.2	302.6	57.2	9.4	141.0	0.7	960.4	312.7	28.9	10.1	—	—	88.4	88.7	1,077.7	411.5
Credit	604.8	1,342.7	64.3	2.1	273.2	197.4	942.3	1,542.2	12.6	73.8	2.7	15.6	69.7	31.7	1,027.3	1,663.3
Errors and omissions, multilateral settlements	97.7	−1,212.2	−277.2	146.1	−160.8	579.7	−340.3	−486.4	363.9	444.5	30.3	36.4	29.0	− 29.9	82.9	− 35.4

first quarter of this year indeed shows an improvement of 70 million dollars in the trade balance in comparison with the last quarter of 1963; no change occurred in invisibles (Chart 3).

CHART 3



Quarterly changes in the balance on trade and invisible account
(million dollars, seasonally adjusted)

In the capital account, an item of particular interest is the export of Italian bank notes. During the first half of last year more than twice the amount (1,017 million dollars as against 454 million) was exported than in the corresponding period of the year before, during the third quarter 60 per cent more (169 as against 105 million dollars), but during the fourth quarter only 37 per cent more (284 as against 207 million dollars). A further improvement took place during the first three months of 1964, when only half as much bank notes were exported than during the corresponding quarter of 1963 and the absolute amount fell back to its level of 260 million early in 1962.

Domestic and Foreign-Exchange Effects. Comparing the composition of total demand during the last two years, it will be seen that in 1963 consumption, both at constant and at current prices, expanded much more sharply, to the detriment of exports and investment (Table 13). This development runs counter to the trend throughout the period 1950-1961, when investment and exports kept gaining steadily at the expense of domestic consumption. It is also confirmed by an analysis of the deterioration of the trade balance last year, 64 per cent being attributable to consumer goods (food, durables and non-durables), with an import rise of 37.6 and an export rise of only 6.9 per cent. It is obvious that in a situation where the country had to draw so heavily on foreign supplies to meet consumption de-

TABLE 13

Growth rates and composition of aggregate demand in Italy, 1950-63

Components of total demand	Percentage composition of total demand at the beginning of the period		Average annual percentage increase		Percentage composition of total demand at the end of the period	
	1954 prices	current prices	1954 prices	current prices	1954 prices	current prices
	Period 1950-1961					
1. Consumption	73.8	72.7	5.0	7.6	60.8	62.7
2. Gross investment	17.0	17.2	9.3	11.4	21.7	21.7
3. Exports of goods and services	9.2	10.1	13.2	13.5	17.5	15.6
Total	100.0	100.0	—	—	100.0	100.0
	Year 1962					
1. Consumption	60.8	62.7	7.6	13.4	60.4	62.8
2. Gross investment	21.7	21.7	8.2	13.9	21.7	21.9
3. Exports of goods and services	17.5	15.6	11.0	11.4	17.9	15.3
Total	100.0	100.0	—	—	100.0	100.0
	Year 1963					
1. Consumption	60.4	62.8	0.9	17.6	61.2	64.2
2. Gross investment	21.7	21.9	4.0	10.2	21.1	20.9
3. Exports of goods and services	17.9	15.3	6.4	11.2	17.7	14.9
Total	100.0	100.0	—	—	100.0	100.0

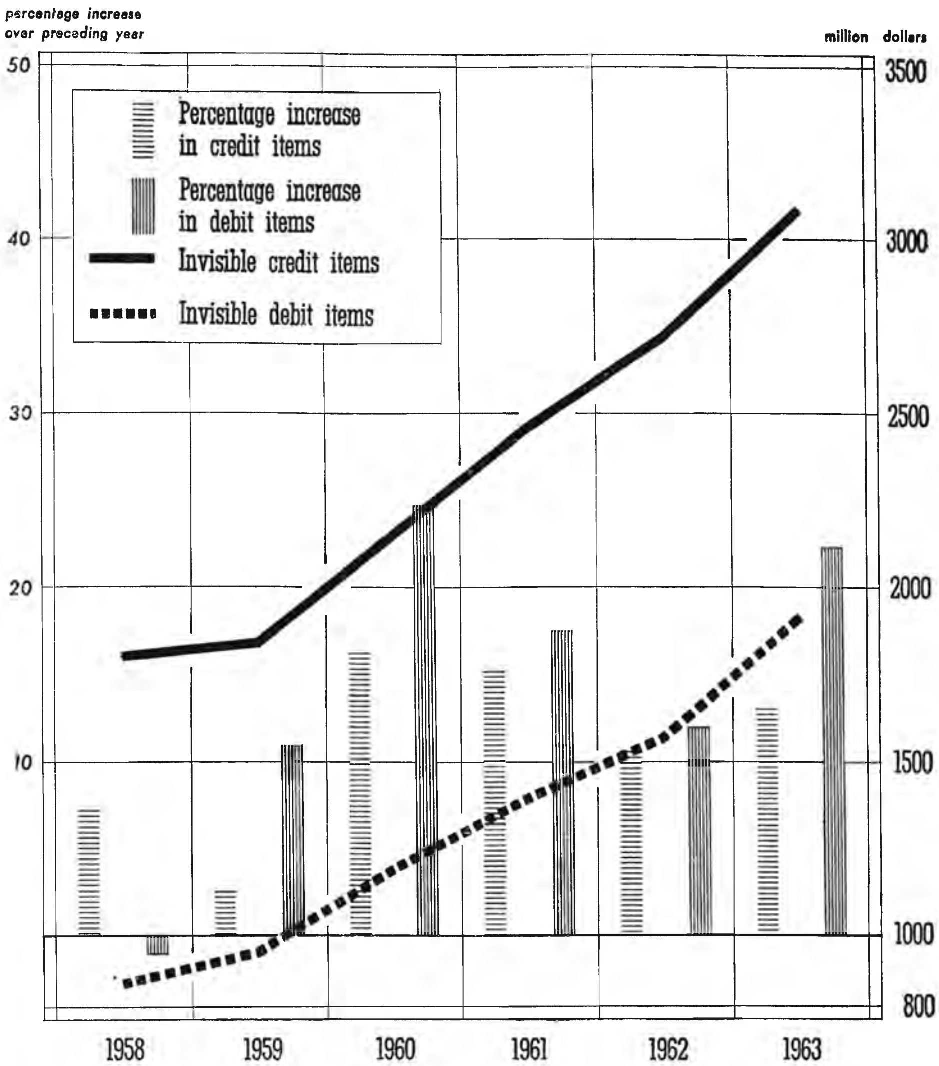
mand, certain resources otherwise available for export were also diverted to domestic consumption—the more so since rising domestic prices made the home market more attractive for certain products. The domestic price rise definitely played its part in slowing down the expansion of exports, in so far as it weakened the competitive position of Italian goods abroad. In fact, estimates based on the index of labour costs per unit of product in manufacturing industry in Italy and elsewhere suggest that our competitive strength is back to where it was in 1958, before all the subsequent improvements.

The recent shift in the distribution of the—itself growing—national income to the benefit of wage earners in Italy was, of course, bound to find expression in an expansion of consumption and in a diversification of the range of consumer demand. It stands to reason that this diversification, in turn, should be reflected in a widening range of imported goods.

Since the effects of the current demand-restricting measures can work themselves out only gradually, imports must be expected to go on expanding at fairly high rates in the immediate future. Unless exports expand faster than imports, there is no hope that the invisible items alone can equilibrate the current balance of payments. The net surplus on services and transfers barely increased last year over the 1962 figure and it is very likely that disbursements will go on growing more than receipts, as they have been doing since 1959 (Chart 4). The reasons are that labour incomes and emigrants' remittances will probably fall off with better employment prospects at home, that foreign tourists will spend less in Italy (as they have been doing since 1960) while Italian tourists will spend more money abroad, that increased foreign investment in Italy will entail a larger outflow of interests and dividends, and finally that high imports will occasion increased outgoings for freight charges.

All in all, we can hope neither to re-equilibrate our balance of payments nor to achieve satisfactory rates of income growth without a successful export drive. It is absolutely essential to reinforce the competitiveness of Italian goods on foreign markets.

CHART 4



Invisibles in the balance of payments

As regards, finally, the foreign-exchange aspects of balance-of-payments developments, the summary of data relating to the public and private sectors presented in Table 14 shows that net short-term foreign assets fell last year from 3,199 to 2,140 million dollars. The reason was that the balance-of-payments deficit had to be financed both by drawing on official reserves and by large-scale bank borrowing abroad. The long-term position has a structural excess of liabilities, mainly because of the large volume of foreign investment in Italy; last year net long-term

TABLE 14

Italy's Foreign Assets and Liabilities, 1962 and 1963

(end-year figures in million dollars)

Items	Assets		Liabilities		Balance	
	1962	1963	1962	1963	1962	1933
A. *Short-term*						
Public sector:						
Gold and convertible exchange reserves	3,440.9	3,057,3	—	—	3,440.9	3,057.3
Other official assets and liabilities	430.1	552.0	67.0	214.6	363.1	337.4
Total . . .	3,871.0	3,609.3	67.0	214.6	3,804.0	3,394.7
Private sector:						
Commercial banks	1,457.3	1,283.8	2,061.9	2,538.2	— 604.6	— 1,254.4
Total short-term . . .	5,328.3	4,893.1	2,128.9	2,752.8	3,199.4	2,140.3
B. *Long-term*						
Public sector:						
Italian Exchange Office . . .	789.4	596.6	—	—	789.4	596.6
Bank of Italy	4.0	4.1	—	—	4.0	4.1
Loans	176.7	216.8	781.6	800.2	— 604.9	— 583.4
Italian government securities held abroad	—	—	6.0	5.2	— 6.0	— 5.2
Subscriptions to international organizations	109.2	112.7	—	—	109.2	112.7
Total . . .	1,079.3	930.2	787.6	805.4	291.7	124.8
Private sector:						
Loans	—	—	568.3	908.7	— 568.3	— 908.7
Investment	1,036.9	1,268.0	3,314.5	3,772.4	—2,277.6	— 2,504.7
Trade credits	307.9	848.5	38.1	48.3	269.8	300.2
Total . . .	1,344.8	1,616.5	3,920.9	4,729.7	—2,576.1	— 3,113.2
Total long-term . . .	2,424.1	2,546.7	4,708.5	5,535.1	—2,284.4	— 2,988.4
Grand total (A + B) . . .	7,752.4	7,439.8	6,837.4	8,287.9	915.0	— 848.1

liabilities increased from 2,284 to 2,988 million dollars, the increment being accounted for almost wholly by an increase in foreign investment and by foreign loans to the private sector.

To some extent, the increase in both these latter items last year was connected with the clandestine export of Italian bank notes, so that part of the increment in long-term foreign liabilities may be regarded as fictitious in the sense that it really refers to Italian assets registered under foreign names. On balance, Italy ended the year 1963 with net foreign liabilities of 848 million dollars, whereas a year earlier she had net foreign assets of 915 million dollars.

During the first quarter of this year, the balance of foreign-exchange movements shows a decided improvement in the capital account, which indeed had begun late in 1963, but persisting pressure on the current account. Compared with the first quarter of 1963, the trade balance deteriorated by 170 million dollars, payments for imports having gone up by 18 per cent and export proceeds by only 11 per cent. However, the rate of increase in imports fell short of the average rate of 23 per cent for the whole of 1963, whereas exports increased by more than the 1963 average of 7 per cent.

At the same time, Italian banks further reduced their indebtedness abroad, so that the balance-of-payments deficit was financed entirely by drawing down the official reserves and other assets of the Bank of Italy and the Italian Exchange Office. Indeed, these two institutions also had to lend to the banks to enable them to pay back some of their foreign debts. In these circumstances, official reserves dropped by 233 million dollars during the first three months of 1964, and the foreign liabilities of the Bank of Italy and the Exchange Office increased by 400 billion. This latter figure included a 225 million dollars drawing on the I.M.F. gold tranche.

The Exchange of Goods and Services.— The salient features of Italy's foreign trade last year were that the volume of imports increased far more than the volume of exports, that import prices did not rise very much, and that a slight improvement in the terms of trade helped to soften the impact of the growing trade deficit.

Imports (cif) rose from 3,792 billion lire in 1962 to 4,712 billion last year, and exports from 2,916 to 3,154 billion (Table 15), the respective increases being 24.3 and 8.2 per cent. As

TABLE 15

Value of Italy's Foreign Trade

(billion lire)

Year	Value of foreign trade	Imports cif	Exports fob	Deficit	Export/Import ratio per cent
1953	2,455	1,513	942	571	*62.3*
1954	2,548	1,524	1,024	500	*67.2*
1955	2,855	1,695	1,160	535	*68.4*
1956	3,325	1,984	1,341	643	*67.6*
1957	3,890	2,296	1,594	702	*69.4*
1958	3,621	2,010	1,611	399	*80.1*
1959	3,926	2,105	1,821	284	*86.5*
1960	5,233	2,953	2,280	673	*77.2*
1961	5,879	3,265	2,614	651	*80.1*
1962	6,708	3,792	2,916	876	*76.9*
1963	7,866	4,712	3,154	1,558	*66.9*

Source: **Central Statistical Institute.**

a result, the trade deficit augmented from 876 to 1,558 billion lire, and the proportion of imports covered by exports dropped from 77 to 67 per cent.

The import expansion was the result of a combination of structural, cyclical and random factors which pushed up domestic demand.

Among structural factors, the most important was the failure of domestic supply to keep step with the growth and changing composition of consumer demand. Foreign supplies became a balancing element as regards both the range of consumer goods and their domestic prices, which were pushed up by the gap between domestic supply and demand. In the structural context, generally, it must also be remembered that Italy has made constant efforts since the war to improve the efficiency of production in a setting of international collaboration and free competition on the basis of world market prices; with the country's advancing industrialization foreign trade flows steadily widened, and to the extent that Italy took, and consolidated, her place among the world's developed nations, the pattern of specialization changed.

The incidence of cyclical factors on last year's imports is exemplified by the disappearance of unused capacity margins in several branches of industry. This raised import demand not only for the products of the industries concerned, which could no longer meet domestic demand, but also for capital goods to set up new factories and to extend or modernize those that had reached capacity limits.

Finally, there was an important random factor at work last year in the shape of adverse weather conditions, which damaged the 1962-1963 crop and raised import demand for food. This applies especially to livestock products, since herds had been reduced when fodder became scarce and expensive. For the rest, domestic food supply is still awaiting the effects of planned changes and adjustments to bring farming techniques into line with the country's new position, whereas demand, especially for quality foods, has surged ahead after long years of restraint when the people did not have enough purchasing power. Quite apart from crop fluctuations, therefore, the obvious difficulties of converting agricultural production to meet growing demand and changing consumer tastes, will no doubt keep food imports high for some time.

The volume of Italian exports expanded by 11.1 per cent in 1962 and by 6.0 per cent in 1963. Apart from a general structural expansion of foreign trade as a whole owing to Italy's progressive integration into the world economy, the reasons which caused the growth of exports to slow down last year were the same that caused imports to accelerate.

Looking back over the last ten years, it will be seen that up to the end of 1961 costs in Italy were relatively lower, and increased less fast, than in other industrial countries; since then, they have been rising much more sharply in Italy than elsewhere. This has not wiped out the advantages gained in ten years, but has brought Italy's competitive position back to what in 1958 (Table 16).

TABLE 16

Labour costs per unit of product in manufacturing industry: Indices for selected industrial countries, weighted by the countries' share in world exports of manufactures

Countries	1958	1959	1960	1961	1962	1963 (p)
Belgium, Federal Republic of Germany, France, Netherlands, Sweden, United Kingdom, Canada, United States, Japan	100.0	98.2	98.9	104.0	106.7	108.7
Italy	100.0	93.2	81.5	92.8	99.2	110.3
Index of Italian labour costs per cent of corresponding index in other countries	100.0	94.9	93.0	89.2	93.0	101.5

(p) Provisional figures.

Notes:

Calculations are based on figures for hourly earnings, production, employment and hours worked in manufacturing, as published in OECD, *General Statistics*, March 1964.

Figures for Japan are from United Nations, *Monthly Bulletin of Statistics*, March 1964. Figures for Italy are from the Central Statistical Institute's Monthly Bulletin of Statistics, and from the Labour Statistics of the Ministry of Labour and Social Security; they differ from those given elsewhere in this Report under the heading General Economic Conditions, in so far as the latter figures refer only to a selected group of 24 manufacturing industries.

Production per man/hour was calculated by correcting industrial production figures for intervening changes in employment and hours worked. Labour costs per unit of product were obtained by dividing hourly earnings by production per man/hour.

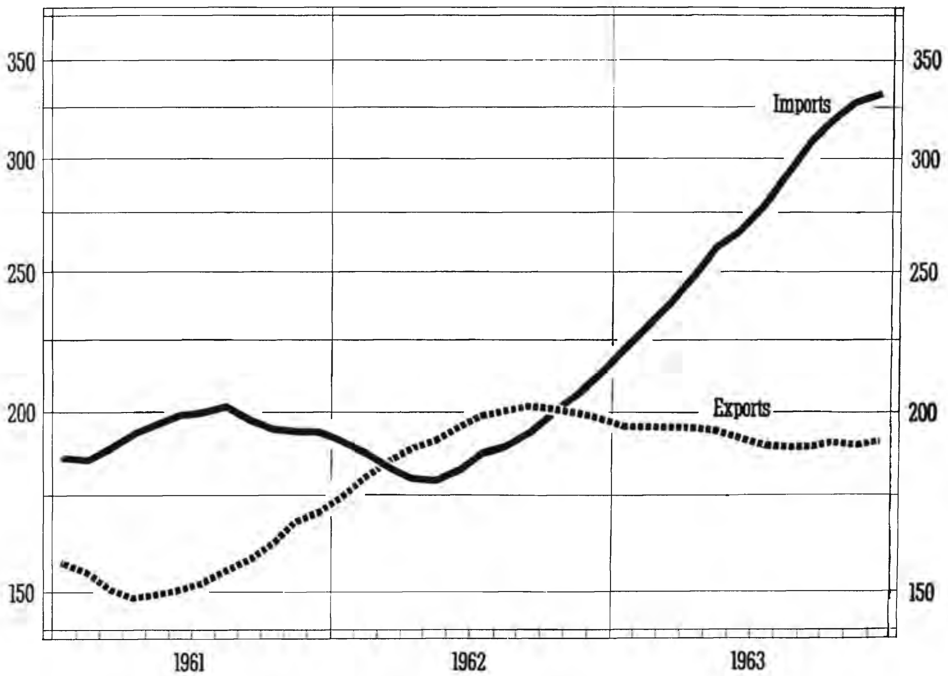
In the case of France, Germany, Netherlands and Canada hourly earnings were deflated by a coefficient reflecting intervening variations in the exchange rate. Figures for man/hour production in Belgium, Netherlands and Sweden were not adjusted for changes in hours worked.

To get a single index of Italy's competitive position vis-à-vis other industrial countries, the figures for labour costs per unit of product were weighted by the separate countries' share in world trade in manufactures, calculated from figures given in *Board of Trade Journal*, 17 April 1964, p. 836.

Foreign trade in food products last year contributed 52 per cent to the deterioration of 682 billion lire in the trade balance (Chart 5). Consumer goods as a whole, including food, contributed 64 per cent, capital goods 22 and producer, goods 14 per cent.

In terms of trading partners, 70 per cent of the overall deterioration occurred in trade with developed countries, from which Italy imported 24.2 per cent more than the year before

CHART 5



Foreign trade in food products

(Seasonally adjusted value index, 12-month moving averages at monthly intervals)
(1953 = 100, logarithmic scale)

and to which she exported only 7.2 per cent more. The deficit in trade with developed countries, therefore, grew by 480 billion lire (Table 17), largely as a result of a 30.9 per cent expansion of imports from the Common Market. With sales to Germany practically stationary, exports to EEC countries rose by a mere 10.3 per cent, and Italy's trade deficit with them increased by 260 billion lire, of which 155 billion are attributable to trade with Germany. But Italy's trade deficit grew all along the line—to the extent of 79 billion with other OECD countries, of 67 billion with the United States and of 55 billion with the United Kingdom. In the case of the United States, 39 per cent of the increment in Italy's deficit is attributable to trade in producer goods, 33 per cent to capital goods and 28 per cent to consumer goods. Within the group of consumer goods, food contributed 53 per cent and durables 14 per cent to the overall increase in the trade deficit with the United States, while the non-durables group provided a partly offsetting improvement of 39 per cent.

TABLE 17

Geographical Distribution of Italy's Foreign Trade

Countries	Billion lire			Annual change 1963		Composition per cent	
	1961	1962	1963	billion lire	per cent	1962	1963
IMPORTS							
Developed countries	*2,217.9*	*2,584.1*	*3,208.4*	*624.3*	*24.2*	*68.1*	*68.1*
United States	539.7	553.3	643.3	89.0	16.1	14.6	13.6
EEC countries	962.3	1,182.0	1,546.7	364.7	30.9	31.2	32.8
United Kingdom	179.2	239.9	289.1	49.2	20.5	6.3	6.2
Other OECD countries (1)	370.1	415.0	500.2	85.2	20.5	10.9	10.6
Other developed countries (2)	166.6	193.9	230.1	36.2	18.7	5.1	4.9
Developing countries	*843.6*	*998.0*	*1,221.2*	*233.2*	*23.6*	*26.1*	*25.9*
In Europe (3)	128.7	145.3	197.8	52.5	36.1	3.8	4.2
Countries associated with the EEC (4)	48.0	54.2	61.9	7.7	14.2	1.5	1.3
Other developing countries	666.9	788.5	961.5	173.0	21.9	20.8	20.4
Sino-Soviet area (5)	*199.9*	*216.4*	*277.3*	*60.9*	*28.1*	*5.7*	*5.9*
Unallocated	*3.1*	*3.3*	*5.1*	*1.8*	*54.5*	*0.1*	*0.1*
Total	*3,264.5*	*3,791.8*	*4,712.0*	*920.2*	*24.3*	*100.0*	*100.0*
EXPORTS							
Developed countries	*1,715.4*	*2,009.0*	*2,153.1*	*144.1*	*7.2*	*68.9*	*68.2*
United States	238.8	275.6	297.2	21.6	7.8	9.5	9.4
EEC countries	817.2	1,015.3	1,120.2	104.9	10.3	34.8	35.5
United Kingdom	175.7	174.8	169.0	— 5.8	— 3.3	6.0	5.4
Other OECD countries (1)	411.0	458.9	464.9	6.0	1.3	15.7	14.7
Other developed countries (2)	72.7	84.4	101.8	17.4	20.6	2.9	3.2
Developing countries	*693.0*	*685.5*	*757.0*	*71.5*	*10.4*	*23.5*	*24.0*
In Europe (3)	192.5	174.8	199.4	24.6	14.1	6.0	6.3
Countries associated with the EEC (4)	19.2	18.6	22.5	3.9	20.9	0.6	0.7
Other developing countries	481.3	492.1	535.1	43.0	8.7	16.9	17.0
Sino-Soviet area (5)	*154.4*	*160.7*	*182.4*	*21.7*	*13.5*	*5.5*	*5.8*
Unallocated	*51.5*	*60.4*	*61.6*	*1.2*	*2.0*	*2.1*	*2.0*
Total	*2,614.3*	*2,915.6*	*3,154.1*	*238.5*	*8.2*	*100.0*	*100.0*
SURPLUS OR DEFICIT							
Developed countries	*— 502.5*	*— 575.1*	*— 1,055.3*				
United States	— 300.9	— 277.7	— 345.1				
EEC countries	— 145.1	— 166.7	— 426.5				
United Kingdom	— 3.5	— 65.1	— 120.1				
Other OECD countries (1)	40.9	43.9	— 35.3				
Other developed countries (2)	— 93.9	— 109.5	— 128.3				
Developing countries	*— 150.6*	*— 302.5*	*— 464.2*				
In Europe (3)	63.8	29.5	1.6				
Countries associated with the EEC (4)	— 28.8	— 35.6	— 39.4				
Other developing countries	— 185.6	— 290.4	— 426.4				
Sino-Soviet area (5)	*— 45.5*	*— 55.7*	*— 94.9*				
Unallocated	*48.4*	*57.1*	*56.5*				
Total	*— 650.2*	*— 876.2*	*— 1,557.9*				

(1) Austria, Canada, Denmark, Iceland, Ireland, Norway, Portugal, Sweden, Switzerland.
(2) Australia, Finland, Japan, New Zealand, Republic of South Africa.
(3) Cyprus, Gibraltar, Greece, Malta, Spain, Turkey, Yugoslavia.
(4) Burundi and Rwanda, Cameroon, Central African Republic, Chad, Congo (Brazzaville), Congo (Leopoldville), Dahomey, Gabon, Ivory Coast, Madagascar, Mali, Mauritania, Niger, Senegal, Somalia, Togo, Upper Volta.
(5) Albania, Bulgaria, China (Mainland), Czechoslovakia, Eastern Germany, Hungary, Mongolia, North Korea, North Vietnam, Poland, Romania, USSR.

Trade with developing countries and with the Sino-Soviet area, finally, also ended up with larger deficits last year than before. In the first case the deterioration amounted to 162 billion lire or 24 per cent of the year's total increase in the trade deficit, in the second case to 39 billion lire and a corresponding 6 per cent.

Turning from trade to services, the balance on transport account closed last year with a deficit af 170 million dollars, compared with 99 million in 1962. Given that there is a permanent excess of Italian demand for shipping space over the Italian fleet's capacity, the stiffening of freight rates last year put some pressure on the transport balance. Rates for both dry cargoes and tankers kept climbing slowly but continuously, and the movement gathered momentum during the second half of the year under the impact of stronger demand for shipping space of all kinds.

Tourism still made progress last year, but less than in 1962, when net receipts grew by 92 million dollars; in 1963 they rose by 85 million dollars to a total of 932 million. The annual increase in foreign tourists' expenditure in Italy amounted to 12 per cent in 1962 and to 10 per cent last year.

If tourist receipts were, therefore, less buoyant, the same applies to the flow of foreign visitors and the time they spent in Italy. Actually, the statistical evidence is that the daily cost of a tourist's stay increased by 10.6 per cent last year, and if this is so the increase in foreign exchange earnings is almost entirely attributable to the rise in prices.

On the other hand, the last few years' tendency for Italian tourists to travel more abroad was strongly reinforced last year, with the result that foreign exchange expenditure on this score was three times as high as the average over the preceding five years. The reason is that families not only earn higher incomes, but can afford to spend a larger part of them on non-essential expenditure. In all, Italian foreign-exchange expenditure for tourism amounted to 20 per cent of tourist receipts last years, as against 15 per cent over the average of the period 1959-1962.

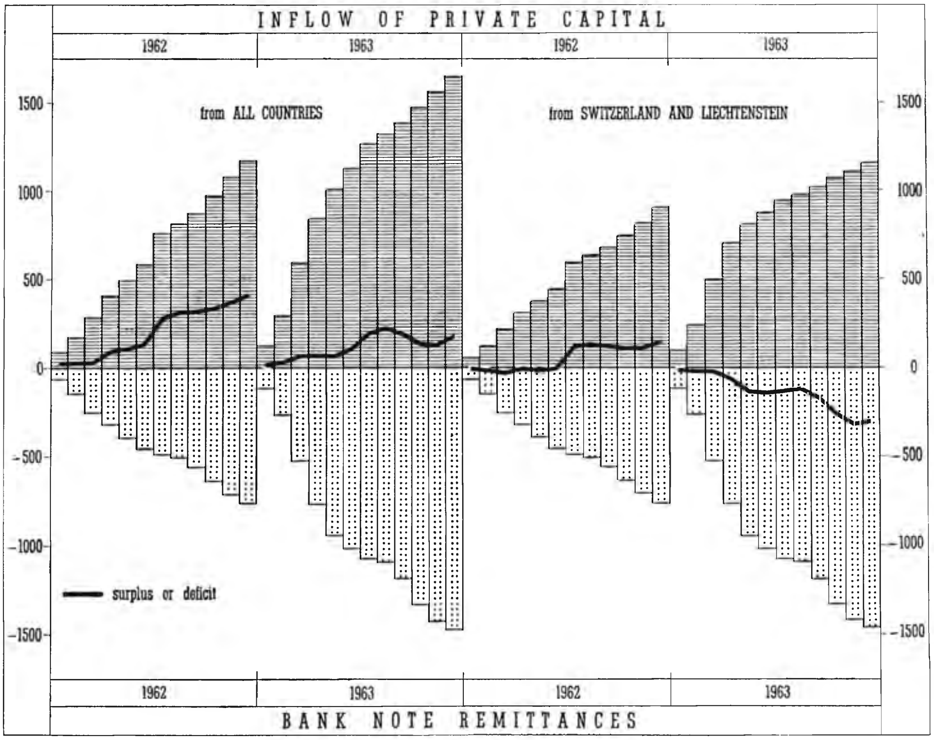
The outward migratory flow from Italy diminished again last year, as it has done since 1961. On provisional estimates, the numbers involved in 1963 were 301,000 persons, as against 366,000 in 1962; the difference of 65,000 amounts to 17.6 per cent. The contraction in the labour supply available for emigration is, of course, a result of the improved employment situation at home, in terms both of more job opportunities and of the gradual rise of Italian wages to levels comparable with other industrial countries.

Capital Movements. On balance, the net outflow of capital from Italy amounted to 559 million dollars last year, compared with 309 million in 1962.

One major element in this deterioration was clandestine capital export of Italian bank notes. Once repatriated, these may be used by Italians either for domestic investment under a foreign name or for investment abroad. In 1962, 766 million dollars' worth of Italian bank notes were repatriated, and it is estimated that three quarters of that amount were invested by Italian residents domestically under a foreign name, and the rest abroad through other than the normal official channels.

In 1963 bank note repatriation doubled to 1,740 million dollars, but there seems to have been a shift in the relative purposes of the movement. In 1962, foreign investment and loans exceeded bank note repatriation by 407 million dollars and in 1963 by 102 million. Now, the great bulk of bank note remittances comes from Switzerland and Liechtenstein, and calculations relating to these two countries alone show a 140 million dollars excess of foreign investment and loans over bank note remittances in 1962 and a shortfall of 304 million last year. It follows that foreign investment and loans originating elsewhere than in Switzerland and Liechtenstein increased, and it is reasonable to assume, therefore, that at least part of last year's changes with respect to these two countries was attributable to operations by Italian residents. In the end effect, the capital outflow was larger last year both in absolute and in relative terms than it had been the year before (Chart 6).

CHART 6



Inflow of private capital and bank note remittances

(cumulative figures in million dollars)

Rough estimates based on the above considerations suggest that in 1963 only 65 per cent of the flow of bank notes were connected with Italian residents' loans and investment under foreign names, and that, therefore, as much as 35 per cent were attributable to Italian investment abroad.

The outflow of bank notes was strongest during the first half of the year; during the second half of 1963 and the first few months of this year the movement weakened, not least probably under the impact of reduced bank liquidity, and at the same time there were signs that part of the funds previously sent abroad were being repatriated.

Foreign investment in Italy amounted last year to 1,292 million dollars, as against 1,063 million in 1962. Direct investment slightly declined from 379 to 373 million dollars, but portfolio investment increased strongly. In terms of geographical distribution, there was an increase in investment originating in the United States and the Benelux countries, and a decrease in the case of Germany, France and the United Kingdom.

Disinvestment on the part of foreigners rose fairly sharply to a total of 358 million dollars in 1963, compared with 290 million the year before. Disinvestment was strongest in April/May and again in September/November, and was most pronounced in the case of Switzerland and Liechtenstein, whose investment in Italy, as noted, consists largely of Italian investment under foreign names.

In its turn, Italian investment abroad through official channels rose slightly last year to a total of 268 million dollars. Direct investment declined by 35 million dollars because of the altered financial situation of Italian companies, which found both their own profits diminished and a scarce supply of savings on the capital market. In these circumstances, some companies had outright recourse to foreign finance, while others liquidated some of their own earlier foreign investment to meet their financial requirements at home. Thus direct disinvestment increased by more than 30 million dollars, from 25 million in 1962 to 56 million last year.

Portfolio investment, on the other hand, rose fairly strongly to a total of 47 million dollars, thanks, in part, to the new provisions of March 1963 which extended to all residents the freedom to invest in foreign securities, which had previously been limited to specified financial institutions.

Private credit extended to Italy trebled last year in comparison with 1962 to reach a total of 349 million dollars (Table 18). Faced with the need to raise finance, government-controlled and private companies in Italy as well as local authorities offered a coupon of as much as 6.75 per cent on capital markets abroad for foreign-exchange loans with maturities not exceeding three years. It became clear in time that all these various moves in the quest for foreign funds needed to be co-ordinated, and the Joint Ministerial Committee on Credit accordingly decided to introduce a system of prior approval on the part of the Committee itself.

Table 18

Foreign Loans and Credits to Italy

(million dollars)

Items	1962	1963
A. Public:		
Cassa per il Mezzogiorno - BIRD	23.2	9.2
Cassa per il Mezzogiorno - European In- Investment Bank	21.5	34.8
State Railways - European Investment Bank	7.0	—
Cassa per il Mezzogiorno - Banque Lambert	—	17.4
Republic of Italy - International Co-operation Administration - Export-Import Bank	22.7	—
City of Milan - Irving Trust Company . .	—	19.1
Total . . .	74.4	80.5
B. Private:		
All origins	109.8	349.3
Grand Total (A + B) . . .	184.2	429.8

A new development last year was the issue of loans in units of account, which afford a better hedge against currency devaluation and so can be useful in mobilizing international saving.

Repayment of private debts to foreign lenders also increased last year, but fell short, both in absolute and in relative terms, of new private borrowing, so that the net capital inflow on this score worked out at 270 million dollars last year, compared with 59 million in 1962.

Like direct investment abroad, private Italian lending abroad reflected the reduced liquidity of Italian companies and banks. New credits extended were 7 million dollars less than in 1962, and repayments by foreign debtors increased from 5 to 44 million dollars.

Financial discussions in Washington in March of this year led to an agreement whereby 450 million dollars of medium-term credits are being made available to Italy in the form of credit lines on the Export-Import Bank and the Commodity

Credit Corporation. These funds are additional to about 550 million dollars in short-term swap facilities, and are intended to help tide over Italy's trade deficit pending the full effects of the country's current domestic stabilization programme.

The credit line on the Export-Import Bank is for 200 million dollars and can be used within one year of the date of the contract; it was agreed that half the amount should be available for purchases of American raw materials and semi-manufactures, whereas the other half should be used for equipment apt to raise productivity and thereby to contain the rise in average production cost.

The credit line was opened in the name of IMI (*Istituto Mobiliare Italiano*), a government agency. Interest is due twice a year at a rate of 4.75 per cent p.a., plus a commission of 0.25 per cent annually on unused balances, and repayment is to begin at any time after the lapse of the first year, but not later than three years hence.

The credit line of 250 million dollars on the Commodity Credit Corporation is to finance purchases of American surplus agricultural products, which otherwise are a normal item in the trade between the two countries. It will be recalled that the CCC is authorized within the Export Credit Sales Program to sell certain agricultural products against payment deferred for a maximum of 36 months, subject to charging interest at 4.5 per cent plus the cost of the required guarantee on the part of an American bank.

As regards trade credits, the Italian Exchange Office now provides statistics about credits for periods exceeding 360 days. At the end of last year, Italy had 350 million dollars outstanding in credits extended to foreign importers of Italian goods; the 43 million dollar increase in net credits was, however, less than the preceding year's increase of 66 million.

The balance of trade credits and repayments connected with Italian imports, on the other hand, left Italy a debtor to the extent of 48 million dollars at the end of 1963. Net credits so extended to Italy last year amounted to 10 million dollars.

All in all, medium-and long-term trade credits in either direction ended up by increasing Italy's foreign claims by 33 million dollars, and short-term trade credits added another 35 million dollars.

Recently, the Italian government adopted a series of important measures to stimulate exports by credit facilities and fiscal reliefs, and also introduced new regulations regarding settlement for imports.

Italy's net financial aid to developing countries declined last year, both as regards bilateral and multilateral aid. Gross financial resources furnished to developing countries were 306 million dollars last year, as against 369 million in 1962; net of repayments, the figures for the two years are 171 and 293 million.

Apart from the well-known structural factors which severely limit the resources which Italy can spare for development aid, cyclical strains last year worked in the same direction. Given that it was found necessary, in present circumstances, to adopt a policy of restricting public expenditure, it is hardly likely that Italy can assume added commitments in this field in the near future.

IV. *Monetary Movements and Domestic Liquidity*

On balance, monetary movements in the Italian balance of payments last year reduced Italy's net foreign assets by 1,252 million dollars. Half of this amount came from reserves and other official assets, the other half from an increase in the banks' foreign indebtedness (Table 19). Thus the net foreign assets of the Bank of Italy and the Italian Exchange Office had dropped to 3,395 million dollars by the end of 1963, of which 3,395 million dollars were first- and second-line reserves (Table 20), whereas the Italian banks' net foreign indebtedness had risen to 1,254 million dollars (Table 21).

As in 1962, therefore, foreign credits to Italian banks mitigated the restrictive monetary effects of the deterioration in the overall balance of payments. Between October 1962, when

TABLE 19

Monetary Movements

(million dollars)

Movements reflected in the balance sheet of the	1962	1963
1) Bank of Italy:		
First- and second-line reserves	52.4	— 409.3
Other official assets abroad	428.3	— 192.7
Total . . .	480.7	— 602.0
(billion lire incl. leads and lags) . . .	*307.9*	— *374.5*
2) Banking system:		
Net bank liabilities abroad	— 430.3	— 649.8
(billion lire) . . .	— *268.9*	— *406.1*
Total 1) + 2) . . .	50.4	— 1,251.8

the banks were again authorized to carry net foreign currency liabilities abroad, and September 1963, when they were told not to increase their net foreign debts beyond the end-August level and, if possible, to reduce them, foreign bank credits to Italy more than offset the liquidity losses due to the balance-of-payments deterioration (Table 22).

The foreign currency credits extended to Italian banks were in part passed on to importers, and in part converted into lire through the closing of forward dollar positions with the Italian Exchange Office. Thus the banks' foreign currency credits to domestic clients rose by 573 million dollars between October 1962 and August 1963, while open lire-dollar swaps with the Exchange Office declined by 544 million dollars. The liquidity effect was the same in both cases, namely, to counteract the liquidity losses due to the balance-of-payments deficit.

Likewise, the Italian banks' borrowing abroad also attenuated the monetary effects of our deficit on other countries, in so far as Italy did not have to sell foreign exchange form the reserve holdings, which would have increased liquidity in the buying

TABLE 20

Foreign Assets of the Italian Exchange Office and the Bank of Italy

(End-month figures in million dollars)

Items	1962 October	1962 December	1963 March	1963 June	1963 August	1963 December	1964 March
1) First-line reserves:							
Gold:							
Exchange Office	639.0	643.4	685,9	689.4	691.3	743.1	543.4
Bank of Italy	1,600.0	1,600.0	1,600.0	1,600.0	1,600.0	1,600.0	1,600.0
Total . . .	2,239.0	2,243.5	2,285.9	2,289.4	2,291.3	2,343.1	2,143.4
Convertible currencies: Exchange Office	1,043.4	1,197.5	1,040.1	1,028.7	1,195.5	714.2	680,9
Total official reserves . . .	3,282.4	3,440.9	3,326.0	3,318.1	3,486.8	6,057.3	2,824.3
Convertible currencies: Bank of Italy	164.5	174.0	164.3	160.1	161,9	123.0	120.9
Lire accounts abroad:							
Exchange Office	− 2.4	− 1.7	− 2.4	− 2.4	− 2.2	− 0.9	− 1.8
Bank of Italy (excluding I.M.F.)	− 81.4	− 65.3	− 58.8	− 61.0	− 74.3	− 46.7	− 47.8
Central Bank swaps	—	50.0	—	—	—	− 50.0	− 150.0
Total 1) . . .	3,363.1	3,597.9	3,429.1	3,414.8	3,572.2	3,082.7	2,745.6
2) Second-line reserves:							
U.S. Treasury notes	—	—	200.0	200.0	200.0	200.0	150.0
U.S. Treasury notes counterpart fund	—	—	—	—	—	− 117.0	− 150.0
International Monetary Fund	202.8	202.8	202.8	205.2	207.7	225.7	0.7
Net position with European Monetary Fund	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Total 2) . . .	206.1	206.1	406.1	408.5	411.0	312.0	4.0
Total 1) + 2) . . .	3,569.2	3,804.0	3,835.2	3,823.3	3,983.2	3,394.7	2,749.6
3) Medium- and long-term assets:							
15-month U.S. Treasury notes	148.8	200.0	—	—	—	—	—
5-year U.S. Treasury notes redeemable after 15 months	—	—	58.0	58.0	13.1	13.1	10.2
Foreign currency bonds issued by the Italian government	327.3	336.3	332.1	326.1	366.4	350.5	345.2
Foreign currency bonds issued by non-residents	49.0	49.0	48.7	48.7	48.5	37.6	37.6
Lire bonds issued by non-residents	19.4	25.7	25.7	25.7	34.2	34.2	52.4
E.P.U. balance	1.4	1.2	1.2	1.0	1.0	0.9	0.8
Consolidated credits and special accounts	161.8	156.3	158.7	148.7	147.9	142.0	143.4
Argentinian loan reserve account	18.3	18.3	18.3	17.5	17.9	16.7	16.7
Bilateral clearings	1.9	2.6	1.5	1.6	1.0	1.6	1.6
I.B.R.D. and European Investment Bank bonds held by Bank of Italy	11.9	4.0	4.0	4.1	4.2	4.1	4.2
Total 3) . . .	739.8	793.4	648.2	631.4	633.8	600.7	612.1
Total foreign assets of the Italian Exchange Office and the Bank of Italy 1) + 2) + 3)	4,309.0	4,597.4	4,483.4	4,454.7	4,617.0	3,995.4	3,361.7

TABLE 21

The Italian Banks' Overall Position in Foreign Exchange and Lire Accounts

(End-month figures in million dollars)

Items	1962 October	1962 December	1963 March	1963 June	1963 August	1963 December	1964 March
ASSETS							
A. Assets abroad	1,470.2	1,457.2	1,540.4	1,554.1	1,381.6	1,283.8	1,240.9
1) *in convertible currencies*	1,407.5	1,384.3	1,424.2	1,453.8	1,304.6	1,190.5	1,135.9
2) *in non-convertible currencies*	2.7	2.9	3.3	3.2	2.8	3.7	4.5
3) *in lire*	60.0	70.0	112.9	97.1	74.2	89.6	100.5
B. Forward commitments abroad	977.5	1,308.4	2,099.9	2,141.1	2,201.0	1,768.7	1,734.3
C. Domestic assets in foreign exchange	1,232.2	1,365.0	1,590.0	1,772.9	1,868.9	1,725.1	1,621.7
D. Forward commitments in Italy	1.6	2.1	2,7	1.1	1.6	0.9	0.9
E. Total assets	3,681.5	4,132.7	5,233.0	5,469.2	5,453.1	4,778.5	4,597.8
LIABILITIES							
F. Liabilities abroad	1,619.7	2,061.8	2,298.7	2,695.2	2,749.8	2,538.2	2,297.9
1) *in convertible currencies*	1,257.4	1,747.0	1,951.2	2,333.8	2,355.9	2,155.8	1,973.3
2) *in non-convertible currencies*	5.2	2.7	2.6	2.4	2.6	2.1	2.2
3) *in lire*	357.1	312.1	344.9	359.0	391.3	380.3	322.4
G. Forward commitments abroad	1,057.5	1,306.7	2,088.4	2,124.4	2,162.0	1,718.2	1,696.6
H. Clients' foreign exchange deposits in Italy	391.7	381.8	401.2	429.6	455.2	458.9	450.2
I. Accounts with the Italian Exchange Office	4.0	4.1	3.5	3.0	1.8	0.9	1.7
J. Forward commitments in Italy	14.2	16.3	14.7	17.0	20.6	33.3	43.6
K. Total liabilities	3,087.1	3,770.7	4,806.5	5,269.2	5,389.4	4,749.5	4,490.0
BALANCES							
L. Net position vis-à-vis abroad (A — F)	— 149.5	— 604.6	— 758.3	—1,141.1	—1,368.2	—1,254.4	—1,057.0
M. Overall net position (E — K)	594.4	362.0	426.5	200.0	63.7	29.0	107.8
N. Spot-and-forward facilities drawn	923.7	584.9	634.8	453.2	379.9	305.4	313.5
O. Forward facilities drawn	92.6	12.5	0.5	— 0.8	— 20.0	—1,254.4	5.0

TABLE 22

Means of Financing the Overall Balance-of-Payments Deficit

(million dollars)

	November 1962 to August 1963 (10 months)	September 1963 to March 1964 (7 months)
1) Balance-of-payments deficit during the period . . .	918.4	936.5
2) Monetary movements during the period:		
a) Italian banks' position vis-à-vis abroad	— 1,218.7	311.2
b) Official assets other than reserves	95.9	— 585.2
c) Official reserves	204.4	— 662.5
Total . . .	— 918.4	— 936.5

country. To the extent that foreign credits are a mere counterpart to the export of Italian capital, no change occurs either in the level of trade or in the degree of liquidity in Italy and abroad. This proposition, of course, holds only in overall terms; bilateral imbalances may well occur, if the country which extends credit to Italy is not the same as that which exports goods and services to Italy or receives Italian capital.

The foreign exchange credits which swelled the Italian banks' net liabilities abroad came entirely from the Eurodollar market. According to the quarterly statistics of the Italian Exchange Office the Italian banks, whose Eurodollar position was to all intents and purposes in balance in September 1962, owed 976 million Eurodollars a year later (Table 23), having borrowed on various European markets and taken in direct deposits from non-residents.

The counterpart to Italy's increased recourse to Eurodollar credits was a decrease in such credits to other countries and an increase in the total supply of Eurodollars.

Monetary policy helped to expand employment and production until the middle of last year, when symptoms of imbalance began to appear in price movements, saving and the balance of payments. When the authorities subsequently adopted increasingly severe liquidity-restricting measures, it became clear that the movement of short-term funds through the banking system might counteract the deflationary intent of monetary policy.

TABLE 23

Eurodollar Assets and Liabilities of Italian Banks

(End-month figures in million dollars)

Country	1962 September	1962 December	1963 March	1963 June	1963 September	1963 December	1964 March
United Kingdom:							
Assets	156.6	144.7	180.7	182.7	120.0	143.4	83.6
Liabilities	149.9	376.0	323.0	453.0	492.2	437.2	345.2
Balance	7.6	— 231.3	— 142.3	— 270.3	— 372.2	— 293.8	— 261.6
Switzerland:							
Assets	156.5	140.0	122.5	124.8	120.2	133.4	150.0
Liabilities	82.9	99.0	103.0	118.0	140.0	147.6	143.7
Balance	74.5	41.0	19.5	6.8	— 19.8	— 14.2	6.3
France:							
Assets	49.9	54.7	55.6	57.1	53.5	44.9	24.2
Liabilities	92.0	164.0	162.0	133.0	207.4	197.9	144.5
Balance	— 42.1	— 109.3	— 106.4	— 75.9	— 153.9	— 153.0	— 120.3
Belgium:							
Assets	14.1	13.2	21.9	24.9	18.1	12.2	6.6
Liabilities	13.0	46.0	40.0	66.0	60.5	43.4	39.9
Balance	1.1	32.8	— 18.1	— 41.1	— 42.4	— 31.2	— 33.3
Germany:							
Assets	23.6	40.9	42.5	34.0	16.3	13.0	3.8
Liabilities	49.0	23.0	70.0	81.0	82.7	24.1	49.8
Balance	— 25.4	17.9	— 27.5	— 47.0	— 66.4	— 11.1	— 46.0
Netherlands:							
Assets	20.7	15.7	10.3	10.3	5.6	3.0	5.5
Liabilities	30.0	69.0	64.0	90.0	46.3	40.4	35.7
Balance	— 9.3	— 53.3	— 53.7	— 79.7	— 40.7	— 37.4	— 30.2
Mediterranean countries:							
Assets	—	—	5.0	3.0	16.7	4.1	9.3
Liabilities	79.0	111.0	100.0	131.0	107.8	139.6	150.1
Balance	— 79.0	— 111.0	— 95.0	— 128.0	— 91.1	— 135.5	— 140.8
Latin American countries:							
Assets	42.5	41.4	48.2	47.8	48.0	47.2	47.9
Liabilities	32.0	30.0	41.0	45.0	43.8	42.9	47.5
Balance	10.5	11.4	7.2	2.8	4.2	4.3	0.4
Other countries:							
Assets	123.5	111.3	124.0	115.4	84.5	72.4	46.8
Liabilities	86.0	100.0	138.0	259.0	277.9	191.7	165.2
Balance	37.5	11.3	— 14.0	— 143.6	— 193.4	— 119.3	— 118.4
Total:							
Assets	587.4	561.9	610.7	600.0	482.9	473.6	377.7
Liabilities	612.0	1,018.0	1,041.0	1,376.0	1,458.6	1,264.8	1,121.6
Balance	— 24.6	— 456.1	— 430.3	— 776.0	— 975.7	— 791.2	— 743.9

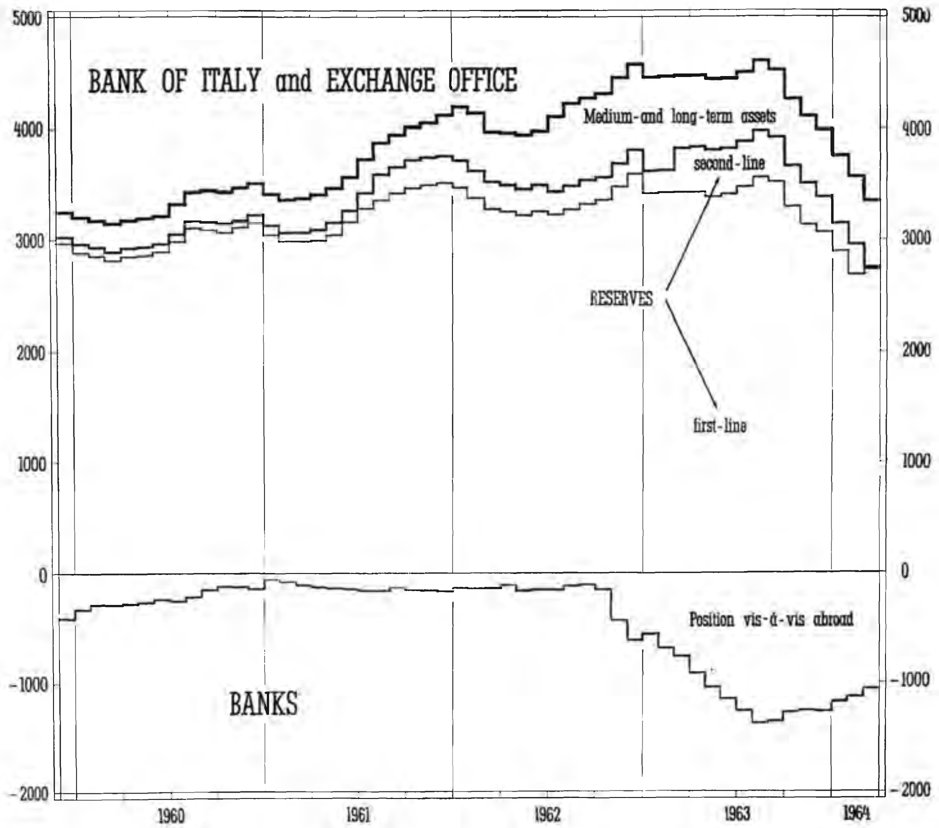
This is why the banks were asked, last September, not to increase their foreign indebtedness beyond the end-August levels and if possible to reduce it; later, in December, this was followed by formal instructions to the banks, which had in the meantime reduced their foreign liabilities, not to exceed their end-November or end-December debt level, whichever was the lower.

Changes in short-term capital movements may also be reflected in the forward lire rate and hence in the cost of foreign exchange credits, including the premium and discount to cover the exchange risk. The period of steadily growing foreign credits, in the course of which overall net bank liabilities had risen to 1,368 million dollars at the end of August 1963, of which 1,051 million in foreign exchange, was followed by a period of gradual contraction in the banks borrowing abroad. This was due in part to the official instructions given to the banks, but in part also to the play of restrictive market influences connected with the mounting cost of foreign currency credits and the equally rising risk premium Italian business men had to pay as a result of the deteriorating forward lire rate. By the end of 1963 the Italian banks' net debit position had falled back to 1,254 million dollars, and at the end of March this year it was only 1,057 million dollars.

Since September of last year, therefore, first- and second-line reserves had to cover not only the growing overall deficit in the balance of payments, but also part of the repayment of foreign bank credits. As a result, these reserves dropped by 588 million dollars in the last quarter of 1963 and by a further 645 million dollars in the first quarter of 1964. This movement is in sharp contrast with the steady growth of first- and second-line reserves since December 1959, to a peak of 3,983 million dollars last August (Chart 7).

In its turn, the ratio between the banks' net foreign liabilities and the first- and second-line reserves also grew steadily until August 1963 because bank indebtedness kept increasing, and since then because it decreased less than the reserves. In March this year the ratio was 38 per cent.

CHART 7



Foreign position of the Bank of Italy, the Italian Exchange Office and Italian banks

(million dollars)

A point worth noting is that in recent months there has been a tendency to transform part of the short-term position into a medium-term one. Last March, medium-term liabilities accounted for 74 million dollars of the banks' net foreign indebtedness.

International Collaboration and Reserves.— We live in an era of progressive interdependence of goods and capital markets, of swift structural changes in the economy of many countries, and of sudden speculative shifts from one currency into another. In this situation we need, more than ever, continuous consultation and collaboration among the representatives of major countries on economic and financial questions; we also need to devise means to counteract any possible speculative manoeuvres. This latter purpose was precisely what Italy had in mind with the reciprocal credit agreements she concluded with other countries. At the end of March this year we also transformed the so-called gold tranche with the IMF, that is, the sum of our gold subscription to the Fund (67.5 million dollars) and of the Fund's drawings of 158.2 million dollars against the lire quota of 202.5 million dollars, into first-line reserves (Table 24). As a result of this operation and of the U.S. Treasury's providing dollars against the lire counterpart fund for U.S. Treasury Notes in Italian hands, Italy's second-line reserves have now become first-line reserves.

Table 24

Changes in Italy's Credit Position with the International Monetary Fund

(million dollars)

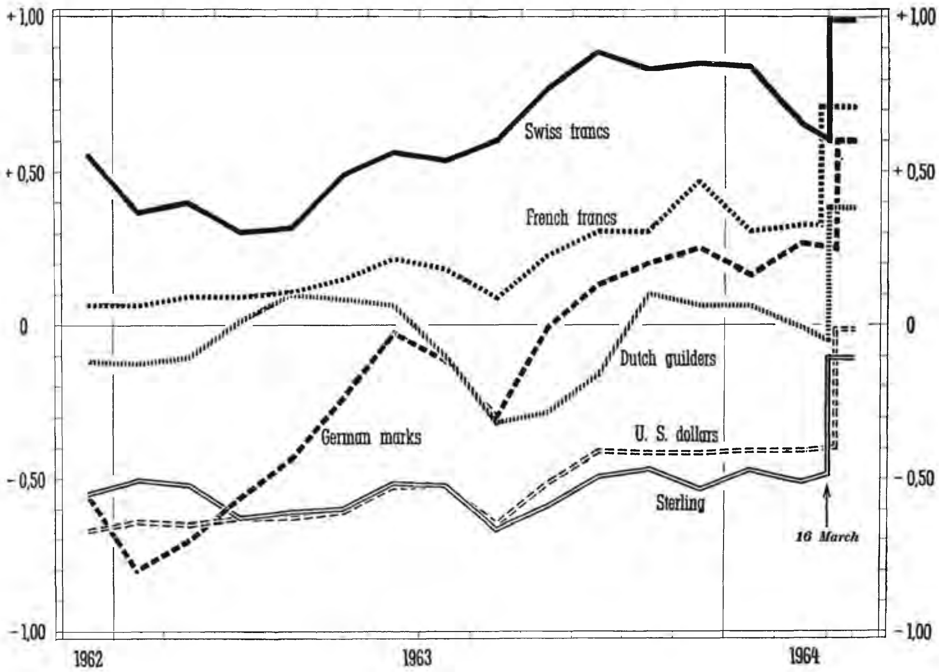
Period	Credit (1)	Debit (2)	Balance
1961	215.2	40.0	175.2
1962	—	40.0	135.2
1963	33.0	10.0	158.2
First quarter of 1964	—	175.5	0.7

(1) Lire drawings on the part of other countries.
(2) Italy's drawings on the Fund, the Fund's gold sales against lire and other countries' lire reimbursements to the Fund.

The Exchange Rate of the Lira.— Throughout 1963 and even more so early this year dealings in lire were very active, as the currency came under increasing strain, but fluctuations in the spot rate were kept within fairly narrow limits (Chart 8). After the first quarter of 1963, when the monthly average rate against dollars was almost stationary (ranging from 620.88 in January to 620.97 in March), the dollar continuously strengthened to a peak of 622.48 in October; only in August was there a seasonal decline to 620.95. During the last few months of 1963 and early this year the dollar rate fluctuated around 622.40 and finaly settled down at the parity level of 625 after the Washington financial agreements.

The balance-of-payments effects of speculative short-term capital movements to some extent forced the hand of the monetary authorities, in so far as they were unable to allow much

CHART 8



Percentage deviation of official exchange rates from the lira parity

(Plus signs indicate that the foreign currency is at a premium against the lira, minus signs that the foreign currency is at a discount)

flexibility in the exchange rate within the lire parity range agreed with the International Monetary Fund. In view of the imbalance of current external payments it would have been expedient to let the exchange rate return to parity level and so to eliminate the now quite unrealistic discount at which the dollar stood against the lira; but the significance of any such changes would probably have been greatly exaggerated, so that there was a danger of increased speculative movements. For this reason the authorities preferred to wait until after the Washington agreements before restoring the lira to parity.

Forward dealings in lire generated very strong speculative pressures, especially in October and November of last year and more recently during the first two weeks of March.

Actually, the lira lost ground gradually from the end of April 1963 onwards until late in June, when the one-month forward rate of the lira against the dollar showed a 0.78 per cent (annual) discount, and the three-month rate a discount of 0.58

per cent. After a brief pause at the end of June, the same tendency reappeared with renewed vigour; in August, the lire forward rate dropped rather sharply and in October and November it plunged, with the one-month discount exceeding 5 per cent and the three-month one 4 per cent. This sharp divergence between the spot and the forward rate induced the Italian banks to engage in swap operations, selling spot lire for foreign exchange and buying them back forward; private business men, on the other hand, reduced their borrowing of foreign exchange.

This helped, of course, to bring down the discount in the forward rate. Similar operations revived again in March of this year, when renewed speculative attacks abruptly lifted the discount to around 7.5 per cent. Quick relief followed the Washington agreements, so that the lire discount fell back to 2 per cent in April.

All these developments, together with the Italian banks' foreign indebtedness, were reffected in the volume of foreign exchange bank credits to Italian clients, as well as in the currencies of these credits and the interest charged on them.

After a peak of 1,805 million dollars last August, foreign currency credits to domestic clients thus fell off gradually to 1,661 million dollars in December and to 1,582 million in March of this year. Shifts in the currency composition of these credits brought dollars to the fore at the expense mainly of Swiss francs and German marks. Interest rates rose sharply to an average level of around 6.5 per cent, owing to the general stiffening of rates on the Eurodollar market, to a further mark-up by Italian banks and, finally, to the restrictions on bank borrowing abroad.

V. *Government Finance*

The final results of the administrative budget for 1962/63 showed a current deficit of 433 billion lire and an overall deficit (excluding public debt operations) of 538 billion (Table 25). Both deficits were about 150 billion higher than had been provided for in the initial estimates, partly because of the incidence of

TABLE 25

Budget Position for the Fiscal Years 1962/63, 1963/64 and 1964/65

(administrative budget; billion lire)

Items	1962/63 Initial estimates	1962/63 Subsequent variations	1962/63 Final results (1)	1963/64 Initial estimates	1963/64 Subsequent variations	1963/64 Revised estimates 31-3-64	1964/65 Initial estimates	July-Dec. 1964 Initial estimates
Current Section								
Revenue	4,482	769	5,251	5,265	7	5,272	6,086	2,947
Expenditure	4,761	923	5,684	5,654	64	5,718	6,445	3,126
Surplus or deficit (—)	— 279	— 154	— 433	— 389	— 57	— 446	— 359	— 179
Capital Movements								
Revenue:								
a) Issue of securities	—	109	109	—	—	—	—	—
b) Issues for various indemnities (2)	3	2	1	3	—	3	3	1
c) Issue of Treasury coin	—	7	7	—	—	—	—	—
d) Balancing items	11	—	11	24	—	24	24	24
e) Other	23	11	34	26	—	26	43	25
	37	125	162	53	—	53	70	50
Expenditure:								
a) Repayment of public debt (3)	267	5	262	307	—	307	277	52
b) Balancing items	11	—	11	24	—	24	24	24
c) Other	133	6	139	139	—	139	106	62
	411	1	412	470	—	470	407	138
Surplus or deficit (—)	— 374	124	— 250	— 417	—	— 417	— 337	— 88
Overall results								
Revenue	4,519	894	5,413	5,138	7	5,325	6,156	2,997
Expenditure	5,172	924	6,096	6,124	64	6,188	6,852	3,264
Overall surplus or deficit (—)	— 653	— 30	— 683	— 806	— 57	— 863	— 696	— 267
Net result of public debt operations	— 264	119	— 145	— 304	—	— 304	— 274	— 51
Net surplus or deficit (—)	— 389	— 149	— 538	— 502	— 57	— 559	— 422	— 316

(1) Provisional figures.
(2) Compensation for confiscation of Italian property abroad.
(3) Including payments into the Amortisation Fund for Treasury Bonds and redemption of bonds issued by the Credit Consortium for Public Works.

expenditure financed directly by recourse to credit, such as expenditure for the agricultural Green Plan.

The two deficits, respectively, amount to 7.6 and 9.2 per cent of the corresponding expenditure, whereas in the initial estimates the figures were 5.9 and 7.9 per cent.

For 1963/64, the revised estimates of 31 March 1964 budget for a current deficit of 446 and an overall deficit (excluding public debt operations) of 559 billion lire, both amounts being 57 billion in excess of initial estimates.

Initial estimates for 1964/65, finally, provide for a smaller current deficit (359 billion lire) than was originally budgeted for the current fiscal year (389 billion). Similary, the estimated overall deficit (net of public debt operations) of 422 billion lire represents an appreciable improvement over the initial provision of a 502 billion lire deficit for the current fiscal year.

The estimates for 1964/65 can, therefore, be regarded as the first-fruits of a new counter-cyclical budgetary policy designed to reduce the size of the deficit. This is no mean achievement, given that each year's budget is in large measure predetermined by prior legislation, so that, barring changes in the latter, there is very little elbow room for economies.

The acknowledged need for a stricter budgetary policy was reflected in a recent speech in Parliament by the Minister of the Treasury. He explained that during the current fiscal year any increase in existing expenditure commitments would be financed by increased revenue, that any residual revenue would be used to reduce the deficit (in line with the policy already outlined by the preceding government) and that any other new expenditure which may become necessary in the course of the year would be covered by new sources of revenue.

We are now on the eve of an important new departure in Italian public finance. With the second half of the calendar year the budget will cease to be ruled by 1923 legislation and will be based on new, more modern and economically more meaningful, concepts.

On 1 March 1964, Law No. 62 gave effect to the long-awaited budget reform as of 1965. The three principal innovations are that successive estimates are to be unified in one single bill, that budget expenditure is to be reclassified in functional and economic terms, and that the fiscal year will henceforward coincide with the calendar year. For this latter reason it became necessary to establish a separate budget for the second half of 1964, to bridge the gap between the current, 1963/64, fiscal year and the new fiscal year which will begin on 1 January 1965.

In Table 26 we present, as usual, a summary of the global figures which show the main features of the final results for the last three years and of the estimates for the current and the next year, with particular reference to the overall deficit and public investment.

TABLE 26

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
1960/61	4,004	4,469	*89.6*	— 408	— 57	— 465	966	501
1961/62	4,603	4,987	*92.3*	— 299	— 85	— 384	1,071	687
1962/63	5,285	5,823	*90.8*	— 433	— 105	— 538	1,221	683
1963/64	5,291	5,793	*91.3*	— 389	— 113	— 502	1,007	505
1964/65	6,129	6,551	*93.6*	— 359	— 63	— 422	1,160	738

(a) The figures for 1960/61, 1961/62 and 1962/63 are provisional, those for 1963/64 and 1964/65 are initial estimates.
(b) Current items plus the "other" capital items shown in Table 25.

In comparing past figures, the behaviour of the revenue/expenditure ratio is of interest: after an improvement in 1961/62 it suffered a renewed setback in 1962/63. This latter was largely the effect of the application of Law No. 64 of 1955, according to which only actual disbursements are imputed to any particular fiscal year, irrespective of the funds set aside for them, which are always credited to the year of appropriation. Another point to note is that the excess of investment over the deficit, which is a rough measure of the extent to which public saving contributes to public investment, increased sharply in 1961/62 and then remained stationary the following year.

The initial estimates for the current and the next fiscal year, on the other hand, show a distinct improvement in the revenue/expenditure ratio in 1964/65, as well as a large increment in the amount of saving earmarked for investment. The latter figure is higher in the 1964/65 estimates than in any one of the other years under consideration, which is all the more remarkable as the current year stands, together with 1960/61, at the bottom of the range.

As regards coverage for the Treasury's cash requirements, the medium- and long-term public debt contracted last year by 183 billion lire, whereas in 1962 it had grown by 130 billion—or, abstracting from foreign debts incurred by the Italian Exchange Office, by 19 billion. The difference between the two years is largely due to the reimbursement of the 1963 Treasury Bond issue.

Post Office Savings provided 51 billion lire more last year then in 1962, though without the 14-billion increase in postal current accounts the effective increment is only 37 billion.

A rather striking reversal of tendency occurred in Treasury Bills. After an increase of 161 billion lire in 1962, of which the Bank of Italy purchased 133 billion, 1963 showed disinvestment in the amount of 186 billion, for 55 billion of which the Bank of Italy was responsible. The explanation lies, in part, in the new system of Treasury Bill tenders and in the new regulations concerning the composition of compulsory bank reserves, and in part in the heavier pressure on bank liquidity in 1963. It is reasonable to assume that this latter cause indirectly also depressed the propensity of other institutions and private investors to hold Treasury Bills, in so far as bank credits became more difficult to obtain.

In these circumstances, the Treasury had to cover its increased cash requirements last year by other short-term borrowing, especially from the Bank of Italy. As a result, the Treasury's 320-billion credit balance on current account with the Bank at the end of 1962 had turned into debit balance of 506 billion by the end of last year.

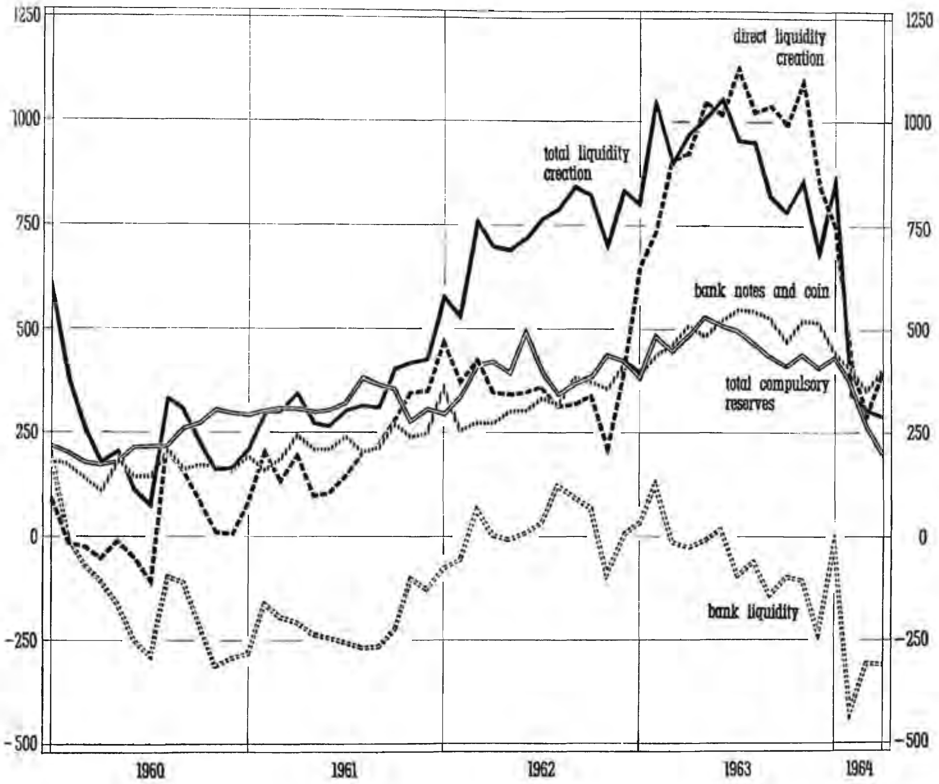
As a result of all these operations, not only the volume, but also the composition of the public debt underwent considerable changes in the course of last year, in line with certain tendencies already visible in 1962. Leaving the Bank of Italy aside, the relative weight of long-term debts and Treasury Bills in the total public debt declined and the proportion of Post Office savings remained fairly stable; on the other hand, there was a large increase in the Treasury's borrowing from the Bank of Italy and, hence, in liquidity creation through the Treasury.

VI. *The Money and Capital Markets and the Control of Liquidity*

During the year 1962 the Bank of Italy and the Italian Exchange Office between them created liquidity in an amount of 801 billion lire (Chart 9); for the twelve months ending in June 1963, the figures was 955 billion, but from July onwards liquidity creation slowed down, so that the figure for the whole of 1963 was kepts to 861 billion lire.

This was enough to enable the banks to expand credit at a gradually decreasing rate. In the event, bank assets closely followed the course of liquidity creation; their annual rate of growth rose from 22.8 per cent in December 1962 to 25.8 per cent in July 1963, and then dropped back to 21.1 per cent in December 1963 and to 16.0 per cent in March this year. Of a total of 861 billion lire liquidity created by the Bank of Italy and the Italian Exchange Office in 1963, 738 billion (79 in 1962) were attributable to the Treasury and 498 billion (414 in 1962) to credits to the domestic market; a partly offsetting amount of 375 billion lire was absorbed by the foreign sector, which in 1962 contributed liquidity to the extent of 308 billion lire. Gross liquidity creation through the Treasury and the domestic market, at 1,236

CHART 9



Bank liquidity

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

billion lire, is therefore seen to be far in excess of the 1962 figure of 493 billion; it was, in part, counteracted by the deflationary effects of the balance of payments.

The banks increased their foreign indebtedness from November 1962 onwards, when they were authorized to carry net foreign-exchange liabilities. This helped the banks to extend more credit to domestic business. In October 1962 net bank indebtedness abroad was only 93 billion lire; by the end of the year, it had risen to 378 billion and by the end of August 1963 to 855 billion lire. Thereafter the movement went into reverse, when the monetary authorities felt that this form of borrowing had outrun its usefulness and requested the Italian banks to stop it. By the end of last year the net foreign liabilities of the banks were down to 784 billion lire, and at the end of March 1964 to 660 billion.

During the first six months of last year, when the banks were free to borrow abroad, they did not make heavy claims on the Bank of Italy; in the opposite situation of the last six months of 1963, they turned increasingly to the Bank.

Recourse to the Bank of Italy amounted, in all, to 431 billion lire in the course of 1963, almost precisely matching the sum of compulsory bank reserves and collateral deposits. The total amount involved was somewhat higher than in 1962, but while the banks had a 20 billion liquidity gain in 1962 on balance between their compulsory reserve payments and their drawings on the Bank, they were left with a slight liquidity loss on the same count last year.

Adding to the liquidity injections by the Bank of Italy and the Italian Exchange Office also those by the banks, we get the full figures of the banking system's contribution to the liquidity of the economy.

Short-term credits to the domestic market increased more last year than in 1962 (2,690 billion lire as against 2,076 bilion), and liquid assets less (2,341 billion lire as against 2,612 billion). Similar, but less pronounced, movements occurred in the sum of loans, mortgages and securities (624 billion last year as against 703 billion in 1962) and non-security assets other than liquid (192 as against 206 billion). The difference between the domestic supply and the domestic use of funds was 781 billion lire—exactly matching the deterioration in the net foreign position of the Bank of Italy, the Exchange Office, and the banks together.

Adding, finally, the operations of the Central Post Office Fund, special credit institutes, insurance companies and social insurance funds, and the capital market, we obtain an overall picture of the flow of money supply and finance funds (Table 27, Charts 10 and 11).

TABLE 27

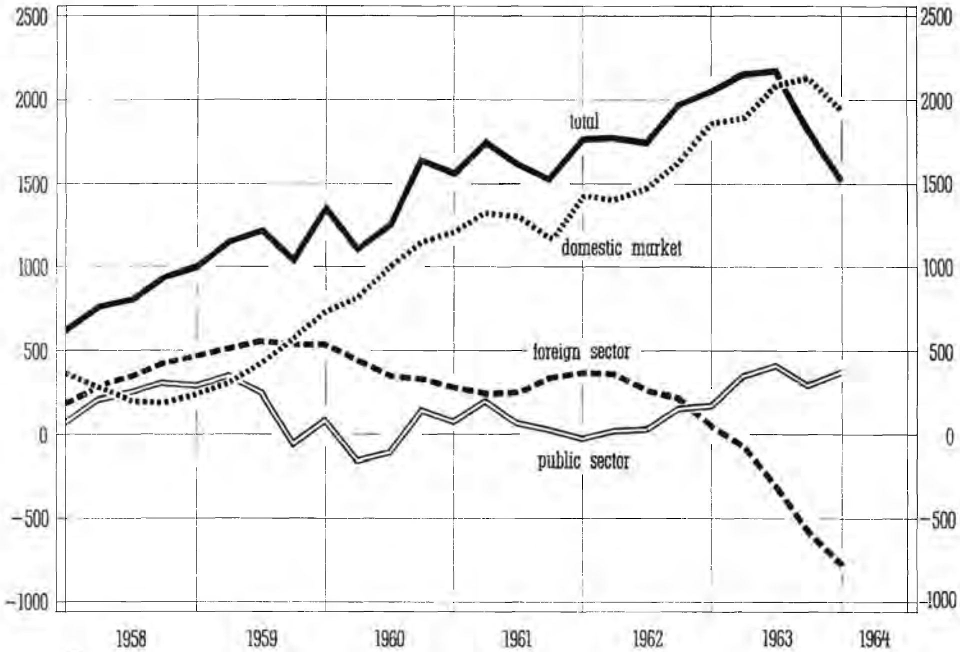
Flow of Money Supply and Finance Funds

(billion lire)

	end-1963 position	Annual changes 1961	1962	1963
Foreign sector				
Net position of the Bank of Italy and Italian Exchange Office	2,518.6	387.4	308.0	− 374.5
Net position of the banks	− 784.0	− 24.8	− 269.0	− 406.1
Total foreign sector	1,734.6	362.6	39.0	− 780.6
Public sector				
Short-term credit (1):				
Bank of Italy and Italian Exchange Office	744.4	− 223.3	34.9	444.8
Banks	3,000.6	179.9	190.3	310.3
Private investors and companies (2)	765,9	15.5	− 81.5	− 330.7
Total	4,510.9	− 27.9	143.7	424.4
Government securities:				
Banks	713.8	63.3	19.6	− 36.3
Central Post Office Savings Fund	286.5	2.5	56.0	133.9
Private investors and companies	1,451.0	50.4	− 43.1	− 152.7
Total	2,451.3	116.2	32.5	− 55.1
Total public sector	6,962.2	88.3	176.2	369.3
Domestic Market				
Short-term credit:				
Bank of Italy and Italian Exchange Office	876.7	240.4	150.7	403.2
Banks	10,921.4	1,174.9	1,699.9	1,531.3
Total	11,798.1	1,415.3	1,850.6	1,934.5
Loans and mortgages:				
Banks	1,264.1	128,4	165.1	254.7
Central Post Office Savings Fund	2,167.2	264.4	287.0	338.0
Special credit institutes	4,737.6	614.2	829.8	1,014.1
Insurance companies and Social Insurance Funds	1,303.6	112.0	140.0	131.7
Total	9,472.5	1,119.0	1,421.9	1,738.5
Securities (3):				
Bank of Italy and Italian Exchange Office	32.6	5.8	7.5	− 0.5
Banks	1,942.3	185.5	511.0	405.9
Central Post Office Savings Fund	341.9	14.7	59.4	198.7
Private investors and companies	18,191.0	982.0	1,014.3	829.4
less: Issues by special credit institutes	4,092.5	514.0	718.2	774.5
Total	16,415.3	674.0	874.0	659.0
Total domestic market	37,685.9	3,208.3	4,146.5	4,332.0
Total credit, loans, mortgages and securities	46,382.7	3,659.2	4,361.7	3,920.7
Primary liquidities				
Notes and coin	3,575.4	360.0	389.9	440.9
Current accounts	7,901.6	799.4	1,169.2	959.1
Total	11,477.0	1,159.4	1,559.1	1,400.0
Secondary liquidities				
Post Office savings books and savings deposits	9,126.3	995.3	1,231.3	1,133.3
Others	198.9	29.3	− 79.2	− 90.4
Total	9,325.2	1,024.6	1,152.1	1,042.9
Non-security assets other than liquid				
Bank of Italy and Italian Exchange Office	657.4	51.6	134.0	23.1
Banks	885.5	− 12.1	71.8	168.6
Central Post Office Savings Fund	2,446.9	191.1	221.9	238.1
Special credit institutes	645.1	100.2	111.6	239.6
Insurance companies and Social Insurance Funds	1,303.6	112.0	140.0	131.7
Total	5,938.5	442.8	679.3	801.1
Securities (4)				
Government securities	1,451.0	50.4	− 43.1	− 152.7
Bonds by special credit institutes	2,556.0	353.8	292.5	414.5
Industrial, ENEL, IRI and ENI bonds	1,435.0	211.4	113.6	147.5
Shares	14,200.0	416.8	608.2	267.4
Total	19,642.0	1,032.4	971.2	676.7
Total money supply and finance funds	46,382.7	3,659.2	3,361.7	3,920.7

(1) Including stockpiling bills; compulsory bank reserves and M accounts appear as an asset with the Bank of Italy (with reversed sign) and as an asset of the 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) Owned by private investors and companies, including social insurance funds. 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 bonds and bond issues on behalf of the Treasury are included under government securities.

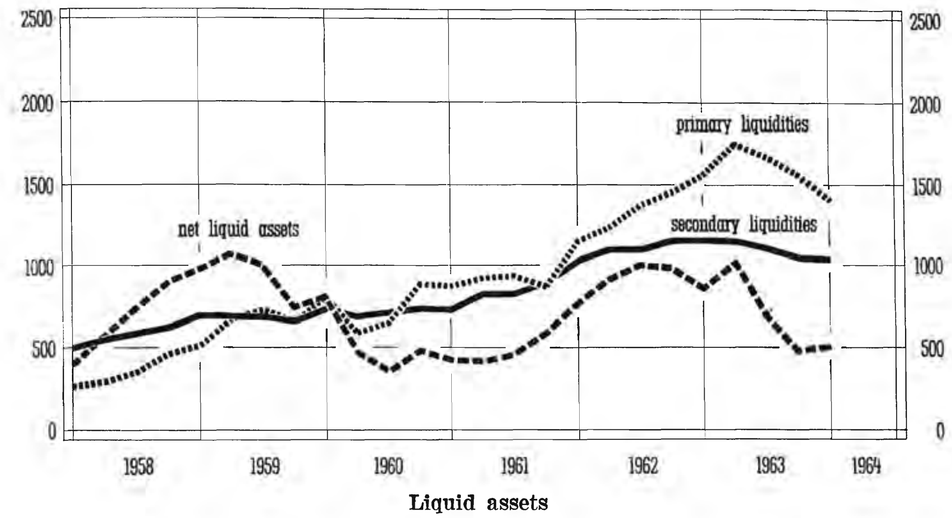
Chart 10



Short-term credit

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

Chart 11



Liquid assets

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

The growth of the economy's liquid assets began to slow down early last year as a result of the slower increase in bank deposits. The deceleration was more marked in primary liquidities, which had grown faster in recent years. But the economy's degree of liquidity is really better reflected in net liquid assets (liquid assets less short-term credits to the domestic market); these latter expanded even more slowly.

At the end of 1963 liquid assets amounted to 20,802 billion lire, having increased in the course of the year by 2,443 billion or 13.3 per cent; in 1962 the corresponding increases were 2,711 billion and 17.3 per cent. Primary liquidities rose by 1,400 billion (13.9 per cent) and secondary liquidities by 1,043 billion (12.6 per cent); net liquid assets, on the other hand, increased by only 508 billion (6 per cent).

Total short-term credits expanded by 1,578 billion lire, thanks to the foreign sector, where a series of improvements in the net position ever since 1954 was broken last year by a deterioration of 781 billion lire. Of the banking system's short-term credits to the domestic market, the Bank of Italy financed 403 billion lire and the banks 1,531 billion, the Central Bank thus contributing a good deal more than the year before.

The public sector drew much more heavily on the banking system last year (755 billion lire, including stockpiling finance) and less heavily on private savers and companies (331 billion), as a result of the redemption of Treasury Bonds and the lesser amount of postal deposits.

While the supply of finance funds also grew at a slower rate last year than before, the deceleration was less marked than in the short-term sector, thanks to the growth of non-security assets and to transfers from the money market. These latter made good some part of the sharp fall in security purchases on the part of companies and the public alike.

Loans, mortgages and the proceeds of security issues all went into the domestic market, whereas the Treasury, notwithstanding its bond issues through the Credit Consortium for Public Works, on balance raised less money on the capital market than it paid back, with the help of funds borrowed from the banking system.

At the end of 1963 the total of money supply and finance funds at the economy's disposal amounted to 46,383 billion lire, including 20,802 billion of liquid assets and 25,581 billion of securities and non-security assets other than liquid. As a result of the differential rate of growth of the two components, the proportion of liquid assets again increased last year. They now account for 45 per cent of the total, as against 43 per cent in 1962; but in 1962 the proportion had risen much more sharply from 38 to 43 per cent. For the rest, some part of the relative decline in the proportion of non-liquid assets was due to falling share prices. Comparing the two years' figures in terms not of absolute values but of their respective changes, liquid assets account for 62 per cent both in 1962 and in 1963.

The important fact which emerges from these comparisons is that over the last three years more and more funds were transferred from the money to the capital market. Starting from a surplus of liquid assets over short-term credits of about 80 billion lire in 1960, the figure rose in rapid progression to 434 billion in 1961, 678 in 1962 and 865 in 1963. The surplus of liquid assets over short-term credits is a measure of the credit system's contribution to the capital market, where private saving proved insufficient to meet investment requirements.

Monetary Circulation.— Throughout the first half of last year monetary circulation (notes and coin) expanded even faster than it had done in 1962; later the rate of increase slowed down somewhat. By the end of the year the note and coin circulation, net of cash holdings by the Bank of Italy and the Treasury, amounted to 3,801.2 billion lire, or 14.2 per cent more than in December 1962 (the corresponding increase between December 1961 and December 1962 had been 14.5 per cent). But in annual average terms last year's increase of 18.5 per cent was much in excess of the—itself exceptionally high—rate of increase in GNP at current prices, which was 13.4 per cent.

As was to be expected in these circumstances, the velocity of circulation, expressed by the ratio of GNP to circulation, fell continuously throughout the year.

The economic system's liquidity preference increased again in 1963 and with it the demand for cash. To some extent this may have been due, as in 1962, to the expectation of rising expenditure in a situation of unstable prices; quite certainly it owed much to the redistribution of incomes. In fact, dependent labour incomes grew faster not only than all other incomes, but more quickly even than monetary circulation. Now, every time income is redistributed to the benefit of wage earners, and in particular when the beneficiaries are among those who get their pay not at weekly, but at longer intervals, it is very likely that the velocity of note circulation drops. Fixed-income earners certainly hold a much bigger proportion of their income in cash.

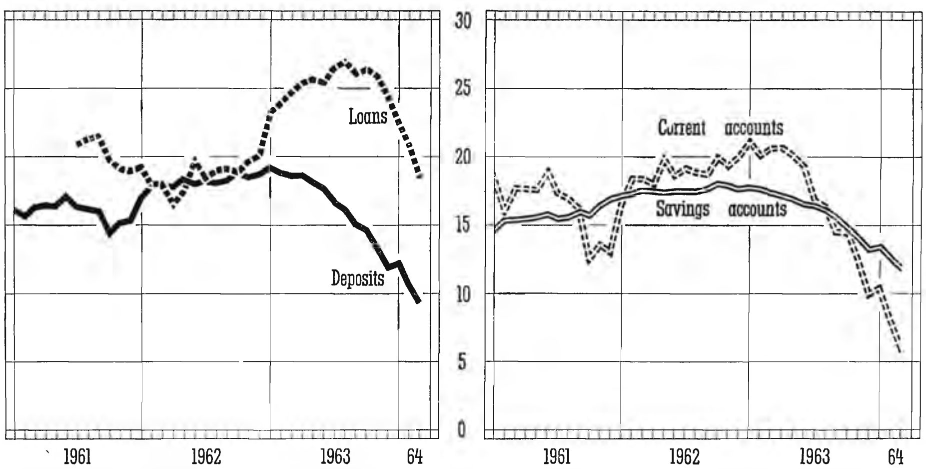
Just how much significance is to be attributed to monetary circulation as an indicator of the underlying real factors depends, of course, upon the type and volume of the transactions for which notes and coin are used. If there were as many types of means of payments as there are types of transactions, there would be no problem. But in practice there are only very few fully fungible kinds of money, and it is impossible to find out how much of the monetary circulation is used for any particular kind of transaction on the average of any given period. However, the principal uses of notes and coin are easy enough to identify.

We know, for instance, that some part of the money stock does not enter into exchange at all but is hoarded. This is confirmed by the average life of the 10,000 lire note, which is much longer than that of the smaller denominations. Even if we can measure neither the size of hoarding nor its increases and decreases, it is safe to assume that this part of the monetary circulation is not the one most subject to changes in intensity or direction.

The notes and coins that actually do circulate are used overwhelmingly for consumption expenditure and for the payment of wages and salaries—in other words, for nearly all those transactions which take place at the end of the process of production and distribution of goods and services, and for a large part of the transactions involved in the distribution of income. If we examine how much net new money the Bank of Italy's branches in the various provinces actually pay out, it will be seen that demand is much stronger in industrial areas and in cities containing concentrations of company headquarters; net outgoings in 1963 amounted to 508 billion lire in Milan, 104 in Rome, 72 in Turin, 28 in Florence, 23 in Genoa and 18 in Trieste. Elsewhere, more money came back to the Bank than was paid out, or if there were net outgoings, they were very small.

Banking and Bank Liquidity.— During large parts of 1963 bank credits to private individuals and companies increased much faster than did the corresponding deposits, which together account for 90 per cent of total bank business; later in the year and during the early months of 1964 the rate of increase of both credits and deposits slowed down very markedly (Chart 12). Looking at last year as a whole, it appears obvious how much strain these developments put on the banks.

Chart 12



Percentage changes in bank loans and in private and business deposits

(12-month changes at monthly intervals)

In effect, the deterioration in the liquidity position of firms showed up, for the banks, in a simultaneous aggravation of the pressure of credit demand and reduction of the inflow of current deposits from business. The imbalance was made worse by the households' reduced propensity to save, which further slowed down the accumulation of new deposits.

Because of the restrictive measures introduced by the authorities, especially as regards bank borrowing abroad, and because access to the international money market gradually became less easy and profitable, the banks had to take the full brunt of the liquidity strain ensuing from the growing excess of new credits over new deposits. At the end of November 1963 the gap was 615 billion lire, and as such only slightly below the peak of October, when half-yearly tax payments fall due, and 107 billion lire bigger than in August. At the same time, the reduction in bank indebtedness abroad amounted to 79 billion.

As a result, the banks entered the end-year period with rather scarce liquid funds (632 billion lire, as against 870 billion at the end of November 1962). Certain banks were in a particularly tight position, as may be deduced from the unusually high amount of day-to-day accommodation which members of the Bank of Italy's clearing houses required in the shape of deferred payments; rediscounts, too, were rather high, at 253 billion lire during the last quarter of 1963 and 169 billion in December alone.

With bank liquidity so tight, the rate of increase of bank credits dropped sharply in December and indeed was less, in absolute figures, than in December 1962 (634 as against 700 billion). Deposits, on the other hand, rose by 821 billion lire last December and a good deal more than during the corresponding month of 1962 (719 billion). In December, therefore, new deposits exceeded new credits by 187 billion lire, compared with 20 billion in December 1962.

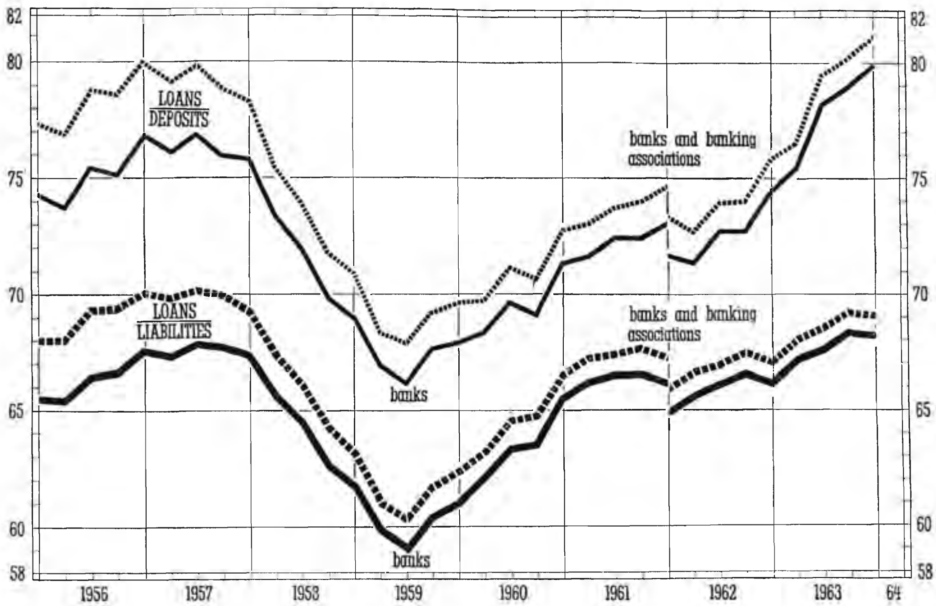
Taking the year 1963 as a whole, the cash requirements of the banks grew strongly, in large part as a result of the excess of new credits over new deposits during the first six months. While in 1962 deposits had grown by 261 billion lire more than credits, they expanded by 421 billion less than credits in 1963. In addition, the banks had to find 432 billion lire in cash last year (180 billion in 1962) for compulsory reserves and collateral deposits against their own cashiers' cheques; four fifths of these payments were concentrated in the first half of the year.

To cover these cash requirements, the banks relied predominantly on foreign borrowing during the first half of the year (335 billion lire out of a total 406 billion), and during the latter two quarters on recourse to the Bank of Italy (257 out of a total of 431 billion lire).

The banks closed the year with liquidity reserves only slightly smaller than in December 1962, the first two quarters' liquidity losses of 220 billion lire having been all but made good by liquidity gains of 208 billion later in the year.

The differential rates of expansion of bank credits and deposits were, of course, reflected in the loan/deposit ratio (Chart 13), which continued, rather faster than before, along the rising trend which began with the upswing in mid-1959. Last year, in fact, the ratio gained 5.4 percentage points, as against 2.7 in 1962.

CHART 13



Percentage ratio of bank loans to deposits and total liabilities

Since, in these circumstances, the banks were forced last year to look for more outside funds, the proportion of deposits in total liabilities fell from 88.9 to 85.5 per cent, largely during the first half of the year. A slight improvement in January 1964 petered out within a month.

In the event, other liabilities increased faster than deposits. Funds borrowed abroad, in particular, accounted for a mounting share of total liabilities (4.2 as against 2.3 per cent)). Consequently, the loan/liability ratio came under much less strain than the loan/deposit ratio; it rose by only 2 points (as against 1.3 in 1962) along a rather more steadily rising curve.

With firms of all sizes needing more bank credit and with the slower inflow of new deposits to both big banks and medium-sized and small ones, the latter had to use for their own purposes rather more of the funds they normally deposit with other banks or banking associations.

Furthermore, the strain on the banks in 1963 was evident also in their security portfolios. Whereas in 1962 the banks had increased their security investments by as much as 404 billion lire, they liquidated 78 billion last year.

On the assets side, bank advances expanded from 10,737 to 13,005 billion lire over the course of last year. Although the increase of 2,268 billion was larger than the 1,995 billion rise in 1962, it was slightly less in relative terms (21.1 as against 22.8 per cent).

This reduction in the rate of expansion is attributable to short-term credits, which account for more than 90 per cent of the total. While both lire and foreign currency credits expanded less fast than before, the deceleration was most marked in the latter case, where a drop from 47.0 to 24.4 per cent compares with vigorous growth in 1962, when the rate of expansion quickened from 32.5 to 47.0 per cent. The slowing-down of the growth of lire assets was evident mostly in overdrafts on current account and in the amount of bills discounted, which consequently represented a lower proportion of total assets. These movements were rather uneven as between different banks. The so-called banks of national interest, for instance, increased their bill portfolio and other minor items at the expense of overdrafts and advances to clients with or without collateral; other banks reduced the proportion of the portfolio and raised that of current overdrafts and of minor items.

The reduction in the rate of expansion of foreign currency credits is largely attributable to the big banks, which are responsible for close to 75 per cent of bank business of this kind; other banks and savings banks, on the other hand, considerably increased their share of the business.

So much for short-term credit. By contrast, medium- and long-term lending increased at a faster rate last year than before (25.2 as against 19.5 per cent) and so also reversed the preceding year's tendency. Savings banks, which in any event occupy the leading place in this field, were responsible for the quicker rate of increase and at the same time raised their share in total medium- and long-term bank credits from 71 to 75 per cent.

The crucial aspect of bank credit last year, however, remains the sharp reversal of trend between the first and the second half of the year as a result of the restrictive measures introduced by the monetary authorities. Given that these measures, among other things, also put a brake on borrowing abroad, their incidence on the banks' foreign currency credits was especially pronounced; the latter in fact declined by 3.1 per cent during the last two quarters of the year.

All this cyclical expansion of total bank credit is entirely attributable to the banks' operations with the private sector (Table 28). Loans to public agencies increased a good deal less than in 1962 (by 130 as against 198 billion lire) and at a much slower rate (10.6 as against 19.3 per cent). This relative downward movement was a continuation of the 1962 tendency; it was most marked in the case of the largest agencies, and most evident in the whole group's transactions with public-law credit institutes. The latter, in fact, had less credit outstanding to the public agency sector than at the end of 1962, a year in which they provided almost half the sector's additional finance. Ordinary commercial banks, which in 1962 had granted new credits of 27 billion lire to public agencies, added practically nothing last year; only the savings banks and central banking associations appreciably expanded their credits to public agencies.

Loans outstanding to private individuals and companies, including government-controlled companies, increased over the course of the year by 2,138 billion lire, or 22.5 per cent, to an end-year total of 11,646 billion lire. In 1962, by comparison, the increase had been 1,797 billion, or 23.3 per cent. Last year, the rate of expansion during the third and fourth quarter hardly exceeded that of the first sixth months, whereas in 1962 it had doubled during the second half of the year.

TABLE 28

Composition of Bank Loans by Categories of Clients

(billion lire)

Type of bank	Public agencies	Government-controlled companies and agencies (1) (2)	Major private companies (1)	Other companies, private firms and individuals	Total
	Outstanding at the end of 1963				
Public-law credit institutes	330.5	305.3	271.5	2,209.4	3,116.7
Banks of national interest	59.5	329.8	457.8	2,247.8	3,094.9
Ordinary commercial banks	188.6	137.5	209.0	2,214.5	2,749,6
People's co-operative banks	54.0	27.1	63.1	1,177.5	1,321.7
Savings banks and pawn banks category I	655.6	89.7	86.4	1,641.3	2,473.0
Total . . .	1,288.2	889.4	1,087.8	9,409.5	12,755.9
Banking associations	70.5	89.5	34.3	54.6	248.7
Grand total . . .	1,358.5	978.9	1,122.1	9,545.1	13,004.6
	Absolute increase in 1963				
Public-law credit institutes	— 18.9	11.3	11.7	549.0	553,1
Banks of national interest	2.8	83.5	114.7	417.5	618.5
Ordinary commercial banks	0.5	16.6	41.0	336.6	394.7
People's co-operative banks	5.9	— 2.7	2.8	172.1	178.1
Savings banks and pawn banks category I	118.8	43.1	24.6	282.6	469.1
Total . . .	109.1	151.8	194.8	1,757.8	2,413.5
Banking associations	20.9	11.6	10.4	11.7	54.6
Grand total . . .	130.0	163.4	205.2	1,769.5	2,268.1

Percentage increase in

Type of bank	Public agencies 1962	Public agencies 1963	Government-controlled 1962	Government-controlled 1963	Major private 1962	Major private 1963	Other companies 1962	Other companies 1963	Total 1962	Total 1963
Public-law credit institutes	*36.9*	*— 5.4*	*40.2*	*3.8*	*30.0*	*4.5*	*18.2*	*33.1*	*23.9*	*21.6*
Banks of national interest	*18.6*	*4.9*	*40.7*	*33.9*	*34.6*	*33.4*	*25.3*	*22.8*	*27.8*	*25.0*
Ordinary commercial banks	*16.5*	*0.3*	*81.0*	*13.7*	*50.4*	*24.4*	*18.3*	*17.9*	*22.2*	*16.8*
People's co-operative banks	*15.1*	*12.3*	*54.7*	*— 9.1*	*42.9*	*4.6*	*21.2*	*17.1*	*22.6*	*15.6*
Savings banks and pawn banks category I	*17.4*	*22.1*	*8.4*	*92.5*	*82.3*	*39.8*	*19.4*	*20.8*	*19.8*	*23.4*
Total . . .	*22.4*	*9.3*	*43.5*	*20.6*	*39.0*	*21.8*	*20.5*	*22.7*	*23.5*	*21.0*
Banking associations	*— 25.7*	*42.3*	*— 5.6*	*14.9*	*28.5*	*45.5*	*26.2*	*27.3*	*— 3.7*	*28.1*
Grand total . . .	*19.3*	*10.6*	*36.7*	*20.0*	*38.7*	*22.4*	*20.5*	*22.8*	*22.8*	*21.1*

(1) Included in the list of 500 companies and agencies with presumed annual sales exceeding 1.5 billion lire.
(2) Including ENEL, the new nationalized electricity board.

Turning, finally, to bank deposits, their total amount rose last year from 14,182 billion lire to 16,629 billion. The 1963 increase of 1,847 billion lire was 409 billion less than the preceding year's, and the annual rate of increase, which had been 17.0 per cent in 1961 and 18.9 per cent in 1962, dropped to 13.0 per cent.

The inflow of new deposits slowed down all through the year, but more sharply during the second half, especially in current accounts. Although all forms of deposits were affected, the main sufferers were time deposits, which last year expanded at a distinctly lower rate than deposits on current account. The same tendency has been in evidence since 1962 for tied savings deposits as against untied ones.

Deposits by companies and individuals amounted to 14,753 billion lire on 31 December 1963, having increased over the year by 1,601 billion or 12.2 per cent (2,119 billion and 19.2 per cent in 1962). Here, it was current accounts which were, more than others, responsible for the striking deceleration; their rate of increase was 10.4 per cent last year compared with 21.1 per cent in 1962, that of savings deposits was 13.5 per cent as against 17.8 per cent in 1962, and as a result the share of current accounts in the total deposits of companies and individuals decreased from 43.3 to 42.6 per cent over the course of last year.

The accounts of this category of depositors stand largely in the names of small and medium-sized firms and of private persons (Table 29). The accounts of major companies and agencies constitute barely 3 per cent of the total, and in any event did not change very much last year; to the extent that they did change, they mostly contracted, exception made of an increase of 52 billion lire in the deposits of government-controlled companies and agencies with banks of national interest.

Postal savings in the form of savings books and certificates accumulated at much the same rate last year as in 1962. The reason is, no doubt, that post offices are more widely dispersed throughout the country and especially in rural areas, and that they can, therefore, collect funds which, being family savings, are less sensitive to cyclical fluctuations.

TABLE 29

Composition of Bank Deposits by Categories of Depositors

(billion lire)

Type of bank	Public agencies	Government-controlled companies and agencies (1) (2)	Major private companies (1)	Other companies, private firms and individuals	Total
	Outstanding at the end of 1963				
Public-law credit institutes	670.6	23.1	127.1	2,774.5	3,595.3
Banks of national interest	158.9	90.4	151.3	2,530.0	2,930.6
Ordinary commercial banks	123.5	10.3	84.4	3,370.0	3,588.2
People's co-operative banks	53.9	2.1	17.7	1,783.1	1,856.8
Savings banks and pawn banks category I	256.6	4.1	26.1	3,730.1	4,016.9
Total . . .	1,263·5	130.0	406.6	14,187.7	15,987.8
Banking associations	12.6	15.1	—	13.2	40.9
Grand total . . .	1,276.1	145.1	406.6	14,200.9	16,028.7
	Absolute increase in 1963				
Public-law credit institutes	217.9	— 8.2	— 7.4	270.6	472.9
Banks of national interest	— 9.8	51.7	1.4	185.2	228.5
Ordinary commercial banks	0.3	— 5.3	2.6	384.1	381.7
People's co-operative banks	4.3	— 1.1	— 6.7	214.0	210.5
Savings banks and pawn banks category I	29.7	2.4	3.0	494.0	529.1
Total . . .	242.4	39.5	— 7.1	1,547.9	1.822.7
Banking associations	3.4	9.2	—	11.9	24.5
Grand total . . .	245.8	48.7	— 7.1	1,559.8	1,847.2

Percentage increase in

Type of bank	Public agencies 1962	Public agencies 1963	Government-controlled 1962	Government-controlled 1963	Major private 1962	Major private 1963	Other 1962	Other 1963	Total 1962	Total 1963
Public-law credit institutes	*12.8*	*48.1*	*28.3*	*— 26.2*	*6.7*	*— 5.5*	*21.1*	*10.8*	*19.2*	*15.1*
Banks of national interest	*21.6*	*— 5.8*	*42.8*	*133.6*	*— 0.1*	*0.9*	*22.5*	*7.9*	*21.2*	*8.5*
Ordinary commercial banks	*25.1*	*0.2*	*— 10.9*	*— 34.0*	*0.5*	*3.2*	*16.3*	*12.9*	*16.0*	*11.9*
People's co-operative banks	*22.8*	*8.7*	*3.2*	*— 34.4*	*19.6*	*— 27.5*	*21.0*	*13.6*	*21.0*	*12.8*
Savings banks and pawn banks category I	*10.3*	*13.1*	*— 32.0*	*141.2*	*9.0*	*13.0*	*19.5*	*15.3*	*18.7*	*15.2*
Total . . .	*15.4*	*23.7*	*21.3*	*43.6*	*3.7*	*— 1.7*	*19.7*	*12.2*	*18.9*	*12.9*
Banking associations	*5.7*	*37.0*	*883.3*	*155.9*	—	—	*— 31.6*	*915.4*	*46.4*	*149.4*
Grand total . . .	*15.3*	*23.9*	*28.2*	*50.5*	*3.7*	*— 1.7*	*19.7*	*12.3*	*18.9*	*13.0*

(1) Included in the list of 500 companies and agencies with presumed annual sales exceeding 1.5 billion lire.
(2) Including ENEL, the new nationalized electricity board.

The Central Risk Pool.— For some time past the banks have been complaining of growing credit risks, connected with the circumstance that borrowers were raising funds from several courses and at geographically dispersed places. At a time of rapidly expanding credit demand, mushroom growth of small and medium-sized firms, and considerable changes in the location of economic activities, this practice implies obvious dangers for the banks. The difficulties of assessing potential losses in advance furthermore raise banking costs and thereby, ultimately, the cost of money.

After prolonged study of the ways and means of reinforcing existing safeguards and forestalling the aggravation of risks through better and quicker information about the precise state of the clients' credit position, the Joint Ministerial Committee on Credit and Saving decided on 16 May 1962 to ask the Bank of Italy to establish a central bankers' risk information pool. In so doing, the Committee was able to draw on the experiences of other countries, where, in conditions similar to Italy's, such services had proved their worth for a long time.

After a period of preparation, the Bank began to put the pool into practice early last December. By the middle of January instructions went out to all registered banks and banking associations, to start the intended monthly statements on 31 March 1964.

The Bank of Italy has powers also to investigate borrowings from special credit institutes and others which handle medium- and long-term funds; but it was thought preferable to limit the pool initially to the ordinary commercial credit sector. Another limitation is that, for the time being, only credits of 250 milion lire or more have to be reported.

The general rules of the central risk pool are as follows:

(1) All bank branches are required to report to the pool, at the end of each month, on all credit risks in or above the amount of the current minimum;

(2) The Bank of Italy puts at the disposal of the banks, free of charge, the technical apparatus needed to make the pool work and for the automatic processing of the information contained in the statements.

(3) The statements, the processed data and all other information pertaining to the pool are covered by the strictest bank secrecy in accordance with the law; this applies both to the Bank of Italy and all other banks.

(4) All the information will be handled exclusively by electronic machines; punched on cards, it will be memorized on magnetic tapes and records, and available only from the specially programmed computers at the Bank of Italy.

(5) The information reported to the pool by the bank branches will be collated every month.

(6) The bank branches registered with the pool and reporting an outstanding credit, will receive from the pool, within 10 days, an anonymous statement on the client's total credit position, in the same locality and elsewhere.

(7) Registered branches having to deal with a credit application by a new client can, subject to certain formalities, obtain a statement from the pool at any time on the new client's total credit position.

Special Credit Institutes.— Special credit institutes last year raised 1,326 billion lire of new funds, thereby matching the preceding year's exceptionally high amount in absolute terms, though the rate of increase was only 20.8 per cent as against 25.8 per cent in 1962. At the end of last year, the institutes had total resources of 6,687 billion lire.

Net of the proceeds of bond issues made on behalf of the Treasury by the Credit Consortium for Public Works, and net also of funds employed in stockpiling operations, the institutes' resources available for their normal activities rose during the year by 1,224 billion lire (1,058 in 1962). More than four fifths of this total came from the traditional sources of finance for the special credit institutes, namely, bonds, time deposits and interest-bearing certificates.

The nominal value of new bond issues, net of repayments, was 859 billion lire last year, compared with 765 billion in 1962. The institutes were unable to step up their fund-raising on the capital market at the exceptionally high rate of the preceding year, so that the 1963 rate of increase of 25.7 per cent fell short of the 1962 rate of 29.8 per cent.

Given the sluggish conditions of the capital market, the institutes had some difficulty in placing their bonds; they had to raise the nominal coupon and sell at reduced prices. Thus the effective yield of the bonds of industrial credit institutes, for instance, rose from 5.95 per cent at the beginning of the year through 6.07 in June to 6.61 per cent in December. However, only part of the increased cost of medium- and long-term funds was passed on to borrowers, in so far as a large proportion of the credits granted enjoyed privilege rates of interest.

More than two fifths (as against one quarter in 1962) of the new bond issues were taken up by private investors and companies last year, and almost one fifth by insurance companies, social insurance funds and the Central Post Office Savings Fund. Consequently subscriptions by the banks, which in 1962 accounted for one half of the total and thus were enabling the institutes to raise so much new money, last year contributed less than two fifths of the increment.

The reason was that the banks themselves were in a tight liquidity position. They not only took up fewer bonds (330 billion lire compared with 382 in 1962), but also reduced their advances on current account to the special credit institutes from 121 to 32 billion lire. All in all, the funds furnished by banks and banking associations to special credit institutes in one form or another dropped sharply from 520 billion lire in 1962 to 390 billion last year. In relative terms, the banks' contribution to the new resources accruing to special credit institutes for their normal loan activities consequently fell from 49.2 per cent in 1962 to 31.9 per cent last year. To all intents and purposes, the situation is thus back to what it was in 1961, when the corresponding ratio was 31.3 per cent.

Time deposits and interest-bearing certificates, on the other hand, furnished 155 billion lire, as against 65 billion in 1962.

This exceptional rise owed much to the new rules introduced in this sector early in 1963 as part of the general reform of the structure of interest rates. It will be recalled that the intention was to widen the range between money rates on the one hand and medium and long rates on the other, so as to adapt the remuneration of funds to the degree of their liquidity. In addition, investments tied for more than four years also enjoy certain tax reliefs (exemption from income tax on interest). But apart from all this the public's increased inclination to place savings in time deposits and interest-bearing certificates no doubt also had much to do with the general reluctance to enter the stock market at a time of rising yields.

Foreign funds, which in 1962 had grown by a mere 9 billion lire, rose by 38 billion last year. Half the new money, which was made available through the intermediary of the Cassa per il Mezzogiorno and the three special credit institutes concerned more particularly with Southern Italy, was used for industrialization in the Mezzogiorno; the other half was channelled towards the largest of the industrial credit institutes, which also raised sizeable foreign currency funds by direct borrowing abroad. Most of the relevant loan operations were finalized during the first quarter of this year.

Lastly, the special credit institutes' own capital and reserves increased last year by the conspicuous amount of 71 billion lire, compared with the, in themselves, high increments of 57 billion in 1962 and 45 in 1961. The reason is that the institutes have to comply with the law in maintaining a certain ratio between capital and bond issues.

In their turn, the special credit institutes' loan operations, while not expanding at the record rate of 1962, when new loans amounted to 1,310 billion lire, last year added another 1,178 billion to the total outstanding. A breakdown by types of credit is shown in Table 30.

The special credit institutes' typical medium- and long-term loans for investment finance expanded slightly less in absolute terms than in 1962 (by 994 as against 1,028 billion lire), and in relative terms last year's increment to the total outstanding was only 20.3 per cent, compared with 26.6 per cent the year before.

This deceleration of the rate of credit expansion coincided with an increased demand for finance funds on the part of firms

TABLE 30

The Special Credit Institutes' Operations and Loans Outstanding

Type of loan	Billion lire outstanding 31 Dec. 1963	Annual increase in			
		1962		1963	
		billion lire	per cent	billion lire	per cent
Medium- and long-term loans	5,884.1	1,027.9	*26.6*	993.6	*20.3*
of which: tied export credits . . .	155.5	21.2	*23.8*	45.1	*40.9*
Short-term credits to agriculture . .	530.1	101.7	*24.9*	20.4	*4.0*
Loans for Treasury account	707.9	161.7	*39.7*	138.7	*24.4*
Total . . .	7,122.1	1,291.3	*27.6*	1,152.7	*19.3*
Loans to developing countries	45.0	19.2	—	25.8	*134.4*
Grand total . . .	7,167.1	1,310.5	*28.0*	1,178.5	*19.7*

which, unable to raise nearly as much money as in 1962 by direct issues on the capital market and lacking enough resources of their own to make good the difference, were driven to rely more heavily on borrowing to finance their investment programmes.

The expansion of loans by *industrial credit institutes* was held back by their inability to raise more money on bond issues, from which they draw two thirds of their loanable funds. In the event, the total of their loans outstanding increased by 623 billion lire last year, compared with 673 billion in 1962; net new loans actually amounted to 652 billion, but there was a partly offsetting diminution of 29 billion in mortgage loans outstanding against special funds. The pace of repayment of these latter loans quickened last year.

Only just over 5 per cent of net new loans extended by industrial credit institutes in 1963 were financed from public funds. On the other hand, much more use was made of the system by which the government provided subsidies for interest payments, and as a result privileged credits expanded by the conspicuous amount of 322 billion lire, compared with 271 billion in 1962. Other credits expanded by 330 billion, which was much less than the 1962 increment of 417 billion.

Credits to small and medium-sized industry and generally for the industrialization of the Mezzogiorno are those which benefit most from the privilege facilities by which the government channels funds to economic activities it wishes to promote or support. New loans extended by industrial credit institutes last year under the terms of Law No. 623, of July 1959, amounted to 133 billion lire (160 billion in 1962), so that by the end of the year the total outstanding on this score had risen to 472 billion. In their turn, Mezzogiorno industrialization credits under the 1957 and 1962 laws No. 634 and 1462 increased nearly twice as much last year as in 1962 (75 billion lire as against 41), to reach an end-1963 total of 159 billion lire.

Thanks to the resulting shift in the geographical distribution of the industrial credit institutes' loans to industry and public works, the share of Southern Italy and the Island in the total rose from 24.8 to 27.1 per cent last year. A few years ago, at the end of 1959, their share was only 20.4 per cent; this rapid progression is a measure of the flow of finance funds channelled to the Mezzogiorno through the industrial credit institutes.

Tied export credits expanded much more last year than in 1962, the respective increments being 45 and 21 billion lire. More than four fifths of the total were connected with engineering exports. These export credits are handled almost exclusively by three industrial credit institutes (IMI, Mediobanca and Efibanca).

Land and building credit institutes were very active last year, even though their operations did not expand at the exceptional rates of the two preceding years. New loans had to keep step with the respective bond issues; while they slightly increased in absolute terms from 328 billion lire in 1962 to 335 billion last year, the rate of increase dropped from 34.4 to 26.1 per cent. Nevertheless, credit expansion here was appreciably faster than in the other two medium- and long-term credit sectors.

Practically the whole of the new loans last year went into urban housing (329 billion) and was remunerated at market rates of interest. Land and building credit institutes altogether furnished 18 per cent of the funds invested in housing last year

(329 out of a total of 1,821 billion lire), whereas in 1962 they had contributed to the extent of 21 per cent.

The Stock Exchange.— Throughout the period 1950-1961 the capital market had expanded along with GNP. Indeed, the high investment which was the principal motive power of national income growth was financed to a growing extent by the capital market. In its turn, the capital market benefited from the growth of incomes and, hence, of saving. Investors, moreover, showed a decided preference for securities, so that security issues expanded more rapidly than did monetary or quasi-monetary investments.

The initial stimulus to demand for securities came from the desire to reconstitute portfolios decimated by the fall in the value of money during and immediately after the war. Equities, especially, were attractive during large parts of the period under review, because investment conditions were favourable, in so far as companies were able to effect large-scale internal savings. The expectation of a continuous and steady growth of company profits mitigated the risks of equity investment, so that shares came to be looked upon as no less safe than other uses of savings. Investors tended to raise the proportion of equities in their portfolios, all the more so in view of the exceptional rise of share prices due, among other things, to the accumulation of undistributed profits.

Price and cost stability also favoured investment in both shares and bonds.

On the average over the whole period since 1950, equity issues accounted for only about 30 per cent of total security issues. Among private issues alone, however, equities accounted for close to one half of all the funds raised on the capital market between 1953 and 1956; later, the proportion dropped somewhat and private bond issues expanded more vigorously in combination with a contraction of government bond issues. Nevertheless, equity issues still grew considerably in absolute terms, and a period of fairly steady growth up to 1959 was eventually succeeded by three years of very vigorous expansion. As a result, more than four times as much money was raised on equity issues in 1962 than in 1953. Last year, by contrast, there was a sharp drop in new share issues, although the absolute amounts involved were still considerably larger than in 1959.

Security purchases by banks were subject to strong fluctuations from one year to another. From an average of just under 50 per cent of total new fixed-interest issues in 1950-1952 the proportion dropped to about one third and later, in 1957, to less than one fifth of new bond issues. After fluctuating between 1958 and 1961, bank purchases of new bond issues settled down during the last two years at just under two thirds of the total.

During these last two years, therefore, the credit system, including the Central Post Office Savings Fund, constituted the decisive factor in the expansion of the capital market. This expansion would indeed not have been possible if the banks had not increased their bond holdings by about 400 billion lire—an amount which was well in excess of total new issues in 1962 and offset the contraction of demand on the part of other investors. In 1963 the credit system took up about as much again, so that the diminution of new issues must be attributed to the persistent weakness of other investors' demand.

The saving public's growing preference for the money market to the detriment of the capital market gave more weight to the banking system in its capacity as a bridge between those who decide to save and those who decide to invest. For the rest, the public's liquidity preference also stimulated the formation of means of payment, which were subsequently used to finance increased investment and so accentuated the monetary nature of investment coverage.

The ratio of bank deposits to the banks' bond holdings, finally, remained at a stable 13-14 per cent right up to 1961 (Table 31).

Contrary to what happens in the case of fixed-interest securities, equity demand and supply have to all intents and purposes to be matched within the private sector, abstraction made of net foreign demand.

Table 31

Fixed-interest Security Holdings (1) and Deposits of Banks and Banking Associations

(end-month figures at book values, in billion lire)

Date	Banks			Savings banks and banking associations			Total		
	Securities	Deposits	Ratio per cent	Securities	Deposits	Ratio per cent	Securities	Deposits	Ratio per cent
Dec. 1949	37.9	1,532.8	*2.5*	97.4	424.4	*23.0*	135.3	1,957.2	*6.9*
1950	95.1	1,761.0	*5.4*	139.0	481.4	*28.9*	234.1	2,242.4	*10.4*
1951	120.8	2,144.4	*5.6*	153.1	554.1	*27.6*	273.9	2,698.5	*10.2*
1952	221.0	2,680.5	*8.2*	191.6	661.0	*29.0*	412.6	3,341.5	*12.3*
1953	295.7	3,142.9	*9.4*	240.9	780.2	*30.9*	536.6	3,923.1	*13.7*
1954	313.5	3,547.8	*8.8*	279.6	942.3	*29.7*	593.1	4,490.1	*13.2*
1955	369.4	4,041.5	*9.1*	356.4	1,147.1	*31.1*	725.8	5,188.6	*14.0*
1956	422.5	4,512.0	*9.4*	405.5	1,338.4	*30.3*	828.0	5,850.4	*14.2*
1957	432.0	4,981.0	*8.7*	437.7	1,534.2	*28.5*	869.7	6,515.2	*13.3*
1958	477.7	5,746.9	*8.3*	508.9	1,821.0	*27.9*	986.6	7,567.9	*13.0*
1959	562.9	6,682.1	*8.4*	665.4	2,156.9	*30.8*	1,228.3	8,839.0	*13.9*
1960	597.1	7,694.8	*7.8*	834.5	2,495.3	*33.4*	1,431.6	10,190.1	*14.0*
1961	664.3	8,976.0	*7.4*	994.9	2,949.7	*33.7*	1,659.2	11,925.7	*13.9*
1962	928.8	10,677.3	*8.7*	1,236.4	3,504.2	*35.3*	2,165.2	14,181.5	*15.3*
1963	1,130.9	11,970.9	*0.4*	1,376.0	4,057.8	*33.9*	2,506.9	16,028.7	*15.6*

(1) Excluding Treasury Bills.

Preferences for one or the other form of security investment are better measured in terms of total holdings than of annual flows. Bond holdings grow through subscriptions to new issues, including reinvestment of repayment and interests; equity holdings grow predominantly through companies' ploughing back undistributed profits, and their growth is therefore evident in rising prices rather than in new issues. A comparison of the volume of new issues, therefore, shows bonds well ahead of shares; a comparison based on the current value of securities outstanding shows the contrary, the relative diminution of new equity issues as against bond issues having been more than made good by the rise in share prices.

But it was precisely the high level of share prices which gradually undermined the private investors' preference for equity investment and so prepared the ground for a weakening of demand. This was particularly evident in 1960-1961, when soaring

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prices coincided with exceptionally lively issue activity—a combination which in itself did much to worsen market conditions. When, on top of that, net company profits began to fall off and eventually to dwindle, investors drastically revised their notions of optimum portfolio composition and accordingly reduced the proportion of shares.

As regards developments in the capital market last year, total public and private demand for funds was a little less than in 1962, but still a little above the high levels of 1960 and 1961. Public agencies had large requirements for programmes in hand, and were responsible for a good part of the claims made on an already sluggish market, suffering from a rise in the cost of bond issues and from falling prices.

Net of redemptions and duplications, the proceeds of security issues last year were 1,340 billion lire, 302 billion less than in 1962. The diminution is attributable in part to the public sector, which paid back 71 billion last year whereas it had drawn on the market to the extent of 62 billion in 1962, and in part to business companies and international credit institutions (Table 32).

The private sector, including government-controlled financial holding companies approaching the market either directly or through special credit institutes, raised 1,397 billion lire on the capital market last year: the diminution of 153 billion in comparison with 1962 is the resultant of a contraction of 210 billion in direct issues and a partly offsetting increase of 57 billion in others.

Thus the bond issues of special credit institutes last year contributed 775 billion lire (57 billion more than in 1962) to business finance, and the government-controlled holding companies 275 billion (215 billion more than in 1962); among the latter, E.N.E.L., which controls the now nationalized electricity industry, figures for the first time with 148 billion from a 5 ½ per cent twenty-year bond issue placed with the Central Post Office Savings Fund.

Private firms, in their turn, raised 347 billion lire in bonds and shares, compared with 772 billion in 1962. The reduction of

TABLE 32

New Security Issues (1)

(billion lire)

Types of security	1962 Bank of Italy & Italian Exchange Office	1962 Banks (2)	1962 Special Credit Institutes	1962 Central Post Office Savings Fund	1962 Insurance companies & social insurance funds	1962 Private investors and companies	1962 Total	1963 Bank of Italy & Italian Exchange Office	1963 Banks (2)	1963 Special Credit Institutes	1963 Central Post Office Savings Fund	1963 Insurance companies & social insurance funds	1963 Private investors and companies	1963 Total
Government securities:														
Government stock	− 47.4	28.7	− 5.3	− 43.2	2.4	− 43.7	−108.5	− 23.1	− 30.7	− 0.4	− 10.0	− 8.1	−128.1	−200.4
Bonds issued for Treasury account (3)	77.0	− 9.1	− 3.8	99.1	− 0.2	7.5	170.5	6.9	− 5.6	− 0.1	143.9	− 0.8	− 15.2	129.1
Total	29.6	19.6	− 9.1	55.9	2.2	− 36.2	62.0	− 16.2	− 36.3	− 0.5	133.9	− 8.9	−143.3	− 71.3
Bonds:														
Industrial credit institutes	2.3	250.1	1.2	31.2	77.7	74.9	437.4	− 0.3	212.3	3.5	30.0	43.9	180.4	469.8
Other special credit institutes	− 0.1	117.4	19.3	24.8	29.0	90.4	280.8	− 0.1	95.2	− 3.3	23.1	33.7	156.3	304.9
E.N.E.L.	—	—	—	—	—	—	—	—	—	—	147.9	—	—	147.9
E.N.I.	—	54.7	1.0	—	− 3.7	12.8	64.8	—	28.4	0.1	—	—	43.9	72.4
I.R.I.	4.7	20.3	− 2.9	− 1.1	− 3.7	− 22.1	− 4.8	− 0.2	21.2	0.7	− 2.3	0.1	35.5	55.0
Business companies	0.2	36.8	2.2	—	7.1	117.9	164.2	5.7	17.4	4.3	—	8.4	44.0	79.8
Local authorities	—	—	—	—	—	− 0.5	− 0.5	—	—	—	—	—	− 0.5	− 0.5
International credit institutions	17.4	7.1	5.0	—	—	0.5	30.0	0.1	3.5	− 0.1	—	—	11.1	14.6
Total bonds	24.5	486.4	25.8	54.9	106.4	273.9	971.9	5.2	378.0	5.2	198.7	86.1	470.7	1,143.9
Shares							716.5							328.5
less Duplicated items . . .							*108.3*							*61.1*
Total shares (net)						608.2	608.2						267.4	267.4
Total bonds and shares						882.1	1,580.1						738.1	1,411.3
Grand total	54.1	506.0	16.7	110.8	108.6	845.9	1,642.1	− 11.0	341.7	4.7	332.6	77.2	594.8	1,340.0

(1) Actual proceeds, net of redemption.
(2) Including banking associations.
(3) Railway, Green Plan and Rural Housing Bonds.

425 billion in their claims on the market is in large part attributable to a sharp fall in equity issues, which amounted to only 267 billion last year, as against 608 in 1962, of which 200 billion alone were floated in January; but bond issues, too, were less than half their 1962 figure (80 as against 164 billion).

As in 1962, though a little less so, the banks were again prominent as a source of investable funds, especially for the bonds of special credit institutes. Among other institutional investors, the Central Post Office Savings Fund trebled its contribution, from 111 to 333 billion lire.

Private investors and companies, which already in 1962 had provided less new funds than before (846 billion as against 945 in 1961), last year invested only 595 billion lire. The entire contraction, and more, was due to a sharp fall in new equity investment, from 608 to 267 billion lire; private bond subscriptions, on the other hand, grew conspicuously, and the bonds of special credit institutes, especially, benefited from the redemption of government bonds. All in all, the part of private investors and companies in last year's new security issues was 44 per cent, as against 52 per cent of a bigger total in 1962.

Government-controlled companies and agencies, which are active mostly in the petroleum and hydrocarbon gas sector, in steel and engineering, and, as of 1963, also in electricity, raised far more new money last year than in 1962, the respective annual totals of 417 and 252 billion lire accounting for 67 and 30 per cent of the corresponding year's entire new security issues. They raised their funds predominantly through bond issues, in an amount exceeding the 1962 figure by 165 billion lire.

The electricity sector raised 148 billion lire through E.N.E.L., whereas its claims on the market in 1962 were barely 12 billion; at the same time, however, the then still largely private electricity companies had borrowed heavily on short term, and also on the medium and long term. The petroleum and hydrocarbon gas sector, which had floated bond issues for 100 billion lire in 1962, last year raised only 72 billion; the steel industry raised 120 billion, as against 58 in 1962.

The prominent part of the bond issues of government-controlled holding companies and special credit institutes in last year's total new security issues is, in part, attributable to the difficulties private companies and other claimants on the market experienced in placing their stock. The demand for finance funds shifted first away from the market towards special credit institutes and then, through the latter, back to the market; as a result, the institutes placed more bonds and the market became less receptive for similar issues by private companies and other agencies, which, in the event, paid back to the market more than they got from it.

What money they did raise, came exclusively from equities, though even here the amount was only 205 billion lire, as against 580 in 1962. The biggest issues were made by the engineering and chemical industries, which obtained 77 billion, compared with 230 in 1962.

Italy last year was one of a group of countries where stock prices retreated and the volume of transactions was unusually small. As in other countries of the same group, investors' expectations were adversely affected by the slower growth of GNP and increasing strains in the economy.

Equity investment could no longer be regarded as an adequate hedge against the depreciation of money in a situation where average costs were generally rising faster than prices and profit margins therefore kept shrinking. In these circumstances, the general index of share prices declined, although, with reference to the base year 1953, it was no lower at the end of last year than in other major industrial countries, with the conspicuous exception of Western Germany (Chart 14). In Italy, the stock exchange suffered, in addition, from psychological uncertainties and apprehensions of a fiscal nature.

The prices of both government and other bonds retreated almost continuously, and those of shares even more sharply; yields rose along parallel lines, although there were sharper fluctuations in the equity department. The margin between bond and share yields, which had widened considerably when equity prices climbed so steeply in 1959 and 1960, narrowed later and at the end of 1963 was about the same as a year earlier (Chart 15).

CHART 14

Average monthly index of share prices in Italy and abroad

(1953 = 100, logarithmic scale)

CHART 15

Security yields

(per cent per annum)

Taking a longer view into the past, it will be seen that from 1959 onwards, when the period of generally falling rates of interest came to an end, the yields of government and other bonds kept very close to each other for a while. They began to diverge at the end of 1960, when the yields of government bonds went on declining and those of other bonds started on a pronounced upward path. In 1963 the gap stopped widening. By the end of the year, yields had returned close to their end-1958 levels well below the peak of the middle fifties.

The divergences in the yield curves were due to sharp shifts in the relative weight of the two kinds of stock in total bond issues. Up to 1960 industrial bonds had accounted on the average for 53 per cent of total fixed-interest security issues, but in 1961 there were no others at all. This naturally raised the respective yields and thereby lifted demand to match the larger supply. The yields of government stock, on the other hand, went on declining in connection with the redemption of maturing issues, but in 1963 the movement was reversed under the impact of certain factors on the demand side. The general contraction of demand for securities affected government stock like all others, and yields rose in spite of further redemptions.

With the cost of bond issues still going up in 1963, issue prices fell and nominal interest rates rose. On the average, the issue price dropped from 97.3 to 95.2 lire per 100 nominal value, and the average yield on the issue price rose from 5.70 to 6.05 per cent—and indeed to 6.70 per cent during the early months of this year (Table 33).

Table 33

Issue Price and Average Effective Yield of Major Bond Issues

Year	Nominal rate 5 %		Nominal rate 5½ %		Total	
	Price	Yield	Price	Yield	Price	Yield
1960	99.0	5.25	99.5	5.65	99.4	5.50
1961	97.5	5.35	99.5	5.65	98.5	5.55
1962	97.0	5.45	97.5	5.90	97.3	5.70
1963	93.5	5.90	95.5	6.15	95,2	6.05

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

The Supply of Funds: The Credit System and the Capital Market.— Between them, the credit system and the capital market furnished the economy last year with new medium- and long-term funds in an amount of 2,156 billion lire—a little less than in the record year 1962, but still more than twice the 1958 and 1959 figure of close to 1,000 billion and well in excess of the 1,685 and 1,786 billion, respectively, of 1960 and 1961.

Bond and share issues provided 622 billion lire, compared with 832 in 1962 and 637 in 1961; special credit institutes, with 1,021 billion, contributed only a little less than the year before (1,040 billion), about three times as much as they had done in 1958 and 1959, and a good deal more than in 1960 (579 billion) and 1961 (729 billion); the Central Post Office Savings Fund, insurance companies and funds and other sources together provided the balance of 512 billion lire, compared with 484 billion in 1962 and 420 in 1961.

Excluding stockpiling bills, commercial banks furnished the economy with 2,402 billion lire of short-term funds, somewhat more than the 2,031 billion of 1962. Short-term bank credit has been expanding strongly ever since 1959, with annual increments beginning at 760 billion lire in that year and rising through 1,335 in 1960 to 1,467 in 1961. By the end of 1963, the banks' total supply of funds to the economy had risen by another 21.2 per cent over the end-1962 figure to 13,328 billion lire, while at the same time the corresponding figures for special credit institutes were 18.5 per cent and 6,307 billion lire.

A breakdown of bank assets by economic sectors shows base metals in the lead last year (+ 34.5 per cent from 435 to 585 billion lire), followed by engineering (+ 28.4 per cent from 1,339 to 1,720 billion), chemicals (+ 30.3 per cent from 398 to 519 billion), and non-metallic minerals (+ 26.9 per cent from 239 to 304 billion).

Bank credits to the electricity industry, which climbed steeply in 1962 from 76 to 177 billion lire, had risen further to 219 billion by the end of last year.

The Use of Funds: Public and Private Investment.— Public investment expenditure in 1963 amounted to 1,751 billion lire, that is, 298 billion more than in 1962 (Table 34). The increment is attributable mostly to government spending (+ 193 billion) and the Central Post Office Savings Fund (+ 140 billion). The biggest items under the former heading were a credit to petroleum companies in the form of tax deferment and some major transfer payments to local authorities, especially regional governments.

TABLE 34

Public Investment Expenditure

(billion lire)

Investment by	1962	1963
Government	659	852
Local authorities	325	249
Autonomous government agencies	96	127
Cassa per il Mezzogiorno	218	248
Central Post Office Savings Fund	104	244
INA-Casa	51	31
Total . . .	1,453	1,751

As regards private investment, comparison between the two last years (Table 35) reveals major shifts among the main categories of sources of finance. The private sector last year drew about 400 billion lire less from the capital market, including direct security issues and loans from special credit institutes and insurance companies and funds. Depreciation reserves went up by just a little more than 200 billion, and the balance, which was much larger owing to the higher volume of investment, was made up by direct investment on the part of savers, self-financing and net bank borrowing, which together rose by about 500 billion lire.

Given the reduced self-financing capacity of companies, it is reasonable to assume that the share of direct investment by the public in this latter composite item must have risen; it follows that the increment in the balancing item must have come principally, if not exclusively, from the banks—as indeed is

TABLE 35

The Finance of Private Investment

(billion lire)

Sources	1962	1963
Share and bond issues	832	622
Loans by agricultural, land and building credit institutes	355	371
Loans by industrial credit institutes (1)	619	544
	1,806	1,537
less: Funds supplied by the Treasury and the Central Post Office Savings Fund (2)	141	292
	1,665	1,245
Loans by insurance companies (3)	71	99
	1,736	1,344
Depreciation reserves	1,637	1,843
Balancing item: direct investment by savers, self-financing by companies and net balance of short-term operations with banks	1,320	1,834
Total private investment . . .	4,693	5,021

(1) Excluding loans to the public sector and export credit.
(2) Either directly to finance institutions or through bond subscriptions.
(3) Excluding loans to the public sector, export credit, security investment and bank deposits.

confirmed by the rise in the loan/deposit ratio last year. These shifts cannot be precisely measured on the basis of available statistical material, but the direction and order of magnitude of the tendencies can be assessed by indirect means.

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

Gentlemen,

The expansion of Italy's economy last year and the strains it experienced made heavy demands on the Bank of Italy. We found we had to intensify and extend our activities in many fields, including rediscounts, operations on the foreign exchange and the capital market, and banking control.

General economic conditions.— In April last year, the Council of Ministers of the European Economic Community addressed a set of recommendations to Member States concerning ways and means to restore economic stability. In so doing, they pointed out that all member countries, save one, were suffering from mounting inflationary pressures and balance-of-payments disequilibria, which propagate the effects of inflation.

Not so very much earlier, at the end of 1962, the Community tendered the advice not to adopt any provisions which might subserve the deceleration of economic expansion and make the economy more sensitive to possible recessive tendencies, including not least those originating abroad. At that time, the conclusion was that cost increases not passed on to prices and therefore depressing profits might slow down the rate of investment, so that governments would have to come to the rescue of the economy with expansionary measures.

If I quote these two conflicting diagnoses following each other in such rapid succession, it is to underline the fact that the growth process of modern economies, and the underlying balance of factors, are subject to sudden major changes and may require equally sudden changes in the treatment by which we try to contain and counteract adverse developments.

Monetary policy is an important tool of the counter-cyclical armoury and, moreover, it can be applied fastest. It is hardly surprising, therefore, that when decisions begin to be taken in this field, some otherwise well-informed circles are not yet sufficiently aware of the changes which may in any particular case render these decisions necessary.

Consequently, the provisions of monetary and credit policy often receive an exaggerated interpretation quite out of proportion with their real significance and are the subject of, occasionally bitter, criticism, precisely because people do not as yet properly understand just why certain measures are proposed or adopted.

I mention this not because I want to complain of the unenviable duties incumbent upon a man who has the honour of presiding over a central bank; on the contrary, I want to say that I am well aware why the remarks I made here a year ago on the deterioration of our economic situation, on the need to take all possible countermeasures and not to rely solely on monetary policy, met with incredulity in certain circles or even with opposition, which waned only in the course of time.

I also knew perfectly well last year that our analysis of the economic situation in Italy was bound to be interpreted as transgressing into fields of competence altogether alien to its purposes. In point of fact we were so anxious to draw attention to the immediate and more remote causes of the reversal of our economic fortunes that we covered a very wide field indeed—so much so that I felt I had to justify myself by saying that we must guard against any partial interpretation of phenomena which were obviously complex and interdependent.

Our analysis could not overlook the monetary implications of the rise of the wage level in excess of the increase in average productivity in the economy as a whole, which occurred in 1962; but our consideration of this aspect of the question was not, and could not properly be, disconnected from consideration of other, though less potent, contributing factors which were discussed on the same occasion.

In dwelling on the strains and stresses originating in old-standing and well known imbalances of the Italian economy, on those of foreign origin which in recent times have assumed particular importance in the system of economic integration to which we belong, on those due to changes in the capital market and, more especially, also on those called forth by the wage rise—in dwelling on all these strains and stresses, I repeat, the intention was to draw a full picture of the by no means easy conditions in which the monetary authorities had to make their choices.

We explained, it will be recalled, how in wide areas of our economy profits could not fully absorb cost increases without forcing firms to interrupt investment programmes they already had in hand; we also explained why, in the conviction that their interruption would lead to serious destruction of wealth, we accepted the need to help finance these investment programmes by means of liquidity injections, even though we knew this meant helping to finance also part of the cost increase and ultimately some price increase. We dwelt at some lenght on the changes which had occurred in the distribution of income and on the diminution of self-financing funds; this caused firms to make heavier claims on industrial credit institutes and these latter to float more bonds, some of which were taken up by the banks thanks to the increased liquidity we allowed them.

By now, the Report on Economic Conditions in Italy in 1963, with its documentation on the profound changes that have taken place in the growht of income, consumption and investment during the last two years and on the upheavals in our balance of payments, has confirmed the view we had founded essentially upon our interpretation of balance-of-payments developments during the last quarter of 1962 and the first quarter of 1963, when, in terms of seasonally adjusted figures, our current account was still in balance.

The years 1962 and 1963 were years of labour conflicts, sometimes upheld by prolonged strikes, which eventually raised wage incomes by 43 per cent on the average. Now, wage incomes account for almost two thirds of our national income, and even if other money incomes had not changed, a rise of such an order of magnitude would have increased aggregate income in monetary terms appreciably more than real income. But mixed capital- and-labour incomes in trade and other tertiary activities also increased, and to prevent the rise in aggregate money income exceeding that in real income—a necessary condition of price stability—would have meant not only wiping out profits in large areas of our system of production, but also making it impossible for firms to set aside normal depreciation allowances.

In terms of economic theory it might be argued that this would have signified no more than passing on to wage earners part of the profits previously accumulated. But it so happens that a large proportion of past profits had been invested in plant and could not, therefore, be distributed in the form of money. As I said, the monetary authorities created liquidity to the extent needed to prevent widespread and serious financial difficulties among firms. But the authorities were well aware of the dilemma they so created for themselves: to the extent that the additional purchasing power did not push up prices, it would increase the deficit in our balance of payments. An inviolable limit was set by our need to protect our reserves at an adequate level.

Even a country like the Netherlands, which was distinguished in recent years for its monetary stability, lately saw its wages rise ahead of average productivity in the economy as a whole, in the course of an adjustment of the wage level to that of neighbouring countries. Last September the Dutch authorities forecast a wage increase of 8 per cent in 1964 and a price increase of 2 per cent; a few months later, in January 1964, the prediction had to be revised upwards to 16 per cent for the wage rise, and the additional 8 per cent increase was expected to raise prices, in turn, by an additional 5 per cent. The burden of this larger increase, the authorities held, could not be shouldered by firms, since such a profit fall would have forced them out of business. More than half the wage increase would have to be passed on to prices in order to reconstitute profits. The original estimate of a 500 million guilder surplus in the Dutch balance of payments had to be revised and a deficit of 1 billion guilders is now expected.

Wage drift, or an excess of effective wages over contract scales, assumed large dimensions in some European countries during the last two years. In Italy, it was confined to the more congested areas and to a few categories of workers. The phenomenon cannot, incidentally, be measured by comparison between the indices of minimum contractual wages and of actual wages. It is true that in recent years the latter were well above the former, but this was due to the application of certain contractual clauses which had the effect of raising effective labour costs. We know for certain, from a mass of information on wage contracts and many representative firms, that the divergence is largely attributable to those components of labour cost which are ruled by agreements.

The initial impulse to the wage rise came both from the increase in contractual minimum wages and—sometimes more so—from changes in contractual conditions concerning such matters as grading, retraining, equal pay for women workers, reduction of working hours and, hence, more overtime at given personnel levels. Later, too, negotiated improvements continued to be the main factor in the progressive wage inflation. On top of that, employers in areas where the labour shortage began to be felt most keenly tried to attract the workers they needed by offering higher then contractual wages. The phenomenon gained ground with the increasing shortage of unskilled workers, who notoriously have more geographical and intersectoral mobility; eventually, matters got still worse as the pool of highly skilled labour approached exhaustion and not nearly enough money was provided for labour training.

Investment displayed a tendency to slow down in the course of 1962 and 1963; in real terms, gross investment rose by 19.2 per cent in 1960, by 11.3 per cent in 1961, by 8.2 per cent in 1962 and last year, when the real gross national product went up by 4.8 per cent, real gross investment rose by only 4.1 per cent. It follows that last year's credit expansion gave no additional impulse to investment or to an expansion of demand which would have derived therefrom, and hence did not pull up prices. The credit expansion was in most part absorbed by the final stages of plant construction begun in earlier years, when companies were confident that they could count on self-financing to a much greater extent.

Wage drift assumed large dimensions during the last two years in building, where activity was greatly stimulated by the inflow of savings withdrawn from the stock market. Reliable estimates suggest that private funds going into housing were about 600 billion lire in 1960 and 1,190 billion in 1963. This increase of 590 billion lire compares with something like 250 billion supplied to the building industry by the credit system during the same period, while new public housing funds decreased by 120 billion. Thus the building industry received only 130 billion lire of new money from sources other than private saving. The clear implication is that higher family incomes and the saving public's disillusionment with tumbling security prices have reinforced the concentration of old and new private savings in the real estate market.

Wage incomes in the public and the private sector rose by almost 4,000 billion lire in 1962 and 1963. This new purchasing power burst upon the consumer goods market and spread like wildfire in all directions, making its strongest impact on food. Food expenditure went up by 28 per cent. Allowing for intervening price increases, food consumption in real terms rose by 5.4 per cent in 1962 and by 7.3 per cent last year. At the same time, the gross marketable product of agriculture increased by barely 1 per cent. The result was an expansion of food imports by 54 per cent, which it proved impossible to make good by the export of manufactures. Last year's additional food imports alone cost 340 billion lire; to pay for this with increased exports of manufactures, would have meant an export expansion of 15 per cent on this score alone. It appears quite obvious that the redistribution of income during the last two years and the consequent shift of demand to sectors like food, where the elasticity of supply is small, were bound to affect the balance of payments.

The adverse effects on the balance of payments of increased demand for other consumer goods and for services are more difficult, if not impossible, to assess individually. In spite of industrial growth some strongly expanding industries last year were unable to satisfy the swollen domestic demand, and at the same time increased investment and, even more so, growing consumption pushed up imports. This applies more particularly to engineering products and among them especially to motor cars, to fuel and power, textile raw materials and many others of lesser individual importance. Nor did our own engineering and textile industries relax their efforts to export more, and the same is true of a few minor industries largely run by small entrepreneurs, who in the past did not often bother to visit foreign markets; the motor car industry, on the other hand, had to neglect its exports to meet high domestic demand. On balance, taking imports and exports of food products on the one hand, and non-food products on the other, the deterioration was about the same in both cases, namely, around 345 billion lire.

Two propositions which are often heard nowadays deserve critical re-examinatiom. These propositions are: (1) The income shifts of the last two years were bound to affect demand; it should have been foreseen that a growing proportion of demand would be directed towards qualitative improvement in some consumption sectors not adequately satisfied before, such as food; had our production system been efficient, it should have immediately supplied more of the products capable of meeting the new demand. (2) The weakening of our competitive position as a result of the transfer of cost increases to prices could have been mitigated if we had at once proceeded to investments designed to raise the productivity of labour by increasing the capital endowment of individual workers.

The truth is that no production system in the world could have withstood without trouble the shock of a redistribution of income and consequent demand shifts on the scale of Italy's experience these last two years. If we look back to the time before the upswing began we see that investment last year was double the 1958 figure in monetary terms and 75 per cent higher in real terms; apart from its investment drive, our industry has had to face, in 1962 and 1963, an increase of 27 per cent in average labour costs per unit of product, whereas prices rose by 7 per cent.

Besides, the adjustment of domestic production to changed consumer demand requires time and there may well occur intervals when aggregate demand exceeds domestic supply, and this is precisely why it is useful to have a place in a wider international market, so that deficiencies in domestic supply can immediately be made good by larger imports.

This is what we need our reserves for, whatever cries of protest went up in our country at the time when we accumulated them. Here also is the function of international collaboration agreements, which help to buttress reserves; and here lies the strength of the reserve currencies, like the U.S. dollar, backed as they are by an enormous production potential which can be transformed into goods whenever need be.

Like many others, the problem is one of degree: it is perfectly in order to supplement domestic supply by imports, but only to the extent that we can afford in the light of the size of our reserves, due allowance made for the time that domestic supply needs to expand in adequate measure.

All this is not said in a critical spirit. I do not wish to pass judgement on the merit of past policies in certain important sectors, as for instance animal husbandry, nor to say whether, by altering these policies, we could expand output sufficiently to close the huge gap which has suddenly appeared between production and consumption. It may well be that, without prejudice to our efforts to step up production in that sector, the ultimate solution is to promote industrial exports, so that we can earn the foreign exchange with which to buy abroad a rather large portion of our food supply.

In any event, it is quite unrealistic to imagine that the productive system can in all circumstances adapt itself instantaneously to changes in the pattern of demand. There are elements of rigidity in any economic order—witness the Soviet Union's sudden shortage of grains and meat. That country, too, has had to shop abroad for conspicuous quantities of food, paying for them with unusually large gold sales.

For a number of reasons, factors of production cannot easily be shifted in practice. It should hardly need repeating, in these circumstances, that the effects are worst when the sectors which attract most demand are those which produce goods having a bearing on the cost-of-living index. When this happens, the mechanism of the sliding wage scale clearly reveals its misconceived function, for it raises purchasing power in monetary terms without any corresponding increase in the quantity of goods.

To some extent the deficit in our balance of payments reflects a shortfall in the domestic supply of agricultural products and certain manufactures; it reflects also, in the case of some manufactures, a failure of domestic products to compete successfully with imports. Our economy is essentially an open one; to say that some sectors could potentially produce more of the goods consumers want, but cannot, in practice, do so because consumers prefer foreign goods as being cheaper or otherwise more attractive, is simply another way of saying that in the market conditions such as they are domestic supply fails to satisfy demand.

The excess of money incomes over gross domestic product at factor cost, in terms of constant prices, was 1,661 billion lire last year; this sum corresponds to 7.7 per cent of GNP so calculated, and prices, in their turn, rose by 7.7 per cent last year. Gross domestic investment was 6,782 billion and gross national saving 6,374 billion; the difference of 398 billion has had to be made good by lending less and borrowing more abroad. In a closed economy, price rises due to excess demand would curtail the consumers' purchasing power and would lead to forced saving for the very reason that consumers could not buy foreign goods.

Some foreign observers have raised the question whether profit expectations had deteriorated to such an extent in our country that entrepreneurs had become reluctant to embark upon new ventures. The way our economic system is set up institutionally and the way it works, it certainly is ruled by the profit motive; even collective economies, incidentally, are known to be moving in the direction of acknowledging profit as an incentive to efficiency. But if we look at the enormous demand for new finance and then at the scarcity of investable funds, we surely cannot escape the conclusion that the limiting factor was, and is, insufficient saving. We were able to make good the savings gap by liquidity injections so long as the latter did not raise prices beyond the point where they would have compromised the maintenance of equality between the internal and the external purchasing power of our currency. Price increases beyond that point would ultimately have caused more unemployment of disposable factors of production and a bigger deficit in our balance of payments.

Italy's experiences in 1962 and 1963 as well as those of many other countries since the war go to show that monetary policy, the prime function of which is to regulate the volume of aggregate demand, cannot, by itself, cope with the business cycle.

Especially when the domestic and external objectives of economic policy get into conflict, monetary policy must soon be bent to the requirements of the balance of payments and budgetary policy must take over at home, both to regulate aggregate demand and to bring about an income distribution such that the relative proportions of investment and consumption enable the economy to expand in a climate of stable prices.

These same experiences also demonstrate, without a shadow of doubt, that in a situation of nearly full employment economic policy cannot achieve its aims without a consistent incomes policy. Incomes policy has become a necessary tool to assist monetary and non-monetary action in preventing income from exceeding the limits compatible with monetary equilibrium.

Regardless of a country's social order, modern economies, with their productivity differentials between broad sectors of economic activity and even within industry, are too complex for the traditional instruments of preventing cost inflation and its repercussions on prices; success in so doing is often accompanied by a sharp deceleration of development, or even brings it to a complete halt. The evidence is clear: there is a choice only between accepting an incomes policy or else recurrent stoppages of development and a consequent fall in employment.

Meanwhile, the economic and social purposes of incomes policy, its means, scope, standards of application and the conditions of its success are gradually taking shape in the discourse between government experts, business men and trade union representatives in all the major Western countries and also in the general economic pronouncements of Soviet policy makers.

If trade unions accept an incomes policy, this does not in any way imply subordination to the decisions of others; on the contrary, by helping in the formulation of the economic plan wich is to underlie government policy and by agreeing to an income distribution which serves the purposes of this plan, organized labour has an opportunity of playing its part in an orderly process of structural social changes to the effective benefit of the working classes. Lately, the governments of the greatest nations have placed before public opinion schemes inspired by different principles, but all proclaiming that the prosperity of the community as a whole depends upon the majority's resisting the temptation to raise the quantity of money they receive for their own work without, in return, raising the quantity of products in the same measure.

But government must do more than admonish. Modern governments are also employers on a large scale, and in this capacity it is up to them to demonstrate by their own behaviour in practice towards what kind of incomes policy they wish to guide the behaviour of the public. In Italy, the wage bill for persons in the employment of the government, local authorities and autonomous government agencies amounted to 3,184 billion lire in 1963. If we add the wage bill of major government-controlled companies and of social insurance institutes, we get a figure well in excess of 4 billion. This means that something like one third of the country's total dependent labour incomes is directly or indirectly under the control of public authority.

Money Supply and the Banks.— The liquidity which the monetary authorities create through their operations with the foreign sector and the domestic market reaches the public either directly in the form of bank notes or indirectly through credits conceded by the banking system. The funds which the banking system supplies to the economy through credits either return to the banks in the form of deposits, or, to the extent that they do not, remain in the hands of the public in the form of bank notes.

Whenever the amount of means of payment which the banks supply through credits is such that the borrowers exercise demand for more goods than domestic supply provides, the excess purchasing power injected into the economy either raises prices or turns abroad or, generally, both.

The monetary authorities do not have unlimited power over the volume of liquidity supplied to the economy and are only partly free to choose, at their discretion, the channels through which liquidity flows into and out of the economy. Within the limits of their discretional power, the monetary authorities inject liquidity through one or the other channel in the light of the immediate effects they wish to produce.

Early in 1962, when we had a large balance-of-payments surplus to mop up, it seemed right to distribute liquidity widely over the whole banking system by reducing the compulsory reserve ratio; this served the additional end of making it possible to complete investment programmes already begun in the public and private sector alike.

At the beginning of 1963, one of the sources of liquidity creation was the redemption of the maturing issue of nine-year Treasury Bonds. The liquid funds so created were channelled to the economy through the special credit institutes, which were enabled to place their own bond issues more easily with the owners of the redeemed government stock.

A similar effect was achieved by placing bonds with those agencies which keep their funds with the Treasury. Finally, the banks were authorized to make good such liquidity losses as the balance-of-payments deficit would have caused them by borrowing abroad; as a counterpart to their foreign debts, the banks made loans explicitly connected with the productive process, because foreign-currency credits may be granted only to facilitate imports, usually of raw materials, and exports of finished products.

An additional reason for giving the banks this faculty was that capital exports and their repercussions on our official reserves required some offsetting inflow. Thus capital exports were met by imports of short-term funds through the banking system. Net capital exports in 1963 amounted to 559 million dollars and were more than matched by an increase in the banks' foreign indebtedness of 650 million dollars.

The accumulation of foreign debts by the Italian banks was stopped early in the summer. It will be recalled that this development was foreshadowed in the Annual Report last year; we warned that we would introduce restrictions if and when they became necessary to supplement other measures we were preparing in order to confine liquidity creation within the limits required to keep a proper balance between the increment of money supply and the increment of real income and so to prevent any further considerable rise in the price level.

The Italian banks' indebtedness vis-à-vis foreign banks reached its peak in August 1963; since then, it has fallen off continuously and, on 31 March 1964, amounted to 311 million dollars.

In addition, we took two other kinds of measures:

a) we facilitated the transformation of short-term debts into medium-term debts, and likewise facilitated medium- and long-term borrowing on the part of companies, local authorities and public agencies, thereby initiating a process of partial funding of short-term debts. The total amount of medium- and long-term debts contracted between July 1963 and March 1964 by banks, local authorities, companies and public agencies together was 407 million dollars;

b) we conducted conversations with central banks abroad, and especially with the Federal Reserve, with a view to reinforcing the system of reciprocal credit agreements.

Speculative capital movements of conspicuous magnitude occurred in October 1963, but they assumed dramatic proportions in the first two weeks of March 1964, when the Italian Exchange Office intervened to the extent of 255 million dollars.

In the second week of last March we held discussions with the monetary authorities of the United States, that is, the Treasury and the Federal Reserve. The outcome of these discussions is known: the conclusion of reciprocal credit agreements involving an amount of altogether 600 million dollars, with the participation of European central banks. These credit facilities were intended to help us defend our official reserves by acting as a shock absorber for the speculative attacks against the lira. We have so far used 150 million dollars of these credit facilities.

In addition, arrangements were made for medium-term credit facilities with the Export-Import Bank and the Commodity Credit Corporation. Finally, loan negotiations were opened with the International Bank for Reconstruction and Development on behalf of the Cassa per il Mezzogiorno.

On that occasion we made a drawing of 225 million dollars on the International Monetary Fund. The size of the operation was tailored, on the one hand, to the Fund's need to reconstitute its lire resources, nearly all of which had been used up in lire operations by the Fund, and, on the other hand, to our gold subscription. This leaves completely intact our chances of borrowing from the Fund; we may wish to do so within the framework of a financial aid programme to be worked out in the first instance with the European Economic Community, in the spirit of structural harmonization and policy co-ordination which it is our common and not easy task to achieve.

* * *

In 1962 net liquidity creation amounted to 801 billion lire, in 1963 to 861 billion. In 1962 390 billion lire went directly to the public in the form of an increase in note circulation, in 1963 the figure was 441 billion. The rest went to the banks and enabled them to fill up their compulsory reserves to the extent required by the increase in bank deposits. The banks' payments into the compulsory reserve accounts amounted to 380 billion lire in 1962 and to 432 billion last year. On balance, the final effects of the liquidity injections was to augment bank liquidity by 31 billion in 1962 and to diminish it by 12 billion in 1963.

In 1962, the foreign component contributed 308 billion lire to total liquidity creation, in 1963 it absorbed 375 billion. The Treasury, on balance, created 12 billion lire of liquidity in 1962 and 777 billion in 1963.

The liquidity component consisting of Treasury operations with the Bank of Italy and commercial banks testifies to the exceptional pressure of the Treasury's cash deficit in 1963. In itself, this would not signify very much without the additional observation that, in actual fact, the deterioration in the Treasury's cash deficit seems attributable not only to budgetary revenue and expenditures, but to the Treasury's overall transactions, including those with the Central Post Office Savings Fund, where enormous quantities of bonds, especially those floated by E.N.E.L., had to be placed.

In 1962 the Bank of Italy, the Italian Exchange Office and the banks between them furnished the economy with credits worth 2,779 billion lire, including security investment; in 1963 the figure was 3,314 billion. The money supply injected into the economy through credits last year raised monetary assets by 2,533 billion lire; the difference of 781 billion went abroad as a result of the deficit in our balance of payments. This deficit was financed to the extent of 375 billion by drawing down official reserves and to the extent of the remaining 406 billion by an increase in the net foreign indebtedness of the banks.

While bank advances grew more in 1963 than in the preceding year, the rate of increase dropped sharply during the latter six months. During the twelve months ending in July 1963 bank credits expanded by 25.8 per cent and during the twelve months ending in December 1963 by 21.1 per cent. In 1962, credits expanded by 15.1 per cent during the last two quarters, in 1963 by 11.4 per cent (the simultaneous increase in deposits was 12.5 and 9.1 per cent, respectively).

In its turn, the note circulation has been growing at a steadily decreasing rate since last June; during the twelve months ending in June 1963 it expanded by 21.0 per cent, during those ending last December by 14.3 per cent.

The slowing down in the growth of money supply since July 1963 began to make a major impact in the early months of this year. Between March 1962 and March 1963 net liquidity creation (969 billion) had taken care of the whole of the increase in the public's liquid assets in the form of bank notes (509 billion lire) as well as of 485 billion for compulsory reserve payments by the banks, thus leaving the latter with a small liquidity loss of about 25 billion. During the twelve months ending in March of this year, by contrast, net liquidity creation (287 billion lire) was much less than would have been needed to finance the 321 billion increase in the public's bank note holdings and the 200 billion compulsory reserve payments by the banks; the shortfall of 234 billion was met by a contraction of bank liquidity.

To round off the picture, it needs to be added that during the twelve months ending in March 1963 the foreign component contributed 323 billion lire to liquidity creation, whereas during the subsequent twelve months it absorbed 701 billion. It follows that the combined effect of the Treasury's and the Bank of Italy's operations was liquidity creation in the amount of 646 billion lire during the former twelve-month period, and in the amount of 988 billion, or 342 billion more, during the latter. Thus the Treasury and the Bank of Italy not only made good the liquidity loss due to the balance-of-payments deficit, but added 287 billion.

Still in terms of twelve-month changes, bank advances expanded by 19.7 per cent up to January 1964, by 17.8 per cent up to February and by 16.0 per cent up to March 1964 (the corresponding increases in deposits were 11.6, 10.6 and 9.5 per cent, respectively). The rate of increase in the note circulation slowed down continuously, with the exception of March, when the Easter holidays during the last week of the month temporarily reversed the tendency. The twelve-month increase up to April 1963 was 18.7 per cent and up to April 1964 8.4 per cent; now, in May, the trend seems to continue.

Taking the combined expansion of current bank accounts and of the circulation of bank notes and other means of payment, total money supply increased by 19.9 per cent in the twelve months up to March 1963, by 17.9 per cent up to June 1963, by 16.9 per cent up September 1963 and by 12.7 per cent up to December 1963. The deceleration has continued so far this year; in January the figure was 11.3 per cent, in February 9.8 per cent and in March 9.0 per cent.

In spite of a deceleration so gradual that foreign observers sometimes expressed doubts as to the effectiveness of our measures, the credit expansion nevertheless did go on. It is hard to understand, in these circumstances, how the monetary authorities can be accused of deflationary policies, as they have been accused by certain circles. Instead of looking at the actual dimensions of the phenomenon and of interpreting it with due regard to the country's overall requirements, these critics seem to draw substance from the inevitable hardships suffered by business. It is true that more credit is needed again because production costs have risen further and it is difficult to transfer the rise onto prices; hence companies have to rely more heavily on outside sources of finance.

But if we take a dispassionate view of last year's economic and monetary events and interpret them in the light of objective statistical figures, we see that over the course of the year bank advances expanded at a higher rate than did deposits, because part of the purchasing power created by the banks through credits did not return to the banks in the form of deposits, but instead went abroad in the form of an excess of import expenditure over export receipts.

Nor is this all. In spite of the failure of part of the purchasing power injected by the banking system into the economy to return to the banks in the form of deposits, current accounts increased at a higher rate than did real income; in other words, the increase in current accounts and monetary circulation, that is, the money supply, was considerably larger than the real income increase and this was reflected in the rise of prices.

Surely, it is not open to doubt that in the presence of more credit expansion producers would have managed to transfer some of the increased cost pressure to prices, and a higher price level would have sucked in more goods from abroad, given that aggregate demand expands not least because of the existence of sliding wage scales. It is just not possible to go on using the mechanism of the sliding wage scale to safeguard the real value of wages and at the same time to want an easy credit policy, for such a policy would do nothing but lift prices still further.

The divergence between the rates of expansion of loans and of deposits was not the same in the various sections of the banking system. However, even in the case of banks with an above-average loan/deposit ratio, the ratio of loans to total liabilities was reassuringly in line with sound banking principles. Banks with a below-average loan/deposit ratio were generally those which keep part of their liquid resources on deposit with other banks, mostly big ones, or with their banking associations. When these smaller banks expand their own credit, they have to draw more on these resources deposited with the big banks, and as a result the latters' liquidity diminished and they present more bills to the central bank for rediscount.

Now, a large part of the banking system's cash pool is concentrated in the biggest banks, and these had to draw more heavily than before on sources other than deposits from the public. These other sources of funds are interbank deposits, foreign deposits, and recourse to the Bank of Italy; the latter amounted to 1,942 billion lire on 31 December 1963. The Bank of Italy had requested the banks to be rather sparing with foreign exchange credits financed by currencies held in deposit from foreign banks; clients, at the same time, tended to replace foreign exchange credits by lire credits. In these circumstances, some banks exercised more demand for deposits from other banks and borrowed more from the Bank of Italy. In the event the big banks were responsible for 63 per cent, or 272 out of a total of 431 billion lire recourse to the Bank of Italy last year.

Interbank deposits, foreign deposits and transactions with the Bank of Italy carry different rates of interest; it follows that certain inequalities arise from the differential proportions of the funds drawn from these various sources by any particular bank. On the other hand, recourse to the Bank of Italy is administered by the latter mainly with reference to the liquidity situation of each separate bank, and the different measure in which banks can draw on this source of funds creates differences in their average borrowing costs. Furthermore, interest rates on interbank deposits being lower than those on foreign deposits, there is a tendency to scramble for these domestic funds and this puts obstacles in the way of our policy to keep the interest rate on interbank deposits in line with the Treasury Bill rate. It would seem necessary, therefore, that monetary policy try to unify the terms on which domestic and foreign money market funds are exchanged, and to eliminate or at least reduce the causes which make for inequality of conditions as between separate banking firms.

Another obstacle to effective liquidity control is that public agencies, seemingly under some sort of peripatetic compulsion, keep moving large sums of money from Treasury accounts to the banks, or *vice versa,* or from one bank to another. When the movement in or out of Treasury accounts takes place with the Treasury's active participation, the close collaboration between the Treasury and the Bank of Italy does away with the danger of distortions in the process of liquidity creation. But this is not so when the owners of the funds act on their own initiative. When huge amounts are withdrawn from one bank and deposited with another at a time of generally tight bank liquidity, the central bank may be obliged to make good the liquidity loss of the bank from which the funds are withdrawn without being able to prevent the liquidity gain of the bank into which these monies are paid.

As conditions are at present, it seemed right to renew the interbank agreement without modifications which would have affected the current relationships between interest rates permissible for the various categories of accounts. In effect, the categories of accounts which attract monetary resources are unevenly distributed among the various sections of the banking system, so that any changes in relative rates of interest would alter the distribution of monetary resources not only among the various categories of accounts, but also among banks, and the results for the system's total recourse to the central bank would be much the same as those described above.

In 1962 the banking system's loans expanded by 1,995 billion lire, and its credits to large companies by 475 billion; in other words, new credit extended to large companies accounted for 24 per cent of total new credit. In 1963, the banking system lent out a net total of 2,268 billion lire, of which 369 billion, or 16 per cent, went to large companies. Its new credits to public agencies were 198 and 130 billion, respectively, and those to medium-sized and small firms 1,322 billion in 1962 and 1,770 billion last year. This latter group of firms thus got 66 per cent of the total credit increment in 1962 and 78 per cent of it in 1963. These figures are eloquent testimony to the fact that a strong flow of new credit in 1963 was directed to the small and medium-sized companies, and not to the big ones—in line with suggestions the Bank of Italy has more than once addressed to the banks.

Special Credit Institutes, the Capital Market and the Use of Finance Funds.— Like the banks, industrial credit institutes last year channelled a relatively larger share of their new loans to medium-sized and small firms. In 1962, these latter had received 286 billion lire out of a total of 673 billion new industrial loans granted; in 1963, they got 313 out of a total of 623 billion, and their share of new credits therefore passed from 42 to 50 per cent. By comparison, government-controlled companies borrowed 215 billion lire of new money from industrial credit institutes in 1962 and 132 billion in 1963, and other large companies received 90 and 77 million, respectively, in the two years.

Privileged credits to medium- and small-scale industry, under the terms of Law No. 623 amounted to 160 billion lire in 1962 and to 133 billion in 1963; those for Mezzogiorno industrialization, under the terms of Law No. 634, rose from 41 to 75 billion. These developments were in line with the policy intention of concentrating a larger proportion of privileged credits within the geograpical area under the competence of the Cassa per il Mezzogiorno.

Together, new loans granted last year by industrial and by land and building credit institutes, including transactions on Treasury account, were 1,310 billion lire in 1962 and 1,178 billion last year. In 1962, the banks furnished 520 billion of the funds required for ordinary loans and in 1963 391 billion, corresponding, respectively, to 49 and 32 per cent of the total. The peak point in the banks' share in the supply of funds to these credit institutes occurred in the third quarter of 1962, when the figure was 56 per cent; in the following quarter it came down to 51 per cent and in the corresponding periods of 1963 it was 40 and 25 per cent, respectively. This relative contraction was a response to a directive of ours of which we gave notice at this meeting last year, when we warned that it would not be possible to finance investment credits by liquidity creation instead of savings.

The containment of bond issues within the afore-mentioned limits has had the result that enormous loan commitments accumulated in industrial credit institutes. On 31 December 1963, these institutes had commitments amounting to 1,049 billion lire, of which 604 billion were promised to small and medium-sized firms, 264 billion to large private and government-controlled companies, and the rest to public agencies. At the same time, credit applications waiting for approval amounted to another 928 billion lire; 6,080 of these applications, involving an amount of 698 billion, came from small and medium-size firms.

Net new security issues on the capital market dropped from 1,642 billion lire in 1962 to 1,340 last year; this was just a little more than in 1960 and 1961. The public, that is, investors other than the banks and those institutions which keep their funds with the Treasury, took up appreciably less than before, namely, 677 billion lire against more than 1,000 billion in 1960 and 1961, and 971 billion in 1962. Equity issues were 608 billion lire in 1962 and 267 billion last year.

These figures may be explained and interpreted as follows.

(*a*) The stock exchange crisis of the second half of 1962 showed its full effects last year, when barely half as much new money was raised on equity issues than the year before. The reason was not that applications for equity issues were refused but that they were not presented or, in some cases, that the applicants themselves seemed in some doubt as to whether they could place their shares on the market.

(*b*) Considerable parts of new bond issues were not sold to the public during the last two years, but placed instead with banks and with agencies which keep their funds with the Treasury; whereas this group of institutional investors took up 28 per cent of net new issues in 1960 and 30 per cent in 1961, they accounted for as much as 65 and 62 per cent, respectively, in 1962 and 1963. The Treasury's support to the market last year amounted to 536 billion lire, in the shape of bond subscriptions by the Central Post Office Savings Fund and redemption of Treasury Bonds.

(*c*) Even though less bond issues were authorized than were applied for and part of them was taken up by the banks, and notwithstanding the Treasury's support to the market, the index of stock exchange prices for the bonds of industrial credit institutes dropped from 117.8 in December 1962 to 107.3 in December 1963; yields correspondingly rose from 6.02 to 6.61 per cent.

The Bank's Annual Report in 1962 discussed at some length the problems connected with the size of the capital market in Italy, in comparison, also, with other countries. The conclusion was that the market could not conceivably go on expanding at the current pace. Last year on the same occasion we warned that no repetition of the events of 1962 must be expected, and drew attention to the danger that the changing quality composition of the securities traded on the market was bound to affect the latter's efficiency.

What happened subsequently confirmed that more bonds were being floated than could be placed without providing inflationary finance for them. Throughout the years 1956 to 1962, with the sole exception of 1959, more than 30 per cent of the new money raised by security issues came from equities; in 1963 the proportion was only 20 per cent.

It seems obvious, in these circumstances, that it would make it easier to finance investment without recourse to inflationary means if we succeeded in rearranging the composition of total security issues to suit investors' preference. We need to interest all the various categories of investors, including new institutional investors. To do so, two conditions are essential:

(*a*) Economic policy must be such as to enable companies to be reasonably sure that they can cover their costs and still to leave open the possibility that changing business conditions would be reflected in profits, as the residual element. Notwithstanding the imperfections or our stock markets, fluctuations in share prices do, in the long run, provide a measure of profit expectations;

(*b*) We should introduce a stabilizing element into the market, such as, for instance, investment or unit trusts. This could be done without waiting for the reform of company law, by means of fiscal provisions; the dividend income of investment trusts could be wholly or partly exempted from tax liability under Law No. 1745 of 29 December 1962 and any profit they made on sales of securities could be declared as income not subject to direct income tax.

If institutional investors, such as insurance companies and social insurance funds, are to be given the faculty of investing in shares, and if we are to have investment or unit trusts, both the enabling legislation and relevant government regulations will have to insist on the investments being split up in adequate manner—majority share holdings must be ruled out—and on full information being furnished to subscribers so that they can exercise proper control. If investment or unit trusts are authorized to include also foreign shares in their portfolio, they will be able to offer the public a composite stock with an additional built-in price stabilizer.

But, however successful we may hope to be in bringing the equity market to the fore again as a source of finance, bond issues still remain large. The reason is the growth of public investment programmes financed by bond issues, and also the further extension of the government-controlled sector in consequence of the nationalization of the electricity industry. As of 31 March 1964, no less than 1,120 billion lire needed to be raised by bond issues to finance the 1964 investment programmes pursuant to existing legislation and planned by ENEL, ENI and IRI.

Special credit institutes will have to make additional claims on the bond issue market, and, adding also short-term credit, we get a total of 1,640 billion lire. Lastly, industrial credit institutes will need some funds to satisfay at least part of private investment demand, and so will land credit institutes. All this together is far more than the market can absorb.

In these circumstances, the government cannot escape the necessity of setting up a scale of priorities in line with its economic programme, and of establishing a timetable of investment such as not to compromise monetary equilibrium. It is a matter of satisfaction to be able to note that the government has, in fact, begun a critical review of investment projects in various sectors, with a view to appropriate co-ordination. Once the government has taken the decisions which give the economy its policy directives, the central bank will play its part by spacing out authorizations for security issues in such a manner as to reduce the amplitude of stock price fluctuations very quickly.

But the central bank cannot make good deficiencies in the formation of saving by creating new money beyond the limit compatible with price stability and a return to balance-of-payments equilibrium. Nor can it force bond issues upon the banks, thus obliging them to restrict credits to firms. It is worth recalling, in this context, that the ratio of the banks' fixed-interest-bearing security holdings to deposits is no less than 15.6 per cent.

Within its powers of overall liquidity control, the central bank can do something to channel newly created liquidity this way or that, according to the immediate effects desired. We have, for instance, purchased government stock from public agencies so as to enable them to invest the proceeds in mortgage bonds; we did this in special consideration of the importance of mortgages for housing construction in some of our large towns.

All in all the capital market last year furnished the economy with 1,608 billion lire, either directly through security issues or indirectly through special credit institutes; in 1962 it had supplied 1,950 billion. Of last year's total 22 per cent went into building (19 per cent in 1962) and 6 per cent into public works (5 per cent in 1962). The bulk of the rest was concentrated in manufacturing industries, among which steel, engineering and chemicals alone got 29 per cent of the total in both years.

The steel industry's share was rather bigger than before, because large sums were needed for the completion of the new steel mills under construction. The concomitant nature of bank credit was evident in its complementary pattern of distribution: the share of housing credit diminished from 14 to 11 per cent, that of credits to manufacturing industries increased and, more particularly, the proportion of credits to the steel, engineering and chemical industries rose from 25 to 28 per cent. Petroleum companies, which had 7 per cent of bank credits in 1962, had only 0.5 per cent last year, as a result of a public credit to them in the form of tax deferment amounting to 122 billion lire; in 1962, on the other hand, the banks lent the petroleum sector a total of 129 billion.

When companies can effect less internal saving because prices do not rise as much as costs, partly because of foreign competition, they naturally have to look for more outside funds on the capital and the money market. This generates the sort of imbalance between demand and supply which we call a credit squeeze. There is ample statistical evidence to the effect that in Italy during the last two years and in 1964 so far the reason for the credit squeeze has been not that the supply of bank credit fell off in absolute terms or expanded at only the same rate as the country's real income, but that demand raced ahead of supply.

Given the price rise and the growing deficit in the balance of payments, it became obvious that there was no point in injecting more liquidity into the market than we had to do in order to avoid serious stoppages of production. In these circumstances many a voice was raised in favour of introducing a policy of more selective bank credits.

With this I do not, of course, mean the opinions of any particular companies which wanted more help from the capital market or the banking system; naturally enough, each one of them feels that its own needs should take priority over all others. I have in mind, rather, a view which is widespread especially among academic economists, to the effect that the credit squeeze could be greatly eased by more stringently selective credit control.

At present, selective control over the medium- and long-term loans of special credit institutes is exercised by the monetary authorities on the occasion of their authorization of bond issues by the institutes; similarly, all other security issues are subject to administrative authorization and, at that moment, to selective credit control. There remains, therefore, the question up to what point to strengthen the system by extending it to short-term bank credit. This is an extremely important question, on which we might usefully dwell for a moment at this point.

Throughout the fifties, the expansion of bank credit corresponded to about one sixth of the volume of simultaneous gross investment; since 1960 the proportion has been one third. But bank credits to some extent also finance the public sector and household consumption; in part, furthermore, they are the counterpart of deposits by companies themselves. The net contribution of the banking system as one of the channels through which company investment is financed is, therefore, a good deal less than the figures of bank advances suggest.

Another important point is that, when it comes to making the financial decisions which are so weighty a factor in guiding investment activity, one lira borrowed from the banks counts less than one lira drawn from self-financing funds or from the capital market. The reason is that profit expectations are scrutinized much more carefully by the investing firms and by the special credit institutes when they decide to finance new plant with funds which, in an orderly market, must be partly the firm's own and partly raised through long-term borrowing. This is the sound financial basis of investment decisions; once it exists or arrangements have been made for it, short-term bank credit may be drawn upon for supplementary or concomitant funds or to prefinance investment.

The question of a qualitative control of bank credit for purposes of investment guidance can, therefore, rationally arise—and then only within the limited scope of bank credit—only after the authorities have already exercised their influence on long-term loans and yet the distribution of investment is still unsatisfactory.

It should be recalled, in this connection, that about one quarter of the country's total gross investment is either made by public agencies in their capacity as investors or decided by them in their capacity as providers of finance; this figure, incidentally, excludes agencies which are themselves producers, and excludes also government-controlled companies and private investment in response to government incentives.

It should also be recalled that during the last four years private fund-raising on the capital market, either directly or through special credit institutes, has financed about one quarter of all investment and one third of private investment; in either case it is subject to the approval of the monetary authorities, who in turn give or withhold approval in accordance with the directives issued by the Joint Ministerial Committee on Credit.

When we say that a considerable part of investment decisions is taken by public authorities and that another considerable part is governed by directives emanating from a Committee of Ministers in exercise of its legal powers, we remain strictly in the field of facts concerning the working of government in its legislative order, with results that are statistically measurable.

But in investment guidance, allowance must also be made for the effects of the government's influence on self-financing, and this is something we cannot measure. All we can say is that, in a mixed economy like ours, this influence must work indirectly, through framing the conditions of competition, through fiscal means, and—I repeat my hope—through an incomes policy. I would not presume to suggest at what rate of profit and at what distribution of profits such subtle government intervention should aim. All I want to do is to explain the setting in which banks have to take their credit decisions and to help fashion this setting in such a way that the banks are not asked to apply contradictory operational standards.

With this limited purpose in view, then, I would say that one of the intermediate objectives of a modern state's economic policy is to create throughout the whole productive system a degree of competition which is judged optimal from the point of view of reconciling social justice with income growth. Another is to modify the conditions of competition through fiscal means, that is, through taxes, exemptions and subsidies, whenever special localized purpose so require; these may include the protection of certain social patterns, incentives to entrepreneurship in certain regions, or capital formation among certain classes. A third of these intermediate objectives is to regulate the volume of aggregate money demand and of its major components through an incomes policy. If we successfully arrange the affairs of the nation so as to achieve these intermediate objectives, we shall have to accept the consequeces—or else we shall be creating internal conflicts within the system of government intervention. In other words, we shall have to accept the structure of demand such as it is fashioned by these fundamental acts of government; then it will not happen that the ultimate objectives of government policy are frustrated if the apparatus of production is left free to adapt itself to this demand, and if the mechanism of bank credit is left to accompany and condition this adaptation process according to normal banking principles—that is, risk appraisal in terms of the firm's profit expectations and in terms of the real and personal guarantees the client can offer.

Even if it were possible to introduce more selectivity into bank credit, it is hard to see how to avoid arbitrariness, given the complexity and variety of the sector of medium-sized and small enterprise which relies upon bank credit and given, above all, the great number of medium-sized and small banks operating in geographically restricted areas. If these latter were asked to implement directives implying choices of high-priority sectors, they would be all but paralysed in practice, or else they would be forced into a concentration of risks incompatible with efficient safeguards for the class of depositors to whom they cater.

For all these reason I believe that, in the conduct of modern government, qualitative control of bank credit is a tool to be kept in reserve and to be applied with moderation in special conditions rather than as a regular component of credit policy. In certain cyclical phases one kind of credit may indeed have to be curbed in favour of others and, in exercising its overall powers of control and direction, the central bank has from time to time done so and may do so again. But we only have to look at the most recent developments to see that cyclical situations can change very quickly, and for this reason we must be watchful and flexible in anything we do to direct the flows of credit. Moreover, intervention of this kind is apt to have so many general and specific effects of opposite sign and unmeasurable magnitude, that it would seem safer for the monetary authorities not to assume direct responsibility for the innumerable adjustments required by cyclical developments, but to leave these adjustments to the market processes, within the general conditions created by control of the volume of liquidity.

Some Problems of the Moment.— Recent experience in the monetary relations between Italy and the United States has proved that swap agreements and the U.S. Treasury's issues of debt certificates denominated in foreign currency are realistic procedures capable of fruitful development. This may prove a flexible way of meeting any possible increase in the world's liquidity and credit needs. The credits being quickly reversible in case of a sudden change in the flow of funds or the respective balance-of-payments position, as the events of last March abundantly demonstrated, these reciprocal agreements effectively serve the interests of both parties concerned and not only those of one of them. They would, therefore, seem to have more merit than some of the abstract formulae suggested in recent times and might suitably become a permanent feature of the international monetary system.

These experiences, as well as the studies conducted by the so-called Group of Ten, have strengthened my conviction that, subject to possible minor adjustments, this system is sufficiently solid and flexible to meet the foreseeable needs of the next few years. However logically coherent other innnovations may apear, they would be acceptable only on condition that they are allowed to prove their worth in a long, and free, transition period.

We are in the fullest possible agreement with the efforts to speed up the process of co-ordinating budgetary and monetary policies with a view to the swift correction, or indeed prevention, of imbalances in international payments.

The progressive intensification of collaboration within the Organization for Economic Co-operation and Development and the recent decision of the Council of Ministers of the European Economic Community are steps in the right direction, in so far as they tend to make major decisions of internal and external monetary policy subject to systematic consultations.

Last April the Council of Ministers of the EEC made a series of recommendations concerning measures to achieve, or consolidate, price and cost stability in Member States, and made it clear that this objective was to take priority over all others at the present stage of the business cycle. For Italy, the particular recommendations were that tax increases should be so distributed as to slow down the expansion of private consumption while interfering as little as possible with company investment; that a full anti-inflationary programme should be worked out to complement the measures already put in hand to stabilize domestic prices and costs quickly and to improve both the country's competitive position and its balance of payments; and that, more generally speaking, the expansion of domestic demand should be held back by fiscal means, the policy of containing the credit expansion should be continued and a balanced incomes policy should be introduced, so as to keep the growth of nominal and real income in line as far as possible.

With the full concurrence of the Italian authorities and in a spirit of constructive collaboration, the EEC Commission is at present also investigating our economic position, under the terms of Article 108 of the Treaty. Discussions so far suggest that the afore-mentioned recommendations will be formulated in more precise terms and that others may be added in the light of such changes as may take place in our situation; these additional recommendations may concern commercial policy, public finance, credit policy and, finally, the ways and means of introducing an incomes policy.

Not only the EEC, but also other international organizations to which Italy belongs are watching with attention our efforts to get our economy back onto an even keel. The success of the set of measures we have adopted in line with, and sometimes in anticipation of, the afore-mentioned recommendations has become a matter of common interest. It is a fact that the evolution of international economic relations limits each country's independence in formulating and implementing its economic policy, but it also diminishes the margin of possible error. Much more than in the past we shall, therefore, have to stand up in the international forum for what we do and don't do, and have to listen to constructive criticism and give account of any delay in the adoption of corrective measures for such domestic or external imbalances as may arise. It is right that this should be so, because, in a régime of fixed exchange rates and open economic frontiers, such imbalances tend to propagate themselves quickly to other economies, which can do little to defend themsleves.

Real magnitudes and monetary magnitudes must be brought back into a proper relationship, which alone can remove the strains from which our economic system now suffers and put it once more on the road of balanced growth. This is a problem which can be solved only by the combined efforts of government, entrepreneurs and trade unions. It is also a problem which has many facets, of which I have discussed only those pertaining to the creation of monetary means in relation to income growth. This limitation corresponds to the boundaries of our sphere of responsibility and is not meant to imply that the other aspects are of lesser importance. To countercheck the conclusions to which our analysis has led us, we conducted a survey of the experience of a large number of countries in matters concerning the comparative movements of wages, production, liquidity and prices.

The survey covered the countries of the Common Market, the Scandinavian countries, Austria, the United States, the United Kingdom, Canada, Japan and Argentina. For each of these countries we calculated two ratios of indices, selecting ratios the time path of which is particularly helpful in interpreting the comparative movements of the factors under consideration. The first ratio was that between the wage index and the index of production, and its variations may be taken as indicators of variations in labour cost per unit of product in the course of the cyclical phases. The second ratio was that between the index of primary liquidities and the wage index; changes in this ratio, together with those in the first-mentioned, indicate whether or not liquidity variations are connected with cost variations.

To put it briefly, the results of our survey show that economic expansion at more or less stable prices coincided with periods when labour costs per unit of product were stable or declining— with periods, that is, when monetary and credit policy was free to regulate the economic system from the sole point of view of an expansion of production and trade, without having to worry about cost inflation. In a phase of rising labour costs per unit of product, on the other hand, the rate of expansion of output was occasionally, and for some time, kept up by an increase in the system's liquidity allowing prices to rise, but in the longer run it always proved inevitable to apply a more restrictive monetary policy, and balance was ultimately restored only at the cost of slowing down the expansion of output for some time.

In Italy, where unit labour cost rose considerably in 1962 and 1963, the increase in the economy's liquidity did not fully reconstitute the liquidity of firms through a price rise, because of the simultaneous deficit in the balance of payments. We were not able to avoid a deceleration of development.

In the light of these facts we must conclude that it would have been wrong, and would still be wrong, to try and re-establish the balanced conditions in which firms can increase production by means of a credit expansion beyond its current dimensions; the result would simply be that prices would rise even further, and once domestic prices rise above foreign ones, the ultimate effect would be a larger deficit in the balance of payments and less employment. In these circumstances, the only acceptable policy is one designed to stabilize labour costs per unit of product. This can be done by prolonging collective agreements due to expire in the near future and by reducing the sensitivity of the sliding wage scale—possibly, among other things, through a lengthening of the intervals between one adjustment and the next.

In the absence of measures to re-establish those internal relationships in the economy which are a condition of continued expansion, we had and still have to rely principally on the containment of the process of liquidity increase, so as to keep the expansion of monetary demand within the limits corresponding to the formation of real domestic resources. This we did, although we were not unaware of the dangers inherent in this mechanism of adjustment; the very containment of monetary demand may impair the formation of real resources.

These dangers are all the more serious, the more rigid is the cost structure and the narrower are profit margins. Any incipient downward move of prices would then at once come up against a solid barrier of costs, at which point a number of firms would have either to restrict production or to go out of business; the subsequent adaptation to the desired level of monetary demand would have to take place *via* employment, or, in other words, *via* an undesired reduction in real income flows.

The conclusions to be drawn from all this for the problems of the moment in the Italian economy seem contradictory at first sight.

There is much to suggest that the cost barrier is both rigid and near-by. The redistribution of income to the benefit of wage earners during the last few years has narrowed down the profit margins of firms, wage levels are fixed by collective agreements and the area of possible deviations from minimum contractual wages has become smaller than it used to be. Firms have higher expenses for social security payments, some taxes are assessed on the volume of production, and the operational conditions of public utility companies are such that tariffs cannot be reduced.

On the other hand, there is also something to suggest that our cost structure has by no means negligible elements of flexibility. In the areas of greatest industrial congestion and in cyclically sensitive branches of production effective wages have tended to rise above contractual wages, as we pointed out before. The overheated boom has made room, especially in building, for many small suppliers and service firms, whose mixed capital-and-labour incomes respond readily enough to demand conditions. The same applies to a considerable part of the incomes in trade, transport and agriculture.

Another element of flexibility is the extent of Italy's relations with the world economy and more especially the European economy, as evident in the large volume of exchange of goods and services and in the mobility of factors of production, especially labour. In a situation of full employment and high prosperity, such as several of our closest partners now enjoy, there should be more opportunity than there ever was in the past to sell our goods and services abroad instead of at home.

Weighing the elements of rigidity against those of flexibility, we are nevertheless forced to conclude that adaptation to a lower absolute level of monetary demand would curtail employment appreciably. But this is not really our problem just now in Italy; our problem is the more limited one of temporarily slowing down the rate of increase in demand. We do not need to bring prices down to the cost barrier or beyond; all that is required is that we do not allow labour costs and income transfers at the expense of the productive system to push costs up towards and beyond present prices. If we manage to avoid this cost push, we shall be able to maintain our economy's competitive position abroad without serious detriment to domestic employment.

We have tried, this year, to quantify the loss of competitiveness our economy suffered in the last two years; as can be seen earlier in this Report under the heading Balance of Payments, it seems that, while we have not wiped out all the advantages we slowly gained in ten years, we are more or less back at the position we held in 1958. In the meantime, however, income has grown more in Italy than elsewhere, and the ratio between the rate of increase in imports and the rate of income growth has gradually risen, especially during the last two years when imports expanded unusually fast.

But income per head is still not as high in Italy as in other countries, and we need to continue expanding income faster than they. To do so, we must not only eliminate the above-mentioned anomalous pressure on our balance-of-payments deficit, but also, more fundamentally, gain a bigger place in world trade. This is not to imply that we must regain the competitive position we had in recent years, when our balance of payments showed large surpluses. It will be enough, in the immediate future, to reduce our current deficit to proportions where we can finance it by ordinary capital movements.

Money supply, defined as the sum of note circulation and current accounts, would seem to be under control at present. During the first quarter of this year it increased at an annual rate of 4.4 per cent. Assuming that in 1964 gross national product in real terms will grow a little less than in 1963, and allowing for a certain margin of uncertainty in the index due to seasonal adjustment, this figure suggests that the formation of money supply has been reduced to a rate where it is compatible with reasonable price stability. We achieved this reduction by containing the expansion of bank credits, which, during the first three months of this year, increased at an annual rate of 6.4 per cent.

After a rise of 5.5 per cent in 1963, the general index of wholesale prices went up by 0.3 per cent during the first quarter of this year. Agricultural prices actually came down, and other prices went on rising only at the slower rate of the last months of 1963.

In the balance of payments, the current account closed with a deficit of 657 million dollars last year, whereas in 1962 it had still been in surplus to the extent of 276 million dollars. Seasonally adjusted quarterly figures deteriorated steadily from a record surplus of 225 million dollars at the end of 1961, down to a record deficit of 275 million dollars in the third quarter of 1963. No further deterioration, however, has occurred since, and indeed the seasonally adjusted current deficit showed some signs of improvement during the first quarter of 1964, when exports of goods and services increased and imports were stationary.

In April 1964, export proceeds fell short of import expenditure by 221 million dollars, as against 138 million in April 1963, but there was an offsetting surplus on other current items, and capital movements, too, were in equilibrium. In May, finally, provisional figures suggest equilibrium in the overall balance of payments; more particularly, the repatriation of bank notes seems to be only about one tenth of what it was in May last year.

I regard it as my duty to state plainly that it would be a mistake entailing irreparable consequences to interpret these latest developments as signs of a reversal of fortunes in our economy. In any event, our monthly figures of external payments are far too heavily influenced by seasonal and random fluctuations to have more than very limited significance. The correct conclusions to be drawn from these apparent improvements is that we must persist with our policies, even though they are bound to involve sacrifices. It is just because experience shows our difficulties not to be uncontrollable, that we should be seriously failing in our responsibilities to the country if we proved ourselves incapable of keeping these difficulties under control.

Other countries, which have already gone through the transformations now taking place in Italy, encountered the same sort of difficulties. In our country, today, entrepreneurs and workers alike are pushing forward on the road to progress; both of them will surely find a way to combine their efforts, in the free discussion proper to a system of political democracy, so that the civic advancement of our country can proceed without interruption.

Gentlemen,

When meeting with you last year, I said that if we had a balance-of-payments surplus, we could pursue a credit policy designed to encourage a vigorous process of capital formation and the creation of many new jobs, but that we could not afford such a policy with an external deficit such as we had at the time. A large part of the additional purchasing power would simply have gone abroad instead of sustaining the liquidity position of producers, and by delaying the moment of decision we would have made the effects harder for the economy.

In discharging our responsibilities in this new and difficult situation, we draw comfort from our conviction that the social and political forces of our nation are becoming fully aware of the problems involved and realize that, while they are grave, they are also controllable.

In the gradual unfolding of actual events, we shall try to match total liquidity creation to the need of keeping prices stable and equilibrating our balance of payments within the period of grace allowed to us by our reserves and by help from abroad. Within the limits of our statutory powers, we shall also try to match our credit control to overriding countercyclical requirements, for it is these that ultimately govern the accomplishment of the fundamental objectives of economic policy, as formulated by the competent branches of government with the intent of sustaining the growth of both income and employment.

IX. *Administrative Matters, the Bank's Balance Sheet and Profit and Loss Account*

Organization and Staff. — At the end of 1963, the Bank of Italy had 7,361 persons in its employment. This was 92 less than a year before, terminations in 1963 having numbered 319 and new appointments 227. On 31 December 23.3 per cent of the staff worked at headquartes and 66.8 per cent in the Bank's branches; the balance of 9.9 per cent was made up by workers in the printing works.

In accordance with an earlier decision by the Board of Directors the Bank closed down all its remaining agencies last year, namely, those at Barletta, Biella, Carrara, Cesena, Crotone, Faenza, Lecco, Lugo, Monfalcone, Prato, Rimini, Rome, Sanremo, Vibo Valentia and Vigevano. In implementation of a decision by the last Extraordinary Meeting of Shareholders the status of the Cagliari branch was raised. As a result, the Bank is now represented only in the 92 provincial capitals, and its network consists of 14 main and 79 subsidiary branches; the only city to have two branches, in addition to headquarters, is Rome.

Note Circulation.— Towards the end of 1963 the Bank began issuing the new 10,000 and 1,000 lire notes, the smaller size of which makes them more convenient. The old types are being replaced gradually as worn-out and damaged notes return for exchange and the stock of serviceable notes of the old type is used up.

Including also the 500-lire coins, the value of the circulation outstanding rose by 14.3 per cent between the end of 1962 and the end of 1963; the circulation of 10,000-lire notes alone rose by 17 per cent. It follows that the share of the biggest denomination in the total increased again, from 81.2 per cent to 83.2 per cent over the twelve months; the share of all other denominations correspondingly decreased, and the circulation of 5,000-

lire notes contracted even in absolute terms, from 315.9 to 310.7 billion lire. There remains, therefore, a continuing need to improve the structure of the note circulation.

More notes were withdrawn last year than before, with a view to maintaining a satisfactory standard. In all, 16.7 per cent of the total value of bank notes and 500-lire coins in circulation on 31 Dicember 1962 were withdrawn last year; the corresponding figure in 1962 had been 14.6 per cent. In the case of 1000-lire notes, which deteriorate fastest because they change hands much more frequently, the proportion withdrawn last year was 48.2 per cent of the circulation as of 31 December 1962 (40.0 per cent in 1962).

Capital, Reserves, and the Profit and Loss Account. — No change occurred last year in the composition of the Bank's shareholders. On 31 December 1963, the Bank's shares therefore were, as a year earlier, distributed as follows.

Shareholdres owning 100 or more shares and therefore entitled to vote:

72	Savings Banks	177,647	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	299,647	shares	with	796	votes
6	Savings banks	353	shares			
99	Shareholders	300,000	shares			

Ordinary Reserves, which stood at 4,320.2 million lire on December 31, 1962, rose during the year to 4,945.1 million. This was the result of an appropriation of 123.5 million from 1962 profits, 569.7 million investment income from the reserve fund itself, and a diminution of 58.3 million, which represents distribution to shareholders of part of the 1962 investment income from the fund (under Article 56 of the Statute).

Extraordinary Reserves rose from 2,324 million lire on December 31, 1962, to 2,664.4 million at the end of 1963. This was the result of an appropriation of 123.5 million from 1962 profits, 247.6 million investment income from the reserve fund itself, and a diminution of 31.7 million, representing distribution to shareholders of part the 1962 investment income (under Article 56 of the Statute).

Profit Appropriation. — 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 658.16 million lire for the year 1963:

	(million lire)
To Ordinary Reserve, 20 per cent	131.63
To shareholders, 6 per cent on capital	18.00
To Extraordinary Reserve, 20 per cent	131.63
To shareholders, a supplementary dividend of 4 per cent on capital	12.00
To the government, the residual of	364.90
Total net profit . . .	658.16

In accordance with Article 56 of the Statute, the Board of Directors further proposes a distribution to shareholders of another 32 per cent on capital, or 96 million lire, out of investment income from the ordinary and extraordinary reserve funds. This amount corresponds to 1.44 per cent of the overall reserves on December 31, 1962, and is, therefore, below the 4 per cent laid down in Article 56 as the upper limit of distribution under this heading.

THE GOVERNOR
GUIDO CARLI

BALANCE SHEET

AND GENERAL PROFIT AND LOSS ACCOUNT

BALANCE SHEET AS

ASSETS

Gold	L.	1,000,000,000,000
Cash in hand	»	24,825,238,185
Domestic bills of exchange	»	942,235,078,207
Bills for collection	»	203,407,715
Advances	»	42,141,268,250
Deferred clearing house payments	»	336,540,097,922
Foreign exchange balances abroad	»	64,810,700,501
Italian Exchange Office current account	»	1,769,760,083,740
Government or government-guaranteed securities	»	167,595,353,871
Premises	»	1
Miscellaneous debtors	»	229,554,331,282
Advances to the Treasury: extraordinary	»	440,000,000,000
Treasury current account	»	506,136,259,010
	L.	5,523,801,818,684
Securities and other valuables deposited	»	4,273,133,836,553
	L.	9,796,935,655,237
Items written off in past years	»	8,886,623
GRAND TOTAL	L.	9,796,944,541,860

Audited and found correct - Rome, 8th May, 1964

The Auditors

ALESSANDRO BACCAGLINI
BRUNO DE MORI
MARIO MAZZANTINI
FELICE PAPPALARDO
RAFFAELE PILOTTI

p. p. **The Accountant General**

ARNALDO FALSINI

OF DECEMBER 31, 1963

LIABILITIES

Note circulation	L.		3,698,618,215,000
Bank drafts, cashier's cheques and other sight liabilities	»		62,104,934,091
Current accounts	»		87,484,573,007
Time deposits (incl. compulsory reserves)	»		1,304,828,566,564
Miscellaneous creditors	»		352,208,054,438
Miscellaneous services for account of government	»		9,979,803,022
Net profit for 1963	»		658,158,517
			5,515,882,304,639
Capital	L.	300,000,000	
Ordinary reserves	»	4,955,118,246	
Extraordinary reserves	»	2,664,395,799	
			7,919,514,045
	L.		5,523,801,818,684
Depositors	»		4,273,133,836,553
	L.		9,796,935,655,237
Items written off in past years	»		8,886,623
GRAND TOTAL	L.		9,796,944,541,860

The Governor

GUIDO CARLI

GENERAL PROFIT

FOR THE

EXPENDITURE

Administration and contributions to staff retirement fund	L.	37,893,181,586	
Directors' emoluments	»	316,747,112	
Transport of notes, coin and other valuables	»	139,886,613	
Note printing	»	5,127,073,370	
Expenditure on premises	»	813,020,746	
			44,289,909,427
Circulation tax on notes and demand drafts	L.	9,366,337,527	
Income and company taxes	»	6,800,000,000	
Sundry taxes and dues	»	448,412,200	
			16,614,749,727
Amounts written off	L.		8,574,803,975
Interest payable	»		1,654,298,592
Charity and other contributions	»		105,505,316
	L.		71,239,267,037
Net profit for distribution	»		658,158,517
TOTAL	L.		71,897,425,554

APPROPRIATION

To Ordinary Reserve . . . .

To Extraordinary Reserve . . . .

10 % Dividend to shareholders . . . .

To the government . . . .

TOTAL DISTRIBUTABLE

Audited and found correct - Rome, 8th May, 1964

The Auditors

ALESSANDRO BACCAGLINI
BRUNO DE MORI
MARIO MAZZANTINI
FELICE PAPPALARDO
RAFFAELE PILOTTI

p. p. **The Accountant General**

ARNALDO FALSINI

AND LOSS ACCOUNT

YEAR 1963

RECEIPTS

Discounts	L.	23,641,324,801	
Interest on advances	»	8,748,957,432	
Interest on other assets	»	27,161,594,662	
Commissions and custody fees	»	1,844,145,069	
Profits on foreign transactions	»	2,347,204,791	
Sundry profits	»	1,227,010,582	
			64,970,237,337
Interest on government securities	L.	6,594,466,871	
Revenue from real estate	»	332,721,346	
			6,927,188,217
		Total . . . L.	71,897,425,554

OF NET PROFIT

	L	131,631,703
	»	131,631,703
	»	30,000,000
	»	364,895,111
profit for the Year	L.	658,158,517

The Governor

Guido Carli

THE ADMINISTRATION OF THE BANK OF ITALY
(1963)

BOARD OF DIRECTORS

CHAIRMAN: Guido CARLI * – GOVERNOR OF THE BANK

Paolo BAFFI * – GENERAL MANAGER

Ernesto BINDOCCI – DEPUTY GENERAL MANAGER AND SECRETARY TO THE BOARD

Paolo BLUMENSTIHL
Renato BRANZI
Gaetano CARBONE *
Gian Luigi DONES *
Antonio FONDA SAVIO *
Francesco MAILLER
Pericle MARTELLI
Paolo MONICO
Lucio MORODER
Raimondo ORRU'
Eugenio VACCARI *
Ernesto VACCARINO
Giambattista VIRGA

* Member of the Executive Committee.

BOARD OF AUDITORS

Alessandro BACCAGLINI
Bruno DE MORI
Felice PAPPALARDO
Raffaele PILOTTI
Mario MAZZANTINI

ALTERNATE AUDITORS

Domenico AMODEO
Raffaele D'ADDARIO

THE CENTRAL ADMINISTRATION

MANAGERS

Tullio RICCIO

Ciro de MARTINO
Salvatore GUIDOTTI
Vincenzo ONORATELLI
Corrado PIROVINE
Emilio RANALLI
Paolo VECCHIA