BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1975

PRESENTED BY THE GOVERNOR TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON MAY 31, 1976

ROME

PRINTING OFFICE OF THE BANCA D'ITALIA

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I. – THE INTERNATIONAL ENONOMY

Cyclical developments in the industrial countries during 1975 present a picture rich in contrasts: during the first six months of the year the volume of national product continued to fall, the rate of inflation slowed down, the unemployment rate increased, world trade declined and the balance-of-payments deficits lessened. The second half of the year saw an upturn in the cycle, although the timing and intensity differed from country to country.

In the early part of 1975, the recessionary tendencies present since 1974 were allowed to develop since no effective change was made in the economic policies of the previous year. In fact, despite an expansionary turn in the monetary area, these economic policies did not appear to be aimed at exerting a significant stimulus. This could be seen not only in countries where difficulties in restoring internal and external equilibria tightened the link between the possibilities of an economic recovery and the upturn in world demand, but especially in the major economies, where weakened price tensions and the strengthening of an already favourable international payments position allowed greater freedom of action. This conduct largely reflected the priority still accorded to progress towards internal and external equilibrium. However, it appears to have been partly influenced by an undervaluation of how far the recessionary effects could spread among the industrial countries via the drop in international trade and to what extent they might gain impetus from phenomena that subsequently turned out to be stronger than expected. The first of these was an unusual uncertainty among households and businessmen, the other the liquidation of excess inventories built up in 1974, which it seemed impossible to defer in the face of expectations of an insufficient rise in demand. Specifically, with public spending still providing limited support to a cycle upswing, one cause of slacker overall demand was the households' growing propensity to save, which largely offset the increase in disposable income following the recovery of real wages. Another cause, as far as investment demand is concerned, was the continued pressure on profit margins stemming from a rise in labour costs at a time when reduced plant utilization was leading to a decline in productivity.

Consequently, the real success in curbing inflation and improving the external current balance could not but lead to a sharp reduction in industrial production and, overall, in the GNP (down by 8.5 and 5 per cent respectively in the first six months of 1975 compared with the second half of 1974). In many countries this reduction was accompanied by a rapid fall in the level of employment. The unacceptable nature of these costs, partly in view of the growing threat of cumulative recessionary tendencies that would be difficult to control over the short run, forced the authorities to accord increasing priority to economic recovery, while still seeking to maintain relative price stability. Given this set of targets and constraints, the use of fiscal instruments, for the most part through selective measures, was considered of paramount importance while monetary policy continued to be aimed at preventing excess liquidity in the economy. Although it was necessary to considerably expand the public deficit in order to provide an effective stimulus to global demand over the short run, in most countries the financial and monetary counterparts of that deficit do not seem to have caused either tensions on the capital markets or any undesired increase in liquidity. However, the likelihood of these effects appearing during a period of solid expansion led some countries to make use of fiscal instruments within a flexible, multi-year plan, aimed at reducing the possible destabilizing effects of an over-expansion in current account public expenditure.

However, the success of the reflationary programme depended on the possibility of achieving international consensus for a convergence of national economic policies, and as the year progressed this condition was to a large extent fulfilled. Nevertheless, if, in content, economic strategies were more or less convergent, business cycles in fact varied from one industrial country to another, partly because of a different timing and vigour in pursuing intermediate targets and partly because of the different incidence of structural problems coupled with unabated cyclical tensions.

In the three largest economies the expansionary process was set in motion by the rise in consumption that is partly linked to increased public transfers to the households, and was followed in early 1976 by an end of the liquidation of inventories and an upturn in industrial production. This expansion gained strength from improved profit expectations. In this regard it should be stressed that, apart from temporary tax benefits, a stable recovery of private investment is wholly dependent upon company profits picking up on a lasting basis. After some delay, similar mechanisms came into action in a group of European countries where persistent cyclical tensions had led the authorities to enact expansionary measures with considerable caution.

In other industrial countries, however, the impulses stemming from public spending do not appear to have been able to strengthen such a recovery process. In some instances, difficulties in putting the Government's new expenditure programmes immediately into effect and, more generally, in increasing the non-current account share of this expenditure, placed much of the burden of expansionary action on monetary policy, thus weakening the desired selective effects on demand. The system's newly built-up liquidity only led to a partial revival of consumer spending, not enough to offset the drop of the previous months. Even more serious was the decline in fixed investment despite the wide availability of credit. This points to a deterioration in profit expectations, caused by the higher wage rises without any corresponding, significant increases in productivity.

As a result of the severe recession, the industrial countries suffered a large drop in foreign trade and, particularly, in their exports, which was aided by the liquidation of excess inventories mentioned earlier. The different reductions in import and export volumes (9.5 and 5.5 per cent respectively) and better terms of trade enabled the OECD countries to wholly recoup in 1975 the previous year's deterioration in their total trade balance thus returning to a surplus of 7 billion dollars. This unexpected swing was mainly achieved through a reduction in the deficit vis-à-vis the OPEC countries. On the one hand, oil imports dropped because of the domestic recession, on the other, exports to OPEC countries continued to increase at a sustained pace and have doubled over the last two years. The other counter-items of the turnaround in the trade balance of the OECD countries were the ample increases in their surpluses vis-à-vis centrally-planned economies and non-oil developing countries. The growing disequilibria in the latter's foreign accounts was the direct result of a further worsening in their terms of trade, this being to a large extent linked to the slump in world commodity prices between 1974 and 1975.

In this framework, the Eurocurrency market continued to fulfill an important intermediation function. However, as far as increases in deposits are concerned, the OPEC countries played a smaller role, whereas on the assets side, the conspicuous channelling of new credit towards certain countries and, more generally, specific areas — chiefly the centrally-planned economies and developing countries — aroused fears of possible defaults. A strong recovery in intermediation through the Eurobond market provided another important form of external financing during 1975.

International financial intermediation by U.S. banks acquired a major role over the year. In addition to traditional business on the Euromarket, operations built up extremely rapidly not only in the new offshore financial centres, but also directly in the United States after the lifting of the Interest Equalization Tax in January 1974. The central role played by the private component of international liquidity again implies a system basically hinged on the dollar, but where the role of lender of last resort falls to the U.S. banks. However, this role can be constrained by the institutional constrictions placed on those banks, by their heavy indebtedness to certain countries and by the greater concentration of deposits.

With regard to liquidity creation through internationally agreed mechanisms, the three major industrial countries, in an attempt to make the adjustment process more binding, on the one hand sought to restore financing of external deficits through traditional IMF channels, while curbing use of the special instruments which deficit countries could tap unconditionally. On the other hand, they reduced the role of gold as a component of international liquidity without setting in motion a corresponding process of SDR creation, thus further weakening some of the industrial countries with the greatest payments problems. It is in this general perspective that one should further consider the constraints introduced by the U.S. Federal Reserve System in arranging currency swaps with other monetary authorities.

Recent decisions on the reform of the international monetary system make it unlikely that the tendency for liquidity creation mechanisms to depend increasingly on private capital markets will wane in the future. No substantial innovations in the creation and distribution of international liquidity are expected, nor have the proposals aimed at diminishing the role of the reserve currencies been accepted. The measures actually approved and able to affect the distribution of liquidity, such as an increase in IMF quotas, reflect a changed balance of power on the world scene rather than the actual need to finance international disequilibria.

Although in 1975 exchange rate movements reflected, in the short run, the impact of changes in relative monetary conditions in the individual countries, they were generally in line with the development of competitive positions, measured by the trends of costs and prices. It is in these terms that one can interpret the general recovery of the dollar on all the main currency markets since the beginning of the year.

Although the performance of these basic economic determinants can explain a large part of the exchange rate changes, there still remains some variability and this has led to criticisms of inefficiency and pronounced instability being levelled against floating exchange rates. Furthermore, these remarks seem to disregard the role played by expectations in forming the exchange rate — viewed as a price arrived at in the pursual of financial portfolio equilibrium — following expected changes in the relative yields obtainable on the different currencies. Thus, with fixed exchange rates momentary equilibrium was achieved through capital movements, whereas with flexible exchange rates adjustment mainly occurs through exchange rate changes, even though this function can be offset in economies with widespread indexation. From this point of view, the short-run instability of exchange rates experienced even outside crisis periods may be a reflection of general difficulties and uncertainty as to economic development during the world slump and the beginnings of the recovery, with repercussions on the formation and revising of expectations.

Recent experience and, in particular, the currency crisis that hit the weakest European currencies in early 1976 and further strengthened the dollar, the Deutschemark and the Swiss franc seem, however, to confirm that the influence of expectations can stretch even to the medium term, with possible destabilizing effects. Expectations are often dominated by extrapolative components, so that exchange rate changes capable of restoring portfolio equilibrium may result in overshooting with regard to those that are justifiable on the grounds of international competitiveness. Specifically, in the case of a tendency towards devaluation, if the new exchange rate level affects the formation of domestic prices directly and rapidly, accompanied by a process of monetary financing, and the volumes of international trade are unable to adjust promptly, there is a risk of being dragged into a vicious circle of internal and external depreciation where speculation is effectively destabilizing. Since this state of affairs is untenable, a quick alternation of restrictive and expansionary policies is often resorted to, despite the deleterious effects on the long-run growth rate.

It is not easy to establish whether floating rates were in themselves the cause of inflation. In the light of acquired experience, the main effect seems to have been to permit a much greater differentiation in the growth rates of prices in the different economies, taking into account the mechanisms mentioned earlier. Floating rates may however have helped to accentuate inflationary impulses partly by allowing less « discipline » at an international level and partly because of the downward rigidity of prices and wages in modern economies and the consequent asymmetrical reactions of prices to devaluations and revaluations.

Cyclical developments and balances of payments

The recession and the characteristics of the recovery

In 1975 the international economy went through the worst recession of the last thirty years, which took shape in a considerable drop in national income, and especially industrial production, and a further increase in unemployment. The rise in prices lost impetus particularly in the sector of wholesale prices, partly as a result of the sagging tendency shown by international market quotations for primary products. The recession severely affected international trade, which dropped by about 6 per cent in real terms: in addition, there was a sharp reduction in the balance-of-payments disequilibria on current account of the industrial countries. In the second part of the year economic activity picked up and then gained force, spreading to a growing number of countries, partly spurred on by an expansionary economic policy enacted, in particular, via public expenditure.

In the major industrial countries taken as a whole the gross national product fell by nearly 2 per cent at constant prices in 1975, having already slightly dwindled the year before. The downturn in national income affecting nearly all countries was partly due to the sharp drop in investments and the unfavourable trend of private consumption, which in some countries (Italy, the United Kingdom, Switzerland) decreased. Public consumption provided the fundamental support to demand throughout the world; in some countries, such as Italy and Japan, this function was also carried out by exports of goods and services.

The cautious behaviour of consumers in 1974-75 is to be ascribed to a lasting change in forecasts for future years: a moderate growth rate of income is expected, whereas grave uncertainties as to job stability and a marked increase in prices persist. In 1975 many countries registered a sizeable rise in disposable income, even in real terms, which was encouraged by current transfers from the public sector to households. This led above all to a considerable increase in the percentage of saving by households, thus accentuating a tendency that has emerged over recent years.

In general, public expenditure played a fundamental role in supporting overall demand and in boosting economic activity; besides public consumption and current transfers of income to households, in some countries (France, the United Kingdom, Japan) there was a remarkable growth in public investments. However, this decidedly expansionary policy coupled with high unemployment benefits inflated the public deficits (Table 1); in some countries these reached particularly high levels that would not be compatible in the long run with an orderly functioning of the credit and capital markets.

Table 1

NET BORROWING REQUIREMENT OF THE PUBLIC SECTOR IN SOME OF THE INDUSTRIAL COUNTRIES

(as a % of gross national product)

COUNTRIES	1973	1974	1975
Italy	10.4	9.8	14.0
United Kingdom	5.0	7.5	9.3
West Germany	0.9	2.7	6.4
Belgium	3.8	3.8	5.4
Netherlands	1.4	2.7	4.3
United States	–0.5	0.2	4.2
France	0.6	0.5	2.1

Source: National bulletins.

Industrial production dropped in nearly all the major countries, with losses of over 10 per cent in Japan, Belgium and Switzerland. In the countries considered, taken as a whole, the decrease was 8 per cent (0.5 per cent in 1974), whereas in the 1958 recession, hitherto the most serious since the war, the drop was only large in the United States.

The slowdown of inflation, linked to the unfavourable trend of demand , was to a large extent due to sagging international market quotations for primary products which, on average for the year, fell by 13 per cent for foodstuffs and industrial raw materials taken as a whole. The prices for the latter began to slip in April 1974: between that month and November 1975, when they began to climb back up, they fell by about 40 per cent. The prices of foodstuffs showed a persistent downward trend as from November 1974 and in the course of one year dropped by almost 30 per cent.

In the first months of 1976 the recovery of the international economy has been building up: the provisional figures for industrial production in the major countries show a 6 per cent increase for the first quarter with respect to the first quarter of 1975. However, forecasts for the whole of 1976 are still cautious as regards the duration of this growth, since there continue to be doubts as to enterprises' propensity to invest, considering the large amount of unutilized productive capacity. If, however, sustained investment activity were to be carried out, it would be mainly directed towards rationalization of the productive structure, with only limited effects on employment. Taking this into account, among other factors, most of the countries envisage a slow absorption of unemployment. The prospects for prices are not very favourable in the light of the new phase of increases in the prices of primary products: between November 1975 and March 1976 international dollar quotations for foodstuffs and industrial raw materials taken as a whole went up by 10 per cent.

Monetary policies

The restrictive nature of the monetary policies pursued since 1973 eased up during the last months of 1974, mainly as a result of the decision taken by many central banks not to counter the downturn in interest rates which was taking place independently, following the drop in real income and the smaller demand for credit. The initiative, expected or hoped for by many because of the desired stabilizing effects it would have on the whole system, came from West Germany and the United States, the two industrial countries with the stablest currency and balance-of-payments position and with rates of inflation among the lowest. At almost the same time Canada, where recessionary impulses were considerably less severe and appeared somewhat later, took similar action. The other industrial countries, including Italy, with more serious problems of domestic and foreign equilibrium then followed suit.

Although the monetary policy measures taken in 1975 were mainly of an expansionary nature in most countries, it should be noted that in May and June the monetary authorities of the United States intervened on the securities market to curb the growth rate of the money stock (in its different forms), which was tending to go beyond the maximum envisaged and announced. The increase in bank deposits arose from tax rebates to private individuals that had been approved in January and paid between May and September. Intervention by the Federal Reserve caused a fluctuation in short-term interest rates, which went up by little more than one point in the third quarter. The tension on the U.S. money markets encouraged a considerable revaluation of the dollar and was reflected on the Euromarket and hence on the policy of the Bank of England which, concerned about the stability of foreign investments in sterling, increased the minimum lending rate between July and October. After the tension had passed in the United States, the British minimum lending rate was also gradually reduced as from November.

In late 1975 and early 1976, some countries introduced measures and made statements that seem to indicate a more cautious line in monetary policy in view of the consolidation of the economic recovery and the persistency of inflationary pressures or of balance-of-payments deficits.

This use of monetary policy instruments for expansionary purposes produced, in the aggregates that more directly reflect the financial objectives pursued by the different central banks, a more rapid growth (taking into account the trend of nominal income) than in 1974, when a considerable part of the effects of the monetary restrictions enacted in 1973 had fully appeared (Table 2). On this basis, the policies followed in West Germany, Japan and Canada show a particularly strong deflationary tendency, for these countries registered higher growth rates for monetary aggregates than for nominal income, in contrast to what occurred in 1974. In the other countries the differentials between the two growth rates switched in favour of the monetary aggregates, with

Table 2

MONETARY AGGREGATES AND NOMINAL INCOME (GNP) IN THE MAIN INDUSTRIAL COUNTRIES

(percentage changes)

Countries	1973	1974	1975
WEST GERMANY			
C.B.M. (1)	10.6	6.1	7.9
G.N.P.	11.5	7.4	4.5
FRANCE			
M_2	14.5	18.2	14.3
G.N.P.	13.7	15.1	9.5
UNITED KINGDOM			
M_2	27.1	19.6	9.7
G.N.P.	16.4	15.0	24.0
ITALY			
M.B. (2)	15.4	16.5	13.8
G.N.P.	19.0	20.2	15.9
UNITED STATES			
M_1	7.5	5.4	4.3
G.N.P.	11.5	7.7	6.5
CANADA			
M_1	14.4	9.8	13.8
G.N.P.	15.9	17.0	9.8
JAPAN			
M_2	23.0	12.9	12.7
G.N.P.	22.6	19.3	11.0

Source: National bulletins.

(1) C.B.M.: " Central bank money" (notes and coin and compulsory reserves on domestic deposits at constant coefficients).

(2) M.B. : monetary base.

Changes in monetary aggregates are calculated from average monthly figures.

the exception of the United Kingdom where changes in the composition of demand for financial assets were particularly marked, owing to variations in the structure of interest rates.

International trade

In 1975, a drop in world production of around 2 per cent was matched by a shrinking in the volume of international trade that can be estimated at roughly 6 per cent. This is the first regression in real terms of world trade since 1958, at which time a 2.5 per cent drop in production coincided with a reduction in world trade of only 1.5 per cent. There has thus been an interruption in the characteristic tendency of economic development over the last twenty years towards a faster rhythm of growth of international trade with respect to world production (in the period from 1954 to 1973 the volume of world exports grew at an average annual rate of 7.8 per cent, while production increased by 5.5 per cent).

The worsening of the recession in the industrial countries was compounded, in the course of 1975, by a reduced demand for goods from the developing and Socialist countries, and the selling-off of the large inventories accumulated in 1973-74.

The decline in international trade stands out even more clearly in the case of trade between developed countries, the trend of which was the opposite of what it had been over the previous twenty years. Economic growth, increased free trade and the process of international integration tended to concentrate trade within the group of industrial countries, to the detriment of trade between them and the developing countries (in 1973 the former represented 52 per cent of total trade, as compared with 29 per cent in 1953). The decrease in real terms of trade among the developed countries, already apparent in 1974, grew much larger in 1975 (11 per cent).

It does not appear that in more recent months uncertainty as to the exchange rate has had any important negative effects on world trade. Exchange risks were on average greater in the period 1973-75, but did not grow during that time, having probably reached a peak in 1973 when effective exchange rates were at their maximum instability. The drop in trade occurred during the year when risks connected with fluctuations in the exchange rates were probably smallest, even if it is reasonable to think that any negative effects of these risks only come through with a certain time-lag. It is likewise to be considered that the more rapid and more frequent adjustment of exchange rates to the changing relative conditions among different countries probably enabled gradual adjustments of the balance of payments to be pursued in this way. In a system of fixed parities these adjustments would eventually have been sought through the imposition of import controls or stricter policies for curbing domestic demand. It should in fact be noted that, as from the first months of 1974, despite the serious deterioration of the balances of payments of many countries, direct controls on imports were not intensified.

The improvement in the terms of trade, the marked drop in imports as a result of the recession and the still lively demand for imports on the part of the oil-exporting countries brought about a sharp reduction in the trade deficit of the developed countries, which dropped from 70 billion dollars in 1974 to around 36 billion in 1975. On the other hand, the surplus of the oil-producing countries, even though smaller than before, remained substantial; the deficit of the other developing countries meanwhile became considerably larger.

1975 was a year of serious difficulties for non-oil exporting developing countries. As from the second half of 1974 their terms of trade substantially worsened and their export volumes suffered from the deepening of the recession in the industrial countries. As a result of the liberalization of trade among the developed countries and, above all, the low income elasticity of their exports, the share held by the non-oil developing countries in world trade has shown a constant tendency to decrease in the post-war period (from 28 per cent in 1950 to 15.5 per cent in 1971). Having risen slightly in 1972-73 as a result of the heavy increase in the price of raw materials, this share was reduced in the following years. Although manufactured products have assumed a growing importance in the exports of these countries, their dependence on the export of primary products remains fundamental. Moreover, the kind of manufactured products that they export (mainly consumer goods) makes it difficult for them to sell in the OPEC countries. Even if the recovery of productive activity in the developed countries entails a certain revival of the exports of the developing countries, the stimulus that the latter in turn may provide for a recovery of international trade will be somewhat limited, since their purchasing power has deteriorated considerably. The ratio reserves/imports for these countries is at present estimated at around 27 per cent, as against 34-35 per cent in the later part of the sixties and 45 per cent at the end of 1973. The drop in this ratio is particularly serious if we consider that the exports of these countries are concentrated in those commodities that have undergone the greatest fall in prices.

The financing of balance-of-payments disequilibria and the international financial markets

The reabsorption of the trade deficits and the consequent improvement in the current accounts of the industrial countries made it possible to grant a larger volume of aid and loans to third-world countries, while the reduction in the surplus of the OPEC countries caused a drop in their financial investments on the capital markets of the West. For this reason, in the balances of payments of the main industrial countries, the net surplus of capital movements, the net foreign debt of the banking system and the marked deterioration in the foreign position of the authorities in 1974 were substituted in 1975 by net outflows of capital and sizeable foreign loans by the banks (Table 3).

The outflow of funds towards the rest of the world was particularly high for the United States and West Germany which, despite their substantial surpluses on current account, registered a deterioration in the foreign position of their official authorities. Canada and the United Kingdom offset (the second only partially) with net inflows of capital their current balances which were still heavily in deficit, whereas France maintained an equilibrium in goods and services and utilized her substantial capital inflows to accumulate a notable volume of reserves.

In a context characterized by smaller imbalances in international economic relations, the financial markets were partly relieved from the task of intermediation between countries in surplus and those in deficit and were thus able to operate in more normal conditions. The Euromarket in particular came out strengthened from the 1974 crisis: the structure of the banks was consolidated, the greater awareness of the risks of lending heightened selectivity in credit granting, the pause in the expansion of activity in the second half of 1974 favoured a return to more orderly competition, while the commitment of the main central banks to sustain the market in case of need increased the public's confidence in the Eurobanks.

Table 3

BALANCES OF PAYMENTS OF THE MAIN INDUSTRIAL COUNTRIES

(millions of dollars)

Countries	Balance on current account	Capital move-ments	Change in the banks' foreign position (in flows +)	Change in the official authorities' foreign position	Percentage change in the weighted exchange rate
			1974		
Italy	–7,968	2,448	912	–4,608	*10.5*
France	–5,978	5,906	–381	–452	*–10.1*
West Germany	9,705	–6,683	–3,758	–736	*4.6*
United Kingdom	–8,824	7,502	1,507	185	*–3.8*
United States	–3,357	–3,543	–1,497	–8,397	*1.6*
Canada	–1,633	1,020	613	–	*–0.9*
Japan	–4,693	–2,146	8,111	1,272	*–7.0*
TOTAL ...	22,748	4,504	5,507	–12,736	–
			1975 (1)		
Italy	–541	–1,513	–695	–2,749	*–4,3*
France	23	5,431	–1,445	4,009	*8.7*
West Germany	3,737	–3,720	–920	–902	*0.8*
United Kingdom	–3,774	2,486	–200	–1,488	*–9.8*
United States	11,916	–5,959	–8,420	–2,463	*–0.7*
Canada	–5,000	3,627	980	–392	*0.6*
Japan	–680	–1,996	1,973	–703	*–2.2*
TOTAL ...	5,681	–1,644	–8,727	–4,688	–

Source: National bullettins; Bank of England, *Quarterly Bulletin.*

(1) Provisional data.

The characteristics of the international financial markets in 1975 were profoundly changed with respect to the previous year as regards the categories of investors and borrowers and the nature of the operations carried out.

First of all there was an exceptional recovery, early signs of which had already appeared at the end of 1974, of the international bond market (with issues to the tune of 19 billion dollars, as against 6.8 in 1974 and 7.8 in 1973) and in particular in the sector of Eurobonds

(8.6 as against 2.1 and 4.1 respectively). At the root of this recovery there was, besides the slowdown in inflation, the normalization of the structure of interest rates. By reversing the trends of the previous year, the prevalently expansionary stance taken in 1975 by the monetary authorities brought about a gradual reduction in short-term rates, in absolute terms and with respect to long-term rates, also on the international markets, thus inducing a growing number of investors to turn to the bond sector of these markets. There was thus an end to the distortions in the activities of the Eurobanks, which in 1974 had been obliged to finance with short-term deposits medium- and long-term loans with maturities that were ever more distant in time; the consequence of this was an increase in the risks of intermediation and a loss of confidence on the part of the public.

The size of the Euromarket grew in 1975 at lower rates than the year before, reflecting the reduction in world economic activity and the slowdown in inflation.

Also on account of the exceptional growth of Eurobond issues in 1975, the slowdown in the growth of the Euromarket was reflected, in particular, in a reduction in the size of the sector of Eurocredits granted to official authorities and to private companies. The very characteristics of the market were considerably changed: the debtors' market that had grown up between 1973 and 1974 as a result of sharper competition by certain banks, especially Japanese ones, was substituted, as from the second half of 1974, by a creditors' market. The banks took a more cautious attitude, submitting loan operations to stricter controls, limiting the size of single credit lines, widening the margins of intermediation and, above all, shortening the maturities of the loans which previously had been dangerously extended.

The attenuation of the balance-of-payments disequilibria, together with the lesser instability of exchange rates, largely explains the particularly modest growth of official reserves in 1975.

World reserves grew by little more than 7 billion dollars, as compared with 37 billion in 1974. The annual growth rate (3.2 per cent) went back to the long-term levels of the sixties after five years (1970-74) of hovering between a minimum of 15 per cent (1973) and a maximum of 41 per cent (1971).

The reduced demand for reserves, moreover, is also to be ascribed to the smaller need for financing international commercial transactions, arising from the fall-off in the volume of international trade and the slowdown in the rise of export prices. Furthermore, although the experience of widespread floating exchange rates is still too brief to be subjected to complete analysis and sound assessment, it is probable that floating has allowed most countries to make economies in the utilization of currency reserves, both when compared to previous periods of fixed parity and even the three-year period from 1973 to 1975.

II. – THE ITALIAN ECONOMY

ECONOMIC TRENDS AND THE FORMATION OF INCOME

The Italian economic system, having already suffered more than the other industrial economies from the energy crisis that erupted at the end of 1973 and from the changes in the international terms of trade, amply reflected in the final figures for 1975 the world recession which in both depth and duration proved worse than expected. The economy thus lacked the expected support of world demand at the very moment when, on the one hand, the restrictive monetary and fiscal policies enacted in 1974 to curb the balance-of-payments deficit were taking effect. On the other hand, there was also an exceptional fall in inventories and a reduction in the propensity to consume, which, having increased considerably in the previous year, returned to a figure close to medium-term levels.

This situation led to a drop in global demand in real terms of 4.8 per cent. Export volumes of goods and services were increased by 3 per cent, using the residual margins of competitiveness which enabled Italy's share of world trade to be raised; as regards domestic demand, a monetary increase of 8 per cent corresponded to a real fall of 6.4 per cent. The national product dropped by 3.7 per cent in real terms, as did imports by 10 per cent (Table 4).

Given the ratio of income to imports, greater stimulus of domestic demand could only have sustained production if a higher foreign deficit had been acceptable, otherwise the only outcome would have been to increase the rate of inflation. However the combined effects of the downward trend of international prices for raw materials, the drop in domestic demand and the reduced scope for manoeuvre of domestic prices owing to the limited growth of foreign prices of manufactures, caused the rate of inflation to fall considerably, even though it remained fairly substantial: in fact, implicit prices of domestic demand increased by 15.4 per cent after the 21.7 per cent rise of 1974. This slowdown is even more striking if the comparison is made during the course of the year instead of between yearly averages.

The cyclical improvement in the terms of trade between manufactured products and raw materials, linked to the world recession, was reflected in a corresponding upturn in the terms of Italian foreign trade. Thus the reduction in the real deficit brought about by the rise in exports and the drop in imports following the decrease in the national product was accompanied by a price effect, with the end result that the current account deficit narrowed from 5,212 billion lire in 1974 to 361 billion in 1975.

Table 4

EVOLUTION OF AGGREGATE DEMAND AND SUPPLY

(percentage changes)

Items	at 1970 prices	implicit prices	at current prices		
	1975/1974	1975/1974	1975/1974	4th qtr 74 (1)/av. 1974	4th qtr 75 (1)/av. 1975
Demand:					
consumption	–1.4	16.1	14.5	8.1	4.5
gross capital formation	–24.0	15.6	–12.2	–9.5	19.2
domestic demand . .	–6.4	15.4	8.0	3.8	7.4
exports of goods and services .	3.1	11.4	14.9	11.7	7.0
total demand	–4.8	14.8	9.3	5.2	7.3
Supply:					
gross national product	–3.7	17.5	13.2	6.3	6.0
imports of goods and services	–10.0	6.3	–4.3	1.6	12.4

Source: General Report on the Economic Situation in Italy. For percentage changes on seasonally adjusted quarterly data, Banca d'Italia estimates have been used.

(1) Figures for the fourth quarter are on an annual basis, i.e. they are multiplied by 4.

The ephemeral nature of these improvements, however, was already apparent towards the end of the year and the beginning of 1976, as soon as inventories touched bottom and supplies from abroad began to return to normal. Meanwhile the world recovery once again tended to push international prices of raw materials upwards. It thus became evident that the prices and the rigidity of our imports imply a foreign deficit that is incompatible with a return to increases in the national product at rates approaching those experienced in the past. Consequently, the interventions on the structure of the entire economy that are necessary if the ratio of exports to income is to grow more rapidly than the ratio of imports to income must be implemented without further delay. This, in fact, is the only way — albeit not over the short run —

to remove permanently the balance-of-payments constraint and hence to raise the potential growth rate of the national product.

The measures enacted in 1974 and 1975, however, were of a prevalently short-term nature with marginal effects on the productive structure. Furthermore, they were mainly monetary and credit measures and hence only loosely aimed at investments. There was a shortage of much needed research into sectoral priorities and into the system's capacity to have a lasting effect on international competitiveness. Intervention directly affecting the productive system did so via a policy of salvaging enterprises or simply guaranteeing jobs.

This failure to introduce structural improvements was compounded by the deterioration of Italy's competitive position owing to an increase in the cost of labour per unit of output which was, once again, the highest among the industrial countries. In addition to the wage increases, which alone were already considerable, Italy also experienced a totally new situation: a fall in productivity. This brought to the fore the problem of the rigidities which, in the short run, prevent labour utilization from being varied as quickly as production would require, and in the medium term may make the attainment of new productive structures slower and more difficult. In this situation, the slowdown of private consumption, while necessary, is not sufficient to alter the structure of foreign trade unless it is accompanied by fiscal policies for rationalizing public spending and policies for boosting investments that can also increase global productivity.

In the period running from 1970 to 1973, however, gross investment in Italy, in relation to gross national income, was the lowest of all the EEC countries, with the sole exception of the United Kingdom. Italy was likewise the only country to have a negative figure for General Government saving and dropped to one of the lowest positions in the international classification for the formation of gross saving.

The investments/income ratio for 1975 was even lower than in the 1970-73 period (20 per cent at current prices and 18.3 per cent at 1970 prices) after the improvement registered in 1974 (Table 5). Although the fall in investments, in contrast to that in private consumption, was not a new experience for Italy (in fact, there had already been decreases in 1964, 1965 and 1971), given its size it was perhaps the most serious negative element during the year because of its reper-

Table 5

CAPITAL ACCOUNT BY INSTITUTIONAL SECTORS

(as a percentage of gross national disposable income)

Years	Domestic sectors					Rest of the world	TOTAL
	Non-financial enterprises	Households and private non profit institutions	Financial institutions	General Government (1)	Total		
	Gross saving						
1970	4.2	18.3	1.0	0.7	24.2	–1.2	23.0
1971	4.0	20.3	0.9	–2.5	22.7	–1.9	20.8
1972	4.1	20.8	0.9	–3.9	21.9	–1.7	20.2
1973	5.3	19.9	0.9	–4.0	22.1	1.9	24.0
1974	5.2	17.2	1.0	–2.8	20.6	5.2	25.8
1975	3.7	20.8	1.0	–5.7	19.8	0.2	20.0
	Gross capital formation						
1970	9.5	9.6	0.4	3.5	23.0	–	23.0
1971	8.0	8.9	0.4	3.5	20.8	–	20.8
1972	8.3	7.8	0.6	3.5	20.2	–	20.2
1973	11.1	9.1	0.6	3.2	24.0	–	24.0
1974	12.1	9.3	0.7	3.7	25.8	–	25.8
1975	7.9	7.8	0.6	3.7	20.0	–	20.0
	Financial surplus (+) or deficit (–) (2)						
1970	–5.3	8.7	0.6	–2.8	1.2	–1.2	–
1971	–4.0	11.4	0.5	–6.0	1.9	–1.9	–
1972	–4.1	12.9	0.4	–7.5	1.7	–1.7	–
1973	–5.8	10.8	0.3	–7.2	–1.9	1.9	–
1974	–6.9	7.9	0.4	–6.5	–5.1	5.1	–
1975	–4.1	13.0	0.4	–9.5	–0.2	0.2	–

(1) Including autonomous government agencies. Capital account taxes have been treated in the same way as other taxes and therefore have been added to the savings of General Government and subtracted from those of the households. – (2) The financial surplus or deficit is equal to the difference between saving and investment plus contributions and other net capital account transfers.

cussions on the qualitative development of the country's productive system. The low levels of domestic and foreign demand and the uncertainties as to future trends on the market prevailed over the enterprises' need to increase their capital-labour ratio in response to reduced flexibility in the use of labour and its greater cost. In fact, with respect to 1974, fixed investments fell by 13 per cent (investments in plant and machinery alone fell by 19 per cent); the downturn is

24 per cent in real terms if we include inventories, which declined considerably over the year.

The shrinkage of investments affected both private and public enterprises, although the latter to a lesser extent, so that their contribution was in fact moderately anti-cyclical. Building investments also shrank considerably (9 per cent) for non-residential building, public works and dwellings. As regards the latter, the recovery of long-term credit achieved with the instruments described below was not sufficient to prevent them falling because of the small number of building sites opened and plans drawn up in 1974.

This situation seems to confirm that, since the public sector is largely absent from residential building, a necessary condition for the recovery of building activity is the revival of demand for dwellings by households. Throughout 1975, this demand was conditioned by uncertain prospects as to income and by market prices which held steady at extremely high levels in absolute terms, but in some cases dropped slightly during the year.

The performance of private consumption was characterized for the first time since the war by a downturn in volume of 2.1 per cent. The modest upturn in consumption by non-residents and the fact that collective consumption continued to show positive rates of change, even if sagging with respect to the long-term trend, kept the decrease in the overall aggregate of domestic final consumption down to 1.4 per cent.

The fall in private consumption occurred while households' real disposable income was increasing as a result of employees' wage rises and larger public sector transfers for higher pensions and social security benefits. It originated from the delayed effects of the reduction in disposable income of the year before, expectations of unemployment and changes in the structure of relative prices, which encouraged consumers to cut down their purchases of certain goods, especially durables, without at the same time spending more on others.

This trend of the components of demand affected the reduction of the national product mainly via the industrial sector, where value added went down by 9.1 per cent; the drop affected all areas of production and particularly investment goods. The agricultural and services sectors limited the negative effect of industry on the overall results. The value added in agriculture, forestry and fisheries went up by 2.5 per cent, that in marketable services by only 0.4 per cent. In fact, whereas credit and insurance, the leasing of buildings and sundry services further increased, albeit at a lower rate than the medium-term average, because structural factors are an important part of the determinants, the other components as a whole showed a decrease.

The effects of the downturn in production on employment levels were apparently limited. Overall, the drop in employment was 0.1 per cent and the number of unemployed rose by 16.8 per cent. In industry, i.e. the sector where production diminished most, the reduction of employment was negligible (0.1 per cent), although it would have been almost 3 per cent but for the massive recourse to the Wage Equalization Fund, which granted 345 million hours as against 156 million the year before. While the number of workers in agriculture continued to diminish, in the services sector there was a 1.4 per cent rise, which seems to indicate that cases of low-productivity marginal employment have again increased. The marked fall-off in the total number of hours worked in industry did not prevent the drop in production from causing for the first time a drop, although not as large, also in the hourly productivity of labour (roughly 3 per cent).

The trend of wages was basically determined by the sliding scale mechanism which had become more sensitive after the agreement reached between employers and trade unions at the beginning of the year, and by the 12,000 lire pro capite wage rise granted at the same time. Coupled with the aforesaid drop in hourly productivity, this meant a heavy increase in the cost of industrial labour per unit of output (more than 30 per cent) which, given the trend of implicit prices in the industrial sector (up by 15 per cent), is indicative of a substantial downturn in unit profits. The weakness of final demand combined with foreign competition slowed down the shifting of increased labour costs onto the prices of industrial products, which rose by about 6 per cent during the year and by around 11 per cent for the year as a whole with respect to 1974; profits would have been squeezed even more had raw material prices not fallen.

Wholesale prices increased during the year by 4.9 per cent. The largest increase was registered in agricultural prices as a result of the devaluation of the « green lira » and the related abolition of monetary compensation amounts on imports. The slowdown in consumer prices was smaller (they grew by 11 per cent over the year); they were affected not only by the progressive shifting of wholesale increases from the year before, but also by the changes in many public utility tariffs.

A comparative analysis of costs and demand therefore indicates that 1975 saw a repetition of the situation already observed in the 1970-72 period and characterized by the erosion of profit margins and by the creation of an inflationary potential. Thus the tapering off of price increases seems to be a temporary phenomenon in a system undergoing severe disequilibria.

Trends during the year

Private consumption and inventories were the factors exerting most influence over the development of economic activity during the year. In the first quarter there was a further drop in consumption, as had been the case throughout 1974 with the sole exception of the last quarter, which saw what was probably a slight comeback after the sharp drop of the previous quarter, when the impact of the restrictive fiscal measures on households' disposable income had been greater. Industrial production of consumer goods thus diminished further, even though the process of excess stockbuilding of finished products by enterprises during the previous year had not yet run its full course.

Real consumption continued to go down in the second quarter too as the number of weekly hours worked continued to fall, probably because of pessimistic expectations as to future employment levels. This trend was reversed in the third quarter owing both to the upturn in households' disposable income, which was considerably affected by the pension rises, and to expectations regarding labour contract renewals, despite the still negative influence of expectations of unemployment.

The production of consumer goods continued to diminish partly owing to the fact that enterprises were starting to cut down rapidly their inventories of finished products as was already being done for raw materials.

The trend of investments showed a downward curve in the first three quarters; the sharp fall-off in orders for capital goods was immediately and entirely shifted onto production, since inventories provided little support to activity in the sector. And yet enterprises, faced with an hourly productivity that was diminishing to an extent never before experienced and thus worsening the increase in labour costs per unit of output, felt even more than in the past the need to increase their capital productivity and capital-labour ratio.

Consequently there was an increase in requests for loans from the special credit institutions in the first half-year, in order both to get on the list for soft credit since the main legislation was re-financed in 1975, and to draw up financial programmes to promote investments aimed at increasing their capital-labour ratio as the recovery of demand set the accelerator mechanism in motion again. In fact, during the year, economic policy and, in particular, the measures approved in the third quarter were aimed at hastening the recovery of demand.

The improvement in the balance of payments, which turned out to be greater than expected, and the sharp deceleration in the rate of inflation had in fact focused attention on the problems of the fall-off in production and the losses of jobs. In the last quarter, as the increase in demand for non-durable consumer goods took a solid hold, consumers' need to replace their durables after the drop in purchases during 1974 and the first part of 1975 led to an albeit cautious recovery of demand for motor-vehicles and other durable goods. The improvement in demand was reflected in a return to the levels of activity that had preceded the heavy downturn of the third quarter, when the enterprises had prolonged the summer closure so as to finish reducing inventories. The effects were immediate as regards the balance of payments: imports neared the usual ratios to income and, as the world recession passed the bottom point, raw material prices moved upwards; the foreign trade position rapidly worsened and this was compounded by speculative movements which led to the closure of the currency markets and the loss in value of the lira. At the same time the rate of inflation started to rise once again.

The economic trend for the first quarter of 1976 was thus characterized by a progressive loss in value of the lira and by negotiations for the renewal of the major labour contracts which expired at the end of 1975. Attempts after the re-opening of the exchange market to keep the devaluation within limits that were compatible with the comparative evolution of costs and inflation brought about numerous restrictive monetary and fiscal measures and the introduction of more rigid exchange controls. The contract renewal negotiations suffered from the climate of tension and uncertainty created by the exchange difficulties, which in turn were at least partly accentuated by the fear that the cost of the new contracts would be excessive.

Despite these conditioning factors, productive activity kept up a steady pace in the first quarter. Under the thrust of demand for consumer goods, industrial production rose by almost 3 per cent with respect to the last quarter of 1975; a process of adjustment of inventory levels also seems to have begun, especially as regards raw materials.

The deficit on current account grew sharply (by about 1,000 billion, according to provisional estimates, as against 295 in the first quarter of 1975) partly because, as normally happens when a currency is devalued, the negative effect on the cost of imports prevailed initially over the positive stimulus given to exports. The trend of the latter, however, allowed the deficit to be limited to the energy section of the trade balance.

The contract renewal negotiations were concluded with agreements the cost of which, coming on top of the heavy increases expected from the cost-of-living index, promises to be higher than what would be compatible with the state of the economy. The increase in the burden on enterprises will be higher still in 1977 when all the contractual wage rises come into force and when the cost-of-living index has been uniformed at the highest level. These events, combined with the effect of the monetary restrictions enacted to defend the lira exchange rate, will place a further serious clamp on investment activity, thus increasing the uncertainty of the enterprises which emerged from an investigation conducted by Banca d'Italia branches. For the first time, in fact, 16 per cent of the enterprises questioned did not give details of their investment programmes.

Private consumption does not seem likely to increase further: the persistence of negative expectations as to employment, the cutback in households' disposable income that will be caused by steeper taxes and the rise in the rate of inflation will, especially in the second half-year, to a certain extent offset the recent contractual improvements. The pursuit of better conditions for increasing exports therefore remains the only way of keeping productive activities at the average levels of the first quarter and thus of obtaining an albeit modest rise in the domestic product for 1976. This will be possible if, as recent international estimates seem to indicate, the growth of world demand is strong enough to compensate, through greater exports of real resources, the worsening of the terms of trade with respect to 1975.

Domestic demand

Consumption

In 1975 consumer spending by Italian households, although 15 per cent higher in monetary terms than in 1974, was down in real terms for the first time since the war, having dropped by 2.1 per cent with respect to the previous year. Given the growth, though modest, in real terms of households' disposable income, the average propensity to consume returned, after the exceptional increase of 1974, to the average level recorded in the period 1970-73 (Table 6).

The drop in private consumption is the result of opposite trends during the year: against a heavy downturn in the first half — a continuation from the second half of 1974 — there was a partial comeback as from the third quarter. The disposable income of households, on the other hand, showed a recovery throughout 1975 after the decline that had characterized the previous year and especially the second half. That decline had led to a reduction in consumption from the second half of 1974 until the first half of 1975, thus bearing out the lag with which households' expenditure reacts to variations in income. The increase in the latter throughout 1975 was matched, as from the third quarter, by the recovery in consumption mentioned above, which carried on into the first months of 1976.

Table 6

CONSUMPTION, DISPOSABLE INCOME AND AVERAGE PROPENSITY TO CONSUME OF HOUSEHOLDS

Items	1970	1971/1970	1972/1971	1973/1972	1974/1973	1975/1974
	(billions of lire)	*(percentage changes)*				
Final national consumption						
at current prices	36,696	*9.0*	*10.2*	*19.1*	*23.1*	*15.0*
at 1970 prices		*2.9*	*3.4*	*6.1*	*2.4*	*–2.1*
Gross disposable income						
at current prices	46,740	*11.3*	*10.5*	*17.9*	*18.7*	*18.6*
at 1970 prices (1)		*5.2*	*3.7*	*5.0*	*–1.3*	*1.0*
Average propensity to consume	78.5	*76.8*	*76.6*	*77.4*	*80.3*	*77.8*

Source: General Report on the Economic Situation in Italy and Banca d'Italia estimates.
(1) Gross disposable income has been deflated using the implicit deflator for consumption.

Other factors contributing to the cutback in consumption by households in 1975 were the decline in their wealth, fears of unemployment and the changes in the structure of relative prices, which reduced purchases, especially of durable goods, without however stimulating expenditure in other sectors.

Investment

The downturn in domestic demand which characterized 1975 was particularly sharp in the area of investment. Total fixed investments diminished by 13 per cent in real terms with respect to 1974; in monetary terms, however, they rose slightly (4.3 per cent), as a result of the large increase in implicit prices which, though one third lower than the year before, was still close to 20 per cent. Including inventories, the levels of which were considerably reduced (1,374 billion less at current prices and 557 billion less at 1970 prices) the downturn in investments is much sharper both in volume (24 per cent) and in value (12.2 per cent).

The ratio of investments to gross domestic product thus showed a drop of about two percentage points in 1975. What appears particularly serious is the fact that the tendency, which had emerged during the seventies, for the ratio of investment in plant and machinery to gross product to grow was interrupted. This ratio, more than any other, is an indicator of the accumulation process and in 1970-73 had already placed Italy at the bottom of the list of EEC countries (Table 7).

Table 7

GROSS FIXED INVESTMENT

(as a percentage of gross domestic product at constant prices)

Countries	Machinery and equipment	Transportation	Construction	total	*Housing*
	Averages 1970-1973 (1)				
Italy	6.2	2.0	12.2	20.4	*6.2*
Belgium	6.6	1.8	12.5	20.9	*4.3*
Denmark	9.5		12.5	22.0	*6.2*
France	9.7	2.0	14.9	26.6	*7.0*
West Germany	9.3	2.9	14.7	26.9	*5.8*
Ireland	6.8	3.2	12.2	22.2	*4.6*
Netherlands	7.9	3.0	14.0	24.9	*5.7*
United Kingdom	6.9	2.1	8.7	17.7	*3.1*
ITALY					
average					
1961-63	6.9	1.9	15.2	24.0	*7.4*
1964-65	5.0	1.8	14.7	21.5	*7.8*
1966-69	5.1	1.8	13.9	20.8	*7.2*
1970	5.9	2.0	13.4	21.3	*7.0*
1971	6.0	2.0	12.3	20.3	*6.0*
1972	6.0	2.0	11.9	19.9	*5.9*
1973	6.8	2.0	11.4	20.2	*5.7*
1974	7.1	1.9	11.2	20.2	*5.6*
1975	5.9	1.8	10.6	18.3	*5.3*

Source: Institute of Statistics of the European Community: ESA Yearbook of National Accounts; General Report on the Economic Situation in Italy.

(1) Uniform Figures for 1974 are not yet available for all countries.

The slump in investment affected above all private enterprises, where the increase in monetary terms was 2.5 per cent compared with 10 per cent in public enterprises and 7.7 per cent in direct investment by General Government. The total share of public investment thus moved from 25.9 per cent in 1974 to 27.2 per cent in

1975 (Table 8). Also in the industrial sector the downturn in investments was greater for private enterprises, while the share of public enterprises, having dropped in 1973 and 1974, rose again, although it was still considerably lower than the average for the 1970-72 period.

Table 8

PUBLIC AND PRIVATE DOMESTIC GROSS INVESTMENT BY BRANCHES OF ECONOMIC ACTIVITY

Type of investment	Billions of lire (at current prices)		Percentage breakdown			Percentage changes		
	1974	1975	1973	1974	1975	1973/1972	1974/1973	1975/1974
AGRICULTURE	1,397	1,723	*6.2*	*6.1*	*7.2*	*10.6*	*31.1*	*23.3*
Private enterprises	1,276	1,537	*5.4*	*5.6*	*6.5*	*9.0*	*37.1*	*20.5*
Public enterprises	121	(1) 186	*0.8*	*0.5*	*0.8*	*22.7*	*–10.4*	*53.7*
INDUSTRY	7,889	7,620	*33.5*	*34.6*	*32.0*	*33.5*	*37.3*	*–3.4*
Private enterprises	5,531	5,090	*21.5*	*24.2*	*21.4*	*66.3*	*50.0*	*–8.0*
Public enterprises	2,358	2,530	*12.0*	*10.4*	*10.6*	*–1.4*	*14.5*	*7.3*
SERVICES	5,407	5,777	*24.4*	*23.7*	*24.3*	*28.9*	*28.9*	*6.8*
Private enterprises	3,675	3,843	*16.0*	*16.1*	*16.2*	*30.2*	*33.5*	*4.6*
Public enterprises	1,732	1,934	*8.4*	*7.6*	*8.1*	*26.6*	*20.0*	*11.7*
DWELLINGS	6,586	7,016	*28.2*	*28.8*	*29.5*	*22.4*	*36.3*	*6.5*
Private enterprises	6,425	6;856	*27.3*	*28.1*	*28.8*	*22.9*	*37.1*	*6.7*
Public enterprises	161	(1) 160	*0.9*	*0.7*	*0.7*	*9.1*	*11.8*	*–0.6*
TOTAL	21,279	22,136	*92.3*	*93.2*	*93.0*	*27.0*	*34.3*	*4.0*
Private enterprises	16,907	17,326	*70.3*	*74.1*	*72.8*	*34.0*	*40.2*	*2.5*
Public enterprises	4,372	4,810	*22.0*	*19.1*	*20.2*	*9.0*	*15.6*	*10.0*
NON – MARKETABLE SERVICES	1,552	1,671	*7.7*	*6.8*	*7.0*	*14.2*	*17.9*	*7.7*
GROSS FIXED INVESTMENT .	22,831	23,807	*100.0*	*100.0*	*100.0*	*25.9*	*33.1*	*4.3*
Public sector	*5,924*	*6,481*	*29.7*	*25.9*	*27.2*	*10.3*	*16.2*	*9.4*

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

Although the events that characterized 1975 slowed down the process of industrial reorganization, they did not cancel out the needs that were at the root of it. On the contrary, in that period of depressed economic activity, there were growing difficulties for enterprises attempting to reduce their manpower or increase the redeployability of the labour force.

The sharp increases in the cost of labour together with a largely stable exchange rate then provided further confirmation for the industrial sector that conditions of price competitiveness can only be maintained both in Italy and abroad when profit margins are squeezed beyond a certain point if there is a marked increase in labour productivity. Increasing the productivity and the intensity of capital investment therefore continued to be a basic necessity for enterprises. In fact, already towards the end of 1975 the first signs of a recovery in investment activity began to appear, even if a more substantial comeback remained impossible until the contract renewals were concluded and a more sustained revival achieved in private consumption and exports, thus allowing increased utilization of plant capacity, at a level closer to the medium-term average.

The progressive devaluation of the lira in early 1976 and the steps taken to curb it caused the external situation of enterprises to undergo a considerable change. Programmes for the external financial coverage of investments that had already been drawn up were rendered partially useless by the sharp rise in the prices of investment goods, most of which are imported.

The recovery of exports envisaged for 1976 and the improvement in profits could therefore turn out to be insufficient to counterbalance the negative elements within the present phase of the cycle and the uncertainties as to the overall situation.

Domestic supply

Agriculture

In 1975 gross marketable production in agriculture showed an increase in real terms of 2.4 per cent (Table 9), that is, more than the previous year's growth (2 per cent) and higher than the average for the last five years (1.5 per cent). Contributing factors were the weather, the attainment of a more balanced price structure and, in certain sectors, an improvement in production techniques.

Table 9

MARKETABLE PRODUCTION AND VALUE ADDED IN AGRICULTURE

Items	Values at 1975 current prices (billions of lire)	Percentage changes over the previous year					
		value		volume		price	
		1974	1975	1974	1975	1974	1975
Marketable production	13,055	*21.3*	*17.0*	*2.0*	*2.4*	*18.9*	*14.3*
Field crops and fodder	4,335	*31.0*	*15.2*	*4.2*	*3.2*	*25.7*	*11.6*
Tree crops	3,309	*14.0*	*9.2*	*–2.1*	*0.6*	*16.4*	*8.5*
Livestock	5,033	*18.5*	*24.9*	*3.2*	*3.3*	*14.8*	*20.9*
Forestry and fisheries	378	*23.4*	*11.8*	*–0.9*	*–4.0*	*24.5*	*16.5*
Intermediate consumption (–)	3,544	*37.4*	*14.8*	*2.1*	*2.1*	*34.6*	*12.4*
Contributions to production (+)	461	*–18.6*	*57.3*	*–5.9*	*22.8*	*–13.5*	*28.1*
Value added at factor cost	9,972	*14.4*	*19.2*	*1.5*	*3.6*	*12.7*	*15.1*

Source: General Report on the Economic Situation in Italy.

The effects of the recession were felt somewhat differently in the agricultural sector and in the processing industries: in the latter, the downturn in domestic demand for food and drink was heavily reflected in production levels, which dropped by 6 per cent with respect to 1974, while in the agricultural sector the fall-off in domestic demand led both to a reduction in net imports, favoured by the adjustment of the « green lira » to its effective value, and to a more moderate increase in prices.

Among field-crop products, which taken as a whole grew by 3.2 per cent, cereals and industrial crops recorded the most satisfactory results. Hard corn production reached 3.46 million metric tons, with a 20 per cent increase over 1974, entirely due to greater yields per hectare (2.23 as against 1.84 metric tons) thanks to good weather conditions and new and better techniques. The maize, oats and barley harvests also gave good results, while the production of soft wheat and rice dropped respectively by 9.6 and 3.3 per cent because the areas under cultivation were reduced; as regards rice, however, this was largely offset by the increase in yields. The production of sugar-beet, stimulated by the 28 per cent price rise, increased by almost 60 per cent and enabled sugar production to cover 70 per cent of domestic demand.

The growth in tree-crop production was only 0.6 per cent since the weather was not favourable either to grapes (down by 7.8 per cent) or to most other kinds of fruit. The olive harvest, on the other hand, was considerably larger (up by 34.7 per cent).

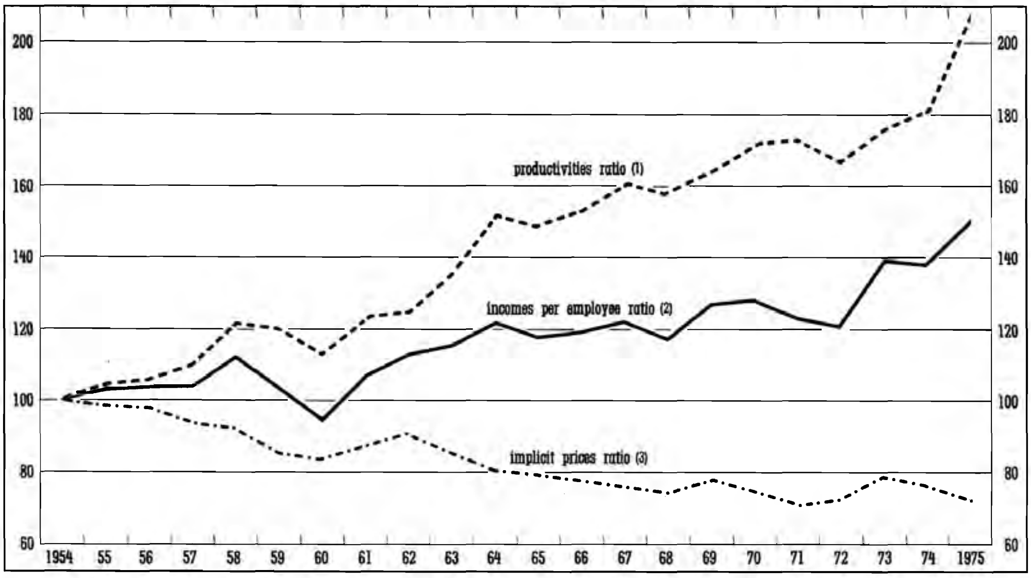
The growth of marketable production of livestock, amounting to 3.3 per cent in real terms, was largely due to beef production, which reacted with a 6.2 per cent increase to the heavy rise in prices (34.3 per cent). Given the downturn in domestic demand, estimated at 8.5 per cent in real terms, the growth of livestock-raising, obtained by importing considerable numbers of calves for fattening, allowed Italy's cattle stock to be rebuilt to a certain extent; in fact, having diminished by 6.7 per cent between the beginning of 1973 and the end of 1974, it rose by 3.6 per cent during the course of 1975. The production of pig-meat, mutton and in particular poultry, rabbits and game also expanded considerably, since domestic consumption concentrated more on these kinds of meat because their prices rose less than beef. Reduced activity in cheese production, on the other hand, affected milk production, which dropped by 2.7 per cent with respect to 1974.

In 1973-74 world prices for cereals hit exceptionally high levels, much higher than their respective EEC entry prices, owing to the exceptional shortage on world markets; at the beginning of 1975 they underwent a sharp turnaround and dropped back to levels lower than the quotations in force within the Community. Thus, the agricultural common market, having defended European consumers from outside inflationary pressures for two years, reverted to its original role of supporting producers and above all had to tackle the problem of surpluses, particularly in the markets for wine, milk and eggs, since sugar had been scarce.

The stabilization of world prices also affected the Italian markets, which however felt the impact of the devaluation of the « green lira » and of various EEC support measures. On the whole, the increase in agricultural prices slowed down considerably: on average for 1975 it was 14.3 per cent as against 18.9 per cent for the previous year (Table 9). However, considering the improvement in the ratio of agricultural prices to input prices, the growth of which fell from 34.6 to 12.4 per cent, and the sharp rise in farming subsidies, largely consisting of the price subsidies granted to hard corn and olive oil producers (up by 168 billion lire as against a 67 billion drop in 1974), the implicit prices of value added at factor cost rose more in 1975 than in 1974 (15.1 as against 12.7 per cent), although they remained below the average increase for non-agricultural sectors (21 per cent).

Despite this situation there was a further improvement in the ratio of income per person employed in the agricultural sector and average income the person employed in the other sectors (Chart 1)

Chart 1



Trend of the ratio of agricultural to non-agricultural income and of the components of this ratio
(indexes, basis 1954 = 100)

Calculated from Istat data.

(1) Ratio of value added at factor cost (at constant prices) per employee in agriculture to that in the other sectors. – (2) Ratio of value added at factor cost (at current prices) per employee in agriculture to that in the other sectors. – (3) Ratio of implicit prices of value added at factor cost in agriculture to that in the other sectors.

insofar as the worsening of relative prices was amply surpassed by the improvement in relative productivities. Output per person in fact increased by 8.7 per cent in agriculture given that employment in this sector continued to diminish, while output per person employed in the other sectors decreased by 5.2 per cent as a result of the cyclical fall-off in productive activity.

Following the rapid depreciation of the lira in early 1976 it was necessary to restore the monetary compensation amounts, which had been progressively abolished over the last two years as the stabilization of the exchange rate had allowed the « green lira » to be adjusted to its effective value.

The principle of a single price, on which the agricultural common market is based, would require a change in the effective value of a currency to be followed by an analogous change in its parity vis-à-vis the unit of account. However, the immediate transfer of an exchange rate depreciation onto domestic prices for agricultural products would lead to inflationary pressures that would be all the less acceptable the more temporary the exchange rate change or the more it reflected speculative pressure. To allow greater stability in « green » parities, in 1971 the EEC generalized the system of monetary compensation amounts applied to imports and exports of agricultural products and regulated in such a way as to correct their price while taking into account the gap between the effective value and the « green » rate of the various currencies. Even this mechanism, however, presents drawbacks (distortion in competition, unjustified redistributions of income between the agricultural and non-agricultural sectors and among the different member countries, disincentives to production), which stand out all the more clearly the more the application of monetary compensation amounts is prolonged in time in order to maintain « green » parities that are no longer justified.

Industry

The continuous growth in industrial value added over the last thirty years was interrupted in 1975. In fact, the gross product of industry decreased by 9.1 per cent compared with 1974 (Table 10); the greatest difficulties arose in industrial processing of products, which fell more (9.7 per cent) than building (8.2 per cent) and energy products (6.9 per cent).

Table 10

VALUE ADDED IN INDUSTRY

Items	Values at 1970 prices in billions of lire			Percentage breakdown 1975	Percentage changes		
	1973	1974	1975		1973/72	1974/73	1975/74
VALUE ADDED:							
including building	27,515	28,722	26,116	*100.0*	*9.0*	*4.4*	*−9.1*
excluding building	22,654	23,768	21,570	*82.6*	*10.3*	*4.9*	*−9.2*
Products:							
of industrial processing	18,579	19,740	17,819	*68.2*	*10.8*	*6.2*	*−9.7*
fuels	4,075	4,028	3,751	*14.4*	*8.2*	*−1.2*	*−6.9*
Building	4,861	4,954	4,546	*17.4*	*3.0*	*1.9*	*−8.2*

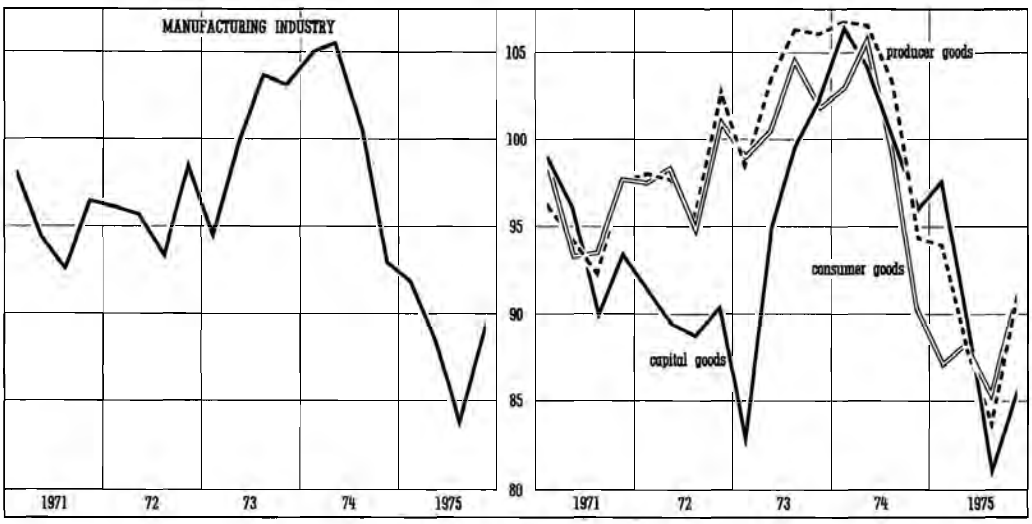
Source: General Report on the Economic Situation in Italy.

The downturn in productive activity had begun about halfway through 1974, when the depressive effects of the weakening of world demand and the worsening of the terms of trade had been compounded by the effects of the policies enacted to bring the balance-of-payments deficit and the rate of inflation back within tolerable limits. The deflationary process had been shifted progressively from the components of domestic demand onto the levels of activity, as the size of inventories of finished products exhausted the possibilities of curbing the drop in production by stock-building.

At the beginning of 1975 the need to thin out inventories, accentuated by the turnaround in inflationary expectations as wholesale prices stabilized, started off a process of unloading which sharpened the depressive effect of the continuing decline in domestic demand for industrial products. The decrease in the latter with respect to 1974, estimated at 11 per cent in real terms on average for the year, in fact reached 18 per cent including changes in inventories.

Moreover not much support for the productive apparatus could be obtained from world demand which, owing to the rapid spread of the recession, showed a sharp decline. Despite the fact that Italy's share of world trade grew considerably thanks to ample margins of unutilized productive capacity (Chart 2) and also to the renewed competitiveness provided by the earlier depreciation of the lira, Italian

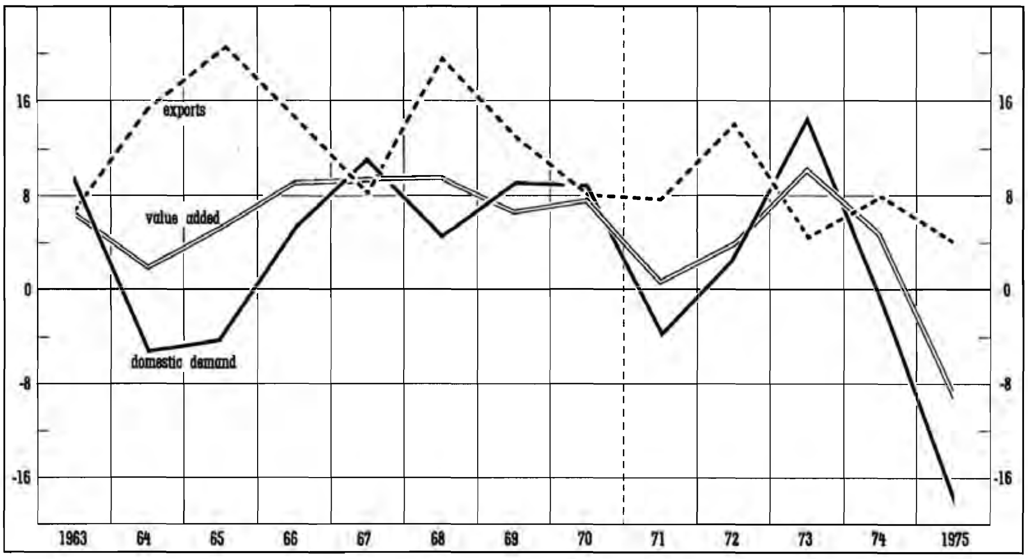
Chart 2



Capacity utilization in the manufacturing industry
(indexes, average 1970=100)

exports of manufactures — although with a 4 per cent increase they represented the most dynamic component of demand for products of the industrial sector— could no longer compensate for the drop in domestic demand in 1975, as they had done ever since the beginning of the sixties (Chart 3).

Chart 3



Value added, domestic demand and exports in industry excluding building

(annual percentage changes on values at 1963 prices until 1970; at 1970 prices thereafter)

Calculated from Istat data

Although these events affected the entire industrial sector, the extent to which they conditioned productive activity varied from one industry to another. In the sectors relying mainly on consumption, the drop in production was heavier than in demand because the latter was met to a greater extent by the reduction of inventories. This occurred mainly in the production of durable goods which, on average for the year, dropped by 17.3 per cent partly owing to the fact that imports fell less than demand.

The production of final capital goods, which taken as a whole fell by 9.0 per cent, was however less affected by the decline in domestic demand for plant and machinery (20 per cent), even if there are marked differences between one industry and another. Besides the fact that inventory policy had a lesser effect here owing to the very nature of this type of production, some sectors seem to have benefited both from the increase in exports and from the reduction in imports of certain categories of goods.

The drop in activity in the capital goods and building industries largely contributed to the decrease in production by the metallurgical (— 11.6 per cent) and non-metallic minerals (— 11.9 per cent) industries. Total production of raw materials, producer goods and semi-finished goods (down by 9.0 per cent) suffered both from the difficulties encountered by enterprises producing final goods and from their cutback in inventories especially in the first part of the year.

Table 11

INDEX OF INDUSTRIAL PRODUCTION (1)

(1970=100)

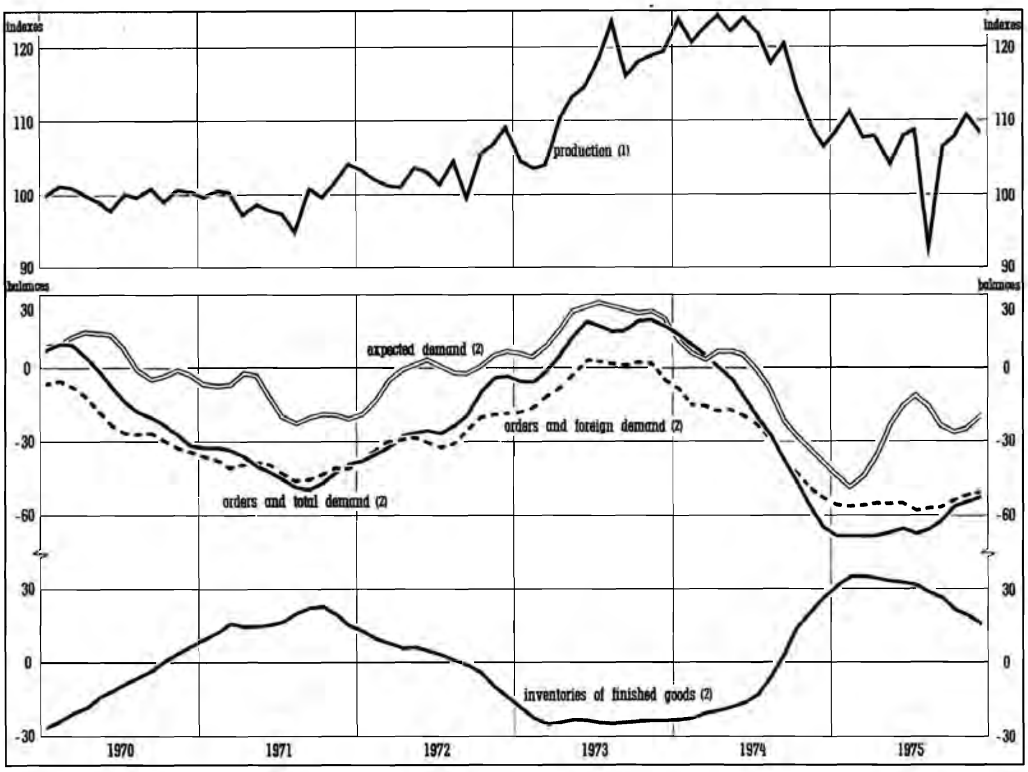
Period	General index		By sector of destination				By branches of activity			
			Raw materials, producer and semi-finished goods	Capital goods		Consumer goods	Mining and quarrying	Manufacturing	Gas and electricity	Building
	including building	excluding building		including building	excluding building					
1973 - average	111.3	114.4	119.1	101.4	105.6	115.7	100.4	114.0	122.5	99.0
I qtr.	103.7	105.0	109.5	95.5	90.0	110.0	96.6	104.1	119.5	98.7
II "	110.5	113.5	118.8	100.8	104.9	114.3	97.6	113.1	122.5	98.4
III "	115.5	119.7	123.9	104.0	112.7	120.4	104.1	119.8	122.7	98.9
IV "	115.3	119.2	124.1	105.5	114.9	118.1	103.4	119.1	125.4	100.0
1974 - average	115.7	119.5	123.9	106.3	115.5	118.5	102.4	119.4	125.2	100.9
I qtr.	118.5	122.7	127.5	107.9	118.2	121.8	108.7	122.9	124.7	101.8
II "	119.4	123.8	127.5	107.8	117.9	124.3	99.1	124.2	125.4	101.9
III "	116.5	120.5	125.0	106.4	115.9	119.8	97.5	120.6	126.1	100.8
IV "	108.5	110.9	115.6	103.1	109.8	108.1	104.2	110.0	124.7	99.1
1975 - average	105.3	108.5	112.7	96.6	103.4	108.2	94.7	107.5	126.0	92.6
I qtr.	107.7	110.5	116.5	101.6	110.5	106.3	98.8	109.5	127.2	96.4
II "	105.2	108.0	111.9	97.9	104.0	107.4	94.1	107.1	124.3	94.3
III "	101.0	103.8	106.0	92.3	96.4	106.3	88.2	102.8	121.5	89.9
IV "	107.2	111.6	116.5	94.6	102.7	113.0	97.8	110.4	131.0	89.9
1976 - Jan-Feb.		112.9	118.6		98.9	116.5	98.7	111.5	135.8	

The indexes of industrial production excluding building are calculated from Istat data; in the case of building, data from the General Report on the Economic Situation in Italy have been used.

(1) Corrected for months with an equal number of working days and seasonally adjusted.

The trend of productive activity in the first three quarters of 1975 was characterized by the continuation, albeit in a more hesitant and irregular manner, of the decline that had begun about half-way through 1974. By contrast, in the fourth quarter there was a recovery of productive activity which continued into the first months of 1976 (Table 11 and Chart 4).

Chart 4



Industrial production, orders and inventories of finished goods in the manufacturing and mining and quarrying industries

(1) Calculated from Istat indexes of industrial production corrected and seasonally adjusted; basis 1970 = 100 – monthly figures. – (2) Moving averages of the monthly balances of businessmen's positive and negative answers to deviations from a normal trend: ISCO-Mondo Economico monthly surveys; for expected demand the data gathered concern the "changes in orders over the next 3-4months" covering the period to which the forecast refers.

In the first quarter of 1975, a slight attenuation of the fall-off in direct orders to producer enterprises, which could still increase their inventories of finished products so as to curb the effects of this, was matched by a halt in the reduction of industrial production that had been a feature of the two previous quarters. This was the result of contrasting trends in the different sectors, which can be attributed not so much to different movements in orders and stocks as, rather, to the different ways in which uncertainties as to the short-term trend affected the processes of stabilization of levels of activity, some of which reflected, moreover, the recovery of the production losses suffered during the dispute over the cost-of-living adjustment mechanism that had carried on into January 1975. This second effect partly explained the recovery of production in February, which contributed significantly to raising the average result for the first quarter.

After the pause in the first quarter, in the second the general index of industrial production continued to drop (2.3 per cent with respect to the first). Meanwhile there was a halt in the decline of orders, which however remained at levels considered by businessmen to be largely unsatisfactory, and the process of stockbuilding finished products, which up to then had helped to sustain production, appeared to have run its course (Chart 4).

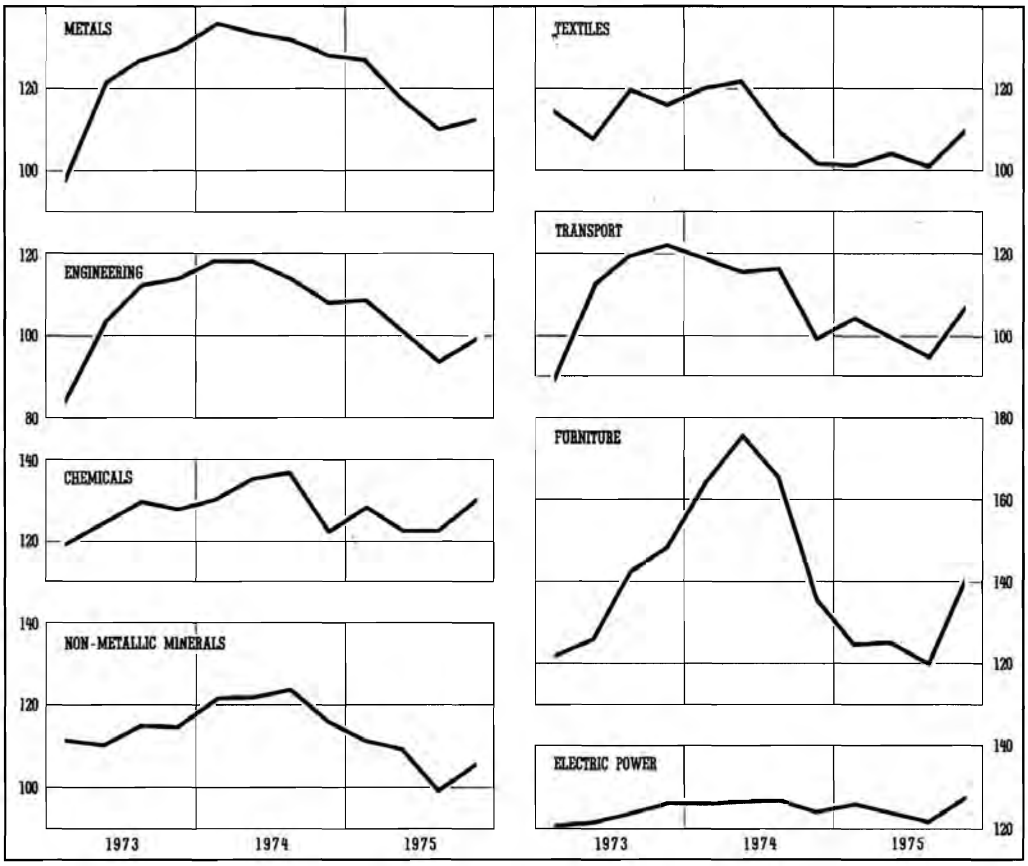
During this period some important differences emerged among the various sectors. In consumer goods, a slowdown in the decline of final demand was matched by a certain improvement in orders to producer enterprises which, despite the reduction of inventories, fostered a recovery of activity (1.1 per cent with respect to the first quarter). This recovery and the further improvement in expectations as to future developments in final consumption were transmitted to the industries producing intermediate goods which had previously been affected by the scarcity of demand from the industries utilizing their products. For some of these the support came directly from foreign demand.

The production of capital goods, after the pause in the first quarter, resumed its decline at high rates: the ample margins of unutilized productive capacity appearing in the system (Chart 2) and the uncertain prospects as to total demand discouraged the enactment of new investment plans. There was consequently a further reduction in orders to this sector of industry which had a negative effect on all activity in the engineering and means-of-transport industries producing capital goods (down 7.1 and 9.3 per cent respectively) and brought about a substantial decline in metallurgical production (Chart 5). The reduction in building activity led to a worsening of building-material production as well as of iron and steel.

The perseverance of a general climate of uncertainty during the third quarter cut down demand expectations. In fact the conditions in which the productive sectors had to operate in the April-June period did not change significantly in the following quarter: the slow improvement in the demand for consumer goods continued, although it remained considerably lower than what was held to be satisfactory by businessmen, while there was a further weakening in orders for investment goods.

In August the fall-off in industrial production, even on seasonally adjusted figures, reached such a size as to give grounds for thinking that the enterprises had used the summer closure to adjust a good part of their production plans to their changed demand expectations. In the months before and after, in fact, productive activity had remained at fairly similar levels.

Chart 5



Production in some branches of industry

(Calculated from Istat indexes: corrected and seasonally adjusted; basis 1970 = 100 – quarterly averages)

In the fourth quarter the general index of industrial production, up by 7.5 per cent with respect to the third quarter, regained the levels reached at the end of 1974. Although this substantial increase over the third quarter on the one hand reflected the August cutback in production, on the other it could be explained by the recovery of demand, which allowed further inventories of finished products to be sold off. For the first time in the year there was also an increase in orders for investment goods while consumer goods consolidated the progress they had made in the previous months.

Within the sphere of consumer goods, durable goods industries were the most dynamic: after six quarters of uninterrupted decline, their production rose by 18.2 per cent, with peaks of 26.8 per cent for motor vehicles and 18.0 per cent for furniture. The recovery in the production of non-durables was much more modest (1.3 per cent); however, given also the need of these industries to rebuild their stocks, they provided a strong stimulus to the production of intermediate goods (11.9 per cent).

As regards capital goods, the engineering industries recovered part of the loss of the previous quarter and the production of industrial vehicles decreased less sharply. Among intermediate goods industries, which increased as a whole by 10 per cent thanks to the improvement in demand levels and expectations, the largest increments were in primary chemicals (15.6 per cent) and in wood products (22.2 per cent), non-ferrous metals (12.9 per cent) and plastics (17.8 per cent). The interruption in the decline of building activity allowed the production of non-metallic minerals to recover partially (6.7 per cent).

Services

The downturn in domestic demand and the ensuing reduction in productive activity gave rise to a considerable slowdown in service industries, which increased their output in the year by only 0.4 per cent in real terms as against 3.3 per cent in 1974 (Table 12). The decrease in private consumption was above all reflected onto value added in commerce and catering. This diminished by 2.1 per cent despite the notable increase in tourism and the hotel industry spurred on by the favourable trend in domestic and foreign tourism.

Value added in the transport and communications sector showed a slight upturn (0.6 per cent), owing on the one hand to a further increase in telephone services and, on the other, to widespread declines in

Table 12

VALUE ADDED IN THE SERVICES SECTOR

(billions of lire)

Branches	1975				Percentage changes			
	Absolute values		Percentage breakdown		Quantity		Prices	
	prices							
	current	1970	current	1970	1974/73	1975/74	1974/73	1975/74
Commerce and catering	16,006	9,966	*34.3*	*37.3*	*2.1*	*−2.1*	*12.2*	*20.1*
Transport and communications	6,217	4,229	*13.3*	*15.8*	*5.2*	*0.6*	*8.2*	*21.2*
Credit and insurance	7,199	2,832	*15.4*	*10.6*	*6.4*	*2.5*	*32.9*	*33.3*
Other services	9,586	5,414	*20.5*	*20.2*	*2.8*	*2.3*	*16.1*	*19.8*
Services, excluding housing	39,008	22,441	*83.5*	*83.9*	*3.4*	–	*15.5*	*22.7*
Lettings	7,720	4,307	*16.5*	*16.1*	*2.9*	*2.3*	*15.7*	*13.4*
SERVICES	46,728	26,748	*100.0*	*100.0*	*3.3*	*0.4*	*15.6*	*21.0*

Source: General Report on the Economic Situation in Italy.

transport, especially of goods, the growth of which was more heavily affected by the recession. Transport of goods by rail in particular suffered, falling by 17.7 per cent with respect to 1974. Passenger rail traffic, down by 3.4 per cent partly on account of a marked increase in private transport, may have been influenced by the rise in the relative price of the former with respect to the latter.

The activity of the other branches of the service industries, less exposed to cyclical fluctuations in demand, showed larger increases than the average, although, with the exception of lettings, they were considerably lower than the long-term growth rate.

The energy balance-sheet

The effects of the recession were widely felt in the energy sector too: in 1975 domestic demand for primary sources diminished, according to provisional estimates, by 4.7 per cent in volume with respect to the previous year (Table 13). This was the result of somewhat different trends in the various sectors: whereas in industry, with a 9.2 per cent drop in production levels, there was a downturn of 12.5 per cent in total utilization of energy sources, consumption of energy for home and commercial purposes and for transportation went up by 4 and 3 per cent respectively, the latter being entirely due to increased consumption of petrol (7 per cent).

Table 13

ENERGY BALANCE

(millions of TOE)

Sources and uses	1974					1975				
	Solid fuels	Natural gas	Oil	Electric power (1)	Total	Solid fuels	Natural gas	Oil	Electric power (1)	Total
Production	1.3	12.6	1.1	10.0	25.0	1.3	12.0	1.0	10.8	25.1
Imports	9.8	3.4	125.6	0.9	139.7	9.7	7.2	104.0	1.1	122.0
Exports (–)	0.5	–	23.6	0.4	24.5	0.5	–	14.7	0.5	15.7
Changes in inventories (–) (2)	0.1	..	0.7	–	0.8	0.1	0.9	–2.4	–	–1.4
DOMESTIC USES OF PRIMARY SOURCES (3)	10.5	16.0	102.4	10.5	139.4	10.4	18.3	92.7	11.4	132.8
Percentage breakdown	*7.5*	*11.5*	*73.5*	*7.5*	*100.0*	*7.8*	*13.8*	*69.8*	*8.6*	*100.0*
Transformation into electric power	–1.9	–0.9	–20.0	22.8	–	–1.9	–1.8	–18.1	21.8	–
Consumption and losses (–)	2.5	0.5	7.6	5.0	15.6	2.4	0.4	6.2	5.2	14.2
DOMESTIC USES OF FINAL SOURCES (3)	6.1	14.6	74.8	28.3	123.8	6.1	16.1	68.4	28.0	118.6
Percentage breakdown	*4.9*	*11.8*	*60.4*	*22.9*	*100.0*	*5.1*	*13.6*	*57.7*	*23.6*	*100.0*
Industry	4.4	7.8	21.3	17.7	51.2	4.4	7.9	16.2	17.0	45.5
Transportation (3)	0.1	0.2	23.9	1.0	25.2	0.1	0.2	24.8	0.9	26.0
Domestic uses etc. (4)	1.2	4.8	22.4	9.6	38.0	1.2	6.3	22.0	10.1	39.6
Non-energy use	0.4	1.8	7.2	–	9.4	0.4	1.7	5.4	–	7.5

Source: For 1974 figures are calculated from "Industria del petrolio e bilancio energetico", 1974, Ministry for Industry, Trade and Handicrafts; for 1975 estimates have been used.

(1) Calculated by thermoelectric input, with a conversion coefficient of 2,200 Kg-cal per Kwhr. – (2) Including changes in ENEL's inventories of fuel oil, amounting to –0.4 million TOE in 1974 and 0.9 million TOE in 1975. – (3) Including bunkers. – (4) Including consumption of energy by agriculture, trade and handicrafts.

The rise in the price of oil, which in 1974 had interrupted the rapid growth of energy consumption, seems to have had less direct influence on the increase in the demand for energy in 1975. Last year's downturn in fact was caused by the reduction in demand by the productive sectors, the requirements of which are closely linked —in the short run— to levels of activity. Energy used for domestic purposes and private transport however began to increase again, albeit at a considerably lower rate than the long-term trend, since it was variously affected, on the one hand, by the low level of households' real disposable income and, on the other, by the reduction in the relative price of oil-derivates. In the absence of an efficacious policy for the rationalization of energy uses, it will be difficult for the increase in cost to curb energy requirements substantially or on a lasting basis.

The structure of energy supply, on the other hand, was affected by the increase in the price of oil and of the policies enforced to cushion its impact. Although the change in the relative prices of energy sources is smaller with respect to the beginning of 1974, it caused oil to be largely substituted with natural gas, the demand for which increased by 14.4 per cent with respect to 1974. In thermoelectric production, in particular, the use of natural gas doubled and this, together with an 8 per cent increment in hydroelectric production and a 1 per cent drop in the demand for electricity cutback fuel oil consumption by 9.5 per cent. Purchases of fuel oil however went down by only 4 per cent owing to the need to reconstitute stocks. As a whole, the share of primary energy supplied by oil decreased from 73.5 per cent to 69.8 with respect to 1974, while that supplied by natural gas rose from 11.5 to 13.8 per cent, with the share from solid fuels remaining pratically stable (7.8 per cent) and a larger contribution of primary electric power (from 7.5 to 8.6 per cent), favoured by the year's good rainfall.

The combined effect of the downturn in the demand for energy and of substitutions brought about a 9.5 per cent fall in domestic consumption of oil derivates. Although, on the one hand, this allowed the country to reduce its oil deficit by half a billion dollars despite a nearly 3 per cent rise in the average price of crude oil, on the other it also affected the levels of activity of the refineries, which dropped by 15 per cent partly because at the same time there was a 38 per cent slump in their exports. Besides the problems arising from the low degree of capacity utilization, which fell below 60 per cent in 1975, the petroleum industry also had to tackle the difficulties connected with the changes in the structure of demand for derivates and, above all, the inadequate functioning of the price-fixing mechanism. This mechanism was created at a time of stable prices and fixed exchange rates and so is unsuitable, especially from the standpoint of the criteria for its application, during the present situation in which the floating of the lira and rapid price changes for derivates on foreign markets require frequent and timely adjustments both in the general level for derivate prices and in their structure.

According to the forecasts contained in the national energy programme, which was updated to take into account both the new estimates on 1975 and the revision of ENEL's nuclear power programme, the share of domestic demand for primary energy met by oil should diminish, on the assumption of a 4 per cent per annum average growth of income, to 65 per cent in 1980 and to 58 per cent in 1985 (Table 14). Oil

Table 14

DOMESTIC DEMAND FOR ELECTRIC POWER AND STRUCTURE OF THE SUPPLY OF PRIMARY SOURCES (1974–1985)

Primary sources	Absolute values (millions of TOE)				Percentage breakdown				Average annual percentage increase	
	1974	1975	1980	1985	1974	1975	1980	1985	1980/1975	1985/1980
Solid fuels (1)	10.5	10.4	13.7	15.1	*7.5*	*7.8*	*8.0*	*7.0*	5.7	1.9
Natural gas (2)	16.0	18.3	33.2	41.1	*11.5*	*13.8*	*19.4*	*19.0*	12.6	4.4
Oil	102.4	92.7	110.6	125.6	*73.5*	*69.8*	*64.6*	*58.0*	3.6	2.6
Hydroelectric power (2)	9.7	10.6	11.6	12.1	*7.0*	*8.0*	*6.8*	*5.6*	1.8	0.9
Nuclear-electric power (3)	0.8	0.8	2.0	22.4	*0.5*	*0.6*	*1.2*	*10.4*	20.0	62.0
Total (4)	139,4	132.8	171.1	216.3	*100.0*	*100.0*	*100.0*	*100.0*	5.2	4.8

Source: Calculations from data contained in the National Energy Plan, updated to take into account final figures for 1974 and new estimates for 1975.

(1) The energy plan forecasts consumption of 15.1 million TOE even in 1980. – (2) The absolute values of consumption are those forecast in the energy plan. – (3) Production forecasts for 1985 have been corrected to take into account the postponement of ENEL's nuclear plan. – (4) Forecasts of domestic demand for electric power in 1980 and 1985 are based on the hypothesis of an average annual increase in income of 4 per cent and an income elasticity of 1.3 during the first five years and 1.2 in the second.

would be substituted in the first five-year period by the increase of natural gas production, the share of which should rise to 19 per cent in 1980, and in the following five years by nuclear power, the contribution of which should rise from 1 to 10 per cent during this period.

The programme for reorganizing energy sources labours under considerable financial difficulties given the huge amount of investment necessary to carry it out. At present prices, the total cost of a 1,000 mw nuclear power plant can be estimated, including the first charge, at around 500 billion lire. Since we envisage an increase in the demand for electric power that over the next ten years will require an average increase in capacity of 3-4 thousand mw per year, the nuclear programme, when fully under way, will absorb annually around 1,500-2,000 billion lire at 1976 prices. Considering, moreover, the investments necessary to develop the cycle of nuclear fuel, to enable growing quantities of natural gas to be transported and distributed and to rationalize energy consumption, it can be seen that the energy programme will involve a serious problem of resource allocation. On the one hand, in fact, the need to effect important structural modifications will require a considerable volume of investments also in other sectors of the economy, on the other, the balance-of-payments constraint may condition the growth possibilities of domestic demand over the next few years too.

A prompt enactment of the energy plan would give the national economy considerable advantages, not only by protecting energy supplies and encouraging the growth of the nuclear power industry, but also by substantially curbing the oil deficit. The structure of energy supply envisaged for 1985 implies, with respect to 1974, a 33 million ton reduction in oil consumption [$216.3 \times (0.735 - 0.58)$], 15 of which to be substituted by natural gas and 18 by nuclear power (Table 14). At present-day prices the reorganization would ensure a cutback in net foreign exchange expenditure for energy sources of around 1.5 billion dollars, equal to a quarter of last year's oil deficit. However, only over the long term will the execution of the nuclear power programme be able to have a beneficent influence on the overall trade balance, insofar as initially the increased imports stimulated by the construction of the nuclear stations will be considerably more than the foreign currency saving on fuel, even if, as regards single units, the foreign currency cost of the investment can be covered in only 2 or 3 years.

Employment, wages, prices and the distribution of income

Employment

The severity of the recession experienced in Italy was not reflected in total employment, which remained at the same level as the previous year with a heavy increase, however, in underemployment. Total employment in fact dropped by 0.1 per cent while employees rose slightly (0.2 per cent; Table 15). Despite the increase in value added

Table 15

EMPLOYMENT IN ITALY

(yearly percentage changes)

Sectors and branches of activity	Total employment					Employees				
	1971	1972	1973	1974	1975	1971	1972	1973	1974	1975
Agriculture	–0.7	–8.1	–3.2	–2.5	–4.7	1.1	0.6	–1.2	–1.9	–5.0
Industry	–1.7	–1.7	0.5	1.5	–0.1	–0.6	–1.5	0.6	1.7	–0.3
Energy products	*0.3*	*–1.3*	*–0.5*	*3.6*	*4.2*	*0.5*	*–1.3*	*–0.5*	*3.6*	*4.2*
Product of industrial processing	..	*–1.1*	*1.6*	*2.3*	–	*1.5*	*–0.7*	*2.2*	*2.5*	*–0.1*
Total industry excluding building	..	*–1.2*	*1.6*	*2.4*	*0.2*	*1.4*	*–0.8*	*2.1*	*2.6*	*0.1*
Construction	*–6.6*	*–3.4*	*–2.8*	*–1.1*	*–1.1*	*–6.0*	*–3.8*	*–3.7*	*–1.3*	*–1.5*
Marketable services	0.5	1.8	2.1	3.1	1.4	2.8	2.9	3.5	4.0	2.0
Commerce, hotels, & catering	*–1.9*	*0.9*	*2.0*	*2.5*	*0.7*	*0.6*	*2.1*	*4.2*	*2.2*	*1.3*
Transport and comunications	*2.8*	*2.1*	*1.8*	*2.8*	*1.4*	*–3.6*	*2.8*	*2.4*	*4.3*	*1.1*
Credit and insurance	*4.8*	*5.6*	*5.4*	*7.7*	*4.7*	*4.8*	*5.7*	*5.3*	*7.7*	*4.7*
Miscellaneous services	*4.0*	*3.1*	*2.1*	*4.1*	*2.4*	*5.0*	*3.5*	*2.8*	*5.4*	*3.1*
Marketable goods and services .	–0.7	–1.8	0.3	1.4	–0.4	0.6	..	1.3	2.0	–0.1
Non-marketable services	3.0	3.7	3.3	2.5	1.4	3.0	3.7	3.3	2.5	1.4
TOTAL . . .	–0.3	–1.1	0.7	1.5	–0.1	1.0	0.7	1.7	2.1	0.2

Source: Istat.

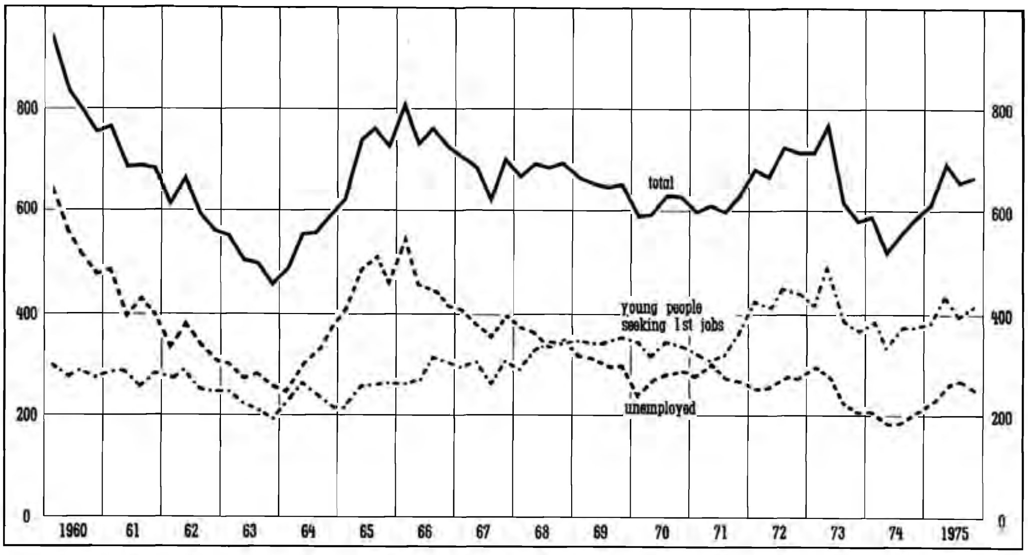
and the reduced possibilities for other sectors to absorb manpower, employment in agriculture dropped by 4.7 per cent (as compared to 2.5 per cent in 1974). In industry employment remained practically stable, considering both the average and the trend over the year. The new calculations made by Istat on the number of persons employed in industry show that, on average for the year, the total was 0.1 per cent less than in 1974. The variation from October 1974 to October 1975 was also 0.1 per cent, as can be seen from the sample surveys on the labour force (for employees the downturn was 0.3 per cent on average and 0.2 per cent over the year). The drop in the gross product of industry did not affect the demand for labour, mainly owing to the greater use made of the Wage Equalization Fund whereby it is possible to stabilize both employment levels and workers' incomes.

The stability of industrial employment levels led to a fall in productivity per worker roughly equal to that of the gross product

(9 per cent), while the greater flexibility in the number of hours actually worked, which partly accompanied the downturn in activity, made it possible to curb the decrease in hourly productivity.

In the marketable services sector the total number of persons employed rose by 1.4 per cent and by 2 per cent if employees alone are considered. Employment in this branch has risen continuously from 1970 to 1975, accompanying in 1973-74 the cyclical upswing in industrial employment. However, the growth of employment in marketable services occurred not only much earlier but also much faster than in industry. Thus the percentage of employment in services continued its long-term rise into 1975.

Chart 6



Trend of unemployment

Source; Istat, seasonally adjusted figures; thousands of units

The drop in production is more clearly reflected in the increase in job searchers, particularly those who have worked before. From 1974 to 1975 the number of non-employed persons rose by an average of 16.8 per cent, the outcome of a 26.8 per cent rise in the number of unemployed in the narrow sense and an 11.5 per cent increase in the number of young people seeking work for the first time. The unemployment rate rose from 2.9 per cent in 1974 to 3.3 per cent.

For the third year running the labour force recorded an increase which in 1975 amounted to 1 per cent. This trend in the supply of labour can only be partly explained by the movements of the various components of employment. During the course of 1975 the slowdown in demand for non-agricultural labour, together with a notable upswing in the exodus from agriculture, did not lead, as is usual, to a smaller change in the supply of labour than in employment because of the simultaneous increase in unemployment (Chart 6).

Wages

Trade union action in the second half of 1974 and the first half of 1975 had as its prime objectives an increase in the monetary incomes of workers and pensioners, better protection of the real value of wages through a reform of the indexation systems and the defence of employment levels. In January 1975 negotiations over the reform of the cost-of-living adjustment mechanism for employees in industry were concluded and the resultant modifications were immediately extended to workers in commerce, in overland transport contracted out by public authorities, and in sea and air transport. A similar reform was agreed on at the end of May for workers in agriculture; and then in July Parliament approved the law modifying the special integrative indemnity for public employees and State pensioners and bringing the value of their cost-of-living allowances closer to that of workers in industry.

Also in the first half of the year, agreements were reached to increase pensions and adjust them annually to changes in contractual wages and in the cost-of-living index. In the middle of the year, while certain important disputes over reductions in working hours were under way and the debate on the problems of industrial reconversion was becoming more heated, details were given of some of the claims later to be put forward during the contract renewals.

In industry particular stress was laid on the demand for information on the enterprises' investment programmes and on the location of new plant in order to assess the possible repercussions on employment and on labour organization. Demands were also put forward to reduce the working hours of particular categories of employees in the engineering and chemical industries and to lower the annual ceilings on overtime.

As regards wages the demands were the same for all sectors of industry: a pro capite increase in the contractual minimum basic pay of 30,000 lire per month, and the inclusion in basic pay of both the 12,000 lire gained in the union agreement of 1975, and the cost-of-living allowances due at the end of 1974. The first agreement between unions and employers was reached on the contract for employees in the public chemical industries, followed later by the other sectors. These agreements granted chemical workers in public enterprises a 25,000 lire monthly increase pro capite as from January 1st 1976 and, as of July 1st 1977, the inclusion in basic pay of this increase, of the 156,000 lire per annum gained in the agreement of January 1975 and, lastly, of 89 cost-of-living scale points. The increases were 20,000 lire per month as of April 1st 1976 for construction and chemical workers in private enterprises and a further 5,000 in 1977; in addition, building workers were granted a 50,000 lire and chemical workers a 70,000 lire indemnity both to be paid in two instalments, to cover the period between the expiry of the old contract and the initial date of the new agreement. In the engineering sector, lastly, in addition to a « once-only » payment of 30,000 lire, the increase agreed was 25,000 lire per month pro capite as of May 1976 to be included, in due course, in the contractual basic pay.

Table 16

GROSS MINIMUM CONTRACTUAL WAGES (1)

(percentage changes)

Sectors	1974 / 1973	1975 / 1974	Dec. '74 / Dec. '73	Dec. '75 / Dec. '74
WAGES				
Agriculture	31.8	32.7	40.2	21.2
Industry	20.1	28.0	24.0	20.3
Mining and quarrying	17.8	24.1	17.2	20.4
Manufacturing	22.4	26.7	21.9	20.9
foodstuffs	*19.0*	*36.7*	*38.8*	*17.3*
textiles	*22.9*	*25.5*	*18.5*	*21.7*
metals and engineering	*24.8*	*24.8*	*19.9*	*20.6*
chemicals	*10.4*	*23.8*	*14.2*	*20.9*
Construction	16.2	31.0	29.6	18.7
Electricity, gas and water	14.2	24.2	13.4	23.4
Commerce	24.1	30.7	22.7	24.0
Transport	26.9	16.3	24.3	17.3
SALARIES				
Industry	16.2	23.3	19.0	18.1
Commerce	22.1	27.7	21.9	21.2
General Government	3.5	6.9	3.5	9.2

Source: Istat.
(1) Excluding family allowances.

From December 1974 to December 1975 gross minimum contractual wages in industry, excluding family allowances, grew by 20.3 per cent for all enterprises and by 20.9 per cent for manufacturing firms (Table 16). This increase was mainly due to the award of 12,000 lire monthly pro capite paid out as a separate part of the wage, and to the new indexation system which enable a much greater part of the loss of purchasing power owing to price rises to be regained than in the past.

In commerce the wage increases granted during the year (24 per cent) were higher than in industry as a result of the delayed application of labour contracts stipulated previously. In agriculture the 21.2 per cent rise is to be attributed for the most part to the increases in the cost-of-living allowances, which produced considerably higher results than in other parts of the private sector because of the lower wage level in this branch of activity.

Table 17

ACTUAL EARNINGS IN INDUSTRY (1)

(percentage changes)

Sectors	1974/1973 (2)	1975/1974 (2)	3rd qtr 1974 / 3rd qtr 1973	3rd qtr 1975 / 3rd qtr 1974
Industry as a whole	25.3	28.9	25.6	27.8
Mining and quarrying	25.2	26.9	25.5	20.7
Manufacturing	26.3	29.3	26.4	28.7
foodstuffs	*23.2*	*40.5*	*30.8*	*31.5*
textiles	*30.9*	*28.4*	*25.5*	*25.4*
metals and engineering	*23.8*	*27.7*	*24.7*	*29.3*
chemicals	*23.2*	*26.8*	*26.5*	*24.4*
Construction	14.1	28.7	29.4	22.8
Electricity, gas and water	10.1	18.7	–2.5	17.1

Source: Ministry of Labour and Social Welfare.
(1) Excluding family allowances. — (2) Average for the first three quarters.

Calculated on the averages, the variations in the contractual wages of all sectors were higher than during the course of the year. In agriculture the average annual increase was 32.7 per cent, 30.7 per cent in commerce and 28 per cent in industry, within which, notably, the figure for the foodstuffs industry rose by 36.7 per cent.

Since there was little company-level negotiation, the trend in actual earnings, excluding family allowances and wage integrations, was not unlike the trend in contractual wages. As an average for the first three quarters of 1975, with respect to the same period in 1974, the increase was 28.9 per cent for all industries (as against a 30.1 per cent rise in contractual wages, excluding fringe benefits, for the same period) with a peak of 40.5 per cent in the foodstuffs industry (Table 17).

Table 18

COST OF LABOUR IN THE PRIVATE SECTOR

(yearly percentage changes)

Years	Gross product at market prices (1)	Total employment (2)	Output per man	Labour income per employed worker	Labour cost per unit of output
	Private sector (excluding housing) (3)				
1971	1.3	–0.7	2.1	13.0	10.7
1972	3.0	–1.8	4.9	10.8	5.7
1973	7.3	0.3	6.9	21.3	13.5
1974	3.7	1.4	2.3	24.1	21.3
1975	–4.4	–0.3	–4.0	21.8	26.9
	Agriculture				
1971	0.5	–0.7	1.2	12.7	11.4
1972	–7.4	–8.1	0.7	17.0	16.2
1973	7.0	–3.2	10.5	20.5	9.0
1974	2.0	–2.5	4.6	33.5	27.7
1975	2.5	–4.7	7.5	32.0	22.7
	Industry				
1971	–0.4	–1.7	1.4	11.6	10.1
1972	3.6	–1.7	5.4	11.2	5.5
1973	9.0	0.5	8.4	22.9	13.3
1974	4.4	1.5	2.8	23.5	20.2
1975	–9.1	–0.1	–9.0	20.7	32.6
	Services (excluding housing) (3)				
1971	3.8	0.5	3.3	14.9	11.2
1972	4.9	1.6	3.2	9.1	5.7
1973	5.3	2.0	3.2	18.4	14.7
1974	3.3	3.1	0.2	22.8	22.5
1975	–	1.4	–1.4	21.1	22.8

Source: General Report on the Economic Situation in Italy.

(1) 1970 prices; in agriculture, industry and services the figures include banking services. – (2) Data on total employment and on employees are taken from new calculations prepared by Istat. – (3) Data also includes "other services not for sale".

Owing to the scanty increase in productivity per worker (2.4 per cent per annum) and, above all, to an unprecedented upwards wage movement, in the five years 1970-75 the cost of labour per unit of output in the private sector grew at an average annual rate of 15.4 per cent; in 1975 this growth was up by 26.9 per cent (Table 18).

In agriculture the progression of unit costs was different from the average, mainly owing to the trend in productivity. In 1975, in particular, the considerable increase in productivity, linked to the reduction in the number of persons employed, made it possible to keep the larger increase in labour income per employee in this sector down with respect to the total figure. The result was an increase in the cost of labour per unit of output of 22.7 per cent, i.e. 4.2 percentage points less than the average. A similar growth took place in the services sector, where the output per worker dropped however by 1.4 per cent.

In industry the exceptional downturn in productivity led to a considerable worsening of unit costs with respect to the other sectors. The latter in fact grew by 32.6 per cent, that is at a rate 12.4 percentage points above the already high rate of the previous year.

Prices

The rise in prices slowed down considerably during the course of 1975 despite the hefty increase in the cost of labour per unit of output. The downturn in international market prices for raw materials, the reduced absorption by domestic and foreign markets and the moderately upward trend in the foreign prices of manufactured products, coupled with a stable exchange rate, put a brake on the growth of home market prices. Over the year, the increase in wholesale prices (4.9 per cent) was the smallest since 1971 (Table 19 and Chart 7).

The trend for 1975 was marked by two distinct phases, coinciding with the two halves of the year. Up to June, the general index of wholesale prices remained stationary: the steeper downturn in prices for industrial materials, which dragged down the entire sector of non-agricultural products, was contrasted to the sharp rises for certain livestock and agricultural foodstuffs, encouraged by the devaluation of the « green lira » and by EEC decisions as to prices and import restrictions.

Table 19

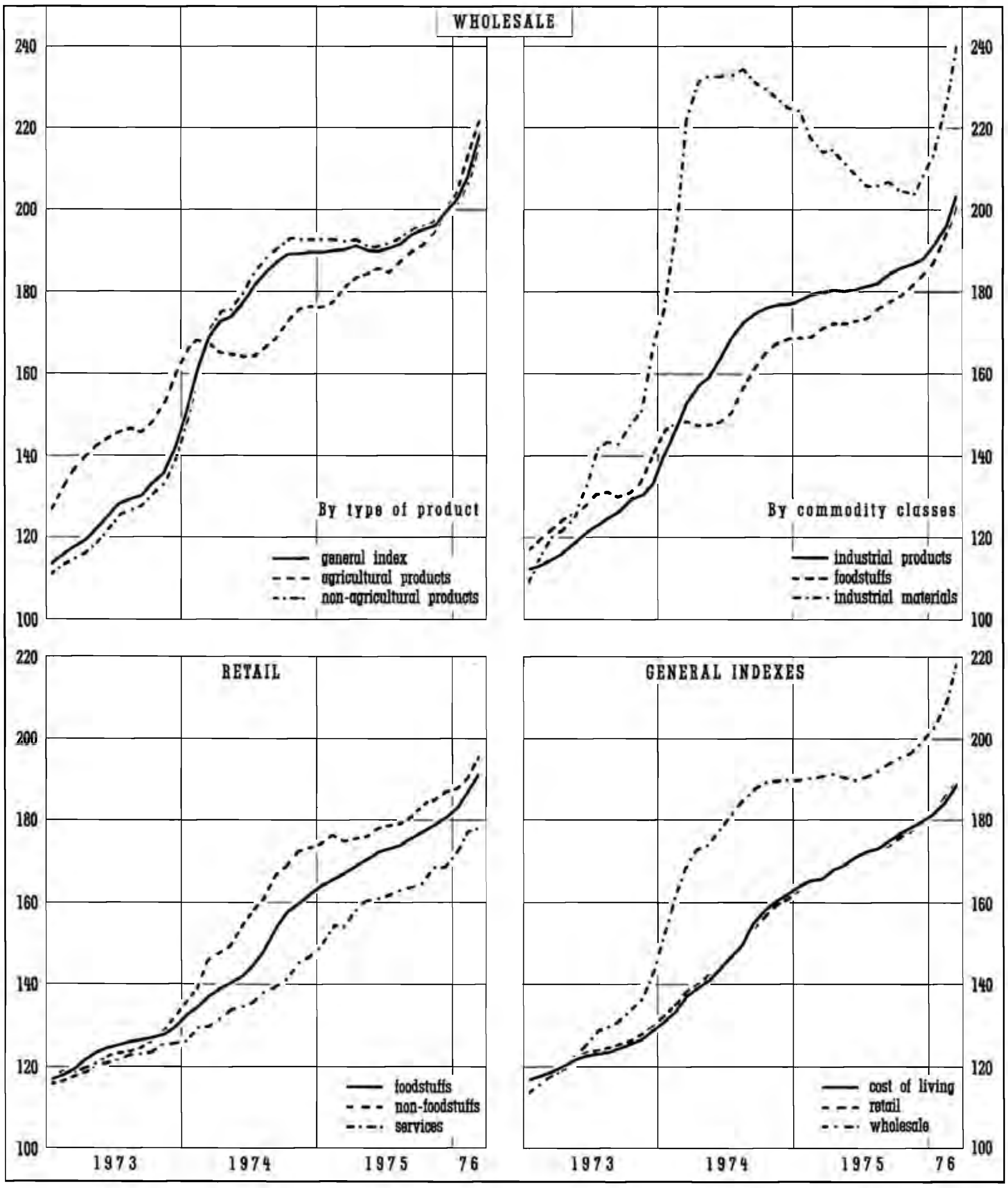
DOMESTIC WHOLESALE PRICES

(percentage changes in indexes, 1970 = 100)

Indexes	1974/1973	1975/1974	Dec. 74/Dec. 73	Dec. 75/Dec. 74	June 75/Dec. 74	Dec. 75/June 75	Mar. 76/Dec. 75
					(on a yearly basis)		
Istat							
General index	40.7	8.6	33.7	4.9	0.1	9.7	38.4
Classification by origin:							
Agricultural	17.3	10.8	9.8	13.0	10.7	14.5	44.2
Non-agricultural	45.5	8.2	38.5	3.6	−1.6	8.8	37.4
Classification by product (1):							
Foodstuffs	21.0	13.0	20.1	9.0	4.4	13.2	38.1
Vegetable	20.5	8.7	11.3	8.4	7.2	9.2	44.5
Animal	13.6	23.1	19.9	22.5	18.5	24.2	38.2
Food manufactures	24.6	11.8	26.6	4.0	−3.1	11.2	33.7
Industrial raw materials and manufactures	48.3	7.2	38.7	3.6	−1.3	8.5	38.5
Raw materials	65.2	−5.4	34.8	−7.3	−14.5	−0.2	61.5
Manufactures	34.4	11.2	33.2	6.2	4.1	8.2	33.0
Classification by use:							
Consumer goods	26.5	9.8	23.3	6.9	2.0	11.7	38.4
Capital goods	39.9	7.6	33.9	2.1	1.8	2.4	41.6
Producer goods	121.5	6.0	80.4	2.7	−7.6	13.4	34.0
Milan Chamber of Commerce							
General index	33.6	7.4	30.1	2.3	−5.1	10.0	49.4
Foodstuffs	18.3	15.0	24.0	9.5	−1.6	20.6	48.1
Industrial raw materials	40.6	4.3	32.7	−0.5	−6.6	5.7	50.0

(1) Istat figures reworked by the Banca d'Italia. The index for industrial material prices does not include crude oil, cement and quarrying products, these being included in the overall index for industrial raw materials and manufactures.

Chart 7



Wholesale and retail prices and cost of living
(indexes, 1970 = 100)

Calculated from Istat data

As from July, the index showed an upturn which gradually became sharper as the months went by, despite the still reduced level of domestic demand. The increase in labour costs was reflected onto prices for manufactured goods, thus intensifying the price rises which hitherto had been confined to certain sectors. At the same time the decline in prices of basic materials came to a halt, while the continuing upswing in agricultural and livestock products generated a rise in the prices of the products of foodstuff processing industries. Globally, wholesale prices showed a 9.7 per cent increase on an annual basis from June to December; 1975 thus closed with a revival of domestic inflation and with stronger expectations of higher rises in connection with both the spread in the trends in labour costs and prices, final products and further wage rises expected from the collective labour contract renewals.

In the first quarter of 1976 a new wave of inflation hit the Italian economy. Between December and March, wholesale price rises were almost double those registered for the whole of 1975 (9.6 per cent, equal to 38.4 per cent on an annual basis).

Table 20

RETAIL PRICES AND COST OF LIVING

(percentage changes in indexes, 1970=100)

Indexes	1974 / 1973	1975 / 1974	Dec. 74 / Dec. 73	Dec. 75 / Dec. 74	June 75 / Dec. 74	Dec. 75 / June 75	Mar. 76 / Dec. 75
					(on a yearly basis)		
RETAIL PRICES							
General index	19.1	17.0	24.5	11.2	11.9	10.0	21.4
Food products	17.8	18.0	24.5	11.6	12.5	10.0	23.7
Non-food products and services	20.3	16.2	24.5	11.0	11.5	10.0	19.5
Clothing and footwear	20.1	16.0	23.3	11.3	8.9	13.1	13.8
Hygiene and health	9.7	12.9	14.6	9.4	9.9	8.5	14.8
Durables and non-durables (1)	21.9	17.7	27.5	10.0	10.9	8.6	15.9
Electricity, gas and fuels:	42.5	6.4	43.2	–7.1	–19.4	5.6	8.5
heating fuels	*111.3*	*10.8*	*56.8*	*5.1*	*0.1*	*10.1*	*11.4*
Housing	5.5	14.0	9.8	11.2	16.0	6.0	11.4
Transport and communications:	27.7	19.5	32.6	14.9	18.2	10.6	40.4
petrol	*60.3*	*11.6*	*50.2*	*4.9*	–	*9.8*	*44.8*
Recreational and cultural goods and services	*19.0*	*19.3*	*25.4*	*14.6*	*14.1*	*14.1*	*11.0*
Other goods and services	25.3	16.4	25.9	13.0	17.3	8.0	20.2
Non-food products	27.4	14.6	31.1	7.9	5.4	10.0	18.4
Services	12.1	18.0	16.6	15.2	19.7	9.8	21.1
COST OF LIVING							
General index	19.4	17.2	25.3	11.1	11.3	10.4	19.4
Food	18.3	18.4	25.4	11.5	12.0	10.3	21.9
Clothing	18.0	15.3	20.9	10.9	8.7	12.6	14.2
Electricity and fuels	41.6	5.1	40.6	–7.3	–21.0	7.2	8.3
Housing	3.8	13.0	8.0	10.5	14.1	6.4	6.8
Miscellaneous expenditure	23.3	18.2	28.8	13.0	14.3	10.8	20.5

Source: Istat.

(1) For domestic use, and services connected with housing.

The retail price index rose by 11.2 per cent in 1975 (Table 20 and Chart 7); the halving of the growth rate with respect to 1974 did not stop Italy's inflation from remaining one of the highest in the Western world. Widespread increases in public utility tariffs pushed the general retail price index up to 11.9 per cent on an annual basis in the first half-year, despite the decrease in electricity prices and the stability of prices for oil derivates. There were sharp rises in the foodstuffs sector, especially as regards meat and fruit, while the increases in labour costs due to wage rises led to a severe upswing in the prices of privately provided services, notably entertainment, hotels and catering.

In the second half of the year the upturn in retail prices slowed down slightly (10 per cent on an annual basis) as a result of the halt in the increase of public utility tariffs and the deceleration in the rises for foodstuffs, while renewed inflationary thrusts were coming in from the industrial sector. The greatest rises were concentrated on certain items of clothing and on means of transport; in November, the prices of petrol and heating fuels also rose (Table 20). In the first quarter of 1976, retail prices, like wholesale prices, showed a decided acceleration (21.4 per cent on an annual basis).

The balance of payments

In 1975 the balance of payments closed with a deficit of 1,341 billion lire, of which 361 billion on current account, 557 on capital movements including 609 billion for repayments of compensatory loans, and 422 on errors and omissions.

The modest deficit recorded on current account in 1975, which stood at 5,212 billion the previous year, was the result of a more extensive adjustment process, even in relative terms, than between 1963 and 1964. Even in comparison with the other industrial countries that made the greatest changes in their current accounts during 1975, the adjustment in Italy appears unmistakably large when taken as a ratio of domestic product.

At constant prices the ratio imports/domestic product was 1.3 points lower than the previous year. The drop in imports (11 per cent in volume) appears exceptionally high when compared, on the basis of

5

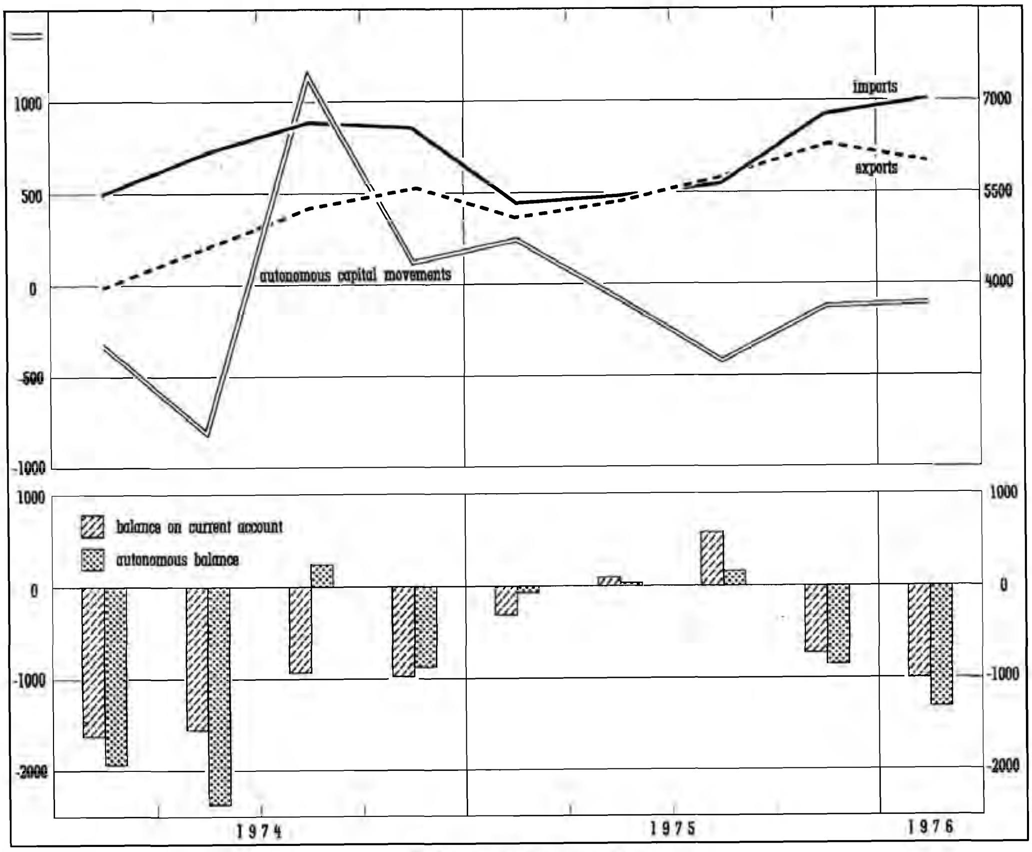
the elasticity coefficient, to the fall-off in domestic product; on the other hand, the yearly average was closer to the trend of industrial production. Extensive changes in inventories accentuated the fall in imports between the last quarter of 1974 and the first quarter of 1975 and then, towards the end of the year, brought forward their recovery with respect to industrial production.

The percentage of output destined for export continued to rise while Italy's share of world trade increased. The inverse correlation that has frequently been observed between the pressure of domestic demand and the increase of exports was again apparent. Some advantage may be gained from the favourable competitive position created by the lira devaluations of 1973 and 1974. The steady pace of exports during 1975 was influenced by agreements, both private and intergovernmental and frequently accompanied by medium- and long-term financing, with East European and OPEC countries. The improvement in the trade balance was partly aided by the performance of the terms of trade, which took an albeit slight turn in Italy's favour after the sharp deterioration of 1974. The surplus of invisibles remained practically stationary compared with 1974.

Capital movements, excluding repayments of compensatory loans, closed in near equilibrium. The inflow of private capital in the form of loans and investments, which began towards mid-1974 and continued through the first half of 1975, fell considerably in the second half (Chart 8). To the extent that these inflows were the result of a restrictive monetary policy, the trend for 1975, when monetary and credit conditions were given an expansionary turn, appears justified. As far as Italian capital is concerned, the administrative controls in force since 1973 reduced the importance of private capital movements in the form of loans and investments, particularly for portfolios. An increasing share of flows of funds was thus absorbed by both short- and long-term export credits. Illegal capital movements meanwhile remained high.

The conditions which paved the way for the marked improvement in the balance of payments in 1975 show that Italy's foreign accounts are still vulnerable and also place a tight constraint on all programmes for a revival of economic activity. The sharp downturn in the propensity to import seems, as already mentioned, to have been largely cyclical in content, a fact which was corroborated by the trend of the trade

Chart 8



Balance of payments
(billions of lire)

balance during the second half of 1975 and the start of 1976. The growth of exports becomes a difficult objective with the climate of world competition tense and oil surpluses being absorbed at a slow pace by certain countries. In any event, successful exports presuppose adequate supply, from both the point of view of a competitive price and the quality of the products. Finally, as international relations now stand, one cannot expect a lasting improvement in the terms of trade from a relative drop in prices for raw materials. Nor, given the price elasticity of our exports, would an improvement of this nature be of much help if it were the result of higher price increases for manufactures in Italy than in competitor countries.

Taking into account the relative scarcity of disposable reserves and the level of foreign debt, which will not easily be increased, the scope for manoeuvre has in fact narrowed. The currency crisis which began in January 1976 is due to the structural weakness and precarious nature of Italy's balance of payments, on which destabilizing capital movements came into play.

Merchandise

In 1975 the trade balance, calculated from customs data, registered a deficit of 2,329 billion, compared with 6,889 in 1974. Of the 4,560 billion drop in the deficit, 3,502 billion was due to an increase in the volume of goods traded and 1,058 to the improved terms of trade. In terms of value, foreign trade was characterized by a complete turnaround in the trend of purchases, which dropped by 6 per cent compared with a 64 per cent increase in 1974, and a drop in the growth rate of exports, which fell from 52 to 15 per cent.

An analysis of the performance of merchandise trade during 1975 using seasonally adjusted data emphasizes that the improvement in the balance, which began in the last half of 1974, was particularly marked in the first quarter. The deficit then remained low until the third quarter and increased sharply in the fourth, returning to levels near those of end-1974.

The fall in imports during 1975 is for the most part linked to a sharpening of the recession, given the strong correlation between the trend of Italian purchases abroad and that of domestic demand. One factor which did much to sharpen the response of imports to changes in the level of domestic activity was inventories. In fact, use of these partly caused the large reduction in Italy's foreign purchases between the second half of 1974 and the first half of 1975 (17 per cent).

With regard to the recovery of demand that began in autumn, there was instead a more than proportional increase in imports, which grew by over 17 per cent in the second half compared with the first half, as against 3 per cent for domestic demand. Export volumes increased by 2.3 per cent during the year. On the basis of seasonally adjusted data, it appears that from quarter to quarter they followed much the same pattern as imports, although variations were less marked.

The slim increase in exports is, however, a positive result when compared with the large drop in foreign demand caused by the worsening of the world recession. It is in fact estimated that world imports of manufactures fell in volume by around 5 per cent in 1975. Consequently, the share of our exports in world trade grew and almost entirely recouped the losses of the previous two years.

The huge drop in the trade deficit for 1975 can be ascribed, as we have already said, both to the positive trend of import and export volumes and to the improvement in the terms of trade, particularly during the third quarter. The latter can be put down to the different performance of prices for raw materials and for manufactures on international markets. The former in fact dropped considerably while the latter increased, though at a slower pace than in 1974. Specifically, the slight rise in crude oil prices and the drop in those for raw materials including foodstuffs appear, considering the importance of these goods in Italy's total foreign purchases (overall about 40 per cent in 1975), to be the main cause of the modest increase in import prices.

During 1975 the rise in Italian export prices quoted in dollars was in line with that of foreign competitors and, consequently, the margins of competitiveness accumulated in recent years following the lira devaluation have remained unchanged. However, considering the basic stability of the exchange rate, Italy managed to maintain her competitive position on international markets by only transferring part of the high increases in unit labour costs onto export prices in lira.

The geographical breakdown of Italy's foreign trade did not change to any very noticeable extent during 1975. The share of sales to developed countries in total exports decreased further (from 65 per cent in 1974 to 62 per cent) in favour of the OPEC countries (from 8 to 11 per cent). On the import side, the only sizeable variations occurred in Italy's purchases from the developing countries which lost ground (from 37 to 34 per cent) following the drop in prices for raw materials. The 4,560 billion improvement in the overall balance was mainly due to lower deficits vis-à-vis OPEC (1,935 billion) and EEC countries (1,814 billion) and to a widening of the surplus vis-à-vis non-oil producing developing countries (806 billion).

Services

In 1975 the balance on transport registered a deficit of 396 billion, 74 billion worse than the previous year. The larger deficit was entirely due to the shipping sector, while the air and overland transport sector recorded respectively a larger surplus (from 121 to 132 billion) and a drop in the deficit (from 179 to 154 billion).

According to available statistics on shipping, Italy's expenditure per ton in 1975 decreased in the case of liquid cargo but rose dramatically for dry cargo. The overall expenditure of Italy for the transport of goods purchased abroad was 1,562 billion, 1,210 billion of which refer to foreign carriers. The revenues of the Italian merchant navy for shipping goods abroad amounted to 821 billion; the growth rate was fairly modest owing to the exceptionally high increase in the number of ships laid up, which more than offset the increased size of the fleet. On the whole, taking into account expenditure by the fleets, it is estimated that the shipping sector registered a deficit of 373 billion in 1975, compared with 264 billion in the previous year.

According to foreign exchange data (not adjusted therefore for the share ascribable to capital outflows), the surplus on tourism more than doubled during 1975, moving from 447 billion in the previous year to nearly 1,000 billion. This improvement was the result of both a sizeable increase in revenues (35 per cent), and a drop in outlays (14 per cent). The favourable trend of revenues for tourism was linked not only to the increase in the number of foreign visitors and in the price of tourist services in Italy (respectively 5 and 20 per cent), but also to a slackening of the distortions connected with illegal capital movements. Even in the case of Italian tourism abroad, lower outlays indicated that foreign exchange data were more accurate and returned to levels that more closely reflected the true size of tourism.

These results depended among other things on the efficacity of the provisions concerning Italian tourism abroad that were enacted in 1974. The introduction of an annual ceiling on foreign currency allowances for residents seems in fact have been more effective than the limits placed on the import and export of Italian bank-notes. In 1975 corrections to foreign exchange data on revenues and outlays amounted, respectively, to 450 and 85 billion lire; in the case of outlays the corrections refer exclusively to the fourth quarter. Figures for the balance of payments on a transactions basis were therefore 2,134 billion for tourism in Italy and 600 for Italian tourism abroad, i.e. a surplus of 1,534 billion compared with 1,160 billion in 1974.

As far as emigrants' remittances are concerned, figures for the balance of payments on a cash basis show an increase of nearly 30 per cent (from 512 billion in 1974 to 665 billion in 1975). The largest rises were registered for remittances from Europe (43 per cent), especially Switzerland (93 per cent). Considering the drop in employment in the countries receiving most of our emigration, these results seem to be connected to the unfreezing of savings kept abroad by Italian workers now unemployed and returning home. The phenomenon, the size of which cannot be ascertained statistically, made it impossible to use traditional techniques to single out possible distortions caused by capital movements. In 1975 therefore, emigrants' remittances and labour incomes were not corrected and the figures for the balance of payments on a transactions basis reflect the foreign exchange data.

Capital movements

Capital movements closed with a deficit of 557 billion compared with a surplus of 1,559 in 1974. Net outflows of Italian capital moved from 1,993 to 1,125 billion, while the inflow of foreign capital dropped from 3,552 to 568 billion mainly in connection with the trend of short-term trade credits and compensatory loans. Repayments of these types of loan amounted to 609 billion whereas in the previous year inflows totalled 1,345 billion. Therefore, net of compensatory loan operations, the 1975 balance registered a surplus of 52 billion, compared with 217 in 1974 (Table 21).

Direct foreign investments, net of disinvestments, stood at 412 billion, more or less at the same level as the previous year. This result does not appear to indicate, at least up to 1975, that foreign capital is gradually being invested less in firms in Italy. Direct Italian investments abroad gave rise to an actual net outflow of around 130 billion, similar to the figure for the previous year, while the accounting outflow, i.e. including corrections for bank shareholdings abroad acquired in previous years, was 226 billion.

Table 21

CAPITAL MOVEMENTS

(billions of lire)

Items	Credit 1974	Credit 1975	Debit 1974	Debit 1975	Balance 1974	Balance 1975
FOREIGN CAPITAL	11,256.8	6,423.0	7,705.0	5,855.2	3,551.8	567.8
Investment:						
direct	807.1	692.1	413.7	279.8	393.4	412.3
portfolio	405.0	246.6	515.1	322.4	–110.1	–75.8
other	48.7	38.3	51.4	31.1	–2.7	7.2
Loans:						
private	2,458.6	917.8	652.7	969.7	1,805.9	–51.9
granted or guaranteed by the Government	177.4	225.5	101.4	99.1	76.0	126.4
other public	83.1	164.3	18.5	49.8	64.6	114.5
Trade credits:						
medium- and long-term	192.7	280.0	211.4	228.9	–18.7	51.1
short-term	3,698.2	3,858.4	2,458.6	3,874.4	1,239.6	–16.0
Capital accounts and others . . .	3,386.0	–	3,282.2	–	103.8	–
ITALIAN CAPITAL	5,404.1	6,764.0	7,396.7	7,888.9	–1,992.6	–1,124.9
Investment:						
direct	160.7	235.4	291.1	461.8	–130.4	–226.4
portfolio	458.1	395.4	375.2	270.1	82.9	125.3
other	0.8	0.3	2.2	2.4	–1.4	–2.1
Loans:						
private	129.0	176.5	251.2	242.5	–122.2	–66.0
granted or guaranteed by the Government (1)	34.5	43.0	19.7	36.2	14.8	6.8
Trade credits:						
medium- and long-term	879.0	1,326.7	749.7	1,300.0	129.3	26.7
short-term	3,742.0	4,586.7	4,708.5	4,825.3	–966.5	–238.6
Other capital	–	–	999.1	750.6	–999.1	–750.6
BALANCE	–	–	–	–	1,559.2	–557.1
BALANCE (excluding compensatory loans)	–	–	–	–	217.2	51.9

(1) Including 6.3 billion for partecipation in the ADF 1975.

Foreign portfolio investments caused a net outflow of 76 billion, 34 less than in 1974. The figure for gross movements, which had already dropped by around 1,000 billion in 1974, decreased by a further 350 billion. Whereas in the past deals almost exclusively concerned shares, recently bond transactions, particularly Treasury bills, have increased. Italian portfolio investments and disinvestments abroad amounted respectively to 270 and 395 billion: the result was a surplus of 125 billion, 42 billion higher than in 1974.

« Other Capital », including the estimate for Italian capital exported outside official channels, indicates an outflow of 750 billion compared with 999 the previous year.

Loans granted abroad amount to 1,308 billion and repayments to 1,186 while in the previous year the figures were respectively 2,719 and 773 billion. Private sector loans, both autonomous and compensatory, outstanding at end-1975 amounted to 7,605 billion, and for the most part were denominated in dollars and marks. Total debt at end-1975, including that of the official monetary institutions, equalled 13,569 billion. The amortization plan is given in Table 22. Italian loans abroad mainly concerned export financing operations and gave rise to an outflow of 66 billion, 56 lower than in the previous. year.

Table 22

AMORTIZATION OF FOREIGN LOANS

(equivalents in billions of lire, at end-year exchange rates)

Oustanding debts at end-1975		Amortization plan	
		Maturity	Amounts
Private loans (1)	7,605	1976	1,834
denominated in:		1977	1,172
dollars	5,369	1978	2,467
marks	270	1979	1,253
lire	1,314	1980	2,071
other currencies	652	later	4,772
Public loans (1)	1,684		
Debts of the official monetary institutions	4,280	....	....
Total . . .	13,569	Total . . .	13,569

(1) Including compensatory loans.

Short-term import credits registered a deficit of 16 billion compared with a net inflow of 1,240 billion in 1974. The deterioration was mainly due to repayments of loans obtained by importers in connection with the import deposit scheme that was abolished in

March last year. The balance for medium- and long-term import credits registered a surplus of 51 billion against a 19 billion deficit for the previous year.

Short-term export credit led to net outflows of 239 billion compared with 967 the year before. Whereas during the middle of the year the situation was one of equilibrium, during the first and last quarters net outflows were recorded. Medium- and long-term export credits created gross movements for 1,000 billion more than the previous year: the suprlus was 27 billion, with a drop of 102 billion.

Monetary movements

In 1975 the net foreign position of the Banca d'Italia and the Italian Foreign Exchange Office (UIC) deteriorated considerably, moving from net assets of 428 billion to net liabilities of 1,367 billion (Table 23). The 1,795 billion deterioration, mainly in the form of liquid assets, was the financial counterpart of the « autonomous » balance-of-payments deficit (732 billion), of repayments of compensatory loans maturing during the year (609 billion), and of the reduction in the net foreign debt of the banks (356 billion). Exchange adjustments registered a deficit of 98 billion.

During the first quarter of 1976 speculative pressure against the lira, excluding the period when the official market was closed, made it necessary to intervene in support of the currency to the tune of 1,200 million dollars. The need to have an adequate amount of liquid reserves available forced the monetary authorities to take up existing credit lines and seek out new ones. Between January and March 500 million dollars were acquired through the swap arrangement with the Federal Reserve and at the beginning of March, 500 million dollars flowed into the official reserves as the bilateral Bundesbank loan was restored to its initial values. Another 450 million dollars were received at the end of the month, being the first instalment of the EEC loan of 1 billion dollars authorized by the Council of Ministers on March 14 (the second and last instalment was paid in April). In addition, negotiations began for a new stand-by credit (530 million dollars) following the Jamaica agreements on extending drawing rights.

Table 23

FOREIGN POSITION OF THE BANCA D'ITALIA, THE UFFICIO ITALIANO DEI CAMBI AND ITALIAN BANKS

(month-end figures in billions of lire)

Items	December 1973	December 1974	December 1975	March 1976 (1)
Banca d'Italia-UIC				
Gold (2)	1,804.3	1,804.3	1,804.3	1,804.3
Special drawing rights (3)	214.3	143.7	66.4	44.0
IMF reserve position (3)	184.0	–	–	–
Foreign currency	1,325.7	2,068.3	826.4	1,135.6
US dollars	944.6	1,636.1	448.1	747.6
Total gross official reserves...	3,528.3	4,016.3	2,697.1	2,983.9
Short-term liabilities	–236.7	–45.5	–27.7	–429.7
Central bank swaps	–186.8	–	–	–420.1
Others	–49.9	–45.5	–27.7	–9.6
Total net official reserves...	3,291.6	3,970.8	2,669.4	2,554.2
Medium- and long-term position:				
Foreign securities in foreign currency and in lire	168.4	176.6	359.6	456.1
Italian securities in foreign currency	131.2	120.2	107.8	127.1
Consolidated accounts	30.5	30.6	30.2	30.2
Special drawing rights accounts	–198.8	–252.8	–254.5	–309.0
IMF accounts	–	–1,093.3	–1,964.7	–2,385.6
stand-by agreement	–	–556.6	–800.2	–971.6
oil facility	–	–536.7	–1,164.5	–1,414.0
Other accounts (EEC, Bundesbank)	–	–2,524.5	–2,315.3	–3,636.2
Total...	131.3	–3,543.2	–4,036.9	–5,717.4
TOTAL BANCA D'ITALIA - UIC...	3,422.9	427.6	–1,367.5	–3,163.2
Banks				
Assets	15,376.9	9,070.8	11,138.0	
Liabilities	15,758.3	9,927.3	11,638.2	
Balance	*–381.4*	*–856.5*	*–500.2*	*–857.6*

(1) Provisional data. – (2) Reserves in gold are calculated on the basis of the exchange rate of 703,297.396 lire per fine gold kilogramme, which was fixed by Law-decree n. 14 of January 28, 1960 and is calculated from a price of 35 dollars per ounce of gold and an exchange rate of 625 lire per dollar. – (3) Special drawing rights and the IMF reserve position are calculated on the basis of the gold parity until June 28, 1974; subsequently, when the gold guarantee no longer existed, calculations were made on the basis of the SDR-dollar and dollar-lira market rate on the last working day of the period.

At the end of March 1976 Italy's external debt, connected with the financing of balance-of-payments deficits, amounted to about 16 billion dollars (Table 24). Little more than half (8.7 billion dollars) came from loans granted by international organizations and central banks and from the net foreign liabilities of the banking system; the rest (7.2 billion dollars) from credit operations on the Euromarket by special credit institutions and public bodies on behalf of the monetary authorities.

Table 24

FOREIGN DEBT FOR OFFICIAL LOANS AND COMPENSATORY FINANCING

(millions of dollars)

Items	1973 December	1974 December	1975 June	1975 December	1976 March
LIABILITIES					
Monetary institutions	*1,016*	*6,957*	*7,306*	*7,035*	*8,738*
Banca d'Italia-UIC	389	5,638	5,514	6,303	7,717
Short-term liabilities	389	70	59	41	545
Medium- and long-term liabilities	–	5,568	5,455	6,262	7,172
EEC	–	1,885	1,885	1,885	2,333
IMF: stand-by	–	857	1,235	1,171	1,156
oil facility	–	826	835	1,706	1,683
Bundesbank	–	2,000	1,500	1,500	2,000
Banks (net foreign liabilities)	627	1,319	1,792	732	1,021
Non-monetary institutions					
Medium-term liabilities (compensatory loans)	6,214	8,284	7,864	7,335	7,235
TOTAL LIABILITIES	7,230	15,241	15,170	14,370	15,973

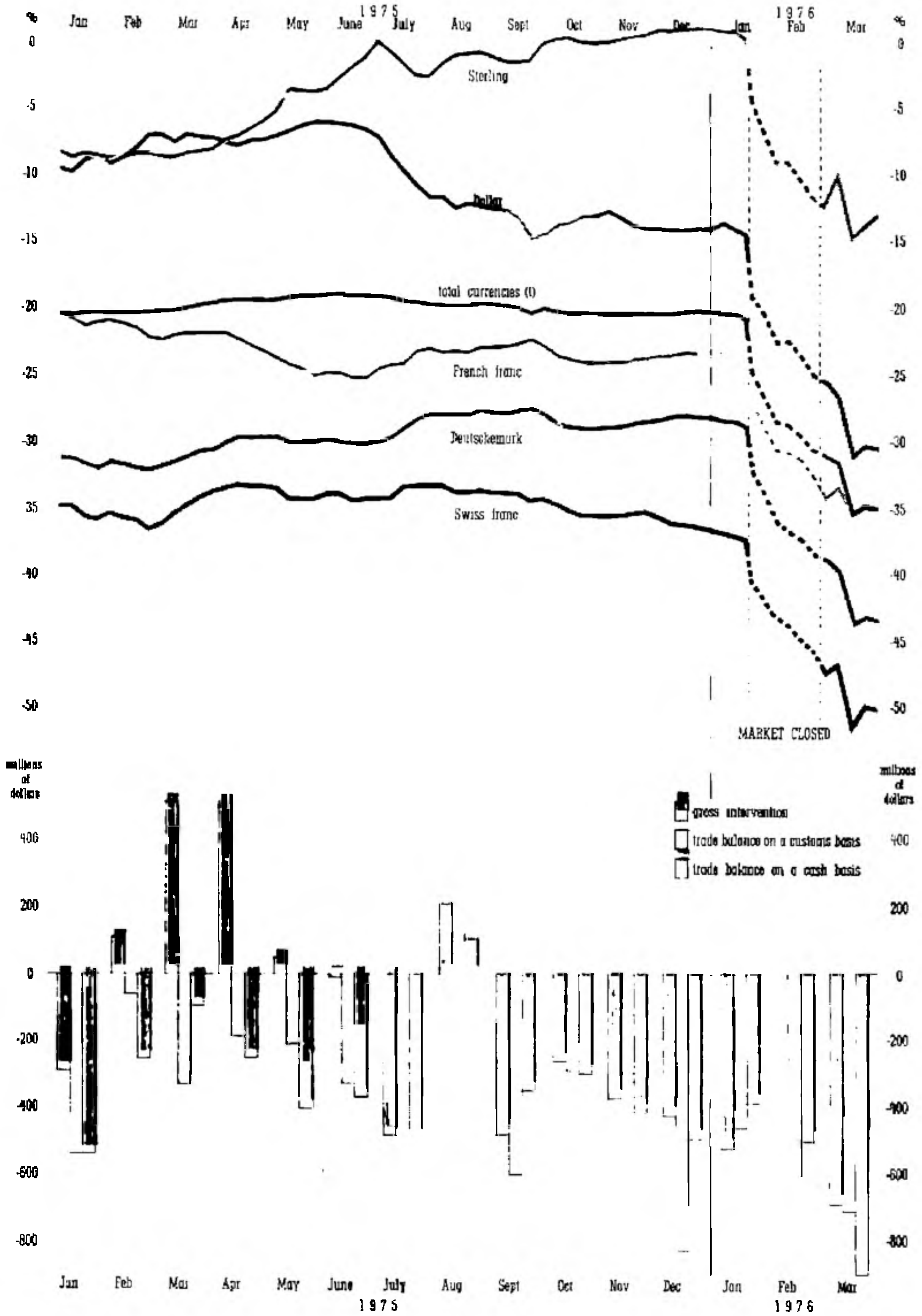
In 1975, the third year of floating, the lira was more stable on the exchange market. During the year the average depreciation rate of the lira vis-à-vis quotations on February 9 1973, weighted according to the geographical distribution of foreign trade, held steady at around 20 per cent. The loss of the lira's external purchasing power compared with average quotations for the previous year was 8.9 per cent in 1973, 9.8 per cent in 1974 and 4.3 per cent in 1975.

The stability of the lira exchange rate during the year was the result of a different trend with respect to the major currencies. In the first half of the year the lira depreciation rate, calculated according to the new weighting, improved by over 1 percentage point (from 20.4

Chart 9

LIRA DEVALUATION RATE, TRADE BALANCE AND SUPPORT INTERVENTION (1)

(for exchange rate changes: weekly averages; for merchandise and intervention: monthly data in millions of dollars)



(1) The lira devalution rate is calculated on the basis of the February 9, 1973 rates and refers to the individual currencies and to the total of the fifteen main currencies. For the latter, the lira exchange rate change is weighted on the basis of the geographical distribution of Italy's foreign trade in 1974.

to 19.1 per cent). The upward movement was restricted by central bank purchases, which absorbed about 900 million dollars from the market, mostly in March and April (Chart 9).

In the second half of the year the average depreciation rate rose by 1 per cent, returning to the same levels as at the beginning of the year (20.4 per cent). Defending the exchange rate implied increasing suport intervention. The appearance of huge disequilibria between demand and supply of currency reflected, in the third quarter, the use of official reserves to finance the drop in the banks' foreign debt, and in the fourth quarter the actual deterioration in the balance of payments caused by the recovery of productive activity. Between end-1975 and the start of 1976 Italy experienced a rapid succession of events of a political and economic nature which added a speculative component to the demand for foreign exchange at a time when the balance of payments was already negatively affected by the economic recovery and by the unfavourable seasonal component. The decision to close the official exchange market on January 20 reflected both the anxiety to save remaining currency reserves and the need to enact the credit and currency measures aimed at reducing external disequilibrium.

When the market opened again at the beginning of March, speculative pressure against the lira did not weaken. Neither the restrictive nature of monetary and credit policy nor the currency provisions were able to reduce the demand for foreign exchange which rose dramatically owing to the accumulation of purchase orders postponed from the previous month and the spreading of the currency crisis to the major countries. The further depreciation of the lira in March is part of the general unease on the exchange markets affecting not only the weaker currencies, such as sterling and the lira, but also the French franc, which was forced to abandon the intra-EEC fluctuation margins, the Belgian franc and the Danish crown. The lira depreciation rate rose at the end of March to 34.7 per cent compared with February 9 1973 and to 17.4 per cent compared with January 20 1976.

Public finance

In 1975 disbursements by the public sector rose by 23 per cent and revenues by 15 per cent: net indebtedness thus increased from 6,700 to about 11,000 billion. Also taking into account the State's funding of debts of certain public bodies, the deficit for 1975 was more than 13,250 billion lire, or almost 12 per cent of the gross domestic product. The growth of net indebtedness was mainly due to current account operations, which were affected by the measures taken during the year to improve social security benefits (increases in pensions, family allowances and benefit payments for the Wage Equalization and Unemployment Funds) and to speed up refunds of indirect taxes. On the other hand, disbursements for investments, like the value of completed public works, did not show any marked increase: the numerous provisions adopted, in fact, could not make their effects felt because of the implementation lags. The operations of the public sector thus provided mainly a stimulus to the spending capacity of the private sector.

Indirect tax revenues grew very little (around 1 per cent), in spite of the heavier rates introduced in the summer of 1974. This slowdown can be referred mainly to VAT, the yield from which remained far below what it should have been according to the trend of consumption at current prices. The reasons for this were a speed-up in refunds of tax credits, mostly in favour of exporters, the redefinition of « minor taxpayers » (which caused part of the receipts to be postponed to 1976) and lastly a possible increase in tax evasion partly because of a reduction of the share, in total taxable income, of imports which are most easily checked.

Direct taxation, on the other hand, increased considerably (over 22 per cent), even though the new personal income taxes for 1974 had not been paid owing to difficulties in administrative collection procedures. Specifically, personal income tax revenues rose by 70 per cent with respect to 1974 (roughly 35 per cent taking into account an estimate of the smaller yield for 1974 as the tax was brought into force). This rise can be attributed to the trend of taxable income of employees (including pensions) and to the high elasticity of this tax, while the increase in tax deductions approved in the summer of 1974 reduced the revenue for 1975 by more than 700 billion lire. The average personal income tax actually levied in 1975 was 7 per cent of the taxable income of employees calculated from the national accounts.

In the State sector (Treasury, Central Post Office Savings Fund and autonomous agencies) total borrowing requirements (including debts contracted to finance other General Government bodies, public enterprises and special credit institutions) amounted to about 14,150 billion lire, as against 8,650 in 1974. This increase was mainly due to greater disbursements for net social benefits, wages and salaries, interest payments, expenditures by autonomous agencies and by the Southern Development Fund and the low increase, already mentioned, in indirect tax revenues. The size of the requirements was, including the funding of debts of public bodies, even higher in 1975, exceeding 16,500 billion lire, or almost 15 per cent of the gross domestic product (Table 25).

Table 25

TREASURY CASH REQUIREMENTS AND THEIR COVERAGE (1)

(calendar years and quarters; on a cash basis; billions of lire)

Items	1973	1974	1975		1976 1st qtr.
			1st qtr.	Year	
Overall cash requirements					
Budget deficit (–)	–7,302	–5,204	–2,725	–10,217	–1,786
Minor Treasury operations	841	–1,936	–120	–4,199	49
Extra-budgetary operations	–1,510	–1,822	–621	–2,147	–762
Total	–7,971	–8,962	–3,466	–16,563	–2,499
Operations to fund local auths' and public health insurance institutions' debts (2)	*–469*	*–315*	*–1,539*	*–2,393*	*–33*
Total, net of funding	–7,502	–8,647	–1,927	–14,170	–2,466
Coverage of overall cash requirements					
Medium- and long-term bonds excluding Banca d'Italia	562	–182	1,611	3,609	1,418
Post Office savings	1.528	837	207	2.309	879
Treasury bills, excluding Banca d'Italia	700	1,881	730	1,627	–2,762
Borrowing from BI-UIC	5,016	6,498	986	8,836	3,479
current account (3)	*1,005*	*50*	*11*	*560*	*584*
Foreign indebtedness	106	3	–1	10	19
Other indebtedness	59	–75	–67	172	–534
Total	7,971	8,962	3,466	16,563	2,499
domestic financing:					
short-term	*7,297*	*9,130*	*1,915*	*12,988*	*1,060*
(monetary base creation, through "Treasury") (4)	*7,143*	*7,671*	*321*	*7,779*	*3,145*
medium- and long-term	*568*	*–171*	*1,552*	*3,565*	*1,420*
Net indebtedness (5)	5,772	6,680	2,601	13,736	1,376

(1) For the 1st quarter of 1976 some figures are estimated. – (2) For 1973 and 1974 bond operations by the Post Office Savings Fund to fund loans granted by banks to Municipalities and, for 1975, operations to place the burden of public health insurance institutions' debts to hospitals and clinics on the budget, which were carried out through issues of special Treasury certificates. – (3) Figures with a plus sign indicate larger Treasury borrowing. – (4) Calculated without taking into account Treasury bill operations to offset the banks' losses. – (5) Changes in the financial situation, i.e. borrowings less lendings.

The increase in borrowing requirements was concentrated into the last months of the year, especially December: in the fourth quarter the requirements were about 3,000 billion more than the programmes implicit in the forecast for the whole of 1975 which had been given to the EEC in October when the ceilings for 1976 envisaged by the medium-term support agreement were being fixed. This sudden expansion at the end of the year posed serious problems for the management of the system's liquidity and caused the growth targets for the monetary base to be exceeded.

Despite the massive increase in borrowing requirements, the large number of bonds placed on the market made it possible to create less monetary base through the Treasury than in the previous year. This reduction, however, was much lower than that registered for absorption of liquidity by the balance of payments net of compensatory loans. Moreover, the massive placements of bonds mentioned above were mainly achieved through issues of short-term Treasury bills, repayment of which has caused and continues to cause further difficulties in managing the system's liquiditity.

Specifically, central bank financing to the Treasury amounted to less than the year before (5,400 billion lire as against 6,500). The new figure takes into account the effect of the recent changes in regulations on compulsory reserves; in fact, the central bank purchased Treasury bills using the funds received as the Treasury bills held in the banks' compulsory reserves were repaid. This reduction can be explained not only by the market placement of bonds mentioned above but also by the recovery of Post Office savings.

The deposits, after the large repayments registered since June 1974 mainly owing to the trend of the differential between bank and Post Office interest rates, began to show substantial inflows as from March 1975. These inflows then continued to grow during the year, as a result both of the increase, in October 1974, in interest on Post Office certificates and deposit accounts, and of the reduction in the interest rates paid by the banks.

An analysis of the ratio of overall tax revenue to GNP, in the major OECD countries for the period 1962-1974 shows that in Italy this ratio, which in 1962 was close to the average (27 per cent), was one of the lowest in 1974, amounting to 31 per cent as against an average of 37 per cent for the other countries. In 1974 social security contributions in the countries examined amounted to an average of one fifth of the total tax revenue in 1974 and to 8 per cent approximately of national income, Italy, the Netherlands and France having the highest proportion. For Italy and the Netherlands, in fact, social security contributions were the main source of revenue in 1974, amounting respectively to 13 and 18 per cent of national income.

In 1974, the ratio of indirect taxation to national income in Italy was one of the lowest (11 per cent as against an average of around 14 per cent for the other countries examined); in 1962 the ratio was 12.5 per cent, practically equal to the average for the other OECD countries. This downturn is at least partly connected to the considerable weight of the revenues from non-ad valorem taxes.

Also as regards direct taxation, Italy, together with France, showed the lowest proportion of national income in 1974 (about 7 per cent, as against an average for the other countries under study of over 15 per cent, with peaks of around 28 and 21 per cent respectively for Denmark and Sweden). However it should be pointed out that after the recent reform of direct taxation the proportion in Italy should grow, owing to both the greater progressiveness of the new personal income tax with respect to the old taxes and to the reduction in the possibilities for evasion, which have been almost eliminated for the incomes of employees.

THE MONEY AND FINANCIAL MARKETS

At the end of 1974, the reduction in the balance-of-payments deficit and the slowdown of inflation induced the monetary authorities to increase the growth rate of the monetary base, albeit with the intention of keeping the expansion of credit within the limits imposed by Italy's international commitments. In the first half of 1975, the growth of the monetary base, though moderate, was still sufficient to allow considerable reductions in interest rates on the money and financial markets. The cost of bank loans, however, did not drop quite as promptly, both because the ceilings on loans were retained until March and compulsory investments in securities remained high, and because the downturn in the demand for credit by private enterprises was offset by the larger growth of financing to the public enterprises and and to General Government.

In order to speed up the reduction of bank interest rates and restore a more normal structure of yields according to maturities — and hence to encourage a return to a balanced composition of households' financial wealth and banks' assets — the monetary authorities changed the rules for the application of the portfolio constraint and did not renew the ceilings on the expansion of loans. At the end of the first half-year, they reduced the quota for the portfolio constraint. This slackening of direct controls over bank credit and the enlargement of the market for Treasury bills tended to pursue the same objectives also by sharpening competition on the money markets.

In the first half of the year, a larger increase in the Treasury deficit than forecast did not, however, immediately create difficulties in controlling liquidity, since large issues of Treasury bills were placed. The increase in households' purchases of medium- and long-term securities also helped to curb deficit financing with monetary assets. The liquidity created by the Treasury was added to that created by abolishing the non-interest-bearing deposit on imports.

The increase in the banks' total reserves allowed bank credit to grow rapidly. However, the composition of demand, the administrative constraints and the conditions prevailing on the money and financial markets encouraged a further rise in the share earmarked for investment in securities, which is in any case normal in times of depressed productive activity. A particular feature of this trend during 1975 was the shift towards shorter-term securities, which was justifiably large in view of the intensity of the previous year's credit squeeze and the uncertainty as to future prospects for the Italian economy, both of which fostered the increase in the banks' demand for liquid or semi-liquid assets: in the first half-year, the amount of Treasury bills held by the banks more than doubled.

The growth in the money stock and, in particular, in bank deposits slackened in the first months of 1975; a contributing factor was the absorption of the liquidity created at the end of the previous year by bank refinancing. In the second quarter the progressive increase in the Treasury deficit caused a turnaround in this tendency and raised the growth rate of money.

The gradual return of households to bond purchases, already stimulated by relatively high long-term yields and by changed expectations of inflation, was strengthened by the reduction of the rates on bank deposits; the banks, however, continued to absorb the largest share of long-term security issues. The flow of funds to the special credit institutions was particularly abundant and certainly much larger than their lending operations, thus increasing their liquid reserves. The increase in the surplus of savings over investments by households and enterprises was greater than that of expenditure over revenue in the public sector and hence sufficient to bring about a marked improvement in the balance of payments on current account, with a slight recovery in the exchange rate.

At the end of the first half of 1975, the low levels of productive activity and the moderate rise in prices induced the authorities to enact a more expansionary monetary and fiscal policy. The Treasury deficit began to grow rapidly as a result of current transfers to households. Moreover, the measures concerning the building industry and the subsequent anticyclical decrees passed in August indicated a desire to give priority to the stimulation of certain sectors of productive activity; the effects of these measures however were not, nor could be, immediate. At the end of June the prime rate was four points lower than at the beginning of the year. In the face of a severe crisis in economic activity there were pressures from various quarters to increase the system's liquidity and to accelerate the downturn in short-term rates, even though these were not sufficient conditions for a recovery.

In July and August, monetary base creation was abundant in spite of a massive placement of Treasury bills and the repayment of debts contracted by the banks with the central bank; the yield on Treasury bills dropped by one point with respect to the June auction. The enterprises began to exchange their indebtedness in foregin currency with the banks, and probably also their foreign debts, for bank loans in lire, which increased rapidly owing to the more permissive conditions on the short-term credit market while the dollar showed a world-wide tendency to rise. In September, the government authorities attempted to reduce interest rates partly by means of direct interventions with the banks. Furthermore, automatic refinancing of export credits by the Italian Foreign Exchange Office (UIC) was introduced for a period of four months. The amount of monetary base that could be created as a result of this measure and the speed at which it entered the system could not be strictly controlled by the central bank. The cost of bank financing dropped rapidly, both as a result of the greater supply of credit and because this measure also had a direct effect on the cost of loans via the subsidized rate applied to the percentage eligible for refinancing. The long-term rates, however, were kept relatively stable at the levels reached in the first quarter.

The reduction of the discount rate to 6 per cent made it more profitable for the enterprises to use the subsidies on export credits. Nevertheless, the expansion of credit still appeared compatible with the international commitments, according to updated forecasts for financial flows which included an estimate of the Treasury deficit for 1975 at not more than 11,000 billion. In the last quarter of 1975, and especially in December, the deficit reached huge and unexpected proportions, rising to 14,200 billion at the end of the year.

The massive flow of funds from the public to the financial market weakened the monetary effects of the Treasury deficit by slowing the growth rate of the money stock. The yields on bonds and government securities remained sufficiently stable, reaching a minimum in November; the slight excess demand for long-term securities on the financial market was reabsorbed through net sales by the Banca d'Italia.

On the other hand, the policy of low short-term interest rates made it more difficult to control liquidity. In the last quarter the huge quantity of maturing Treasury bills owned by the financial intermediaries and the public exceeded the amount of new placements owing to the insufficient yields offered, while the demand for credit by the private sector was recovering. In fact there was a more rapid growth both of loans by the banks and of long-term financing by the special credit institutions, which used part of the liquidity they had previously accumulated.

In addition the repayment by the banks of the fixed-term advances and of the rediscount with the central bank reduced the possibilities of maintaining monetary base creation at the desired level, given the Treasury's cash requirements.

The fact that the public sector continued to resort heavily to the bond market, at a time when the demand for credit by the private sector was recovering, induced the monetary authorities to prolong the banks' compulsory investment in long-term securities to the first half of 1976. At the same time the provision for automatic refinancing of short-term export credit was extended to April.

At the end of December, as notes began return to the banks, their excess reserves became abundant and in the first three days of January alone increased by 770 billion; the huge quantities of Treasury bills strengthened the banking system's degree of liquidity. Since this expansion of liquidity was dependent on the financing of the Treasury's requirements, the banks were not obliged to resort to advances and rediscount in spite of December's seasonal needs, and thus the usual reabsorption through repayment of debts with the Banca d'Italia did not occur at the beginning of 1976; at the beginning of January 1,500 billion's worth of four-year Treasury bills were issued.

In the last months of 1975 the fall in short-term rates had encouraged the rebuilding of inventories and a shift towards foreign assets, thus contributing to the progressive worsening of the balance of payments. The prospects as to the development of foreign accounts were, moreover, negatively influenced by the trend of the unit cost of labour in Italy compared to that of the other major industrial countries. At the beginning of 1976, during the government crisis, a speculative attack was launched against the lira, and made it necessary, in view of the scarcity of foreign exchange reserves, to suspend official quotations and interventions by the monetary authorities on the foreign exchange market. The increase in the banks net foreign debt allowed the balance-of-payments deficit to be financed.

The progressiveness of the subsequent restrictive monetary measures was due to a fear of endangering the recovery that was under way. Use of compulsory reserves allowed part of the monetary base created to finance the Treasury to be absorbed: short-term rates were brought back to levels more suitable for limiting the disequilibrium in foreign accounts and the structure of yields by maturity underwent a complete turnaround. During this period of interest-rate adjustment, when the households were not contributing long-term funds, the portfolio constraint helped to maintain orderly conditions on the financial market and to ensure the relative stability of the flow of funds to the special credit institutions and of their outlays.

Since it was impossible to enact an adequate fiscal policy and curb the growth of monetary incomes, the worsening of the foreign exchange crisis led the monetary authorities to step up the credit squeeze in order to limit the depreciation of the lira and to prevent its positive effects on the balance of payments from being rapidly nullified. Before the reopening of official quotations the automatic refinancing of export credit was revoked. The tension on the money market forced the Banca d'Italia to grant last-resort credit and to buy back Treasury bills with the earliest maturities; the official discount rate was raised to 12 per cent after the increases already applied in February.

At the end of March, the difficulties in controlling liquidity were worsened by the huge quantities of Treasury bills reaching maturity, placement of which had made it possible, in 1975, to regulate the monetary effects of the swelling of the Treasury deficits for the time being. The fiscal measures taken in March affected the public sector's deficits only marginally over the short run. The situation of severe uncertainty and the lack of an efficient secondary market for Treasury bills caused the financial intermediaries to change the composition of their liquid assets in favour of monetary base assets; in the Treasury bill auction held that month the market obtained a net refund of 1,090 billion.

In April, the Treasury deficit was higher than forecast; in the following months, to the deficit could be added the needs arising from an only partial renewal of the Treasury bills reaching maturity held by the financial intermediaries and other operators (roughly 3,400 billion between May and July). At the beginning of May, as speculative pressures on the foreign exchange market sharpened, the compulsory non-interest-bearing deposit on all foreign exchange purchases was reintroduced for three months as an emergency measure, with the foreseeable effect of draining liquidity to the tune of about 1,000-1,500 billion a month.

Total financing for 1975 and forecasts for 1976

In 1975, the expansion of credit to domestic users reached 32,400 billion lire (22,326 in 1974). Credit to the public sector, net of financing to the economy, reached about 16,960 billion (9,722 in 1974), growing much more rapidly than that granted to the private sector mainly owing to the swelling of current deficits. Financing to the economy rose by 14.1 per cent (12.5 in 1974).

The net debt of the public sector and the enterprises led, either directly or via the intermediation of the credit institutions, to the creation of a vast quantity of financial assets, which were entered in the households' balance-sheet. The balance-of-payments deficit on current account provided only 360 billion towards covering the insufficient savings by domestic sectors.

Up to the month of June, total credit expansion was slightly less than envisaged (24,700 billion in the year ending in March 1976) under the terms requested by the EEC when the loan for 1,562 million units of account was granted, even though Treasury requirements had exceeded the agreed amount by about 1,000 billion, owing to a larger fall in production than expected. In the last months of 1975, the unexpected and exceptionally high increase in the requirements of the government sector pushed the Treasury deficit for the year up to 14,150 billion instead of the 8,000 billion forecast. In early 1976, the recovery of the demand for credit by the enterprises was added to the massive deficits in the government sector, and was reflected not only in the formation of financial assets but also in the large balance-of-payments deficit. It is estimated that, for the twelve months ending in March, total domestic credit exceeded the amount agreed with the EEC by 8,900 billion.

The limits fixed for total domestic credit and for credit to the government sector were renewed in November 1975, when a ceiling

Chart 10

SOURCES OF MONETARY BASE

(cumulative monthly changes; seasonally adjusted data in billions of lire)

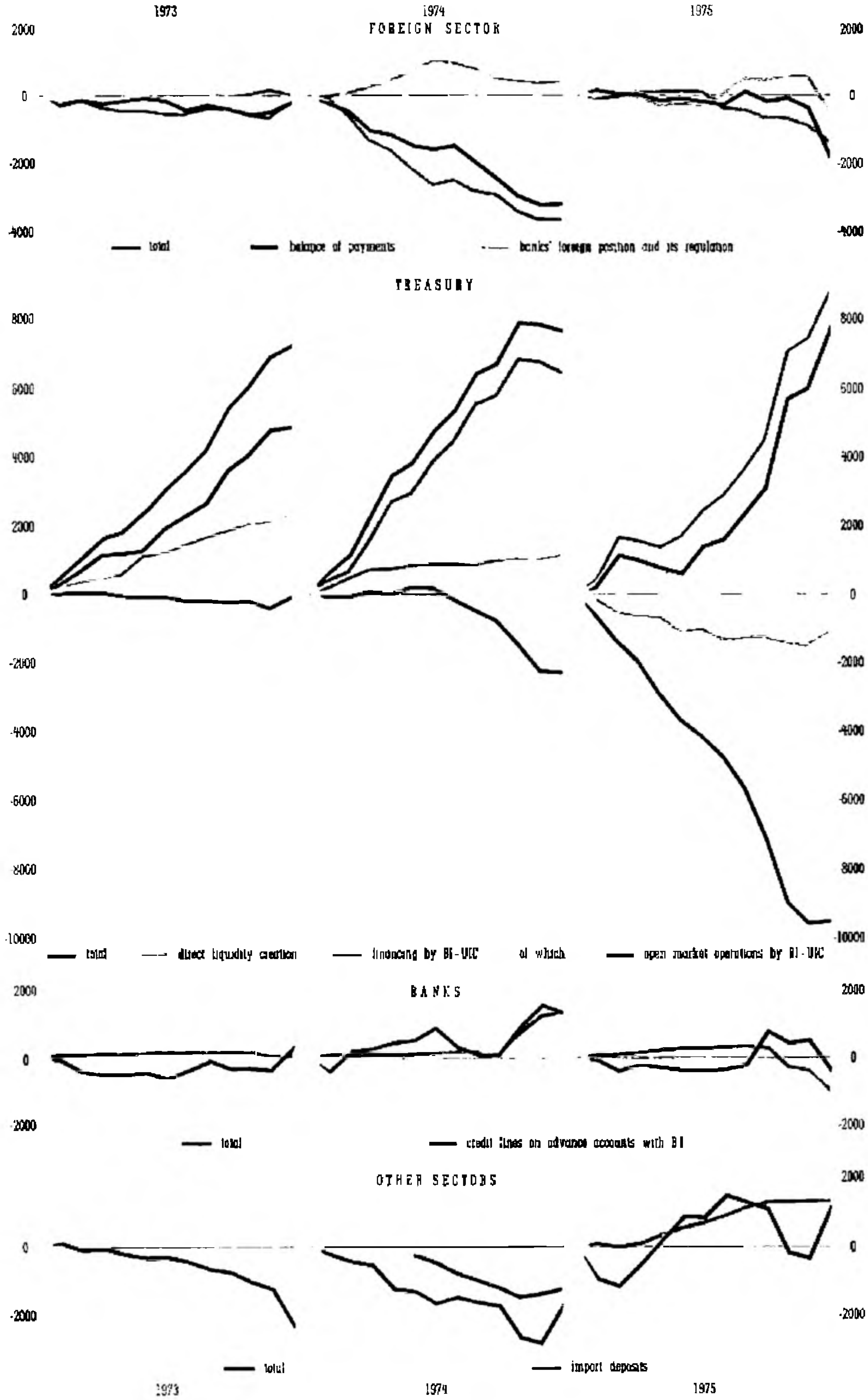
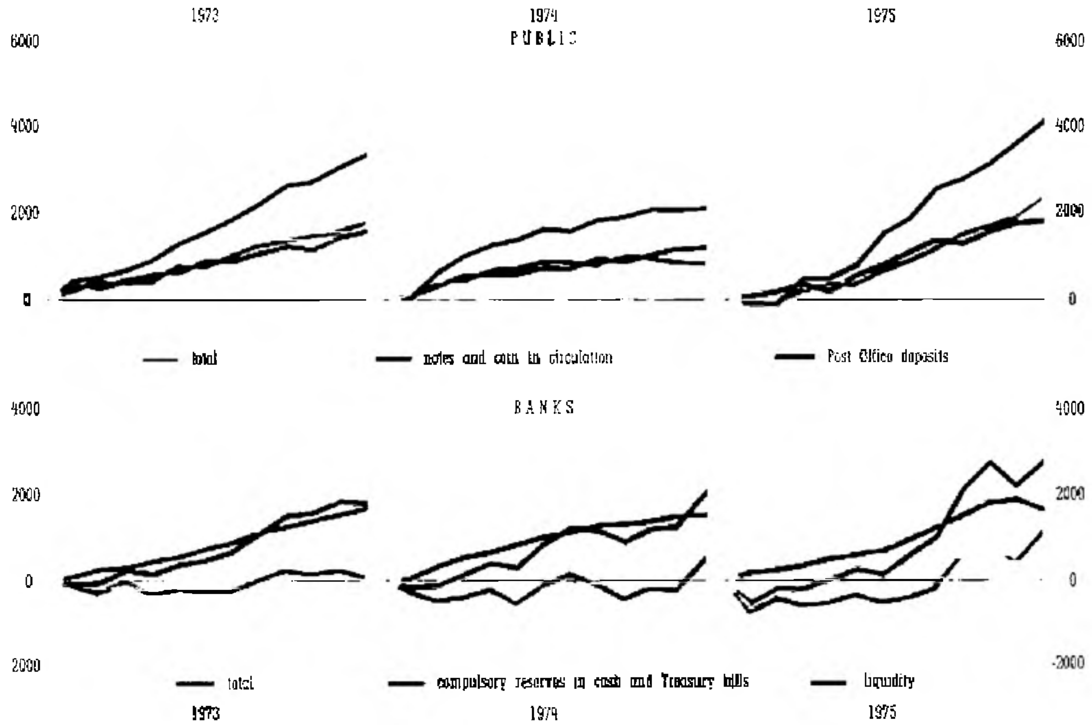


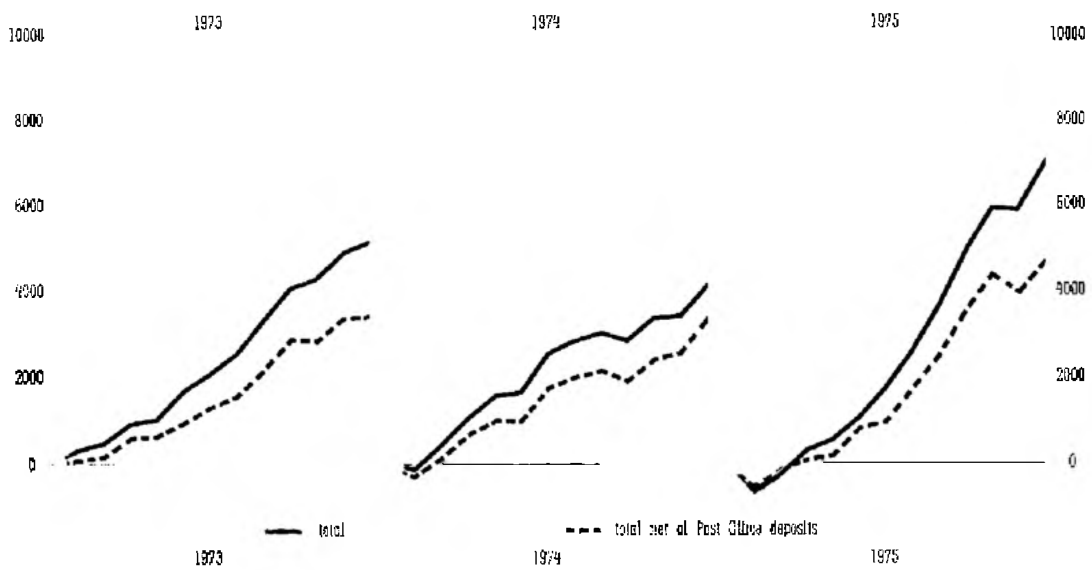
Chart 11

USES OF MONETARY BASE

(cumulative monthly changes; seasonally adjusted data in billions of lire)



TOTAL MONETARY BASE



was also introduced on central bank financing to the Treasury. These limits were changed in March of this year, in connection with the approval of a one-billion dollar Community loan to Italy. According to the recommendations of the EEC Council of Finance Ministers, total credit should not exceed 29,500 billion lire in the calendar year 1976, the government sector's requirements should not rise above 13,800 billion (14,000 billion including credit operations in favour of the special credit institutions), and the central bank's financing to the Treasury should not exceed 5,700 billion. Given the expected rise in prices, this volume of total financing implies restricting credit to the private sector, unless the deficit of the government sector turns out to be less than forecast or unless there is a considerable improvement in the balance of payments.

The central bank's operations and the regulation of monetary base

During 1975 the monetary authorities attempted to create gradually the conditions that would favour the recovery of the economy and this led to a limited creation of monetary base in the first half of the year. In the second half, the automatic refinancing of export credits and, above all, the exceptional and unforeseen increase in the Treasury deficit caused a sharp acceleration in the growth of monetary base, since in that period it was sought to reduce interest rates.

The total amount of monetary base in the system was 42,438 billion at the end of 1975, and 29,125 billion net of Post Office deposits. If we consider the trend of these two figures over the last three years we observe that, after the 1974 downturn, 1975 saw a return to the very high growth rates of 1973: the increases were 19.4 per cent in 1975, 13.1 in 1974 and 19.3 in 1973 (excluding Post Office deposits the figures for these three years were respectively 18.6, 15.4 and 18.6 per cent; Table 26).

The foreign sector absorbed 1,699 billion's worth of monetary base, about half of the figure for the previous year. Creation by the Treasury amounted to 7,779 billion (Charts 10 and 11).

Since liquidity gradually became abundant over the year and demand for loans was slack, the banks were encouraged to repay 389

Table 26

MONETARY BASE

(changes in billions of lire)

Items	1973 (1)	1974	1975					1976
			Year	Quarters				Quarter
				I	II	III	IV	I (2)
SOURCES:								
FOREIGN SECTOR .	−204.6	−3,115.0	−1,699.4	−72.0	37.1	−926.6	−737.9	−1,095.2
TREASURY	7,242.8	7,670.6	7,779.3	320.9	941.3	1,652.6	4,864.5	3,145.2
BANKS	277.2	1,362.3	−389.0	−675.5	32.3	849.8	−595.6	−1,197.2
OTHER SECTORS . .	−2,229.1	−1,812.4	1,191.2	8.0	287.3	1,120.2	−224.3	120.5
tied foreign currency deposits with BI-UIC	*−2,164.1*	*−1,118.6*	*599.9*	*270.0*	*211.7*	*78.5*	*39.7*	*−737.4*
TOTAL (*) . . .	5,086.3	4,105.5	6,882.1	−418.6	1,298.0	2.696.0	3,306.7	973.3
Total (excluding Post Office deposits)	3,333.3	3,276.2	4,573.3	−640.0	844.4	2,267.6	2,101.3	93.9
USES:								
PUBLIC SECTOR . .	3,313.1	2,042.9	4,123.5	−282.5	1,165.0	623.6	2,617.4	410.9
BANKS	1,773.2	2,062.6	2,758.6	−136.1	133.0	2,072.4	689.3	562.4
Compulsory reserves and backing for cashiers' cheques (2)	1,661.5	1,494.2	1,633.7	553.3	324.7	566.0	189.7	2,165.4
Excess reserves . . .	111.7	568.4	1,124.9	−689.4	−191.7	1,506.4	499.6	−1,603.0
(*) of which:								
domestic component (4)	*7,455.0*	*8,339.1*	*7,981.6*	*−616.6*	*1,049.2*	*3,544.1*	*4,004.9*	*2,805.9*
foreign component (5)	*−2,368.7*	*−4,233.6*	*−1,099.5*	*198.0*	*248.8*	*−848.1*	*−698.2*	*−1,832.6*

(1) Data adjusted for an estimate of random movements caused by strikes of bank employees at end-1972, which increased the end-December amounts of notes and coin in circulation by 500 billion (the public's currency by 450 billion and the banks' vault cash by 50 billion), of Post Office deposits by 250 billion, of BI-UIC financing to the banks by 500 billion, of the autonomous components of the Treasury's sources by 100 billion (Post Office deposits + 250 billion and Treasury current account -150 billion) and of the other BI-UIC liabilities by 150 billion. — (2) Provisional figures. — (3) Includes cash, Treasury bills and long-term securities deposited in return for releasing cash. — (4) Treasury, banks and other sectors (net of compensatory loans). — (5) Foreign sector and compensatory loans of the other sector.

billion's worth of financing to the central bank. The other sectors created monetary base to the value of 1,191 billion, practically the same figure as that for liquidity put back into circulation via the gradual reimbursement of the import deposit.

By contrast with 1974, the sharp reduction of bank interest rates led to a large absorption of monetary base by the public (18.8 per cent).

Table 27

CONSOLIDATED BALANCE SHEET OF THE BANCA D'ITALIA AND THE UFFICIO ITALIANO DEI CAMBI

(amounts and changes in billions of lire)

Items	Amounts at end of 1975	1973	1974	1975 Year	1975 Quarters I	II	III	IV
ASSETS		*(changes)*						
Lending to the Foreign sector and gold (1) . .	4,161.8	159.1	764.7	−989.8	−216.2	47.8	−215.0	−606.4
Lending to the Treasury	32,005.7	5,214.1	6,209.0	11,050.8	1,036.8	2,193.0	3,276.7	4,544.3
current account	*3,522.3*	*1,004.9*	*49.6*	*560.1*	*10.5*	*56.6*	*644.4*	*−151.4*
securities (2)	*24,154.6*	*4,009.6*	*5,911.6*	*8,769.1*	*1,035.7*	*2,170.1*	*687.9*	*4,875.4*
other credit	*4,328.8*	*199.6*	*247.8*	*1,721.6*	*−9.4*	*−33.7*	*1,944.4*	*−179.7*
Lending to the banks (3)	2,531.0	−235.1	1,083.8	−656.5	−692.3	343.8	490.2	−798.2
Lending to the special credit institutions . . .	196.3	34.0	24.8	−29.0	−53.3	−3.7	42.1	−14.1
Other accounts	1,867.3	194.1	2,425.2	−1,266.2	−1,760.4	254.9	−34.8	274.1
TOTAL . . .	40,762.1	5,366.2	10,507.5	8,109.3	−1,685.4	2,835.8	3,559.2	3,399.7
LIABILITIES								
Currency in circulation	12,996.9	1,283.0	1,143.2	1,780.2	−692.9	690.6	157.1	1,625.4
Notes	*12,921.3*	*1,281.5*	*1,130.5*	*1,761.8*	*−678.9*	*653.8*	*174.7*	*1,612.2*
Banca d'Italia cheques	*75.6*	*1.5*	*12.7*	*18.4*	*−14.0*	*36.8*	*−17.6*	*13.2*
Deposits of the special credit institutions (4) .	4,024.6	1,865.4	929.8	142.9	−280.9	362.5	−607.8	669.1
Deposits of the banks	13,382.6	845.6	1,722.4	5,795.1	871.4	1,429.0	2,401.0	1,093.7
compulsory reserves and backing for cashiers' cheques	*11,680.7*	*1,048.1*	*1,255.6*	*5,042.5*	*1,291.4*	*1,423.0*	*1,316.8*	*1,011.3*
other accounts (5)	*1,701.9*	*−202.5*	*466.8*	*752.6*	*−420.0*	*6.0*	*1,084.2*	*82.4*
Deposits and credit of the Treasury	2,497.8	120.9	−38.5	2,216.4	54.9	224.4	1,852.0	85.1
current account	–	–	–	–	–	–	–	
other accounts	*2,497.8*	*120.9*	*−38.5*	*2,216.4*	*54.9*	*224.4*	*1,852.0*	*85.1*
Deposits of the Foreign sector	5,528.4	282.0	3,759.8	804.4	−179.8	−2.4	859.6	127.0
Other accounts (6)	943.8	734.5	3,004.5	−2,954.4	−1,454.3	−54.7	−1,092.1	−353.3
Equity capital	1,388.0	234.8	−13.7	324.7	−3.8	186.4	−10.6	152.7
TOTAL . . .	40,762.1	5,366.2	10,507.5	8,109.3	−1,685.4	2,835.8	3,559.2	3,399.7

(1) Differences with the balance-of-payments monetary movements are the result of reclassification of foreign currencies held in trust on behalf of third parties.— (2) Book values net of end-year depreciation and revaluation.— (3) This item differs from Tables 26 and 30 because it does not include the unused borrowing margin on ordinary advance accounts.— (4) From December 1969, this item includes the special credit institutions' foreign currency deposits with the BI-UIC, 3,240.7 billion lire at end 1975.— (5) From June 1972, this item includes the banks' foreign currency deposits with the BI-UIC totalling 239.2 billion lire at end 1975.— (6) This item includes the foreign currency deposits of various institutions with the BI-UIC totalling 102.5 billion lire at end 1975.

Notes and coin increased by 1,771 billion at a rate of 16.5 per cent (1,158 billion and 12 per cent in 1974), and Post Office deposits, favoured by stable yields, registered an even greater increase: 2,309 billion or 21 per cent (829 billion and 8.1 per cent in 1974; Table 27).

Looking at the performance of the different components of monetary base over the year it appears that, after the rapid expansionary turn-around at the end of 1974, there was a higher reabsorption in January than usual for the season. This could be seen above all in the considerable reduction of bank liquidity (802 billion).

In February, March and April, once the drainage by the foreign sector had ceased following the improvement in the balance of payments, the creation of monetary base was kept down to 480 billion owing to large purchases of government securities by the banks and the public. The progressive reduction of the import deposits began in March: within seven months this was to create monetary base for about 1,250 billion through the channel « other sectors ».

In May the new regulations on Treasury bill auctions came into force and, in view of the situation of relatively abundant liquidity, this allowed purchases at issue to increase considerably. Between June and August, although purchases of Treasury bills by the banks and other institutional investors continued at a steady rate (2,303 billion during those three months) there was a marked increase in the creation of monetary base to finance the very high cash requirements of the Treasury (4,688 billion as against 2,755 the year before).

In September and October the growth of total monetary base increased considerably (1,632 billion in the two months as against a reduction of 618 billion in the same period in 1974) particularly after the introduction of the provision for refinancing exports (1,409 billion at the end of October). This measure, being automatic, introduced an element of rigidity into a system where the Banca d'Italia already found difficulty in controlling monetary base owing to the repayment in full of the banks' short-term debts with the central bank. Liquidity thus underwent a sudden expansion with further depressive effects on interest rates (in October the rate on Treasury bills was 9.47 per cent on twelve-month and 7.16 on six-month issues, while the interbank rate went down to 8.60 per cent from the 9.28 of the month before).

In December monetary base creation via the Treasury was particularly large (4,146 billion as against 1,740 in December of the year before) because an exceptional cash requirement (3,105 billion as against 1,637 in December 1974) was added to 980 billion's worth of securities refunds. Also in December there was a marked increase in notes and coin (1,229 billion), partly because the length of the Christmas holidays delayed the normal re-entry until January.

The beginning of 1976 was characterized by the sharp rise in the foreign accounts deficit which made it necessary to close down the foreign exchange market in the second half of January. The disequilibrium of foreign accounts was not reflected in the creation of monetary base but above all in the exchange rate; in January monetary base diminished by 787 billion mostly on account of purchases of securities by the banks and public to the tune of 1,765 billion (of which 576 consisting in Treasury bills).

In February and March the further loss of value of the lira induced the authorities to pass restrictive measures. The discount rate was raised from 6 to 12 per cent in three successive increases; to accelerate the drainage of the system's liquidity it was decided that 0.75 per cent of the total deposits as of December 31, 1975 be lodged with the central bank, as part of the compulsory reserves, on a once-only basis (800 billion in two tranches), and as from February 26 the mechanism for refinancing export credits was abolished. As a whole these two measures reduced bank liquidity by about 1,670 billion divided in almost equal parts between compulsory reserves and the cancellation of the deposits lodged against the refinancing of export credits.

Interest rates soon reflected the bottleneck created by the aforementioned measures: at the end of March the interbank rate was up to 17.83 per cent (a level that had previously been reached only in July 1974) and in the auction only a small quantity of three-month Treasury bills were sold and at a rate of 16.28 per cent.

The central bank's assets and the creation of monetary base

Foreign operations destroyed monetary base to the value of 1,699 billion which was considerably less than in 1974 (3,115 billion). Contributing factors were the balance-of-payments deficit, lower than the year before (1,340 billion, of which about 600 for the repayment of compensatory loans, as against 3,588 in 1974) and the reduction of the banks' net foreign debt by 359 billion (Table 28).

In the first half-year, 270 billion of the total balance-of-payments deficit (305 billion), which was mainly due to the 264 billion repayments of compensatory loans, was covered by the growth of the banks' foreign debt. For this reason the effect on the monetary base was almost nil (an absorption of 35 billion).

Table 28

MONETARY BASE CREATION: FOREIGN SECTOR

(changes in billions of lire)

Items	1973	1974	1975				
			Year	Quarters			
				I	II	III	IV
Balance of payments (1)	*−207.7*	*−3,588.3*	*−1,340.0*	*−113.4*	*−191.3*	*−173.4*	*−861.9*
current account	−2,306.6	−5,829.8	−1,355.5	−347.4	−321.7	173.0	−859.4
capital movements	2,321.9	2,330.5	373.1	335.1	153.0	−151.5	36.5
compensatory	2,570.0	1,342.0	−609.0	−63.0	−201.0	−325.0	−20.0
others	−248.1	988.5	982.1	398.1	354.0	173.5	56.5
errors and omissions	−223.1	−89.0	−358.4	−101.1	−22.6	−194.9	−39.8
Banks' position and its regulation	*3.1*	*473.3*	*−359.4*	*41.4*	*228.4*	*−753.2*	*124.0*
net foreign position (increase −)	30.8	475.1	−356.3	44.6	228.8	−756.9	127.2
foreign currency (increase +)	−27.7	−1.8	−3.1	−3.2	−0.4	3.7	−3.2
Total effect (a)	*−204,6*	*−3,115.0*	*−1,699.4*	*−72.0*	*37.1*	*−926.6*	*−737.9*
in lire: net foreign position of BI-UIC	−122.7	−2.995.2	−1,794.3	−36.4	50.2	−1,074.7	−733.4
exchange rate adjustments	−54.2	−118.0	98.0	−32.4	−12.7	144.4	−1.3
in foreign currency: banks' foreign exchange	−27.7	−1.8	−3.1	−3.2	−0.4	3.7	−3.2
Pro memoria:							
tied foreign currency deposits with BI-UIC of other sectors (b)	*2,164.1*	*1,118.6*	*−599.9*	*−270.0*	*−211.7*	*−78.5*	*−39.7*
tied foreign currency deposits with BI-UIC of Treasury (c)	*34.0*	*−34.0*	–	–	–	–	–
foreign effect net of tied foreign currency deposits with BI-UIC (a−b−c)	*−2,402.7*	*−4,199.6*	*−1,099.5*	*198.0*	*248.8*	*−848,1*	*−698.2*

(1) Including accounting discrepancies between the balance-sheet items of BI-UIC concerning the sector and the balance-of-payments results.

In the third quarter, the seasonal upturn in the balance of payments —which showed a surplus on current account of 173 billion— was accompanied by a decided improvement in the net foreign position of the banks (757 billion) connected with the repayment of the foreign currency loans by resident customers already mentioned in other chapters of this Report. This entailed absorption of 927 billion's worth of monetary base during the period considered, which indicated a turnaround in the trend of the previous months. This new tendency was confirmed in the last quarter of the year, but, in contrast to what occurred in the third quarter, the destruction of monetary base (738 billion) was due to the considerable worsening of the balance of payments, which, with the rise in imports, reflected the first symptoms of economic recovery.

With regard to the Treasury sector, the unprecedented growth of the Treasury's cash deficit (16,563 billion including funding operations, as against 8,962 in the previous year and 8,071 in 1973) exerted a powerful influence not only on the creation of monetary base, but also on the entire management of monetary policy and financial flows. Unlike the previous five years, a high proportion of the requirements were financed with non-monetary assets, above all because the increase in the public debt over the year largely took the shape of short-term securities (5,036 billion's worth of Treasury bills out of a total of 8,645 billion in securities; Table 29).

The drop in the share of the Treasury's requirements covered by monetary base was encouraged by the abundance of liquidity on the market, the relatively more favourable rates on Treasury bills and the new regulations for the auction which, as from May, allowed these circumstances to exert a stronger effect. With the reform of the auctions the number of potential participants grew, they were allowed to put in bids at different prices, the central bank was admitted and the asked yield was reduced considerably with respect to the presumed final rate.

The efficacy of placement at auction of Treasury bills as an instrument — albeit a short-term one — for controlling the monetary base depends on whether their rate is allowed to float freely. Whereas, in fact, in times of scarce demand for loans and of ample liquidity, as was the case on average for 1975, the banks find it profitable to purchase short-term securities, when there is a squeeze, as in the first

Table 29

MONETARY BASE CREATION: TREASURY

(changes in billions of lire)

Items	1973 (1)	1974	1975 Year	1975 Quarters I	II	III	IV	Dec.
Budget deficit (+) or surplus (-)	*8,070.9*	*8,961.9*	*16,563.2*	*3,465.8*	*3,566.6*	*3,985.0*	*5,545.8*	*3,104.5*
Intervention by monetary authorities (2)	*-828.1*	*-1,291.3*	*-8,783.9*	*-3,144.9*	*-2,625.3*	*-2,332.4*	*-681.3*	*1,041.1*
Operations in government securities	-643.6	-1,446.9	-8,645.3	-3,079.1	-2,570.0	-2,278.1	-718.1	999.9
public debt (3)	-622.3	841.2	838.1	-1,146.6	-334.0	650.7	1,668.0	977.1
Treasury bills for free investment	-249.4	732.2	2,215.4	355.5	-464.1	824.9	1,499.1	718.0
long-term securities	-372.9	109.0	-1,377.3	-1,502.1	130.1	-174.2	168.9	259.1
open market operations by BI-UIC	-21.3	-2,288.1	-9,483.4	-1,932.5	-2,236.0	-2,928.8	-2,386.1	22.8
Treasury bills for free investment	167.8	-2,360.7	-7,251.2	-1,823.8	-1,493.9	-2,900.7	-1,032.8	33.4
long-term securities	-189.1	72.6	-2,232.2	-108.7	-742.1	-28.1	-1,353.3	-10.6
Other operations (4)	-184.5	155.6	-138.6	-65.8	-55.3	-54.3	36.8	41.2
Total effect	*7,242.8*	*7,670.6*	*7,779.3*	*320.9*	*941.3*	*1,652.6*	*4,864.5*	*4,145.6*
Direct liquidity creation	2,377.0	1,172.5	-1,043.7	-665.4	-479.1	-279.7	380.5	722.5
Post Office deposits	1,753.0	829.3	2,308.8	221.4	453.6	428.4	1,205.4	945.4
other operations	624.0	343.2	-3,352.5	-886.8	-932.7	-708.1	-824.9	-222.9
Financing by BI-UIC (5)	4,865.8	6,498.1	8,823.0	986.3	1,420.4	1,932.3	4,484.0	3,423.1
long-term securities	2,473.7	1,300.8	3,440.6	-146.0	662.5	130.5	2,793.6	2,106.1
net purchases of new issues	2,662.8	1,228.2	5,672.8	-37.3	1,404.6	158.6	4,146.9	2,116.7
open market operations	-189.1	72.6	-2,232.2	-108.7	-742.1	-28.1	-1,353.3	-10.6
Treasury bills for free investment	1,468.4	4,821.5	5,363.9	1,181.7	1,492.0	624.2	2,066.0	533.4
Treasury current account	854.9	49.6	560.1	10.5	56.6	644.3	-151.3	991.8
other financing (6)	68.8	326.2	-541.6	-59.9	-790.7	533.3	-224.3	-208.2

(1) Net of random movements in Table 26. – (2) The sign refers to the effect produced on the creation of monetary base; i.e. Banca d'Italia sales on the market and securities issues bear a negative sign. – (3) Issues net of BI-UIC purchases. – (4) Excluding securities sold to the banks in substitution for compulsory reserves in currency and Treasury bills. – (5) Guarantee deposits at the Central Post Office Savings Fund, foreign debts and net lending of banks and special credit institutions to autonomous agencies. – (6) Including the securities under (4). – (7) The figures for securities do not make allowance for depreciation which is shown in the balance-sheet of the B.I. at December 31, 1972, 1973 and 1974. – (8) Including interest-bearing certificates of the Post Office Savings Fund, AIMA credit certificates and tied foreign currency deposits with the BI-UIC.

months of 1976, they tend to renew their liquidity by selling Treasury bills or simply by not renewing them as they reach maturity.

Post Office deposits increased considerably (2,309 billion as against 829 the year before), partly because, whereas the rates on bank deposits declined rapidly during the year, those offered by the Post Office remained constant after the increase in October 1974. The direct creation of liquidity by the Treasury, which besides Post Office deposits includes Treasury bills for compulsory reserves, dropped however as a whole as a result of the substitution of Treasury bills for compulsory reserves with cash to the value of 3,409 billion. This situation, which arose as a result of the new regulations on compulsory reserves, had no effect on the overall creation of monetary base, since the Banca d'Italia purchased securities to counterbalance it.

In the first quarter, coverage in monetary base of the Treasury's large requirements (3,466 billion), mostly due to funding operations (1,539 billion), only amounted to 321 billion. Owing to changed expectations as to the inflationary process it was possible to place medium- and long-term securities to the value of 1,616 billlion on the market, while the banks purchased net 1,468 billion's worth of Treasury bills, of which 1,824 from the Banca d'Italia.

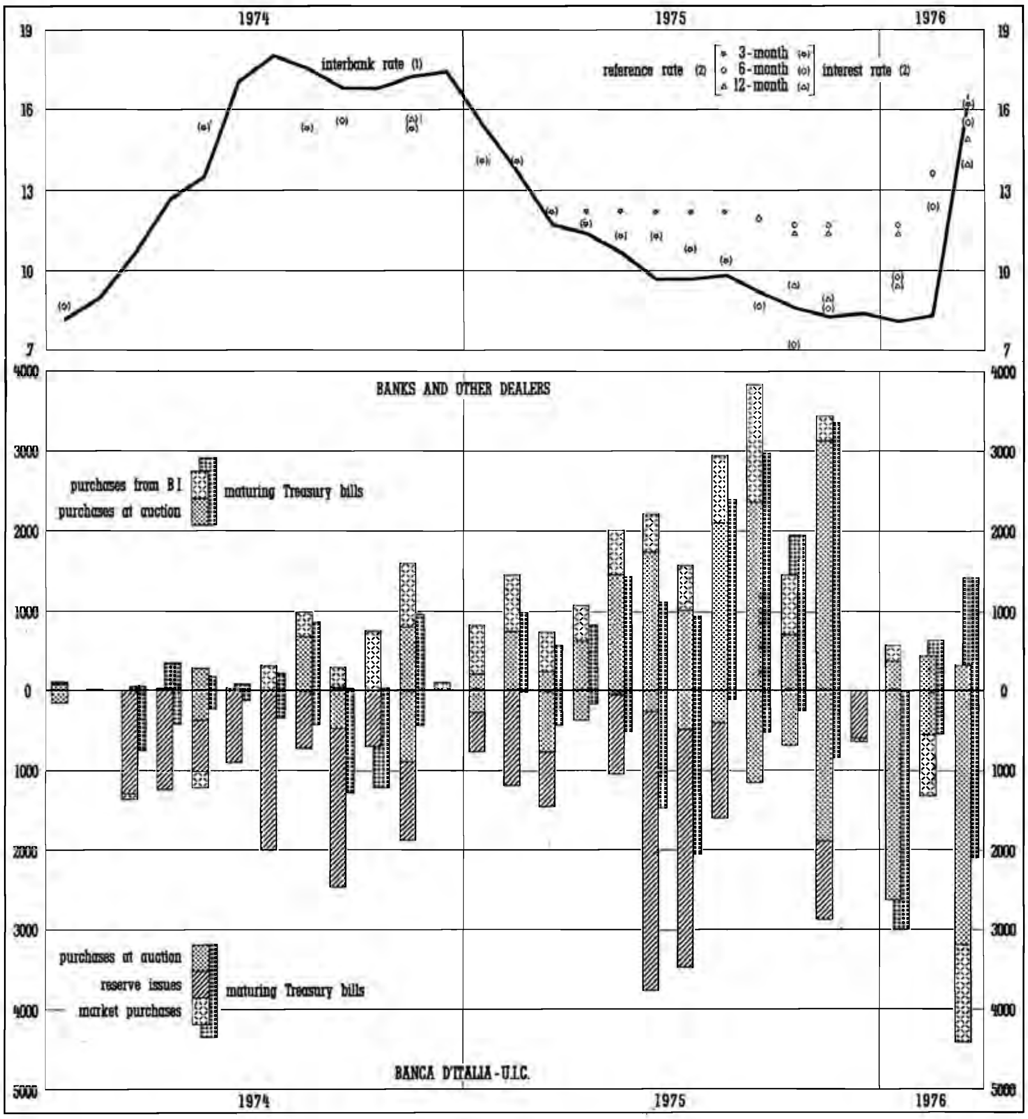
In the second quarter, although purchases of medium- and long-term securities continued, intervention on Treasury bills acquired increasing importance. In May and June enormous quantities of very short-term securities were put up for auction (respectively 1,500 and 2,000 billion's worth of 3-month bills).

The control of monetary base creation became extremely difficult in December when the cash requirement of the Treasury reached 3,105 billion (Chart 12) to which must be added 259 billion's worth of disinvestments in medium- and long-term securities by the public and redemptions of Treasury bills for 718 billion.

With no monthly auction — normally avoided in December owing to the seasonal requirements of bank liquidity — monetary base creation by the Treasury reached 4,146 billion, 945 billion of which in the form of Post Office deposits. Throughout December the Banca d'Italia continued selling operations on the secondary securities market.

Turning to lending to the banking sector, the refinancing of the banks, net of refinancing for export credits starting in September,

Chart 12



Gross and net issues of Treasury bills and their distribution between BI-UIC and other dealers

(1) Weekly figures; datum corresponding to the central week of the month. — (2) Yield to maturity calculated according to the compound interest method, on the basis of the commercial year.

diminished by 2,165 billion during the year (— 389 including the component mentioned). This points to the conditions of ample liquidity in which the banks carried out their activities during 1975, even taking into account that the drop is partly due to the reduction in the credit lines opened as a result of the extraordinary advances granted at the end of 1974 (Table 30).

In September, when repayments had already been completed (only the ordinary advance accounts remained open, since the credit lines are never revoked), the measure concerning the automatic refinancing, at subsidized rates, of bank loans to exporters came into force. Refinancing was granted on the basis of the presumed trend of the loans in the following fortnight and the first effect was a sudden increase in monetary base creation for an amount equal to the requests put forward by the banks (1,198 billion in September). Before being used to cover new credits to exporters, a large part of this refinancing (1,063 billion in September and 1,026 in December) remained available to the banks in the form of deposits with the central bank. Since

Table 30

MONETARY BASE CREATION: BANKS

(changes in billions of lire)

Items	1973 (1)	1974	1975 Year	1975 Quarters I	II	III	IV
Banks: financing by BI-UIC	*277.2*	*1,362.3*	*−389.0*	*−675.5*	*32.3*	*849.8*	*−595.6*
credit lines	38.4	1,338.8	−938.8	75.6	86.8	75.6	−1,176.8
fixed-term advances . . .	195.6	−32.6	−1.089.8	−678.3	4.3	−420.3	4.5
ordinary discount	43.1	56.4	−135.6	−72.9	−57.9	−4.0	−0.8
refinancing of export credits	–	–	1.776.0	–	–	1,198.5	577.5
other minor operations . .	0.1	−0.3	−0.8	0.1	−0.9	–	–

(1) Net of random movements in Table 26.

this mechanism, which will be described in detail below, was automatic, the authorities found it more difficult to control the monetary base, mainly because it was not possible to reduce any further the other forms of bank indebtedness.

As to other sectors, monetary base to the value of 1,191 billion was created through this channel whereas in 1974 1,812 billion had been destroyed. As in the previous year, though in the opposite direction, the main component was the tied import deposits, the progressive reduction of which, down to nil in September, added 1,237 billion to the system's liquidity (1,142 billion in the period from March to August; Table 31).

Table 31

MONETARY BASE CREATION: OTHER SECTORS

(changes in billions of lire)

Items	1973 (1)	1974	1975 Year	1975 quarters I	II	III	IV
Other sectors	*-2,229.1*	*-1,812.4*	*1,191.2*	*8.0*	*287.3*	*1.120.2*	*-224.3*
financing to special credit institutions and other activities (2)	33.8	292.8	-128.1	-89.9	-20.0	10.8	-29.0
tied foreign currency deposits with BI-UIC (increase -)	-2,164.1	-1,118.6	599.9	270.0	211.7	78.5	39.7
tied imports deposits (increase -)	–	-1,237.3	1,237.3	69.4	624.0	543.8	0.1
lira deposits of special credit institutions (increase -)	-182,9	494,6	-649.2	53.7	-573.2	558.3	-688.0
balance of other BI-UIC accounts (3)	84.1	-243.9	131.3	-295.2	44.8	-71.2	452.9

(1) Net of random movements in the note under Table 26. – (2) Including open market operations in non-government securities. – (3) Including the devaluation and revaluation of government and non-government securities registered on the balance-sheet at December 31, 1973, 1974 and 1975.

Central bank liabilities and the uses of monetary base

The distribution of monetary base among the various operators changed again in 1975, when the amount of monetary base held by the public grew by 4,124 billion and 18.8 per cent (2,043 billion in 1974), a figure equal to 59.9 per cent of the total monetary base creation for the year. There was thus a return, after the drop in 1974 when the percentage had been 49.7, to the situation of 1972 and 1973 when the public had absorbed 66.9 and 65.1 per cent respectively of the liquidity issued into the system (Table 32).

In the first four months of the year, the growth rates of both notes and coin and Post Office deposits were still very slack and lower than those of the second half of the previous year. The former, on seasonally adjusted figures, grew by 1.7 per cent in four months

Table 32

USE OF MONETARY BASE: PUBLIC

(amounts and changes in billions of lire)

Items	Amounts at end of 1975	Changes						
		1973 (1)	1974	1975				
				Year	Quarters			
					I	II	III	IV
Public	*26,104.1*	*3,313.1*	*2,042.9*	*4,123.5*	*−282.5*	*1,165.0*	*623.6*	*2,617.4*
notes and coin in circulation	12,538.5	1,600.9	1,157.6	1,771.3	−370.2	554.9	159.5	1,427.1
deposits with the Treasury and BI-UIC	251.8	−40.8	56.0	43.4	−133.7	156.5	35.7	−15.1
deposits with the Central Post Office .	13,313.8	1,753.0	829.3	2,308.8	221.4	453.6	428.4	1,205.4

(1) Net of random movements in Table 26.

(Table 33), and Post Office deposits by 3.2 per cent (5.8 and 6.1 per cent respectively in the same period of the previous year). From May onwards, when the new banking agreement on deposit rates came into force, the rise in both these magnitudes accelerated considerably reaching, on seasonally adjusted figures, particularly high levels in December, when notes and coin increased by 1,229 billion and Post Office deposits by 945 billion (including the capitalization of interest).

The monetary base held by the banks in the form of excess and compulsory reserves increased by 2,759 billion, i.e. at a growth rate of 20.3 per cent (2,062 billion and 17.9 per cent in 1974). This increase is the result of a proportionally very high growth of liquidity (1,125 billion as against 568 the year before) and of a very modest rise in compulsory reserves with respect to the growth of deposits (1,634 as against 1,494 in 1974; Table 34).

Different factors of an exogenous and exceptional nature were partly responsible for the reduction in monetary base lodged for compulsory reserves in 1975 and caused the ratio of the annual increase in the reserve to that of deposits to fall from 12.8 per cent in 1974 to 8.1 per cent in 1975. In the first half of the year the banks substituted cash with mortgage bonds for around 330 billion following

Table 33

CIRCULATION OF NOTES AND COIN IN RELATION TO THE GROSS DOMESTIC PRODUCT

Period	Notes and coin in circulation (C) (1)	Gross domestic product at current prices (GDP) (2)	Net wages and social security outlays (W) (2)	C/GDP (3)	W/GDP
		(billions of lire)		*(percentage ratios)*	
1971 - IV qtr.	6,615	63,056	33,450	*10.13*	*53.4*
1972 - I qtr.	6,758	64,404	34,579	*10.09*	*53.69*
II "	7,026	65,808	35,474	*10.44*	*53.90*
III "	7,216	67,310	36,413	*10.55*	*54.09*
IV "	7,404	69,080	37,914	*10.03*	*54.88*
1973 - I qtr.	7,775	70,663	39,058	*10.45*	*55.27*
II "	8,157	73,968	40,639	*10.08*	*54.94*
III "	8,504	78,167	42,923	*9.96*	*54.91*
IV "	8,735	82,142	45,780	*9.93*	*55.73*
1974 - I qtr.	9,249	86,072	48,497	*9.98*	*56.34*
II "	9,605	90,275	51,371	*9.88*	*56.90*
III "	9,746	94,722	53,623	*9.58*	*56.61*
IV "	9,940	99,238	56,731	*9.42*	*57.16*
1975 - I qtr.	10,247	102,918	59,932	*9.42*	*58.23*
II "	10,511	105,969	62.972	*9.63*	*59.42*
III "	11,212	108,785	66,332	*9.96*	*60.97*
IV "	11,640	112,357	68,825	*9.76*	*61.25*

(1) Quarterly averages of seasonally adjusted monthly data; datum for December 1972 is adjusted for random movements. — (2) Data refer to the four quarters ending with that shown. — (3) The denominator is the quarterly gross domestic product, at the seasonally adjusted annual rate.

the decision taken by the CICR (Interministerial Committee for Credit and Saving) on July 18, 1974 to remove the constraint on the composition by issuer of mortgage bonds lodged in compulsory reserves. Even greater was the effect of the measure passed on August 27 whereby the Minister of the Treasury allowed the banks interested to request, once only, that the reserves due on December 31, 1974 be recalculated according to the regulations in force prior to the 1975 reform and which allowed the banks whose capital exceeded about 4.37 per cent of their deposits to reduce their compulsory reserves by four times the amount of the capital increase. Altogether, therefore, the expansion of monetary base brought about by these two phenomena amounts to roughly 700 billion, almost half of which was concentrated into the months of November and December.

The total liquidity of the banks showed divergent trends during the course of the year. In the first half there was a sharp contraction (881 billion as against 501 in the corresponding period of the previous year) which for seasonal reasons mostly occurred in January. The ratio of liquidity to deposits was on average 2.2 and 2.0 per cent in the first and second quarters respectively, thus remaining at basically the same levels as in the second half of 1974 (2.3 per cent in the third and fourth quarters: the ratios are calculated on seasonally adjusted figures). This confirms that monetary policy was only given a mildly expansionary turn in the first half of the year, especially if one takes into account the extremely burdensome nature of the portfolio constraint during that period.

Table 34

USE OF MONETARY BASE: THE BANKS' EXCESS RESERVES

(amounts and changes in billions of lire)

Items	Amounts at end of 1975	Changes							
		1973 (1)	1974	1975					
				Year	quarters				
					I	II	III	IV	Dec.
Excess reserves	*3,609.0*	*111.7*	*568.4*	*1,124.9*	*−689.4*	*−191.7*	*1.506.4*	*499.6*	*1,142.6*
vault cash	674.8	196.4	−10.7	13.7	−299.9	106.9	17.8	188.9	315.2
disposable deposits at BI-UIC	437.2	−92.8	281.1	−174.4	−379.4	6.9	63.3	134.8	319.6
disposable margin	1,306.0	12.4	278.5	267.5	16.8	−311.5	359.6	202.6	278.6
disposable margin on re financing of export credits	1,025.5	–	–	1,025.5	–	–	1,062.8	−37.3	203.6
other credits	96.5	23.4	21.3	−4.3	−23.7	6.4	−0.8	13.8	26.4
convertible currencies	69.0	−27.7	−1.8	−3.1	−3.2	−0.4	3.7	−3.2	−0.8

(1) Net of random movements in Table 26.

At the end of the third quarter the provision for refinancing export credits came into force; as already mentioned, this had the immediate effect of increasing liquidity by about 1,000 billion in the form of deposits with the Banca d'Italia. The utilization of these liquid assets was however subject to the banks' proving that they had actually granted the financing to exporters by exhibiting the bank permits for deferred payment. From calculations made on the basis of these permits which became available only in the early months of 1976, it is estimated that only 75 per cent of the deposits lodged were backed by deferred payments and therefore utilizable. This correction must therefore be made in order to interpret correctly the meaning of the liquidity created through this channel in the last four months of the year.

The ratio of liquidity calculated net of the short-term refinancing granted by the central bank (rediscounts, fixed-term advances and, as of September 1975, refinancing operations for export credits) to deposits was 2.1 per cent in the second half, and in December reached 2.5 per cent. Although these levels were higher than in 1974 (1.1 and 1.5 per cent respectively) when there was a severe credit squeeze, they were in line with the figures for 1973 (the average ratio for that year was 2.3 per cent; Table 35). Nevertheless, although the level of liquidity, in the usual sense of the word, at which the banks carried out their operations was not over-high, in the last quarter of the year a potentially dangerous factor was introduced by the ample availability of « quasi-liquid » assets (Treasury bills) held by the banks in their portfolios.

Table 35

RATIO OF BANKS' EXCESS RESERVES TO DEPOSITS

(ratio of the amounts at the end of the period)

Period	September		October		November		December		Average for the year	
2	$\frac{L_1}{D}$	$\frac{L_2}{D}$	$\frac{L_1}{D}$	$\frac{L_2}{D}$	$\frac{L_1}{D}$	$\frac{L_2}{D}$	$\frac{L_1}{D}$	$\frac{L_2}{D}$	$\frac{L_1}{D}$	$\frac{L_2}{D}$
1971	5.33	*5.31*	3.49	*3.48*	4.31	*4.30*	3.90	*3.56*	4.25	*4.16*
1972	4.79	*4.74*	3.02	*2.98*	2.50	*2.37*	3.20	*0.64*	3.37	*2.68*
1973	3.52	*3.48*	2.64	*2.58*	2.67	*2.62*	2.81	*1.01*	2.91	*2.42*
1974	2.00	*1.16*	1.87	*0.79*	1.80	*0.61*	3.06	*1.54*	2.18	*1.02*
1975 (1)	3.36	*3.36* *2.20*	3.37	*3.36* *2.30*	2.62	*2.61* *1.74*	3.53	*3.52* *2.50*	3.22	*3.21* *2.18*

L_1 = excess reserves

L_2 = L_1 minus discounting and fixed-term advances (net excess reserves)

(1) The second figure for 1975 has been obtained by subtracting from net excess reserves deposits to cover refinancing of export credits.

Banking

Bank reserves and interest rates

During 1975, bank intermediation increased to a marked extent: credits grew by 24.4 per cent (21.8 per cent in 1974) and deposits by 25 per cent (16.8 per cent in 1974). Bank lending and deposit rates fell considerably, from 17.4 and 10 per cent respectively in the last quarter of 1974 to 12.3 and 8 per cent in the last quarter of 1975.

The gradual reduction of the differential between interest rates on loans and those on bonds, which by the end of the year had returned to the level recorded prior to the 1973-74 cyclical phase, the slackening of demand for loans by enterprises and the substantial issues of Treasury bills drove the banking system to make large investments in bonds, even in excess of the portfolio constraint (Chart 13). The tendency to increase the share of securities in total bank credit, already apparent for some time, thus gained strength during 1975.

In addition, the tendency for a growing portion of bank credit to go to public agencies and services rather than enterprises was also more marked in 1975. Contributing factors to this development were the depressed level of economic activity and the strong upturn in public deficits. Bank financing to the public sector and to hospitals, in the form of loans and purchases of securities, grew by 44.2 per cent, while financing to enterprises grew by 19 per cent (Table 36).

During the year the performance of bank credit, including Treasury bills for free investment, was characterized by a very rapid growth in the first half and by a tapering-off in the second. However, the growth of deposits, which was somewhat limited after interest payments in January, gained fresh impetus from June onwards. The more dynamic performance of deposits compared to loans in the second half of the year was partly due to the large Treasury deficit and led to the settlement of discount operations and fixed-term advances (Chart 13).

Following the large increase in December 1974 and the subsequent partial absorption in January, excess and compulsory bank reserves in monetary base grew slowly throughout the first half of 1975, while

Table 36

BANKS' ASSETS AND LIABILITIES (*)

(amounts and changes in billions of lire)

Items	Amounts at end of 1975	Changes						
		1973	1974			1975		
		Year (1)	half-year I (1)	half-year II	Year (1)	half-year I	half-year II	Year
DOMESTIC ASSETS	134,859.7	14,725.6	4,340.8	13,925.4	18,266.2	8,863.6	19,251.8	28,115.4
Excess reserves (2)	3,609.0	111.7	−500.7	1,069.1	568.4	−881.1	2,006.0	1,124.9
Compulsory reserves and backing for cashiers' cheques (2)	12,725.4	1,661.5	1,220.6	273.6	1,494.2	878.0	755.7	1,633.7
Credit *(a+b) (**)*	98,842.0	13,245.7	4,170.5	8,489.9	12,660.4	8,511.7	11,271.1	19,782.8
Securities *(a)*	39,444.6	6,073.6	1,859.5	3,495.5	5,355.0	6,299.3	4,425.9	10,725.2
Treasury bills	*6,626.7*	*−97.7*	*−403.8*	*1,886.8*	*1,483.0*	*2,953.4*	*1,433.8*	*4,387.2*
long-term (3)	*32,817.9*	*6,171.3*	*2,263.3*	*1,608.7*	*3,872.0*	*3,345.9*	*2,992.1*	*6,338.0*
Domestic lending *(b)* (4)	59,397.4	7,172.1	2,311.0	4,994.4	7,305.4	2,212.4	6,845.2	9,057.6
Interbank accounts	19,683.3	−293.3	−549.6	4,092.8	3,543.2	355.0	5,219.0	5,574.0
TOTAL . . .	134,859.7	14,725.6	4,340.8	13,925.4	18,266.2	8,863.6	19,251.8	28,115.4
DOMESTIC LIABILITIES	134,359.5	14,694.8	3,299.6	14,491.5	17,791.1	8,590,2	19,881.5	28,471.7
Customers' deposits	101,167.5	13,402.6	3,335.6	8,317.4	11,653.0	5,859.9	14,381.7	20,241.6
savings	*49,079.7*	*4,737.7*	*2,792.0*	*4,733.0*	*7,525.0*	*8,515.6*	*6,483.2*	*14,998.8*
current account	*52,087.8*	*8,664.9*	*543.6*	*3,584.4*	*4,128.0*	*−2,655.7*	*7,898.5*	*5,242.8*
Lending by BI-UIC (2)	3,837.0	277.2	601.8	760.5	1,362.3	−643.2	254.2	−389.0
Accounts with special credit institutions (5)	4,062.2	1,876.5	−520.6	−33.7	−554.3	1,316.2	−614.2	702.0
Interbank accounts	16,865.5	−338.3	−960.1	5,487.6	4,527.5	92.3	4,477.9	4,570.2
Other items	8,427.3	−523.2	842.9	−40.3	802.6	1,965.0	1,381.9	3,346.9
NET FOREIGN POSITION (2) (6)	500.2	30.8	1,041.2	−566.1	475.1	273.4	−629.7	−356.3

(*) Data contained in this table are calculated in order to assess the flow of funds between banks and other sectors and are made to coincide with data in the corresponding tables in other chapters (Tables 26, 43, 47). The figures in the other statistical tables on banks do not therefore always correspond to those given here because they are directly taken from the banks' balance sheets or from a homogeneous sample. – (**) In the columns giving changes, the funding of Hospital debts to the banks is classified under lending and not under securities.

(1) Data adjusted according to an estimate of random movements caused by strikes of bank employees at end-1972, which are estimated to have increased, at end-December, the amounts of liquidity by 50 billion lire, domestic lending by 200 billion, deposits by 1,800 billion and BI-UIC lending by 500 billion. The counter-item of the balance of these random movements is under interbank accounts and under the other items. – (2) The figures used for excess reserves and lending by BI-UIC are not taken from the banks' balance-sheets, but from the consolidated balance-sheet of the BI-UIC, which is the statistical source used for calculating the monetary base. Moreover, the net foreign position of the banks does not coincide with the balance between foreign assets and liabilities owing to the different criteria used when registering relations with "non-residents" in banking and in balance-of-payments statistics. – (3) Increases in securities portfolios calculated on the basis of market prices during the year. – (4) Data for 1974 are calculated net of a variation, estimated at 1,400 billion, due to a change in statistics. – (5) Data taken from the special credit institutions' accounts. – (6) Also includes the foreign exchange forming part of the excess reserves.

the credit multiplier remained high. As a result of the freeing of cash mentioned in the previous chapter, the compulsory reserve coefficient in fact decreased, even though the new regulations introduced in January prevented the changes in the composition of deposits that had occured during the year from causing a greater reduction in payments due in monetary base. Throughout the first half of 1975, the ratio of excess reserves to deposits was maintained at the low level prevailing in the second half of 1974 — despite the easing of tension on the money market apparent from the nearly 8-point drop in the interbank rate — partly owing to the creation of a huge second-line reserve of excess bank reserves in that period, consisting of very short-term Treasury bills (between February and June about 1,000 billion's worth of free Treasury bills owned by the banks matured each month). It should however be noted that if excess reserves are taken net of discounts and fixed-term advances granted by the central bank, the ratio of excess reserves is seen to have grown from an average of 1.1 per cent in the second half of 1974 to 1.6 per cent in the first half of 1975.

The slackening of the demand for bank loans, the increase in excess reserves that had already begun at the end of 1974, and the lower yield on securities induced the banks, after difficult negotiations, to reduce interest rates on deposits in the early months of the year (Table 37). This tendency towards a less vigorous fund-raising policy was also strengthened by the new regulation on the portfolio constraint. In fact, since compulsory investments in securities must now be equal to the increase in deposits rather than their previous total amount, there is less incentive to gather more deposits in order to reduce the percentage of the constraint.

The decline in bank interest rates in 1975 was not as rapid as the previous upswing. As has already been mentioned in connection with the trend of the money and financial markets, two factors among others helped to slow down the fall in rates: the increase in the public sector's demand for funds and the considerable impact of the portfolio constraint. Moreover, as in 1970-71, the banks did not appear eager to lower the interest on deposits individually for fear of losing their share of the market and competition on the loans side was not sufficient to start off a reduction in lending rates. With respect to 1970-71, a closer link was observed between the reductions in bank interest rates and those in the discount rate (Chart 14).

Halfway through 1975, while interbank rates and Treasury bill rates, which are more sensitive to market liquidity, had returned to levels near those of the first quarter of 1974, bank deposit rates, and especially lending rates, were still considerably higher than those levels. Taking into account the fact that expectations of inflation had been decreasing up to that moment, it appears that the expected real cost of bank loans for enterprises was increasing compared with 1974.

Table 37

BANK INTEREST RATES

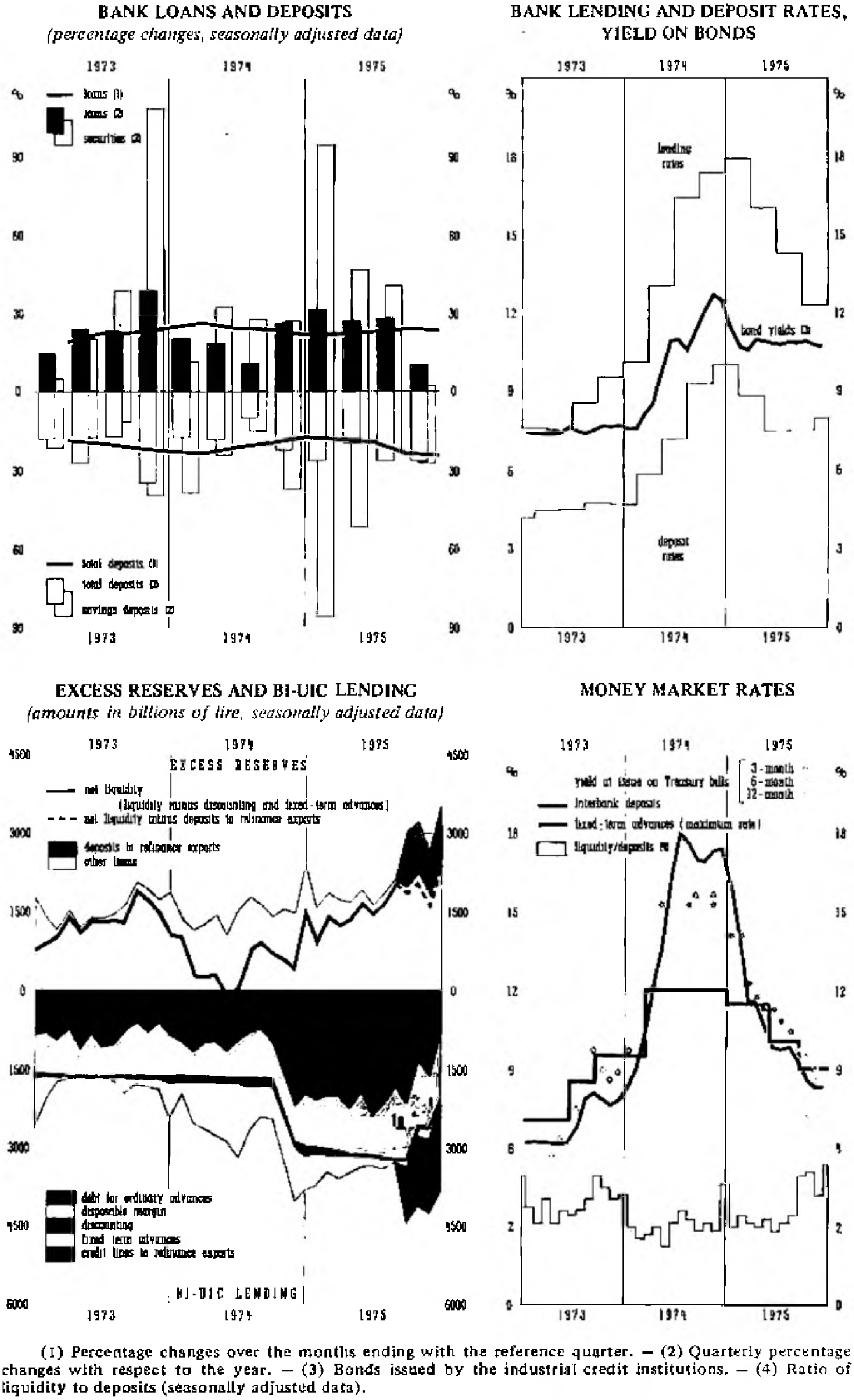
Rates	Quarters 1974 I	II	III	IV	1975 I	II	III	IV
LENDING RATES (1)								
Total loans	10.09	13.02	16.38	17.37	17.90	15.92	14.26	12.25
current accounts	10.22	13.26	16.58	17.74	18.28	16.41	14.61	12.51
DEPOSIT RATES (2)								
Total deposits (3)	5.82	7.14	9.25	10.03	7.90	7.47	7.50	8.02
current accounts (4)	5.84	7.18	9.33	10.07	7.50	7.01	7.01	7.63
INTERBANK (2)								
Current accounts	6.90	8.78	11.43	10.77	10.01	9.67	6.78	7.71
Demand deposits	7.44	8.97	11.94	10.97	11.17	8.84	8.52	8.77
3-6 month time deposits	7.69	8.83	10.98	11.45	10.91	7.86	9.43	7.95

(1) Quarterly averages of rates on operations reported to the Central Risks Office. Interbank and intercredit financing are not included. – (2) Averages of rates at end-quarter on deposits over 20 million lire. Data for 1974 include the substitutory tax on interest, amounting to 15 per cent of interest payments. – (3) Demand or time current accounts and savings deposits in lire of ordinary resident customers. – (4) Demand or time current accounts in lire of ordinary resident customers.

For these reasons, and in view of the continued worsening of industrial production, there was much demand for a further lowering of the cost of money. In July and August the inflow of monetary base to the banks accelerated sharply. Also in August it was decided to grant automatic refinancing of half of the bank loans for the payment of

Chart 13

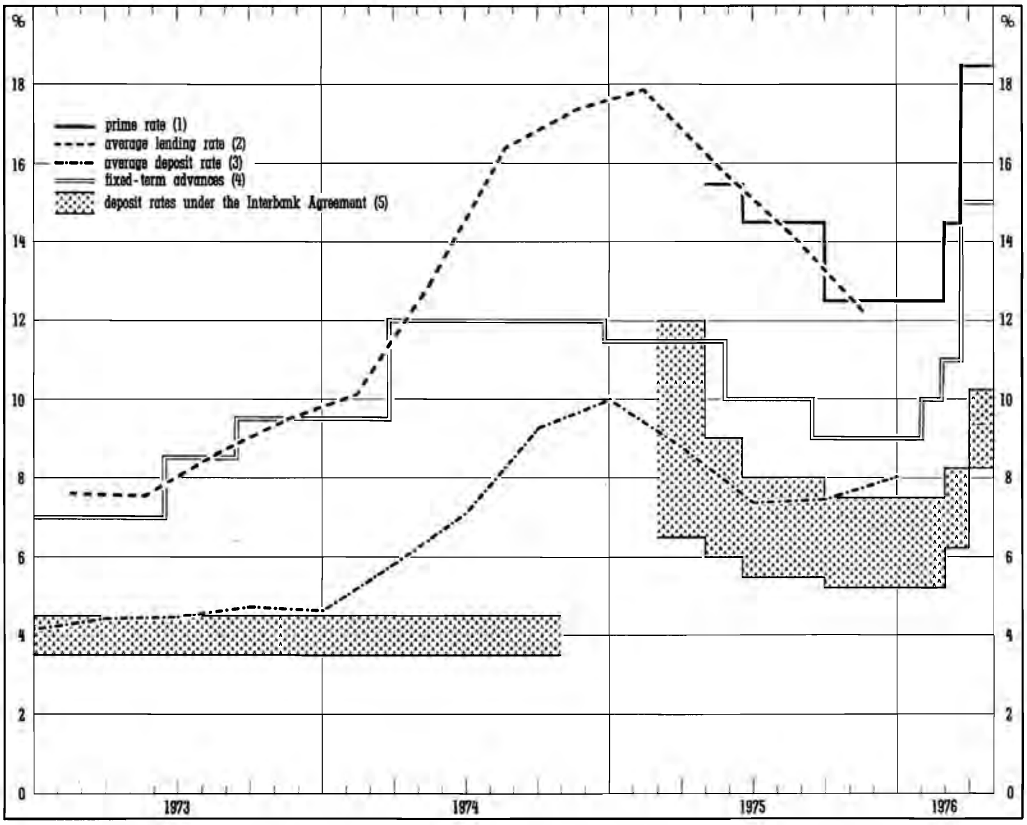
BANKS: CAPITAL AND INTEREST RATES



(1) Percentage changes over the months ending with the reference quarter. — (2) Quarterly percentage changes with respect to the year. — (3) Bonds issued by the industrial credit institutions. — (4) Ratio of liquidity to deposits (seasonally adjusted data).

exports at rates not higher than 8.5 per cent. As the discount rate was lowered this figure was then brought down to 7.5 per cent in September and in the same month the government authorities intervened directly with the banks to induce them to reduce the prime rate by 2 points as from October 1st. As a result of these direct interventions, and with the policy for monetary base creation still expansionary, average lending rates continued to fall rapidly until the end of the year.

Chart 14



Interest rates: interbank agreements

(1) Minimum rate recommended for unlimited credit on current account. – (2) Average rate of loans of at least 30 million lire. – (3) Average rate on deposits of at least 20 million lire. – (4) Maximum rate. – (5) Spread between the highest and the lowest value for maximum rates according to the Interbank Agreement.

The recovery of industrial activity and the reduction of interest rates in the second half of the year seem to have encouraged the demand for loans; their growth however was not sufficient to offset the slowdown in purchases of securities. The inflow of monetary base to the banks therefore partly led to an accumulation of excess reserves. At the end of the year excess reserves, net of deposits with the Banca d'Italia to refinance export credits, amounted to 2.5 per cent of deposits (seasonally adjusted data); since there were no open operations for discount and fixed-term advances, this figure was equal to that for net excess reserves. If, however, the deposits mentioned above are included, the ratio of excess reserves rises to 3.6 per cent. Yet it should be considered that the multiplier capacity of these deposits was slowed down by the fact that they could only be employed to increase export credits and that about a quarter of their total could not in any case have been used since Italian exporters had not granted the required amount of postponements of payment schedules (Chart 13).

Domestic bank credit

Both the vigour and the composition of the growth in bank credit differed in the two halves of the year. The seasonally adjusted growth rate moved from 13.7 per cent in the first half of the year to 8.9 per cent in the second, while the share of ordinary lending in the total diminished from 65.4 per cent at the end of 1974 to 60 per cent in mid-1975 and remained constant in the last half of the year.

During the first six months some tension continued to prevail on the credit market and at the same time flows shifted more decidedly towards investments in long- and short-term securities. Both the larger impact of the portfolio constraint and the retention until March of the ceiling on loans were contributing factors to this trend in banking activity. The result was that bank rates declined less, the credit multiplier remained at high levels and also the composition of assets altered in favour of securities.

In the second half of the year, the effect of the expansion of the monetary base that had begun in December 1974 and the considerable lowering of the portfolio constraint helped to greatly increase the availability of funds for unregulated operations. The enterprises seem to have taken advantage of these more favourable circumstances to improve their profit and loss accounts through the rapid fall in bank rates rather than to increase their indebtedness, so that the expansion of total bank credit slowed down and its composition remained unchanged.

In 1975, loans to residents grew at the lowest rate since 1972 even if the data are corrected to take into account the funding of the debts of the Municipalities and hospitals. With this correction, the growth rate for loans is in fact 17.3 per cent in 1975, whereas it had averaged 19.3 per cent during the previous three years and 13.5 per cent in the period running from 1968 to 1971. When evaluating these figures one must also consider the sharp acceleration of the inflationary process from 1972 on; a slackening of the process in 1975, on the other hand, offsets the effect of the slowdown in loans this year with respect to 1974.

In contrast with total credit, the seasonally adjusted figure for loans grew slightly more in the second half of the year than in the first. Specifically, adjusting the figures for the repayment of loans on the eve of the expiry of ceilings in March and for seasonal factors, the growth of loans is high in the first quarter, very weak in the second and stable on average levels in the last two. The lending rate, which throughout the first quarter of 1975 remained on the extremely high levels of end-1974 so that the average for that period is half a point higher than for the fourth quarter of 1974, dropped two points in the second quarter and four more points during the second half of the year.

These trends are the result of a growth in supply, which, though still weak in the first half of the year, became much larger in the second half, and of a domand that showed alternate phases, reaching a peak in January and February, a subsequent sluggishness up to the middle of the year and some recovery in the last half. The trend of supply was brought about not only by the creation of monetary base and the administrative constraints on purchases of securities already mentioned, but also by the policy on issues of Treasury bills which, thanks to the yields offered, provided strong competition for lending. The trend of demand appears to be dominated by industrial enterprises' requirements for short-term financing, which absorbs about 60 per cent of total loans.

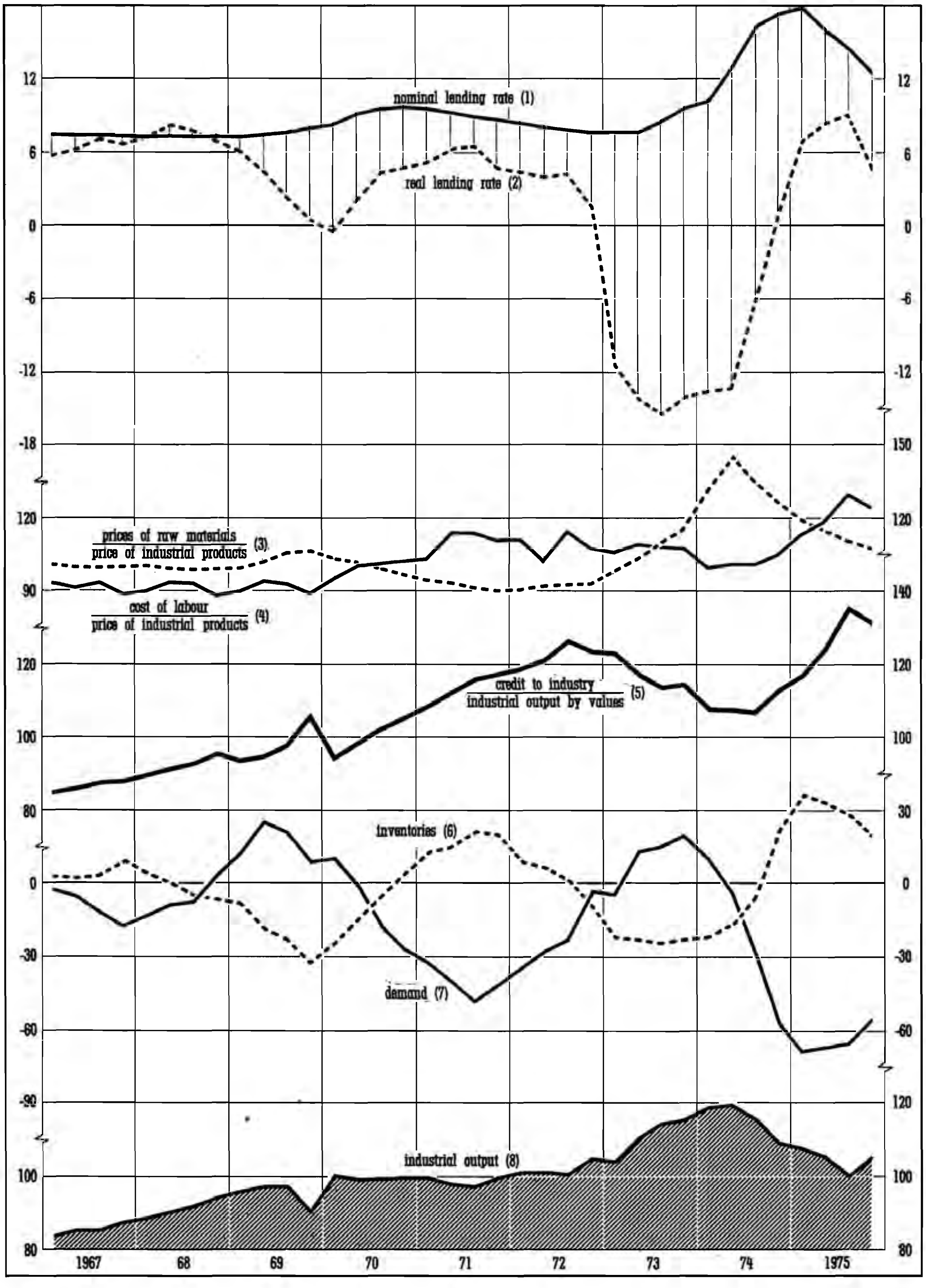
Bank loans to industrial enterprises increased by 4,748 billion in 1975, only slightly less than in 1974 (5,156 billion). The expansion was rapid in the first and third quarters (with increases of over 6 per cent on seasonally adjusted figures), more restrained in the second quarter and very weak in the fourth.

The ratio of bank loans to the value of production rose sharply in the first three quarters of the year, returning to the long-term trend below which it had fallen in 1973-74. The speed of this recovery was due not only to the expansionary monetary policy initiated in the fourth quarter of 1974, but also to the severity of the recession culminating in the third quarter of 1975 (Chart 15).

Enterprises used the flow of bank credit above all to rebuild their excess reserves, which in 1974 had run dangerously low as a result of the monetary restriction on the one hand and an accumulation of unsold products on the other. In 1975 the further fall in productive activity enabled them to reduce part of their inventories of finished products, but at the same time gave rise to a need for additional external financing owing to the negative effect on the productivity of labour, which caused an increase, at unprecedented rates, in the ratio of labour cost per unit of output to selling prices (Chart 15). Bank credit, besides contributing to the readjustment of the balance-sheet disequilibria that had arisen in 1974, absorbed the short-term fluctuations in the financial requirements of enterprises, so that the performance over the year is basically connected with the trend of inventories of finished products and raw materials, in turn a consequence of the trend of sales.

Demand for credit was still high in the first quarter of 1975, mainly owing to the accumulation of unsold products. In fact, most of this accumulation was carried out by the large enterprises which, since their production programmes are more rigid, reacted to the fall in demand for goods by increasing their inventories of finished products. It was precisely this phenomenon —and the obvious futility of keeping a reserve supply of credit for the smaller enterprises, whose demand for funds had already dropped abruptly together with their production— that induced the monetary authorities to eliminate, at the end of 1974, the specific ceiling on larger credits, while retaining the global ceiling until its expiry on March 31, 1975.

Chart 15



Bank credit and industrial activity

(1) Average rate on short-term loans reported to the Central Risks Office. — (2) Average lending rate net of the expected change in prices, taken from surveys by ISCO—Mondo Economico— EEC. — (3) Ratio of indexes. — (4) Ratio of index of total wage bill to index of value of production (product of the index of industrial output by the index of prices for industrial products); seasonally adjusted data. — (5) Ratio of the index of bank lending to industry to the index of the value of production; seasonally adjusted data. — (6) Spread from the normal level of inventories of finished products; indicator taken from surveys by ISCO—Mondon Economico—EEC. — (7) Spread from the normal level of demand and the level of orders; indicator taken from surveys by ISCO—Mondo Economico—EEC. — (8) Index of industrial production in volume, seasonally adjusted.

In the second quarter inventories of finished products began to run down while production continued to diminish; the demand for credit slackened considerably. Credit began to expand again in the third quarter, partly because, while sales remained very depressed, the process of accumulation of raw materials and semi-finished products was set again in motion in the expectation of a recovery of demand. The very sharp downturn in industrial production in August as recourse to the Wage Equalization Fund increased and holidays were brought forward, does not seem to have had a depressive effect on the demand for credit, presumably because the interruption of work reduced variable costs only to a small extent. It is in this light that one should interpret the sharp increase in the ratio of credit to production in the third quarter and the subsequent downturn in the fourth, which should not therefore represent a reversal of the trend.

In the fourth quarter, the recovery of sales and the resulting liquidation of inventories of finished products helped to reduce the need for working capital, even though inventories of raw materials continued to increase and productive activity was given a new lease of life. This recovery seems to have had a strong positive effect on the productivity of labour, which in turn was reflected in the drop in the ratio of labour cost per unit of output to selling prices (Chart 15), with a resultant drop in requirements for external financing.

The level of interest rates did not appreciably deter the enterprises from taking out loans, firstly because they had few alternatives if they were to finance disequilibria created in previous years, and secondly because expectations of inflation reduced the real cost of indebtedness as seen by the enterprises. In effect, the cost in real terms of bank financing in 1975 stood at the long-run average, though much higher than the negative levels registered in 1974 (Chart 15).

Throughout the second half of 1975 the growth of credit above all favoured smaller enterprises (Table 38). This trend, the opposite of that registered in the second half of 1974, can be explained by the larger size of the cyclical fluctuations in the levels of activity of enterprises. In fact they react fairly promptly to reductions in the demand for products by reducing proportionately productive activity and inventories, for it is less costly for them to vary their levels of productive activity than to accumulate inventories of unsold products.

Their short-term credit requirements, therefore, decline rapidly in times of recession, to then recover just as rapidly when their sales expectations improve. The larger enterprises, on the other hand, for which abrupt variations in levels of productive activity are more burdensome, adjust their production to demand only after some delay by accumulating or selling off large amounts of inventories of finished products. Their credit requirements therefore tend to increase precisely when they are entering a recession and their sales are falling below production, whereas it

Table 38

LOANS BY CATEGORIES OF CUSTOMERS

(Central Risks Office data)

Categories of customers	Amounts at 31-12-75 (billions of lire)	Percentage changes					
		half-year					
		1973		1974		1975	
		I	II	I	II	I	II
Industry (1)	29,233	7.65	15.27	12.12	11.05	5.15	12.70
Public enterprises	5,028	7.02	10.29	9.58	30.11	4.69	39.12
Main private enterprises	9,317	2.03	4.17	11.89	14.33	8.36	−0.30
Remaining enterprises	14,888	12.53	24.98	12.84	4.79	3.08	14.70
Electric-power industries	1,181	21.58	27.86	−6.42	52.35	37.26	−14.05
Other enterprises (2)	12,893	11.79	2.88	3.90	9.82	3.25	17.39
Public enterprises	2,262	9.85	−31.80	17.76	40.75	1.75	14.53
Main private enterprises	3,287	1.82	5.70	2.33	2.21	3.28	14.80
Remaining enterprises	7,344	18.55	13.73	1.70	5.89	3.73	19.51
TOTAL ENTERPRISES	43,307	8.18	11.33	9.12	11.52	5.48	13.08
Public enterprises	8,471	3.40	−3.75	9.19	36.36	8.89	21.65
Main private enterprises	12,604	1.97	4.60	9.20	11.12	7.12	3.24
Remaining enterprises	22,232	14.64	20.90	9.05	5.14	3.29	16.25
PUBLIC SECTOR AND HOSPITALS	9,089	11.26	14.57	8.53	9.25	−7.68	16.60
Local authorities	6,081	8.26	7.84	9.27	1.34	12.19	18.23
Other General Government agencies	1,776	−1.69	31.92	3.89	5.29	4.11	19.03
Autonomous agencies	261	35.44	0.00	−60.61	34.26	9.37	24.28
Hospitals	971	33.85	28.23	30.04	31.33	−57.48	2.21
NON-PROFIT INSTITUTIONS AND HOUSEHOLDS	1,176	5.67	8.45	−8.43	5.17	3.39	24.44
TOTAL . . .	53,572	8.66	11.85	8.57	10.96	3.00	13.89

(1) Excluding electric-power industries. — (2) Excluding hospitals and autonomous agencies.

diminishes at the beginning of an expansion, when the growth of sales is met not so much by increasing production as by selling off inventories previously accumulated.

Table 39

LOANS AND DEPOSITS OF THE BANKS BY CATEGORIES OF CUSTOMERS

(changes in billions of lire)

Categories of customers	Loans (1)		Purchases of securities (2)		Deposits (3)		BALANCE (4)	
	1974	1975	1974	1975	1974	1975	1974	1975
PUBLIC SECTOR AND HOSPITALS	1,323	633	1,724	7,002	−183	969	3,230	6,666
Central Government	36	56	1,494	5,098	−128	120	1,658	5,034
Local authorities (5)	445	1,497	265	197	−18	304	728	1,390
Autonomous agencies	−170	69	−35	1	33	3	−238	67
Social security institutions	87	287	—	—	−70	542	157	−255
Hospitals (6)	925	−1,276	—	1,706	....	....	925	430
ENTERPRISES (7)	5,829	6.489	110	747	94	6,664	5,845	572
Public enterprises	2,102	2,092	139	722	18	1,320	2,223	1,494
Main private enterprises	2,005	1,208	−29	25	12	806	1,964	427
Other enterprises	1,722	3,189	—	—	64	4,538	1,658	−1,349
Households (8)	287	495	—	—	11.962	12.596	−11.675	−12.101
TOTAL FOR ORDINARY RESIDENT CUSTOMERS	7,439	7,617	1,834	7,749	11,873	20,229	−2,600	−4,863
SPECIAL CREDIT INSTITUTIONS	54	20	3,521	4,682	−554	702	4,129	4,000
GRAND TOTAL	7,493	7,637	5,355	12,431	11,319	20,931	1,529	−863

(1) Includes financing of compulsory stockpiling, collectable debts and outstanding bills. Figures for 1974 are net of the variation, estimated at 1,400 billion, due to the reform of banking statistics. — (2) Investments in securities are calculated on the basis of average monthly market prices, with the exception of Treasury bills which are calculated at face value. — (3) Includes: deposits, foreign exchange accounts and third parties' funds held in trust. — (4) Credits (loans and purchases of securities less deposits). — (5) Purchases of securities includes Post Office certificates issued to fund loans to the Municipalities. — (6) Purchases of securities includes Treasury certificates issued to fund the hospitals' bank debts. — (7) Data on deposits are estimated. — (8) Estimates.

In 1975 non-industrial enterprises benefited from a larger increase in bank loans than industrial enterprises (21.5 per cent as against 18.5) and much higher than in 1974 (11.8 per cent; Tables 38 and 39). About half the loans in this sector went to commercial enterprises, which tackled the turnaround in consumption and the recovery in production by rebuilding their inventories and considerably increasing their indebtedness with the banks. This mainly took place in the second half of the year, after the sluggishness that had characterized the end of 1974 and the beginning of 1975. The marked growth in credit to the commercial sector (22.1 per cent) was made possible by the abolition, after March, of the selective credit controls; however, the very small increase (4.2 per cent) of the previous year cannot be ascribed to these controls, since it was much lower than the maximum allowed. In the commercial sector too, the credit that grew most rapidly was that to small sized enterprises, which make up about four-fifths of the total.

Securities portfolios

The management of securities held by the banks was carried out in a very different context from 1974 as regards both administrative regulations and conditions on the financial market.

The new feature of the administrative regulations was the abolition of investment in securities as part of compulsory reserves and the grouping together under the portfolio constraint of all the banks' compulsory investments in bonds; at the same time these investments were made proportional to the increases in deposits and distributed according to issuers. In complying with the regulations the banks could rely on a market where issues by the special credit institutions were picking p vigorously and monetary policy was maintaining bond yields relatively stable and at fairly high levels.

The balance-sheet value of the bond portfolios of the banks at end-December 1975 was 32,818 billion lire, 29.9 per cent higher than at the end of 1974. The flow of funds shifted from the banking system to other sectors through bond purchases was estimated at about 6,300 billion, taking into account the trend of prices over the year and leaving aside the operations to fund loans to local government bodies and social security agencies. In absolute terms the flow is a little higher than the figure recorded under exceptional circumstances for 1973, and represents a share of the flow of deposits not far from that observed in 1971 and 1974. The share of securities in the banks' portfolios out of the total of long-term securities in circulation rose further in 1975, from 42.5 to 43.5 per cent; there was also an increase, to over 50 per cent, in the proportion of loans by the special credit institutions financed by securities placed in the portfolios of the banking system (Table 40).

Table 40

THE BANKS' LONG-TERM SECURITIES (1)

Period	TOTAL		GOVT. AND CREDIOP ON BEHALF OF TREASURY	SPECIAL CREDIT INSTITUTIONS	
	As a share of total securities in circulation (2)	As a share of total deposits			As a share of loans by special credit institutions
1951-55	25.72	12.65	6.91	3.76	12.22
1956-60	25.32	13.68	7.94	4.06	12.07
1961-65	29.12	16.34	5.08	7.79	20.15
1966-70	36.83	24.66	8.54	10.37	25.82
1971-75	40.97	29.29	9.28	14.98	38.54
1971	37.77	25.87	9.76	11.03	26.82
1972	39.29	26.22	10.25	10.98	28.05
1973	41.89	30.74	9.62	15.93	39.01
1974	42.46	31.22	7.78	18.13	47.27
1975	43.48	32.44	9.00	18.87	51.59

(1) Includes securities invested for compulsory reserves and backing for cashiers' cheques. — (2) Ratio calculated on the face values.

The portfolio constraint followed a uniform pattern throughout the year although the impact varied in the two periods owing to the different rates and to seasonal factors. Since compulsory investment in securities is proportional in each period to the increase in deposits in the period starting and ending one month earlier, the considerable growth of deposits in December had an unfavourable effect in the first half-year, whereas it reduced tension in the second. The ratio of investment due during the period to the increase in deposits was 65.6 per cent in the first half and 17.3 in the second (Table 41). Even in view of the huge impact of the portfolio constraint during the first six months, the banks nonetheless purchased more securities than required and, as shall be discussed later, also increased considerably their portfolios of Treasury bills.

As in the case of bonds, investment in Treasury bills also became an increasingly important aspect of the banks' portfolios: at the end of 1975 they amounted to 6,627 billion (2,240 billion at end-1974). The copiousness and regularity of issues of three-month Treasury bills, which offered an instrument midway between sight assets and assets that are not easily negotiable (loans and long-term securities), probably induced the banks to readjust the average composition of their assets. There would thus have been the « once-only » effect of a change-over to a new balance-sheet structure, which would also explain the fact that the ratio of excess reserves to deposits remained only a little above the level recorded during the previous period of restriction. It should however be noted that the growth of the percentage of Treasury bills in the banks' assets probably also had a negative effect on loans, since they offer a more interesting alternative than bonds from the point of view of both yield and degree of liquidity.

Table 41

BANKS' COMPULSORY INVESTMENTS IN SECURITIES (1)

(face values; billions of lire)

Date	Deposits	Investment in securities (2)			$\frac{\Delta \text{ Actual inv.}}{\Delta \text{Deposits}}$
		Due	Actual (3)	Surplus (3)	
1973 - 31 December	69,273	3,482	4,192	710	*36.1*
1974 - 28 February	69,202	4,072	4,448	376	*−360.6*
30 April	71,351	4,648	4,976	328	*24.6*
30 June	72,609	5,224	5,433	209	*36.3*
31 August	73,375	5,659	5,910	251	*62.3*
31 October	74,963	6,072	6,563	491	*41.1*
31 December	80,926	6,786	7,197	411	*10.6*
1975 - 31 March	83,453	9,386	9,769	383	*101.8*
30 June	86,786	10,628	11,458	830	*50.7*
30 September	91,729	11,937	12,774	837	*26.6*
31 December	101,167	13,120	13,930	810	*12.2*
		Variation			
1975 - I quarter	*2,527*	*2,600*	*2,572*	*−28*	
II quarter	*3,333*	*1,242*	*1,689*	*447*	
III quarter	*4,943*	*1,309*	*1,316*	*7*	
IV quarter	*9,438*	*1,183*	*1,156*	*−27*	

Δ = Variation in respect to the preceding date (the first ratio is calculated from the variations in respect to December 31, 1972).

(1) Calculated for all the banks subject to the constraint. – (2) Cumulative increases from December 31, 1972. – (3) Securities which can be used to fulfill the requirement.

The new technique of issue persuaded a large number of banks, even small ones, to take part in the auction; the broadening of the market, however, was accompanied by a greater concentration of bills in the portfolios of only a few categories of banks. In June 1975, the five major banks, which receive about 25 per cent of all bank deposits, were holding 64.8 per cent of the Treasury bills in the banks' portfolios, more than double the share in June 1974 (30.7 per cent). At that date no category or group of banks had invested more than 0.6 per cent of their deposits in Treasury bills; in June 1975 the proportion had risen to 14.8 per cent on average for the five major banks and to 4.8 and 2.6 per cent for the five large banks and for the other banks; for the savings banks the proportion remained below 0.5 per cent. It should, however, be stressed that against these tendencies there are sharp fluctuations both in the distribution of Treasury bills among the various banks and in their share in bank assets. These are signs that, owing to the size of both issues and movements in the demand for loans, the role of this type of security in bank management is still unstabilized.

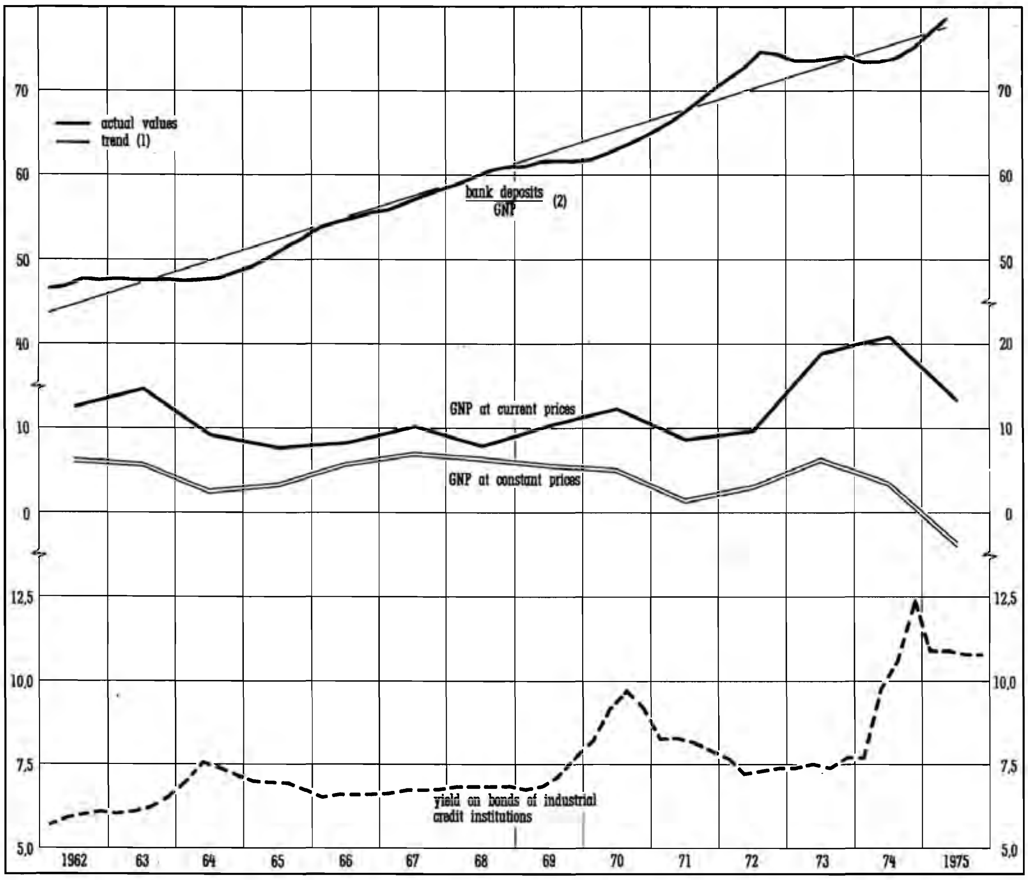
Customers' deposits

Bank deposits rose by 20,242 billion lire, at a rate of 25 per cent; this increase is significantly higher not only than in 1974 (16.8 per cent), but also than in the period from 1970 to 1974 when deposits grew, on average, by 18.6 per cent per annum.

Even compared to the increase in the gross domestic product, the growth in deposits showed a strong acceleration with respect to the two previous years (Chart 16). The ratio of the two magnitudes which had remained higher than the trend for the period 1971 to 1973 and in 1974 dropped slightly below, shot up above it in 1975, reflecting the expansionary monetary policy pursued by the authorities and the economic recession that was under way.

As already mentioned above, in the first half of the year the rapid growth in bank credit was matched by a more limited increase in the Treasury deficit and a massive absorption of fixed-interest securities by the public. The growth of deposits, calculated on seasonally adjusted figures, was thus kept down to 11 per cent, the equivalent of a 23.2 per cent annual growth rate. In the second half, and especially towards the end of the year, the sharp acceleration of the public deficit, which was not matched by an equal rise in the amount of securities placed on the market, led, in spite of a worsening of foreign accounts, to a more buoyant growth of deposits, which increased by 12.6 per cent, equivalent to an annual rate of 26.8 per cent.

Chart 16



Bank deposits and gross national product

(1) Linear interpolation. – (2) Ratio of the average amount of bank deposits to the gross national product for the 12–month period centered on the reference quarter. Amounts at end–1972 are adjusted for random mevements.

The tendency, already apparent at the end of 1973, towards a more sustained growth of savings deposits than current accounts became considerably more marked since the former rose at a rate that was roughly four times that of the latter (44 and 11.2 per cent respectively). The phenomenon was particularly strong in the first half of the year, when the differential between average yields was shifting rapidly in favour of savings deposits and up to levels never before reached in last decade. This process was probably both sanctioned and reinforced by the nature of the four successive cartel agreements in 1975: the yield differential between the two types of deposit was fixed at 1.5 per cent after the first two agreements (in force as from March 1st and May 1st respectively) and subsequently at 1 percentage point (Table 42).

Table 42

DEPOSITS OF BANK CUSTOMERS

(yearly percentage rates of increase)

Items	1971	1972	1973	1974	1975
Customers' deposits					
OVERALL TOTAL (1)	18.0	22.1	20.1	16.8	25.0
Total for banks	17.5	21.3	19.9	16.8	25.2
major	15.6	19.1	17.5	12.4	17.8
large	11.9	22.8	17.9	21.8	28.0
others	22.3	22.9	23.0	18.9	30.5
Total for savings banks	18.7	23.4	21.2	17.3	24.5
Current accounts					
OVERALL TOTAL (1)	21.7	25.0	18.5	9.7	11.2
Total for banks	20.8	23.4	17.0	8.2	11.1
major	16.6	19.8	13.3	4.4	3.7
large	12.3	23.9	17.1	14.3	11.2
others	33.7	28.6	22.4	10.3	20.3
Total for savings banks	24.3	29.6	24.9	15.7	11.5
Savings accounts					
OVERALL TOTAL (1)	12.6	17.6	22.8	28.3	44.0
Total for banks	11.5	17.2	25.9	33.9	47.8
major	11.6	15.8	37.2	42.8	56.9
large	11.3	20.7	19.4	35.6	54.0
others	11.5	16.5	23.8	29.4	41.3
Total for savings banks	14.5	18.3	17.9	18.8	36.4

(1) Including the central institutions.

Credits and deposits by sector

By observing together the variations in the main assets and liabilities items on the consolidated baalnce-sheet of the banking system it is possible to see how the system redistributes funds among the various sectors forming and using savings (households, enterprises, public sector), as well as the way in which it gathers funds which other financial operators (the special credit system and the central banks) then direct to their final destination. In a year when productive activity and investments were undergoing a severe crisis and the credit requirements of the enterprises were slight, the increase in bank intermediation among final sectors mainly consisted in a growth of the flow of funds from households to the public sector, a result of the increase in its deficits and its limited capacity for direct financing.

The net flow of funds from the banking system to the public sector and the hospitals was about 6,600 billion lire in 1975, as against 3,200 in 1974 and 1972, 1,900 in 1973 and 2,800 in 1971. Gross bank financing to the public sector, calculated according to outlays for loans and purchases of securities without deducting deposits, grew enormously; part of these funds did however flow back to the banking system in the shape of deposits, especially from the social security institutions. The acceleration of recourse to bank loans covered nearly all categories of public bodies. The largest increase was for the civil service, which obtained a flow of funds from the banking system amounting to roughly 5,100 billion, as against 1,700 billion in 1974 (Treasury bills for compulsory reserves are excluded from the calculations). Local government bodies also resorted on a large scale to the banks to finance their rapidly growing deficits: the placement of securities with the banks produced a relatively modest figure; much more rapid was the growth of loans, no longer curbed by constraints of an administrative nature. The drawing of funds by hospitals however diminished and that of social security agencies increased only slightly.

The figure for bank loans to enterprises was only a little higher than the previous year. The increase in their indebtedness was however accompanied by a corresponding increase in their stocks of liquid assets, which had been severely jeopardized by the squeeze of 1974; the net drawing of funds from the banking system was therefore practically nil. The behaviour of the different categories of enterprise varied dramatically: whereas the net bank indebtedness of the public enterprises was increasing, that of the main private companies was almost stationary and that of the smaller ones decreased. This divergence can probably be explained by the strong tendency of the public enterprises and, to a lesser extent, of the major private enterprises to stabilize production and employment levels, cutting the links with fluctuations in demand.

In 1975 households' deposits grew to much the same extent as in 1974 and, since their indebtedness with the banks is negligible as an absolute figure, the result was a corresponding increase in their credit balance with the banks. In fact, the increase in that of households exceeded the growth of the debit balances of enterprises and of the public sector by a larger amount than in the previous year, the difference lying largely in the increase in bank liquidity and in the reduction of their indebtedness to the central bank.

Besides providing a centre for the redistribution of funds among final operators, the banks also act as funds-raisers for the special credit institutions, which as mentioned in connection with operations in securities, are not able to raise funds as easily as they manage to lend them. The change in the balance with respect to these institutions has remained practically constant over the last two years. In 1975, although the flow of funds transferred from the banking system increased again, the accumulation of funds deposited with the banks also increased to same extent.

The securities market

In 1975 net issues totalled 13,264 billion, since private investors had shown renewed interest in securities and the banks also adopted a more favourable attitude; this figure was considerably larger than the the 4,244 billion of 1974, a year characterized by sharp contraction, and even exceeded the exceptional results of 1973 (12,436 billion). The ratio of total net issues to gross national product was 12 per cent as against 4.4 per cent in 1974 and 15.4 per cent in 1973 (Table 43).

The difficulties which had afflicted the bond market in 1974 and led to a policy of reducing issues to a minimum were, at least temporarily, overcome in 1975. Consequently a much larger volume of issues was possible. The increase was also partly due to the fact that issuers were well aware of the precariousness of the equilibria achieved in a year when inflation was contained and the balance of payments improved at the cost of a severe recession and a serious deterioration of enterprises' profits.

Table 43

NET ISSUES OF SECURITIES (1)

(billions of lire)

Items	Amounts at December		Net issues						
			1973 Year	1974			1975		
				half-year		Year	half-year		Year
	1974	1975		I	II		I	II	
ISSUERS:									
Treasury (2)	20,925	26,572	3,179	5	1,221	1,226	1,247	3,854	5,101
Special credit institutions	26,930	33,454	6,438	251	1,902	2,153	3,217	2,193	5,410
Others	8,103	9,619	836	−125	219	94	513	883	1,396
TOTAL ...	55,958	69,645	10,453	131	3,342	3,473	4,977	6,930	11,907
PURCHASERS:									
Banca d'Italia and U.I.C.	10,337	13,119	2,539	56	1,561	1,617	−82	2,503	2,421
Central Post Office Savings Fund (3)	674	1,281	−44	26	−6	20	522	67	589
Banks (4)	27,565	35,305	6,171	2,264	1,608	3,872	3,346	2,992	6,338
Public	17,382	19,940	1,787	−2,215	179	−2,036	1,191	1,368	2,559
Shares	*15,000*	*16,650*	*1,983*	*286*	*485*	*771*	*617*	*740*	*1,357*

(1) The item "issues abroad" which was included in this table up to last year has been eliminated. In fact, during recent years foreign loans have taken the form of direct financing. For statistical information the reader is referred to the chapter on the balance of payments. — (2) Includes 20-year certificates issued by the Central Post Office Savings Fund, bonds issued on behalf of the Treasury and bonds issued by the autonomous government agencies and the local authorities. Excluding Treasury bills, Post Office interest-bearing certificates, short-term Treasury certificates and special certificates. — (3) Purchases by the Post Office Savings Fund also include some of the certificates issued by the Fund itself (45.5 billion in 1974 and 386.4 in 1975). — (4) Owing to the reform of banking statistics, as of 1974 the amounts also include securities of staff retirement funds, ICCREA and Federalcasse and those used for swap operations. For easy comparison, therefore, the amount corresponding to the changes in data recording has been deducted from the total for bank purchases in 1974.

The public sector, the special credit institutions and enterprises all contributed, though in varying degrees, to the expansion of net issues of fixed-interest securities (11,907 billion in 1975 as against 3,473 billion in 1974 and 10,453 billion in 1973). The Treasury and the local authorities stepped up their net issues considerably (5,101 billion in 1975 as against 1,226 in 1974 and 3,179 billion in 1973). This was necessary in view of the exceptionally large budget deficit and despite continuous and increasing recourse to issues of Treasury bills. The special credit institutions considerably increased the amount of funds raised on the market (5,410 billion in 1975 as against 2,153 billion in 1974) but still raised less than in 1973 (6,438 billion) when a substantial number of issues planned for 1974 were brought forward as described in previous issues of the Report. Two of the main reasons why the industrial credit institutions raised more funds on the capital market were their need to increase liquidity in the face of growing commitments and the expansion of their lending. In fact, despite the drastic reduction in investment there was even an expansion in real terms, partly in consequence of enterprises' funding a part of their bank debts which had risen sharply in 1974.

The other issuers, for the most part public enterprises, raised 1,396 billion net of redemptions (94 billion in 1974 and 836 billion in 1973). By reducing their investments less than private enterprises, public enterprises accelerated the issue of bonds and slowed down borrowing from the banks.

The nominal value of outstanding fixed-interest securities rose by 24 per cent (as against 8 per cent in 1974 and 27 per cent in 1973) and therefore also increased in real terms.

Table 44

INVESTORS IN FIXED-INTEREST SECURITIES

(percentage breakdown)

Investors	Yearly average 1962-71	1972	1973	1974	1975
Banca d'Italia and UIC	*19.1*	*19.8*	*24.3*	*46.5*	*20.3*
Banks	*42.3*	*48.6*	*59.0*	*111.5*	*53.2*
Other financial intermediaries (1)	*7.0*	*1.7*	*2.6*	*–2.0*	*7.3*
Enterprises, households and foreign investors	*31.6*	*29.9*	*14.1*	*–56.0*	*19.2*
Total	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
Total in billions of lire	2,393	5,970	10,453	3,473	11,907

(1) Over the three years 1962-1964, purchases by the Central Post Office Savings Fund equalled 20 per cent of the total.

The most important aspect with regard to demand was the return to the market of private investors who invested 2,559 billion in securities after disinvesting more than 2,000 billion in 1974 and investing 1,787 billion in 1973 (Table 44). After the first signs of the recovery of private investors' demand for securities in the second half of 1974, substantial net purchases were made in both halves of 1975. Among the causes of this pattern were: the increase in the available funds of the private sector, the decline of both the actual and expected rate of inflation, the decline in the interest rates paid on bank deposits, less marked variations and prospects of greater stability in the quotations of securities — factors which, in part, interacted. 1975 also saw the fruits of the policy designed to render new issues technically attractive to private investors who traditionally increase their portfolios of fixed-interest securities by buying on the primary market. The public did, in fact, give clear signs of appreciating nominal interest rates close to actual yields, shorter-term securities and simpler amortization plans.

The net purchases of bonds by the Banca d'Italia and the UIC (Italian Foreign Exchange Office) amounted to 2,421 billion (1,617 billion in 1974). A large part of this total consisted of Crediop (Credit Consortium for Public Works) bonds issued on behalf of the Treasury which were partially offset by limited sales of public enterprise and special credit institution bonds. The Banca d'Italia, after making net sales of 240 billion during the first five months of the year, started making modest purchases and, during the last quarter, bought bonds totalling 2,372 billion, including a number of very large new issues made by the Crediop on behalf of the Treasury. On the secondary market the central bank, contrary to the policy adopted in previous years, considered it advisable to avoid too large a decline in yields. This explains why most of the Bank's operations consisted of sales on the main stock exchanges especially during the first quarter when there was a marked tendency for yields to weaken. There were also substantial net sales in November and December when money market rates were once more falling. These sales confirmed the policy of not allowing long-term security rates to decline.

As in past years the banks absorbed the largest proportion of the new fixed-interest securities (6,338 billion, as against 3,872 billion in 1974 and 6,171 billion in 1973), without considering their underwriting of special certificates issued by the Treasury to fund the debts of the health insurance institutions. The banks acquired more bonds than necessary to meet the compulsory investment requirements which were extended to cover both halves of the year. Underlying this behaviour of the banks were a weakening of demand for loans and a high level of liquidity. The purchase of bonds beyond the compulsory limit was also partly due to both the investment requirement itself — insofar as this tended to stabilize expectations — and to the advantages to be gained from facilitating the fund-raising operations of the special credit institutions. Most of the banks' purchases were made on the primary market where the securities issued satisfied the technical conditions of the investment obligation.

The dispositions regulating the banks' portfolio constraint for 1975 were considerably changed in two ways. First, the obligation was related to variations in the banks' deposits instead of to their absolute value. This went a long way towards eliminating the distortions inherent in the previous system whereby it had been to the banks' advantage to seek expansion of their deposits at almost any cost. Second, a coupon constraint was imposed which obliged the banks to underwrite bonds with high nominal rates of interest — a feature almost exclusively limited to new issues.

The banks purchases over the course of the year reflected the deadlines established by the Interministerial Committee for Credit and Saving, with investments concentrated in March, June, September and December in coincidence with large new issues of bonds. The fact that the coupon contraint caused the bank's to make most of their purchases on the primary market resulted in net monthly issues and net purchases by the banks being well balanced, whereas there had been considerable imbalance in 1974 (expecially during the first six months) because the banks had bought a large proportion of their bonds directly from the public. This, however, was not the only reason why the banks turned to bonds with high coupons since, in a period of abundant liquidity, there was no longer any advantage in limiting the funds invested by purchasing low coupon bonds carrying large discounts.

The distribution of bonds in circulation varied slightly among the different categories of investors in line with the trends of previous years. At the end of 1975 the Banca d'Italia held 18.8 per cent of outstanding bonds (18.5 per cent in 1974 and 16.3 per cent in 1973), the banks 50.7 per cent (49.2 per cent in 1974 and 43.6 per cent in 1973) and the public 30.5 per cent (32.3 per cent in 1974 and 40.1 per cent in 1973). The increase in the proportion of bonds held by the banks and the resulting double intermediation typical of medium-and long-term financing are the result of the upsurge in issues caused by the swelling of the budget deficit and the fall in enterprises' self-financing. In addition, the prevailing yield structure of the market was such that the public was not prepared to raise its holdings of bonds in line with the increase in issues, while recently the share of the banks has also been enlarged by the constraints imposed upon their assets. The reappearance of the public as a net purchaser on the market did no more than slow down the decline in the proportion of its share.

The yields on medium- and long-term fixed-interest securities, after rising sharply in 1974 until towards the end of the year when there was a reversal of the trend, fell during the first few months of 1975. However, the fall was limited in comparison with that of 1970-71: another period during which yields varied considerably (Table 45).

Table 45

AVERAGE ACTUAL YIELD ON FIXED-INTEREST SECURITIES

Assets	December 1973	December 1974	December 1975	March 1976	Changes between		
					Dec. 74 / Dec. 73	Dec. 75 / Dec. 74	March 76 / Dec. 75
Government securities	7.06	10.78	9.65	10.98	*3.72*	*–1.13*	*1.33*
Consolidated	4.83	5.98	5.29	5.21	*1.15*	*–0.69*	*–0.08*
Redeemable	6.97	9.68	10.51	11.30	*2.71*	*0.83*	*0.79*
Treasury bonds	7.15	11.66	9.39	10.95	*4.51*	*–2.27*	*1.56*
Bonds	7.38	11.43	10.52	11.47	*4.05*	*–0.91*	*0.95*
On behalf of Treasury	7.45	12.15	11.63	12.38	*4.70*	*–0.52*	*0.75*
Industrial credit institutions	7.67	12.49	10.66	12.05	*4.82*	*–1.83*	*1.39*
Real estate credit institutions	6.86	9.07	8.55	9.22	*2.21*	*–0.52*	*0.67*
ENEL-ENI-IRI	7.81	13.28	11.21	12.64	*5.47*	*–2.07*	*1.43*
Other companies	7.95	13.41	11.72	13.35	*5.46*	*–1.69*	*1.63*

The pattern described above is similar to that of most of the major foreign markets where yields, after an initial fall, settled down at a higher level in the United Kingdom and at lower levels in the United States and West Germany (probably in relation to the different expected rates of inflation). Though not directly concerning the level of long-term yields itself there was, however, an important difference between the Italian market and foreign ones with respect to the spread between

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long-term yields and short-term interest rates. In Italy the latter declined rapidly from the beginning to the end of the year while after an initial fall money market rates abroad tended to rise (in the United Kingdom and the United States) or stabilize in the last quarter (West Germany). Thus the striking feature of the Italian situation was not the stability of long-term rates but rather the fact that this stability was maintained despite the continuous decline in short-term rates. The authorities' aim was to provide favourable conditions for savers and at the same time to underline the persisting difficulties of the Italian economy.

The yields on the bonds of the industrial credit institutions sank to a minimum of 10.5 per cent in March, rose to 11 per cent in April and then settled down for the rest of the year around 10.8 per cent. The variations in these yields were more marked than those for the bonds issued by the Crediop on behalf of the Treasury where the Banca d'Italia's interventions exerted a direct stabilizing effect. In fact, these yields only weakened in January when they declined to 11.5 per cent, the level they maintained for the rest of the year as a result of sales by the Banca d'Italia which were particularly heavy in February.

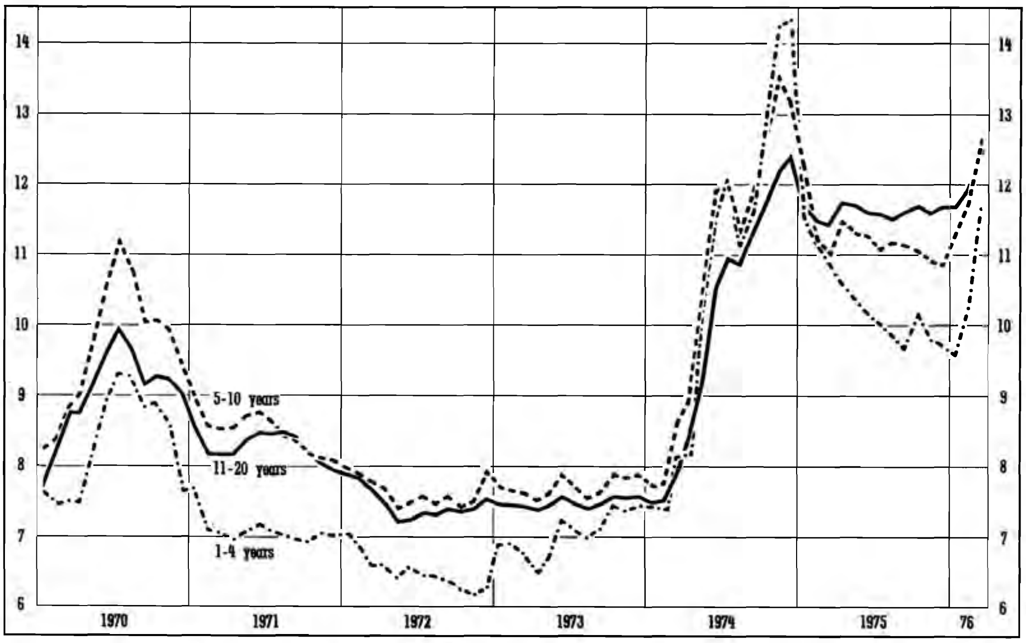
The yields on the bonds of the real-estate credit institutions weakened slightly during the year and were at a much lower level than those of other bonds, both because of limited price support interventions and because of certain provisions of the banks' compulsory investment requirements intended to ensure a sufficient flow of funds to the housing sector.

In line with the change in monetary policy the structure of the yields on bonds classified by years of residual life reversed at the beginning of 1975. Yields on securities with the shortest residual lives (1-4 years) dropped back to form the lower limit of the range and the divergence between the yields on these bonds and those on the longer terms bonds increased over the year. From March onwards the yields on the 5-10 year group weakened a little while those on the 11-20 year group became slightly firmer (Chart 17).

Capital raised through share issues (1,357 billion) was much greater than in 1974 (771 billion) but still considerably less than in 1973 (1,983 billion). Most of the increases in capital were made by the state-controlled enterprises and served to cover trading losses.

As a ratio of gross national product, share issues rose from 0.8 per cent in 1974 to 1.2 per cent in 1975; as a ratio of private fixed investment they rose from 3.6 per cent in 1974 to 6 per cent in 1975. These levels have, therefore, climbed back up towards the average values of the period 1965-1974 when they were higher than those of the other major industrial countries.

Chart 17



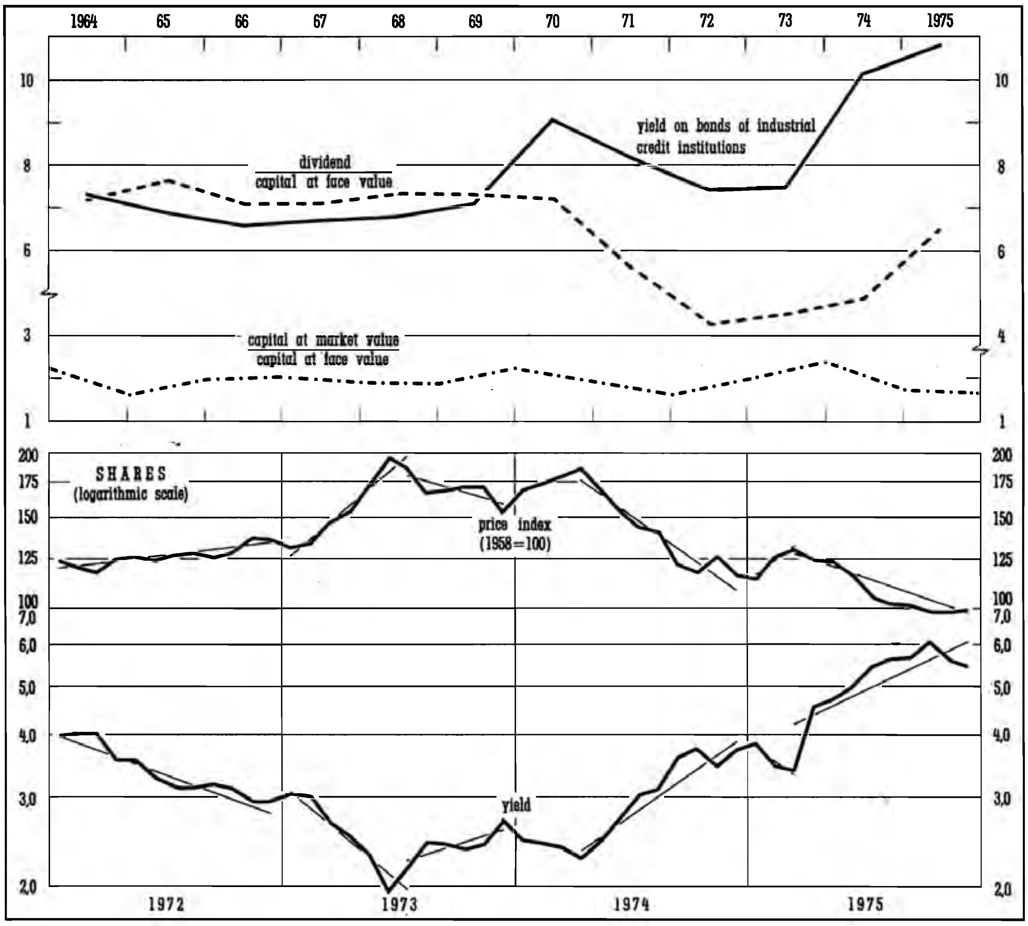
Yields on bonds classified by years of residual life

The increase in share issues by state-controlled enterprises was particularly marked and the capital they raised corresponded to 31.5 per cent in 1975 compared with 16.9 per cent in 1974.

The proportion of new issues originating with listed companies continued to decline on the primary market to approximately 12 per cent (from 14 per cent in 1974 and 23 per cent in 1973). One of the factors impeding expansion in this area was the further drop in the ratio of market to nominal values (Chart 18). Among unlisted companies, those controlled by the State increased their share of new issues from 9.6 to 23.6 per cent.

The annual survey of share ownership revealed an increase in « foreign » holdings (23.2 per cent as against 20.6 per cent in 1974) and a decrease in those of all the other categories. Non-resident investors substantially increased their holdings in unlisted companies while slightly reducing those in listed companies. The « company » sector's holdings declined slightly with the contraction of the public enterprises, public agencies and financial companies outweighing the expansion of private companies which was principally in the holdings of industrial companies. Private investors also continued to run down their share of issued capital.

Chart 18



Shares and bonds: prices and yields

Unit trusts are included among « public » shareholders in Table 46. The net assets of the eleven trusts analyzed rose by about 9 per cent in 1975 (362 billion at the end of 1975 as against 331 at the end of 1974) despite net disinvestment by the public amounting to 12 billion (as against net investment of 3 billion in 1974 and 31 billion in 1973).

Shares worth 263 billion represented 73 per cent of the unit trusts' net assets at the end of 1975 (56 per cent at the end of 1974 and 73 per cent at the end of 1973); other securities (55 billion) 15 per cent (22 and 10 per cent respectively at the ends of 1974 and 1973); liquid funds (44 billion) 12 per cent (22 and 17 per cent respectively at the ends of 1974 and 1973). The fall in other securities and liquid funds as a percentage of total net assets is due to the reduction in short-term interest rates in Italy and the other major industrial countries as well as by the decline in Italian share quotations.

Table 46

SHARES BY CATEGORIES OF HOLDERS

(amounts at end-year; percentage breakdown; total in billions of lire)

Categories of holders	Yearly average 1961-70	1971	1972	1973	1974	1975
Public	*34.8*	*29.9*	*28.6*	*27.0*	*25.6*	*24.5*
Companies	*45.2*	*45.3*	*45.7*	*48.3*	*51.1*	*50.2*
Foreign sector	*17.7*	*22.2*	*23.1*	*22.0*	*20.6*	*23.2*
Banking system	*0.9*	*0.9*	*0.9*	*0.8*	*1.0*	*0.5*
Other financial intermediaries	*1.4*	*1.7*	*1.7*	*1.9*	*1.7*	*1.6*
Total...	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
listed	*46.0*	*36.1*	*34.4*	*33.1*	*32.6*	*30.6*
unlisted	*54.0*	*63.9*	*65.6*	*66.9*	*67.4*	*69.4*
Total at market value	17,824	17,282	17,269	26,355	25,500	20,979

While the share indexes of the other major industrial countries all recovered considerably during 1975, with the end of the worldwide recession being discounted right from the beginning of the year, the Italian index fell 16 per cent from 115.2 in December 1974 to 97.3 in December 1975 (compared with a 25 per cent fall in 1974 and a 13 per cent rise in 1973). From January to March 1975 the Italian index rose while long-term interest rates were falling, as in the other main industrial countries. The continuous decline in share prices between March (130.3) and November (93.9), amounting to a 28 per cent fall, was due to uncertainty with respect to the economic recovery and political prospects of the country.

There was a slight upward movement during the last two months of 1975 (Chart 18) which reflected signs of a recovery in industrial production, the passing of fiscal reforms allowing enterprises' physical assets to be revalued and increased bank liquidity.

The dividends distributed were relatively large. Those distributed by the companies in the sample used by the Banca d'Italia to calculate share yields rose by about 35 per cent. The total amount distributed was 216 billion in 1975 (as against 161 billion in 1974 and 150 billion in 1973).

Share price movements varied considerably from sector to sector during the year. Banking and insurance shares rose strongly, other financial company shares declined much less than the average while the shares of all the other sectors registered large falls.

The activity of the special credit institutions

In 1975, outstanding domestic loans of the special credit institutions, net of transactions by the Crediop (Credit Consortium for Public Works) on behalf of the Treasury, increased by 6,072 billion (19.3 per cent) compared with an increase of 3,245 billion (11.5 per cent) in 1974 (Table 47). There was a considerable rise in the debts contracted by public enterprises and agencies, whereas the share of new loans contracted by private enterprises fell from 65 per cent in 1974 to 43 per cent. In absolute terms the increase in loans was larger than the already substantial one registered in 1973 (5,718 billion); however, the difference between the level of prices in the two years should be borne in mind. The explanation for this situation during a period of weak investment activity is, in part, to be found in the financing of investment plans carried out during 1974 and in the granting of requests for loans which the credit institutions had accumulated as a result of the difficult market conditions prevailing during the first half of 1974.

During 1975, the net value of the securities issued was 5,410 billion, a figure which was only exceeded in 1973 (6,438 billion) when issues were brought forward for fiscal reasons. The renewal of the banks' portfolio constraint to cover 1975, besides allowing the special credit institutions to plan their issues, made continuous placings possible during the early months of the year when the public sector was still reluctant to buy bonds.

Table 47

ASSETS AND LIABILITIES OF THE SPECIAL CREDIT INSTITUTIONS

(billions of lire)

Items	Amounts at end of 1975	Changes						
		1973	1974			1975		
			half-year		Year	half-year		Year
			I	II		I	II	
ASSETS								
Loans: domestic (1)	37,576	5,718	846	2,399	3,245	2,694	3,378	6,072
foreign	1,289	150	–1	71	70	75	145	220
on behalf of the Treasury . .	13,610	2,660	–150	898	748	365	1,752	2,117
Securities portfolio:	1,603	184	–112	111	–1	586	169	755
Treasury bills	*700*	..	*21*	*2*	*23*	*521*	*144*	*665*
Cash and liquid assets	8,274	3,761	773	–418	355	1,324	–468	856
with: *B.I. in foreign currency (2)* .	*3,248*	*1,680*	*1,414*	*12*	*1,426*	*–439*	*–68*	*–507*
B.I. in lire (2)	*777*	*186*	*–116*	*–381*	*–497*	*521*	*129*	*650*
banks	*4,062*	*1,876*	*–521*	*–34*	*–555*	*1,316*	*–614*	*702*
others	*187*	*19*	*–4*	*–15*	*–19*	*–74*	*85*	*11*
Total	62,352	12,473	1,356	3,061	4,417	5,044	4,976	10,020
LIABILITIES								
Bonds (3) ordinary	33,456	6,438	251	1,902	2,153	3,217	2,193	5,410
on behalf of the Treasury	13,858	2,576	–194	813	619	278	1,827	2,105
Deposits and interest-bearing certificates	4,080	388	–27	255	228	1,033	–99	934
Current accounts with banks	1,381	–1	–149	203	54	–114	134	20
Funds from the Treasury (4)	2,527	227	60	114	174	170	96	266
Foreign loans	4,418	1,888	1,409	34	1,443	–299	–101	–400
Equity capital (5)	2,401	236	149	97	246	281	41	322
Others (6)	231	721	–143	–357	–500	478	885	1,363

(1) Including financing of stockpiling. – (2) The total for these deposits, which is taken from the balance sheet of the Banca d'Italia, differs from that reported by the institutions mainly owing to accounting time lags. – (3) Net value; includes issues by the Mediocredito centrale (medium-term credit institution). – (4) Also includes funds supplied by the regions, by the Southern Development Fund (own funds) and by the Mediocredito centrale. – (5) Capital and reserves. – (6) Discount, current accounts with other credit institutions and other items. This item is also affected by the alterations introduced in the items under notes (2) and (3) with respect to those in the balance sheets of the institutions.

The increase in funds raised on the domestic market in 1975 was greater than that of loans, although the situation varied during the course of the year. In the first half 4,300 billion were raised and 2,800 billion lent, while in the second half lending activity accelerated

(3,500 billion) and 400 billion of the liquidity previously accumulated was utilized.

The liquid assets which became available were used to buy Treasury bills (665 billion) and to increase deposits with the banks. The ratio of liquid assets (including Treasury bills) to funds raised rose from 9.9 per cent in December 1974 to 14 per cent in June and then dropped back to 12.6 per cent at the end of 1975. The increase in the liquid assets of the special credit institutions is also demonstrated by the ratio of liquid assets to loan commitments which stood at 39 per cent in December 1974, 58 per cent in June 1975 and ended the year at 47 per cent.

Subsidized credit also showed a recovery in the presence of profitable reference rates. Outlays rose from 2,400 billion in 1974 to 3,200 and were largely affected by the growth of loans to agriculture, exports and medium- and small-sized firms. There was, however, a decline in the share of subsidized loans which fell during the year from 34.2 per cent of the total to 33.6 per cent. This decline can probably be attributed to the extremely limited effects produced by the refinancing measures taken during the year.

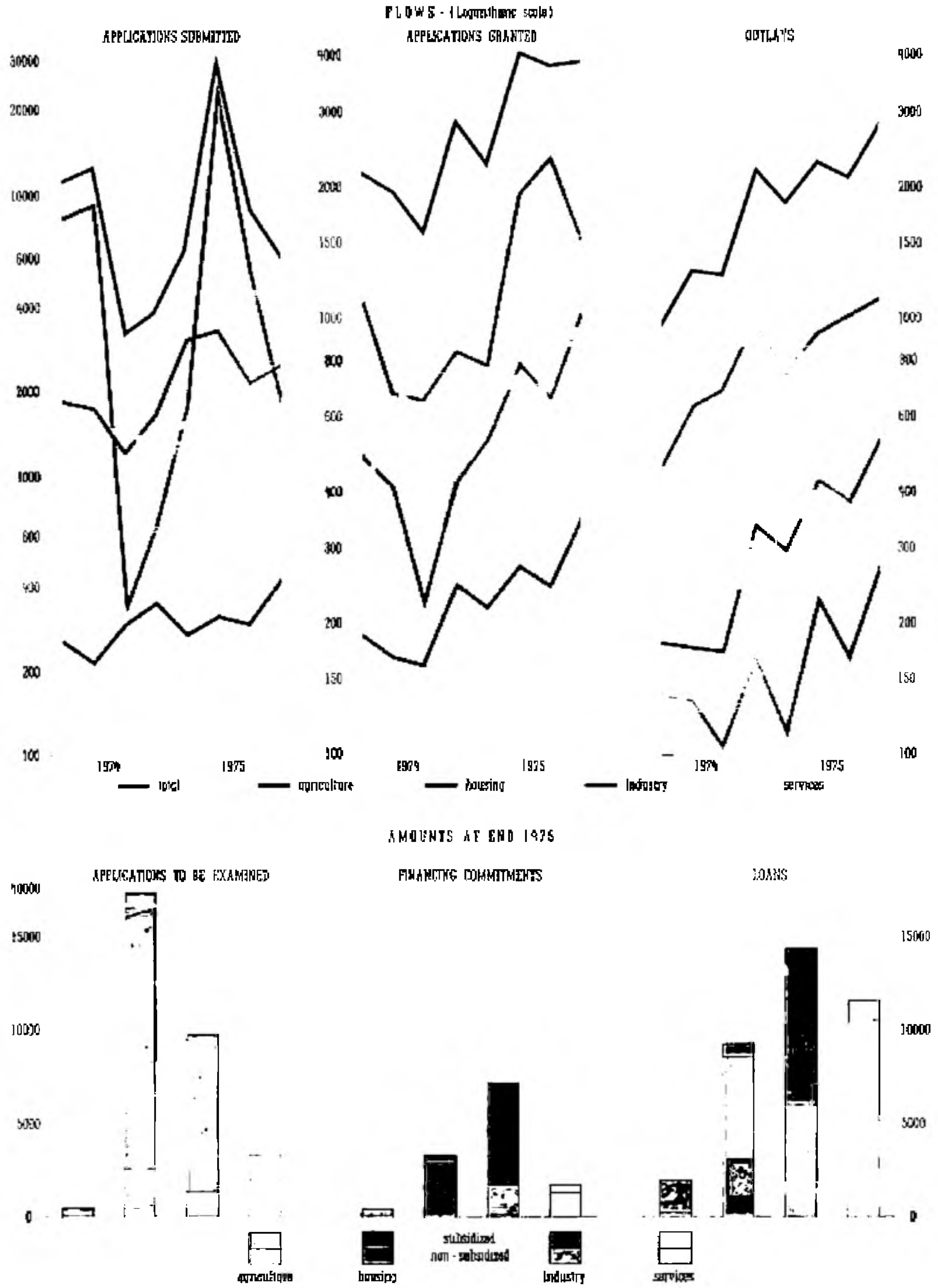
Applications for domestic loans made to the special credit institutions during the year, excluding those for subsidized building, increased sharply (21,800 billion as against 15,500 billion in 1974) and, particularly in the case of the industrial sector, indicate an upturn in investment planning. The applications granted by the special institutions also rose sharply (13,900 billion as against 7,900 billion; Chart 19).

The completion during 1976 of the considerable domestic commitments outstanding at the end of 1975 (12,600 billion, of which about half is for subsidized credit) depends both on the prerequisites for investment being fulfilled and on the state of the capital market. Expectations which had become increasingly favourable in 1975 faded sharply owing to the events of the first few months of 1976 and the economic measures adopted. In addition, the special credit institutions will have greater difficulty in placing their securities this year partly because the private sector will be less willing to invest in bonds because of the higher short-term rates.

The evolution of the economic cycle has not yet influenced the activity of the institutions. In the first quarter of 1976, in fact, lending

DEMAND FOR AND SUPPLY OF SPECIAL CREDIT

(billions of lire)



increased by about 1,600 billion, the same rate as in the first quarter of 1975. Despite the tendency for interest rates to rise, fund-raising has continued at a high level, partly as a result of the quarterly deadline for the portfolio contraint, and this has allowed a further accumulation of liquid assets.

Fund-raising sources

Ordinary fund-raising during 1975 totalled 8,176 billion compared with 3,227 billion in 1974. About four-fifths of this total was obtained on the bond market (Table 48). Net of repayments, the placing of bond loans equalled 6,418 billion as against 2,498 billion in 1974. The increase in issues was common to all branches of special credit

Table 48

FUND-RAISING SOURCES OF THE SPECIAL CREDIT INSTITUTIONS

(percentage breakdown of changes)

Types of liabilities / Sectors of origin	1973	1974 half-year I	1974 half-year II	1974 Year	1975 half-year I	1975 half-year II	1975 Year
TYPES OF LIABILITIES							
Bonds (1)	84.6	88.5	75.9	77.4	69.9	95.4	78.5
Deposits and interest-bearing certificates	4.9	−7.4	9.0	7.1	19.1	−3.6	11.4
Mediocredito funds	3.4	26.6	2.6	5.4	1.1	2.3	1.5
Foreign loans (2)	3.2	−1.5	0.9	0.6	2.5	−1.2	1.3
Equity capital	3.0	39.0	3.4	7.6	5.2	1.5	3.9
Others	0.9	−45.2	8.2	1.9	2.2	5.6	3.4
Total...	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SECTORS OF ORIGIN							
Public and companies	25.4	−304.8	−21,0	−54.5	23.0	−5.8	13.2
Banca d'Italia and UIC	0.4	2.3	1.8	1.9	−0.5	0.6	−0.1
Banks	62.2	402.0	106.6	141.5	60.2	103.3	74.7
Other credit institutions (3)	5.5	−11.1	5.0	3.0	7.6	2.0	5.7
Public sector	3.2	8.6	7.0	7.2	7.3	1.6	5.4
Foreign sector (2)	3.3	3.0	0.6	0.9	2.4	−1.7	1.1
Total...	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (in billions of lire)	7,911	381	2,846	3,227	5,419	2,757	8,176

(1) Excluding bonds issued on behalf of the Treasury and by the Mediocredito centrale, the value of which increased by 108 billion in 1975 (81 billion in 1974). – (2) Net of compensatory loans held by the Banca d'Italia, which dropped by 506 billion in 1975 (1,425 billion increase in 1974). – (3) Special credit institutions and insurance companies.

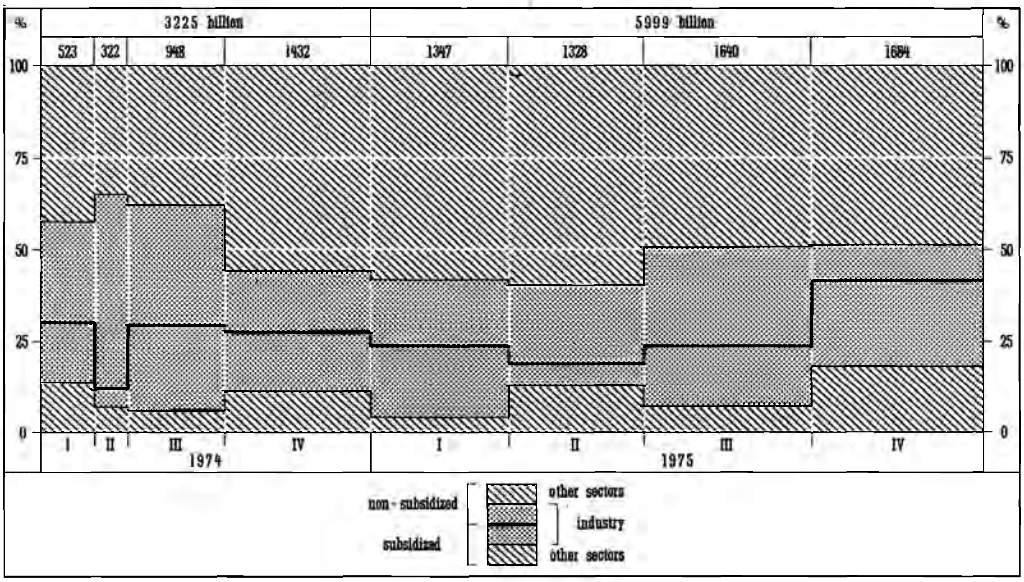
and was made easier, as mentioned in previous chapters, both by the recovery in demand for securities by the public and by the compulsory inclusion in the banks' portfolio constraint of a percentage of securities issued by the special credit institutions. The funds raised through deposits and interest-bearing certificates totalled 934 billion (228 billion in 1974), and represented an alternative source of funds for the industrial credit institutions (nearly 20 per cent of the total). These medium-term funds were mainly provided by the public; those provided by the banks for their portfolio constraint only amounted to 209 billion.

The substantial increase in funds raised, although matched by a large volume of outlays, caused liquid assets to increase from 3,663 billion at the end of 1974 to 5,026 billion in December 1975; an increase which occurred almost exclusively in the industrial credit sector. Considered in the light of commitments, the high level of liquidity reflects a cautious attitude in the face of more variable rates on the bond market and,therefore, greater difficulty in placing securities.

Lending by categories of customers

Loans by the special credit institutions grew at an annual rate which, after the fall in 1974, was in line with the 1970-73 average

Chart 20



Domestic lending by special credit institutions by sectors and categories of operations

(about 20 per cent). The recovery of financing was virtually steady throughout the year and, although it affected all economic sectors, was particularly strong in the housing, agricultural and services sectors (Chart 20).

The favourable development of lending by the special credit institutions is partly due to funding of short-term debts. The widespread use made of prefinancing in 1974 was a result of the high cost of long-term debt and of the expectations that rates would fall as, in fact, they did in the first quarter of 1975.

Table 49

DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS BY CATEGORIES OF CUSTOMERS

(Central Risks Office data)

Categories of customers	Absolute changes				percentage changes	
	billions of lire		percentage breakdown			
	1974	1975	1974	1975	1974	1975
GOVERNMENT SECTOR	360	872	11.2	14.6	10.7	23.5
general government bodies and agencies	–71	2	–2.2	..	–61.1	5.5
local authorities	319	667	9.9	11.2	11.6	21.7
other public bodies (1)	112	203	3.5	3.4	22.8	33.6
FINANCE AND INSURANCE COMPANIES	10	84	0.3	1.4	4.1	31.6
public	–36	64	–1.1	1.1	–72.9	479.7
others	46	20	1.4	0.3	22.5	7.8
NON-FINANCE COMPANIES	2,919	4,681	90.5	78.0	15.3	21.3
public	835	2,131	25.9	35.5	15.8	34.7
private	2,084	2,550	64.6	42.5	15.1	16.1
HOUSEHOLDS (2)	–64	362	–2.0	6.0	–1.3	7.1
Total . . .	3,225	5,999	100.0	100.0	11.6	19.3
public enterprises and bodies	*1,159*	*3,067*	*35.9*	*51.1*	*13.3*	*31.1*
households and private enterprises	*2,066*	*2,932*	*64.1*	*48.9*	*10.8*	*13.8*

(1) Including social security institutions. – (2) Also includes non-recorded risks.

While the expansion of credit affected all categories of customers, there were large differences between the individual rates of increase: 31 per cent for the public sector (public enterprises and bodies) and about 14 per cent for the private sector (in 1974 these figures were respectively 13 and 11 per cent). This resulted in a substantial change in the flows of credit to the two sectors: the public sector's share increased from 36 per cent in 1974 to 51 per cent in 1975, while that of the private sector fell from 64 per cent to 49 per cent. The reduction in the share of the private sector did not affect households, who benefited from the recovery in the granting of loans for residential building so that in 1975 net lending to households increased by 362 billion, compared with net repayments of 64 billion in 1974 (Table 49).

The greater share of financing going to public enterprises and, to a lesser extent, to general government indicates a sharp acceleration of the long-term trend. In particular, in 1975 private enterprises were more affected by the general slackening of investment than were those of the public sector.

Subsidized credit and the cost of medium- and long-term finance

The outlays of subsidized credit by the special credit institutions totalled 3,177 billion in 1975, equal to 34 per cent of total outlays (2,368 billion and 39 per cent in 1974).

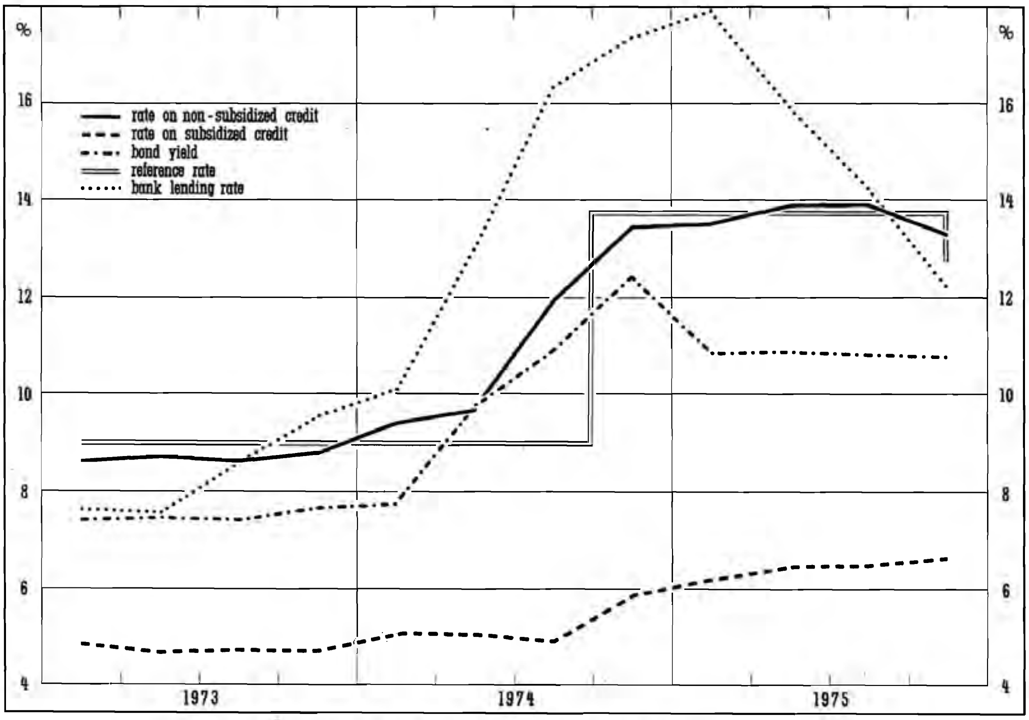
There were only modest increases in lending to medium- and small-sized industries (568 billion in 1975 as against 439 in 1974), in financing the industrialization of the Mezzogiorno (741 billion against 602) and in providing export credits (678 billion against 502). Rather larger was the increase in credit granted to agriculture (605 billion against 374), a situation which was not only favoured by the availability of public funds but also benefited from the opening of the bond market to all the special credit institutions.

Medium- and long-term market rates had risen sharply during 1974 and remained high throughout 1975 (Chart 21). Furthermore, at the end of the first quarter of 1976, new inflationary tensions, together with the indications provided by monetary policy, did not fail to push up sharply the cost of raising funds on the bond market.

As a result of the general rise introduced in the fourth quarter of 1974, subsidized rates have followed market rates to a certain extent. Towards the end of 1975, partly because of the reduction in financial market rates which had taken place in the first quarter and because of the subsequent stability of yields, both the reference and the subsidized rates were lowered by about one percentage point.

The cost in real terms of subsidized financing remained, however very high, although lower than in 1974 since the pattern of prices was different. The weighted annual average rate for subsidized loans rose from 4.80 per cent in 1974 to 5.85 per cent in 1975.

Chart 21



Interest rates applied by the industrial credit institutions

The cost to the public sector of interest-reducing subsidies rose from 561 billion in 1974 to 927 in 1975. However, the amount of subsidized credit made available by each unit of the funds allocated for this purpose dropped by about 30 per cent compared with the previous year owing to the widening of the gap between the reference rates applied to the financial institutions and the rates charged to customers (Chart 21).

The upturn in rates which occurred in the first quarter of 1976 once more jeopardized the subsidized credit sector since the cost to the industrial credit institutions of raising funds came close to the current reference rate for subsidized lending. Uncertainty as to the future course of the market made it more difficult to establish an adequate level for reference rates. These were, however, raised in April and this measure also led to an increase in subsidized rates.

A more regular flow of subsidized credit could be guaranteed both by introducing an automatic mechanism for establishing reference rates and by setting fixed interest-reducing subsidies which would differ in accordance with the importance of the project in question. A similar mechanism, which has already been adopted in a number of sectors would allow the subsidized rate to fluctuate in line with the cost to the institutions of raising funds, while leaving unvaried the amount of subsidized credit that can be made available with a given State contribution.

Financing of industry and services

The outlays of credit to industrial enterprises amounted to 3,752 billion in 1975 (2,714 in 1974); net of repayments the total debt of the sector rose by 2,156 billion, equal to 17.7 per cent (1,441 billion and 13.4 per cent in 1974; Table 50). In a year when investment was weakening even in money terms this situation can be explained by the lag between the completion of works and the disbursement of loans. The ratio of outlays (net of export credits) to industrial investments made during the year rose from 31 per cent in 1974 to 45 per cent in 1975. If, however, the disbursements are compared with the investments of the previous years the ratio remains virtually constant at about 43 per cent. The increase in the industrial enterprises' borrowing from the special credit institutions can in any case be regarded as having improved their liabilities structures and reduced the average cost of their total debt, since three-fifths of the loans outstanding at the end of 1975 were at subsidized rates.

The subsidized credit granted to industry accounted for a larger share of the increase in lending than in 1974, though not large enough to alter the tendency towards a decline in its share of total industrial investment. At the end of 1972, this stood at 68 per cent whereas at the end of 1975 it was down to 58 per cent. Borrowing at subsidized rates, although increasing over the last three years while borrowing at market rates varied considerably, did not keep up in money terms with the growth of investment expenditure.

Table 50

DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS BY SECTOR

(billions of lire)

Categories of operation	Agricolture		Housing		Industry		Transport, commerce and misc. services		Total	
	1974	1975	1974	1975	1974	1975	1974	1975	1974	1975
					Outlays					
Subsidized	347	569	96	145	1,526	1,825	150	275	2,119	2,814
Non subsidized	188	200	753	1,451	1,188	1,927	1,447	2,618	3,576	6,196
TOTAL	535	769	849	1,596	2,714	3,752	1,597	2,893	5,695	9,010
					Net increases in lending *(absolute values)*					
Subsidized	133	319	110	128	578	1,027	55	176	876	1,650
Non-subsidized	29	−3	470	1,156	863	1,129	987	2,067	2,349	4,349
TOTAL	162	316	580	1,284	1,441	2,156	1,042	2,243	3,225	5,999
					(percentage breakdown)					
by region:										
Northern	*34.4*	*48.8*	*20.7*	*40.6*	*40.0*	*40.3*	*61.0*	*69.6*	*43.0*	*51.8*
Central	*26.3*	*22.2*	*50.0*	*35.2*	*17.3*	*17.7*	*12.7*	*11.6*	*22.2*	*19.4*
Southern and islands	*39.3*	*29.0*	*29.3*	*24.2*	*42.7*	*42.0*	*26.3*	*18.8*	*34.8*	*28.8*

Net of requests for export credits, the industrial sector applied to the special credit institutions for 9,100 billion worth of loans in 1975 as against 5,300 billion in 1974. With fund-raising conditions favourable and substantial liquid assets, the institutions granted applications for 5,500 billion (2,800 in 1974). An analysis by project of these applications for investment finance seems to confirm the tendency towards restructuring enterprises: the percentage of applications for new plant, which at a time when plant capacity utilization is low can be seen as indicative of plans to reconvert companies, rose in fact from 32 per cent in 1974 to 38 per cent in 1975.

Lending to the services sector rose further in 1975 than in any other sector (24.3 per cent compared with 19.3 per cent for the whole economy). Most of this increase in borrowing, equal to 2,005 billion in 1975 (854 billion in 1974), was contracted at market rates. The non-marketable services, transport and communications branches accounted for a large part of the increase, with most of the investments being carried out by public enterprises to finance widescale projects for restructuring and enlargement.

Financing of housing

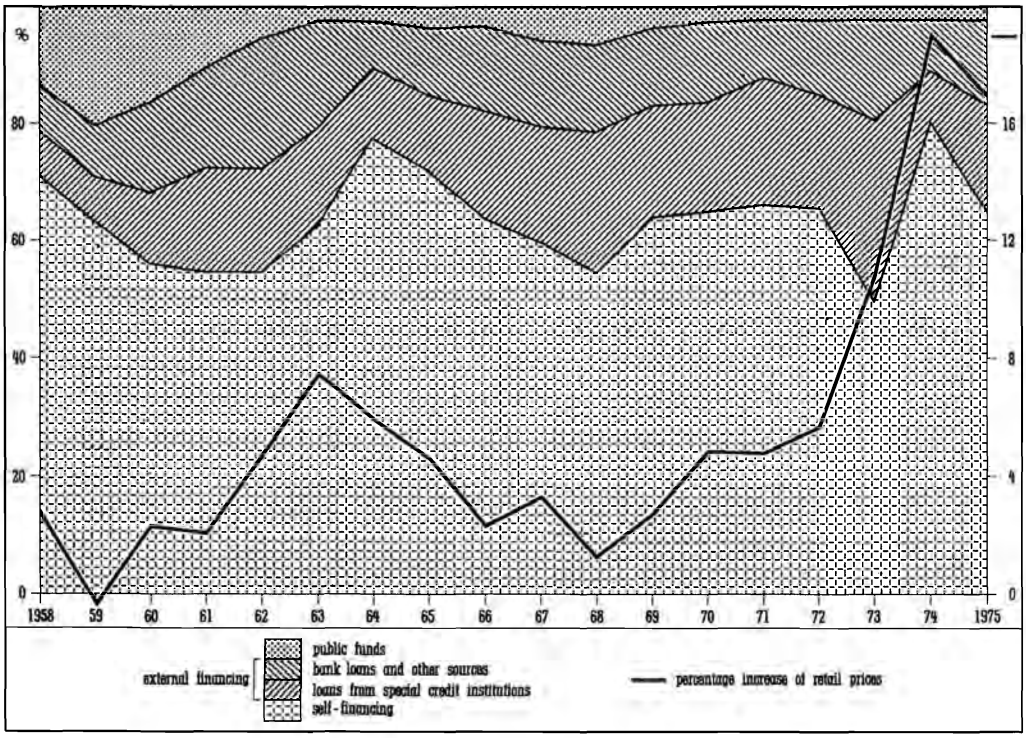
Loans to the building sector also grew considerably during the year: outlays in fact amounted to 1,596 billion compared with 849 in 1974, while loans net of repayments increased by 1,284 billion (up by 16.2 per cent) as against 580 billion (7.9 per cent) the previous year (Table 50).

In recent years investment in housing has often been out of step with long-term building credit. A partial explanation for this situation is to be found in the lag, due to the length of the production cycle, existing between the actual investment and the disbursement of the corresponding credit.

Despite the bottleneck on the long-term credit market in 1974, investment in housing rose even in real terms (2.7 per cent). The buildings under construction (there had been a very large number of starts towards the end of 1973) were in fact completed with a direct contribution from the savings of households and enterprises, which covered more than three-quarters of the total investment. The scarcity of credit in 1974 tended, however, to discourage new projects and the opening of new building sites so that the substantial reduction which followed conditioned investment in the following year. In fact, 1975 saw a fall in investment of 9.8 per cent in real terms, despite an abundance of long-term credit which financed 18.3 per cent of investment in housing (Chart 22). Nor was the availability of credit in itself enough to prevent new projects and the opening of building sites from remaining at the low levels of 1974.

The determinants of investment decisions must, therefore, be sought not so much in the availability of long-term credit as in the weakening demand for housing in the second half of 1974. The high cost of finance can, instead, acquire particular importance even though it may be negative in real terms; the threshold effect represented by the burden of mortgage payments on family incomes, especially in the medium-low bracket, tends to depress the demand for housing.

Chart 22



Financing of investments in housing

Private investment continued to preponderate in the area of residential building, with public investment maintaining a minimal share (2.3 per cent; Table 51). The subsidized loans of the special credit institutions amounted to 145 billion, equal to 9 per cent of their total financing to the sector. Total subsidized credit rose at a rate of 21.7 per cent in 1975, much the same as in 1974. During 1975 a number of measures were taken to relaunch building but their cyclical effects were negligible.

In August the whole operating system of the real-estate and building credit institutions and of those responsible for financing public works was profoundly changed so as to bring it into line with the other sectors of special credit. In particular, the new regulations abolish the close link between the outlay (or amortization) of mortgages and the issue (or repayment) of mortgage bonds and lays down that these institutions must obtain the capital they need for their business through bond issues which have been previously authorized by the Banca d'Italia.

Table 51

FINANCING OF INVESTMENT IN HOUSING (1)

(billions of lire)

Investors / Forms of financing	Public bodies		Insurance and social security institutes		Households	Enterprises	Households	Enterprises	Total	
	1974	1975	1974	1975	1974		1975		1974	1975
PUBLIC FUNDS	145	134							145	134
LOANS	16	26	25	170	118	921	516	1,472	1,080	2,184
Special credit institutions . . .	16	26	25	170	–64	603	362	727	580	1,285
Banks					182	317	154	740	499	894
Ins. & social sec. institutions .						1		5	1	5
SECURITIES MARKET						65		124	65	124
SELF-FINANCING			335	183	4,961		4,391		5,296	4,574
repayment of mortgages . . .					*269*		*312*		*269*	*312*
TOTAL . . .	161	160	360	353	6,065		6,503		6,586	7,016

(1) For 1975 provisional and partly estimated data.

The new system will both enable the monetary authorities to excercise more effective control over the capital market and enable the institutions to be more flexible in their fund-raising and lending activities.

Financing of agriculture

Agricultural enterprises were not adversely affected by the recession of the Italian economy in 1975 and there was a substantial increase in lending to the sector. Net of stockpile financing, the agricultural credit system supplied 629 billion (+ 23.4 per cent) compared with 243 billion (+ 9.9 per cent) in 1974 (Table 52). Large increases were registered in both working credit (up by 25.8 per cent against 7.2 per cent in 1974) and improvement credit (up 21.1 per cent compared with 12.6 per cent in 1974).

At the end of 1975, outstanding loans for working credit represented 17.3 per cent of the value added of the sector compared with 16.2 per cent in 1974. The ratio of outlays of improvement loans to gross investment in agriculture rose to 22.4 per cent after falling to 16.5 per cent in 1974.

The increase in working credit was, to a large extent, provided by the other institutions which raised their lending by 258 billion, an increase of 32.5 per cent, which constituted a sharp acceleration with respect to the trend of preceding years.

Table 52

LENDING BY THE AGRICULTURAL CREDIT SYSTEM

(changes in billions of lire)

Items	Agricultural special credit institutions		Other institutions		Total	
	1974	1975	1974	1975	1974	1975
Working credit	27	79	61	258	88	337
Improvement credit	117	247	38	45	155	292
TOTAL ...	144	326	99	303	243	629
Financing of stockpiling system operations	20	72	43	55	63	127
compulsory	*14*	*15*	*24*	*25*	*38*	*40*
voluntary	*6*	*57*	*19*	*30*	*25*	*87*
Other loans	..	2	–	–	..	2
GENERAL TOTAL ...	164	400	142	358	306	758

This development was perhaps partly favoured by the greater availability of credit for the agricultural sector resulting from the cyclical weakness of the other sectors and in particular of industry, and partly by the substantial refinancing provided for interest-reducing subsidies and revolving funds, at both national and regional levels.

In fact, 76 per cent of outstanding working credit granted by other institutions at end-1975 was for subsidized lending (a figure equal to that for the previous year).

The allocation of further funds for subsidized rate grants also proved important for the growth of improvement loans, outlays for which by the other institutions expanded moderately while those of the special credit institutions almost doubled to 308 billion, of which 83 per cent were at subsidized rates.

At least with respect to improvement credit the prospects for the financing of agriculture are less unfavourable than those for other sectors. This is both because a share of the portfolio constraint will continue to be reserved for agricultural bonds and because of the integration of the funds destined to stimulate the sector.

Financing of exports

The raising of the insurance ceiling for 1975 to 2,500 billion (in addition to 1,000 billion for operations previously insured) tended to increase the flow of applications to the special credit institutions for export credits. These applications totalled 3,240 billion compared with 1,430 billion the previous year. The rise in the value of applications granted from 750 billion in 1974 to 2,580 billion was made possible by new allocations for interest-reducing subsidies and by the increase in the endowment fund of the Mediocredito centrale (medium-term credit institution).

The disbursements of the industrial credit institutions amounted to 678 billion (502 billion in 1974); 315 billion were loans to Italian exporters while the other 363 were credits granted to foreign countries and usually tied to the purchase of Italian goods and services (Table 53). The outlays were equal to 3 per cent of the value of all exports and 10.4 per cent of capital goods exported (the respective figures for 1974 were 2.5 per cent and 9.3 per cent). At the end of the year, outstanding loans totalled 2,122 billion.

Table 53

EXPORT CREDITS (1)

(billions of lire)

Categories of operations	Outlays		Repayments		Net increase		Loans	Financing commit-ments	Applica-tions to examine
	1974	1975	1974	1975	1974	1975			
	Flows						*Outstanding at end-December 1974*		
Exporters	252.9	314.8	224.7	221.7	28.2	93.1	1,084.9	1,561.9	542.8
Financial	249.1	362.8	145.1	141.9	104.0	220.9	1,036.6	1,636.3	315.1
tied	*233.9*	*356.0*	*101.4*	*101.7*	*132.5*	*254.3*	*862.2*	*1,563.9*	*311.6*
untied	*15.2*	*6.8*	*43.7*	*40.2*	*–28.5*	*–33.4*	*174.4*	*72.4*	*3.5*
TOTAL . . .	502.0	677.6	369.8	363.6	132.2	314.0	2,121.5	3,198.2	857.9

(1) Excluding refinancing and funding by UIC and INA totalling, at end-1975, 377 billion (219 at end-1974).

Net of repayments export credits increased by 314 billion (132 billion in 1974). Taking into account the contributions of the UIC (Italian Foreign Exchange Office) and of the INA (National Insurance Institute), which went up by 158 billion during the year, total financing of exports amounted to 472 billion (170 billion in 1974). The increase in the lending of the special institutions to Italian exporters was equal to 93 billion and was mainly directed towards the engineering industry. The countries to receive the most benefit from these credits were the developing areas and particularly those in South America. Financial credits increased by 221 billion 160 of which were granted to Socialist countries in East Europe. With respect to the geographical distribution of Italian exports these countries benefited far more from these credits than any others, especially when the large transactions and commitments of the UIC are considered.

Together with the growth of outlays there was a substantial rise in loan commitments from 1,740 to 3,200 billion. In consideration of the applications waiting to be examined and those likely to be received during 1976 it became clear that there was a need for further allocations which would enable interest-reducing subsidies to be applied to a volume of transactions compatible with the insurance ceiling, fixed at 2,500 billion also for 1976. Recently, in fact, an allocation of 600 billion was made to the Mediocredito centrale fund for interest-reducing grants, an amount which is in line with the institution's own requirement forecasts.

It is therefore likely that there will be a considerable expansion of subsidized credit for deferred-payment exports provided that the financing institutions have no difficulty in raising the necessary funds on the market. On the other hand, further recourse to financing by the UIC would be ill-advised, given the effects that this has on the liquidity situation.

The formation of financial assets and the financing of investments

The growth of the financial assets of the Economy (households and enterprises), after the slowdown in 1974, quickly picked up again in 1975: their absolute value incerased by 28,356 billion compared with 16,225 in 1974; the annual rate of increase was thus 18.2 per cent compared with 11.2 per cent in 1974 and 17.7 per cent in 1973. The ratio of the formation of the financial assets of the Economy to gross national product rose from 16.4 per cent in 1974 to 25.4 per cent in 1975, coming close to the very high values, 26.3 per cent, which had been registered in 1973 (Tables 54 and 56).

The greater accumulation of financial assets was due both to households and, to a larger extent, to enterprises. After the increase in their propensity to consume in 1974, households reacted to the worsening of economic and, in particular, employment prospects by increasing both saving as a percentage of disposable income and investment in financial assets as a percentage of saving. Given the easy conditions of credit markets and the low level of investment, enterprises also accumulated financial assets during the year, protecting themselves against the uncertain development of expected demand and net cash flows by increasing their holdings of precautionary balances of liquid assets.

Table 54

THE ECONOMY'S FINANCIAL ASSETS AND TOTAL FINANCING (1)

(percentage ratio to GNP and growth rates)

Years	Changes in assets		Total financing/GNP	Percentage growth rates		
	financial/GNP	liquid/GNP		financial assets	liquid assets	total financing
1964	10.2	5.8	9.3	7.4	8.8	6.7
1969	17.0	9.0	14.6	11.7	11.6	10.6
1970	16.5	10.8	16.7	10.9	14.0	11.9
1971	20.3	13.0	19.8	13.8	16.1	14.1
1972	25.1	16.4	23.7	16.8	19.0	16.6
1973	26.3	19.8	28.4	17.7	23.2	19.9
1974	16.4	14.3	24.3	11.2	16.8	17.0
1975	25.4	20.9	29.0	18.2	23.7	20.5
Average 1964-1971	16.4	9.9	14.9	11.3	13.0	10.5

Total financing includes financing of the Economy and of the public sector.

The growth of the Economy's financial assets described above stands vis-à-vis a 32,400 billion increase in total lending to domestic final users (enterprises and the public sector), compared with 22,326 billion in 1974, and a small balance-of-payments deficit on current account. The expansion of *total* domestic credit, according to the definition agreed upon with international organizations, was 30,522 billion in 1975. During the nine months from March — the beginning of the reference period for the agreements with the EEC in connection with medium-term support — to December, the expansion was 26,340 billion. This was 5,840 billion above the agreed limit because the Treasury deficit was larger than forecast. The growth of credit picked up sharply in the first months of 1976 and, as a result, the total expansion of domestic credit in the year to March 1976 was 33,600 billion — well above both the originally established ceiling of 24,700 billion and the 26,200 billion forecast in November.

Table 55

LENDING TO DOMESTIC FINAL-USER SECTORS

Items	Flows					
	Average 1966-1970	1971	1972	1973	1974	1975 (3)
	(billions of lire)					
TOTAL LENDING TO:						
Economy (1)	4,960	7,971	10,062	14,958	12,604	15,443
Public sector (consolidated) (2)	2,200	4,592	6,401	8,412	9,722	16,956
Total...	7,160	12,563	16,463	23,370	22,326	32,399
	(percentage breakdown)					
TOTAL LENDING TO:						
Economy	*69.3*	*63.4*	*61.1*	*64.0*	*56.5*	*47.7*
Public sector (consolidated)	*30.7*	*36.6*	*38.9*	*36.0*	*43.5*	*52.3*
Total...	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*

(1) For 1973, data does not include compensatory loans deposited with the Banca d'Ialia, whereas for 1974 it includes drawings on these deposits. For the latter year, the data are calculated net of a variation due to a change in statistics. – (2) Excluding funds provided directly and indirectly by the public sector to the Economy. – (3) By ascribing 2,246 billion of financing to fund hospital debts to the Economy rather than the public sector, the allocation of lending is altered as follows: 54.6 per cent to the Economy and 45.4 per cent to the public sector.

The distribution of financing between the public sector — comprising the Treasury, the Central Post Office Savings Fund, the autonomous government agencies, local governement bodies and the social security institutions — and the Economy shifted even further in favour of the former, which received 52.3 per cent in 1975 (43.5 per cent in 1974; Table 55). However, if one takes into account that a part of the Treasury borrowing requirement in 1975 was due to an operation to fund short-term debts of the health insurance bodies with the hospitals, clinics and suppliers, the shift in the distribution appears to be less marked, with 45.4 per cent of the total going to the public sector and 54.6 per cent to the Economy. With respect to the medium-term trend of the share of financing provided to the public sector, which increased from 31 per cent in 1966-70 to about 50 per cent in 1975, one finds that the increases occurred as a result of the anticyclical measures taken during the periods of depression, without there being any reductions during the periods of expansion which followed.

The credit granted to the Economy rose from 12,604 billion in 1974 to 15,443 billion while that to the public sector rose from 9,722 billion to 16,959 billion. Correcting for the above-mentioned funding operation, the Economy received 17,689 billion and the public sector 14,710 billion.

With gross investment lower than in 1974 and a decline in productive activity most of the financing to both sectors was employed in covering deficits on current account and in the case of the private sector, as already mentioned, in accumulating liquid assets.

In fact, financing represented a much larger share of gross private investment at current prices, rising from 52.5 per cent in 1974 to 74.4 per cent in 1975 if the funding operation mentioned above is not taken into account, and to 85.2 per cent if it is (Table 59).

The composition of total financing reflects the improvement in the supply of long-term funds owing, in particular, to the return of private investors to the bond market. Bond issues by the Economy, loans contracted with the special credit institutions and other forms of medium- and long-term credit increased their share of the total flow of external finance from 31.5 per cent in 1974 to 51.5 per cent in 1975. Conversely the share of short-term credit fell from 52.2 per cent to 33.1 per cent. The contribution of the remaining financing instruments was as follows: grants by the Treasury to public enterprises and share issues both rose sharply and accounted for 12 per cent of the total compared with 7.8 per cent in 1974; enterprises' borrowing abroad dropped from 8.5 per cent in 1974 to 3.4 per cent in 1975. These changes in financing resulted in a substantial increase in the long-term component and thereby brought about an improvement in the debt structure of the economy. Against this, how-

Table 56

THE ECONOMY'S FINANCIAL ASSETS AND THEIR COUNTER-ITEMS

(amounts and flows in billions of lire)

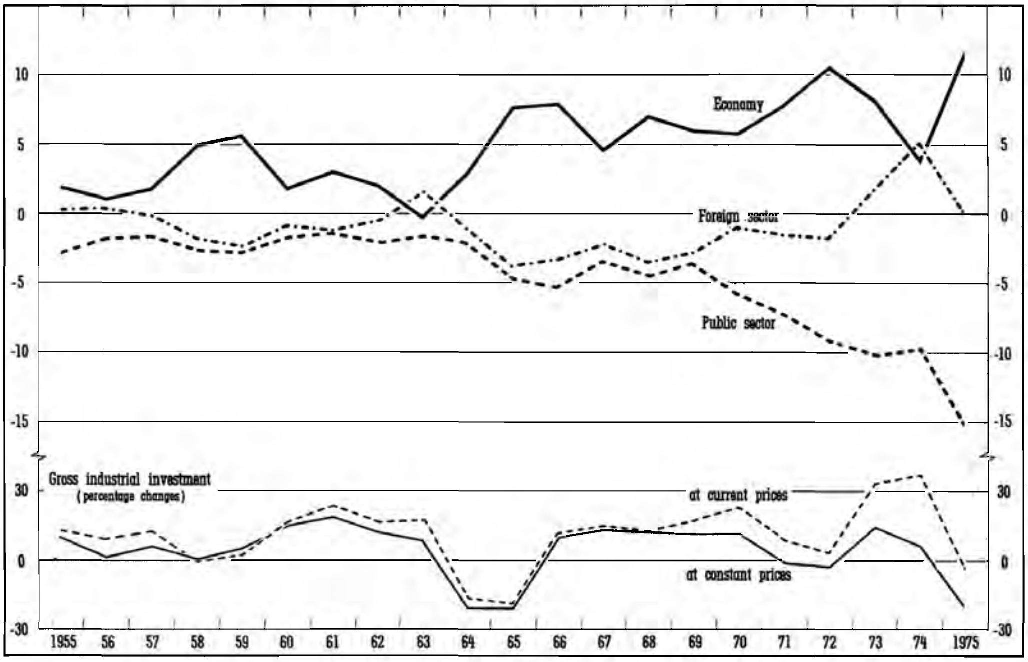
Items	Amounts at end-1974	Flows 1974 half-year I	1974 half-year II	1974 Year (1)	1975 half-year I	1975 half-year II	1975 Year (1)
Financial assets:							
DOMESTIC	140,907	3,734	11,857	15,591	8,392	19,185	27,577
Currency	10,597	242	897	1,139	101	1,604	1,705
Deposits: Post Office & with Treasury	11,010	747	82	829	675	1,634	2,309
bank	77,005	3,354	8,848	12,202	5,312	13,972	19,284
Other deposits and savings certificates and Treasury bills	3,358	–27	252	225	1,084	–78	1,006
Fixed-interest securities	14,947	–1,956	318	–1,638	1,007	1,295	2,302
Shares and equity capital	13,112	406	55	461	312	704	1,016
Import deposits	–	490	747	1,237	–693	–544	–1,237
Other financial assets	10.878	478	658	1,136	594	598	1,192
FOREIGN	14.603	1,091	–457	634	311	468	779
Total...	155,510	4,825	11,400	16,225	8,703	19,653	28,356
Against financing of:							
ECONOMY	109,494	4,353	8,251	12,604	4,591	10,852	15,443
DOMESTIC	99,755	3,819	7,447	11,266	3,777	10,768	14,545
Indebtedness to: Banks	44,465	2,519	4,441	6,960	–62	5,446	5,384
Special credit institutions	27,030	715	1,948	2,663	2,224	2,774	4,998
Bonds	7,583	–139	214	75	534	876	1,410
Shares and equity capital	13,227	327	155	482	287	692	979
Endowment funds	3,178	1	236	237	147	362	509
Other financial liabilities	4,272	396	453	849	647	618	1,265
FOREIGN	9,739	534	804	1,338	814	84	898
FOREIGN SECTOR	1,298	–3,184	–2,028	–5,212	–206	–155	–361
PUBLIC SECTOR (consolidated)	48,395	5,094	4,628	9,722	7,639	9,317	16,956
UNCLASSIFIED	–3,677	–1,438	549	–889	–3,321	–361	–3,682
Total...	155,510	4,825	11,400	16,225	8,703	19,653	28,356
Economy's financial surplus or deficit	46,016	472	3,149	3,621	4,112	8,801	12,913

(1) For 1974 Foreign financing includes the drawing of deposits with the Banca d'Italia to cover compensatory loans (492 billion). For 1974 the Economy's fixed-interest securities and bank debts have been calculated net of a variation due to a change in banking statistics. – (2) Balance of payments on current account. – (3) Including discrepancies.

ever, must be set the further reduction in the ratio of enterprises' own funds to total liabilities which was due to their reduced capacity for self-financing (Tables 56 and 60).

The reduction of the disequilibrium between domestic saving and investment resulted in an improvement in the balance-of-payments deficit on current account down from 5,212 billion in 1974 to 361 billion in 1975 (Chart 23 and Table 57). In particular, there was a considerable

Chart 23



Financial balances of the sectors

(ratios to gross national product)

increase in the financial surplus of the Economy (from 3,621 billion in 1974 to 12,913 billion in 1975, respectively 3.7 and 11.5 per cent of national income) as a result of a fall in the financial deficit of enterprises and a sharp rise in the financial surplus of households, and a substantial rise in the financial deficit of the public sector (from 9,722 billion in 1974 to 16,956 billion in 1975, respectively 9.8 and 15.2 per cent of national income). The rise in the public sector deficit, given the increasingly large share represented in public expenditure by transfers to the private sector (23,298 billion lire in 1975), mainly resulted in the year under examination in the accumulation of financial assets by households.

Table 57

FINANCIAL BALANCES OF DOMESTIC FINAL-USER SECTORS

(Billions of lire)

Years	Economy			Public sector (consolidated) (1)	Foreign sector (2)	Unclassified and discrepancies (3)
	Households	Enterprises	Total			
1964	2,114	−1,110	1,004	−691	−387	74
1965	3,112	−230	2,882	−1,719	−1,381	218
1966	4,279	−1,176	3,103	−2,097	−1,323	317
1967	4,428	−2,449	1,979	−1,454	−999	474
1968	5,258	−1,903	3,355	−2,149	−1,642	434
1969	6,138	−3,049	3,089	−1,849	−1,462	222
1970	6,396	−3,020	3,376	−3,452	−476	552
1971	8,345	−3,436	4,909	−4,592	−981	664
1972	9,736	−2,396	7,340	−6,401	−1,169	230
1973	12,764	−6,066	6,698	−8,413	1,473	242
1974	13,480	−9,859	3,621	−9,722	5,212	889
1975	20,207	−7,294	12,913	−16,956	361	3,682

(1) Net debt. — (2) Balance of payments on current account. — (3) Includes the financial balance of credit institutions.

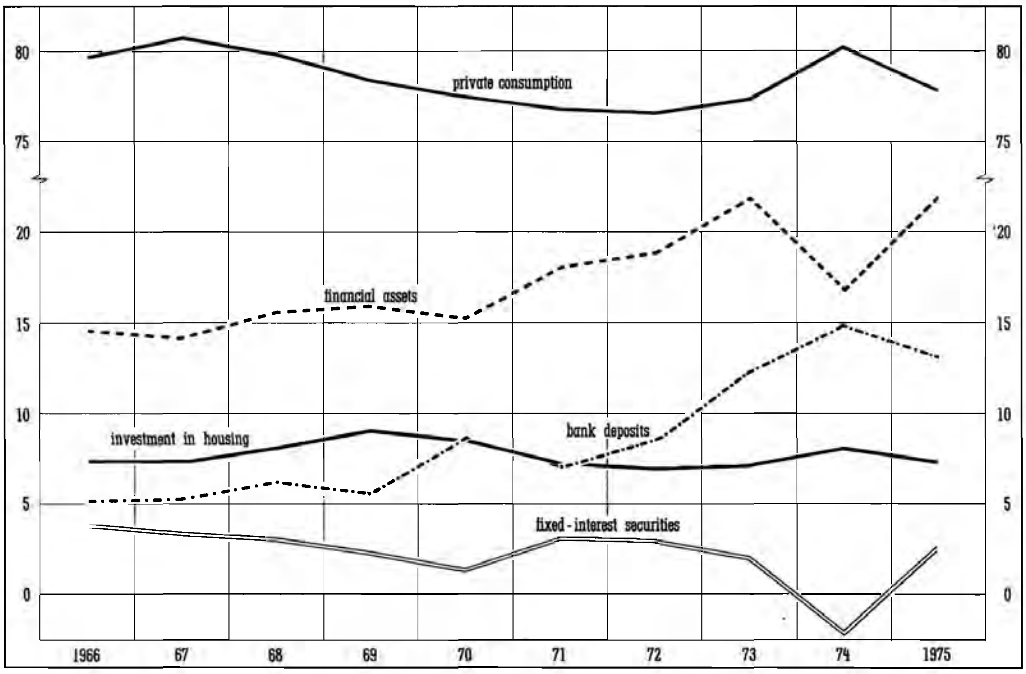
The financial assets and saving of households

Household's financial assets rose by about 21,000 billion in 1975, at a rate of 19.6 per cent compared with rates of 14 and 18 per cent respectively in 1974 and 1973. The relative importance of saving in the formation of financial assets (measured as the ratio of financial assets acquired to disposable income), after falling from 21.7 per cent in 1973 to 17 per cent in 1974, rose to 22 per cent in 1975.

In fact, after investing heavily in tangible assets (housing and other *inflation-proof* goods) in 1974, households invested by far the larger part of their savings in financial assets in 1975, while the demand for housing was generally weak (Chart 24).

The acquisition of foreign financial assets, which offer protection against the greater loss of purchasing power of the lira with respect to other currencies, was modest and amounted to only 255 billion, equal to 1.2 per cent of the total increase in financial assets (compared with 3.7 per cent in 1974 and an average of 9.5 per cent between 1965 and 1974). The fact that non-interest-bearing deposits with the UIC have to be made against investments abroad has resulted in purchases of foreign financial assets through official channels drying up over the last two years. The limits imposed on foreign currency allowances and the stability of the lira on exchange markets in 1975 also slowed down the outflow of capital through unofficial channels.

Chart 24



Households' financial assets (1)

(changes in relation to disposable income)

(1) The chart also includes the trends of consumption and investments in housing, as a ratio to disposable income, in order to compare them with the development of the sector's financial assets.

The composition of the flow of financial assets was more balanced after the sharp switch in favour of liquid assets in 1974 though the adjustment was not complete. In fact, the share of liquid assets (75.8 per cent of the total flow of financial assets, compared with 98.6 in 1974) was still considerably greater than the average for the previous decade (67.5 per cent). The relative importance of liquid assets out of total holdings of financial assets has, therefore, continued to increase and they now represent 66.4 per cent of the total, compared with 64.2

per cent at the end of 1974 and 49.5 per cent at the end of 1964. Among long-term assets there was a revival in the public's demand for fixed-interest securities which, in absolute terms, recovered part of the ground they had lost in 1974 while shares and foreign assets continued to decline in relative importance.

Table 58

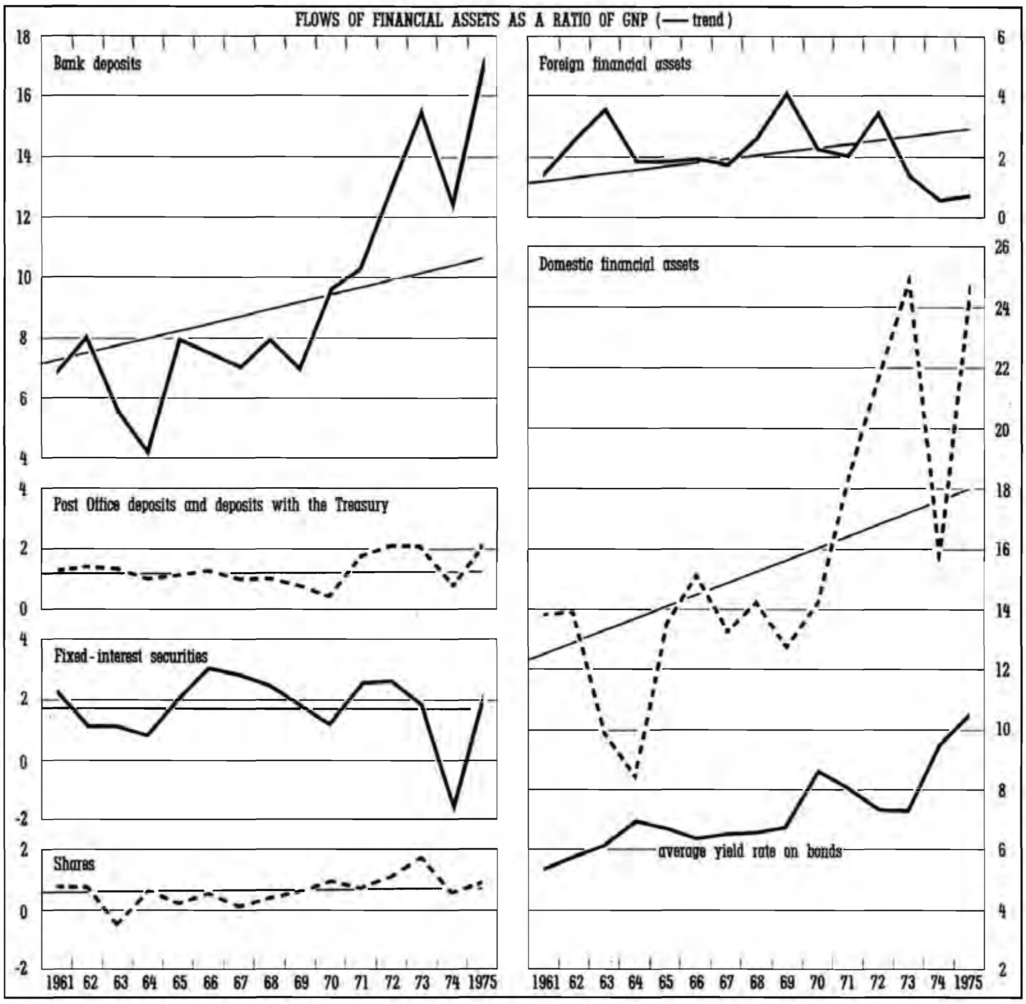
ANALYSIS OF HOUSEHOLDS' FINANCIAL ASSETS (1)

Items	Amounts at end of		Flows				
	1964	1974	Average 1965-1974	1972	1973	1974	1975
	(billions of lire)						
Notes and coins (2)	2,849	8,725	592	798	1,282	949	1,386
Bank deposits (2)	8,691	51,057	4,222	4,794	8,363	11,962	12,596
Post Office deposits	2,952	9,042	610	1,275	1,486	564	1,936
Other deposits and P.O. certificates	588	3,355	275	410	577	211	1,004
Fixed-interest securities (3)	4,829	14,542	887	1,663	1,421	−1,602	2,369
Shares	4,837	3,767	97	185	252	24	410
Actuarial reserves	2,549	8,261	593	686	779	1,051	1,047
Foreign assets	1,969	8,524	760	981	554	499	255
Total...	29,264	107,273	8,036	10,792	14,714	13,658	.21,003
	(percentage breakdown)						
Notes and coins (2)	*9.7*	*8.2*	*7.4*	*7.4*	*8.7*	*6.9*	*6.6*
Bank deposits (2)	*29.7*	*47.6*	*52.5*	*44.4*	*56.8*	*87.6*	*60.0*
Post Office deposits	*10.1*	*8.4*	*7.6*	*11.8*	*10.1*	*4.1*	*9.2*
Other deposits and P.O. certificates	*2.0*	*3.1*	*3.4*	*3.8*	*3.9*	*1.5*	*4.8*
Fixed-interest securities (3)	*16.5*	*13.7*	*11.0*	*15.4*	*9.7*	*−11.7*	*11.3*
Shares	*16.5*	*3.5*	*1.2*	*1.7*	*1.7*	*0.2*	*1.9*
Actuarial reserves	*8.7*	*7.7*	*7.4*	*6.4*	*5.3*	*7.7*	*5.0*
Foreign assets	*6.8*	*7.8*	*9.5*	*9.1*	*3.8*	*3.7*	*1.2*
Total...	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*

(1) Figures partly estimated. – (2) Data adjusted for random movements at end-1972. – (3) For 1974, the figures are calculated net of a variation due to a change in statistics.

Although bank deposits represented a smaller share (60 per cent) of new assets than in 1974 (87.6 per cent), their share of total financial assets continued to increase, up from 47.6 per cent in December 1974 to 49.8 per cent in December 1975. Despite expectations of capital gains at certain periods of the year, the demand for fixed-interest securities did not return to its medium-term level: net purchases amounted to 2,369 billion (compared with net sales of 1,602 billion in 1974) and contributed 11.3 per cent to the total of new assets (Table 58). Post office deposits recovered a part of the share of total financial assets which they had lost in 1974, with new deposits in 1975 amounting to 9.2 per cent of new assets compared with 4.1 per cent in 1974.

Chart 25



Economy's financial assets (1)
(changes in relation to GNP)

(1) The *trends* are calculated for the period 1951—1974.

Among the remaining financial assets shareholdings continued to decline in relative importance since new purchases were more than offset by a fall in quotations. Shares and equities represented 1.9 per cent of the flow of financial assets and 2.8 of their stock at the end of 1975, the latter compared with 3.5 per cent in 1974 and 16.3 per cent in 1964. Actuarial reserves also declined in relative importance (down from 7.7 per cent of the flow of financial assets in 1974 to 5 per cent) as a result of the spreading of national insurance (Table 58 and Chart 25).

The financial assets and liquidity of enterprises

Enterprises' financial assets grew by 15.4 per cent in 1975 after 1974's very slow rate of growth (2.8 per cent net of importers' tied deposits). The ratio of new financial assets to the private sector's gross product rose to 7.3 per cent compared with 1.5 per cent in 1974 and 10 per cent in the two-year period 1972-73.

In 1975 the liquid assets held by enterprises rose by 7,380 billion or 24.8 per cent (695 billion or 2.4 per cent in 1974). The ratio of enterprises' average holdings of liquid assets for the year to the gross product of the private sector, as a measure of transaction requirements, appeared substantially stable between 1974 (32 per cent) and 1975 (32.3 per cent). But since the 1975 average of enterprises' liquid asset holdings was affected by the very low level these had sunk to at the end of 1974, this ratio does not provide a sufficiently accurate indication of the change which took place during 1975. In fact, while the liquidity situation was progressively deteriorating in 1974, it gradually improved in 1975. Utilizing end-of-year data instead of annual averages the ratio improves from 33.6 per cent in 1974 to 37 per cent.

Medium- and long-term assets were characterized by increased acquisitions of shares and equity capital (606 billion as against 437 in 1974) designed to maintain controlling quotas of share capital in the presence of a substantial amount of new issues. Holdings of fixed-interest securities fell slightly despite the general improvement in liquidity. Purchases of foreign financial assets appear to have increased considerably (about 520 billion in 1975 as against 135 billion in 1974 and 630 billion in 1973). Most of these purchases (about 350 billion) were made through illegal channels.

Transactions through official channels gave rise to a net reduction in medium-term loans of 295 billion, while short-term commercial credits rose by 255 billion and securities by 200 billion.

The financing of enterprises

The growth rate of financing granted to the Economy in 1975 was higher than in 1974, but less than in the preceding two-year period. In absolute terms the credit provided was 15,443 billion, an increase of 14.1 per cent, compared with 12,604 billion and 12.5 per cent in 1974 and an average of 12,500 and 15.8 per cent for the two-year period 1972-73 (Table 59). The ratio of the total financing provided

Table 59

THE ECONOMY'S FINANCIAL LIABILITIES

(growth rates and ratio to gross product and investments)

Years	Financing of the Economy				Loans to the building sector
	Percentage growth rates	as a percentage of			gross investment in housing
		gross private product (1)	gross private investment (2)	gross private investment (3)	(4)
1951	14.6	6.4	31.5	38.2	28.2
1959	8.4	7.9	35.6	50.1	24.6
1970	9.8	12.0	50.6	73.8	31.5
1971	11.9	14.2	65.6	93.3	32.0
1972	13.9	16.4	77.9	110.5	33.6
1973	17.7	20.4	81.0	108.5	50.0
1974	12.5	14.2	52.5	71.8	18.7
1975	14.1	15.4	74.4	111.1	31.5
Average 1951-1959 .	10.9	7.1	33.3	45.0	26.0
" 1960-1973 . .	10.6	13.6	60.5	87.7	34.8

(1) At market prices. — (2) Including housing. — (3) Excluding housing. — (4) Excluding housing financed by the public sector.

to the private sector to its gross product increased slightly to 15.4 per cent in 1975, after falling to 14.2 per cent in 1974 from 20.4 per cent in 1973; however this ratio does not represent an accurate indicator of total credit to enterprises in 1975, since account must be taken of the funding of hospitals' debts mentioned earlier. Adding the amounts relative to these operations the above ratio of financing to gross product rises to 17.6 per cent.

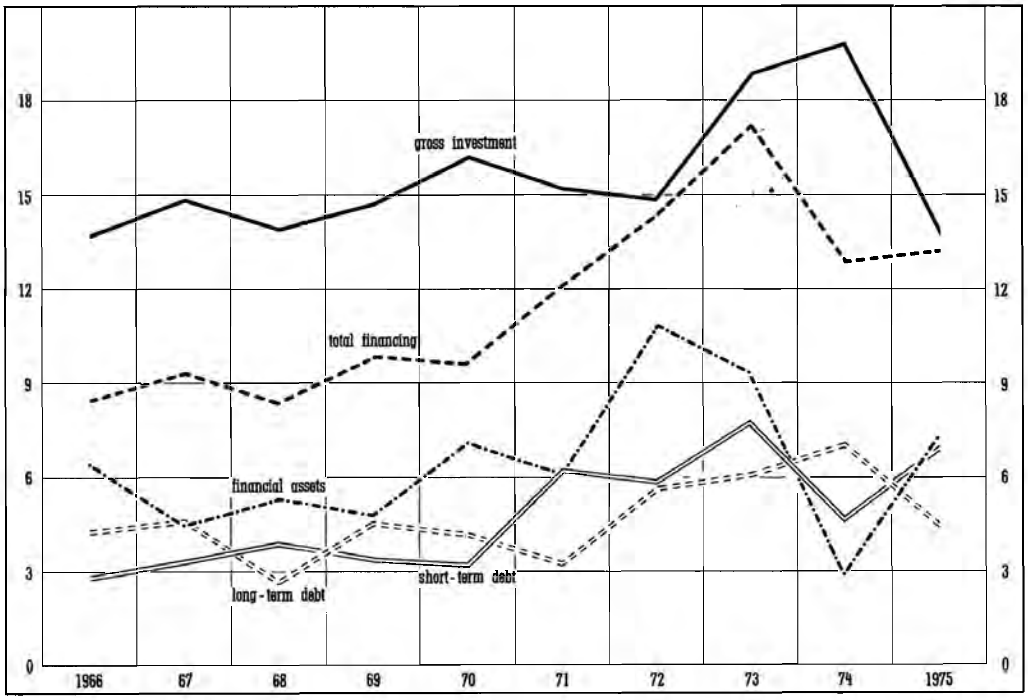
The credit granted directly to households amounted to 796 billion (179 billion in 1974). The increase was mainly due to the recovery of mortage loans where reimbursements had prevailed in 1974, nonetheless the amount was still small at about half the level of the two-year period 1972-73. This was mainly due to the weak demand for houses and the persistence of extremely high long-term interest rates in a period when inflationary expectations had been fading. Enterprises received funds totalling 14,647 billion as against 12,425 in 1974 (16,893 billion if the funding of the hospitals' debts is included). This increase of financing in a period when gross investment fell can be seen as largely due to a weakening of sales and profits and of a building up of liquid balances.

The modest increase in demand (Istat data indicate a 2 per cent rise in industrial turnover) and the rapid rise in unit labour costs worsened enterprises' cash flow and caused more of their working capital requirements to be satisfied by recourse to borrowing, especially as they had started the year with a very low level of liquid assets.

The situation described above led the portion of investments financed by borrowing to rise — without considering the hospital debt funding operations — from 52.5 per cent in 1974 to 74.4 per cent, in other words nearly back to the 1973 level. But whereas in 1973 productive investment was rising very fast so that the lag between saving and investment seemed natural, in 1975 private sector gross investment fell and the increase of the ratio highlights the decline in the saving of enterprises.

The rate of expansion of external financing remained virtually constant throughout the year but its composition changed. During the first few months enterprises continued to make recourse to bank credit to finance the large stocks of finished products they had accumulated when demand for consumer and investment goods fell. If account is taken of the constraint imposed on banks by the funding of the hospitals' debts and of the lending restrictions which expired at the end of March, the increase in bank loans during the first quarter was considerable. During the second part of the year recourse to bank credit gradually declined (in 1974 it had constituted 52.4 per cent of all credit but in 1975 only 33 per cent) while the share of medium- and long-term financing increased (Chart 26 and Table 60). In particular, the disbursements of the special credit institutions reached 4,619 billion, 31.5 per cent of all credit, in 1974 the figures were respectively 2,788 billion and 22.4 per cent. Enterprises took full advantage of the fact that these institutions were generally highly liquid as a result of refinancing of the main subsidized credit laws and because more funds became available from the sale of bonds to private investors. In part these loans were used to fund short-term debts previously contracted with the banks. This enabled enterprises to reduce the financial burden attached to the loans contracted at high rates in 1974 and to improve the maturity structure of their debts.

Chart 26



Gross investment, financial assets and liabilities of the enterprises (1)

(changes in relation to GNP)

(1) Excluding investments by General Government and those in housing; changes in financial liabilities are also net of indebtedness to purchase homes.

In addition, the more favourable climate on the capital market made it possible for enterprises, especially public enterprises, to raise through securities issues 1,376 billion compared with 96 billion in 1974. However, despite this substantial increase the contribution of the bond market to meeting enterprises' borrowing requirements over the two-year period 1974-75 was still below the medium-term average (5.4 per cent for 1974-75 as against 6.8 per cent for 1965-74).

Table 60

ANALYSIS OF THE STRUCTURE OF BALANCE-SHEET LIABILITIES AND EXTERNAL FINANCING OF THE ENTERPRISES

Items	Amounts at end of		Flows				
	1964	1974	Average 1965 1974	1972	1973	1974 (1)	1975
			(billions of lire)				
Short-term loans	10,740	36,769	2,644	3,278	4,608	6,509	4,831
Medium- and long-term loans	7,613	31,180	2,463	3,199	5,172	4,424	5,952
special credit institutions .	*5,066*	*21,413*	*1,715*	*2,274*	*3,782*	*2,788*	*4,619*
Bonds	2,663	7,697	458	757	797	96	1,376
Shares and equity capital . .	12,596	19,541	746	1,157	1,708	743	1,350
Endowment funds	486	3,178	294	517	639	237	509
Financing by local authorities	320	1,304	74	99	83	416	629
Total . . .	34,418	99,699	6,679	9,007	13,007	12,425	14,647
			(percentage breakdown)				
Short-term loans	*31.2*	*36.9*	*39.6*	*36.4*	*35.4*	*52.4*	*33.0*
Medium- and long-term loans	*22.1*	*31.3*	*36.9*	*35.5*	*39.8*	*35.6*	*40.6*
special credit institutions .	*14.7*	*21.5*	*25.7*	*25.7*	*29.1*	*22.4*	*31.5*
Bonds	*7.8*	*7.7*	*6.8*	*8.4*	*6.1*	*0.8*	*9.4*
Shares and equity capital . .	*36.6*	*19.6*	*11.2*	*12.9*	*13.1*	*6.0*	*9.2*
Endowment funds	*1.4*	*3.2*	*4.4*	*5.7*	*4.9*	*1.9*	*3.5*
Financing by local authorities	*0.9*	*1.3*	*1.1*	*1.1*	*0.7*	*3.3*	*4.3*
Total . . .	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*

(1) For 1973, medium- and long-term loans are net of the portion of foreign loans deposited with the Banca d'Italia (589 billion); for 1974, they include drawings on these deposits (492 billion). For 1974, debts vis-à-vis the banks are calculated net of a variation due to a change in statistics.

Borrowing abroad during the first six months resulted in an inflow of 576 billion. In the second half of the year there was a net repayment of foreign loans equal to 22 billion, due to: the abolition of the import deposit scheme, the introduction of subsidized export credit and, more generally, the changed liquidity situation of the economy which resulted in a fall in short-term rates. The contribution of non-residents to the risk capital of Italian companies through purchases of shares followed the same pattern as foreign loans; over the whole year shareholdings increased by 371 billion compared with 262 billion in 1974. The proportion of the share capital of Italian companies held by non-residents continued to grow since 27 per cent of the new shares issued in 1975 were taken up by non-residents who, at the end of 1974, had held only 21 per cent of outstanding equity capital.

Funds raised through selling of shares rose to 1,350 billion, about twice the amount obtained in 1974 (743 billion). About 80 per cent of the increases in share capital were made by unquoted companies and, therefore, without recourse to the market. The slackening of share quotations for most of the year made the raising of share capital through issues placed with the public extremely uncertain and, in fact, the amounts involved were very small. A further negative aspect which accompanied the increased flow of risk capital concerns the *raison d'être* of these operations, a third of which were inspired by the need to provide fresh capital to make good trading losses. Additions to the capital of public enterprises through increases in their endowment funds — a form of financing influenced by the state of the bond market on which the Treasury normally raises the necessary funds — more than doubled with respect to 1974 (509 billion in 1975 as against 237). The funds supplied to enterprises in the form of capital represented 12.7 of the total flow of financing in 1975 as against 7.9 per cent in 1974 and thus returned close to the average value of the preceding decade.

The funding of enterprises' debt reduced the unit cost of borrowed capital both as a result of the reduction in interest rates and of the increase in the share of subsidized credit; on the other hand the ratio of financial charges to turnover went up. The greater amount of risk capital raised in 1975 also helped to improve the structure of enterprises' balance sheets as did the revaluation — rendered advantageous through tax allowances — of tangible assets whose book values had failed to take account of the rapid inflation of the last few years. Against these positive elements must be set the lower level of enterprises' internally generated funds, negatively influenced by the rigidity of the productive structure in the face of a sharp fall in economic activity.

Industrial enterprises' share of the total flow of financing to the Economy dropped slightly, falling from 60.7 per cent in 1974 to 57.7 per cent in 1975; this was entirely due to private enterprises whose borrowing declined from 4,931 billion in 1974 to 4,260 billion in 1975. Public enterprises in contrast increased their borrowing from 2,716 billion in 1974 to 4,646 billion in 1975 and thus borrowed more than private enterprises for the first time (Table 61).

Table 61

EXTERNAL FINANCING BY PUBLIC AND PRIVATE INDUSTRIES (1)

Financial instruments	Flows in billions of lire			Percentage breakdown		
	average 1966-1974	1974	1975	average 1966-1974	1974	1975
PUBLIC ENTERPRISES	1,360	2,716	4,646	*100.0*	*100.0*	*100.0*
Bank loans	424	1,301	1,603	*31.2*	*47.9*	*34.5*
Loans by special institutions	273	341	1,174	*20.1*	*12.5*	*25.3*
Bonds	251	285	1,150	*18.4*	*10.5*	*24.8*
Shares	150	109	223	*11.0*	*4.0*	*4.8*
Capital, transfers from holding companies (2)	166	114	262	*12.2*	*4.2*	*5.6*
ENEL compensation payments	18	–	–	*1.3*	–	–
Foreign sector (3)	78	566	234	*5.8*	*20.9*	*5.0*
PRIVATE ENTERPRISES	2,768	4,931	4,260	*100.0*	*100.0*	*100.0*
Bank loans	1,581	3,433	2,502	*57.1*	*69.6*	*58.8*
Loans by special institutions	657	1,023	904	*23.8*	*20.7*	*21.2*
Bonds	–34	–86	25	*–1.2*	*–1.7*	*0.6*
Shares	475	414	717	*17.1*	*8.4*	*16.8*
ENEL compensation payments	50	–	–	*1.8*	–	–
Foreign sector	39	147	112	*1.4*	*3.0*	*2.6*

(1) Excluding the building industry.– (2) Financing by holding companies through endowment funds, net of share purchases.– (3) For 1974 financing by the foreign sector includes the portion of loans obtained from ENEL and deposited with the Banca d'Italia (486 billion).

Examination of the distribution of financing among the different branches of economic activity shows a marked increase in the share absorbed by the chemical and mineral oils sector (from 18 to 25 per cent of the total) and a sharp drop in that of the engineering and means of transport sector (from 31 to 21 per cent of the total).

Financing of investments by sector

The net borrowing of the public sector (general government, autonomous government agencies, local government bodies and social security institutions) rose by 16,956 billion in 1975 (14,710 billion net of the funding of the hospitals' debts) from 9,722 billion in 1974. The ratio of net indebtedness to national income therefore rose from 9.8 per cent to 15.2 per cent (13.2 per cent excluding the above funding operations (Table 62).

he large size of the item « adjustments » in Table 62 indicates a divergence between the total net borrowing of the sector calculated on the basis of data in the national accounts and that obtained from the statistics of the organizations providing the funds. The explanation for this difference is to be found in the chapter on public finance.

The increase in public sector borrowing — apart from the hospital debt funding — was mainly due to the deficit on current account resulting from the larger transfers to the private sector. Public sector investment rose by 14.9 per cent, from 3,636 to 4,179 billion, and increased its share of total gross investment from 14.2 to 18.6 per cent. Financial asset formation by the public sector rose to 3,203 billion with large increases in the bank deposits of local authorities and especially of the social security institutions, contributions from the Treasury to the endowment funds of public enterprises, and funds supplied by the regions and other local government bodies.

The composition of the public sectors' liabilities which in 1974 had seen the share of short-term debts rise from 81 to 91 per cent, in 1975 registered a swing towards long-term debts, the share of which increased from 9 to 28 per cent.

Public enterprises' fixed investment went from 3,510 billion in 1974 to 4,025 billion in 1975. Considering that the requirement for inventories and financial assets was virtually unchanged (at a very high level) and that gross internally generated funds declined slightly, public enterprises were obliged to increase their borrowing which rose 12 per cent to 4,490 billion.

There was a sharp drop (22 per cent) in the investment of the private sector of the economy which, nonetheless, also increased its borrowing from 8,604 billion in 1974 to 10,953 billion in 1975, mainly in connection with the process of restoring liquid assets holdings.

Table 62

INVESTMENTS AND THEIR COVERAGE

(changes in billions of lire)

Items	Public sector (consolidated)	Public enterprises	Private sector	Credit institutions (consolidated)	Total	Foreign sector
			1974 (1)			
Investments: in fixed assets	3,636	3,510	15,024	661	22,931	–
in inventories	–	1,444	1,267	–	2,711	–
Transfers in capital account	710	–25	–617	–	68	–68
Gross saving	–2,362	1,096	20,676	1,021	20,431	5,111
Capital account surplus (+) or deficit (–)	***–6,708***	***–3,833***	***5,002***	***360***	***–5,179***	***5,179***
Financial assets	1,015	167	16,058	13,388	30,628	80
Liquid assets	–230	–201	14,537	7,547	21,653	–191
Fixed-interest securities	–46	....	–1,725	1,542	–229	19
Other assets (net)	1,015	208	2,831	4,247	8,301	–10
Shares and equity capital (3)	276	160	415	52	903	262
Financial liabilities	10,737	4,000	8,604	12,446	35,787	–5,132
Short-term loans (2)	9,754	1,991	4,583	8,001	24,329	–6,091
Other loans: from domestic sectors	1,189	749	3,151	532	5,621	901
from foreign sectors	–65	677	661	5,255	6,528	–
Bonds (3)	–141	214	–140	–1,384	–1,451	–78
Shares and equity capital (3)	–	369	349	42	760	136
Net financial investment	***–9,722***	***–3,833***	***7,454***	***942***	***–5,159***	***5,212***
Adjustments	3,014	–	–2,452	–582	–20	–33
			1975			
Investments: in fixed assets	4,179	4,025	14,911	692	23,807	–
in inventories	–	844	–2,218	–	–1,374	–
Transfers in capital account	3,187	–69	–3,032	–	86	–86
Gross saving	–5,907	1,065	25,863	1,154	22,175	258
Capital account surplus (+) or deficit (–)	***–13,273***	***–3,735***	***16,202***	***462***	***–344***	***344***
Financial assets	3,203	755	27,601	30,655	62,214	2,843
Liquid assets	1,026	226	23,143	6,008	30,403	–18
Fixed-interest securities	210	....	2,178	7,025	9,413	–34
Other assets (net)	1,294	448	1,082	17,660	20,484	2,525
Shares and equity capital (3)	673	81	1,198	–38	1,914	370
Financial liabilities	20,159	4,490	10,953	28,785	64,387	2,482
Short-term loans (2)	14.509	911	4,200	25,737	45,357	1,003
Other loans: from domestic sectors	1,837	1,330	5,205	2,146	10,518	1,165
from foreign sectors	–25	556	342	166	1,039	–
Bonds (3)	3,838	1,259	151	590	5,838	114
Shares and equity capital (3)	–	434	1,055	146	1,635	200
Net financial investment	***–16,956***	***–3,735***	***16,648***	***1,870***	***–2,173***	***361***
Adjustments	3,683	–	–446	–1,408	1,829	–17

(1) For 1974 see note (1) under Table 56. – (2) Includes BI-UIC financing to the Treasury, the Central Post Office Savings Fund and the autonomous agencies. – (3) Issued on the domestic market; bonds and shares issued on the international markets are included under the heading "other loans from foreign sectors".

Investment, profits and financing of the manufacturing industry as in the companies' balance sheets

The customary annual survey conducted by the Banca d'Italia reveals that there were sharp drops in both profitability and capital formation during 1975 (Tables 63 and 64). These can be ascribed to the weakeness of domestic demand, the high cost and the rigidity of labour, and the growing burden of financial charges which were aggravated by the further increase in borrowing.

Table 63

GROSS AND NET PROFITS IN A GROUP OF 137 ITALIAN MANUFACTURING COMPANIES

(billions of lire)

Years	Increase in net worth	Depreciation	Increase in retirement funds	Profits gross	Profits net
	(1)	(2)	(3)	(4)=(1)+(2)+(3)	(5)=(4)−(2)
1963	137.6	296.2	68.7	502.5	206.3
1964	118.4	304.8	42.0	465.2	160.4
1965	132.3	330.3	53.1	515.7	185.4
1966	140.9	378.4	48.3	567.6	189.2
1967	146.1	391.9	47.7	585.7	193.8
1968	176.2	436.3	43.3	655.8	219.5
1969	143.3	478.4	87.3	709.0	230.6
1970	30.2	515.0	132.4	677.6	162.6
1971	−161.5	560.1	113.5	512.1	−48.0
1972	−187.8	608.4	122.5	543.1	−65.3
1973	144.7	752.3	218.9	1,115.9	363.6
1974	99.7	972.0	376.7	1,448.4	476.4
1975	−298.8	976.4	303.2	980.8	4.4

The analysis, as in past years, covers a group of large and medium-sized companies (137 this year) which between them make up about a quarter of all fixed investment in the manufacturing industry.

In 1975 gross internally generated funds fell by more than a third in comparison with 1974 (1,015 billion as against 1,560 billion) and only covered about two-thirds of gross fixed investment. Nor was new share capital sufficient to bridge the gap so that recourse had to be made to financial intermediaries. Here the special credit institutions played a particularly important role, disbursing funds totalling 870 billion (291 in 1974) which exceeded the requirements for investment in fixed assets and in other companies.

Table 64

INVESTMENTS AND THEIR FINANCING IN A GROUP OF 137 ITALIAN MANUFACTURING COMPANIES

State-controlled and private companies

(billions of lire)

Items	State-controlled companies (13 companies)		Private companies (124 companies)	
	1974	1975	1974	1975
Gross fixed investment	558.4	620.6	879.7	916.6
gross changes in fixed capital	*137.9*	*498.0*	*704.6*	*568.9*
Changes in shares and equity capital	243.3	7.9	277.8	186.5
(1) Total investment in fixed assets	801.7	628.5	1,157.5	1,103.1
Gross self-financing	545.2	392.0	1,014.6	623.3
Stock paid in	40.4	50.6	121.1	37.8
Repayments of ENEL debt	0.1	0.1	13.8	2.4
(2) Total of sources of non-borrowed funds	585.7	442.7	1,149.5	663.5
(2): (1) *per cent*	*73.1*	*70.4*	*99.3*	*60.1*
Medium- and long-term borrowing	136.8	842.6	183.9	689.9
(3) Total of sources of medium- and long-term funds	722.5	1,285.3	1,333.4	1,353.4
Balances (3)–(1)	–79.2	656.8	175.9	250.3
Changes in net bank indebtedness	530.5	237.6	849.5	221.4
Changes in inventories	370.0	252.9	923.5	190.7

The balance sheets of both the public and the private companies underwent considerable changes as a result of the situation described above (Table 65). Despite the substantial contribution to reserves (about 600 billion, equal to about 46 per cent of the risk capital in the 1975 balance sheets) which emerged when changes in the tax laws made it profitable to revalue assets in line with inflation, the ratio of debts to total funds managed increased from 80.6 to 82.8 per cent for state-controlled companies and from 63.3 to 65.9 per cent for the private companies. This increase in indebtedness, due almost entirely to the rise in the long-term component, resulted in a higher ratio of permanent funds (own funds plus long-term debts) to fixed assets and investments in other companies. Besides permitting positive comments regarding the better balance between maturities of assets and liabilities, this phenomenon, in conjunction with the changes in other aspects of the balance sheet, leads to a much more important consi-

Table 65

STRUCTURE OF THE BALANCE SHEETS OF A GROUP OF 137 ITALIAN MANUFACTURING COMPANIES

Items	1962		1974		1975	
	billions of lire	per cent	billions of lire	per cent	billions of lire	per cent
	State-controlled companies (13 companies)					
ASSETS						
Land, buildings and equipment (*)	803.9	*49.9*	3,498.1	*51.8*	3,736.7	*47.3*
Inventories	217.8	*13.5*	971.3	*14.4*	1,224.2	*15.5*
Shares and equity capital	73.5	*4.6*	418.6	*6.2*	426.5	*5.4*
Receivables	451.8	*28.0*	1,818.5	*26.9*	2,502.1	*31.6*
Cash and bank deposits	64.8	*4.0*	44.3	*0.7*	16.0	*0.2*
Total assets . . .	1,611.8	*100.0*	6,750.8	*100.0*	7,905.5	*100.0*
LIABILITIES						
Share capital	393.5	*24.4*	656.8	*9.7*	659.3	*8.3*
Reserves	311.5	*19.3*	282.3	*4.2*	299.1	*3.8*
Retirement funds	47.2	*2.9*	320.8	*4.8*	397.6	*5.0*
Medium- and long-term debts	462.4	*28.7*	2.449.6	*36.3*	3,292.2	*41.7*
bonds	*15.5*	*1.0*	*4.5*	*0.1*	*3.6*	–
Payables	220.7	*13.7*	1,614.3	*23.9*	1,656.3	*21.0*
Debts to banks	151.0	*9.4*	1,380.2	*20.4*	1,589.6	*20.1*
Net profit	25.5	*1.6*	46.8	*0.7*	11.4	*0.1*
distributed	*23.9*	*1.5*	*20.6*	*0.3*	*4.7*	*0.1*
Total liabilities . . .	1,611.8	*100.0*	6,750.8	*100.0*	7,905.5	*100.0*
	Private companies (124 companies)					
ASSETS						
Land, buildings and equipment (*)	2,400.7	*42.5*	4,109.3	*33.4*	4,281.2	*32.9*
Inventories	721.0	*12.8*	2,583.8	*21.0*	2,774.5	*21.3*
Shares and equity capital	703.0	*12.4*	2,176.9	*17.7*	2,363.5	*18.1*
Receivables	1,601.3	*28.3*	3,183.0	*25.9*	3,383.3	*26.0*
Cash and bank deposits	223.2	*4.0*	241.0	*2.0*	225.5	*1.7*
Total assets . . .	5,649.2	*100.0*	12,294.0	*100.0*	13,028.0	*100.0*
LIABILITIES						
Share capital	1,286.3	*22.8*	1,444.1	*11.7*	1,370.8	*10.5*
Reserves	1,615.6	*28.6*	1,571.2	*12.8*	1,430.0	*11.0*
Retirement funds	289.8	*5.1*	1,370.5	*11.1*	1,597.0	*12.3*
Medium- and long-term debts	979.8	*17.3*	2,183.0	*17.8*	2,872.9	*22.0*
bonds	*498.1*	*8.8*	*216.4*	*1.8*	*188.1*	*1.4*
Payables	952.9	*16.9*	3,373.9	*27.4*	3,296.7	*25.3*
Debts to banks	412.0	*7.3*	2,218.9	*18.1*	2,424.8	*18.6*
Net profit	112.8	*2.0*	132.4	*1.1*	35.8	*0.3*
distributed	*102.7*	*1.8*	*95.3*	*0.8*	*55.7*	*0.4*
Total liabilities . . .	5,649.2	*100.0*	12,294.0	*100.0*	13,028.0	*100.0*

(*) Net of depreciation; this adjustment was necessary in order to ensure comparison with data on the structure, which changed considerably between 1962 and 1975 also owing to the elimination of capital goods and corresponding transfers from depreciation funds.

deration. Since the ratio of permanent funds to fixed and financial investments is greater than 1 (1.11 for the public sector companies and 1.09 for those of the private sector) and since among the assets there was a considerable increase in receivables, it follows that in a period of improved liquidity but uncertain economic and political prospects these companies preferred to utilize the sources available to pursue commercial policies rather than longer-term strategic ones tending to increase productivity.

The trading profits, as already mentioned, reflect the weakness of demand which characterized 1975. Gross profits per unit of fixed capital (net of depreciation) dropped, in fact, from 19 to 12 per cent while total profits fell by about a third to a value almost equal to that of the depreciation allowances. Further, it should be noted that the latter were unchanged with respect to 1974 even though the increase of fiscal allowances for depreciation, due to monetary revaluation, can be estimated at about 50 billion. Since from 1970 onwards, with the exception of 1973, the dividends distributed by the sample companies, although quite small, exceeded net profits it must be concluded that the failure to fully exploit the depreciation tax allowances in 1975 was not a cyclical phenomenon but rather evidence that Italian enterprises are now structurally incapable of maintaining their capital intact at replacement cost.

III. — THE GOVERNOR'S CONCLUDING REMARKS

During 1975 the Banca d'Italia confronted the complex problems deriving from its institutional tasks and from the country's economic situation in a spirit of service to the community. This spirit marked both its external relations and its internal management.

For its efficiency the Bank depends less on technical instruments, though these are constantly kept up-to-date, than on making full use of its human capital. In this firm belief, which is widely shared by the staff of the Bank, particular attention has been paid to methods of work.

Regular consultations have been organized at the various levels of the Bank's branches and its Head Office in order to give the entire staff new opportunities to meet and engage in discussion, in addition to those provided by the existing instruction and training schemes, which have themselves been developed and enlarged. If these meetings are not to descend into unproductive discourse they must be kept within strict limits as regards subject-matter, frequency and size, but it is hoped that debate and the exchange of ideas and experience will bring an improvement in professional standards and a more harmonious and wholehearted collaboration. The periodical meetings between the senior management and the unions that have recently been instituted for the purpose of exchanging information on fundamental aspects of staff administration may help to promote this kind of cooperation.

The wide spectrum of professional training and backgrounds to be found among the Bank's staff — which has undergone significant changes with the selection of personnel exclusively according to merit — and the consequent plurality of interests and requirements will somehow converge and, as in the past, be strictly channelled towards achieving the Bank's institutional aims. This is the best way to reconcile, at all levels of responsibility, fulfilment of professional and social duties.

As staff recruited at the end of the fifties gradually take over senior management responsibilities, proof is given of their ability. We have had occasion to observe this once again during the past year as they have had to carry out more demanding tasks, both within the Head Office and at the Bank's branches where, despite closer liaison, there is still considerable need for fast and independent decisions. This can be seen from the events described in the Report, which is largely the work of the Research Department and which I submit as evidence of the dedication of the entire staff of the Bank.

In its external relations the Bank has collaborated daily with government bodies over a wide range of subjects, without ever evading the demands made of it on the grounds that they are not strictly part of the Bank's functions or that the burden of work is too great.

In the area of draft legislation, the Bank has prepared papers, undertaken preparatory research and assigned representatives and experts to take part in fact-finding commissions. Among these contributions I should like to call attention to the Bank's role in the reform of legislation concerning real-estate, building and public works credits; the regulations covering violation of the foreign exchange controls; tax legislation, including the laws on bank intermediation in the payment of direct taxes; the standards for the profit and loss statements of banks and credit institutions in application of the founding act of Consob (the Italian Stock Exchange Commission); and the current preparation of regulations concerning the credit cooperatives and of regional legislation.

Personal contact is maintained with government departments at various levels of the management, sometimes through joint commissions as in the case of studies for the reform of the state-controlled enterprises or the improvement of security measures. The Bank works side by side with the civil service, providing any information required and committing itself fully to the common search for solutions to problems concerning the issuing and placing of loans and the complex mechanism of Treasury operations (under which falls the proposed scheme for a government cheque as a means of payment); a collaboration which also extends to foreign trade and payments regulations and the fight against certain forms of crime. Representatives of the Bank are frequently present alongside government officials in international fora.

In Parliament, some of the Bank's highest-ranking officials have brought their expert knowledge to the deliberations of the Fifth Senate Commission on the Budget for 1976, the Second Senate Commission examining legislation to curb violation of exchange controls, and the Parliamentary Committee of Inquiry studying the structure, terms and levels of wages and salaries and working conditions in the public sector.

In the courts, the Bank is frequently called upon to give expert evidence, whether on forged bank-notes or, increasingly, on various aspects of banking activity.

All these contacts with other bodies form part of a continuous updating of professional knowledge which also draws on experience gained and research conducted outside the Bank.

The Bank is able to render an important service to the community by making available to other bodies, within the limits of the law, a mass of information acquired in the pursuit of its institutional functions.

In August last year Guido Carli tendered his resignation as Governor of the Banca d'Italia. During his fifteen years in office he won the highest regard as he wholeheartedly dedicated his remarkable energies to solving the increasingly grave problems facing the monetary authorities as a result of political and economic developments. His task was rendered all the more difficult since the root causes of the crisis, with their effects accumulating over the years, were partly of a structural nature and thus less easily countered with monetary policy instruments, however sophisticated and modern.

On the international level, these roots may be identified in the gradual strengthening of sellers' markets for commodities; a stronger wage momentum, with greater disparity among individual national economies exposed to social pressures varying in nature and degree; and disequilibria in the distribution of international liquidity, sharpened by the emergence of an unregulated capital market. The failure to achieve full European economic and monetary union — towards which Guido Carli worked with great tenacity and dedication and to which he will certainly devote further energy — has meant that, the advantages of commercial integration having been secured, important elements of national economic life in Europe, such as exchange rates, balances of payments, employment and regional development, have suffered from the disequilibria created by a half-completed process.

It is thanks to Guido Carli that Italy has been able to make a vital contribution at conferences called to try to put the system on a rational basis. He was guided by a desire to move towards a monetary order in which the international credit market would ensure the rational allocation of financial resources, within a framework of stability that would not exclude a degree of exchange rate flexibility during progress towards European unification. The personal standing of Guido Carli has contributed much to the financial credibility of our country and has strengthened the international community's willingness to support the efforts that Italy has made and must continue to make in order to overcome its difficulties. Since he resigned office as Governor, evidence of the esteem he has won is to be found in the close attention with which his contributions to the debate on the major economic topics are followed in international circles.

In Italy itself, after a decade of steady progress during which stability and growth not only coexisted but also provided mutual stimulus, Dr. Carli was required to employ all the resources of central bank instruments and personal persuasive powers in argument to meet the emergence of increasingly acute and frequent disequilibria, which led up to the crises of 1963-64, 1969-70 and 1973-74. Cyclical and confidence crises also occur in countries where there are no serious structural problems, so it is not only here that the origins must be sought. In Italy, however, such crises are undoubtedly aggravated by the dual fabric of the economy, which the growth of income over the last thirty years has only partially rectified; by the disparities in working and income conditions which the Government is asked to level out through massive transfer expenditure; by the coexistence of advanced sectors exposed to external competition, and low productivity areas which enjoy varying degrees of protection; and, finally, by the problems of administrative inefficiency. By checking growth and impairing social cohesion, these factors have made the economic system unable to fully meet the demands of society as a whole and have led to frequent conflicts between the objectives of stability and growth. In other words, they have made it impossible to pursue several aims at one and the same time, so that economic policy has had to give priority to one and then to another, in ever swifter rotation because of the desire or the need to salvage that which has been neglected. The rotation of objectives has introduced into the Italian economy a marked cyclical content, accompanied by a progressive deterioration in the financial structures of both private and public enterprises and of the State and, in recent years, with destabilizing external factors at play, a massive balance-of-payments deficit, thus leaving less and less scope for absorbing external shocks through the foreign exchange reserves. Under the leadership of Guido Carli, the central bank has, despite many constraints, been able to moderate the negative repercussions of these disequilibria on internal and external monetary stability.

Monetary management has been used increasingly for anticyclical purposes, in the first instance via traditional instruments. But the former Governor, with his remarkable command of financial techniques and his originality of thought, led the way in the subsequent employment of new instruments, touching upon the banks' external and foreign exchange positions, the composition of compulsory reserves, intervention on the stock market and the volume and structure of bank assets.

Within an institutional context basically unchanged for lack of new legislation, these interventions on the whole ensured continuity in the processes of financial intermediation, which expanded as a result of the greater gap between savings and investment. During the sixties, the preference of Italian savers for liquid assets was countered for many years by enlarging the proportion of securities placed with the public.

In the pursuit of these monetary aims, Guido Carli directed the Bank's activities in their various stages: in helping to define the broad lines of monetary policy through personal contact and an exchange of information with government departments and other public bodies; in mediating between the financial and political worlds; and in carrying out autonomous daily intervention on the foreign exchange, stock and money markets — all within the framework outlined above.

He has strengthened the instruments available by ensuring high professional standards among Bank personnel, both in the spheres of direct action and in those concerned with processing and research. He is now making his own contribution to research as President of the Ente Einaudi, which under his direction has begun an extensive study on corporate financial structures and the Italian banking system. The management of the Bank continues to be inspired by his example in all these areas.

Although the multitude and variety of interventions formulated in rapid succession under different monetary conditions may have satisfied Guido Carli's propensity to exercise his talents in situations abounding in difficulties, also of an analytic nature, I believe that he must occasionally have felt a certain nostalgia for the simpler course that his two distinguished predecessors were able to follow, with undisputed efficiency, in a different context. There is, to my mind, something profoundly unsatisfying in having to direct central bank action in such a way that it suffocates a system that possesses its own valid parameters and mechanisms; in having to constrain the volume of credit potentially expressed by the flow of monetary base because it is not possible to regulate that flow; in having to channel the flow of credit because, in the absence of adequate budget and incomes policies, the free decisions of market operators are distorted by inflationary or exchange rate expectations. This is unsatisfying not only from the point of view of logic but also because the effects tend to be ephemeral since the mobility of credit flows, profit considerations and the adaptability of market operators in the long run bring the flows back into line with basic economic conditions.

I believe that I express not only my own feelings but also yours in thanking Guido Carli for having developed these new financial instruments and for having used them opportunely and well: a justly deserved and sincere homage to his creative abilities. Looking ahead I would like to hope on behalf of all that the present grave situation will improve so as to allow a gradual return to less constricting methods of intervention: for the more uniform rules on the employment of financial resources are imposed by the central authority, the more the pluralistic nature of banking becomes meaningless.

The international economy

The recession and the efforts made to overcome it dominated the stage of the world economy in 1975. International trade, which in the post-war period had been a constant growth factor, with higher rates of increase than those of the world product, became a contractionary element in demand, showing a decline of 6 per cent in real terms. The recession coincided with a process of concentration of international liquidity in a small number of countries: the oil exporters and a few industrial countries. Long-term trends indicate that when the distribution of reserves becomes more concentrated, the growth of international trade tends to slow down; this concentration is equivalent to a reduction in global liquidity. What is more, countries holding substantial stocks of gold could not in effect depend on them as liquid reserves. The negotiations on the reform of the international monetary system, culminating in the Jamaica meeting last January, left gold still in practice excluded from the flow of international payments. Only if it were transferable at a marked-related price, within a system so managed as to preserve its function as a store of value, could gold be mobilized. To this end the EEC countries should press more forcefully in the various international institutions for an unfreezing of gold, in a context characterized by inflated international trade values brought about by the rise in the prices of traded goods and of oil in particular.

If at the same time the role of special drawing rights were strengthened, so that they might become the principal instrument of settlement, this would gradually lessen the drawbacks of an international monetary system which today basically pivots on the dollar and gives to American banks the role of lenders of last resort.

The shortage of international liquidity, which is felt by a growing number of countries, could be alleviated not only with issues of special drawing rights, but also by adjusting the financing mechanisms that exist within European and international institutions to the growth of trade flows. A useful addition at the present time, given the strong growth in East-West trade in recent years, could be the introduction, on a Community or international level, of rediscounting facilities for the medium- and long-term credits that Western countries grant to finance their exports to Eastern Europe. Common mechanisms for rediscounting medium- and long-term export credits would avoid the distortion of international competition caused by the unequal credit potential of the exporting countries.

Reactions to the shortage of reserves played some part in the decline in 1974-75 of deficit industrial countries' propensity to import and the more recent fall in imports of the non-oil-producing developing countries.

Coming in the wake of a sharp expansion of production and a violent bout of inflation, these reactions took the form of restrictive economic policies aimed at stabilization, rather than administrative controls on imports. Furthermore, the general floating of exchange rates reduced reserves needs and lessened the risk of a collapse of the multilateral system of trade and payments which had been built up with patience and perseverance since the war.

On the other hand, the shortage of reserves, as experienced by Italy between the end of 1975 and the beginning of this year, aggravated exchange rate instability by making it more difficult to offset seasonal factors and short-term speculation, while encouraging the extension of extrapolative expectations and their destabilizing influence to the medium term.

The reciprocal influence between exchange rates and domestic prices is a factor of instability. The greater the degree of openness of an economy and the greater the degree of indexation of incomes to the cost of living, the greater is the interaction between changes in the exchange rate and in prices. In the absence of an incomes policy capable of moderating these automatic mechanisms which determine costs and prices and which rapidly nullify the effectiveness of exchange rate changes as an instrument of adjustment, there is the risk that the depreciation of the currency could be transformed from a « finite process » into a circular one in which each depreciation introduces the next. This risk can be avoided by refusing to finance the increase in costs and prices, i.e. by pursuing a restrictive monetary and credit policy; but an ever shorter « stop-go » cycle has negative repercussions on the long-term growth rate.

In a system of fixed exchange rates, the excess of demand in one country has an impact, through a large drain on reserves, on the balances of payments, and hence also on the demand and prices, of competitor countries. In a system of flexible exchange rates this automatic adjustment mechanism is weakened: for those countries in a strong position, there is greater room for manoeuvre in monetary policy, which can pursue its allotted set of objectives more consistently; for those in a weak position, the insufficiency of reserves means that, if domestic and external monetary instability are to be avoided, the adjustment process has to be carried out within narrower margins.

The recession that hit the major industrial economies was the worst since the end of the war. It gave even greater cause for concern because of the persistence of inflationary tendencies even while economic activity slackened. The gross national product of the main industrialized countries as a whole, already slightly down in 1974, dropped by almost 2 per cent at constant prices in 1975; consumer prices rose on average by 13 per cent in 1974 and by 10 per cent in 1975.

On the demand side, the sharp rise in prices reduced the real value of households' financial assets; their propensity to save increased in response, without a corresponding expansion in investments. The slowdown in final demand was accompanied by a large-scale liquidation of stocks, which had reached abnormally high levels during the inflation boom of 1973-74.

On the supply side, the adjustment process was blocked by bottlenecks and rigidities, some of the latter being due to the introduction of restrictions regarding the use of plant and manpower. The inadequate elasticity of supply then weakened the impact on the real variables of expansionary monetary demand management, which in the circumstances tended rather to feed inflationary forces, especially when it was based on public sector deficits due to increases in current expenditure.

The leap in the price of oil in 1974 had given a sharp external thrust to the process of inflation and recession. The adjustments that it made necessary cannot, with a few exceptions, be said to have been completed, although the importing countries took steps — some of them harsh — to reduce the proportion of the national product devoted to domestic uses; to the extent that real resources are not transferred to external use, problems arise in financing the balance-of-payments deficit on current account, which for some countries have taken on unprecedented proportions. Investment activity fell, not only for domestic reasons, but also because the recycling of the oil-producing countries' financial surpluses with the rest of the world has not re-established the previous equilibria between the supply of savings and real capital formation in the importer countries.

While there were fears that the conditions for a world-shaking economic crisis were being created, the authorities of the main industrial countries were becoming more and more convinced that the traditional mechanism of anti-cyclical monetary expansion could turn bad to evil by giving a new lease of life to the wage/price spiral and weakening the inducement to reallocate resources in line with the new cost of energy and the new pattern of world demand — in a word, by stoking the fire of inflation which was not yet dead. The realization that, in order to avoid the risk of broadening the oscillation of the world economy around a downward trend, the remedy was not to be found in a general expansion of monetary demand guided policies to revive economic activity, especially in those countries with the greatest weight in the world economy. For this reason these policies were applied with caution and flexibility. At first the decline in economic activity and in the demand for credit was allowed to express itself in an easing of the monetary and credit markets; subsequently, as the extent of the recession became apparent, a real stimulus was given, chiefly through fiscal measures chosen for their ability to produce support for demand quickly and for a limited period. A general preference was given to instruments whose stimulatory effects would automatically work themselves out once the demand gap forecast during part of 1975 had been eliminated. In Germany, at the same time that measures were adopted increasing the public sector deficit in 1975, steps were taken to ensure its reduction in 1976.

The first signs of recovery appeared in Japan and the United States during the second quarter of 1975; in Germany they were seen towards the end of the summer, with a short lead over the other European countries. Although the American recovery rapidly gained momentum, it did not to any appreciable extent pull the other economies along with it; owing to the existence of large margins of idle productive capacity and the depreciation of the dollar in the years before, the recovery did not result in an increase in net imports of goods and services. On the contrary, in 1975 the United States achieved a surplus on merchandise and services account of 16 billion dollars, more than four times the surplus of the previous year.

The promising performance of trade in goods and services was the basis for a strengthening of the dollar, which was also favoured by a cautious monetary policy which, in the presence of brisk demand for credit, caused interest rates to rise during the middle two quarters of the year while they continued to decline in the other industrial countries. In fact, from March onwards the dollar was almost constantly firm and its upward tendency became stronger from the summer. The strength of the dollar and of the currencies of those European countries that had met with greater success in 1975 in their attempts to restore domestic monetary stability caught the other countries at a time when their fiscal and monetary policies were being directed towards stimulating productive activity. This generated expectations which in some countries, including Italy, helped set in motion a process of deterioration in their foreign payments positions, ultimately triggering the external constraint while recovery had hardly got under way.

For most of the European countries the turning-point in industrial production came in the autumn. The slowness with which the recovery of economic activity spread meant repeated downward revisions of the forecasts for 1975 as the months passed. The OECD forecasts for the growth of the gross national product in real terms in member countries were revised from an initial estimate of a 0.5 per cent increase to a 2 per cent decline. The course of events caused international organizations and European institutions to make a number of calls on the industrial countries to take steps to boost demand. In particular, the EEC Commission adopted a recommendation in July « on the fight against the recession » according to which certain member countries, including Italy though « to a limited extent », were asked to take « additional steps to stimulate their economies ». Towards the end of the following month, the European Ministers for Economic and Financial Affairs, meeting in Venice, said that they were « concerned about the depth and persistence of the economic recession and its effects on employment ». They decided that « further efforts to stimulate the economy shall be undertaken immediately by those member countries that are in a sufficiently strong position as regards current account balance of payments, prices and public sector finances ». Again in December the Council of the Communities stated that the Italian Government « should do all in its power to hasten the enactement of the measures adopted to stimulate the economy, since delays in this sector could soon undermine the basis for balanced economic development ».

In the seventies the public sector deficits of the major industrial countries have shown a tendency to grow. As a proportion of the gross national product, they were kept initially within the bounds of a few percentage points; the jump took place between 1974 and 1975 and was clearly anti-cyclical. But in some countries, because of the reversible nature of the measures taken, budget management did not represent an impediment to the shift in policy priorities towards the curbing of inflation.

A structurally fairly sound public budget and agreement between labour and management on wage increases compatible with anti-inflationary objectives are, especially in strong-currency countries, bringing the rate of inflation back to the levels of the sixties. Since the moderate increases in wages and salaries will be almost entirely offset by productivity gains, which tend to be more marked during the upward phase of the cycle, profit prospects are improving; this stimulates investment activity in a « virtuous » circle similar to that which maintained economic expansion in Italy in the fifties, when the benefits of higher productivity were passed on to workers in the form of wage rises and to the community at large in the form of a reduction in the relative prices of manufactured goods.

The awareness of the need to give priority to curbing inflation also spread to countries, such as the United Kingdom, where the problems both of the public finances and of industrial relations were objectively more difficult. Agreement was reached on a norm limiting the average wage increase in the twelve months to July this year to 13 per cent, half what it had been the year before; the norm recently agreed upon will allow the rate of increase to be kept within 5 per cent in the twelve months ending in July 1977. The fall in the nominal rate of wage increases, which implies a slight decline in real terms over the two periods, is making it possible to reduce the rate of price increase substantially. Although it was the highest among the major industrial countries in the first half of 1975, it should drop to around 4-5 per cent towards the end of 1977, i.e. the same level as Germany has set as a target for the current year.

In the first few months of 1976 the broadening of the recovery was evident; however, while the success of their stabilization policies tended to consolidate the revival in those countries that had come out of the recession first, the others suffered under expectations of a new bout of inflation and of a worsening in their external accounts, which in some cases led to large reserve losses and a weakening of their currencies. Currency depreciation, coupled with the increase in prices at source, placed further pressure on the chain of domestic costs and prices.

In a number of countries the result was a fresh acceleration in the rate of price increase and, in general, a worsening of prospects for restoring monetary stability, calling for renewed caution after the expansionary stimuli which had appeared necessary on the basis of assessments of the economic situation, especially in Europe, during the summer and autumn of 1975. In countries where the deterioration in the balance of payments was worst, the trend of the main monetary aggregates was switched to one of restriction. This has given rise to uncertainty and anxiety, which tend to have a negative effect on demand and in particular on the propensity to invest, at a stage when the recovery has hardly got under way and therefore has not yet brought those economies back near their potential growth path.

The economic trend, assessments and policies in 1974-75

As elsewhere, measures taken in Italy to regulate the economic trend in 1974-75 were aimed first at restoring external equilibrium and easing inflationary pressures and subsequently at promoting recovery. The restrictive policies applied during the stabilization period led to a decline in output and a drop in imports. The fall in production was accompanied by a sharp increase in unit labour costs: thus, while price pressures appeared to have eased, the problem of inflation, far from being eliminated, re-emerged in more intractable form on the cost side.

After the autumn of 1969, industrial enterprises, faced with less flexbility in the utilization of manpower and plant, had attempted to absorb at least part of the increases in labour costs by stepping up capital intensive investment so as to rationalize productive processess and acquire new technology. As a result, the level of capital invested per hour of work rose much faster between 1970 and 1973 than in previous years. But the productivity gains were nonetheless outpaced by the sprint in wages, which in the three years from 1971 to 1973 raised unit labour costs by 10 per cent per annum. International competition made it impossible to pass on more than part of the higher costs in prices, obliging enterprises to accept a contraction in unit profits.

While employment of the most readily available productive factor, labour, stagnated, the capital market tightened further. Italian competitiveness was impaired and the country's market share ceased to increase.

In 1973, for the first time in a decade, Italy's balance of payments on current account showed a deficit. There was heavy pressure on the reserves, also as a result of capital movements; the fixed exchange rate was abandoned and the floating of the lira resulted in a 20 per cent depreciation in two years, despite substantial foreign borrowing.

A brief period of recovery in demand was sufficient to cause tensions, even though margins of unused capacity existed in many sectors. The swiftness with which crisis conditions emerged showed just how far the economically exploitable margins of capacity had been narrowed by the increase in costs, the rigidities in the employment of capital and labour and the pattern of domestic consumption since the beginning of the sixties. The inflationary pressures were aggravated by the poor rates of productivity increase in those sectors less exposed to competition.

In an attempt to correct the structural distortions in the Italian economy, the authorities imposed further constraints on the money and capital markets; heavier and heavier burdens were shifted onto the public purse until the scale of official intervention exceeded the bounds of financial compatibility.

These tensions were exacerbated in the autumn of 1973 by the oil crisis, which hit the Italian economy harder than the other industrialized countries owing to its lack of energy sources; in Italy the cost of imported energy supplies rose in 1974 by some 4,000 billion lire, equivalent to 3.8 per cent of gross national product, as against a 1.8 per cent average increase in the other OECD countries.

It was soon clear that any attempt by the oil-importing countries to restore balance-of-payments equilibrium through restrictive policies would strengthen and disseminate recessionary forces. Thus, when in February-March 1974 Italy negotiated a stand-by credit with the International Monetary Fund, it was asked to eliminate, by the end of 1975, just the oil-induced component of its current account deficit. But in the absence of international agreements for the financing of the entire « oil » deficit, and with the balance of payments continuing to be in the red, already by the second quarter of 1974 there was a growing conviction both at home and abroad that Italy was on the eve of a major crisis. Thus it became imperative to try to absorb, during 1975, not only the « non-oil » deficit, but also a large part of the oil deficit. However, as late as the autumn of 1974 the Government Report on economic projects and programmes proposed, as economic policy targets for 1975, that the level of domestic demand be kept unchanged in real terms and that the rise in income deriving from the growth of exports be used to reduce the current account deficit, which was expected to contract from the 5,300 billion reached in 1974 to 2,900 billion in 1975, a figure equal to a still very high proportion of the oil deficit.

The Italian recession thus became a feature of the international recession. From the second half of 1974 to the first half of 1975 world trade contracted unexpectedly by 11 per cent at an annual rate. Again contrary to all the forecasts, in the spring-summer of 1975, the major world economies experienced the heaviest declines in industrial activity, viz. 13 per cent at annual rates in Japan, 12 per cent in the United States, 11 per cent in Germany and France and 7 per cent in the United Kingdom. Italian exports just managed to hold steady in value terms.

At the end of June industrial output in Italy showed a drop of 12 per cent from twelve months earlier; the gross domestic product for the first half of the year was 6 per cent lower than that for the first half of 1974. Recourse to the Wage Equalization Fund reached a massive scale. The improvement in the balance of payments arose from the huge fall in imports, which in the first half of the year declined by 8 per cent in value terms and 19 per cent in volume as compared with the same period of the previous year.

By the summer of 1975 the current account deficit had been practically eliminated; the wholesale price index had been stable for several months — partly owing to the decline in raw material prices — and the increase in consumer prices was down to 12 per cent from the 24 per cent reached in 1974.

The objective of balance-of-payments equilibrium had been achieved sooner than expected, partly owing to a cyclical run-down in stocks and at the cost of a sharp fall in the level of activity and a serious fundamental deterioration in the cost/price ratio, only partially cushioned by shifting the burden of maintaining employment levels and other costs onto the public purse. Instead of adapting to the deterioration in the terms of trade due to the higher relative cost of energy and raw materials, wages rose during the period of adjustment proportionally faster than the national income at current prices as a result of pay rises and improvements in the system of automatic cost-of-living adjustments negotiated in January 1975. In industry labour costs per unit of output, having already increased by 20 per cent in 1974, rose by an unparalleled 33 per cent in 1975, two-thirds of which was due to wage rises and one-third to the drop productivity.

The course of domestic and external developments led to a re-examination of economic policy in Italy in official, business, trade-union and academic circles. The climate of opinion was such that the debate went beyond cyclical to include structural problems, calling for extensive financial interventions against the background of an equilibrium which more careful observation would have shown to be vulnerable, as subsequent events were to prove: in fact this equilibrium rested on the influence of cyclical factors on the current balance of payments and was undermined by the underlying trend of unit costs. Attention was focused on productivity in industry as well as on corporate finances in general. On the one hand, in order to improve Italy's competitiveness, an attempt was made to identify those productive sectors with the most stable growth prospects and to determine what forms of industrial reorganization could help to raise productivity; on the other, ways were sought to reduce the level and cost of debt. As a means to improve corporate financial structures, some proposed risk capital contributions from newly created financial agencies or from the special credit institutions and even the banks; others suggested that the State should help by funding debts with risk capital offered on concessionary terms; yet others talked of the conversion of the long-term debts contracted at high rates in 1974. Schemes for improving company structures were accompanied by proposals for modifying the institutional framework of the financial intermediaries themselves. In the area of legislation, some of the ideas debated in those months were later to be incorporated in the plan for industrial reorganization tabled in Parliament on January 2nd this year, when the government and currency crises were already brewing.

The diversity of opinion as to the structural changes required contrasted with a broad consensus in favour of an expansionary economic policy. It was generally agreed that the productive system could be undermined by a lengthy recession, which, apart from the cost in human terms, would lead to the destruction or dispersal of technical, labour and entrepreneurial resources. Advice was also received from abroad, as I have already mentioned, in favour of a policy of reflation.

Plans to stimulate economic activity therefore took shape, initially through the promotion of exports and support for investment, especially in social infrastructure, residential building and export industries. With little room for manoeuvre, success depended on avoiding further escalations in costs and current public expenditure, and on achieving a broader consensus among political and social groups as to the choice of priorities and the means of achieving them.

Within this context support from monetary policy came in the form of export refinancing and a reduction in short-term interest rates.

In August the export credit insurance ceiling of INA (National Insurance Institute) was raised from 1,400 to 2,500 billion and a special ceiling of a further 1,000 billion was set to give cover for transactions that had previously been only partially insured. At the same time the endowment fund of Mediocredito Centrale, the medium-term credit institution, was raised by 300 billion, and it was also granted 50 billion as a subsidy towards interest on export credits.

As to short-term measures, steps were taken to promote exports in the form of refinancing facilities for the banks in respect of 50 per cent of credits granted by Italian exporters to foreign importers. In amounts that they themselves specified, the banks concluded forward foreign currency swaps with the Italian Foreign Exchange Office (UIC), against which the Banca d'Italia opened deposits in lire which could be drawn upon pari passu with evidence of financing in respect of credits granted by exporters. The forward foreign currency facility had to be granted automatically on request; its size was inflated by precautionary demand on the part of the banks, so that only a part of the counterpart deposits opened by the Banca d'Italia could be considered as actually utilizable and hence as liquid reserves.

During this period the Treasury's cash deficit widened unexpectedly. In October estimates for 1975 had still put the deficit at 11,000 billion, but by the end of the year it had reached 14,200 billion. The Treasury financing requirement for the fourth quarter amounted to 5,400 billion, 3,200 billion higher than in the fourth quarter of 1974 and than previously estimated. In the same quarter Treasury bills amounting to 8,122 billion fell due for redemption, two and a half times more than in the corresponding period of 1974 and nine times more than in the final quarter of 1973. Soaring public sector deficits have so increased the volume of maturing government paper that it is becoming more and more difficult to roll it forward. This difficulty is frequently ignored in arguments conducted in terms of the net borrowing requirement.

In parallel with the liquidity measures, a further step was taken by the Government to bring about a rapid fall in interest rates; in September major banks were asked to lower their lending rates by two percentage points. In the same month the discount rate was reduced by one percentage point; in October the nominal tender rate on short-term Treasury bills was lowered; in November, to assist enterprises, the reference rates for the various types of subsidized credit were reduced.

The export credit provisions came into effect on September 15th; at the end of that month the foreign currency facilities granted amounted to 1,198 billion; of the counterpart, 1,063 billion was still lying unutilized in the deposits opened by the Banca d'Italia. Over the next few months the credit facilities rose to 1,776 billion and the deposits declined to 1,026 billion.

In addition, while the large volume of short-term paper issued to meet Treasury financing needs meant that the creation of monetary base to cover the public sector deficit could be held down to a level that would certainly not have been possible with the issue of long-term stock only, it nevertheless provided the banking system with additional liquidity over and above that narrowly defined. Even taking into account only the total of short-term Treasury bills falling due each month, these reserves of secondary liquidity — for that is what they really represent — amounted to 3,000 billion in September, 1,300 billion in October and 2,600 billion in November; in December no bills came to maturity.

The total of short-term Treasury bills for free investment in circulation rose from 2,300 billion at the end of 1973 to 19,400 billion at the end of 1975; during the same period the amount held by the banks and the public rose from 900 to 7,500 billion.

Within the framework of the new economic policy guide-lines and within the limits of the need to provide the State with the means of financing its cash deficit, the central bank used the instruments falling directly within its own competence to ensure the smooth operation of the money and capital markets. These instruments include bank financing, purchases and sales of government securities and bonds on the secondary market, and bids at the Treasury bill auctions.

In August the banking system wiped out its indebtedness towards the Banca d'Italia in the form of rediscount facilities and fixed-term advances; from that moment on, and even in December when recourse to the central bank is normally substantial, no further operations of this type took place.

Between September and December the central bank took up 7,873 billion of newly issued securities and made net placements of 3,882 billion on the market. The total of purchases was two and a half times the corresponding figure in 1974 and five times that in 1973. Despite this increase, the amount of placements as a proportion of purchases was only a little lower than in 1974, and much higher than in previous years.

At the same time, the Bank's interventions on the stock exchanges were directed at keeping long-term yields high enough to encourage bond investment by the public. From the last week of October until January the Bank was a net seller. This is without precedent in the last five years.

In the short-term sector, intervention to reduce rates was very active in September and October; subsequently it became cautious, with large placements of bills immediately after the October auction and an increase in the yield offered at the November auction for six-month bills. In the three months from September to November the Bank sold 2,546 billion of short-term Treasury bills on the market.

Under the combined effect of the measures and operations described above, bank liquidity, including the precautionary deposits intended for financing exports, rose to about 3,000 billion in September and remained at around that level until the end of the year.

In particular, in December, when Treasury bills are not normally auctioned owing to seasonal liquidity conditions, the central bank continued its sales on the stock exchange and took up huge issues of Treasury paper for its own portfolio. The banks bought 728 billion of bonds; 260 billion of securities were placed with the non-bank public, which in December does not usually enter the bond market.

In January the public and the banks purchased medium- and long-term government securities for a net amount of 1,000 billion and short-term Treasury bills for 580 billion, 370 billion of these at the monthly auction.

If we compare the course of events in 1975 with the corresponding phase of the previous cycle of monetary policy, which had begun when, in about mid-1970, the economy emerged from the restrictive phase, we see that between the second quarter of 1970 and the second quarter of 1971 the ratio of liquidity to deposits rose from 2.7 to 5.3 per cent. Between the fourth quarter of 1974 and the fourth quarter of 1975 it rose from 2.1 to 3.1 per cent; in the same period liquidity net of short-term central bank refinancing (rediscounting, fixed-term advances and deposits opened against estimated export credits) rose from 0.9 to 2.1 per cent of deposits, while between the second quarter of 1970 and the second quarter of 1971 it had risen from 0.4 to 5.4 per cent.

In the final quarter of 1975 the ratio of net liquidity to deposits was higher than in the final quarter of 1974, a period of rigorous monetary restraint, but below the levels registered in the corresponding periods of 1971, 1972 and 1973.

The exchange rate

In order to draw the full picture of the immediate causes of the serious exchange crisis that broke out at the beginning of 1976 it is necessary at this point to look back over the course of events on the foreign exchange market in 1975.

During the early months of last year the dollar had shown a downward trend on international markets, followed by a period of greater stability and, from mid-year, the vigorous recovery mentioned earlier. These movements, along with the recovery of the French franc and the weakening of sterling, produced tensions which, however, left the lira untouched. Monetary policy, which continued to follow cautious lines, encouraged Italian businessmen to obtain financing in dollars and other foreign currencies; this, together with the fall in imports, strengthened the lira exchange rate, thus enabling the authorities to purchase foreign exchange on the market. The subsequent improvement in the exchange reserves, which included a 400 million dollar drawing on the IMF loan, made it advisable to repay in advance 500 million dollars of the Bundesbank deposit.

In April and May, despite the violent shockwaves affecting foreign markets and the introduction of an easier monetary policy — with a lowering of the discount rate and the abolition of compulsory financing in foreign currency of advance payments of imports — the lira continued to gain strength and the authorities were able to make further foreign exchange purchases to repay maturing debts. The performance of the exchange rate and the direction of official foreign exchange transactions reflected the improvement in the current balance of payments, backed up by the inflow of capital and the banks' foreign indebtedness as a result of residents' propensity to contract debts in foreign exchange.

During the first half of June market interventions again resulted in an increase in official reserves. However, a sudden reversal occurred in mid-month as expectations showed a marked change.

In July and August, the appreciation of the dollar gave further cause for concern for the weaker currencies, particularly sterling and the lira. Residents were thus induced to extinguish foreign exchange debt and to acquire foreign currency in advance for future payments, as monetary policy became more expansionary in an attempt to foster economic recovery. The anti-cyclical measures adopted on August 13th are to be viewed in this context. Market intervention ensured the maintenance of a stable exchange rate on a trade-weighted basis, which did not preclude a fall vis-à-vis the dollar.

The situation began to worsen after mid-September owing to a combination of external and internal factors: abroad, a new gold régime began to take shape, depressing the price of the metal and pushing the dollar further upwards; in Italy, demand accelerated under the stimulus of a recovery in stock-building and the introduction of the scheme for subsidized short-term export credit, whose effects on liquidity put downward pressure on short-term rates. This stimulated residents' demand for foreign exchange and subsequently induced the banking system to invest liquid lira balances abroad within the limits of the « spot against forward » ceiling.

However, between July and October the ıly adverse effects on the level of the reserves came from the decrea in the banks' debtor position and the turnaround in « autonomou capital movements, especially trade credits, which appeared to be closely linked to the drawing down of the compulsory import deposits. During the first ten months of the year, in fact, the « autonomous » balance of payments (i.e. net of compensatory loans) recorded a surplus of around 200 million dollars, thus seeming to confirm the latest forecasts of possible equilibrium on current account in 1975. Estimates prepared in the autumn of 1974 of a deficit of 2,900 billion lire had been progressively scaled down until in the late summer of 1975, with the economy clearly going through a recessionary phase, current account equilibrium was forecast. A number of international organizations were even predicting a surplus. Consequently the climate of opinion was not in favour of a devaluation of the lira, nor did the balance-of-payments situation give any justification for such a move.

Furthermore, in the formulation of foreign exchange policy weight was attached to the consideration that depreciation would fuel inflation and that a recovery in production might improve productivity and help bring unit costs back to a level compatible with the prevailing exchange rate.

Throughout this period, while the recovery was slow to materialize, exporters justifiably grew more insistent in their demands for additional support other than through the depreciation of the exchange rate. A number of measures were taken in this direction: in March the directive of the Committee for Credit allowing banks that increased their export credits priority access to central-bank credit facilities at normal rates; the August provisions mentioned above, which included subsidized financing; the extension of the maximum term for deferred receipts for exports from 3 to 4 months granted in December; the acceleration of VAT refunds on exported goods; and the proposal for a tax, refundable at the time of export, to replace social security contributions. Apart from the March decision, which was not in fact applied, these various measures, though justifiable in view of the stability of the exchange rate against a background of rising costs, did reduce the authorities' control over domestic liquidity flows and foreign exchange movements; in other words, they created conditions that weakened the defence of the exchange rate.

The balance of payments on an exchange records basis worsened considerably in the second half of November; however, not until January did detailed statistics become available which showed that the deterioration was on the current balance. This returned to equilibrium in the first half of December, so that it appeared that the November figure would, after the surplus of the first ten months, have brought the results for the year as a whole within the forecast range. In the second half of December, however, there was a sharp deterioration, and when the complete figures for the month as a whole became available in February they showed a large current account deficit. Part of the deterioration had occurred on the invisibles item, which may conceal capital outflows, showing that the pressure on the lira was not due solely to imports but also to a serious crisis of confidence.

Despite the deterioration at year-end the balance of payments on a transactions basis for the year as a whole closed with a deficit on current account of barely half a billion dollars, compared with one of 8 billion in 1974. Two-thirds of the 1.7 billion dollar fall in reserves was due to the deficit on capital movements, the improvements in the banks' foreign position and net loan repayments.

Around the turn of the year the government crisis, the hostile attention focused on the level of the country's reserves and rumours that one of the American banking supervisory agencies was making a critical reassessment of lending to Italy brought pressure on the lira. Although intervention to support the currency was not large compared with major foreign exchange crises it was still massive in relation to Italy's depleted reserves; official quotations were finally suspended and intervention abandoned on January 20th. The volume of intervention during December and January was barely a fifth of that carried out by France to defend the franc between the end of January and March this year.

The January crisis on the foreign exchange market thus did not originate from a persistent balance-of-payments deficit. Rather its ultimate causes are to be found in the underlying disequilibria which have worsened over the years, while the immediate causes may be traced to the low level of the country's reserves and its poor credit-standing owing to the burden of debt accumulated over the three years from 1972 to 1974.

An economy such as Italy's where financial intermediation is highly developed, always contains margins of liquidity for speculative movements against the currency. These margins are present not only in the liquidity available to the banking system, in the form of deposits and credit lines with the central bank, but also in the pockets of liquidity existing within the banking system itself in the form of interbank deposits, and in liquidity substitutes such as short-term Treasury bills. When this internal liquidity and quasi-liquidity is drawn upon, the central bank cannot refuse to assist the central institutions and banks affected by withdrawals of interbank deposits, or the Treasury, without serious repercussions. In addition, apart from the banking system's external and internal liquidity, there is the liquidity of the general economy, which can draw upon unutilized credit lines, amounting to 30,000 billion lire in Italy (compared with 2-3 thousand of bank liquidity), and on its holdings of deposits and short-term securities.

The inadequacy of the reserves in the face of a large potential demand for foreign exchange was heightened by the limitations imposed on the use of gold as an international means of payment. Moreover, assistance in the form of credit from official sources turned out to be less readily available than anticipated, as was shown by the difficulties encountered in January in drawing anything more than a modest slice of the reciprocal credit line with the Federal Reserve Bank of New York, which in any case gives only short-term relief.

The closure of the foreign exchange market coindided with a round of re-negotiation of the main nation-wide labour contracts based on clearly inflationary claims which, if granted, would destroy any hope of compatibility between the old exchange rate and the onerous new labour costs. The suspension of official quotations both called attention to the gravity of the situation and left the stage free for a first market test of the external value of the lira. Had it been possible at that point to form a government with sufficient political strength and to adopt a suitable economic programme, the exchange rate might then have settled at a level which it could hold. But since neither of these conditions was fulfilled and the season was unfavourable, the exchange rate at once recommenced the decline of 1973-74 and towards the end of February the fall gathered such pace that an immediate resumption of intervention became indispensable. The announcement of the reopening of the market on March 1st reversed the trend for a few days.

During the forty days that the market was closed, although no comprehensive corrective programme was formulated, various restrictive measures were undertaken: the subsidized export credit facilities were withdrawn, with the destruction of potential liquidity to the value of over 800 billion lire; compulsory reserve requirements were raised, draining off a further 800 billion of monetary base; the period of validity of foreign currency accounts was reduced to 15 days; and the discount rate was raised by two percentage points. In addition, the foreign exchange reserves were built up from 600 to 1,900 billion dollars through a partial drawing on the credit line with the Federal Reserve and the reconstitution in full of the Bundesbank deposit. Negotiations for EEC and IMF loans continued.

When the market was re-opened, orders that had accumulated during the closure — perhaps partly in expectation of moderating intervention by the Banca d'Italia — led to a heavy demand for foreign exchange, which was also stimulated by the troubles of sterling and the French franc. The drop in the exchange rate and the drain on reserves that followed led to a new turn of the screw on the fiscal, monetary and foreign exchange fronts in mid-March. The discount rate was raised from 8 to 12 per cent; compulsory bank financing in foreign exchange for advance settlement of imports was re-introduced.

But each restriction was followed by fresh causes of tension. Thus, since then the political crisis and the dissolution of Parliament have led to expectations that have made it necessary to restore the compulsory import deposit requirement and extend it to all purchases of foreign exchange, to impose compulsory partial financing in foreign exchange of export credits, to negotiate new foreign loans to supplement the reserves, and to raise money market rates to extremely high levels.

The Banca d'Italia and the Italian Foreign Exchange Office are faced with the unpleasant task of presiding over a process which, as far as the management of monetary and foreign exchange flows is concerned, is coming to resemble an economy under seige.

Beyond the crisis

If this process is to be reversed Italian society must have the will and determination to tackle the problem of expanding real supply without resorting to the easy and illusory way of monetary stimulation.

To the extent that the central bank does not possess sufficient foreign exchange reserves to counter the probable use of liquidity for unproductive purposes that accompanies expansionary monetary policies, unforeseeable events, some of which would otherwise be of little significance, can, coming on top of underlying disequilibria, provoke exchange rate crises. These fundamental disequilibria have been aggravated by the burden that the quadrupling of the oil price and the increases in raw material prices has placed on an economic system which over the years has suffered under the cumulative effects of weakening structures and diminishing returns.

Even when the targets of the national energy programme have been achieved (the programme, which is at present under discussion, should be completed within ten years), the foreign exchange savings on energy imports will, at current prices, not be much more than a third of the present oil deficit. That part of the deficit that cannot be eliminated must therefore be offset by expanding exports and reducing imports of other goods. The depreciation of the exchange rate provides scope for moving towards this goal. However, its effects will soon be absorbed unless inflation is halted by means of other economic policy measures. In a system in which wages are closely indexed, its effects might even become perverse.

In the past the public sector budget has had to offset imbalances in corporate profitability due either to wage rises in excess of productivity or to unequal productivity gains by sector and geographical area. The scope for public intervention was considered ample on the demand side, given the unsatisfactory level of utilization of productive factors, and particularly of labour. But stimulation of monetary demand should have taken into account a twofold requirement: that the intervention should be temporary and its scale flexible. This was not the case, however, and the result was a greater cyclical sensitivity of the balance of payments and a chronic dependence of large sections of employment on the national budget, leading to a permanent alteration of market forms and, ultimately, of the economy's efficiency owing to the existence of subsidized firms.

On the basis of experience in the United Kingdom it has been said that employment can be maintained only by creating the conditions for « self-financing » of jobs, in other words, by ensuring that their cost is at least covered by the market value of the product obtained. Every time that this principle is violated, the job becomes no longer economically viable. If the State intervenes, the result will sooner or later be increased taxation or inflation; if the firm intervenes, either its capital structure will weaken, or the burden will be transferred onto the financing institutions or, again, an inflationary impulse will be created.

The distinction between jobs that are self-financed and those that must be maintained through taxation underlines how inadequate an analysis of the situation is given by those who explain the crisis in terms of wage disequilibrium and those who find the key in excessive public sector deficits, both in their inflationary content and in their « crowding-out » of private expenditure. The analysis of the crisis must finally be reduced to a common denominator: the utilization of the labour force. Public expenditure and wages are thus re-analyzed in terms of their reciprocal effects, i.e. the repercussions that the one variable has on the other and that both have on the soundness of the use of labour.

Leaving aside the problems of the size and composition of public spending, important as they are, let us return to the question of determining by what course, in a context of monetary stability, the obstacles to growth may be removed and the right conditions for the accumulation and optimal use of productive capacity re-created. There would seem to be two rules here: the growth of unit labour costs must not exceed that in other countries competing on international markets and the creation of monetary base to cover public spending must follow a similar line of growth to that of those same countries.

Recently, the Italian economy has strayed too far away from these rules. In fact, in the six years from 1970 to 1975 unit labour costs in industry increased by 137 per cent, more than in any of the other major countries: 107 per cent in the United Kingdom, 84 in Japan, 75 in France, 51 in Belgium, 43 in West Germany, 40 in the Netherlands, down to 29 per cent in the United States. During the same period the public sector contribution to the growth of total monetary base was 238 per cent, compared with 87 in Japan, 48 in the United States and 6 in West Germany. As a measure of the monetary surplus that has been created on the Italian market through the public sector, the total growth of monetary base was 194 per cent in Italy, 167 per cent in Japan, 48 per cent in the United States and 86 per cent in Germany.

There are a number of ways in which the present system can begin to observe these widely accepted rules, and this is a question that has been the subject of study in various fora. As far as the growth of wages is concerned, the compatibility of the combined effects of the system of automatic cost-of-living adjustments and of the renegotiation of contracts has recently come under debate. The cost-of-living adjustment was originally created as a means of moderating wage disputes, since it should guarantee the worker his purchasing power and the entrepreneur a more stable basis for company planning. This aim was largely frustrated by permanent forms of bargaining; moreover, it is inconsistent to extend indexation to inflationary factors of external origin, such as the rise in the prices of oil and raw materials, or those deliberately sought by economic policy, such as the increase in indirect taxation, which are bound to reduce the purchasing power of domestic incomes in the short term. To maintain the system of cost-of-living adjustments unchanged in situations such as the present one means that the lira exchange rate will be permanently unstable owing to the links between depreciation and inflation and that a larger contraction in the domestic product will be needed to eliminate the external deficit or reduce the rate of inflation than would otherwise be necessary. And ultimately, this means a greater deterioration in workers' living standards than is dictated by events.

A study carried out in the United Kingdom in support of the new « social contract » shows that, on the assumption of unchanged public expenditure and a floating exchange rate, a modest wage growth (6 per cent) leads to a higher standard of living than would a higher increase (20 per cent). In the second case, unlike the first, there would in particular be a fall in employment and real disposable income: the economy would move towards « a decidedly worse situation from all points of view ».

On a practical level, one means of correcting the distortions caused by the system of indexation in situations of serious disequilibrium would be that, once the technical services have completed their annual forecasts of the movement of the main aggregates on an international comparison and once economic policy choices have been determined, agreement could be reached with unions on the reference inflation rate that would be compatible with observance of the rule of wage growth. If during the year the rate of inflation were to become faster than the reference one, the unit of compensatory increase would have to be reduced or changed, but with adequate protection for the lower income brackets.

This alone would alleviate the burden placed on the Treasury by the disruptive effects of excessive wage bills on companies' finances. However, it is a prerequisite of success in wage restraint that direct action be taken on the public sector deficit to reduce its inflationary effects. A distinction must be made between types of action that have a direct impact on the real economy, such as, in particular, the priority to be accorded to social investments above other public spending, and those relating to the money and capital markets. In the case of the latter, a periodical check must be made on the trend of money creation for the needs of the public sector and a programme of flows mapped out that is not limited to the net borrowing requirement but also covers renewal of the public debt, especially the floating debt, and takes into account the possible consequences on liquidity.

Should deficit public spending or the non-renewal of short-term debt create an excess of liquidity with regard to the trends prevailing in the countries with which Italy trades, then the need to maintain exchange rate stability will imply rationing the directly productive sector, i.e. its financing requirements will be only partially met. The reduction of the volume of credit available to the productive sector and the rise in its cost will have a negative impact on private investment, deriving from public indebtedness. In order to limit these effects the public sector budget must be given greater cyclical elasticity on the expenditure side, and if this turned out to be either impossible or inadequate, on the revenue side. The rate of direct taxes should be a dependent variable of success in achieving the targets set in relation to prices and the balance of payments within the framework of the agreements on wage growth.

The current deficit of general government now stands at 6 per cent of net national income and absorbs about a third of households' savings. This partial erosion of households' savings and, to a lesser extent, the fact that corporate sector savings are now also negative, are at the root of the alarming contraction in net national savings, which have fallen from 22 per cent of net national income in 1960 to 19 per cent ten years later, 16 per cent in 1973 and 12 per cent in 1975.

In such circumstances, no action to contain the deficit can be rapid enough without a parliamentary review of the expenditure approved when the situation was very different from the critical condition in which the Italian economy now finds itself. An essential part of this review would be a re-examination of the deficits of public enterprises and public services, drawing a distinction between services of social value, the cost of which should be covered mainly by taxation, and other services, where the rule should be that charges are matched to costs. Society, through its representatives, must, without jeopardizing its original objectives, call a halt to this kind of destruction of savings which could be otherwise employed in improving social infrastructures and productive equipment.

A banking system on a tight leash

In budget and incomes policies, failure to observe principles that are compatible with monetary stability has two consequences. The first is that the banking system's ability to function as a mechanism for the allocation of resources is impaired; the second, that the authorities are obliged to attempt to restore that compatibility through administrative intervention. The banking system is then drawn into a process of ever tighter constraints which, at the same time, exposes it to criticism for its high rates and credit allocation criteria.

Long experience of inflation has destroyed money illusion and caused interest rats to follow the depreciation of the currency less slowly. The adjustment, however, is not complete; except for a brief period, over the last three years real rates in Italy have been close to zero or negative. In these circumstances, the banking system in fact functions as a giant mechanism for redistributing the financial wealth accumulated by households to borrowers, chiefly the public and corporate sectors.

The instability of the bond market exposes holders of securities to the risk of losses, just as losses may arise from lending to firms with inadequate capital base and low profitability. Lending to government agencies and public authorities, though it cannot technically be considered as bad debt, still holds the hidden, but no less real, danger of a frozen asset. The wide spread between bank lending and deposit rates also reflects the higher risks attending banking activity and the precautionary nature of rate fixing, which the banks frequently carry out jointly. Moreover, the Bank in its supervisory capacity has in recent years introduced new elements of competitiveness in an effort to improve the banks' economic viability, by broadening their sphere of activity through the regulations concerning territorial competence and lending beyond the short term.

As regards credit allocation, there is no doubt but that, in times of inflation and depreciation of the currency, borrowers begin to find it increasingly advantageous to take up credit for speculative purposes, such as accumulating stocks or other real assets, or advancing payments or deferring receipts in foreign exchange. However, it is extremely difficult to devise measures that will isolate and strike at the speculative elements of industrial and commercial transactions without damaging their truly productive component.

More serious, however, is the distortion caused by the public sector, which the central bank and the banking system are called upon to finance in a process that generates additional monetary base and multiplies it through the creation of deposits. The central bank and the banking system expand their own liabilities, and hence the liquidity of the economy, while acquiring assets over which they have no choice and renouncing the task of distributing savings among alternative uses.

Although originally created to provide temporary support to the financing of productive investment, the portfolio reserve requirement is now becoming an established fact of life. It is to be hoped that it will not be deflected from its original objective and used to succour other borrowers who, unlike the special credit institutions, are able to go directly to the market with short-term issues. By restricting the banks' freedom of choice and narrowing the play of competition, the bond investment requirement comes into conflict with the monetary authorities' desire to promote the development of an efficient money market; in fact, whereas this would strengthen competition on the markets for bank lending and fund-raising, it might also lead to a quicker circumvention of administrative controls.

In addition, the unhappy experience of administrative controls in the shape of the portfolio reserve requirement and credit ceilings has led to unsettled expectations. This became apparent last January, when the market, as a sort of conditioned reflex, reacted prematurely to the mere idea that administrative measures would be introduced.

Finally, an increase in the proportion of banks' assets that is held in long-term securities, especially at a time when movements in short-term rates are wider and more frequent, produces a cyclical change in the ratio that sound bank management requires between the average yield on lending and that on deposits. This raises serious problems because it engenders instability in terms of both profitability and asset evaluation. These problems would be aggravated if a portion of lending to customers were governed by conditions such as to render the structure of yields on assets more rigid than is compatible with fluctuations in the cost of short-term funds. In order to avoid this, the Bank as supervisory agent has sanctioned certain important funding operations only on condition that agreement is reached on a variable lending rate based on money market rates. The subsequent course of interest rates has shown that this was in fact an elementary precaution.

The practical work of banking supervision provides a constant inducement to re-assess the basic structures necessary for sound credit management.

One of the problems with which we are faced concerns the volume of bank intermediation. The separation of the centres of savings formation from those of investment or expenditure, a preference for assets that are not subject to changes in rates, the protection of depositors against the risk of bank failures, the competition to attract deposits, and the fiscal and other conditions that make it harder to raise risk capital are among the factors that have caused bank intermediation in Italy to grow to an extent unparalleled in other countries. An excess of liquid assets and a shortage of foreign exchange reserves provide the most likely setting for an exchange rate crisis. And since the banking system is bound to suffer from crisis measures, it should not look unfavourably on the development of alternative financial circuits but actively encourage them by using its contacts with savers to smooth the way for direct communication between them and borrowers. By helping to make many banks more aware of the need for rational cash management, the new system for Treasury bill issues stimulates competition between banks. The fact that this competitive spirit is beginning to be seen in sales of Treasury bills to the public is a positive development, as is the fact that deposit rate policy has reduced the monetary component in the funds raised by the banks.

On a more general level, since the balance-of-payments constraint will continue to determine the growth potential of domestic demand over the next few years, it may be necessary to raise the rate of savings formation in order to carry out programmes for structural reform (the energy plan, the restructuring of industry, agricultural modernization); this could be done both by increasing public saving and company self-financing and by achieving a higher rate of personal saving. Among the devices that can be used to promote the formation and efficient allocation of savings, special emphasis should be placed on perfecting and enriching the range of financial instruments, especially in a period of high inflationary expectations.

One topic of study in various fora last year was the problem of the ownership structure of banks. The variety of forms existing in the Italian banking system, as in those of other countries, safeguards the function of credit distribution. Moreover, the fact that under present institutional arrangements the banks are grouped under a single supervisory body despite this variety is a guarantee of consistency, and proposals for legislation in other countries are also moving in this direction. If the banks were to receive different directives and stimuli from the supervisory authorities, depending on their ownership structure, with the different categories of banks being placed under separate controlling bodies or supervision being inspired by different principles, the unity of purpose of credit policy would be lost.

This principle is particularly applicable to banks, of a variety of legal forms, which fall in the public sphere, the very area in which the functions of guidance and supervision are carried out. In general, the coexistence of public and private enterprises within the same sector of economic activity implies neither that the public interest in regulating that sector must be confined to the segment in public hands, nor that supervision must be identified with the rights of ownership. Particularly if it is desired to preserve the coexistence of different forms of bank, the fact that a single authority performs the function of supervision and guidance may ensure that a distinction is kept between politico-economic motives and techno-economic ones, without which there would no longer be equality of operating conditions.

It is a more difficult matter to establish the principles and objectives that should govern credit-granting by the publicly-owned institutions and banks. To the question whether, when extending credit, they should favour enterprises belonging to the same group there can only be a negative reply. If a public utility contract is awarded not to the firm tendering the best technical or most economical proposal but to the State-owned firm, then a matter of public interest would be wrongfully governed by group logic.

Similar problems arise in the case of privately-owned banks that are controlled by financial or industrial groups. The phenomenon of group banks, common in other countries, has spread in Italy in recent years. Precisely because it has grown up in a system in which firms' self-financing capacity has been reduced, this phenomenon raises the same dangers as those mentioned above with reference to banks belonging to State-controlled groups. When examining applications for authorization to grant loans above the permitted ceilings, the Bank pays particular attention to these dangers.

The frequent recurrence of periods of monetary restraint has exposed the special credit institutions, and especially those not linked to banks, to repeated fund-raising difficulties that cannot be overcome even by the most ingenious cash management policies, to the detriment of continuity in the flow of funds to investment. The bond investment requirement was intended to build a bridge between long-term investment and short-term funds through a twofold intermediation. Careful thought must be given to the methods used and the limits to be observed when establishing organic links between banks belonging to different categories that will weaken the administrative constraints on the working of the banking system.

Problems also occur in the case of banks with mixed ownership: among these, the credit cooperatives were the subject in 1975 of reform projects concerning the overall regulation of cooperatives. In this regard, and precisely in mind of what has been said above, the Bank has not failed to call the attention of the competent authorities to the fact that banking is a unitary function, which, while structural diversity between individual banks and between categories of banks should be preserved, requires that the monetary authorities maintain the existing system of supervision and guidance.

A reform of the special laws governing the two categories of credit cooperatives might achieve a balance between the need to promote cooperative banking and redefine the sphere of operation of the smaller banks and the need to preserve a satisfactory capital structure and encourage direct share participation in cooperative banks with a large membership.

When inflation does not create major changes in the operational framework of the banks, the channelling of savings towards what appear to be soundest short-term uses on the basis of firms' profit prospects and the guarantees offered by customers is something in which, to our mind, no regulation or guide-line can usefully replace the banker's own judgement. We cannot therefore associate ourselves with the repeated calls from various quarters — ignoring the present resurgence of inflation — that, in addition to existing constraints, selective norms should be introduced in the short-term credit sector. With reference to this problem, it was observed in the Report for 1963 that the most appropriate point for the authorities to intervene to guide economic activity was the moment of investment decision-making. For this the State has numerous instruments at its disposal, both financial and non-financial; if the intervention is effective, it will in the natural course of events be backed up by the distribution of working credit on normal banking criteria. Further selective norms in the field of bank credit might not so much strengthen the system of intervention as make it contradictory. In the Report for 1963 it is concluded that « in the economic strategy of a modern State, qualitative control of bank credit must be classified as a fall-back measure and used with moderation in specific economic situations, rather than become a permanent feature of credit policy ». Since then no ideas seem to have been put forward that invalidate the logic of these views, and in fact it is gratifying to note that they have been taken up independently by others. The emergency recourse to selective norms in the short-term credit sector in 1973-74 has shown that the difficulties involved in their application are even greater than was then anticipated.

The instruments available to the authorities for channelling investment include selective control exercised through authorization to issue fixed-interest securities. The recent extension of this kind of control to mortgage bonds is an important step towards establishing a comprehensive and coherent range of selective policy instruments.

The Bank and the community

The tasks with which our Bank is entrusted are intended as means to achieve goals of community interest.

This year marks the fiftieth anniversary of the formal confirmation of the Banca d'Italia's role of public interest within the framework of the law. The designation of the Bank as the sole institution responsible for the regulation of currency circulation under the supervision of Parliament and the Government dates back, in fact, to 1926 when, in addition to this role of central bank, the Banca d'Italia was charged with assisting the competent ministries in their statutory control of the banks.

The Banca d'Italia, whose legal status was that of a joint-stock company, was thus granted powers in the pursuit of public aims with regard to both the liquidity of the system and observance by the banks of operative laws and regulations.

This organizational model of an institution with the structure of a bank, endowed with legal autonomy under private law but charged with public responsibilities in support of the competent organs of the public administration, was taken over only in part ten years later in the legislation of 1936, which entrusted the function of central bank to one body and banking supervision to another. The organizational structure of the Inspectorate thus created was, however, flexible and unbureaucratic. Furthermore, by placing the Governor of the Banca d'Italia at the head of the Inspectorate the new legislation maintained a link between the central bank and the supervisory body and sought to avoid the predominance of a merely formal and repressive administrative control of banking activity.

A further ten years later, the 1936 legislation was the subject of detailed debate in the Economic Commission of the Ministry for Constitutional Affairs. While the banking law and its effects were held to have been positive the need was felt for a more « substantial control » to be exercised by an organ endowed with sufficient decision-making autonomy to enable it to perform its supervisory tasks on the basis of essentially technical criteria, thus ensuring the highest degree of objectivity. Because of « the need for rapid decisions in the field of credit » it was felt that the Banca d'Italia should be directly charged with the supervision of the banking system. The Economic Commission considered, in fact, that the « activities, status and operation » of the Banca d'Italia involved daily contacts with the banks and credit institutions and an appreciation of their needs which made it closer to them than any other body. The Commission held, therefore, that the Banca d'Italia would be able to exercise all the necessary supervision provided it were granted sufficient autonomy.

To this end it was decided that « all the powers assigned to the Inspectorate for Credit under the law of 1936 should be devolved to the central bank ». It was also decided that the Bank should retain the structure established by the 1936 reform, which allowed it to operate in a way that guaranteed its ability to interpret the needs of the market. In fact, it was recognized that the Bank's organizational structure should be preserved « for its mediacy between the public and the private spheres, which renders it receptive to Treasury directives while preserving a degree of autonomy which ensures continuity in the performance of its function as regulator of the money market ».

The Commission thus reaffirmed the need to retain the organizational model adopted in 1936: that of an institution linked to the will of the organs of the State — and therefore public — which, by virtue of autonomy under private law, is able to guarantee its independence and therefore safeguard its function.

The supervision of banking by an institution with such an organization was preferred since the Commission held that « on the assumption that the present economic order is maintained, the State should not propose to interfere actively and directly in the working of the banks through its own organs » and, therefore, that the intervention of the State to influence credit and investment is justifiable « as a general action in defence of the objective basis of the currency ».

Accordingly, the Inspectorate was abolished in 1947 and its powers transferred to a public body — the Banca d'Italia — which was institutionally capable of transmitting to the banking system the specific public aims of the Government with regard to the protection of savings and credit operations, as well as of regulating the money market and credit flows on the basis of productivity. By conserving its autonomy, the Bank would safeguard the supervisory function from outside pressure, whether political or from the banking sector itself. The 1947 law definitively confirmed the principles underlying the law of 1936; principles whose origins are to be found in the legislation of 1926 and which underwent continuous development from Stringher to Menichella.

The autonomy under private law conferred on the Banca d'Italia through its powers as a central bank extend the scope and content of the administrative powers inherent in its role of supervisor of the banking system and, conversely, the former powers reinforce the latter and place them more clearly in the context of public interest. The Bank is therefore fully conscious of the need for constant reflection and analysis in drawing up general frames of reference to make its action in the pursuit of each function explicit.

Within the present institutional framework the supervision of the banking system must be coherent with the general direction of monetary policy since the two were deliberately linked by making a single legal entity, the Banca d'Italia, responsible for their execution. Recourse to administrative instruments of control such as portfolio reserve requirements and credit ceilings have recently demonstrated the extent to which monetary policy and the structure of the banks' balance sheets are bound together.

The exercise of its supervisory function requires that the Bank be in close contact with the banks and able to identify itself with their activities and prospects in order to intervene effectively while respecting all the due administrative procedures.

The formulation of policies and principles under the Bank's powers of authorization is a continuous process which covers matters such as the opening of new branches, real-estate investments and the acquisition by banks of capital interests in other enterprises, which is only authorized when it falls into one of the categories specified in the directives of the Interministerial Committee for Credit and Saving.

Also in its role of lender of last resort it is desirable that the Bank exercise its autonomy within the framework of a set of parameters which will ensure the rationality and transparency of its action. Measures to regulate liquidity spread out through the concentric circles of a system of interrelationships in which interbank accounts form the technical link: the smaller banks usually depositing their surplus liquid balances with one of the central institutions to which the banks of each category are attached or with the major banks; these in turn have a similar relationship with the central bank. The Bank accordingly conducts its lending operations chiefly with the institutions which administer the liquidity of the system.

The structure of the system and its recent evolution should also be taken into account in determining the cost of loans of last resort. For many years the flow of funds between banks was based on bilateral relationships, which frequently remained sheltered from the stimulus of competition; money market rates were rarely a real indicator and the cost of refinancing did not change. Partly under the stimulus of the entry of new financial intermediaries into the market, the pursuit of more efficient cash management subsequently led to a degree of competition which has tended to make the interbank rate an effective indicator of the liquidity situation. In these changed circumstances the rates determined by the Banca d'Italia, including the official rates for rediscounts and advances, should also become more flexible in order to preserve their link with money market rates.

* * *

Over and above these distributive aspects there is the greater problem of the Bank's role in the process of money creation.

In recent years the public sector deficit and the rise in wages have together come to dominate this process, relegating the central bank to a position in which it had practically no influence over the process of money creation and little say in the decisions which determine the size of the deficit and the trend of wages.

In the Report for 1946, Luigi Einaudi spoke of the hand of fate behind the conditions which compelled the central bank either « to expand the volume of money in circulation or bring about economic chaos. Both are evils, but the second is by far the greater ». And in the Report for 1973 Guido Carli asked whether the Bank could have refused to finance the deficit and himself replied that a refusal would have led to paralysis of the institutions and administrative chaos.

However, if in times of acute financial imbalance and wage inflation control of the money supply has to be abandoned in order to avoid, or at least postpone, worse evils, then the central bank will have to carry the campaign for monetary stability further afield. It will thus have to provide facts and figures, to reason and above all to warn in order to prevent a recurrence of the state of necessity described by Einaudi and Carli. In appealing to public opinion and to political and social groups the Bank may well irritate its listeners and lay itself open to evasive and impatient replies. But the attempt to persuade these groups not to abuse their ultimate dominion over the currency is a fundamental task which the central bank cannot abandon without betraying its role.

In a number of countries the law expressly charges the central bank with the protection of monetary stability. In Germany the law entrusts the Bundesbank with the task of defending the currency, *die Währung zu sichern*; in the Netherlands the central bank is called upon to stabilize the currency; in Sweden the central bank is directly responsible to Parliament.

An interesting move in this direction was made in this country in February 1976, when a government economic programme was drawn up which stated that « once the volume of liquidity creation has been determined, the central bank will be able to carry out its programmes without having to concern itself constantly about the provision of funds to meet the Treasury's requirements ».

Nonetheless the outstanding records of Germany and the Netherlands with regard to stability and growth are due less to legislative formulae than to a climate of opinion which, in the light of analysis and experience, no longer believes that a budget deficit will produce lasting economic expansion or that nominal wage increases will improve the conditions of the working class in terms of real income and employment. A similar disenchantment is gaining ground in both the United Kingdom and the United States.

Italy, on the other hand, and especially the Italy of today, is suffering from a de facto alliance which both encourages and sustains inflation: an alliance between the country's political and social groups, between those who determine the content of the budget and those who determine the terms of labour agreements.

Despite very high interest rates, the budget deficit generates a volume of liquidity which tends to be greater than the total amount the economy would require in a less highly inflationary context. The direct effect of the deficit is to expand the flow of public sector money wages and transfer payments, while indirectly it introduces into the monetary circuit sufficient liquidity to finance an inflationary growth of wages and, in consequence, of the other forms of income.

With a balanced budget, compatibility between the expansion of money incomes and the liquidity of the system should be achieved either through a balance-of-payments surplus or through the banks having recourse to central bank lending. The Bank would, in this case, be dealing with a large number of banks seeking credit and not, as today, with one single borrower entrusted with functions touching the very foundations of civil life and invested with democratic legitimacy. Central bank resistance to the pressure of the banks would, in turn, be passed on by them to the enterprise sector and thus influence the formation of wages and prices.

When individual enterprises are protected from the specific effects of wage increases because labour agreements are nation-wide, when industry as a whole feels somehow protected from foreign competition by flexible exchange rates, when inflation reduces the burden of large corporate indebtedness, and when a huge and compliant public sector exists, then the budget deficit creates the basic permissive liquidity conditions for the inflation of incomes.

If this analysis is correct, the first step towards restoring greater room for manoeuvre to the central bank must be in the direction of curbing the budget deficit; and it must be a sufficiently long stride to bring liquidity creation on behalf of the Government well below the rate of overall liquidity growth which is compatible with the control of inflation. The central bank would then have scope to restore monetary stability to its position as an operational objective.

It is worth remembering, in this year which marks the bicentenary of two historic messages of liberty, a principle which forms part of our democratic heritage. It is summed up in the maxim: « No taxation without representation ». This principle is violated by inflation, which introduces an enormously powerful and wholly arbitrary redistributive mechanism into our society. In a society which believes in democracy this principle bestows on the Banca d'Italia both the right and the duty to champion the cause of the defence of the currency, especially now that economic conditions are the reverse of those of last year, with a recovery in production combined with monetary instability.

Gentlemen,

Since its foundation the Banca d'Italia has known varying fortunes, in close parallel with those of the country. With respect to both its balance-sheet structure and its control of the money supply last year, like those immediately preceding it, was not a happy one.

The consolidated balance sheet of the Banca d'Italia-Italian Foreign Exchange Office shows a structural change on the assets side at the expense of foreign currency while on the liabilities side the level of foreign borrowing is very high. The prized asset — foreign currency — is, therefore, very scarce, or appears with the wrong sign.

In the control of the money supply other forces have overwhelmed the influence that can be exerted by the Bank through its normal lending operations with the banks, nor have these forces been counterbalanced by balance-of-payments surpluses, now a memory of the distant past.

Faced with these disappointing results, some comfort can be drawn from the determination and drive with which the staff of the Bank have carried out their tasks in these difficult times.

A new, seasoned generation, mindful of attitudes and experience both within Italy and in the international community, dedicated to the Bank and already widely involved in the decision-making process, is ready to play a loyal part in helping Italy to surmount the many obstacles on the long and painful path to financial recovery.

IV. – THE BANK'S CAPITAL AND RESERVES

Capital.— There were no changes during the year in the amount of the Bank's capital or in the distribution of its shares, which, on December 31st, was as follows:

Shareholders with voting rights:

Savings banks and loan offices	76	with	177,898	shares	and	471	votes
Public-law credit institutions	8	»	54,500	»	»	141	»
Banks of national interest .	3	»	21,000	»	»	54	»
Social insurance funds . . .	1	»	15,000	»	»	34	»
Insurance companies . . .	8	»	31,500	»	»	95	»
	96	with	299,898	shares	and	795	votes

Shareholders without voting rights:

Savings banks and loan offices	13	with	102	shares
Total:	109	with	300,000	shares

Reserves.— During 1975 the reserve funds underwent the following changes:

	Ordinary reserve fund	Extraordinary reserve fund
Amount on December 31, 1974	Lit. 37,139,653,474	Lit. 36,621,932,019
increase:		
– allocation from profits for the year 1974 . .	» 7,093,609,996	» 7,093,609,996
– income received in 1975 from investment and reserves	» 4,746,686,380	» 3,633,946,184
	Lit. 48,979,949,850	Lit. 47,349,488,199

	Ordinary reserve fund		Extraordinary reserve fund	
decrease:				
– distribution to shareholders of a part of the income accruing in the course of 1974 (Article 56 of the Statute) . .	Lit.	82,869,896	Lit.	79,130,104
Amount on December 31, 1975	Lit.	48,897,079,954	Lit.	47,270,358,095

V. – BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

BALANCE SHEET AS

ASSETS

Gold			L.	1,804,287,663,615
Cash			»	255,107,399,615
Domestic bills of exchange:				
discounting for the banks	L.	12,579,257,724		
discount on Treasury bills and coupons	»	—		12,579,257,724
Advances:				
current account	L.	711,139,357,865		
under Treasury decree of September 27, 1974	»	53,422,500,000		
fixed-term	»	4,451,360,000		769,013,217,865
Deferred payment at the clearing system			L.	—
Foreign currency external assets			»	3,470,818,783
Ufficio Italiano Cambi:				
ordinary current accounts	L.	713,191,503,042		
special accounts	»	8,824,731,940,658		9,537,923,443,700
Extraordinary advances to the Treasury			L.	339,000,000,000
Discounting for financing stockpiling			»	1,216,139,511,325
Treasury current account			»	3,522,323,220,870
Miscellaneous services on behalf of the Government - debit balance			»	63,630,180,367
Investment in government or government-guaranteed securities			»	18,225,959,127,929
Treasury credit certificates under Law n. 386 of August 17, 1974			»	39,860,703,417
Investment of reserve funds and other funds set aside:				
government or government-guaranteed securities	L.	454,675,174,715		
other assets	»	227,214,348,148		681,889,522,863
Office buildings			L.	1
Other assets			»	515,136,508,230
			L.	36,986,320,576,304
Commitments:				
unused part of credits on advance accounts			L.	1,316,132,638,852
Deposits:				
guarantee	L.	3,121,286,195,918		
for compulsory bank reserves	»	650,251,700,000		
others	»	14,450,776,014,958		18,222,313,910,876
Securities and other valuables on deposit			L.	516,295,529
Items written off in past years			»	2,162,342,001
TOTAL			L.	56,527,445,763,562

Audited and found correct. – Rome, April 29, 1976

THE AUDITORS

DOMENICO AMODEO
MICHELE BENEDETTI
ALBERTO CAMPOLONGO
GIUSEPPE GUARINO
ARTURO LISDERO

THE ACCOUNTANT GENERAL

TINUCCIO ROVIDA

EIGHTY-SECOND YEAR

OF DECEMBER 31, 1975

LIABILITIES

Notes in circulation	L.		12,921,254,566,000
Bank drafts and other sight liabilities	»		134,566,071,027
Free deposits on current account	»		2,040,301,993,604
Tied time deposits on current account	»		1,000,020,000
Special accounts under Law n. 386 of August 17, 1974	»		50,691,415,599
Compulsory deposits on current account:			
compulsory bank reserves	L.	11,679,739,991,243	
others	»	990,532,701	11,680,730,523,944
Foreign currency deposits:			
on behalf of UIC	L.	5,031,874,350,000	
others	»	3,470,818,783	5,035,345,168,783
Foreign lira accounts:			
on behalf of UIC	L.	2,767,338,791,442	
others	»	21,925,727,180	2,789,264,518,622
Miscellaneous services on behalf of the Government - credit balance	L.		115,787,067,451
Treasury services for various agencies	»		144,758,818,972
Other funds set aside	»		1,178,876,866,478
Other liabilities	»		757,887,753,283
Capital	L.	300,000,000	
Ordinary reserves	»	48,897,079,954	
Extraordinary reserves	»	47,270,358,095	96,467,438,049
Net profit for 1974	L.		39,388,354,492
	L.		36,986,320,576,304
Commitments	L.		1,316,132,638,852
Depositors	»		18,222,313,910,876
Securities and other valuables	»		516,295,529
Items written off in past years	»		2,162,342,001
TOTAL	L.		56,527,445,763,562

THE GOVERNOR

PAOLO BAFFI

GENERAL PROFIT

FOR THE

EXPENDITURE			
Administration	L.	193,612,487,398	
Emoluments of Directors, etc.	»	449,110,766	
Transport of notes, coin and other valuables	»	1,161,962,136	
Note-printing and note-destruction	»	12,742,255,390	
Computerized data processing	»	15,601,114,753	
Expenditure on premises	»	2,390,486,510	225,957,416,953
Circulation tax on notes and demand drafts	L.	21,341,527,500	
Income and company taxes	»	500,000,000	
Sundry taxes	»	50,960,555	21,892,488,055
Interest paid out — on the compulsory bank reserve	L.	461,927,977,872	
Interest paid out — other	»	3,675,338,677	465,603,316,549
Charity and social and cultural aid contributions	»		551,388,125
Depreciation and allowances	»		346,680,552,196
	L.		1,060,685,161,878
Net profit for distribution	»		39,388,354,492
TOTAL . . .	L.		1,100,073,516,370

PROFIT

To ordinary reserves . . . .
To extraordinary reserves . . . .
To shareholders . . . .
To the Treasury . . . .

TOTAL

Audited and found correct. – Rome, April 29, 1976

THE AUDITORS

DOMENICO AMODEO
MICHELE BENEDETTI
ALBERTO CAMPOLONGO
GIUSEPPE GUARINO
ARTURO LISDERO

THE ACCOUNTANT GENERAL

TINUCCIO ROVIDA

AND LOSS STATEMENT

YEAR 1975

RECEIPTS

Discounts	L.	16,363,052,294	
Interest on advances	»	93,093,568,082	
Interest on accounts with the Treasury	»	39,008,118,061	
Interest on other assets	»	1,405,707,927	
Commissions and other fees	»	8,773,355,271	
Other revenues	»	68,366,647,480	
			227,010,449,115
Interest on Treasury bills at the compulsory bank reserve rate	L.	386,970,445,474	
Interest and premiums on other securities	»	485,505,268,881	
Revenue from real estate	»	587,352,900	
			873,063,067,255
		TOTAL . . . L.	1,100,073,516,370

DISTRIBUTION

. . . .	L.	7,877,670,898
. . . .	»	7,877,670,898
. . . .	»	30,000,000
. . . .	»	23,603,012,696
. . . .	L.	39,388,354,492

THE GOVERNOR

PAOLO BAFFI

ADMINISTRATION OF THE BANK OF ITALY

AS OF DECEMBER 31, 1975

BOARD OF DIRECTORS

Paolo BAFFI – Governor and chairman of the Board

Rinaldo OSSOLA – Director General

Antonino OCCHIUTO – Deputy Director General

Mario ERCOLANI – Deputy Director General and Secretary to the Board

DIRECTORS

Alessandro BARNABO'
Guido BORSELLINO CASTELLANA
Gaetano CARBONE *
Umberto CARUSO *
Carlo D'AMELIO
Giovanni Battista DEL BALZO
Danilo de MICHELI
Dario DORIA *
Luigi FANTOLA
Lucio MORODER
Remo MORONE
Giambattista PARODI *
Giovanni POGGI

* Member of the Executive Committee.

BOARD OF AUDITORS

Domenico AMODEO
Michele BENEDETTI
Alberto CAMPOLONGO
Giuseppe GUARINO
Arturo LISDERO

ALTERNATE AUDITORS

Antonio CONFALONIERI
Luigi GUATRI

CENTRAL ADMINISTRATION

MANAGERS

Ugo BRUNO * – Central Manager for Administration of Premises and Property
Carlo CIAMPI – General Secretary
Tinuccio ROVIDA – Accountant General
Mario DI LORENZO – Central Manager for Supervision of Banks
Giancarlo ULIVIERI – General Inspector
Giuliano MONTERASTELLI – Central Operations Manager
Giorgio BIANCHI ** – Central Manager (Turin Branch)
Antonino ARISTA – Central Manager for Works and Supplies
Vincenzo TEDESCHINI – Central Manager for the Note-Pritting Departement

* Retired 1.1.1976
** Deceased 19.2.1976

LIST OF ABBREVIATIONS

ADF	African Development Fund
AIMA	Azienda di Stato per gli interventi sul mercato agricolo – Government Agency for Intervention on the Agricultural Market –
BI	Banca d'Italia
CICR	Comitato interministeriale per il credito e il risparmio – Interministerial Committee for Credit and Savings –
CREDIOP	Consorzio di credito per le opere pubbliche – Credit Consortium for Public Works –
EEC	European Economic Community
ENEL	Ente nazionale energia elettrica – National Electricity Agency –
ENI	Ente nazionale idrocarburi – National Hydrocarbon Agency –
ESA	European System of Integrated Accounts
GNP	Gross national product
ICCREA	Istituto di credito per le casse rurali ed artigiane – Credit Institute for Rural and Artisans Banks –
IMF	International Monetary Fund
INA	Istituto nazionale delle assicurazioni – National Insurance Institute –
IRI	Istituto per la ricostruzione industriale – Institute for Industrial Reconstruction –
ISCO	Istituto nazionale per lo studio della congiuntura – National Institute for Studies of the Economic Situation –
ISTAT	Istituto centrale di statistica – Central Institute for Statistics –
OECD	Organization for Economic Co-operation and Development
OPEC	Oil producing exporting countries
SDR	Special drawing rights
TOE	Tons of oil equivalents
UIC	Ufficio italiano dei cambi – Italian Foreign Exchange Office –
VAT	Value added tax