BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1976

PRESENTED BY THE GOVERNOR TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON MAY 31, 1977

ROME

PRINTING OFFICE OF THE BANCA D'ITALIA

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The recovery that had begun in 1975 continued into 1976, thus enabling the world economy to overcome the most serious recession since the war, and the average rate of inflation declined considerably. In addition profits rose, and this was both an indication and a prerequisite of the process of reallocation of resources currently underway, and necessary if the system is to recover once and for all from the crisis suffered in the first half of the seventies.

However, various factors indicate that these positive results are less favourable than they appear and that future prospects are uncertain. These are the very slowness of the recovery and the difficulties of transforming it into a steady expansion based on the demand for investment goods; the persistence of a high rate of inflation, and one likely to accelerate further; the only partial reabsorption of unemployment; and the failure to narrow the gap between the performances of the various economies, leading to balance-of-payments disequilibria and the accumulation of huge and potentially destabilizing foreign debt.

The growth of the real gross national product of the OECD countries (Table 1) averaged around 5 per cent (— 1.2 per cent in 1975). A comparison with previous post-war cycles, however, shows that the pace of recovery in the main OECD countries was no faster, and in many cases slower, than on previous occasions, even though the 1974-75 recession was by far the harshest.

Demand policies, which had played an important role in overcoming the most acute phase of the recession, were conducted along cautious lines, and aimed at reabsorbing the large budget deficits and funding the public debt. This strategy of gradual recovery was designed to avoid both a new bout of inflationary tensions and heavier deficits in foreign accounts.

The scarcely satisfactory performance of fixed investment is the result of a combination of factors. The wide margins of unutilized capacity caused by the recession were only partly reabsorbed, and at

Table 1

ECONOMIC INDICATORS FOR THE MAIN INDUSTRIAL COUNTRIES

(percentage changes)

Countries	Years	Demand (1)				Supply (1)		Implicit GNP deflator	Manufacturing industry			Unemployment as a % of the labour force
		Domestic			Foreign							
		private consumption	public consumption	gross fixed investment	exports of goods and services	Imports of goods and services	Gross national product		Production	Earnings per unit of output	Wholesale prices	
Italy	1974	2.5	2.9	3.5	9.8	2.1	3.9	24.3	6.4	18.4	34.4	2.9
	1975	–1.4	2.8	–13.0	3.5	–9.9	–3.5	13.3	–9.7	35.2	11.2	3.3
	1976	3.2	1.9	2.3	12.6	13.1	5.6	20.9	12.4	10.1	21.6	3.7
Belgium	1974	2.5	4.5	8.0	13.3	13.1	4.0	12.7	4.3	15.5	17.3	2.8
	1975	0.8	8.1	–3.3	–8.8	–10.0	–1.9	12.2	–10.7	15.4	6.9	4.8
	1976	3.5	4.4	–1.0	12.9	11.7	2.9	9.6	10.0	3.4	3.8	6.0
France	1974	2.7	2.6	1.3	10.3	4.9	2.9	11.5	2.5	14.8	29.0	2.7
	1975	3.3	2.6	–4.3	–3.7	–7.0	–1.2	14.0	–8.9	21.1	–5.7	4.1
	1976	4.3	4.5	4.0	10.5	17.1	5.0	9.6	10.1	3.8	8.2	4.0
West Germany	1974	0.2	4.6	–8.1	13.3	4.8	0.4	6.9	–1.8	7.4	13.3	2.6
	1975	2.6	3.8	–4.2	–8.9	0.7	–3.4	8.1	–7.2	7.7	3.3	4.7
	1976	3.4	2.9	4.4	10.9	11.4	5.5	3.1	7.7	–1.5	3.5	4.7
Netherlands	1974	2.5	0.5	–4.0	2.0	–1.5	3.0	8.0	1.8	15.7	10.5	3.5
	1975	3.5	2.5	–4.5	–3.5	–5.0	–2.0	11.0	–7.0	18.5	7.0	5.2
	1976	4.0	3.9	–4.0	10.5	9.9	4.0	9.0	5.9	0.5	7.0	5.4
United Kingdom	1974	–0.6	3.2	–2.0	6.7	0.3	0.7	13.2	2.7	21.1	24.7	2.6
	1975	–0.7	4.7	–1.2	–3.9	–6.3	–1.5	27.9	–5.6	32.2	24.0	4.0
	1976	0.6	2.9	–4.4	6.3	5.8	0.9	15.3	1.6	12.0	16.5	5.4
United States	1974	–1.1	1.5	–9.0	11.2	0.9	–1.7	10.0	–	9.6	22.2	5.6
	1975	1.5	1.8	–13.5	–6.8	–15.6	–1.8	9.3	–10.1	11.4	11.5	8.5
	1976	5.6	1.2	8.8	5.6	17.2	6.1	5.1	11.5	0.8	6.3	7.7
Canada	1974	4.2	7.9	5.1	–4.9	10.3	2.8	13.8	4.1	11.0	19.0	5.4
	1975	4.9	4.1	2.4	–7.1	–4.6	0.6	10.7	–4.7	13.8	11.1	6.9
	1976	6.3	1.6	1.6	12.1	7.7	4.6	9.5	4.7	10.1	5.0	7.2
Japan	1974	1.4	4.4	–9.8	21.2	12.4	–1.3	20.7	–3.1	28.7	26.6	1.4
	1975	6.1	7.0	–3.3	4.4	–8.2	2.4	7.1	–11.0	22.3	2.3	1.9
	1976	4.4	4.4	4.4	17.1	7.9	6.3	6.8	13.7	–	5.5	2.0
Sweden	1974	4.5	3.0	1.3	4.3	13.2	4.0	8.8	5.5	17.3	23.3	2.0
	1975	2.9	5.2	–2.8	–11.2	–	0.9	14.6	–2.6	25.2	6.1	1.6
	1976	3.2	3.9	–1.6	7.3	1.7	1.5	10.0	–1.5	14.7	8.3	1.6
Switzerland	1974	–0.5	1.6	–4.2	1.0	–1.0	1.5	7.1	1.8	9.4	16.2	. .
	1975	–2.9	1.4	–13.7	–6.6	–15.4	–7.4	6.6	–15.2	12.0	–1.6	0.4
	1976	–1.7	6.2	–6.3	9.3	12.3	–0.8	1.7	1.5	–1.6	–0.7	0.6

Source: National bulletins. Figures for 1976 are provisional and partly estimated.

(1) Changes are calculated on values at constant prices.

the end of 1976, utilized productive capacity in the manufacturing industry was still well below what are considered normal levels, even in the United States and West Germany (Table 2). On the other hand, although the recovery of gross profits, with real interest rates relatively stable, may have improved the expected net yield on an investment, investment risks were heightened by the knowledge that the monetary and fiscal authorities (in the very countries with the lowest inflation rates and high unemployment) were fully determined

Table 2

UTILIZATION OF RESOURCES IN THE MAIN INDUSTRIAL COUNTRIES

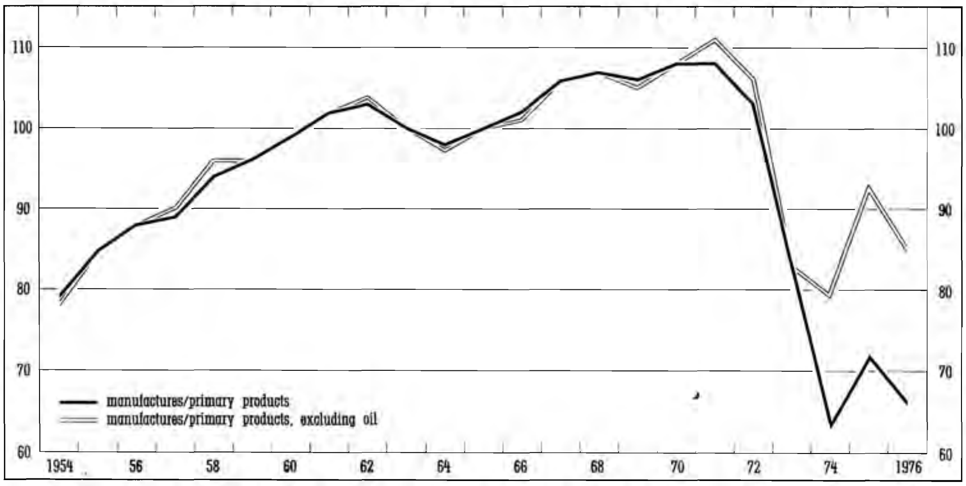
Countries	Percentage rate of productive capacity utilization in industry			Percentage rate of unemployment		Unemployed persons under 25 years of age (as a % of total unemployment)
	1973 (annual average)	1975 (annual average)	1976 (December)	1975 (in month of maximum unemployment)	1976 (December)	1976 (December)
United States	88	74	81	8.7	7.8	50
Japan	100	81	87	2.2	2.0	....
Canada	....	85	85	7.3	7.5	50
West Germany	97	83	86	5.2	4.4	29
United Kingdom	98	88	88	5.0	5.6	37
France	99	86	88	4.4	4.4	46
Italy	91	80	91	3.7	3.6	64

Sources: National bulletins; Morgan Guaranty Trust Company, *World Financial Markets*; EEC, *Demographic and Social Statistics*.

to prevent a trend in demand that might produce higher growth rates for domestic prices. Although the very need to make investments aimed at reallocating resources more consistently with the new prices of products and factors on the one side encouraged accumulation, on the other it also implied heavy risks, in view of the likelihood of further changes in relative prices. Finally, the cautious behaviour of enterprises in carrying out fixed investments was also due to the more strictly financial risks inherent in balance-sheet structures in which both the degree of financial leverage and the ratio of short-term liabilities to short-term assets remained higher than the long run trends, although their tendency to decrease during 1975 continued into 1976.

The slowdown of inflation in 1976 is closely linked to the phase of cyclical recovery experienced by the world economy. The productivity increases were in fact considerable, especially in the first part of the year, while the wage trend was dampened by the excess supply of labour generated by the recession, by the awareness of unions in several countries that the profits-investment mechanism must be reactivated in order to create new jobs, and lastly, by incomes policies that have proved particularly effective in both the United Kingdom and Canada.

Chart 1



International terms of trade between manufactures and primary products

Source: UNO, *Monthly Bulletin of Statistics*

The general tendency for prices to rise, however, still appears deeply rooted in the system and in the public's expectations. The rate of inflation for 1976 was still more than double the average for the period 1962-1972. Long-term interest rates remained practically stationary at high levels, which continue to take into account expectations of strong inflation. It is possible that present domestic relative prices and the international terms of trade between primary products and manufactured goods (Chart 1) have not yet reached levels of long-term equilibrium. Further changes in both would exert new pressures on price levels, on markets that appear less and less of the competitive type.

In 1976 the number of employed workers increased in all the main industrial countries, except West Germany and the United Kingdom, after the virtually universal drop registered in 1975. Moreover, in several countries the participation rates of the labour force have declined or remained stationary. Nevertheless, at end-1976 the number of unemployed in the entire OECD area was estimated at 15.1 million (7.1 in the United States and 5.3 in Europe), i. e. practically the same as at the cyclical peak of October 1975. The young unemployed (under 25 years of age) totalled about 7 million (45 per cent of the total unemployed; Table 2). The sluggishness of the recovery, the vigorous cyclical increase in productivity and the lack of fixed investment added their negative effects on employment to those produced by factors of a more structural nature, such as the increase in so-called « voluntary » unemployment and the tendency for new investments to be labour saving.

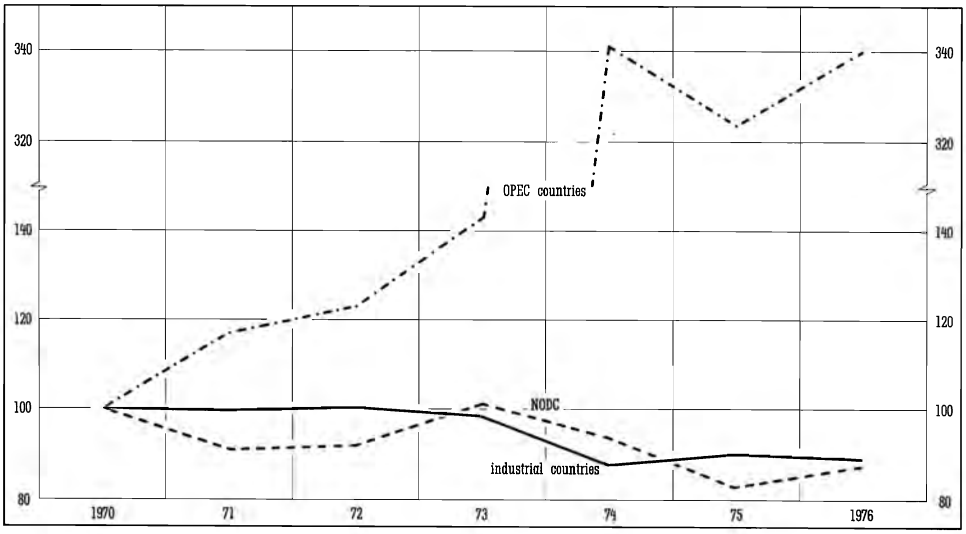
International trade, balances of payments on current account and medium and long-term capital movements

During 1976 world trade increased conspicuously and international prices remained basically stable. Following the drop (5 per cent) in the volume of trade in 1975, the growth rate (11 per cent) is now above the long run average, while the index of international dollar prices, which had recorded particularly high rates of increase in the first half of the seventies, has risen by about 3 per cent.

The expansion of international trade was greatly assisted by the fact that inventory accumulation was concentrated over a short period and that the cycles of the industrial economies were synchronized. In the second half of the year, however, the growth of trade slowed down and, in particular, the rate of increase of exports of the developed countries dropped by nearly half.

With the economic recovery of the industrial countries the current account disequilibria of the OPEC and OECD countries have sharpened: the OPEC surplus totalled 46 billion dollars (compared with 31 in 1975 and 59.5 in 1974) and the OECD deficit 24 billion (6.5 in 1975 and 33 in 1974). The current account deficits of the other main areas instead declined with respect to 1975, in the wake of the recovery in the OECD area: the deficit of the non-oil developing countries in fact decreased from 32.5 billion dollars in 1975 to 24 in 1976, owing to improved terms of trade (Chart 2), while that of the group incorporating all the remaining countries (mainly centrally-planned economies) dropped from 14 to 12.5 billion (Table 3).

Chart 2



Terms of trade by geographical area
(indexes 1970 = 100)

Source: IMF, *World Economic Outlook. Statistical Summary,* March 1977

However, the performances of these large groups of countries conceal major differences within each area; in the case of the OPEC, the largest surpluses for 1976 were concentrated in the so-called low-absorption countries: Saudi Arabia, the United Arab Emirates, Kuwait, Libya, Oman, Qatar. Similarly, within the OECD a distinction should be made, on the one hand, between the group comprising West Germany, the Netherlands, Switzerland and Japan, which in 1975 recorded a current surplus of 7.2 billion dollars and in 1976, despite the economic recovery, nearly doubled that figure; and, on the other, all the

Table 3

FINANCING OF THE OECD CURRENT ACCOUNT DEFICIT

(billions of dollars)

Items and countries	1973	1974	1975	1976 (1)
Balance on current account				
Japan, West Germany, Netherlands and Switzerland	6.00	7.25	7.25	13.00
United States	0.50	–0.75	11.75	–1.00
Other OECD countries	–4.00	–39.50	–25.50	–36.00
Total for OECD	2.50	–33.00	–6.50	–24.00
Long-term capital movements				
Japan, West Germany, Netherlands and Switzerland	–9.00	–8.00	–12.50	–7.00
United States	–1.50	–9.00	–7.75	–8.00
Other OECD countries	2.25	11.00	10.50	11.00
Total for OECD	–8.25	–6.00	–9.75	–4.00
Short-term capital movements (including banks) and errors and omissions				
Japan, West Germany, Netherlands and Switzerland	8.00	2.75	5.50	1.00
United States	–4.50	1.00	–6.75	14.00
Other OECD countries	–5.00	18.00	14.00	14.00
Total for OECD	–1.50	21.75	12.75	19.50
Movements of net reserves (2)				
Japan, West Germany, Netherlands and Switzerland	–5.00	–2.00	–0.25	–7.00
United States	5.50	8.75	2.75	4.50
Other OECD countries	6.75	10.50	1.00	11.00
Total for OECD	7.25	17.25	3.50	8.50
Pro memoria:				
Balance on current account				
OECD	2.50	–33.00	–6.50	–24.00
OPEC	3.00	59.50	31.00	46.00
NODC	–5.50	–21.50	–32.50	–24.00
Centrally-planned economies and other countries	–4.00	–6.50	–14.00	–12.50
Residual item	4.00	1.50	22.00	14.50

Source: OECD.

(1) Estimates. — (2) Compensatory loans to Italy, the United Kingdom, Sweden and France are included under reserve movements; + indicates a loss of reserves or deficit financing; — indicates an accumulation of reserves. The change in the banks' net foreign position is included under short-term capital movements.

remaining OECD countries, excluding the United States, which have moved from a 25.5 billion deficit in 1975 to one of 36 billion in 1976. The United States, in turn, have dropped from a surplus of 11.8 billion in 1975 to a small deficit.

The figures quoted above indicate clearly the existence of two groups of surplus countries — the low-absorption OPEC countries and four « strong » OECD countries — which contrast with the industrial countries with a weak external position, the non-oil developing countries, and the centrally-planned economies.

According to the latest forecasts the current account surplus of the OPEC area should last at least until the mid-eighties. The oil deficit of the importing areas, therefore, cannot be reduced but very gradually and must be promptly financed to avoid widespread deflationary impulses. The same cannot be said for the surpluses of the « strong » OECD countries, which may be reduced even over the short run by means of more expansionary policies and an appreciation of their exchange rates, thus helping the « weak » OECD countries and the other areas towards adjustment. Thus there is a pressing need to strengthen international economic cooperation by seeking agreement on a fair and symmetric distribution of the burden of adjusting current disequilibria within the OECD area.

During the seventies, and especially after the oil crisis, the disequilibria in the balance on current account of the OECD countries were only partially offset by steady flows of the opposite sign in medium- and long-term capital and particularly in direct investments which, because of their specific characteristics, do not increase the burden of the external debt.

However, the problem emerges in all its gravity mainly with regard to the major economies of the West: it does not appear that during the seventies mechanisms to offset the current account disequilibria through long-term capital have been set in motion within these countries (except Canada). Between 1970 and 1976, with the exception of 1974-75, West Germany recorded, alongside constant and massive current account surpluses, also considerable inflows of long-term capital; according to OECD estimates, in 1976 these amounted to 0.5 billion dollars, against a 3.4 billion current surplus. Japan, which until 1973 had kept current surpluses and net exports of long-term capital in equilibrium, over the following three years (1973-75) continued to register heavy outflows of long-term capital vis-à-vis current account deficits. In 1976, when the balance on current account again recorded a massive surplus of 3.8 billion dollars, these outflows did not exceed one billion dollars. Over recent years net inflows of long-term capital also in the main deficit countries have fluctuated considerably, without any bearing on the corresponding performance of the balance on current account.

The financing of balance-of-payments disequilibria and exchange rate movements

Available data on the balances of payments by large areas indicate that in 1976 also the greater part of current deficit financing was provided by short- and medium-term capital movements and changes in reserves rather than long-term capital movements (Table 3).

In the four OECD countries with a strong foreign position (West Germany, Japan, the Netherlands and Switzerland), long-term capital outflows dropped to around 7 billion dollars in 1976, compared with 12.5 in 1975 and 8 in 1974. These countries used about half of their current surplus to increase reserves and invested the remainder in long-term foreign assets, since net movements of short-term funds were more or less in equilibrium. The other OECD countries financed about 40 per cent of their current deficits for 1976 with inflows of short-term capital (around 55 per cent in 1975 and 45 in 1974), and another 30 per cent roughly by resorting to net reserves, which played much the same role in 1974 but were of scarce importance in 1975. Long-term capital movements remained practically stationary in absolute value but decreased with respect to the overall deficit for the area (31 per cent in 1976 compared with 41 in 1975 and 28 in 1974).

The United States, whose current account closed largely in equilibrium, stepped up its major role as financial intermediary. This appears not only from gross data on movements of capital funds, but also from maturity transformation: in fact, in 1976, the U.S. increased its net long-term foreign assets by about 8 billion dollars (compared with 7.7 in 1975 and 9 in 1974), while the net inflow of short-term capital amounted to around 5 billion dollars, against an outflow of 6.7 billion in 1975 and an inflow of 1 billion in 1974.

Estimates show that also in 1976 a large share of the OPEC countries' financial surplus was channelled towards the United States financial and money market and towards the xenomarkets, whereas previously accumulated funds were withdrawn from the United Kingdom. Moreover, it does not appear that the OPEC countries have altered to any great extent their preference for short- or medium-term financial investments.

The methods of financing current deficits described above clearly reveal, especially in perspective, the limitations of the international capital markets in financing external disequilibria. The persistence of large current account surpluses in some areas of the world and the preference of the OPEC countries for short-to-medium term private financial assets contrast with the need of countries in structural deficit to obtain long-term loans to enable them, among other things, to undertake projects for redistributing productive resources towards more competitive lines of production. In order to reconcile these contrasting needs official bodies must undertake a greater share of intermediation by granting long-term financing, so as to dampen the accumulated tension on international capital markets.

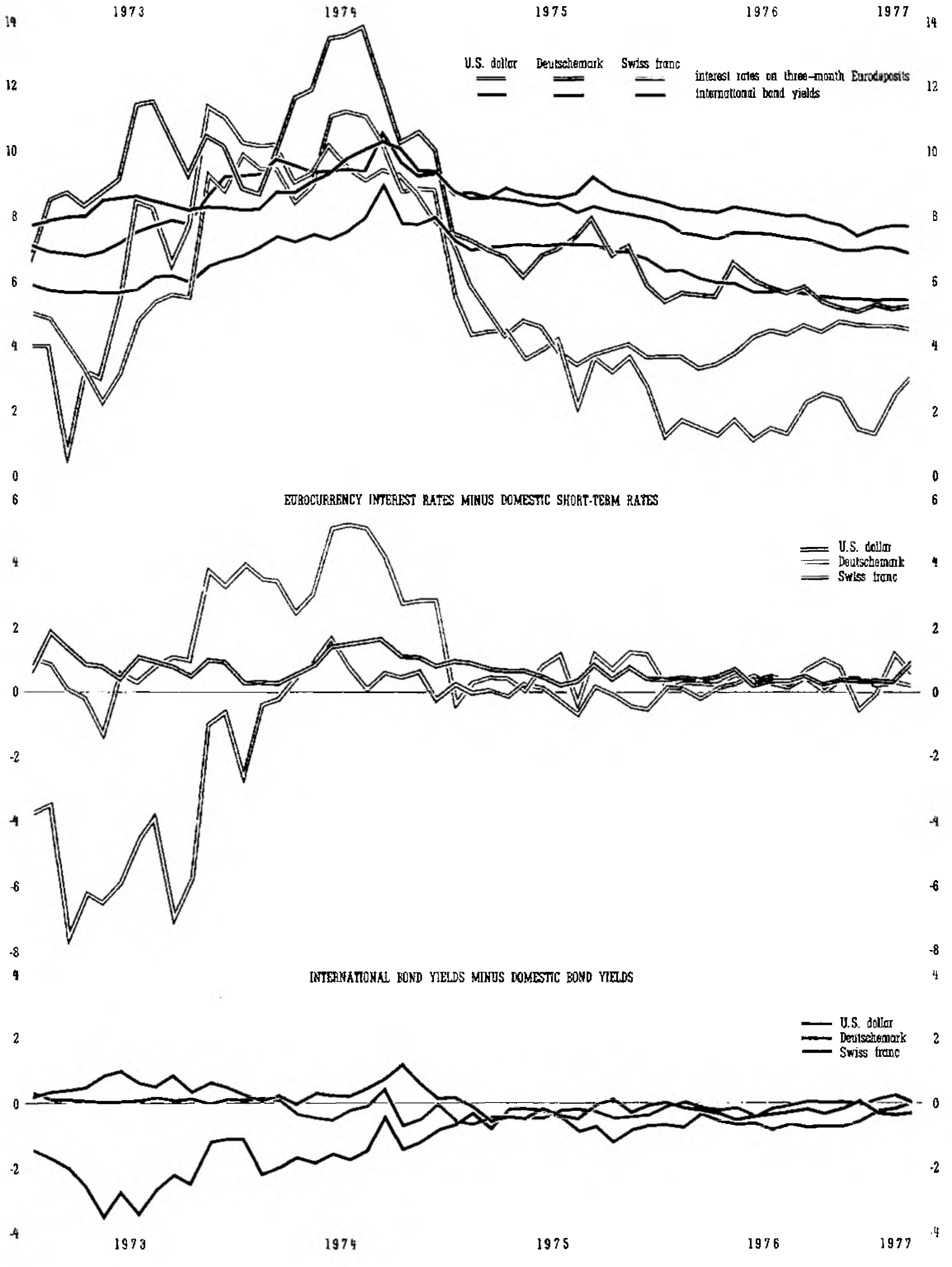
The international financial markets

One of the salient features of the heavy expansion in credit flows intermediated by the international markets during 1976 was the continuous and rapid increase in medium-term financing; and since new accruals largely consisted of short-term funds, this led to extensive maturity transformation by the banks. This development is mainly due to the normalization of the structure of interest rates according to their maturity which continued in the United States, West Germany and Switzerland, encouraging recourse to the securities markets and the funding of debts. Since the domestic financial markets of these countries and the international markets are closely linked at present (Chart 3), these developments have been matched by similar trends as regards international financial assets, which are chiefly denominated in the currencies of those countries.

With regard to new issues of international securities, a total of around 30 billion dollars was placed in 1976 (nearly nine-tenths of which denominated in dollars, Deutschemarks or Swiss francs), compared with 22 billion in 1975 and 12.3 billion in 1974. Most of the issues in both the Eurobond market and the market for foreign securities

Chart 3

INTEREST RATES IN INTERNATIONAL MARKETS AND DIFFERENTIALS WITH THE CORRESPONDING RATES



(issues by non-residents on the various national markets) were launched, as in previous years, by the Group of Ten countries and, generally, by the developed countries.

As for medium-term bank intermediation (publicly announced credits) in Eurocurrencies, substantial increases were recorded during the year. After the decline in the gross flow during 1975, the total for new credits returned to the record level registered in 1974, i.e. almost 28.5 billion dollars. Borrowers were very much more evenly distributed over the various areas and countries than in the case of securities.

Data published by the BIS show that the xenocurrency market in the broadest sense — i.e. including the foreign assets and liabilities, irrespective of maturity, of banks belonging to the Group of Ten countries and Switzerland and of branches of U.S. banks in the major off-shore international financial centres — continued to develop at an extremely strong pace. In 1976 the gross foreign assets of these bank's increased by 105 billion dollars, bringing the total to 548 billion: in percentage terms this corresponds to an annual rate of 24 per cent.

The performance of exchange rates

Under the present exchange rate system, in which not only are exchange rates flexible but the monetary authorities are able to intervene discretionally on the market, disequilibria in the balance on current transactions and on autonomous capital movements give rise to a combination of changes in exchange rates and in the net foreign reserves of central banks. The interventions of the monetary authorities have largely been inspired by a fear that, at least over the short run, the market would not be able to achieve equilibrium without too sharp fluctuations. In fact, experience over the last few years has shown that exchange rate changes do not appear capable of rapidly restoring current account equilibrium, owing to delays in the adjustment, in volume terms, of international trade.

Consequently, the free formation of the exchange rate over the short run depends on achieving equilibrium in international monetary and financial portfolios, where expectations concerning the relative yields on the various currencies play a decisive role. Moreover, it has been observed that expectations are sometimes dominated by extrapolative components; also, recent experience has confirmed what had already emerged in previous periods of floating rates, i.e. that the performance of the forward rate is consistent with that of the spot rate and, more specifically, has no power to forecast turning points in the latter. This means that this market contributed less to exchange rate stability than was predicted by some supporters of flexible exchange rates.

The arguments generally advanced in favour of adjustment by means of exchange rates were mainly based on the reasoning that it would have been a simpler and less costly method of obtaining balance-of-payments equilibrium to intervene on the level of only one price — the foreign price of a currency — rather than on the entire spectrum of internal costs and prices. However, these arguments obviously lose weight when applied to economies which are internationally open and bound by rigid wage indexation constraints. In these cases exchange rate changes do not bring about lasting readjustments of the ratio of domestic to foreign costs since they mainly affect domestic inflation, especially when exchange rate movements are not countered but financed by domestic credit expansion policies. Under these conditions expansionary or recessionary monetary impulses have frequently exerted a powerful influence on the exchange rate and, thus, on inflation, while the impact on the level of economic activity has been slight.

Experience during 1976 has confirmed that over the medium run exchange rate changes are generally associated with slight shifts in competitive positions, but at the same time has underlined the importance of changes in monetary conditions in explaining short run movements despite extensive central bank intervention on the markets during the year. More specifically, the heavy depreciations of the Italian lira and pound sterling were halted, respectively in April and November, only after monetary and financial restrictions had been introduced in both countries.

II. – THE ITALIAN ECONOMY

ECONOMIC TRENDS AND THE FORMATION OF INCOME

The recovery of the world economy which had begun in the second half of 1975, the effects of the expansionary economic policy pursued by the Italian authorities during that period to overcome the recession, and a greater than expected inventory build-up enabled the Italian economy to achieve a 5.6 per cent increase of the gross domestic product in 1976. This growth, while one of the highest among the OECD countries, entailed a heavy worsening of the current account deficit, which rose to 2,340 billion or 1.7 per cent of the gross national product from 368 billion or 0.3 per cent in 1975. However, the authorities' intention to keep this deficit within limits where it could be financed with the then available reserves had led them, at the beginning of the year, to place the maximum growth rate of the gross domestic product at about 2 per cent.

Among the components of aggregate demand the role played by inventories was particularly important, not only as a powerful overall support to production (inventories increased by 1,329 billion at 1970 prices, equal to 1.9 per cent of GDP) but also as an initial stimulus to the upswing of the cycle. This inventory build-up, especially of raw materials, which had begun towards the end of 1975 when liquidity was abundant and world prices were expected to rise, produced an increase in imports, which was all the faster and sharper because it followed a phase when stocks were being depleted. There ensued a serious worsening in the balance of trade on goods and services, which immediately gave rise to speculative activity.

It was then decided to close the exchange market, which remained thus for over a month, while the approaching elections and the limited power of the Government left no room for incisive economic policy interventions; the lira quotation fell rapidly, raising expectations of further losses. The depreciation of the lira was followed by an upsurge of inflation, which had been slowing down considerably until January, and by a renewed growth of profits for enterprises, which increased their unit margins and improved their liquidity, thus further boosting inventory accumulation and halting the decline of investment by private industry.

Throughout the first half of 1976, households' consumption settled, though with some fluctuations, on the high levels reached after the expansion of the second half of 1975, despite the fact that disposable income was decreasing in real terms owing to the combined effect of the price rises and the introduction of the « self-taxation » system for personal income taxes. In fact, the slight improvement in the employment outlook, associated with the first signs of an increase in working hours, after a period of exceedingly low levels due to the decline in production, as well as the partly psychological effect of the signing of important collective labour contracts, helped to maintain the already established levels of consumption.

All these spontaneous reactions of the economic system gave rise to a continuous growth of industrial production which reached a peak in May. As usually happens in phases of recovery, the increase in production was accompanied by a recovery of productivity, which was particularly rapid owing to the exceptionally low levels reached during the previous recession. However, labour costs per unit of output continued to grow, albeit more moderately, owing to the heavy increase in costs per worker.

The recovery of production soon came into conflict with the further worsening of the balance-of-payments deficit, which was partly due to temporary difficulties encountered by exports, and with the subsequent sharpening of exchange rate difficulties at the beginning of May. In order to cope with these growing tensions a compulsory deposit on purchases of foreign exchange was introduced. This, on the one hand, had a direct effect on the balance of payments by stimulating the flow of trade credits to importers, and on the other, had a domestic restrictive effect by setting in motion a mechanism for reducing the monetary base, in addition to those already in operation following the repeal of the export refinancing measure and the special withdrawals of compulsory reserves.

The raising of the discount rate in February and March, and the policy of intervention on the money market thus characterized the course followed by monetary policy, which aimed at curbing the external depreciation of the lira and the rate of inflation. Short-term interest rates rose rapidly after the low-point reached in January, approaching the rate of inflation; long-term interest rates followed a similar but less marked trend, owing to intervention by the monetary authorities.

In the third quarter, in synchrony with the stagnation experienced by all the major world economies, the general level of demand and production in Italy came to a standstill, partly owing to social and political factors of a domestic nature and, in particular, to uncertainties as to how to interpret the election results. Once the Government had been formed in autumn, a complex programme of fiscal, monetary and credit measures was launched with the aim of bringing about a rapid improvement in foreign accounts and subsequently slowing down the rate of inflation. Over the short run these measures were mainly hinged on adjustments to taxes and public utility tariffs, but also tied in with a medium-term policy to reduce the absorption of saving by the budget deficit.

The programme laboured under the impossibility of reducing, in the short run, the structural dependance of domestic demand on imports. And since it was also impossible to expand exports at a much higher rate than that of international trade, the import volume was established so as to obtain a current account balance in equilibrium or slightly in surplus; consequently a ceiling was placed on domestic demand, to be maintained by appropriate action, especially of a fiscal nature.

Since the need to strengthen the productive apparatus meant that investment activity could not be cramped any further, domestic demand was to be curbed through policies to reduce consumption. Thus, in view of the difficulties of using direct taxation alone to cut households' disposable income, substantial increases were also applied to indirect taxes, administered prices and public utility tariffs, with the intention of curbing the growth of consumption and of making an initial adjustment in its structure by bringing the political prices of certain public services closer to those consistent with costs and with the country's economic situation.

This programme took into account the major requisite, i.e. not to worsen the already serious employment situation, and hence not to cause during 1977, when the policy measures would actually begin to take effect, any drop in productive activity from the levels reached at end-1976.

The prospects which then began to emerge that the national product would remain stationary in 1977 on the levels reached in 1976 were linked to forecasts that production would reach a standstill in the last quarter of the year, if not indeed decline as in the third quarter. By contrast, partly in response to an unexpected recovery of the cycle in the major industrial economies, all the components of demand increased considerably. Consumption was affected by the growth of households' real disposable income following both the wage rises obtained during the year and the gradual increase in the utilization of labour brought about by the recovery of production. Investment, in turn, was boosted by the increased utilization of productive capacity, despite the fact that the curb on credit expansion had begun to affect the enterprises' liquidity even though global profits had again improved.

The strong growth of production in the last quarter brought the increase of the gross domestic product in real terms to 5.6 per cent on average for the year, compared with estimates of around 4.5 per cent made in autumn. This rise in GDP corresponded to a growth of aggregate demand which mainly relied on exports and inventories: the former rose by 33.9 per cent in value and 12.6 per cent in volume, while the latter produced an increase in domestic demand of 26.3 per cent in monetary terms and 5.5 per cent in real terms, compared with 21.5 and 2.9 per cent respectively for consumption and fixed investment as a whole.

Fixed investment grew by 2.3 per cent in quantity, to recover only a small part of the drop recorded in 1975. However, the increase would have been even smaller without the support of major public investment projects in the services sector and if the healthy performance of industrial profits had not enabled a large part of the further rise in prices of capital goods to be absorbed.

Consumption increased by 21.6 per cent in value and 3.0 per cent in volume, with a higher increase for consumption by households (3.2 per cent in real terms) than for collective consumption (1.9 per cent).

The economic performance for 1976 did not show the improvements expected in the utilization of resources. Investment increased less than consumption and its ratio to GDP dropped again, even though the component formed by equipment and means of transport did increase over the year; some progress was made in channelling public expenditure to increase the share of that on capital account.

On the supply side, imports rose in volume at a rate more than double that of domestic demand and of the gross national product, thus indicating that — even excluding the recovery effect following the 1975 downturn — the economic system is still structurally dependent on imports. Owing to the combined effect of the performance of international prices and the depreciation of the lira, import prices rose by almost 25 per cent (as against 19 per cent for exports), so that the improvement in the terms of trade that had taken place in 1975 was completely reabsorbed.

The 5.6 per cent growth of the gross domestic product in real terms was provided mainly by the industrial sector, where value added rose by 9.7 per cent. Within this sector, a further decline in construction contrasted with a 12 per cent increase in the rest of industry. Services increased by 4 per cent, largely as a result of the performance of the credit and insurance and the transport and communication sectors.

Agriculture, lastly, was hit by a considerable drop in production (— 4.3 per cent) as a result of bad weather coming on top of the existing structural problems, which remained as serious as ever despite efforts over recent years to increase human and capital investment. The already considerable agricultural food deficit worsened further.

During 1976 the performance of the economy brought demand and production to higher than average end-year levels (Table 4). This circumstance, together with an assessment of the effects of the economic policy measures enacted towards the end of 1976 and in the early months of this year, and the ceilings placed on the growth of monetary and financial aggregates in agreement with the International Monetary Fund and the EEC, makes it possible to project the probable development of economic activity in 1977.

According to forecasts on world demand and on the competitiveness of Italian products, the growth rate of exports of goods and services should be about 3 points less than in 1976. Given the balance-of-payments constraint, the increase in domestic demand will be between 1 and 2 per cent. Taking into account a small improvement in the terms of trade, this figure is to be achieved by means of a series of fiscal and tariff measures adopted to keep the rise in domestic demand in line with a growth of imports in real terms such as to produce a heavy reduction in the foreign deficit during the calendar year and a modest surplus in the period March 1977 to March 1978, covered in the « letter of intent » to the International Monetary Fund.

The increase in taxation will yield about 4,900 billion, net of the Government taking up around 1,400 billion of employers' social security contributions.

About 1,400 billion of the increased revenue will be obtained from direct taxation (advances on personal and company income taxes, changes in local income taxes, and other minor variations) and around 4,900 billion from indirect taxes (taxes on mineral oils, business, tobacco and VAT, partly as the Government takes up some of the sickness contributions paid by employers) and public utility tariffs (railways, telephones, electricity, postal services and tobacco).

Table 4

EVOLUTION OF AGGREGATE DEMAND AND SUPPLY

(percentage changes)

Items	at current prices	implicit prices	at 1970 prices		
	1976/1975	1976/1975	1976/1975	4th qtr. '75 (1)/av. 1975	4th qtr. '76 (1)/av. 1976
Demand:					
consumption	21.6	18.1	3.0	2.6	1.3
private consumption	*21.3*	*17.5*	*3.2*	*3.0*	*1.4*
gross investment	45.4	24.3	17.0	4.7	8.2
gross fixed investment	*21.3*	*18.6*	*2.3*	*–2.6*	*3.4*
domestic demand	26.3	19.7	5.5	3.0	2.7
exports of goods and services	33.9	18.9	12.6	8.1	4.9
total demand	27.7	19.6	6.8	3.9	3.1
Supply:					
gross national product	24.4	17.8	5.6	1.5	1.9
imports of goods and services	41.0	24.7	13.1	17.1	9.0

Source: Data from the General Report on the Economic Situation in Italy. For seasonally adjusted quarterly data, ISCO-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.

If one also takes into account the changes in administered prices, which will increase households' expenditure by 1,100 billion, these measures as a whole will raise it by an estimated 5,000 billion (without considering the backflow into wages through the automatic sliding scale mechanism). Their spending capacity will be further reduced by the conversion of wage increases due to cost-of-living adjustments into Treasury bills for the upper income brackets, by the abolition of the sliding scale systems that are more burdensome than that adopted in industry, and by annulling the adjustments to increases in the sliding scale of pensions and severance payments due during the year.

These measures, along with a reduction of the weight of certain public services and of daily newspapers in the basket of consumer goods adopted for the trade union cost-of-living index, have brought about certain changes in the sliding scale mechanism which, added to the Government's taking over part of employers' sickness contributions, will help to keep the increase in enterprise labour costs under control. Moreover, the cost of labour per unit of output can effectively be kept within limits that are compatible with the stabilization policy and with the strengthening of the competitive position of Italian products at home and abroad, only if the unions act on their commitment to keep down the cost of renewing labour contracts at the enterprise level. In fact, in a year such as 1977 when the growth of productivity will only be slight despite the agreement to abolish seven holidays and reduce absenteeism, labour costs per unit of output will basically be reduced, even after the Government has taken up part of employers' social security contributions, by affecting the total cost of labour.

Even if the above conditions are observed little progress will be made towards changing the composition of domestic utilization of resources, since the expected increase in domestic demand will affect consumption and investment equally. Moreover, investment in equipment and means of transport should increase, and construction, on the other hand, remain practically stationary.

Within this framework, the ceilings placed on total credit expansion (30,000 billion for the twelve-month period ending March 31st 1978 and 30,600 billion for the calendar year 1977) also imply a structure of interest rates that is in keeping with the trend of inflation. Also they should, on the one hand, encourage short-term capital inflows from abroad or at least prevent outflows and, on the other, keep inventory build-up within the bounds of what is strictly necessary to productive activity.

Although inflation in Italy continues to be the highest among the industrial countries it will decline progressively during the year.

The almost 20 per cent increase envisaged for the implicit prices of final domestic demand for 1977 is in fact partly due to the effects that increased indirect taxation and the adjustment of public utility tariffs and administered prices will have on the first half of the year.

The major problem in 1977 is that raised by employment prospects. In fact, with a roughly 3 per cent growth of the gross domestic product the only space for the market to absorb the supply of the young labour force will be in replacement of elderly workers.

The economic policy choices made during 1977 reflect the limitations on the growth of income arising from the need to bring the inflation rate down to the level of the main industrial countries by the end of 1980 and to reduce the foreign debt over the next few years. In view of the high income elasticity of imports and the existing rigidities on the labour market, it does not appear possible to reconcile current account equilibrium with a satisfactory growth rate for the economy, not only this year but also in 1978.

In the following years the growth rate may be higher, but estimates based on OECD forecasts on the trend of demand and world prices show that it will probably be below both the average for the years prior to the 1973 crisis and that for the main industrial countries. The most serious repercussions will continue to affect employment, whose level in industry should not change significantly from the present figure. With an increase in the population this would produce a rise in the unemployment rate that would be higher the more the performance of the relative factor costs encouraged labour saving investments.

Consequently, over the next few years curbing labour costs becomes a necessary condition not only for a reduction in the inflation rate but also, along with a drop in the ratio of the budget deficit to GDP, for an accumulation process that will enlarge the productive basis and support employment levels.

The changes to be made in the import content of final demand, in the industrial and agricultural productive apparatus and, more generally, in the economic system's efficiency, will necessarily take a few years to actually affect the structure of the economy. Thus the constraints on the growth of output and employment can only be weakened over the short run through suitable, though difficult to enact, labour policies, and above all through the support provided by exports.

However the policies aimed at altering the structure of the economic system must be implemented without delay, not only because they alone can enable the country to overcome the crisis once and for all, but also, since there is a considerable time lag before they take effect, so that it will not be necessary in the future to continue to make the necessary adjustments chiefly on the level of domestic demand.

Domestic demand

Consumption

Consumer expenditure, which had dropped for the first time since the war in 1975, rose by 3.1 per cent in 1976; compared with 1974, however, the increase only amounts to 1.4 per cent, i.e. equal to the increase in the resident population. In monetary terms, national consumption grew by 21.1 per cent in 1976, as against an approximately 20 per cent rise in households' disposable income; this generated an average propensity to consume that was higher than the year before, but the same as the average for the period 1971-74 (Table 5).

Table 5

CONSUMPTION, DISPOSABLE INCOME AND AVERAGE PROPENSITY TO CONSUME OF HOUSEHOLDS

Items	1970	1971/1970	1972/1971	1973/1972	1974/1973	1975/1974	1976/1975
	(billions of lire)	*(percentage changes)*					
Final national consumption:							
at current prices	36,696	*9.0*	*10.2*	*19.1*	*23.8*	*15.7*	*21.1*
at 1970 prices		*2.9*	*3.4*	*6.1*	*2.4*	*−1.6*	*3.1*
Gross disposable income:							
at current prices	46,512	*11.3*	*10.5*	*19.1*	*21.4*	*18.3*	*20.2*
at 1970 prices (1)		*5.2*	*3.7*	*6.0*	*0.5*	*0.6*	*2.3*
Average propensity to consume	78.9	*77.2*	*77.0*	*77.0*	*78.5*	*76.8*	*77.4*

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.

By the end of 1975 the volume of consumption had already surpassed the average for the year by 3 per cent. The trend for 1976 recorded a slight increase in the first quarter followed by a decline and a standstill in the next two quarters; finally, the fourth quarter saw a recovery.

After a lag of about one quarter, consumption followed the trend of disposable income, which dropped in real terms throughout the first half of 1976 owing to the rise in prices and the introduction of « self-taxation ». The subsequent transfer of higher prices onto wages and the growth of production then generated, in the second half of the year, an increase in disposable income, which on average was 2.3 per cent higher in real terms in 1976 than the year before.

Investment

In 1976, the rise in fixed investment (2.3 per cent in real terms) did not even cover a fifth of the previous year's drop (— 13 per cent) and at present the flow is lower than in 1971. In monetary terms, however, there was a marked increase (21.3 per cent), since for the third year running the heavy rises in implicit prices showed no signs of abating (18.6 per cent in 1976, after increasing by 28.5 and 19.5 per cent in 1974 and 1975 respectively).

Table 6

INVESTMENT AND SAVING

(as a percentage of the gross domestic product at current prices)

Items	1970	1971	1972	1973	1974	1975	1976
Gross investment	23.1	21.0	20.4	24.4	26.6	20.0	23.4
Net investment	14.5	12.4	11.8	15.5	16.9	9.8	13.4
Balance on current foreign transactions	1.3	1.9	1.7	−1.9	−5.1	−0.2	−1.6
Gross saving	24.4	22.9	22.1	22.5	21.5	19.8	21.8
private sector	*23.3*	*24.3*	*25.5*	*25.5*	*23,8*	*26.1*	*25.9*
Net saving	15.7	14.3	13.5	13.6	11.8	9.6	11.8

Source: General Report on the Economic Situation in Italy.

The slack growth of fixed investment contrasted with a strong increase in inventory-building (1,329 billion at 1970 prices and 4,407 billion at current prices) after the previous year's downturn. Including the variation in stocks, investment grew by 17 per cent in volume and by 45 per cent in value.

Table 7

PUBLIC AND PRIVATE GROSS DOMESTIC INVESTMENT BY BRANCHES OF ECONOMIC ACTIVITY

Type of investment	Billions of lire (at current prices)	Percentage breakdown (at 1970 prices)		Percentage changes					
				at current prices			at 1970 prices		
	1976	1975	1976	1974/1973	1975/1974	1976/1975	1974/1973	1975/1974	1976/1975
AGRICULTURE	2,344	*7.6*	*8.3*	*31.1*	*25.4*	*33.8*	*1.3*	*3.4*	*11.8*
Private enterprises	2,155	*7.4*	*7.6*	*37.7*	*34.0*	*26.5*	*6.4*	*10.5*	*5.8*
Public enterprises (1)	189	*0.2*	*0.7*	*−11.9*	*38.9*	*285.7*	*−31.6*	*−67.9*	*220.0*
INDUSTRY	8,663	*29.5*	*28.3*	*37.3*	*94.8*	*15.9*	*6.2*	*−21.9*	*−1.9*
Private enterprises	5,843	*18.7*	*19.0*	*50.1*	*86.2*	*22.6*	*17.3*	*−29.1*	*3.8*
Public enterprises	2,820	*10.8*	*9.3*	*14.5*	*15.0*	*4.0*	*−13.0*	*−5.2*	*−11.9*
SERVICES	7,311	*25.6*	*27.3*	*28.9*	*5.3*	*28.4*	*3.7*	*−11.1*	*9.1*
Private enterprises	4,738	*16.2*	*16.8*	*33.5*	*1.0*	*27.7*	*7.2*	*−15.3*	*5.6*
Public enterprises	2,573	*9.4*	*10.5*	*20.0*	*14.6*	*29.6*	*−2.5*	*−2.7*	*15.3*
DWELLINGS	8,179	*28.8*	*27.8*	*36.3*	*5.5*	*17.8*	*2.7*	*−10.9*	*−1.2*
Private enterprises	7,489	*26.6*	*25.4*	*34.4*	*3.2*	*16.5*	*1.2*	*−12.8*	*−2.3*
Public enterprises	(2) 690	*2.2*	*2.4*	*82.6*	*44.9*	*33.7*	*36.9*	*22.5*	*12.0*
TOTAL	26,497	*91.5*	*91.7*	*34.3*	*2.8*	*21.2*	*4.1*	*−13.9*	*2.5*
Private enterprises	20,225	*69.0*	*68.8*	*39.2*	*−0.6*	*21.8*	*7.7*	*−16.7*	*2.1*
Public enterprises	6,272	*22.5*	*22.9*	*19.0*	*15.1*	*19.2*	*−7.1*	*−3.9*	*3.9*
GENERAL GOVERNMENT	2,313	*8.5*	*8.3*	*17.9*	*21.3*	*22.8*	*−2.8*	*−2.0*	*−0.6*
GROSS FIXED INVESTMENT	28,810	*100.0*	*100.0*	*33.1*	*4.0*	*21.3*	*3.5*	*−13.0*	*2.3*
Public sector	*8,585*	*31.0*	*31.2*	*18.8*	*16.7*	*20.2*	*−6.0*	*−3.4*	*2.7*

Source: General Report on the Economic Situation in Italy.
(1) Payments by the State for investment expenditure. — (2) Estimated.

As a ratio of the gross domestic product, fixed investment declined further: at constant prices the ratio between the two aggregates dropped to 17.4 per cent, which is the lowest point reached since the mid-fifties.

However, the formation of savings was insufficient to cover the small volume of fixed investment (and the variation in inventories) with domestic resources. Since 1970, although saving in the private sector has grown more than GDP, the formation of a large current deficit for General Government has gradually made it impossible to obtain simultaneously greater investment and a balance on current account in equilibrium. It therefore follows that, unless one posits a further rise in the ratio of private sector saving to GDP, which is at present one of the highest in Europe, equilibrium in the General Government current budget appears to be a necessary condition for a growth of investment that will not produce disequilibria in our foreign accounts (Table 6).

By contrast with previous years, the growth of fixed investment in real terms did not show much percentage difference between public and private enterprises. Nonetheless, whereas for the latter the growth rates in the different branches were largely similar (except for residential building which dropped slightly in real terms), for the public sector the decline of investment in industry was contrasted by a strong upsurge in the other branches, partly owing to the subsidies granted to social and agricultural investments under laws enacted in 1975 (Law n. 166 of May 27, 1975 and Laws n. 492 and n. 493 of October 16, 1975). Lastly, direct investments by General Government remained stationary (Table 7).

Domestic supply

Agriculture

The bad weather conditions, in the form of a prolonged drought in the northern regions and heavy disturbances and rain in central and southern Italy, had an adverse effect on agriculture in 1976. Production dropped by 1.1 per cent in real terms with respect to the year before (Table 8) despite a 5.4 per cent rise in intermediate consumption and a considerable slowdown in the decline of employment (— 1.2 per cent as against an average decrease of 3.5 per cent in the previous three-year period). Given the increase in intermediate consumption and the reduction of production subsidies, the value added at factor cost declined even further (— 4.3 per cent), to a level little higher than that registered in 1967.

The worst results were those recorded for tree crops, which dropped by almost 9 per cent despite the healthy performance of most of the citrus and other fruit crops. Grapes in fact showed a further reduction of 6 per cent after the 8 per cent drop in 1975, while the decline in the olive harvest, though fully expected after the previous year's bumper crop, was 35 per cent, thus implying a 6 per cent loss even with respect to 1974.

Table 8

MARKETABLE PRODUCTION AND VALUE ADDED IN AGRICULTURE

Items	Values at 1976 current prices (billions of lire)	Percentage changes over the previous year					
		value		volume		price	
		1975	1976	1975	1976	1975	1976
Marketable production	15,715	*17.8*	*19.5*	*2.9*	*−1.1*	*14.5*	*20.8*
Field crops and fodder	5,556	*16.2*	*27.1*	*4.3*	*−1.6*	*11.4*	*29.2*
Tree crops	3,333	*11.3*	*−1.2*	*2.3*	*−8.7*	*8.8*	*8.2*
Livestock	6,336	*24.2*	*26.6*	*2.6*	*3.8*	*21.1*	*22.0*
Forestry and fisheries	490	*18.6*	*22.2*	*−4.5*	*4.7*	*24.2*	*16.7*
Intermediate consumption (−)	4,467	*14.3*	*26.2*	*1.5*	*5.4*	*12.6*	*19.7*
Contributions to production (+)	493	*74.7*	*−3.3*	*27.8*	*−18.1*	*36.7*	*18.1*
Value added at factor cost	11,741	*21.1*	*16.0*	*4.7*	*−4.3*	*15.7*	*21.2*

Source: General Report on the Economic Situation in Italy.

Among field-crop products, which taken as a whole fell by 1.6 per cent, cereals suffered most from the bad weather (— 4.4 per cent), and especially hard wheat and rice, with harvests down by 12 and 11 per cent respectively despite the substantial expansion of areas under cultivation. The average yield per hectare of hard wheat dropped back again from 2,200 to 1,800 kilos and that of rice from 5,700 to 4,850.

The performance of livestock production was however positive, with the 3.8 per cent increase confirming the expansionary trend of the last few years. In particular as regards cattle-raising, beef production rose (5.1 per cent) as did the number of head of cattle, which increased from 8.5 to 8.8 million during the year. There was also a growth in the production of pig-meat (2.7 per cent) mutton and goat meat (10.6 per cent), poultry (7.5 per cent) and milk (2.1 per cent).

The acceleration of inflation accompanying the cyclical recovery that began in the autumn of 1975 also extended to the agricultural sector, where it produced price rises which, although extremely uneven, as a whole were much higher than those recorded the year before. The increase in agricultural prices was influenced both by factors of a general nature, such as the lira depreciation and the rise in domestic costs, and by sectoral disequilibria between supply and demand caused by the poor performance of certain crops in Italy and in other areas of the EEC.

Taken as a whole the index of implicit prices of marketable produce rose by 20.8 per cent as against 14.5 per cent in 1975, and so the value added at factor cost could increase at current prices by 16 per cent, despite the fall in output and production subsidies and the hefty increase in intermediate consumption. However the growth of property income and earnings of self-employed labour was smaller (12.4 per cent), since wages went up by 25 per cent.

Industry

The rapid increase in aggregate demand in the second half of 1975 was reflected in 1976 in an increase in industrial value added which averaged 9.7 per cent over the year (Table 9). This growth

Table 9

VALUE ADDED IN INDUSTRY AT MARKET PRICES

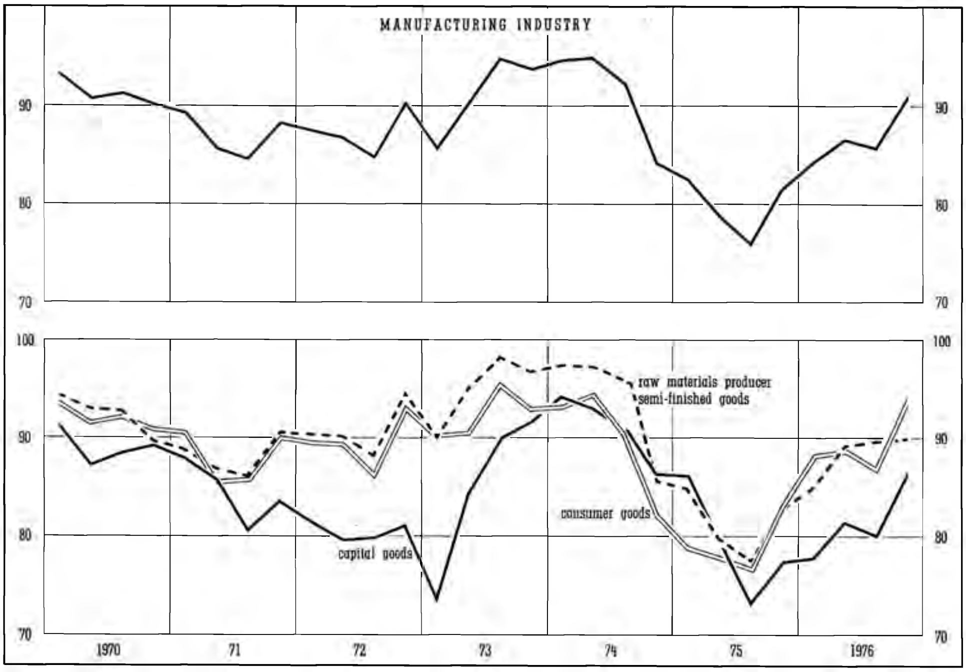
Items	Values at 1970 prices in billions of lire			Percentage breakdown 1976	Percentage changes		
	1974	1975	1976		1974/73	1975/74	1976/75
VALUE ADDED:							
including construction	28,786	26,217	28,758	*100.0*	*4.5*	*−8.9*	*9.7*
excluding construction	23,817	21,618	24,216	*84.2*	*5.1*	*−9.2*	*12.0*
Products:							
of industrial processing	19,777	17,854	20,069	*69.8*	*6.4*	*−9.7*	*12.4*
fuels	4,040	3,764	4,147	*14.4*	*−0.9*	*−6.8*	*10.2*
Construction	4,969	4,599	4,542	*15.8*	*2.2*	*−7.4*	*−1.2*

Source: General Report on the Economic Situation in Italy.

made it possible to bring the volume of output back to the levels already reached two years earlier, although capacity utilization did not achieve, even at end-1976, the peak of the first half of 1974 (Chart 4).

The expansion of industrial activity affected all productive sectors with the sole exception of construction which continued, albeit more slowly, its downward trend in 1976 (— 1.2 per cent). The largest growth, by contrast, occurred in industrial processing (12.4 per cent) which in 1975 had suffered more than the other branches from a reduction of activity.

Chart 4

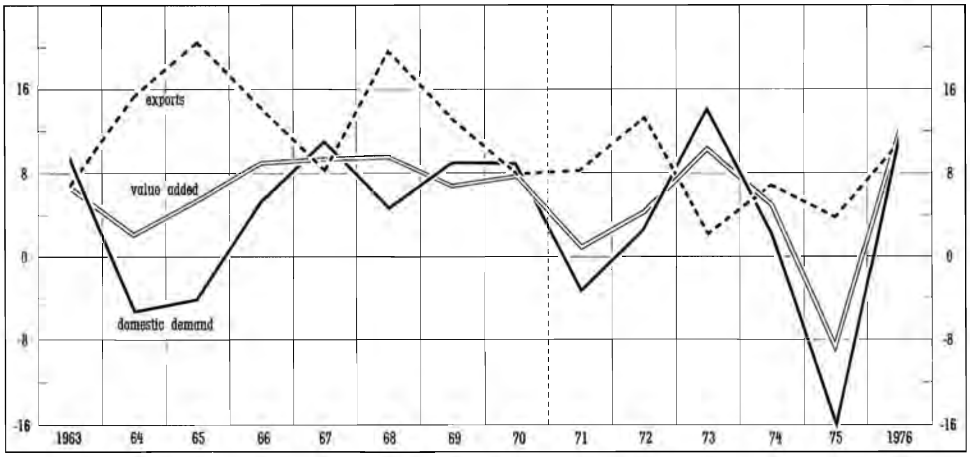


Capacity utilization in the manufacturing industry

Stimuli to the growth of production were provided by the favourable performance of all the components of demand, in particular foreign demand and inventory build-up.

The relatively small increases in gross fixed investment and in domestic consumption of industrial products (2.3 and 5.8 per cent respectively) contrasted in fact with a considerable upsurge in the export of manufactured goods (roughly 11 per cent as against an almost 4 per cent increase in 1975; Chart 5) enabling particularly large gains in output to be made especially in certain branches of industry. The effects of the increase in these demand components on production were then amplified during the year by massive inventory build-up.

Chart 5



Value added, domestic demand and exports in industry excluding construction
(annual percentage changes on values at 1963 prices until 1970; at 1970 prices thereafter)

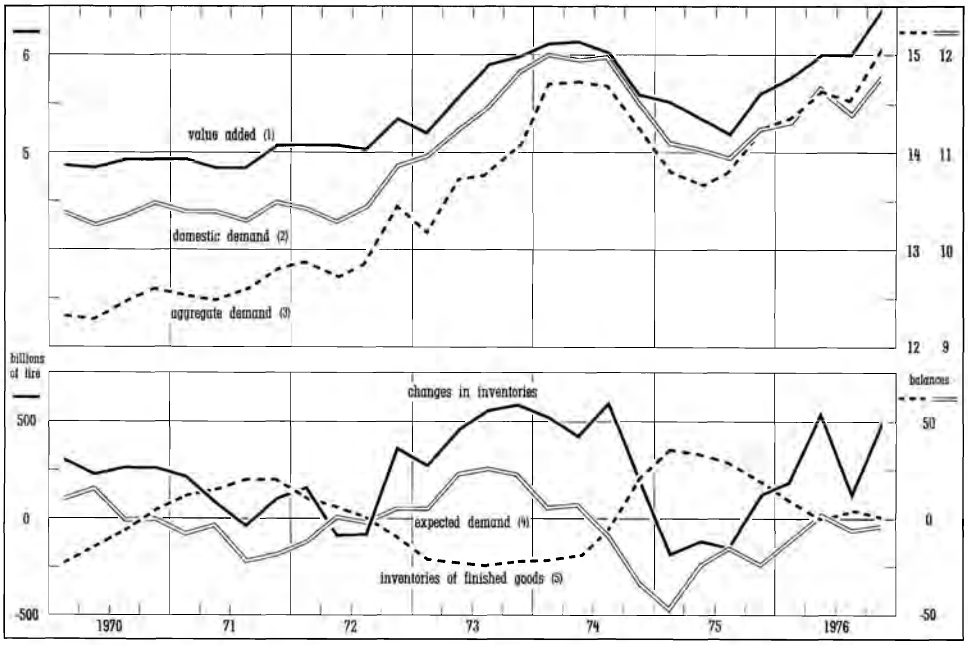
Calculated from Istat data

Among the different branches of industry, consumer goods recorded the largest production increase, mainly in response to demand from abroad and for inventories (15.3 per cent). This increase mainly concerned the manufacture of final durables and intermediate consumption goods; production of the former, however, remained on average for the year below the figure for 1974, despite an increase of 19.4 per cent over the previous year, while the increase in the latter (17.8 per cent) more than compensated the 1975 downturn.

The manufacture of raw materials, producer goods and semi-finished products increased at a rate similar to that of industry as a whole (12.7 per cent). Less outstanding, albeit with certain exceptions, was the trend of production of capital goods, since their growth (6.2 per cent) suffered both from the scarce vitality of domestic demand, especially in construction, and from the slack performance of sales abroad.

The improvement in expected orders already apparent in the second quarter of 1975 (Chart 6) was matched by a reversal of the trend of actual demand and production only in the second half of that year, when there was both an upturn in households' consumption, breaking off the decline that had lasted nearly a year, and a rapid growth of exports.

Chart 6



Value added, orders and inventories in industry excluding construction

(1) Quarterly values have been obtained by dividing annual data on value added according to the behaviour of seasonally adjusted quarterly indexes of industrial production; thousands of billion lire at 1970 prices. — (2) The values equal the sum of households' final consumption and gross investment minus imports of goods; thousands of billion lire at 1970 prices. — (3) The values equal the sum of domestic demand as defined above and exports of goods; thousands of billion lire at 1970 prices. — (4) Quarterly averages of the monthly balances of entrepreneur's answers concerning "the trend of orders over the next 3-4 months" gathered during ISCO-Mondo Economico surveys. The data covers the period to which the forecast refers. — (5) Quarterly averages of the monthly balances of entrepreneur's answers concerning "the deviations from a normal trend" gathered during ISCO-Mondo Economico surveys.

Inventories, by contrast, seem to have provided little contribution to the recovery of production; on the one hand, industrial enterprises' stocks of finished products were much higher than normal at the moment when the trend of production was reversed, and on the other the increase in the economy's total inventories was also due to the restoration of a more balanced ratio between imports and production levels after the large decline up to the first half of 1975.

In the first quarter of 1976 the production increase was more moderate than in the previous quarter (4.4 against 8 per cent; Table 10) both on account of the smaller growth of demand and of stoppages during negotiations for labour contract renewals in the engineering and chemical industries. Meanwhile the industrial enterprises continued to bring their stocks of finished products back to normal levels, a process which involved the manufacture of both capital and consumer goods (Chart 7).

Table 10

INDEX OF INDUSTRIAL PRODUCTION (1)

(1970=100)

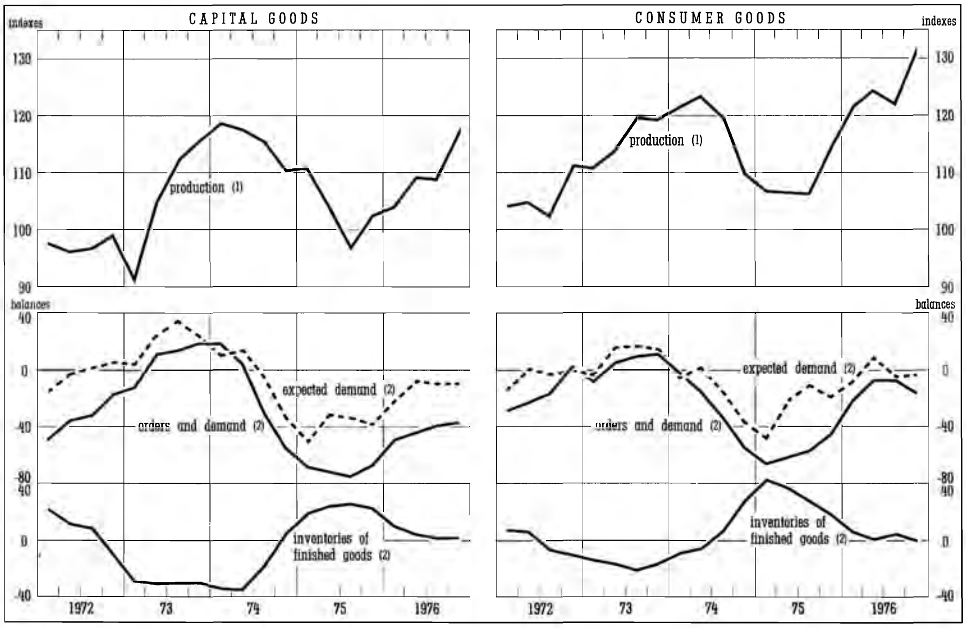
Period	General index		By sector of destination				By branches of activity			
			Raw materials, producer and semi-finished goods	Capital goods		Consumer goods	Mining and quarrying	Manufacturing	Gas and electricity	Construction
	including construction	excluding construction		including construction	excluding construction					
1974 - average	115.8	119.5	123.9	106.5	115.5	118.5	102.4	119.4	125.3	101.2
I qtr.	118.4	122.5	127.2	108.1	118.7	121.3	108.0	122.7	124.4	101.9
II "	118.9	123.1	127.1	107.8	117.5	123.3	98.6	123.5	125.4	102.1
III "	116.5	120.4	125.2	106.5	115.5	119.7	98.4	120.5	126.3	101.2
IV "	109.4	111.9	116.2	103.5	110.1	109.8	104.5	111.0	124.8	99.6
1975 - average	105.5	108.5	112.7	97.3	103.4	108.2	94.7	107.5	126.0	93.7
I qtr.	107.6	110.4	115.9	101.9	110.8	106.3	98.0	109.5	126.6	96.7
II "	104.7	107.3	111.5	97.9	103.7	106.2	93.4	106.3	124.3	94.5
III "	101.6	103.8	106.5	94.1	96.5	106.0	89.4	102.8	121.5	92.7
IV "	108.1	112.4	117.0	95.2	102.6	114.5	98.1	111.3	131.5	90.8
1976 - average	116.0	121.9	127.0	98.9	109.8	124.8	98.9	121.0	140.4	92.5
I qtr.	112.1	117.3	122.0	96.0	103.8	121.4	100.2	116.3	136.4	91.4
II "	116.0	121.6	127.1	99.5	109.2	124.4	102.6	120.6	140.2	93.7
III "	114.5	120.0	126.4	98.5	108.6	121.6	97.1	118.9	141.8	92.5
IV "	121.3	128.6	132.5	101.8	117.7	131.6	95.6	128.2	143.2	92.5
1977 - Jan-Feb.		130.7	132.7		122.5	133.9	93.3	130.7	142.5	

The indexes of industrial production excluding construction are calculated from Istat data; in the case of construction, 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 second quarter saw a considerable improvement in demand expectations which was not, however, accompanied by similar progress

Chart 7



Industrial production, orders and inventories of finished goods by sector of destination

(1) Calculated from ISTAT data corrected and seasonally adjusted; basis 1970=100 – quarterly averages. – (2) Quarterly averages of the monthly balances of entrepreneur's answers concerning "the deviations from a normal trend": ISCO-Mondo Economico monthly surveys; for expected demand the data gathered concern the "trend of orders over the next 3-4 months" covering the period to which the forecast refers.

on the part of most components of aggregate demand. The downturn in households' consumption and in exports was partly offset by a modest increase in building activity. Production was sustained mainly by a strong build-up of inventories both by industrial enterprises, where the growth of stocks of finished products seems to have roughly kept pace with that of production, and by other firms. This upswing in production mainly occurred in capital goods (up 5.2 per cent from the previous quarter), due to both the manufacture of final capital goods, which recouped losses provoked by the trade disputes, and to building materials. The index of industrial production peaked in May, partly owing to the recovery that followed contract renewals in the engineering and chemical sectors, and did not regain that level until after October. The downward trend from May on was largely caused by a slackening of production in the textiles, clothing and footwear branches, involved in the second major cycle of contract renewals. The third quarter moreover was characterized by a downward revision of demand expectations — affecting both industries producing consumer goods and those supplying capital goods — and by a reduction of effective demand. However exports increased as, to a lesser extent, did investment in plant and means of transport. On average for the quarter, the general index of industrial production declined by 1.3 per cent, despite the upswing in September.

The index for industrial production recorded the highest growth rate in the fourth quarter (7.1 per cent over the previous period), as a result of the healthy increase of all components of aggregate demand, except investment in contruction. At the beginning of that quarter, however, the trend of the various cyclical indicators was still highly uncertain: in October production declined, albeit slightly, from September; expected entrepreneurial demand and orders received were stationary or declining; stocks of finished products were close to equilibrium level.

The last two months of the year, in contrast, saw a very rapid growth of production and the index for December was 6.7 per cent higher than for October. This sharp upsurge, which could not be deduced from the indicators then available, was produced by a new and vigorous build-up of inventories, and by exports and investments in machinery and means of transport. The latter rose, as in the previous quarter, partly owing to the return to a high degree of plant utilization, especially in industries producing consumer goods, raw materials and semi-finished products.

Services

After the standstill that had characterized 1975, the value added of marketable services in 1976 grew at a rate (4 per cent) close to the average for the period 1970-74 (Table 11). At the basis of consumer demand on which this sector largely depends, and the rapid increase in foreign trade.

On average annual data the acceleration of output in the services sector was sharpest in commerce and catering, which, after the previous

Table 11

VALUE ADDED AT MARKET PRICES OF MARKETABLE SERVICES

(billions of lire)

Branches	1976				Percentage changes			
	Absolute values		Percentage breakdown		Quantity		Prices	
	prices				1975/1974	1976/1975	1975/1974	1976/1975
	current	1970	current	1970				
Commerce and catering .	20,020	10,545	*35.3*	*37.5*	*−1.5*	*3.7*	*19.4*	*17.7*
Transport and communication	7,880	4,553	*13.9*	*16.2*	*0.6*	*6.9*	*17.3*	*18.6*
Credit and insurance . . .	8,719	3,017	*15.4*	*10.8*	*2.5*	*6.0*	*30.5*	*14.8*
Other services	11,238	5,602	*19.8*	*19.9*	*0.5*	*3.0*	*20.6*	*12.1*
Services, excluding housing	47,857	23,717	*84.4*	*84.4*	*−0.2*	*4.4*	*21.4*	*16.1*
Lettings	8,806	4,387	*15.6*	*15.6*	*2.3*	*1.9*	*12.4*	*13.3*
TOTAL . . .	56,663	28,104	*100.0*	*100.0*	*0.2*	*4.0*	*20.0*	*15.6*

Source: General Report on the Economic Situation in Italy.

year's 1.5 per cent drop, recorded a 3.7 per cent rise for 1976, and in transport where the growth rate was up from 0.6 per cent in 1975 to 6.9 per cent in 1976. In transport, which has increased its share of value added uninterruptedly since 1970, all transport services increased their output except air transport, both freight and passenger traffic, which again declined, though less than in 1975.

The energy balance sheet

The reversal of the economic cycle was amply reflected by the trend of domestic demand for primary energy sources which, having dropped by 4.3 per cent in 1975, recorded an estimated 6.2 per cent increase for 1976 to reach around 142 million tons of oil equivalents (Table 12). This was largely due to industrial utilization, also for non-energy uses, which closely followed the trend of industrial production; however in the recovery phase the performance was less elastic (8.6 as against 12 per cent), which could be a reflection of efforts directed towards a reorganization in view of the higher cost of energy. There was a particularly sharp increase in the demand for fuel oil for transport (20 per cent), while petrol consumption dropped by 3.2 per cent owing to heavier taxes. A comparison with 1973 highlights the considerable slowdown of domestic demand for energy caused by the oil crisis: from 1973 to 1976 domestic uses of primary sources, including international maritime bunkering, rose at an annual rate of 0.5 per cent as against 8.4 per cent for the period 1955 to 1973, owing to both the lower growth rate of income (2 per cent compared with 5.2) and the lower income elasticity of energy consumption (0.25 as against 1.6). The latter, however, reflects above all the initial impact of the rises in crude oil prices, since in 1976 the elasticity rose back to 1.1.

Table 12

ENERGY BALANCE

(millions of TOE)

Sources and uses	1975					1976				
	Solid fuels	Natural gas	Oil	Electric power (1)	Total	Solid fuels	Natural gas	Oil	Electric power (1)	Total
Production	1.3	12.0	1.1	10.8	25.2	1.3	12.9	1.0	10.4	25.6
Imports	9.5	7.2	104.5	1.1	122.3	10.0	9.7	111.8	0.9	132.4
Exports (–)	0.6	–	14.7	0.6	15.9	0.5	–	15.3	0.7	16.5
Changes in inventories (–) (2)	0.2	0.9	–2.9	–	–1.8	–	0.5	–0.7	–	–0.2
Domestic uses of primary sources (3)	**10.0**	**18.3**	**93.8**	**11.3**	**133.4**	**10.8**	**22.1**	**98.2**	**10.6**	**141.7**
Percentage breakdown	*7.5*	*13.7*	*70.3*	*8.5*	*100.0*	*7.6*	*15.6*	*69.3*	*7.5*	*100.0*
Trasformation into electric power	–1.8	–1.7	–18.2	21.7	–	–2.1	–3.2	–20.2	25.5	–
Consumption and losses (–)	2.1	0.4	6.3	5.3	14.1	2.2	0.4	6.6	5.6	14.8
Domestic uses of final sources (3)	**6.1**	**16.2**	**69.3**	**27.7**	**119.3**	**6.5**	**18.5**	**71.4**	**30.5**	**126.9**
Percentage breakdown	*5.1*	*13.6*	*58.1*	*23.2*	*100.0*	*5.1*	*14.6*	*56.3*	*24.0*	*100.0*
Industry	4.6	8.3	17.8	16.8	47.5	5.0	9.5	17.6	18.7	50.8
Transportation (3)	0.1	0.3	24.4	0.9	25.7	0.1	0.3	25.3	0.9	26.6
Other energy uses	1.0	5.9	22.1	10.0	39.0	1.0	6.8	22.3	10.9	41.0
Non-energy uses	0.4	1.7	5.0	–	7.1	0.4	1.9	6.2	–	8.5

Source: For 1975 figures are calculated from Ministry for Industry, Trade and Handicrafts data; for 1976 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 0.9 million TOE in 1975 and –0.7 million TOE in 1976. – (3) Including international maritime bunkers.

As regards supply, that of natural gas continued its expansionary trend, increasing by 21 per cent with respect to 1975 and by 55 per cent with respect to 1973, thus enabling domestic oil consumption to be kept down to a level 4.7 per cent higher than in 1975 but still 6.5 per cent below the 1973 level. Given the standstill of domestic production, which over the last four years hovered between 12 and 13 million TOE, the greater availability of natural gas arose entirely from imports from Libya and above all from Holland and the USSR, which increased from 1.7 million TOE in 1973 to 9.7 in 1976. As a whole, the share of primary energy provided by natural gas rose from 10.2 per cent in 1973 to 15.6 in 1976, and that provided by oil fell from 75.3 to 69.3 per cent, while solid fuels and primary electric power remained practically unchanged at around 7.5 per cent each. The degree of total self-sufficiency also remained constant (18 per cent).

Despite the slowdown in domestic demand for energy and the growth of natural gas imports, the oil deficit for 1976 reached 7.3 billion dollars on a *fob* basis as against 6.4 in 1975 and 1.6 in 1973. This situation is all the more worrying if one considers, on the one hand, that the present deficit reflects the reduction obtained through action which it would be either socially expensive (cutting the growth rate) or technically difficult (increasing natural gas) to continue, and on the other the serious repercussions that any future rises in the price of crude oil would have.

The energy problem, of which the foreign exchange disequilibrium is only the most immediate and glaring feature, therefore remains as serious as ever and requires much more incisive action than has hitherto been adopted. This action must not only be aimed at getting the nuclear-power programme really started, but also involve a more diligent research into the possibility of exploiting alternative energy sources and, above all, into ways of curbing energy consumption.

Employment, wages, prices and the distribution of income

Employment

The recovery of production was accompanied by a 0.6 per cent increase in private sector demand for labour (0.9 per cent for employees in employment; Table 13) and a 15 per cent reduction in the number of underemployed persons. If one also includes non-marketable services the figures are 0.8 and 1.2 per cent respectively.

In agriculture the decline of employment slackened considerably, 1.2 per cent as against 4.7 in 1975. For the most part this was due to the growth in the number of workers in employment (1.5 per cent in 1976 compared with a 5 per cent drop in 1975) which contrasts with a clearly downward long-term tendency: over the last fourteen years workers in agriculture have decreased by 34.7 per cent at an average annual rate of 3 per cent.

Table 13

EMPLOYMENT IN ITALY

(yearly percentage changes)

Sectors and branches of activity	Employed labour force					Employees in employment				
	1972	1973	1974	1975	1976	1972	1973	1974	1975	1976
Agriculture	–8.1	–3.2	–2.5	–4.7	–1.2	0.6	–1.2	–1.9	–5.0	1.5
Industry	–1.7	0.5	1.5	–0.3	–0.1	–1.5	0.6	1.7	–0.5	–0.2
Energy products	*–1.3*	*–0.5*	*3.6*	*4.2*	*2.9*	*–1.3*	*–0.5*	*3.6*	*4.2*	*3.0*
Product of industrial processing	*–1.1*	*1.6*	*2.3*	*–0.2*	*0.4*	*–0.7*	*2.2*	*2.5*	*–0.4*	*0.4*
Total industry excluding construction	*–1.2*	*1.6*	*2.4*	*0.1*	*0.4*	*–0.8*	*2.1*	*2.6*	*–0.2*	*0.5*
Construction	*–3.4*	*–2.8*	*–1.1*	*–1.1*	*–1.7*	*–3.8*	*–3.7*	*–1.3*	*–1.5*	*–2.5*
Marketable services	1.8	2.1	3.1	1.8	2.2	2.9	3.5	4.0	2.5	2.8
Commerce, catering & entertainment	*0.9*	*2.0*	*2.5*	*0.8*	*1.2*	*2.1*	*4.2*	*2.2*	*0.9*	*1.8*
Transport and communication	*2.1*	*1.8*	*2.8*	*1.6*	*2.3*	*2.8*	*2.4*	*4.3*	*1.3*	*2.3*
Credit and insurance	*5.6*	*5.4*	*7.7*	*7.6*	*4.7*	*5.7*	*5.3*	*7.7*	*7.6*	*4.7*
Miscellaneous services	*3.1*	*2.1*	*4.1*	*3.4*	*3.8*	*3.5*	*2.8*	*5.4*	*4.3*	*4.1*
Marketable goods and services	–1.8	0.3	1.4	–0.3	0.6	–	1.3	2.0	–	0.9
Non-marketable services	3.7	3.3	3.1	3.1	2.4	3.7	3.3	3.1	3.1	2.4
TOTAL	–1.1	0.7	1.6	0.1	0.8	0.7	1.7	2.2	0.6	1.2

Source: Istat.

As regards the industrial sector, the marked stability of total employment (— 0.1 per cent with respect to 1975) is the result of a considerable reduction in those employed in construction (— 1.7 per cent) and a moderate increase in the number of those employed in the rest of industry (0.4 per cent). In construction, labour demand in 1976 reflected the poor performance of production and was in line with a downward trend that has been continuing since 1970.

In the rest of industry the minor variations in labour demand, over a two-year period (1975-76) when cyclical changes in production were exceptionally large, are linked to the institutional constraints that tend to guarantee employment levels during the slump.

The recovery of production above all generated a 29.8 per cent drop in the hours granted by the Wage Equalization Fund (— 18.4 per cent, including construction) which helped to reduce the number of underemployed for industry as a whole by 41 per cent. Intervention by the Wage Equalization Fund was not however negligible, 109 million hours more than the already very high figure for 1974. The main industries using the Fund were engineering and vehicles, the processing of non-metallic minerals, where the hours granted by the Fund were more than in 1975, and the chemical industry.

The slack increase in employment levels in industry excluding construction only affected medium-to-small sized enterprises. In those with more than 500 workers the number of employees in employment in fact fell at a slightly faster pace than in 1975 (— 0.9 per cent compared with — 1.1 per cent in 1976).

The fact that labour demand in industry responded slackly to the increase in production entailed a considerable growth of output per worker, which rose by 11.5 per cent with respect to 1975, when it had dropped by 9.1 per cent. The rise in output per hour was more modest however, owing to a small increase in total hours worked after the pronounced decline of 1975. The only slight adjustment of total labour inputs to the increase in production was thus chiefly due to the rise in average working hours per man.

Employment in the services sector increased in 1975 by 2.2 per cent, as a result of an almost equal growth of employment in non-marketable and marketable services. Owing to the favourable performance of labour demand in this sector the number of those employed continued to grow, raising their share in total employment from 42.2 per cent in 1970 to 47.3 per cent in 1976.

The increase in total employment, which according to quarterly surveys on the labour force was 0.7 per cent higher than in 1975, was accompanied by an 11.9 per cent rise in the number of unemployed persons. This rise was largely due to the increased number of young people seeking first jobs (16.9 per cent) which widely overshot the already very high figure for 1975 (11.5 per cent). However there was a considerable slowdown in the rest of unemployment, which rose by 3.7 per cent in 1976 as against a 26.8 per cent increase the year before.

Among young people seeking first jobs the greatest difficulties were encountered by women, whose numbers grew almost twice as fast as men (23 per cent as against 12.2 per cent). The percentage of young women seeking first jobs thus increased to 45.9 of the total. The opposite was true for the rest of unemployment, since the total increase can be broken down into a 4.2 per cent rise for men and 2.6 per cent for women.

As a consequence of the trends described above, as in the previous year the increase in the labour force (1.1 per cent) was higher than the increase of employment, so that the unemployment rate rose from 3.3 per cent in 1975 to 3.7. These results confirm the tendency for the labour force to increase, producing over the last four years a 0.4 per cent growth of the total participation rate, i.e. of the ratio between the labour force and the population.

The growth in labour supply with respect to the population can be entirely ascribed to the trend of the female labour force. In fact the participation rate for women increased by 1.6 percentage points between 1972 and 1976 (from 18.6 to 20.2 per cent), whereas for men it dropped during the same period by 0.9 points (from 53.3 to 52.4 per cent).

Wages

Trade union activity was characterized by two phases in 1976. The first concerned national labour contract renewals in most of the industrial sector, in agriculture and in some branches of the services sector, and came to an end during the year when specific agreements on wages and conditions were reached. The second, largely concerned with the reduction of unit labour costs, continued to be a central theme during the first months of the present year.

The phase of contract renewals was marked by the large number of working hours lost in labour disputes, especially in manufacturing industry, agriculture and commerce.

The disputes relative to the chemical, engineering and building workers' contracts came to an end in the first half of the year. The main results of these agreements have already been examined in last year's Report; they included practically equal wage increases for all employees and all categories, and on a more general level, understandings as to information on investment projects. In the second half of 1976, much the same results were obtained for the other contracts up for renewal, of which the most important, from the point of view of the number of employees, were those of workers in the textile industry, agricultural labourers, employees in commerce, civil servants and bank employees.

In the second half of the year negotiations intensified between Government and unions over the steps to be taken to overcome the country's economic difficulties. The unions asserted that the workers were willing to make the necessary sacrifices but at the same time demanded changes in the industrial reconversion plan and guarantees of control over the reconversion fund and over labour mobility. They also stated that they remained opposed on principle to any changes either in the basket of the union cost-of-living index or in the sliding scale system that would reduce the degree of wage and salary indexation.

With the currency crisis in September and the Government's proposals for tackling it, labour costs became the central issue; at the invitation of the Government, the Confindustria (General Confederation of Italian Industry) and the national unions decided to meet in the hope of reaching an agreement that would enable the upward trend of labour costs to be reduced. After many meetings and talks an understanding was reached on January 26, 1977; in addition to certain adjustments of working conditions concerning the distribution of holidays, overtime, workshifts and internal mobility, the two sides agreed on the system of payment to be adopted in 1977 to compensate for the seven holidays permanently abolished by Parliament (Law n. 54 of March 5, 1977) and on the annulment, as from January 31st of the present year, of increases in severance and retirement bonuses linked to the sliding scale.

The abolition of this severance pay system was then passed by Parliament with Law n. 91 of March 31, 1977, which also repealed all the more favourable wage indexation systems and replaced them with the one applied in industry. This followed the measure (Law n. 797 of December 10, 1976) whereby long-term Treasury bills are paid in lieu of 50 per cent of the sliding scale increases for those with annual wages (calculated net of social security contributions but before tax) between 6 and 8 million lire and in lieu of 100 per cent for those over 8 million; these bills may not be sold by the bearers until 5 years after their issue.

Although the Confindustria-national unions agreement represented a positive step towards reducing enterprises' labour costs, it was not considered enough to reduce them to any great extent for 1977. The Government therefore decided that it would take over part of the industrial (but not construction) enterprises' social security contributions, and would finance this operation by increasing VAT rates and taxes on certain oil products; subsequently certain sectors of commerce and the hotel industry were also included. This measure, which reduced the burden on employers by 14,000 lire per month for each employee from February to April 1977 and by 24,500 lire from May 1977 to January 1978, contained two conditions: firstly, the enterprises granting wage increases during company-level labour negotiations were not entitled to these benefits and could not deduct the wage rises for tax purposes; secondly, the increases in indirect taxes mentioned above were to be excluded when calculating the trade union cost-of-living index, to prevent the effects of the measure on labour costs from being destroyed by higher wage rises linked to the sliding scale which the harsher taxation would otherwise have entailed.

These two points were strongly opposed by the unions and were eliminated after an agreement had been reached between the Government and the unions at the end of March 1977, when the Government measure was passed (Law n. 102 April 7, 1977). In place of the sterilization of increases in VAT rates, the unions accepted a reduction of the expenditure items « daily newspaper », « urban transport » and « electricity » in the basket of the trade union cost-of-living index, which immediately brings the index itself down by about one and a half points, and in the future will allow the Government to pursue a more flexible prices policy. Furthermore the national unions confirmed their intention to curb wage-rise demands during company-level bargaining, as stated at the time of the agreement with the Confindustria.

From December 1975 to December 1976 minimum contractual hourly wages for industry as a whole rose by 28.9 per cent for manual and by 22 per cent for clerical workers (Table 14), showing a considerable acceleration with respect to the previous year. The factors causing this upswing were the wage increases obtained with the national contract renewals for most industrial sectors and the 20-point rise in the trade union index, together with a progressive increase in the average value of the sliding scale point.

Table 14

GROSS MINIMUM CONTRACTUAL WAGES (1)

(percentage changes)

Sectors	1975 / 1974	1976 / 1975	Dec. '75 / Dec. '74	Dec. '76 / Dec. '75
WAGES				
Agriculture	32.7	25.1	21.2	33.6
Industry	28.0	20.8	20.3	28.9
Mining and quarrying	24.1	21.8	20.4	29.8
Manufacturing	26.7	20.9	20.9	29.0
foodstuffs	*36.7*	*15.2*	*17.3*	*20.6*
textiles	*25.5*	*22.5*	*21.7*	*34.6*
metals and engineering	*24.8*	*22.3*	*20.6*	*30.2*
chemicals	*23.8*	*22.5*	*20.9*	*29.2*
Construction	31.0	21.0	18.7	29.0
Electricity and gas	24.2	16.3	23.4	20.8
Commerce	30.7	16.3	24.0	18.8
Catering and entertainment (2)	. .	30.0	. .	31.1
Transport	16.3	21.7	17.3	25.1
Communication (2)	. .	13.6	. .	16.9
SALARIES				
Industry	23.3	16.9	18.1	22.0
Commerce	27.7	14.4	21.2	16.2
Catering and entertainment (2)	. .	27.8	. .	28.8
Transport	10.6	16.7	11.0	18.0
Communication (2)	. .	13.9	. .	11.5
Credit and insurance (2)	. .	16.1	. .	19.8

Source: Istat.

(1) Excluding family allowances. – (2) Data on these sectors have only been collected since 1975.

The trend proved strongest in the middle of the year, as negotiations for the more important contracts ended and the higher price rises pushed the sliding scale up by six points in May and seven in August. In the second and third quarters of 1976 wages grew, with respect to the previous period, by 9.5 and 9.8 per cent for manual workers in industry and by 7.1 and 6.0 per cent for clerical workers.

In 1976 wage differentials tended increasingly to narrow, both among the various sectors and, within each, between the wages of manual and those of clerical workers. With respect to the increases in the trade union cost-of-living index, from December 1975 to December 1976 the wages of manual workers grew in real terms by 9.8 per cent in agriculture, 5.9 per cent in industry and 2.8 per cent in transport (the average annual variations were 7.2, 3.5 and 4.3 per cent respectively) while for commerce there was a 2.4 per cent decline (— 0.3 on average for the year). During the year minimum wages for clerical workers, however, were stationary in real terms for industry and fell by 4.5 per cent in the commercial sector, by 3 per cent in transport and by 1.6 per cent in the credit and insurance sector.

Contributory factors to this phenomenon were, on the one hand, the awarding of equal contractual rises for all workers and, on the other, the equal treatment guaranteed by gradually uniforming the sliding scale at the highest level. This standardization was completed in February 1977 when all grades, categories and age-groups were granted sliding scale points of the same value, amounting to 2,389 lire per month; this involves a recuperation of purchasing power inversely proportional to the wage received. Thus, assuming a constant rate of inflation, there will therefore be only one level of gross pay, which, through the sliding scale mechanism, could return every three months to the value in real terms obtained in February 1977.

The labour costs per unit of output in the private sector continued to rise considerably in 1976 (14.8 per cent) even if less than the exceptionally high rate of the previous year. The fact that unit costs grew less than costs per employee (21.1 per cent) is due to the large cyclical increase in productivity that followed the decline of 1975.

The rise in productivity appears stronger in the industrial sector where, given the substantial stability of employment, it reflected the increase in production. The cost of labour per unit of output in this sector grew by 11.5 per cent (3.3 percentage points less than the average for the private sector) while the cost of labour per employee increased more than the average.

Much higher than in industry were the increases in labour costs per unit of output in agriculture (25.8 per cent) and in the services sector (16.4 per cent). Although agricultural wages grew at much the same rate as in industry, there was a decline in productivity chiefly as a result of the drop in production with respect to 1975. In services the output per person employed grew by only 2 per cent in 1976 (owing to the considerable growth of employment) and was thus not able to reduce to any great extent the upward thrust of unit costs due to higher labour costs per employee.

Prices

In recent years, the growth of production costs that manufacturing enterprises have had to bear has been much greater than the rise in domestic prices: from 1970 to 1975 the average annual increase in labour costs per unit of output was 16.3 per cent as against 12.4 and 14.8 per cent respectively for the deflator of value added in industry excluding construction and for wholesale prices. Moreover, since 1973 the purchase of raw materials on the international markets has become more and more costly owing to both heavy rises in their prices at source, which were interrupted only in 1975 following the serious recession suffered by all the main economies, and the gradual devaluation of the lira.

Over the last few years the system has thus acquired a considerable inflationary potential, which has exerted a pressure that the enterprises have found increasingly hard to resist owing to the difficulties of further squeezing their profit margins. In fact, with only modest gains in productivity, the enterprises can only restore their profit margins to cope with a constantly upward trend in costs by considerably raising prices.

During 1976, the devaluation of the lira and the economic recovery — which was largely due to improved demand for consumer goods and to the gradual normalization of inventory levels, as well as to the satisfactory performance of world demand — helped to absorb more of the economy's inflationary potential than in the past. On average for 1976, a 10.1 per cent increase in labour costs per unit of output in industry excluding construction was matched by 16.9 and 22.9 per cent increases respectively for the deflator of industrial value added and wholesale prices.

During the year the general wholesale price index rose by 31.5 per cent (22.9 per cent on average). The increase was particularly high in the first half of the year, with a 5.2 per cent peak in April; the

Table 15

DOMESTIC WHOLESALE PRICES

(percentage changes of indexes, until 1976: 1970=100 – from 1977: 1976=100)

Indexes	1975 / 1974	1976 / 1975	Dec.'75 / Dec.'74	Dec.'76 / Dec.'75	June'76 / Dec.'75	Dec.'76 / June'76	Mar.'77 / Dec.'76
					(on a yearly basis)		
Istat							
General index	8.6	22.9	4.9	31.5	39.2	19.9	15.6
Classification by origin:							
Agricultural	10.8	23.9	13.0	27.8	28.4	23.8	18.4
Non-agricultural	8.2	22.8	3.6	32.1	41.0	19.3	15.6
Classification by product (1):							
Foodstuffs	13.0	21.2	9.0	27.7	24.9	27.1	16.1
Vegetable	8.7	21.9	8.4	27.9	30.1	22.4	23.6
Animal	23.1	23.3	22.5	20.9	16.3	23.6	9.1
Food manufactures	11.8	19.9	4.0	30.7	25.3	32.0	14.2
Industrial raw materials and manufactures	7.2	23.5	3.6	32.7	44.0	17.6	15.6
Raw materials	–5.4	27.8	–7.3	41.9	73.6	7.4	12.2
Manufactures	11.2	21.6	6.2	31.5	36.4	22.5	17.3
Classification by use:							
Consumer goods	9.8	23.8	6.9	33.4	34.8	27.3	17.2
Capital goods	7.6	19.8	2.1	27.9	42.2	11.2	19.3
Producer goods	6.0	24.7	2.7	30.8	48.8	10.2	14.3
Milan Chamber of Commerce							
General index	7.4	25.0	2.3	34.9	43.0	22.0	11.0
Foodstuffs	15.0	26.6	9.5	31.7	30.3	28.8	13.0
Industrial raw materials	4.3	24.3	–0.5	36.2	49.3	18.5	10.2

(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.

brusque depreciation of the lira loosened the constraints on domestic prices arising from the need to retain international competitiveness and at the same time made it more expensive to obtain supplies of raw materials and semi-finished products from abroad during an upswing in international prices. The largest rises in fact occurred in industrial materials which are mostly imported. In the first six months of the year their prices increased as a whole by 36.8 per cent (73.6 on an annual basis; Table 15). The stability of the exchange rate, the slowdown of production in the summer, and the effect of seasonal factors in containing prices for foodstuffs, as well as the gradual fade-out of the effects of the previous lira devaluation on prices of imported raw materials and intermediate products, were the factors that helped to slow down the pace of wholesale price rises during the summer months.

As from September, new inflationary pressures were recorded, though milder than in the first half of the year, as a combined result of the new weakening of the lira on the exchange market and of a considerable upsurge in foodstuff prices (4.2 per cent in September). The latter, having suffered the effects of the two devaluations of the « green lira » (in March and April, respectively of 5.6 and 6.4 per cent), were also influenced by the exceptional price rises on world markets for certain colonial products (coffee and cocoa) and the bad weather that reduced harvests of the main cereal crops and certain kinds of horticultural produce. The rise in prices for agricultural and livestock produce was immediately reflected onto the prices of the foodstuff processing industries, which in the second half of the year rose by 32.0 per cent on an annual basis (Table 15).

In the first quarter of 1977 a certain slackening of the rises in industrial raw material prices on international markets and above all the stability of the exchange rate slowed the growth rate of wholesale prices which equalled 3.9 per cent (15.6 on an annual basis).

The general index of consumer prices recorded an increase of 16.8 on average for 1976 and 22.0 per cent over the year (Table 16). This made Italy the most inflationary of the main industrial countries. Cyclically, consumer prices followed a trend not unlike that of wholesale prices despite the substantial difference in the contents of the two baskets. The two inflationary peaks of spring and autumn were in fact matched by a fair slackening of price rises during the summer months.

The acceleration of wholesale prices is therefore to be regarded as one of the main causes of the increase in retail prices. During the year, however, the fact that the latter rose strongly was also due both to the policy of revising public utility tariffs, and to the harshening of indirect taxation and the many price rises granted by the Interministerial Price Committee (CIP) to a broad range of regulated products.

Table 16

RETAIL PRICES AND COST OF LIVING

(percentage changes of indexes, until 1976: 1970=100 – from 1977: 1976=100)

Indexes	1975 / 1974	1976 / 1975	Dec. '75 / Dec. '74	Dec. '76 / Dec. '75	June '76 / Dec. '75	Dec. '76 / June '76	Mar. '77 / Dec. '76
					(on a yearly basis)		
RETAIL PRICES							
General index	17.0	16.8	11.2	22.0	21.7	20.1	18.1
Food products	18.0	17.1	11.6	22.5	21.5	21.2	19.7
Non-food products and services	16.2	16.5	11.0	21.5	21.8	19.2	18.1
Clothing and footwear	16.0	16.0	11.3	21.8	16.3	25.3	22.4
Hygiene and health (1)	12.9	10.9	9.4	13.0	13.9	11.3	5.4
Durables and non-durables (2)	17.7	15.0	10.0	21.0	20.7	19.3	20.4
Electricity, gas and fuels:	6.4	12.8	−7.1	31.3	22.2	36.4	33.4
heating fuels	*10.8*	*21.6*	*5.1*	*40.7*	*34.6*	*39.9*	*41.4*
Housing	14.0	12.0	11.2	14.2	16.0	11.5	5.8
Transport and communication:	19.5	26.9	14.9	34.4	38.5	25.4	19.6
petrol	*11.6*	*35.1*	*4.9*	*59.0*	*54.5*	*49.8*	–
Recreational and cultural goods and services	19.3	12.7	14.6	11.9	11.1	12.1	17.0
Other goods and services	16.4	15.5	13.0	18.7	24.8	11.2	23.0
Non-food products	14.6	17.4	7.9	25.5	23.8	24.2	17.6
Services	18.0	15.3	15.2	16.7	19.2	13.0	18.6
COST OF LIVING							
General index	17.2	16.5	11.1	21.8	20.6	20.8	21.0
Food	18.4	16.6	11.5	21.4	21.1	19.7	19.7
Clothing	15.3	16.3	10.9	22.5	17.7	25.1	24.8
Electricity and fuels	5.1	12.9	−7.3	30.9	21.4	36.6	35.2
Housing	13.0	10.4	10.5	12.5	13.3	11.0	4.3
Miscellaneous expenditure	18.2	17.9	13.0	22.8	22.1	21.2	22.0

Source: Istat.

(1) Following the new classification by ISTAT, March '77/Dec. '76 changes refer only to the item "Hygiene and health". – (2) For domestic use and services connected with housing.

Among the indexes of the various categories, the sharpest upward trend was for non-foodstuff products (25.5 per cent over the year), with peaks of 3.6 and 4.8 per cent in April and October respectively, due to the automatic effects of the tax measures already discussed.

Despite the hefty increase in public utility tariffs, which only appear in the basket of consumer prices, as a whole the latter did not register as sharp an upward trend as wholesale prices. As regards the various sectors, the discrepancy between the year's growth for wholesale and for consumer prices was greatest for non-durable goods (the figures were 34.3 and 21.5 per cent respectively) and practically nil for durables (26.0 as against 25.9 per cent) where the retail price is in many cases imposed by the manufacturer.

The index of consumer prices for manual and clerical workers' households recorded an increase for 1976 not much below that of consumer prices (21.8 per cent; Table 16). As for single items, the largest increases occurred for electricity and fuel (30.9 per cent) following the already mentioned rises in electricity charges and prices of oil products, for miscellaneous expenditure (22.8 per cent) and for clothing (22.5 per cent).

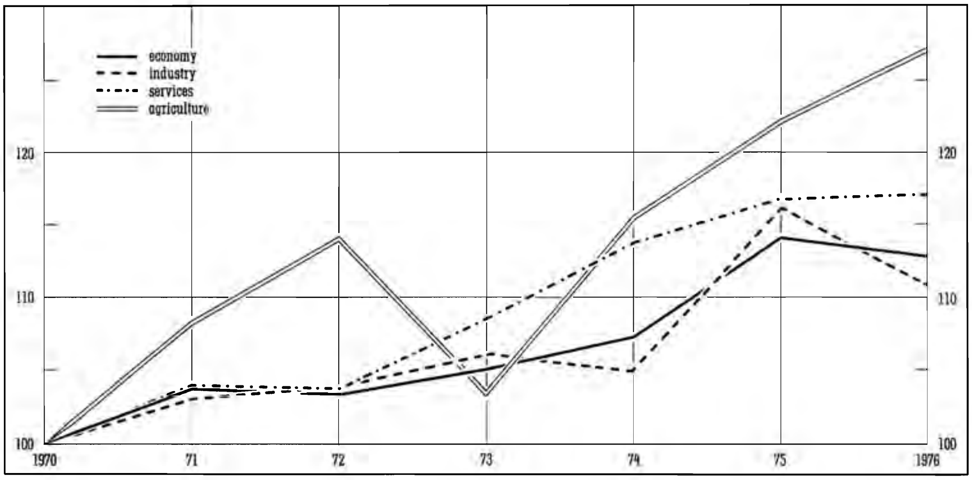
In the first quarter of 1977, albeit with some signs of weakening, consumer prices and the cost-of-living index continued to climb at high rates, which on a yearly basis amounted to 18.1 and 21.0 per cent respectively.

The distribution of income

The national income net of factor costs grew by 23.1 per cent in 1976, reflecting an increase in the incomes of employees (22.6 per cent) that was not much higher than in 1975 and lower than the increase in capital and entrepreneurial income and that from self-employed labour, where the rise was much higher than the year before (24.1 per cent as against 2.5 in 1975). The share of incomes from employed labour out of national income, which had risen from 60.3 per cent in 1970 to 70.4 in 1975, thus dropped very slightly to 70.2 per cent.

The improvement in income distribution in favour of capital and entrepreneurial income and that from self-employed labour was particularly noticeable in industry (Chart 8) where the growth of value added at market prices, amounting to 28.4 per cent, was over 6 points higher than that of incomes from employed labour (inclusive of social security contributions). A heavy shift towards the latter took place however in agriculture, while in the services sector the distribution of income showed no appreciable variation.

Chart 8



Percentage of income from employed labour over value added corrected for changes in employed labour over total employment

(indexes, 1970=100)

Calculated from ISTAT data

N.B.: The services sector includes not only marketable services, net of lettings, but also non-marketable services; in the industrial, services and agricultural sectors bank services are included; in the value added of the Economy they are excluded.

The balance of payments

In 1976 the balance of payments recorded a deficit of 1,028 billion lire; in fact, the 2,340 billion current account deficit, equal to 1.7 per cent of the gross domestic product, was offset to the tune of 1,392 billion by net capital inflows (errors and omissions were − 80 billion). The net foreign indebtedness of the banking system rose by 2,134 billion, thus making it possible not only to finance the total deficit, but also to increase official reserves (Table 17).

The recovery of productive activity, which had begun in the second half of 1975 with the upturn in foreign demand and was then sustained by policies designed to pull the economic system out of the recession, soon came up against the foreign accounts constraint. As a result, a rapid rebuilding of inventories began and, in view of expectations of a dollar appreciation, there was a widespread substitution of foreign exchange loans for financing in lira, causing a reduction in the banks' foreign debt and in official reserves. Thus, at the start of 1976 the balance-of-payments and reserves situation not only encouraged an adjustment of the exchange rate to the faster rise of costs occurring earlier in Italy than in competitor countries, but also made it difficult for the authorities to keep the lira devaluation within limits compatible with relative inflation.

Table 17

BALANCE OF PAYMENTS ON A TRANSACTIONS BASIS

(billions of lire)

Items	Credit		Debit		Balance	
	1975	1976	1975	1976	1975	1976
CURRENT ACCOUNT	**30,833.2**	**40,881.9**	**31,210.2**	**43,221.5**	**–377.0**	**–2,339.6**
Goods *(fob)*	22,563.0	30,524.4	23,324.5	33,883.9	–761.5	–3,359.5
Oil and oil derivates	*1,258.7*	*1,675.7*	*5,462.9*	*7,631.6*	*–4,204.2*	*–5,955.9*
Services	7,190.7	9,034.8	6,969.7	8,309.0	221.0	725.8
Transfer payments	1,079.5	1,322.7	916.0	1,028.6	163.5	294.1
CAPITAL MOVEMENTS	**13,182.3**	**17,436.1**	**13,709.5**	**16,043.9**	**–527.2**	**1,392.2**
Compensatory loans	–	–	644.8	281.9	–644.8	–281.9
Others	13,182.3	17,436.1	13,064.7	15,762.0	117.6	1,674.1
ERRORS AND OMISSIONS					**–437.5**	**–80.4**
TOTAL					**–1,341.7**	**–1,027.8**
TOTAL (excluding compensatory loans)					**–696.9**	**–745.9**
MONETARY MOVEMENTS	**1,813.0**	**10,218.4**	**471.3**	**9,190.6**	**1,341.7**	**1,027.8**
Banca d'Italia-UIC	1,813.0	8,084.0	17.9	8,278.6	1,795.1	–194.6
Banks	–	2,134.4	356.3	–	–356.3	2,134.4
Exchange rate adjustments	–	–	97.1	912.0	–97.1	–912.0

The pressing need for intervention to prevent an over-large devaluation of the currency made it necessary to adopt exchange and monetary measures aimed, over the short run, at curbing demand for foreign exchange while creating conditions for encouraging net inflows of private and bank capital. During the second half of the year the programme of fiscal measures described in earlier chapters was prepared with the intention of restoring current account equilibrium during 1977.

Experience in 1976 has again revealed how rapidly and fully domestic prices respond to exchange rate changes, but has also shown more clearly than in the past that lira export prices also behave in a similar way. This adjustment of export prices to prior cost increases has improved the profitability of sales abroad over the short run and dampened the negative effects of depreciation on the terms of trade. However, it has also eroded competitiveness gains and thus made it more difficult to increase market shares. In this situation, the role of the exchange rate in the balance-of-payments adjustment process becomes less effective, since any devaluation tends rather to boost the rate of inflation.

Given foreign demand, control of domestic demand and of its composition is essential in order to achieve the desired current account balance. If the deficit on current account is to be eliminated and surpluses achieved, thus improving Italy's debtor position, the country must in the foreseeable future develop at a slower pace than the industrial countries with a strong balance-of-payments position.

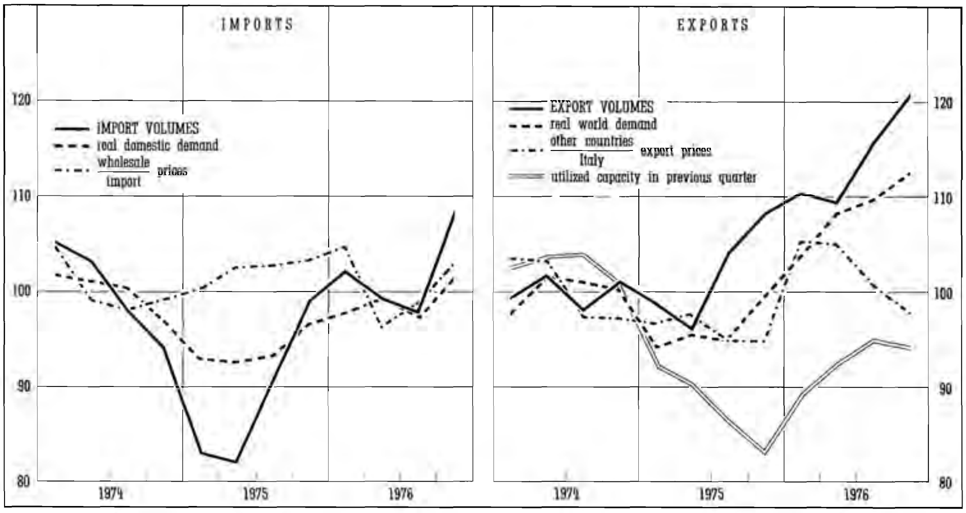
Movements of private, public and bank capital recorded a net inflow of 3,526 billion lire. The reasons for these massive capital movements should be sought in the many monetary and exchange policy measures enacted in 1976. More specifically, the obligation for exporters to obtain foreign exchange financing for part of the short-term loans granted abroad acted as a stimulus to bank indebtedness abroad; the same effect was produced in the last quarter of the year by the ceilings on bank loans in lire. The deposit and special levy on purchases of foreign exchange along with the ceilings mentioned above have led Italian importers to step up their requests for deferred payment, and it is in fact estimated that foreign short-term trade credits, net of those granted abroad, amounted to 1,444 billion during the year under study. Net inflows of capital funds would have been much higher had there not been a massive disinvestment of foreign capital, particularly in the first half of the year, and continued illegal capital outflows, amounting to slightly less than in 1975. These outflows, however, largely occurred in the first six months, subsequently declining with the enactment of new laws on the violation of exchange regulations.

Merchandise

Compared with 1975 the growth rate of exports rose from 15 to 35 per cent, while imports increased by 44 per cent, as against the 6 per cent drop recorded the previous year. The 5,402 billion lire trade deficit thus more than doubled, largely (i.e. for about two-thirds) owing to the poor performance of the terms of trade. The export volume rose by 12 per cent compared with 1975 and the corresponding unit values by over 20 per cent. On the import side these increases were respectively 15 and 25 per cent.

An examination of the performance over the year using seasonally adjusted data shows that the gradual increase in the deficit during the first half-year compared with the average levels for 1975 can be related both to the deterioration in the balance at constant prices and to the worsening of the terms of trade. However, although the latter then improved, the deficit remained high also in the second half of the year.

Chart 9



Main factors of change in Italy's foreign trade
(indexes 1974=100; seasonally adjusted data)

The performance of the volume of imports and of their main determinants is illustrated in Chart 9. The drop recorded in the third quarter and the end-year recovery are mainly linked to the behaviour of domestic demand. A comparison of imports of non-finished goods and production shows that inventories settled at normal levels: in fact, between the fourth quarter of 1976 and the same period of the previous year, the growth rate of these imports was almost equal to that of industrial production. The evolution of relative prices had only a mild impact on purchases abroad in view of the rapid recovery of domestic compared with import prices during the second half of the year.

The largest increases in the export volume were recorded in the second half of the year, while world demand grew mostly in the first six months. Consequently the loss of market shares in the early months of the year was reabsorbed, thus allowing Italy to more or less retain her position on the international markets on average for 1976. The recovery of domestic demand may have applied a brake to the faster growth of exports: utilized capacity in fact increased considerably compared with the low levels recorded at end-1975. Moreover, the unsatisfactory export performance in the first six months appears to be linked to production losses following strikes during labour contract renewals, for the most part in the metals and engineering, chemicals, textiles and clothing branches. The healthier pace of sales in the last two quarters of the year was due to the delayed effects on our exports of an improved price competitiveness as the exchange rate depreciated.

Although Italy's share of world exports remained unchanged in real terms with respect to 1975, at current prices it experienced a drop. This contrasting performance should be ascribed to the decline, on average for the year, of Italy's dollar export prices following the lira devaluation.

The worsening in the terms of trade during the year under study can be traced not only to the depreciation of the lira but also, to a lesser extent, to renewed tensions on the international markets for raw materials. Their prices increased by about 9 per cent, while export prices of manufactures remained basically stable. On average for the year, the devaluation of the lira improved the competitiveness of Italian products, and the average unit values, in dollars, of our exports dropped by around 6 per cent. Moreover, these advantages were gained at a time when the enterprises' profitability had already improved; in fact, in 1976, both lira export prices and domestic wholesale prices rose at much faster rates than unit labour costs.

Competitiveness improved mostly in the first six months of 1976, while during the two following quarters Italy's export prices rose faster than world prices. This can, on the one hand, be attributed to the behaviour of exporters who, it seems, take some time to translate the devaluation of the lira into profit gains and, on the other, to the increase in enterprises' production costs induced by depreciation.

Capital movements

Capital movements recorded a surplus of 1,392 billion lire, compared with a 527 billion deficit the previous year (Table 18). The outflow for repayments of compensatory loans amounted to 282 billion (645 in 1975), while the inflow from disinvestments of assets illegally acquired abroad, following the enactment of Law n. 159 of April 30, 1976 (and subsequent amendments), amounted to 500 billion. Net of these figures, but including 230 billion outflows for net export credits financed by the UIC (Italian Foreign Exchange Office) and thus registered as monetary movements (158 in 1975), the total inflow drops to 944 billion, compared with an outflow of 40 billion in 1975. The surpluses were larger in the second half of the year, largely in connection with the inflow of capital under Law n. 159 and with the import trade credits encouraged by the deposit and special levy on purchases of foreign exchange and payments abroad.

Monetary movements

The inflow of short-term bank funds from abroad (2,134 billion lire) made it possible during the year not only to finance the autonomous balance-of-payments deficit, but also to repay maturing debts taken out in previous years on the international markets and to improve the Banca d'Italia-UIC net foreign position (194 billion, net of the revaluation of the gold reserves). Exchange adjustments amounted to 912 billion (Table 17).

In the first half of 1976, the external deficit was financed by resorting to credit lines with international organizations (1 billion dollars from the EEC) and central banks (500 million dollars from the

Bundesbank and the same amount from the Federal Reserve). These operations, along with the rising foreign debt of the banking system made it possible to finance intervention in support of the exchange market and to consolidate the level of foreign exchange reserves.

In the third quarter, the improved performance of the balance of payments produced, mostly in July and August, an accumulation of massive foreign exchange holdings, which were in part used to reduce the country's foreign debt.

Table 18

CAPITAL MOVEMENTS

(billions of lire)

Items	Credit		Debit		Balance	
	1975	1976	1975	1976	1975	1976
FOREIGN CAPITAL	**6,490.0**	**8,807.7**	**5,819.6**	**6,147.7**	**670.4**	**2,660.0**
Investment:						
direct	692.1	353.7	279.8	276.3	412.3	77.4
portfolio	246.6	367.1	322.4	471.8	−75.8	−104.7
other	38.3	47.8	31.1	36.9	7.2	10.9
Loans:						
private	917.8	751.2	969.7	797.7	−51.9	−46.5
granted or guaranteed by the Government	225.5	290.7	99.1	166.5	126.4	124.2
Trade credits:						
medium- and long-term	300.5	350.0	228.3	300.0	72.2	50.0
short-term	3,905.1	6,436.1	3,848.8	3,944.8	56.3	2,491.3
Other capital	164.1	211.1	40.4	153.7	123.7	57.4
ITALIAN CAPITAL	**6,692.3**	**8,628.4**	**7,889.9**	**9,896.2**	**−1,197.6**	**−1,267.8**
Investment:						
direct	235.4	313.8	461.8	446.4	−226.4	−132.6
portfolio	395.4	578.9	270.1	351.6	125.3	227.3
other	0.3	1.5	2.4	1.5	−2.1	–
sales under Law n. 159	–	500.4	–	–	–	500.4
Loans:						
private	176.5	187.7	242.5	488.5	−66.0	−300.8
granted or guaranteed by the Government	43.0	39.0	36.2	55.4	6.8	−16.4
Trade credits:						
medium- and long-term	1,308.9	1,632.0	1,145.0	1,523.0	163.9	109.0
short-term	4,532.8	5,375.1	4,981.3	6,422.9	−448.5	−1,047.8
Other capital	–	–	750.6	606.9	−750.6	−606.9
BALANCE	**–**	**–**	**–**	**–**	**−527.2**	**1,392.2**

In the last two weeks of September, the emergence of new tensions on the exchange market required massive support intervention, bringing the level of foreign exchange holdings to 1.5 billion dollars at the end of the month. Recourse to emergency measures (the special levy on purchases of foreign exchange) and to more incisive demand control policies caused pressures against the lira to recede in the fourth quarter: the volume of foreign exchange reserves doubled in that quarter, to reach 3.1 billion dollars at year-end.

At the end of the year Italy's foreign debt rose to around 17 billion dollars (Table 19). Only a third of the almost 3 billion

Table 19

ITALY'S FOREIGN DEBT AND OFFICIAL RESERVES

(millions of dollars)

Items	1973 Dec.	1974 Dec.	1975 Dec.	1976 June	1976 Dec.	1977 March
LIABILITIES						
Monetary institutions	*1,016*	*6,957*	*7,035*	*10,227*	*10,115*	*11,745*
Banca d'Italia-UIC	389	5,638	6,303	8,298	7,104	7,316
Short-term liabilities	389	70	41	602	108	220
Medium- and long-term liabilities	–	5,568	6,262	7,696	6,996	7,096
EEC	–	1,885	1,885	2,882	2,407	2,406
IMF: stand-by	–	857	1,171	1,146	1,162	1,161
oil facility	–	826	1,706	1,668	1,691	1,689
Bundesbank	–	2,000	1,500	2,000	1,736	1,840
Banks (net foreign liabilities)	627	1,319	732	1,929	3,011	4,429
Non-monetary institutions						
Medium-term liabilities (compensatory loans)	6,063	8,120	7,146	7,018	6,811	6,761
TOTAL LIABILITIES ...	7,079	15,077	14,181	17,245	16,926	18,506
ASSETS						
Gold (1)	7,869	13,073	9,832	8,677	9,320	10,183
Special drawing rights	414	221	97	86	91	94
IMF reserve position	359	–	–	–	–	–
Foreign currency	2,181	3,187	1,209	1,685	3,132	2,888
TOTAL ASSETS ...	10,823	16,481	11,138	10,448	12,543	13,165

(1) The price of gold is that adopted on the London market at the end of the month indicated, less 15 per cent. For December 1976 and March 1977 the price, still based on the market quotation, is that officially adopted to calculate Italy's gold reserves.

increase recorded during the year reflected the actual deterioration in Italy's foreign position, while two-thirds were the counterpart of the increase in foreign exchange reserves. In the first quarter of 1977, the foreign debt recorded a further increase (1.6 billion dollars), mainly in the form of a rise in the banking system's net foreign liabilities.

Table 20

TRADE-WEIGHTED LIRA DEPRECIATION RATE VIS-A-VIS QUOTATIONS ON FEBRUARY 9, 1973

(monthly averages of the daily rate)

Months	Weighting: geographical distribution of Italy's foreign trade					
	in 1972			in 1974		
	1973	1974	1975	1975	1976	1977
January	–	−12.9	−21.8	−20.4	−22.7	−37.1
February	−1.9	−15.8	−21.9	−20.4	−29.4	−37.1
March	−5.6	−15.4	−21.6	−20.1	−33.5	−37.4
April	−7.7	−16.4	−21.0	−19.6	−37.3	−37.7
May	−8.7	−17.0	−20.8	−19.2	−35.2	
June	−13.4	−18.3	−20.7	−19.1	−34.2	
July	−14.7	−17.9	−20.8	−19.4	−33.1	
August	−11.4	−18.3	−21.0	−19.8	−33.3	
September	−9.8	−18.5	−21.2	−20.0	−34.0	
October	−10.5	−20.2	−21.7	−20.5	−34.6	
November	−11.2	−21.3	−21.7	−20.5	−35.5	
December	−11.5	−21.7	−21.5	−20.4	−36.1	
YEAR	−8.9	−17.8	−21.3	−20.0	−33.2	

In 1976 the loss of external purchasing power of the lira was the highest, on a yearly basis, recorded since the start of floating. The average rate of depreciation of the currency, weighted according to the geographical distribution of foreign trade in 1974, was 16.1 per cent on average for 1976 compared with 1975; during the year the lira's external value dropped by around 20 per cent (Table 20). The lira devaluation occurred entirely during the first four months of the year when the exchange crisis was most severe. After the recovery during the summer months, which was partly of a seasonal nature, the external value of the lira suffered new downward pressures in autumn, of both domestic and international origin. In order to curb the decline of the lira, an economic policy programme based on fiscal, credit and exchange measures was launched and soon reversed the tendency on the exchange market. In this regard, the introduction of a temporary levy on purchases of foreign exchange (10 per cent in the first two weeks of October, then 7 per cent from October 25th on) was particularly effective. The slowdown in demand for foreign exchange during that period made it possible to curb the exchange rate devaluation, which moved from 34.6 per cent in October to 36.1 per cent in December (with reference to quotations at February 9, 1973).

Public finance

After heavy interventions during 1975 to sustain the private sector's disposable income, fiscal policy in 1976 was aimed at curbing the deficit. During the year public sector operations, excluding the funding of debts of health insurance bodies, produced net indebtedness amounting to 13,940 billion, almost the same as in 1975. Indebtedness as a ratio of gross domestic product declined from 12.2 to 9.8 per cent. Opposite trends were shown by the current account and by capital account deficits; the decrease in the former was mainly achieved by raising taxes and public utility tariffs and was in fact matched by an increase in the latter due to the rise in disbursements for direct investments, especially by local government and autonomous agencies, following the enactment of expenditure programmes decided during the last three years.

Disbursements exceeded 67,500 billion (increasing by 24 per cent) and remained at around 48 per cent of the gross domestic product. Despite the reduction in personal income tax rates decided at end-1975, fiscal revenues increased by 32 per cent, as a result not only of the growth of tax base, but mainly of changes in collection schedules for certain direct taxes and several increases in indirect taxes. The ratio of fiscal revenue (including social security contributions) to GDP which was 31 per cent in 1975, reached 33 per cent in 1976 and is expected to be over 35 per cent in 1977, thus narrowing the gap between the ratio for Italy and that for the other EEC countries. Direct taxes rose from 7.4 to 8.6 per cent of GDP and indirect taxes from 9.6 to 10.5 per cent. Social security contributions, which constitute the largest share of the revenue, remained stable at about 14 per cent of GDP.

The increases in taxes, tariffs and administered prices adopted in autumn, together with restrictive monetary, credit and currency measures aimed at improving the balance of payments by curbing private consumption, produced a limited yield in 1976 (little over 700 billion); however they had negative effects on inflation at the end of the year.

In 1977 these measures should increase revenues from taxes and public utility tariffs by 6,300 billion (of which 1,400 billion from direct taxation, 3,500 from indirect taxation, 500 from autonomous agency tariffs and 900 from ENEL, the National Electricity Agency) matched by a reduction of 1,400 billion in the health insurance contributions paid by the enterprises.

The public sector deficit remained stationary for 1976 and a considerable reduction is envisaged for 1977 indicating a turning point in the performance of this aggregate.

A lasting adjustment of public finance should be based on a reduction of tax evasion, which is still remarkably high for incomes other than those of employees and for VAT, and on measures to curb the growth (and increase the efficiency) of public expenditure. It should also be necessary to restore the mechanism for controlling the expenditure itself and to increase mobility in the civil service. These interventions are all the more urgent because they cannot produce appreciable results in the short run.

Within the public sector the total borrowing requirements of the State sector (Treasury, Central Post Office Savings Fund and autonomous agencies) net of funding operations, were also nearly the same as in the previous year (14,300 billion as against 14,130). The figure for 1976 (once budget lending to the special credit institutions has been deducted) is thus well within the ceiling set by the EEC on this aggregate, as one of the conditions for the Community loan granted in March 1976. By contrast the ceiling on budget disbursements was exceeded by 1,000 billion, largely due to the interventions necessary for the Friuli earthquake and to the advance payment of the increase in ENEL's endowment fund, which had originally been included in the budget payments forecast for 1977.

In the « letter of intent » to the International Monetary Fund last April, the Italian Government undertook to respect the following limits for 1977, as conditions for utilizing the credit line: *a*) the cash requirements of the State sector (including interventions by the Central

Post Office Savings Fund for local authorities in lieu of bank advances, but excluding 300 billion's worth of credit to the special credit institutions) shall not exceed 13,100 billion (specifically 8,700 in the first half of the year and 11,200 over the first nine months); *b*) budget outlays by the State (including transfers to INAM — the National Health Insurance Institution — to finance the State's taking over of social security contributions in 1977) shall not exceed 55,350 billion, while the net disbursements by the Central Post Office Savings Fund, the autonomous government agencies and for Treasury operations not included in the budget shall remain below 3,500 billion; *c)* the cash requirements of the public sector, including ENEL and hospitals, which were estimated at 18,700 billion for 1976 shall not exceed 16,450 billion. The estimates of the cash requirements of the State sector and public sector imply further increases in revenue or decreases in expenditure for a total of 2,000 billion, of which roughly 1,000 in the form of higher revenues needed to pay for the social security contributions taken over by the Government for the period July 1st 1977-January 31st 1978.

When the EEC, as part of its medium-term financial support, granted a 500 million dollar loan in April 1977 it fixed the same limits, except for the balance of the operations of the Central Post Office Savings Fund and autonomous government agencies, and Treasury operations not included in the budget, and also placed a 4,000 billion ceiling for 1977 on Banca d'Italia financing to the Treasury.

In 1976 the financing of the State sector was chiefly covered with the creation of monetary base: the appearance of new tensions on the bond market, the introduction of the compulsory deposit on purchases of foreign currency, as well as other interventions restricting the banks' monetary base, did not in fact allow the Treasury to finance its own cash requirements to any large extent by placing securities with the market (Table 21).

Consequently, monetary base creation via the Treasury, despite the marked stability of its cash requirements (net of the aforesaid placements of securities to fund debts) was much larger than the year before. More specifically this growth was due to heavier central bank financing, which rose from 5,410 to 9,280 billion mainly as a result of the large increase in net purchases of securities.

Table 21

TREASURY CASH REQUIREMENTS AND THEIR COVERAGE (1)

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

Items	1974	1975	1976 1st qtr.	1976 Year	1977 1st qtr.
Overall cash requirements					
Budget deficit (–)	–5,149	–10,282	–1,795	–10,406	–2,698
Minor Treasury operations	–1,991	–4,103	60	–1,664	621
Extra-budgetary operations	–1,822	–2,135	–808	–2,638	–1,330
Total	–8,962	–16,520	–2,543	–14,708	–3,407
Operations to fund local auths' and public health insurance institutions' debts (2)	*–315*	*–2,393*	*–33*	*–407*	*–278*
Total, net of funding	–8,647	–14,127	–2,510	–14,301	–3,129
Coverage of overall cash requirements					
Medium- and long-term bonds excluding Banca d'Italia	–182	3,609	1,417	779	757
Post Office savings	1,881	1,627	–2,762	1,531	2,718
Treasury bills, excluding Banca d'Italia	837	2,309	880	2,635	688
Borrowing from BI-UIC	6,498	8,823	3,086	9,936	–865
current account (3)	*50*	*560*	*584*	*1,694*	*693*
Foreign indebtedness	3	8	18	2	13
Other indebtedness	–75	144	–96	–175	96
Total	8,962	16,520	2,543	14,708	3,407
domestic financing:					
short-term	*9,130*	*12,960*	*1,106*	*13,922*	*2,607*
(monetary base creation, through "Treasury")	*7,671*	*7,779*	*3,147*	*11,746*	*–120*
medium- and long-term	*–171*	*3,552*	*1,419*	*784*	*787*
Net indebtedness (4)	6,680	13,689	1,418	10,426	1,587

(1) For the 1st quarter of 1977 some figures are estimated. — (2) For 1974 bond operations by the Post Office Savings Fund to fund loans granted by banks to Municipalities and, for 1975 e 1976 mainly, 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) Changes in the financial situation, i.e. borrowings less lendings.

Recourse to the central bank thus exceeded by about 3,300 billion (excluding the purchase of securities to fund the debts of the health insurance bodies) the 5,700 billion limit set by the EEC in March 1976. However, in this regard one should also consider the consequences of the introduction, in May 1976, of the compulsory deposit on purchases of foreign currencies. This in fact caused the banks to reduce their purchases of Treasury bills, which were instead made by the Banca d'Italia, recipient of the compulsory deposit.

THE MONEY AND FINANCIAL MARKETS

The central bank's operations and their effects on lending and interest rates

The regulation of the monetary base and the other measures adopted by the central bank in 1976 were designed to keep the expansion of the monetary base and credit below that of nominal income. This policy, though it did not prevent production from expanding rapidly, did cause considerable upward pressure on interest rates, and especially on short-term ones. The average increase was, however, less than the rate of inflation. The use of normal monetary and credit policy instruments — such as the availability of refinancing, its cost and auctions of Treasury bills — was integrated by special measures regarding both the uses of monetary base and the growth of bank lending.

The expansion of the monetary base net of Post Office deposits equalled 4,773 billion or 16.4 per cent (4,573 billion or 18.6 per cent in 1975) and, for the first time in the last four years, the foreign sector made a small but nonetheless positive contribution to the creation of monetary base. Compared with 1973 and 1974, the two most recent years of rapid inflationary income growth, 1976 was characterized by two phenomena: first, the size of the gap between the large percentage increase of income and the much smaller one of the monetary base; second, the fact that the percentage increases of the monetary and credit aggregates were closer to that of income than to that of the monetary base (Table 22). This increase in the amount of money and credit generated by each new unit of monetary base seems all the more surprising in view of the special deposits of compulsory reserves which banks had to make on three occasions during the year. It can be seen to have had several different causes: the high level of liquid reserves at the beginning of the year, owing to the expansionary policy of 1975; the sharp rise of short-term interest rates which led the banks to reduce their liquidity; the decline in the demand for notes and coin, from 9.7 to 8.6 per cent of income. Another factor which contributed to the increase of money supply was the tendency for the public to prefer short-term assets in view of the general climate of uncertainty and the fact that short-term rates had risen more than long-term ones.

The first few months of 1976 saw a stream of measures designed to contain the effects of the exchange rate crisis by acting both directly on the regulations concerning foreign currency transactions and indirectly on the various other components of the monetary base.

Table 22

MONETARY AND CREDIT AGGREGATES, GROSS DOMESTIC PRODUCT AND INTEREST RATES

Items	1967/1970	1971/1975	1970	1971	1972	1973	1974	1975	1976
	PERCENTAGE INCREASES (1)								
Monetary base (2) . . .	9.3	16.5	14.3	16.4	13.6	18.6	15.4	18.6	16.4
Adjusted monetary base (3)	9.6	16.9	12.4	14.5	13.1	18.8	16.3	21.8	11.7
M2 (4)	12.5	19.5	13.6	17.0	18.2	23.1	15.5	23.5	21.1
Total domestic credit . .	10.4	19.1	10.3	16.6	18.4	21.5	16.5	22.5	19.8
	RATIO TO THE GROSS DOMESTIC PRODUCT								
Adjusted monetary base (5)	22.8	23.5	22.3	23.3	24.2	23.5	22.6	23.8	22.2
M2 (5)	84.0	96.9	85.6	90.8	97.5	98.7	95.9	101.5	99.6
Total domestic credit (5)	116.4	128.1	115.6	120.7	129.5	130.2	126.5	133.8	130.1
	INTEREST RATES (6)								
Interbank call rate . . .	....	8.62	7.57	5.76	5.18	6.93	14.57	10.64	15.68
Bank loans	7.80	10.90	9.15	9.03	7.88	8.31	14.22	15.08	17.33
Industrial bonds	7.39	8.81	9.05	8.17	7.40	7.48	10.20	10.82	12.84

(1) On end-period values. — (2) Excluding Post Office deposits. — (3) Excluding Post Office deposits and adjusted for changes in the compulsory reserve coefficient. — (4) Notes and coin, current account deposits, savings deposits; not including Treasury bills. — (5) Average amounts during the period. — (6) Average values during the period.

During the first quarter the total creation of monetary base net of Post Office deposits amounted to 82 billion. This was the result of the creation of 2,250 billion by the Treasury and the destruction of an almost equal amount by the foreign sector together with the banks. In the same way, the changes in the various uses of monetary base were considerably larger than the total net change, since a 2,165 billion increase of compulsory reserves (of which 792 billion corresponded to special reserve requirements) was offset by a 1,468 billion fall in bank liquidity together with a seasonal decline in currency circulation (Table 23).

Table 23

MONETARY BASE

(changes in billions of lire)

Items	1974	1975	1976 Year	1976 Quarters I	II	III	IV	1977 Qtr. I (1)
				SOURCES				
Foreign sector	**–3,115.0**	**–1,700.3**	**1,092.7**	**–1,114.5**	**–214.3**	**739.7**	**1,681.8**	**–310.0**
balance of payments (2)	–4,913.3	–732.2	–779.9	–1,312.4	–1,007.8	735.5	804.8	–1,530.6
interventions	1,798.3	–968.1	1,872.6	197.9	793.5	4.2	877.0	1,220.6
Treasury	**7,670.6**	**7,779.3**	**11,745.5**	**3,147.4**	**3,719.8**	**1,773.7**	**3,104.6**	**–119.8**
Treasury excluding Post Office deposits	6,841.3	5,470.5	9,137.9	2,254.2	3,589.5	1,448.9	1,845.3	–807,3
overall cash requirements	8,961.9	16,519.5	14,708.1	2,542.7	3,230.9	4,672.9	4,261.6	3,407.3
non–monetary financing (3)	–1,291.3	–8,740.2	–2,962.6	604.7	488.9	–2,899.2	–1,157.0	–3,527.1
Banks	**1,362.3**	**–389.0**	**–1,477.0**	**–1,197.2**	**995.2**	**–591.0**	**–684.0**	**469.9**
Other sectors	**–1,812.4**	**1,192.1**	**–3,981.1**	**139.1**	**–3,053.0**	**–1,738.1**	**670.9**	**1,664.5**
deposits: on imports and purchases of foreign exchange	–1,237.3	1,237.3	–3,544.6	–	–2,379.0	–1,833.9	668.3	1,347.3
in foreign exchange	–1,118.6	599.9	–650.0	–737.4	66.0	36.5	–15.1	60.2
TOTAL	**4,105.5**	**6,882.1**	**7,380.1**	**974.8**	**1,447.7**	**184.3**	**4,773.3**	**1,704.6**
TOTAL excluding Post Office deposits	3,276.2	4,573.3	4,772.5	81.6	1,317.4	–140.5	3,514.0	1,017.1
				USES				
Public sector	**2,042.9**	**4,123.5**	**4,081.7**	**277.8**	**1,172.4**	**295.7**	**2,335.8**	**–136.4**
Public sector excluding Post Office deposits	1,213.6	1,814.7	1,474.1	–615.4	1,042.1	–29.1	1,076.5	–823.9
Banks	**2,062.6**	**2,758.6**	**3,298.4**	**697.0**	**275.3**	**–111.4**	**2,437.5**	**1,841.0**
compulsory reserves (4)	1,494.2	1,633.7	4,414.8	2,165.4	385.1	413.3	1,451.0	1,781.8
excess reserves	568.4	1,124.9	–1,116.4	–1,468.4	–109.8	–524.7	986.5	59.2
				COMPONENTS OF TOTAL MONETARY BASE (5)				
Domestic component (6)	*7,509.8*	*5,673.7*	*4,329.8*	*1,933.5*	*1,465.7*	*–916.7*	*1,847.3*	*407.9*
Foreign component (7)	*–4,233.6*	*–1,100.4*	*442.7*	*–1,851.9*	*–148.3*	*776.2*	*1,666.7*	*609.2*
				FACTORS OF CHANGE IN BANKS MONETARY BASE				
Autonomous (8)	*3,385.6*	*13,366.8*	*12,493.8*	*2,261.9*	*886.4*	*6,117.3*	*3,228.2*	*3,598.9*
Intervention (9)	*–1,323.0*	*–10,608.2*	*–9,195.4*	*–1,564.9*	*–611.1*	*–6,228.7*	*–790.7*	*–1,757.9*
TOTAL BANK RESERVES	*2,062.6*	*2,758.6*	*3,298.4*	*697.0*	*275.3*	*–111.4*	*2,437.5*	*1,841.0*
of which extraordinary deposits	–	–	*1,343.0*	*792.0*	–	–	*551.0*	–

(1) Provisional figures. – (2) Autonomous balance. – (3) Public and bank purchases of Treasury bills at issue and/or on the open market. – (4) Includes cash, Treasury bills and long–term securities deposited against the release of cash. – (5) Excluding Post Office deposits. – (6) Treasury, Banks and Other Sectors (net of compensatory loans). – (7) Foreign sector and compensatory loans. – (8) Autonomous balance of payments, Treasury cash requirements, *less* notes and coin held by the public and special credit institutions' deposits. – (9) Foreign interventions, non–monetary Treasury financing, financing to the banks, other sectors net of special credit institutions' deposits, *less* public deposits with the Treasury and BI–UIC and Post Office deposits.

The worsening of the exchange rate crisis at the beginning of May led to the introduction of a compulsory deposit against purchases of foreign currency. This deposit, besides encouraging an inflow of import trade credits, set in motion a mechanism for the automatic absorption of monetary base. The measure had, in fact, important effects on the volume and the composition of the main financial flows: by imposing on the economy a sort of 3-month compulsory reserve in monetary base, it increased the demand for financing, thereby accelerating the expansion of domestic credit, and also partially substituted the purchase of Treasury bills, thus increasing the share of monetary base created by the Treasury. At the same time it tended to shift the composition of bank credit away from securities and towards loans, as a result of both reduced placements of Treasury bills and the increased demand for short-term financing.

Conditions on the money, financial and foreign exchange markets in June were markedly different from those existing at the beginning of the year. The interbank rate rose above 20 per cent, and the prime rate was close to this value. Long-term rates, instead, had increased much less: those on Treasury bonds by two points and those on bonds issued by the industrial credit institutions by two and a half points.

The money market remained relatively stable, with interest rates only slightly below the highs registered in the spring and with liquidity slightly greater than the May and June lows, until the end of September when a speculative attack initially launched against other currencies spread to the lira. New measures were taken in the monetary and foreign exchange fields: a special compulsory reserve requirement amounting to 551 billion was set for 15 October and the discount rate raised from 12 to 15 per cent. On the foreign exchange front the compulsory deposit on purchases of foreign exchange, which it had been planned to abolish on November 5th, was extended to the middle of April 1977, though the coefficients were progressively lowered. A special 10 per cent levy on purchases of foreign currency was also introduced. This tax was renewed at the end of October at 7 per cent, and then progressively eliminated between December and February 1977.

Despite the reduction of the monetary base, the banks met the massive demand for short-term funds both by employing more of their excess reserves and by borrowing more abroad. Though extremely high, the cost of short-term borrowing did not have a stabilizing effect on the demand for credit because of the rapid acceleration of inflation. The various factors mentioned above, together with the large quantities of maturing Treasury bills, made it more difficult to control bank lending through measures affecting the monetary base and, in consequence, to defend the exchange rate. These difficulties and the particularly large rise in the amount of short-term credit granted during the summer months led the monetary authorities to impose monthly limits on the nominal increases of bank loans over the period November 1976-March 1977. As a result the annual rate of expansion of bank credit fell from over 25 per cent in September and October to below 20 per cent in the first few months of this year.

The limits placed on bank credit tended to shift the composition of bank credit away from loans and back towards Treasury bills, thereby creating pressure in opposite directions on their respective interest rates. While the prime rate stayed unchanged at the 20 per cent level and the average lending rate rose again slightly in the fourth quarter, the expansion of the monetary base due to the foreign sector, the Treasury and the progressive reduction of the compulsory deposit on purchases of foreign currency encouraged the banks to repay their fixed-term advances and to reinvest in Treasury bills, a switch which started a slow downward movement of money market rates.

At the end of the year the money and foreign exchange markets were relatively calm. The creation of monetary base net of Post Office deposits in the fourth quarter amounted to 3,514 billion: 1,490 billion was used to meet end-of-year demand for notes and coin, 1,451 billion to satisfy ordinary and special compulsory reserve requirements, and 987 billion helped to raise bank liquidity above the extremely low level registered at the end of September.

1976 was undoubtedly one of the most difficult years for monetary policy of the whole post-war period. During the year the authorities made use of the wide range of instruments with which the country is institutionally endowed, but this also revealed the limits which monetary policy comes up against in the domestic market when it has to bear the whole burden of the adjustment in order to fight speculation with interventions of rapid effect but without adequate foreign exchange reserves. Over the last few years the high average rate of inflation has made it difficult to cover the deficits of the public sector by issuing medium- and long-term securities. This has resulted in an increasing proportion of the Treasury's borrowing requirements being satisfied by placing short-term securities with the banks and, in part, with the public. Economic and financial operators have thus armed themselves with resources that can easily be transformed into monetary base as soon as a restriction on its use without an adequate parallel increase in interest rates pushes them to rebuild their stocks of primary liquidity. Compared with the policy adopted in 1973-74, that of 1976 was faced with the added difficulty of being pursued in a system which was much more liquid and better able to avoid the effects of coercive interventions designed to regulate the monetary base. On the other hand, the long period of flexible exchange rates and the growth of the domestic money market, together with shorter and sharper cyclical swings and uncertainty as to medium-term prospects, have made operators much more alert to optimizing their short and very short-term financial and foreign currency investments and led them to organize themselves in order to achieve this end. The need for a nearly daily control of liquidity and the monetary base has, therefore, become greater.

The experience gained in the situation described above led to the adoption of new and more flexible criteria for intervention on the money market at the end of 1976. Since the December auction the fixing of the yields offered on Treasury bills by the central bank has taken account of prevailing market yields and has been designed to help achieve the monetary base targets for the month. The more frequent variation of the yield offered and the more active policy of selling bills to the banks and other financial intermediaries resulting from this change of criteria have made it possible to control the monetary base more continuously. In fact, there is no longer only one opportunity each month, that of the monthly auction, for regulating the liquidity of the system. The yields which are fixed on a daily basis for Treasury bills depend on the behaviour of banking and non-banking operators seeking to optimize their cash management and that of the central bank attempting to regulate the monetary base. The bank only deals in amounts which will have a real effect on liquidity — negotiations involve lots of not less than 10 billion — while smaller amounts are handled directly by the other members of the market. Since the Treasury is continuously contributing to the creation of monetary base, the central bank is nearly always a seller. If a number of banks have a pressing need for cash which they are unable to satisfy by raising funds in the market, the bank prefers to employ fixed-term advances. This instrument provides more certain and rapid re-entry of the liquidity temporarily supplied to the market, and this has been especially the case since 1976; since then, in fact, nearly all advances made have been for the shortest period, 8 days.

Total domestic credit, final figures and forecasts

In 1976 the expansion of total domestic credit, as defined in agreement with the international organizations, reached 33,270 billion. Of this figure 13,520 billion represents the cash requirements of the State sector (net of loans to the special credit institutions) while the remaining part (19,750 billion) are debts contracted by the economy and by public bodies not included in the State sector with banks and special credit institutions, or direct bond issues. However, when calculating the funds effectively available to operators other than the State, account must be taken of the effects of the compulsory deposit on purchases of foreign currency instituted in May, amounting to about 3,550 billion by the end of the year. Funds actually supplied by importers accounted for 1,450 billion of the deposit, while the remaining part was placed with the Banca d'Italia by the banks on behalf of the operators and therefore only had the effect of freezing the same amount of bank monetary base without expanding total domestic credit. Therefore the funds used by the economy and the « other » public bodies, beside their own resources, to finance investments and purchase non-compulsory financial assets totalled around 18,300 billion (which added to the 13,520 State sector cash requirements produces a total flow of 31,820 billion). In 1975, while total credit amounted to 30,870 billion, the requirements of the State sector totalled 13,660 billion and loans to other operators, considering refunds of the compulsory import deposit introduced the previous year, stood at 18,450 billion.

Credit expansion widely overshot the amount (29,500 billion) agreed in March 1976 with the EEC not only because of the introduction of the compulsory deposit on purchases of foreign currency, but chiefly as a result of the higher levels recorded by the gross domestic product and by investment. The target set for the former was a 2 per cent increase in real terms (17.7 per cent in monetary terms) aimed at keeping the balance-of-payments deficit on current account within the limit of 1,000 billion: the final figures however were 5.6 per cent in real terms and 24.4 in monetary terms. Investments, including inventories, reached 33,200 billion as against the 27,200 forecast.

In March 1977 during the consultations with the International Monetary Fund, it was estimated that total credit must expand by 30,600 billion in 1977 in order to finance the public sector requirements and enable GDP and investments to grow to an extent compatible with the balance-of-payments adjustment.

Specifically in the « letter of intent » to the IMF the requirements of the public sector, including ENEL (the National Electricity Agency) and the hospitals, were set at 16,450 billion, of which 13,100 for the State sector. The growth of the gross domestic product was estimated at 2-3 per cent in volume and 22 per cent at current prices; investments were expected to grow by about 14 per cent; and the balance-of-payments deficit on current account was set at 500 billion (compared with a 2,300 billion deficit in 1976).

Total credit, adjusted to take account of the refunding of the deposits on foreign currency purchases made by importers in 1976, should amount to 32,050 billion. This forecast implies that enterprises will have to dampen their purchases of financial assets; therefore decreases in interest rates will only be feasible in relation to the slowdown of inflation envisaged for the year.

The above-mentioned 30,600 estimate was agreed with the EEC as the ceiling on total domestic credit expansion for 1977 as a condition for the 500 million dollar loan granted in April this year. Moreover in the « letter of intent » to the IMF, the Italian Government undertook to keep credit expansion below 30,000 billion for the twelve-month period ending March 1978; over this period the balance of payments on current account should record a small surplus (500 billion lire).

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

Despite the balance-of-payments disequilibria, for the first time since 1971 foreign operations gave rise to a net creation of monetary base (1,093 billion during the year). This was the outcome of a series of interventions by the monetary authorities which reduced the demand and increased the supply of foreign exchange.

The largest contribution to monetary base creation came from an increase in the banks' indebtedness under the stimulus not only of the foreign exchange measures, but also of the exclusion of foreign currency financing from the ceilings placed on the expansion of bank loans on October 15th.

Monetary base creation by the Treasury totalled 11,746 billion (51 per cent more than the previous year) and covered 80 per cent of its cash requirements; the share in total monetary base creation was 159 per cent.

The increase in the monetary resources created by the Treasury was the highest recorded so far, and as a ratio to total monetary base creation approaches the figure for 1974. Two factors were behind this increase: the still high level of the cash requirement (14,708 billion), although 10 per cent lower than in 1975, and the difficulty of financing the deficit with non-monetary resources.

In the first half of the year the cash requirement reached 5,774 billion or 39 per cent of the total deficit for 1976, while the creation of monetary base, net of Post Office deposits, amounted to 5,844 billion, or 64 per cent of monetary base creation for the whole year. Only in the first half of 1974, when the credit squeeze was harshest, had a similar phenomenon occurred, albeit on a smaller scale, where monetary base creation almost equalled the cash requirement (Table 24). However, whereas at that time the major cause had been the failure to renew long-term securities, in 1976 the banking system reacted to the restrictions by replenishing excess reserves through redemptions of Treasury bills, since the rate at issue of these securities was only partially flexible and the money market as yet undeveloped.

In the second half of 1976 the ratio of monetary base created by the Treasury, net of Post Office savings, to the cash requirement dropped to 37 per cent from 101 per cent in the first half. Once again this was largely due to purchases of Treasury bills by the banks and the public, which recovered in the third quarter before reaching high points in November and December (2,126 billion) that more than offset the disinvestment early in the year. In fact Treasury bills in the banks' portfolios increased from 7,279 billion in December 1975 to 7,472 billion in December 1976. Moreover, as from November, an attempt was made to encourage the banks to lengthen the average maturity of their Treasury bill portfolios by again putting twelve-month bills up for auction, small amounts of which were in fact purchased by the banks.

Table 24

TREASURY MONETARY BASE AND ITS COMPONENTS: INDICATORS (1)

Period	Ratio of Treasury monetary base to: Total monetary base	Ratio of Treasury monetary base to: Overall cash requirements	Treasury bills placed / Total interventions (2)
1966-1968	34.6	13.5	-9.8
1969-1971	122.5	58.5	13.2
1972	126.5	48.2	5.0
1973	164.7	68.0	9.9
1974	208.8	76.3	126.1
1975	119.6	33.1	57.6
1976	191.5	62.1	73.7
1974 - I half-year	*399.1*	*98.6*	*46.1*
II "	*128.1*	*58.8*	*98.2*
1975 - I "	*287.3*	*8.4*	*59.7*
II "	*111.8*	*51.3*	*53.7*
1976 - I "	*417.7*	*101.2*	*219.5*
II "	*97.6*	*36.9*	*113.0*

(1) Data on the monetary base are net of Post Office deposits. — (2) Share of net purchases of Treasury bills (at auctions and on the open market) by the banks and the public in that part of overall Treasury cash requirements not covered with monetary base.

In 1976, as the effects of the squeeze began to hit bank liquidity, refinancing of the banks once more became an effective instrument for controlling the monetary base, after an interval in 1975 when fixed-term advances were nil in the second half, after having been entirely refunded in the first half of the year.

In the Italian system, where ordinary advance account credit is stable and, in practice, never revoked, the monetary base is controlled by changing discounts and fixed-term advances, which are granted for very short periods (always less than one month) and may only be prolonged at the discretion of the central bank. Refinancing enables eventual pressure on the banks' cash management to be eased, while at the same time keeping their liquidity under control. In 1976, in particular, the central bank sought to make this instrument more flexible by reducing the average duration of these advances. As a result recourse to these operations became not only more uncertain but also more costly, since the increases in the basic rate depend on the frequency with which the banks resort to this form of indebtedness with the central bank. In 1976, out of a total of 134 operations, 8 were granted for 22 days and the rest for 8 days, whereas in 1975 only 10 operations, out of a total of 80, were for the shorter term.

The demand for discounts and fixed-term advances was on average lower than in 1974 (286 billion per month as against 847) when there was also a credit squeeze and a sharp decline in bank liquidity. The reasons for this were firstly that the banks found Treasury bill operations to be a good substitute for indebtedness with the central bank and, secondly, the cost of refinancing. The basic rate in fact rose from 6 per cent at end-1975 to 7 and then to 8 per cent in February, to 12 per cent in March and finally to an unprecedented 15 per cent in October. The average actual rate on fixed-term advances and on discounts (including the increases applied according to the frequency of the bank's recourse to this form of indebtedness) reached 15 per cent in May and 18 in November, which was higher than the yield on interbank deposits and on the Treasury bills auctioned that month.

The central bank's liabilities and the uses of monetary base

The growth rate of the monetary base held by the public was 16 per cent (as against 19 per cent in 1975) and almost 2 points lower than that of the total monetary base. Notes and coin in circulation only increased by 13 per cent as against 16 per cent the previous year. The fall in demand for monetary base for transactions can be explained by the performance of interest rates on bank deposits, which are partly a substitute for notes and coin.

During the year the increase in notes and coin, seasonally adjusted, was more buoyant in the first two quarters when the rise in the yield on bank deposits, which lagged behind the growth of lending and money market rates, had not yet had full effect on the behaviour of the public. These effects, however, were fully felt in the second half of the year and in particular in the fourth quarter.

The growth of Post Office deposits (2,608 billion) was greater than that of notes and coin and, in percentage terms (19.6) almost equal to the figure for 1975 and only a little less than the increase in bank deposits.

The monetary base of the banks increased by 3,298 billion and 20.2 per cent, only slightly less than in 1975 (20.3 per cent). If corrected to take account of the effects of administrative variations in the compulsory reserve coefficient, the growth of the banks' monetary base was only 12 per cent (as against 35 per cent the year before under the effect of the freeing of compulsory reserves following the increase in the banks' capital funds). This figure is a better indicator of the restricted conditions in which banks were operating (Table 25).

Table 25

EXCESS AND COMPULSORY BANK RESERVES: INDICATORS

(percentage increases over the previous year)

Year	Total bank reserves		Total bank reserves			
			compulsory		excess	
	gross	adjusted and net	gross	adjusted (1)	L1 (2)	(L2) (3)
	(a)+(c)	*(b)+(d)*	*(a)*	*(b)*	*(c)*	*(d)*
1974	17.9	20.9	15.6	17.1	29.7	77.2
1975	18.4	34.6	14.7	20.9	35.0	167.5
1976	22.1	12.0	34.7	20.6	−25.7	−25.7

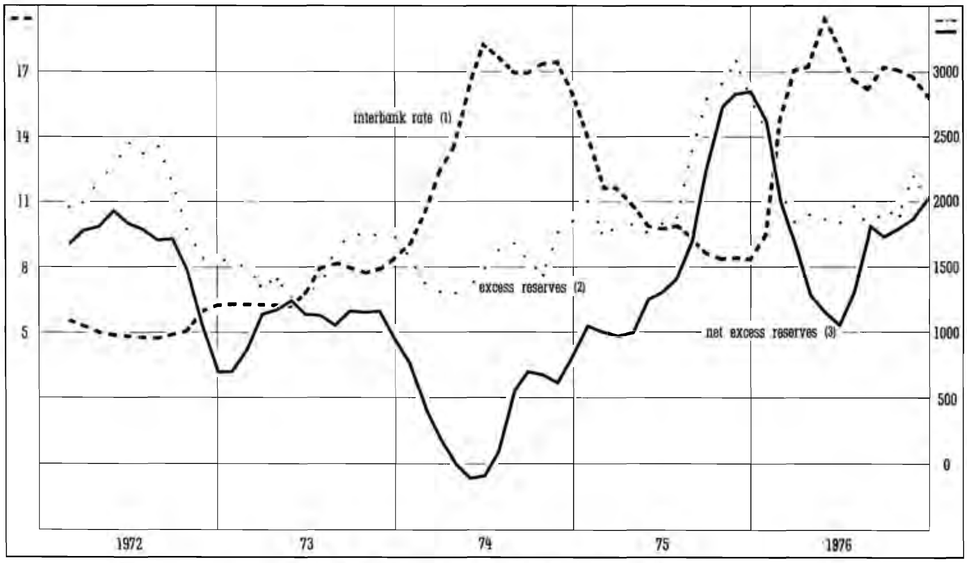
(1) Adjusted for changes in the effective compulsory reserve coefficient. — (2) L1 = Excess reserves; end-period data. — (3) L2 = L1 minus fixed-term advances and discounting. All data on excess reserves for 1975 are net of the share of export refinancing deposits which could not be used owing to the lack of eligible export trade credits.

While the compulsory reserves increased by 4,415 billion (1,634 in the previous year) liquidity fell by 1,116 billion, compared with a growth of 1,125 in 1975. This means that the banks kept the growth rate of deposits practically unaltered by reducing considerably their liquid assets; this increase in the multiplier was matched by the rise in interest rates.

The sharp drop in excess reserves, measured on end-of-period data, was partly due to random movements which affect the month-end figure, especially since the banks increased their participation in Treasury bill auctions. A better measurement of the banks' degree of liquidity is provided by an indicator that takes account of the average level of this variable over the month, of the average indebtedness of the banks with the central bank and of the different degrees of liquidity of the various components of excess reserves (Chart 10).

This indicator is the monthly liquidity, obtained as an average of daily data, net of fixed-term advances and discount operations. The share of liquidity held in the shape of disposable margin has been weighted with a coefficient of less than one, directly correlated to the differential between the interbank rate and the rate on ordinary advances. The hypothesis underlying this weighting is that the alternative cost of holding a disposable margin is less than that of untied deposits with the Banca d'Italia and that it is lower the smaller the difference between the lack of earning arising from not investing these funds on the money market and the cost to the bank in terms of interest on the debt.

Chart 10



Excess reserves and interbank rate

(1) Monthly average of weekly data. (2) Moving average of three data: end-month value. — (3) Moving average of three data: monthly values obtained from an average of daily data; the disposable margin component is weighted for a coefficient below the unit.

In the first four months of the year, the credit squeeze introduced by the monetary authorities after the January foreign exchange crisis reached its severest point. This was largely due to the reduction of the disposable margin on refinancing export credits which reduced the banks' liquidity by 1,025 billion. Liquidity remained low in the second quarter and the banks, who had been selling Treasury bills in the preceding months, resorted widely to fixed-term advances; hence the further reduction in net liquidity. From July on, together with the improvement in the foreign accounts, excess reserves started to increase gradually, though remaining at much lower levels than in 1975. Except in October when the credit squeeze was tightened to tackle the new foreign exchange crisis, this trend continued until the end of the year and was reflected in a drop in the interbank rate and in greater purchases of Treasury bills by the banks.

Banking

Performance during the year

Banking activity during 1976 was characterized by two phenomena: an extremely strong rise in loan demand, which was largely the outcome of the recovery of productive activity, and numerous interventions by the monetary authorities, some of an extraordinary nature. Under these pressures the banks managed to provide the enterprises with sufficient financing to meet the productive recovery, and achieved equilibrium on the credit and deposits markets by raising interest rates both rapidly and substantially and by considerably altering the composition of bank credit flows.

Bank monetary base, adjusted for variations in the compulsory reserve coefficient, rose by only 10.5 per cent, while deposits increased by 22 per cent and credits by 19.6. Although the ceiling on bank loans caused a drop in the last two months of the year, they nevertheless increased by 22 per cent, while the portfolios of long-term securities and of Treasury bills were enlarged respectively by 17 and 9.5 per cent. Lending rates rose by about seven points during the year and deposit rates by four. Thus 1975, which was marked by falling interest rates, heavy accumulation of excess reserves and a shift in credit from loans to securities, gave way to a year in which loan operations regained importance, more active use was made of the monetary base, and rates increased rapidly (Table 26).

Unlike the previous phase of income expansion that began in 1973, at the very start the rapid growth of productive activity in 1976 came up against high and rapidly increasing interest rates and, more

Table 26

THE ACTIVITY OF THE BANKS: INDICATORS

Items	1972 (1)	1973 (1)	1974 (2)	1975	1976 Year	1976 Quarters (3) I	II	III	IV
					FINANCIAL RATIOS (4)				
Bank credit / Bank reserves (5)	4.7	5.2	5.5	5.6	**5.8**	5.7	5.7	5.8	5.9
Excess reserves / Deposits (6)	4.2	2.6	2.1	2.5	**1.8**	2.2	1.8	1.7	1.8
					PERCENTAGE INCREASES (7)				
Bank reserves (5)	13.3	18.5	19.4	25.5	**10.5**	1.1	12.9	6.5	29.4
Deposits	18.2	24.1	16.8	25.0	**22.0**	29.7	11.0	16.9	31.4
Credits	19.5	25.0	18.6	24.4	**19.6**	16.2	9.0	32.0	18.1
Lending (8)	18.1	19.4	16.3	17.7	**22.0**	26.8	18.1	34.6	7.2
Tresury bills	11.0	–12.9	208.4	198.9	**9.5**	–76.3	–69.5	376.6	299.2
Long-term securities (8)	23.8	40.8	16.8	22.5	**17.0**	32.4	9.9	7.0	14.6
					RATIO TO GROSS DOMESTIC PRODUCT (4) (9)				
Bank credit (6)	68.0	69.3	70.6	77.1	**74.7**	77.9	73.9	74.3	73.2
Lending (6)	47,5	48.2	46.6	48.1	**47.4**	48.3	46.7	47.8	46.6

(1) Excess reserves, deposits and lending are adjusted for random movements at end-1972. – (2) Lending, Treasury bills and long-term securities are adjusted for gaps due to the reform of banking statistics in January 1974. – (3) Quarterly data are seasonally adjusted. – (4) Ratio of average values for the period. – (5) Total bank reserves (excess and compulsory reserves) are adjusted for changes in the compulsory reserve coefficient. – (6) Percentage ratios. – (7) Quarterly rates of increase are calculated as yearly percentage changes of moving averages of three data. – (8) The funding of hospital and local authorities' debts to the banks are included under lending and not under long-term securities. – (9) The quarterly gross domestic product is on a yearly basis.

generally, a non-permissive monetary policy. The main repercussion for the enterprises was a stronger tendency to economize working capital, which also took the form of a rapid return of the ratio of bank loans to value of production to the lows recorded in 1974 (Chart 12). They kept their investments in inventories below the levels for 1973, just as the ratio of their liquid assets to bank loans was also extremely low. However, these signs, in addition to the relative lack of medium- and long-term credit, were not accompanied by evidence of a rationing of short-term credit as in previous periods of restriction. On the contrary, the share of the flow of bank loans allocated to small-sized enterprises, which normally drops in times of rationing, was higher than in 1975 and greater than the share in the total indebtedness of the enterprises at the start of the year.

Despite the reduced flow of monetary base available to increase credit, the banks were able to finance the productive expansion by making maximum use of the flexibility in interest rates and balance-sheet composition allowed by the monetary authorities' policy. To expand credit to the economy they were assisted not so much by the margins of liquidity at the start of the year, since these in addition to being recently formed and only partly available were already completely reabsorbed in February by the authorities' interventions, as by massive sales of Treasury bills, by fund-raising abroad which does not absorb monetary base for compulsory reserves, and by the weaker impact of the portfolio constraint (Table 27).

Over the year as a whole, the portfolio constraint led the banks to invest 25.2 per cent of deposits in bonds. Because of the wider gap between face value and issue price of bonds issued in 1976, this percentage was lower than in any of the other years when the constraint was in force, and left more room than in the past for an increase in the other components of bank credit (Table 28).

Moreover, part of the demand for funds was met with loans in foreign currency which are exempt from the ceiling, demand for which was also boosted by the compulsory foreign exchange financing regulation applying to operators granting trade credits abroad. This was accompanied by a marked upturn in net funds raised abroad.

The most important aspect of flexibility in the banks' operations was the continued availability of a large portfolio of maturing Treasury bills, since by not renewing these securities the banks were rapidly able to obtain massive funds to expand loans. Consequently, they were able to redirect rapidly the flows of bank credit, despite their lack of liquid reserves. Their Treasury bills portfolio, amounting to 7,270 billion lire in January 1976, dropped to 3,542 in June, to then rise back in January 1977 to 9,225 billion, or around two-thirds of credit expansion over the year.

The level of refinancing rates with the central bank also persuaded the banks to manage their stocks of liquid assets more economically. Since the maximum rate applicable was exceptionally high, reaching 18 per cent in October, and for a long time equal to or above money

Table 27

BANKS' ASSETS AND LIABILITIES (*)

(amounts and changes in billions of lire)

Items	Amounts at end of 1976	Changes 1974 Year	1975 Half-year I	1975 Half-year II	1975 Year	1976 Half-year I	1976 Half-year II	1976 Year
ASSETS								
Bank reserves (1)	**18,932.8**	**2,062.8**	**–3.1**	**2,761.7**	**2,758.6**	**972.3**	**2,326.1**	**3,296.4**
Excess reserves	2,308.0	568.4	–881.1	2,006.0	1,124.9	–1,578.2	461.8	–1,116.4
Compulsory reserves and backing for cashiers' cheques	16,624.4	1,494.2	878.0	755.7	1,633.7	2,550.5	1,864.3	4,414.8
Credit (2)	**118,433.4**	**12,774.4**	**8,445.2**	**11,492.7**	**19,937.9**	**4,997.6**	**14,716.1**	**19,713.7**
Lending (3)	72,694.4	7,305.4	2,211.6	6,848.3	9,059.9	4,950.2	8,519.8	13,470.0
in foreign currency	*3,059.5*	*–300.7*	*696.4*	*–1,113.6*	*–417.2*	*838.3*	*1,338.2*	*2,176.5*
Treasury bills (4)	7,471.9	1,597.0	2,887.7	1,652.3	4,540.0	–3,281.2	3,930.3	649.1
Long-term securities (5)	38,267.1	3,872.0	3,345.9	2,992.1	6,338.0	3,328.6	2,266.0	5,594.6
Stocks and shares	**1,328.9**	**79.1**	**142.5**	**77.4**	**219.9**	**87.5**	**209.9**	**297.4**
Interbank accounts	**24,792.1**	**4,063.2**	**355.0**	**5,219.0**	**5,574.0**	**–4,499.1**	**9,607.9**	**5,108.8**
Guarantee deposits on behalf of third parties (6)	2,162.5	....	–3.3	17.0	13.7	55.7	2,046.8	2,102.5
TOTAL ...	**165,649.3**	**18,979.3**	**8,936.3**	**19,567.8**	**28,504.1**	**1,614.0**	**28,906.8**	**30,520.8**
LIABILITIES								
Deposits	**123,404.5**	**11,653.0**	**5,859.9**	**14,381.6**	**20,241.5**	**5,658.7**	**16,578.4**	**22,237.1**
Savings deposits	60,254.3	7,525.0	8,515.6	6,483.2	14,998.8	2,924.9	8,249.7	11,174.6
Current account	63,150.2	4,128.0	–2,655.7	7,898.4	5,242.7	2,733.8	8,328.7	11,062.5
Other deposits	**1,463.8**	**–119.2**	**48.8**	**–194.7**	**–145.9**	**135.7**	**375.9**	**511.9**
Foreign currency accounts of residents	454.1	–119.5	32.9	–141.0	–108.1	22.7	117.2	139.9
Third parties' funds held in trust	1,009.7	0.3	15.9	–53.7	–37.8	113.0	258.7	371.7
Interbank accounts	**26,270.0**	**4,646.3**	**1,408.8**	**3,872.4**	**5,281.2**	**–4,945.5**	**10,211.4**	**5,265.9**
Special credit institutions' deposits (7)	*4,959.5*	*–554.3*	*1,317.1*	*–614.1*	*703.0*	*642.3*	*–119.0*	*522.9*
Lending by BI-UIC (1)	**2,344.6**	**1,362.7**	**–643.2**	**254.2**	**–389.0**	**–202.0**	**–1,275.0**	**–1,477.0**
Equity capital	**5,095.3**	**835.2**	**922.1**	**493.9**	**1,416.0**	**731.7**	**249.4**	**981.1**
Net foreign position (8)	**2,430.4**	**475.1**	**273.4**	**–629.7**	**–356.3**	**1,121.2**	**1,013.2**	**2,134.4**
Other items	4,640.7	126.2	1,066.5	1,390.1	2,456.6	–885.8	1,753.5	867.7

(*) 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 23, 32, 36). The figures in the other statistical tables on banks do not therefore always correspond with those given here because they are taken directly from the banks' balance sheets or from a homogeneous sample.

(1) The figures used for excess and compulsory 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. – (2) In the columns giving changes the funding of hospital debts to the banks are classified under lending and not under long-term securities. – (3) Data for 1974 are calculated net of a variation, estimated at 1,400 billion, due to changes in banking statistics. – (4) At face value. – (5) Increases in securities portfolios are calculated on the basis of market prices during the year. – (6) From May 1976 this item includes the compulsory deposit on purchases of foreign exchange paid by the banks with their own funds on behalf of their customers. – (7) Data taken from the special credit institutions' accounts. – (8) 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 balance-of-payments statistics. Also includes the foreign exchange forming part of the excess reserves.

market rates, which is unusual in a year of low liquidity, the banks only resorted to fixed-term advances, within the limits allowed by the Banca d'Italia, when the squeeze was at its harshest and always for shorter periods than in similar cyclical phases, using it as a sort of emergency credit to cope with specific and purely temporary situations. Such high refinancing rates also made it less convenient for the banks to turn to the ordinary advance account as a steady source of funds.

Table 28

LONG–TERM BONDS OF BANKS (1)

(billions of lire)

Items	1971	1972	1973	1974	1975	1976
FACE VALUE AT DEC. 31st	13,203.7	16,150.7	22,570.9	27,564.7	37,159.2	44,370.1
(percentage changes)	*24.2*	*22.3*	*39.8*	*22.1*	*34.8*	*19.4*
BOOK VALUE AT DEC. 31st	12,217.9	15,122.4	21,296.7	25,281.6	32,821.9	38,267.1
(percentage changes)	*23.6*	*23.8*	*40.8*	*18.7*	*29.8*	*16.6*
Index of industrial bonds (2)	*82.5*	*91.2*	*90.1*	*68.4*	*62.2*	*52.8*
FLOW OF FUNDS DURING THE YEAR (3)	2,326.5	2,904.4	6,171.3	3,872.0	6.338.0	5,594.6
Flows with respect to increase in deposits	*32.3*	*27.8*	*53.2*	*33.2*	*31.3*	*25.2*

(1) Excluding shares. – (2) Bonds issued by the industrial credit institutions. – (3) Estimated from the performance during the year.

The banks' ability to meet a heavy demand for loans largely by playing with the composition of credit and with interest rates at a time of low liquidity is reflected in the performance of the ratio between the actual volume of deposits and the maximum volume potentially obtainable with the existing monetary base, i.e. the deposits which, considering the average timing of the multiplier process, would form if liquidity tended towards zero in equilibrium. This ratio, which in the past had varied widely with the performance of interest rates and thus reflected the formation of a large stock of unutilized monetary base during phases of productive recession and monetary expansion, did not follow the downturn of rates in 1975 because the banks had invested in Treasury bills the liquidity surplus created by the slack demand for credit by the enterprises. The increase in the ratio in 1976 was thus necessarily small, despite the rise in interest rates. Peaks were reached in the first and last quarters, while the drop in the middle of the year can be ascribed to a fall-off in the public's demand for deposits, partly in view of the compulsory deposit on purchases of foreign exchange (Chart 11).

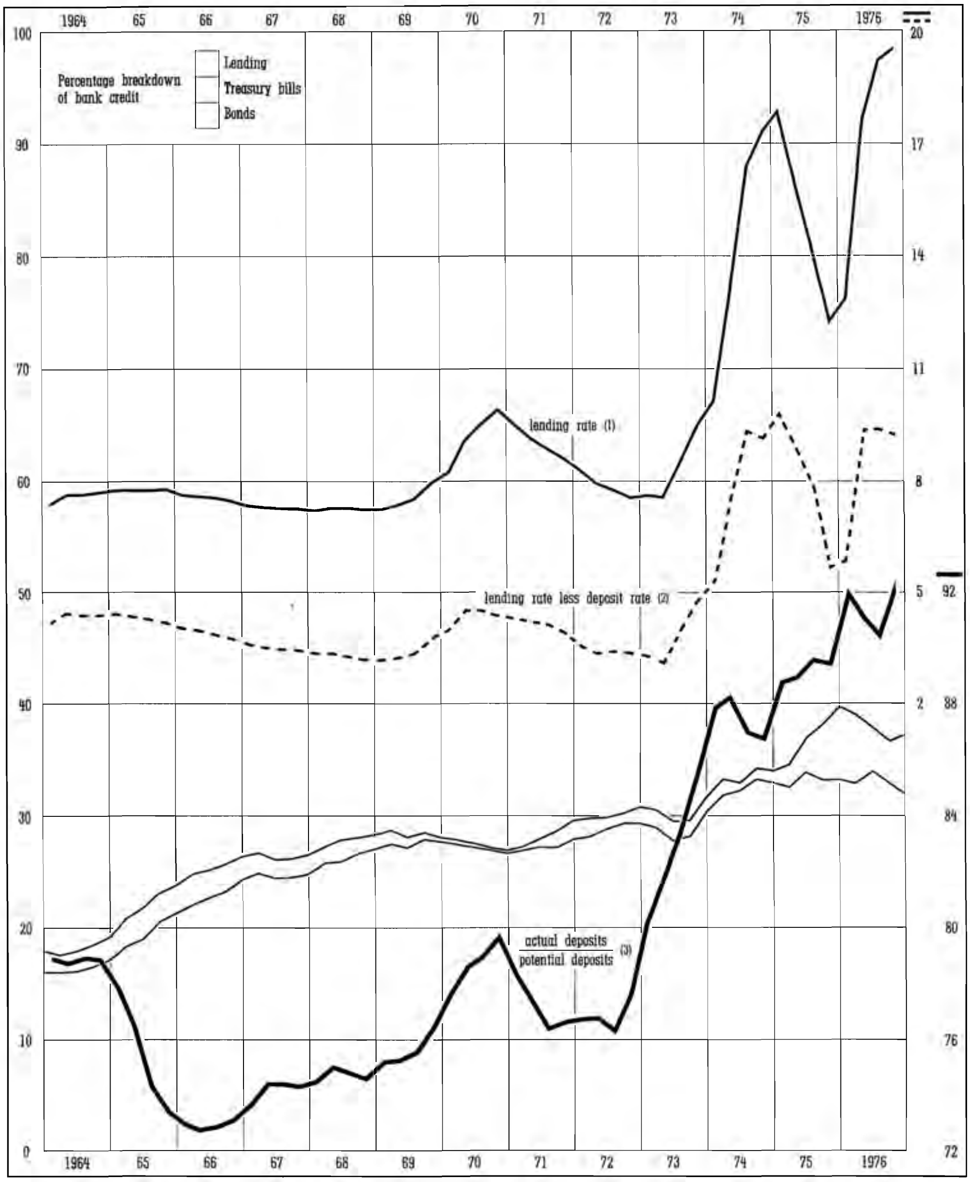
Domestic credit

The expansion of bank credit granted to the public and private sectors together in the form of loans, long-term securities and Treasury bills was not as large as in 1975 (19.6 as against 24.4 per cent). However, credit to the Economy (enterprises and households) grew more than in the previous year (22.6 compared with 19 per cent). In fact the expansion of bank credit was dominated by the enterprises' heavy demand for funds, which as the quarters passed caused both a large increase and wide fluctuations in the multiplier and changes in the composition of bank assets (Chart 11).

The enterprises' demand for loans was stimulated not only by the accelerating economic activity and increase in inventories, but also by a reduction in credit granted by the special credit institutions. During the summer demand had also grown in response to the need to finance the compulsory deposit on purchases of foreign exchange. The bank credit requirements of the enterprises instead were reduced by the rise in their profits, linked to the relative performance of prices and unit costs. Specifically, the large-sized enterprises' demand for credit grew considerably less than that of the others, whereas the public enterprises' requirements were particularly heavy, partly because of the delay in adjusting the charges for some public utilities (Chart 12 and Table 29).

During November and December, loans were much affected by the ceilings on monthly expansion introduced on October 15th, and taking into account seasonal factors, they actually dropped by 0.8 per cent. In fact, the decrease in those subject to the ceiling (mainly loans in lire above 100 million) was even more marked, partly because the banks kept this aggregate more than 1,100 billion lire below the figure

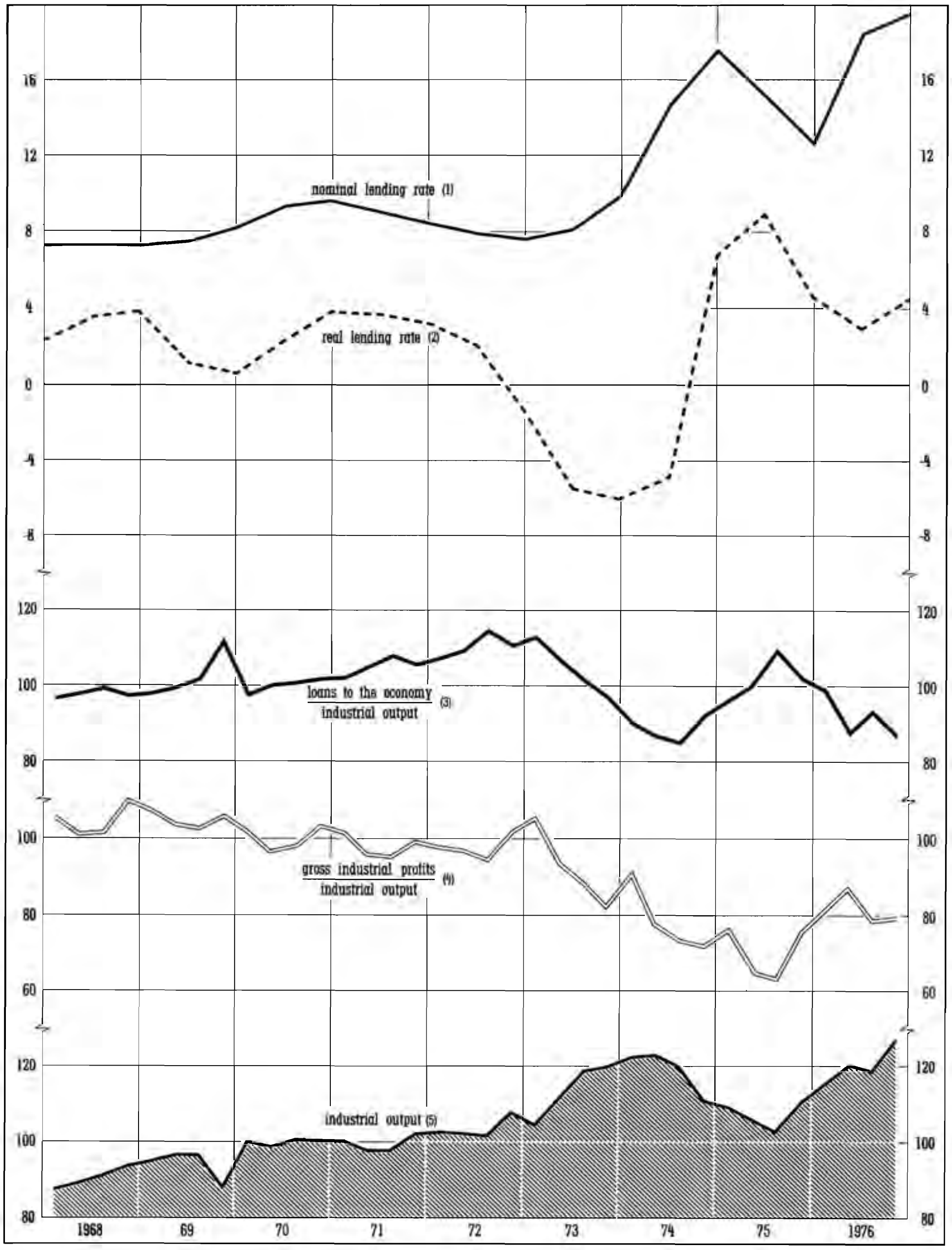
Chart 11



Actual and potential deposits, credit breakdown

(1) Average quarterly rate on short-term loans of at least 30 million lire. – (2) The deposit rate is a quarterly average of the rates on accounts of at least 20 million lire. – (3) Percentage ratio of average quarterly actual deposits to the maximum deposits that would be formed if bank liquidity tended to zero in equilibrium.

Chart 12



Bank loans and industrial activity

Seasonally adjusted data

(1) Rate on short-term loans at the start of each half-year. — (2) Lending rate net of the expected rate of change of consumer prices for the following six months (calculated from replies to the "opinion forum" of Mondo Economico. — (3) Index, basis 1970=100. Industrial production at current prices. — (4) Index, basis 1970=100. Gross profits are obtained by deducting labour costs in the industrial sector from industrial value added. — (5) Index, basis 1970=100 of production at constant prices in the mining and quarrying and manufacturing industries.

Table 29

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)	
	1975	1976	1975	1976	1975	1976	1975	1976
Public sector and hospitals	**633**	**1,858**	**7,148**	**1,107**	**969**	**1,819**	**6,812**	**1,146**
Central Government	55	1	5,217	780	120	330	5,152	451
Local authorities (5)	1,497	1,806	232	397	304	1,432	1,425	771
Autonomous agencies	69	−57	1	−18	3	−27	67	−48
Social security institutions	287	63	—	—	542	84	−255	−21
Hospitals (6)	−1,275	45	1,698	−52	....	....	423	−7
Enterprises (7)	**6,521**	**11,094**	**743**	**930**	**6,343**	**5,822**	**921**	**6,202**
Public enterprises	2,092	2,575	722	930	1,260	187	1,554	3,318
Main private enterprises	1,208	1,258	21	—	766	1,028	463	230
Other enterprises	3,221	7,261	—	—	4,317	4,607	−1,096	2,654
Households (8)	**464**	**634**	—	—	**12,784**	**15,102**	**−12,320**	**−14,468**
TOTAL FOR ORDINARY RESIDENT CUSTOMERS	**7,618**	**13,586**	**7,891**	**2,037**	**20,096**	**22,743**	**−4,587**	**−7,120**
Special credit institutions	**20**	**−2**	**4,682**	**4,164**	**703**	**523**	**3,999**	**3,639**
GRAND TOTAL	**7,638**	**13,584**	**12,573**	**6,201**	**20,799**	**23,266**	**−588**	**−3,481**

(1) Includes financing of compulsory stockpiling, bad debts and outstanding bills. — (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 include Post Office certificates issued to fund loans to the Municipalities. — (6) Purchases of securities include Treasury certificates issued to fund the hospitals' bank debts. — (7) Data on deposits are estimated. — (8) Estimates.

allowed. However, the rapid expansion of exempt loans in part compensated for this trend and, with respect to the June amounts which were used as basis for the ceiling, loans in foreign currency increased by 1,339 billion, or 77.7 per cent, those in lire below 100 million by 3,093 billion or 20.5 per cent, and total credit by 13.2 per cent (Table 30).

The impact of the ceiling was particularly evident in the area of large private enterprises: the figures for December show that they actually used less credit than in September, despite the influence of seasonal factors. In this regard it should be observed that, since only loans above 100 million were subject to the ceiling, about 93 per cent

Table 30

CEILING ON BANK CREDIT

(measure enacted on October 15th 1976)

Credit categories	Amounts at June 30th 1976 (1)	Percentage changes							
		1974	1975	1976			1977		
				I half-year	Changes from June 30th 1976				
					Nov.	Dec.	Jan.	Feb.	March (3)
Maximum permitted increase .					*7.0*	*11.0*	*10.0*	*11.0*	*11.0*
Loans subject to ceiling (2) . .	47,455	23.2	18.2	8.3	4.8	8.6	10.4	9.8	11.2
Exempt loans	16,772	1.9	3.7	7.5	16.2	26.4	23.8	27.0	35.6
in foreign currency	1,721	26.2	–32.1	94.9	62.3	77.7	80.6	102.3	135.8
others	15,051	–	7.2	2.2	11.0	20.5	17.3	18.4	21.9
TOTAL	64,227	16.3	10.3	8.1	7.7	13.2	13.9	14.3	17.1

Source: Central Risks Pool for loans subject to the ceiling and banks' balance sheets for remaining loans.

(1) Billions of lire. – (2) The aggregate "loans subject to ceiling" is partially estimated for the periods prior to the enactment of the provision. Variations in 1974 have been adjusted for the change of series following the reform of banking statistics. – (3) Provisional figures.

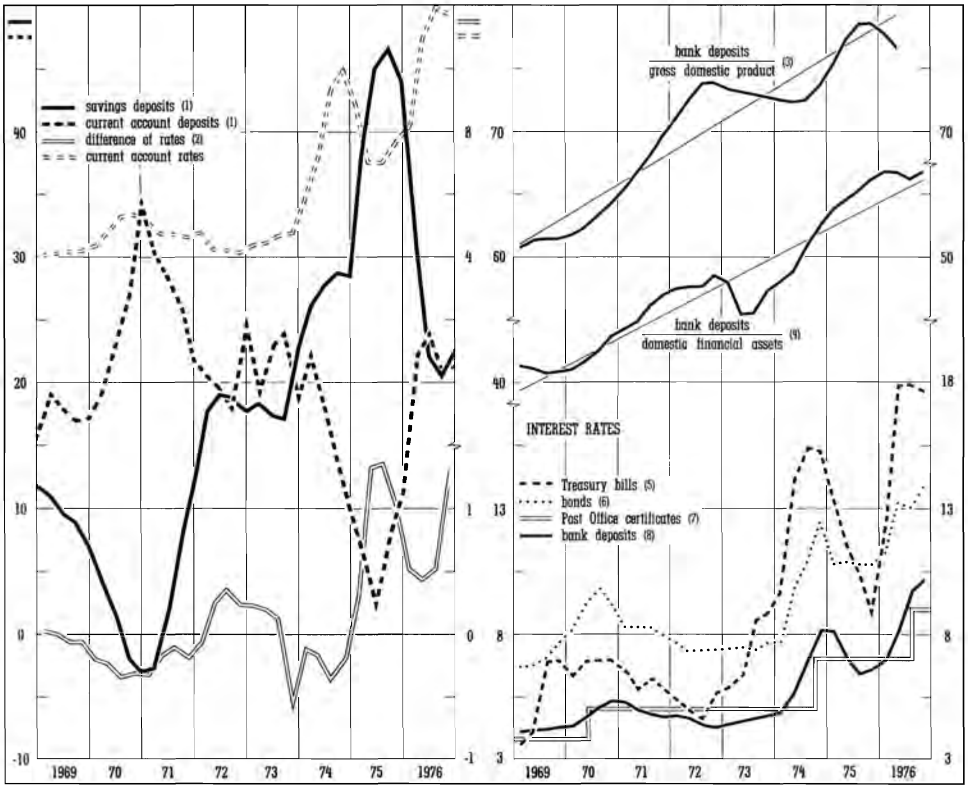
of the indebtedness of these enterprises fell under the provision, compared with about 64 per cent for the smaller enterprises. The public enterprises instead increased their share of total loans also in the fourth quarter of 1976, although on average their bank loans are extremely large.

Customers' deposits

After the unprecedented growth of 1975 (25 per cent) bank deposits in 1976 grew by 22 per cent or 22,237 billion. This mild slowdown can also be observed in the fact that the ratio of deposits to the gross domestic product dropped below the trend line. As in the previous credit squeezes of 1969-1970 and 1974 (Chart 13) this performance can be ascribed to the monetary policy pursued during the year which dampened the expansion of bank intermediation.

Stimulus to the expansion of deposits instead was provided by the public's increased propensity to acquire liquid financial assets, in view of expectations of capital account losses on medium- and long-term securities and of the drop in the yield differential between bonds and deposits. While the yield on the former rose on average by 3.2 percentage points between the last quarter of 1975 and that of 1976, the yield on bonds rose from 8 to 12.2 per cent even though the interbank agreements of March and April fixed smaller rises (Chart 13).

Chart 13



Bank deposits and interest rates

(1) Annual percentage rates of increase. — (2) Difference between quarterly interest rates on savings and current account deposits. — (3) Ratio of average total bank deposits to gross domestic product for the 12-month period centered on the reference quarter. The total for deposits at end-1972 is adjusted for random movements. — (4) Ratio of average quarterly data, seasonally adjusted. — (5) Average of annual deferred adjudication rates at the monthly auctions. — (6) Average yield on industrial bonds. — (7) Yield on 12-month Post Office interest-bearing certificates. — (8) Yield on savings and current account bank deposits.

The yield on deposits increased enough to encourage the public to hold proportionally less notes and coin than the previous year and to switch from Post Office to bank deposits, which however still faced considerable competition from Treasury bills. For the first time the public's preference largely went to these securities, the amount of which in the portfolios of non-institutional investors rose from 209 to 1,622 billion. There are two reasons for this phenomenon: firstly yields rose from 8.5 to 17.4 per cent during the year for six-month bills and were thus higher than those of any other financial asset offered on the market; secondly, the money market expanded and stock brokers and financial companies increased their activity, thus opening up this form of investment to the public.

Profit and loss accounts

Compared with the past, 1976 marks a change in the ways working profits were formed. Despite the fact that the gap between lending and deposit rates, measured from the profit and loss accounts, reached the unprecedented level of 9.5 percentage points, for the first time since 1970 the gross margin of intermediation decreased (Table 31). In the first place the 1.94 point increase in the average cost of fund-raising had a greater impact than the combined effect of the increase in lending rates (2.84 points) and the insignificant rise in bond yields, given the considerable weight of the latter (35.7 per cent of funds raised). In the second place, unit earnings fell with the increased importance of low yield assets, such as deposits with the Banca d'Italia and Treasury, partly for extraordinary compulsory reserves.

The narrowing of the gross margin of intermediation was offset by the smaller impact of general costs and specifically of losses on securities and funds set aside for the devaluation of loans. In 1976 in fact, although the average price of bonds dropped by 19 per cent, only very small losses were recorded in the balance sheets. Moreover, there was a heavy reduction in the amount of funds set aside to cover losses on loans, despite the fact that the ratio of bad debts to loans increased again, as in 1974 and 1975.

The performance of costs and earnings produced net profits of 294 billion; the increase with respect to the previous year was 80 billion or 37.5 per cent, and is one of the largest improvements of the last few years. However, compared with 1975 there was a drop in gross profits including depreciation and allowances since the latter decreased.

Table 31

PROFIT AND LOSS ACCOUNTS OF THE BANKS

Items	1970	1971	1972	1973	1974	1975	1976
	billions of lire						
Proceeds (w.r.t. capital assets) (1)	3,709.6	4,367.1	4,858.1	6,429.6	11,624.5	13,975.4	19,098.8
Costs (w.r.t. capital assets) (2)	2,335.3	2,744.1	3,070.0	4,044.8	7,844.4	8,899.4	13,442.6
Other proceeds	498.0	630.6	776.6	1,110.4	1,859.7	2,222.7	2,525.7
Personnel costs	1,066.1	1,300.5	1,468.2	1,956.1	2,682.9	3,319.6	4,135.2
General costs	721.1	843.8	974.2	1,402.5	2,785.5	3,765.4	3,753.0
Net profit	85.1	109.3	122.3	136.6	171.4	213.7	293.7
	formation of profit as a percentage ratio of deposits						
Gross intermediation margin (3)	3.73	3.79	3.52	3.91	5.13	5.71	5.16
Other proceeds	1.35	1.47	1.53	1.82	2.52	2.50	2.31
Personnel costs	2.89	3.04	2.88	3.21	3.78	3.73	3.78
General costs:	1.96	1.97	1.93	2.30	3.64	4.24	3.42
– *depreciation and allowances*	*0.62*	*0.71*	*0.66*	*1.16*	*1.58*	*1.97*	*1.73*
of which: devaluation of credits	....	....	....	....	*0.44*	*0.60*	*0.37*
devaluation of securities	....	....	....	....	*0.81*	*0.80*	*0.79*
– *losses on securities*	*0.15*	*0.01*	*0.01*	*0.06*	*0.59*	*0.64*	*0.07*
Net profit	0.23	0.25	0.24	0.22	0.23	0.24	0.27
	other data						
DEPOSITS (billions of lire) (4)	*36,841.1*	*42,800.8*	*50,895.6*	*61,000.2*	*73,719.4*	*88,925.5*	*109,494.7*
NUMBER OF EMPLOYEES (at June)	*141,589*	*158,348*	*165,825*	*177,648*	*204,159*	*217,051*	*228,159*
DEPOSITS PER EMPLOYEE (millions of lire)	*260.20*	*270.30*	*306.92*	*343.38*	*361.09*	*409.70*	*479.90*
COST PER EMPLOYEE (millions of lire)	*7.53*	*8.21*	*8.85*	*11.01*	*13.64*	*15.29*	*18.12*
NET PROFIT/ TOTAL ASSETS (as a percentage)	*7.12*	*8.45*	*8.64*	*8.18*	*7.86*	*6.27*	*6.38*

(1) Proceeds from interest-payments, and fees and commissions on domestic and foreign loans, on deposits with the Banca d'Italia and UIC, on securities and investments in partnerships and on interbank accounts and accounts with special credit institutions. – (2) Costs of interest-payments, and fees and commissions on domestic and foreign deposits, advances, rediscounts and swaps and on interbank accounts and accounts with special credit institutions. – (3) Proceeds less costs (regarding only capital assets). – (4) Moving average centered on 5 quarterly data.

The securities market

In 1976 net issues of securities dropped sharply from the year before (9,422 billion in 1976 as against 13,264 in 1975). As a ratio to the gross domestic product, they fell to 6.6 per cent (11.6 per cent in 1975; Table 32).

Table 32

NET ISSUES OF SECURITIES

(billions of lire)

Items	Amounts at December		Net issues						
			1974	1975			1976		
				half-year		Year	half-year		Year
	1975	1976	Year	I	II		I	II	
ISSUERS:									
Treasury (1)	26,572	29,466	1,226	1,247	3,854	5,101	1,986	584	2,570
Special credit institutions	33,432	38,749	2,153	3,217	2,193	5,410	2,548	1,615	4,163
Others	9,619	10,689	94	513	883	1,396	611	381	992
TOTAL . . .	**69,623**	**78,904**	**3,473**	**4,977**	**6,930**	**11,907**	**5,145**	**2,580**	**7,725**
PURCHASERS:									
Banca d'Italia and U.I.C.	13,119	14,607	1,617	−82	2,503	2,421	887	447	1,334
Central Post Office Savings Fund (2)	1,281	1,467	20	522	67	589	113	40	153
Banks	35,305	42,567	3,872	3,346	2,992	6,338	3,329	2,266	5,595
Public	19,918	20,263	−2,036	1,191	1,368	2,559	816	−173	643
Shares	*16,650*	*18,500*	*771*	*617*	*740*	*1,357*	*860*	*837*	*1,697*

(1) Including 20-year certificates issued by the Central Post Office Savings Fund and bonds issued on behalf of the Treasury and by the autonomous government agencies and local authorities. Excluding Treasury bills, Post Office interest-bearing certificates, short-term Treasury certificates and special certificates. — (2) Purchases by the Central Post Office Savings Fund also include part of its own certificates (45.5 billion in 1974, 386.4 in 1975 and 196.2 in 1976).

The downturn involved exclusively fixed-interest securities (7,725 billion in 1976, compared with 11,907 in 1975) and reflected the changed attitude of the public and the banks in a year marked by the currency crises, by the worsening of inflationary expectations and by a policy of interest rate twist, which permitted an immediate and large increase in short-term rates while moderating the adjustment of long-term rates.

The reduction of issues reflected not only the difficulties encountered on the side of demand for securities, but also the authorities' control of supply itself, already dampened by uncertainty as to future trends in interest rates and by the fear of an excessive future burden of debts, if inflation were gradually to slacken.

The Treasury and the local authorities halved their net raising of medium- and long-term funds (2,570 billion in 1976, as against 5,101 in 1975). On the other hand, there was a growth in net issues of Treasury bills, while the State sector deficit was smaller than the year before. Net issues by the public sector in the first two months accounted for roughly 75 per cent of the total for the year. In the following months the progressive weakening of the bond market induced the Treasury to resort exclusively to short-term financing, with securities largely purchased by the Banca d'Italia. The severe check on the supply of long-term public securities (from March to August there were net redemptions for 616 billion) helped to curb the increase of long-term and accentuate the rise of short-term rates. A modest recovery in placements occurred only at the end of the year when certain public securities were underwritten for the portfolio requirement.

The reduction in issues was less marked for the special credit institutions, owing to the steady performance of the real-estate and agricultural credit sector. Until February, i.e. as long as the yield curve set long-term above short-term rates, it was easier to place securities on the market; purchases by the banks continued through March, when the portfolio requirement is checked, so that 43 per cent of the sector's annual net issues were concentrated into the first quarter. Subsequently, the reversal of the term-structure of interest rates had a negative effect on the demand for securities and compelled the enterprises to move towards the short-term market. In the summer the slackening of inflationary pressure gradually narrowed the gap in interest rates; forecasts of a possible deceleration of prices made enterprises cautious in taking on the burden of long-term interest rates and brought about a reduction in the demand for long-term funds. In the last months there was a modest recovery of issues, encouraged by the falling due of the portfolio requirement.

The other issuers, mostly public enterprises, also had to reduce their net issues (992 billion in 1976, as against 1,396 in 1975) since it was impossible to place a larger volume of securities with the public and banks. Therefore, like the private enterprises, they also resorted to bank loans to a larger extent than in the previous year.

The shrinking of demand for fixed-interest securities marked the whole of 1976 from the very start of the currency crisis in January, with the result that the public purchased fewer securities (643 billion, equal to one fourth of the figure for the previous year). The structure of interest rates and the inflationary expectations shifted the preferences of the public towards bank deposits and towards Treasury bills (1,331 billion).

After the rapid absorption of the issue of four-year Treasury bonds in January, the public changed its expectations radically and stayed on the side-lines of the market, although there were offers of securities characterized by shorter average life, relatively high coupons, simplified amortization plans, and financial indexation mechanisms. However, the massive sales, which might have been feared after the experience of 1974, did not materialize, owing to the considerable upward adjustment of yields which the authorities promptly accepted, although moderating it slightly.

The banks made net purchases within the limits of the portfolio requirement and increased their relative share of the primary market (Table 33).

Table 33

INVESTORS IN FIXED-INTEREST SECURITIES

(percentage breakdown)

Investors	Yearly average 1963-72	1973	1974	1975	1976
Banca d'Italia and UIC	*19.3*	*24.3*	*46.5*	*20.3*	*17.3*
Banks	*43.7*	*59.0*	*111.5*	*53.2*	*72.4*
Other financial intermediaries	*5.8*	*2.6*	*–2.0*	*7.3*	*1.3*
Enterprises, households and foreign investors	*31.2*	*14.1*	*–56.0*	*19.2*	*9.0*
Total . . .	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
Total in billions of lire . . .	**2,751**	**10,453**	**3,473**	**11,907**	**7,725**

There was heavy buying in the first two months of the year when the yield structure had not yet changed, and purchases were later concentrated into the months when the requirement fell due. The composition of the banks' portfolios was changed to the advantage of securities issued by the special credit institutions, and particularly by those linked to the various banks. Purchases of securities of the real-estate and agricultural credit institutions in particular were favoured by the regulations on the composition of compulsory investments and exceeded, even in absolute terms, the figures reached in 1975. Considerable purchases were also made on issue of securities of the public enterprises, particularly ENEL (National Electricity Agency), which were eligible for compliance with the requirement and were partly intended to fund ENEL's outstanding debts with ICCRI (Credit Institute for Italian Savings Banks). Subsequently, the difficulty in setting up placement consortia amongst the banks prevented the placement of further large loans to the public enterprises.

The Banca d'Italia and the UIC (Italian Foreign Exchange Office) purchased securities for 1,334 billion (as against 2,421 billion in 1975). The Banca d'Italia aimed to prevent the Treasury's demand for funds from flooding onto the financial market, and therefore eased the pressures on interest rates also by making small purchases on the secondary market (138 billion).

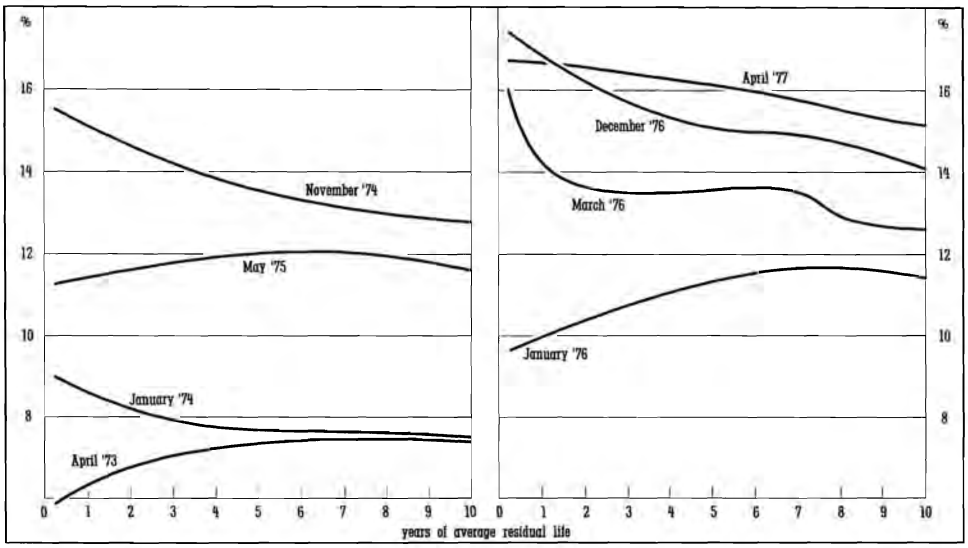
These purchases were much less than in 1973 and 1974 (respectively 254 and 246 billion), owing to the greater elasticity of intervention methods. Purchases were concentrated in the first half-year and in October, i.e. in the months of greatest tension; and over half of them were for long-term Treasury bonds.

The amount of fixed-interest securities in circulation grew by 13 per cent at face value (as against a 24 per cent growth in 1975): with regard to the distribution among the main categories of investors, the portion of securities held by the public tended to diminish further (from 28.6 per cent in 1975 to 25.7 per cent). The share of securities held in the banks' portfolios rose from 50.7 per cent in 1975 to 53.9 per cent, confirming the progressive expansion of double intermediation between savers and final users of funds, which was encouraged by the banks' portfolio requirement.

The events connected with the currency crisis in the first weeks of the year changed the public's expectations of inflation and thus caused disequilibrium both in the level and in the structure of interest rates. The adjustment of interest rates was encouraged by the behaviour of the authorities, who in 1975 were aware of the precariousness of the equilibrium on the financial market and so had curbed the decline of long-term rates. In 1976 the authorities confined themselves to moderating the intensity and smoothing the unevenness of the rise in long-term rates through support intervention, concentrated mainly in the first half-year, with the intention of not impeding the gradual approach to a new equilibrium level.

In the first months of the year the policy of intervention in the bond market was directed at curbing the pressures transmitted to the financial markets by the currency crisis. As from March the curve of the term structure of interest rates began to slope downwards, reaching its maximum gradient at the beginning of the summer. Only in the last months of 1976 did the yield curve slope less owing to the combined effect of a lowering of short-term and a raising of medium- and long-term rates (Chart 14).

Chart 14



Yield curves according to maturity

Interest rates thus developed along much the same lines as in 1974, but started from a different maturity structure. In January 1974 the pattern sloped downwards and reflected action to curb long-term rates that had been implemented in the previous months partly by heavy intervention in the secondary bond market. By contrast in January 1976 the yield curve sloped upwards and the authorities were preventing a lowering of long-term rates. The rapid change in expectations in 1976 could thus be absorbed more easily by the market than in 1974.

The evolution of interest rates on the Italian financial market differed from that on the main foreign financial markets where, with the exception of the United Kingdom, the level was considerably lower, keeping in step with the development of their domestic inflation rates, and the term structure sloped upwards. The performance of yields on Treasury bonds was particularly dynamic, rising from 9.61 per cent in January to 14.46 per cent in December and overtaking, at the end of the year, the level of yields on bonds issued by the industrial credit institutions, which are normally higher. This situation should be attributed to the fact that at present Treasury bonds have a shorter average residual life than the bonds of the industrial credit institutions. Moreover they are very widely spread among the public and therefore more exposed than the latter bonds to the shift in demand for securities since, as already mentioned, they are not eligible for compliance with the banks' investment requirement (Table 34).

Table 34

AVERAGE ACTUAL YIELD ON FIXED-INTEREST SECURITIES

Assets	December 1974	December 1975	December 1976	March 1977	Changes between Dec. '75 / Dec. '74	Dec. '76 / Dec. '75	March '77 / Dec. '76
Government securities	**10.90**	**9.65**	**14.39**	**15.11**	*−1.25*	*4.74*	*0.72*
Consolidated	5.98	5.29	5.80	6.18	*−0.69*	*0.51*	*0.38*
Redeemable	9.82	10.51	14.31	15.19	*0.69*	*3.80*	*0.88*
Treasury bonds	11.66	9.58	14.46	15.17	*−2.08*	*4.88*	*0.71*
Bonds	**11.71**	**11.24**	**14.16**	**14.83**	***−0.47***	***2.92***	***0.67***
On behalf of Treasury	12.15	11.63	13.95	14.77	*−0.52*	*2.32*	*0.82*
Industrial credit institutions	12.49	10.66	14.18	14.88	*−1.83*	*3.52*	*0.70*
Real estate credit institutions	9.59	9.81	14.31	14.52	*0.22*	*4.50*	*0.21*
ENEL-ENI-IRI	13.28	11.21	14.12	14.78	*−2.07*	*2.91*	*0.66*
Other companies	13.41	11.72	15.14	15.81	*−1.69*	*3.42*	*0.67*

The yields on bonds subject to « substitutory » tax showed a different evolution from that of tax-exempt bonds. In fact the banks and the institutional investors tended to prefer taxable bonds because they pay the tax in advance and so are in credit for the entire amount of tax paid. The interest for taxable bonds shown by financial institutions seems to be reflected in a lower net yield than that on similar, tax-exempt bonds.

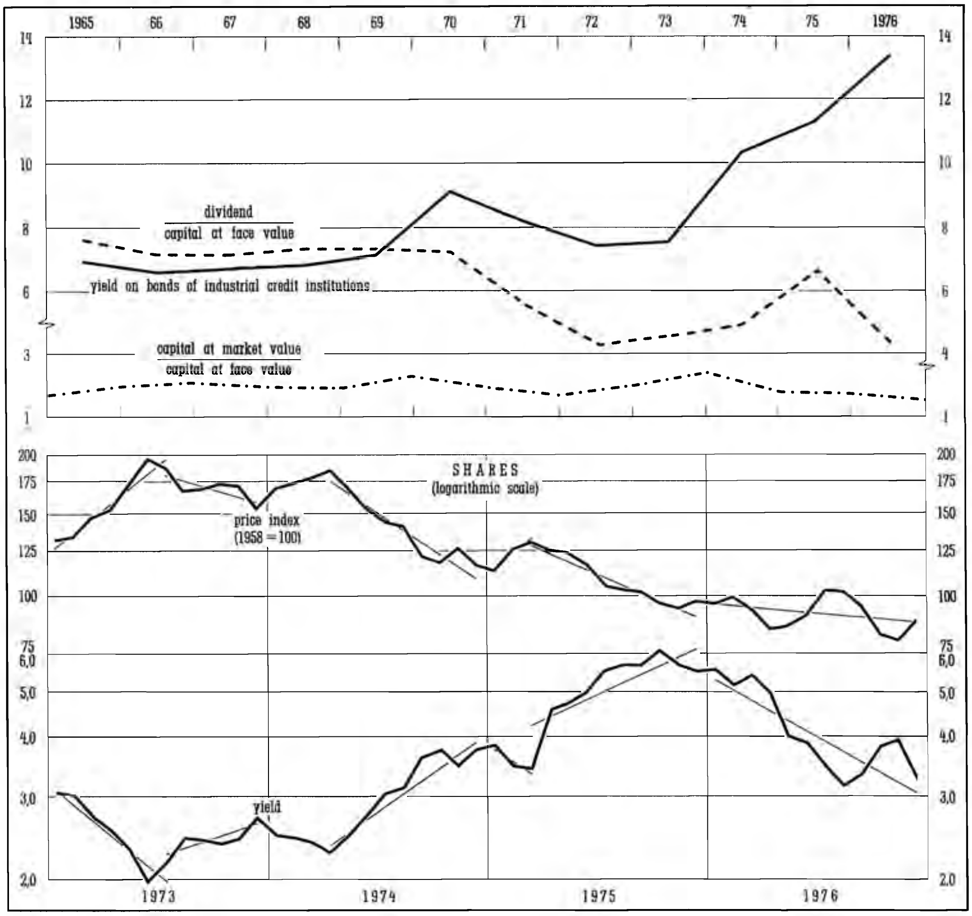
In contrast with the downturn in issues of fixed-interest securities, share issues, net of double-counting, increased with respect to the year before (1,697 billion in 1976, as against 1,357 in 1975); as in the past the funds raised were prevalently for companies not listed on the stock exchange. The enterprises thus corrected, at least partially, the distortions in their financial structures, also because they were able to count on a growing volume of gross self-financing. The stock exchange, however, continued to play a minor role in raising risk capital, also due to the lowering of the ratio of market value to face value. This confirmed the need for an effective reform to make the secondary market more functional, as a first step towards a greater spreading of shareholding (Chart 15).

The ratio of issues to GDP remained unchanged with respect to 1975 (1.2 per cent), nor did the ratio of issues to gross fixed investment move away from the 1975 figure (5.9 per cent in 1976 as against 5.7 in 1975).

A survey of the companies that issued shares in the five-year period from 1972 to 1976 shows that 78 per cent of share capital belongs to the public sector and to private limited companies, 11 per cent to non-residents and the remaining 11 per cent to Italian private savers. These figures indicate that the direct flow of saving from households to enterprises through shareholding is very small and consequently the funds raised as risk capital are largely supplied by other enterprises. Italian private savers hold 33 per cent of the shares of listed companies (as against 6 per cent of unlisted companies) which points to the need to improve the efficiency of the secondary markets so as to encourage investment in shares by the public.

Savings shares, introduced under Law n. 216 of June 7th 1974, are beginning to be favourably received by companies and by the public. They have certain advantages over common and preferred stock, such as the fact that they are made out to the bearer, the dividend paid can be included under costs in the balance sheet, withholding tax is lower, the expected dividend is 2 per cent higher than that paid on common stock and may be accumulated for three years.

Chart 15



Shares and bonds: prices and yields

The annual survey on share demand showed a considerable reduction in foreign sector demand (15.2 per cent, as against 23.2 in 1975) and, conversely, an increase in that of private residents (25.8 as against 20.4 per cent in 1975). This shift affected both listed and unlisted shares and was mainly due to the enactment of the regulations on the re-entry of capital, which had the effect of reclassifying investors who formerly had appeared under a foreign name. There was a slight growth in the portions of « companies », « banking system » and « other financial intermediaries » (Table 35).

The activity of unit trusts was affected by the brusque variation in the exchange rate that occurred in the first quarter of 1976. The net assets of the eleven trusts surveyed rose from 362 billion lire at the end of 1975 to 417 billion at the end of 1976, i.e. by 15 per cent. However, if one considers the dollar value of the net assets of the same sample, there was a decrease of 10 per cent (476 million dollars at end-1976, as against 529 million dollars at end-1975).

Table 35

SHARES BY CATEGORIES OF HOLDERS

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

Categories of holders	Yearly average 1963-72	1973	1974	1975	1976
The public	*30.8*	*22.4*	*21.1*	*20.4*	*25.8*
Companies	*45.2*	*48.3*	*51.1*	*50.0*	*52.2*
Foreign sector	*18.7*	*22.0*	*20.7*	*23.2*	*15.2*
Banking system	*3.5*	*4.8*	*4.4*	*3.8*	*4.0*
Other financial intermediaries	*1.8*	*2.5*	*2.7*	*2.6*	*2.8*
Total...	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
listed	*43.9*	*33.1*	*32.6*	*30.6*	*28.9*
unlisted	*56.1*	*66.9*	*67.4*	*69.4*	*71.1*
Total at market value	17,714	26,355	25,500	20,979	20,720

Following the sharp drop in Italian share prices, the market value of Italian shares held by the eleven funds fell from 145 billion at end-1975 to 127 billion at end-1976. The ratio of Italian shares to net assets dropped considerably, from 40 per cent at end-1975 to 30 per cent at end-1976; total Italian securities were 35 per cent of net assets, as against 43 per cent at end-1975. Consequently, the proportion of foreign securities in the portfolios of the eleven trusts grew considerably, in contrast to the experience of the previous years.

Share prices suffered a further decline in 1976, confirming a three-year-long trend. The share index (1958 = 100) moved from 97.3 in December 1975 to 88.7 in December 1976, falling by 9 per cent (as against a 16 per cent decrease in 1975 and a 25 per cent drop in 1974). In contrast to 1975, when the downturn of share prices in Italy was in opposition to the progress registered by the stock exchange indexes of the major industrial countries, in 1976 there was a downward trend of foreign prices too, which was very strong in the United Kingdom, more moderate in West Germany, and scarcely noticeable in the United States. In Italy however, prices fluctuated to a greater extent.

In the first months of the year, the depreciation of the lira had a positive effect on quotations. However in March the share index dropped considerably, reaching the lowest point in twenty years, as a result of the sharp reduction in dividends, the instability of the political situation and the rapid increase in interest rates. Bearish speculation flourished in this negative setting, hastening the downward trend of prices, until on April 14th the Consob (National Commission for Companies and the Stock Exchange) in order to put a brake on speculation, decided to require sellers to deposit with the Banca d'Italia the securities sold or a sum equivalent to 90 per cent of their value, within three days of the contract.

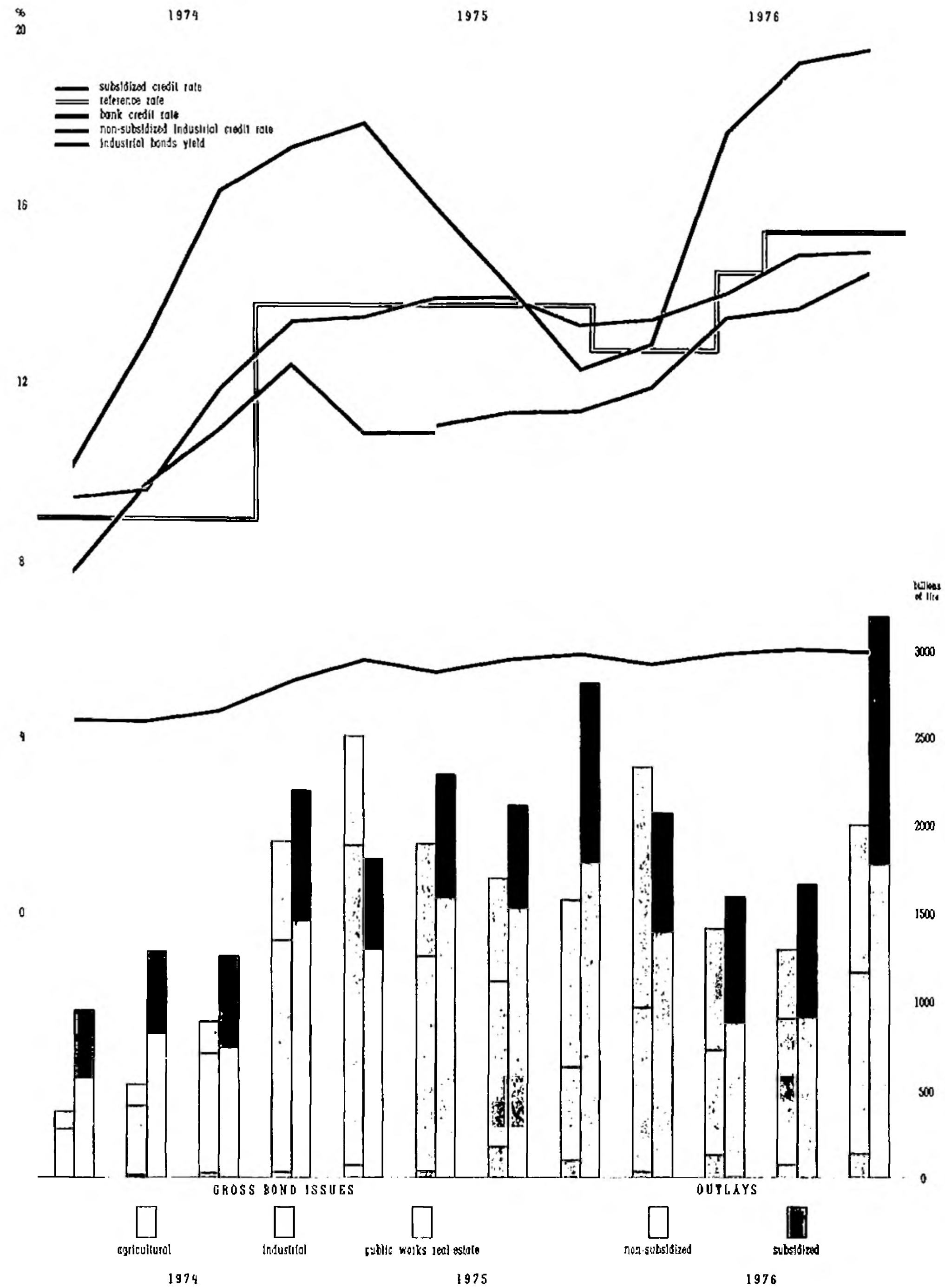
As from June, after the Parliamentary elections, there was a brief upward movement, encouraged by improvements in companies' accounts and by some easing of tension on the money and bond markets. From August onwards share prices declined again owing to uncertainties as to the economic cycle and the increase in the withholding tax on dividends which sharpened fiscal discrimination against shareholders. After a new low in November, the index recovered momentarily, partly owing to the announcement of the agreement between Fiat and the Libyan Government.

Dividends offered no comfort, as they reflected the fall in profits of the year before. The drop in the dividends distributed by the companies included in the Banca d'Italia's sample was so large (123 billion in 1976, as against 216 billion in 1975 and 161 in 1974) that it caused a severe cut in the yield of shares, despite the simultaneous reduction in quotations.

The activity of the special credit institutions

In 1976 intermediation by the special credit institutions (medium- and long-term financing) registered a slowdown, which was particularly marked in the middle part of the year. Their outstanding domestic loans, net of transactions by Crediop (Credit Consortium for Public Works) on behalf of the Treasury, increased by 5,020 billion at an

BONDS, OUTLAYS AND AVERAGE INTEREST RATES OF THE SPECIAL CREDIT INSTITUTIONS



annual rate of 13.4 per cent, as against 6,072 billion (19.3 per cent) in 1975; by contrast foreign loans rose from 220 billion in 1975 to 482 in 1976. Funds raised by bond issues, the institutions' principal source, dropped from 5,410 to 4,173 billion (Table 36).

Table 36

ASSETS AND LIABILITIES OF THE SPECIAL CREDIT INSTITUTIONS

(billions of lire)

Items	Amounts at end of 1976	Changes						
		1974	1975			1976		
			half-year I	half-year II	Year	half-year I	half-year II	Year
ASSETS								
Loans: domestic (1)	42,596	3,245	2,694	3,378	6,072	2,091	2,929	5,020
foreign	1,771	70	75	145	220	270	212	482
on behalf of the Treasury	13,209	748	365	1,752	2,117	–35	–366	–401
Securities portfolio:	1,460	–1	586	169	755	–91	–52	–143
Treasury bills	*480*	*23*	*521*	*144*	*665*	*–86*	*–134*	*–220*
Cash and liquid assets	9,105	355	1,324	–468	856	408	–374	34
with: *B.I. in foreign currency* (2) (3)	*3,845*	*1,426*	*–439*	*–68*	*–507*	*–26*	*–175*	*–201*
B.I. in lire (2)	*525*	*–497*	*521*	*129*	*650*	*–195*	*–56*	*–251*
Banks	*4,585*	*–555*	*1,316*	*–614*	*702*	*642*	*–119*	*523*
Others	*150*	*–19*	*–74*	*85*	*11*	*–13*	*–24*	*–37*
Others (4)	1,880	524	–549	–1,134	–1,683	374	–251	123
Total	**70,021**	**4,941**	**4,495**	**3,842**	**8,337**	**3,017**	**2,098**	**5,115**
LIABILITIES								
Bonds (5): ordinary	38,749	2,153	3,217	2,193	5,410	2,548	1,615	4,163
on behalf of the Treasury	13,589	619	207	1,569	1,776	–60	–209	–269
Deposits and interest-bearing certificates	4,269	228	1,033	–99	934	22	167	189
Financing by banks	1,378	54	–114	134	20	–186	184	–2
Public funds (6)	2,960	174	170	96	266	243	190	433
Foreign loans (3)	5,682	1,443	–299	–101	–400	87	–2	85
Equity capital (7)	2,889	246	281	41	322	348	140	488
Rediscount	505	24	–	9	9	15	13	28

(1) Including financing of compulsory stock–piling. – (2) The total for these deposits, which is calculated from the Banca d'Italia balance sheet, differs from that reported by the institutions chiefly owing to accounting time lags. – (3) For 1976 the changes are adjusted for exchange rate variations. – (4) This balance item is also affected by differences in the items under notes (2), (3) and (5) with respect to those contained in the institutions' balance sheets. – (5) Only in this table are the changes adjusted for spreads between face value and bid value price. Also includes issues by the Mediocredito centrale (medium–term credit institution). – (6) Also includes funds from the regions, the Cassa per il Mezzogiorno (own funds) and the Mediocredito centrale. – (7) Paid up capital and reserves.

The larger flow of investments in monetary terms made by enterprises in 1976 did not have much impact on the performance of loans since the special institutions outlay the funds on average two or three quarters after the investment, which is normally prefinanced with short-term credit, has been carried out.

The main cause of the drop in fund-raising was the slump in demand for securities on the financial market. Consequently the special institutions were able to place their bonds almost exclusively with the banks and two thirds of their gross issues were made in the months when the portfolio constraint is checked.

The time profile of the activity of the special institutions during 1976 shows that both the placement of bonds and lending activity were concentrated into the first and last quarters of the year (Chart 16). Intermediation was particularly heavy in the first quarter owing to the expansion of the activity of the real-estate and public works credit institutions, while the subsequent slowdown in the middle six months of the year was the result of less possibility of placing securities through the portfolio constraint, owing to the deceleration in the formation of bank deposits, and of the public's absence from the market. The recovery in outlays registered in the last three months of 1976 was sustained by increased placements of securities with the banking system and by the introduction in October of ceilings on the expansion of bank loans. This measure drove the enterprises, which were faced with a situation of stationary interest rates and an upsurge of inflationary pressure, to accelerate the funding of their short-term debts. Moreover the banks themselves encouraged these funding operations since it was to their advantage to transfer the debts of the enterprises to the special institutions in exchange for bonds that were valid for compliance with the portfolio constraint, thus reducing the impact of the ceilings placed on their operations.

This tendency appears confirmed by the recovery, in November and especially in December, of operations at market rates which had been extremely slack in the previous two quarters. The operations at subsidized rates, however, were favoured by sufficient availability of interest-reducing subsidies and by a rapid adjustment of the reference rates (rates officially applied to special institutions on subsidized outlays), and thus increased strongly over the year. The exception to this trend however was the performance of subsidized credit for the industrialization of the Mezzogiorno, which suffered from the initial difficulties encountered by the new law regulating credit incentives managed by the Cassa per il Mezzogiorno (Southern Development Fund).

In 1977 applications for funds to the special credit institutions should regain the levels recorded in 1975, in view of the large increase in value of the investments made in 1976 and the ceilings placed on bank loans. If the public's preference for holding short-term financial assets does not change, the financial requirements of the institutions can be satisfied by bank purchases of securities. In the first quarter of 1977 in fact, the institutions placed securities with the banks obtaining net proceeds of around 1,800 billion, only part of which (1,250 billion) were used to grant loans.

Fund-raising sources

The total flow of funds to the special institutions in 1976 amounted to 6,797 billion, compared with 8,176 in 1975. Net funds raised by issues of fixed-interest securities, though less than in 1975, represented 79.4 per cent of total financial resources, which was practically the same as the percentage registered in the previous two-year period (Table 37).

The difficulties of the capital market had a negative effect also on medium-term deposits, which dropped from 934 billion in 1975 to 189 in 1976; the share of deposits in total fund-raising thus fell from 11.4 to 2.8 per cent. The new deposit certificates were purchased by the banks in compliance with the portfolio constraint for about 250 billion, thus offsetting the repayments demanded by the public. Of the other fund-raising sources, public funds exceeded 400 billion, roughly twice as much as the year before. Recourse to foreign loans, net of repayments of those falling due, amounted to 85 billion lire (— 400 billion in 1975), pointing to the increased possibilities of access to the international market for Italian operators.

In a year when the public made almost no contribution to the institutions' fund-raising and the other sectors again only a slight one, there was an increase in the flow of funds from the banks, which represented 86.4 per cent of total funds raised (74.7 per cent in 1975).

Table 37

FUND-RAISING SOURCES OF THE SPECIAL CREDIT INSTITUTIONS

(percentage breakdown of changes)

Types of liabilities / Sectors of origin	1974	1975 half-year I	1975 half-year II	1975 Year	1976 half-year I	1976 half-year II	1976 Year
TYPES OF LIABILITIES							
Bonds (1)	77.4	69.9	95.4	78.5	83.9	74.2	79.4
Deposits and interest-bearing certificates	7.1	19.1	–3.6	11.4	0.6	5.2	2.8
Mediocredito funds	5.4	1.1	2.3	1.5	1.4	2.4	1.8
Foreign loans (2)	0.6	2.5	–1.2	1.3	3.2	5.4	4.2
Equity capital	7.6	5.2	1.5	3.9	9.7	4.4	7.2
Others	1.9	2.2	5.6	3.4	1.2	8.4	4.6
Total ...	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SECTORS OF ORIGIN							
The public and companies	–54.5	23.0	–5.8	13.2	–6.9	–1.7	–4.5
Banca d'Italia and UIC	1.9	–0.5	0.6	–0.1	0.9	2.1	1.5
Banks	141.5	60.2	103.3	74.7	88.1	84.4	86.4
Other credit institutions (3)	3.0	7.6	2.0	5.7	8.4	4.9	6.7
Public sector	7.2	7.3	1.6	5.4	6.2	4.9	5.6
Foreign sector (2)	0.9	2.4	–1.7	1.1	3.3	5.4	4.3
Total ...	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (in billions of lire)	3,227	5,419	2,757	8,176	3,602	3,195	6,797

(1) Excluding bonds issued on behalf of the Treasury and by the Mediocredito centrale, the value of which decreased by 100 billion in 1976 (increased by 108 billion in 1975). – (2) Net of compensatory loans held by the Banca d'Italia, which dropped by 207 billion in 1976 and 506 billion in 1975. For 1976 the figures exclude exchange rate changes. – (3) Special credit institutions and insurance companies.

Lending

In 1976 domestic lending by the special credit institutions amounted to 8,513 billion, as against 9,010 billion in 1975. Given the time lag mentioned earlier, the ratio of credit granted in 1976 to the volume of investments of the previous year was 36 per cent. This was the lowest figure for the last five years (over which it averaged about 41 per cent), with the exception of 1974 when the volume of outlays was small because of the institutions' decision in 1973 to bring forward some of their operations.

The reduction in the volume of loans was sharpest for the public sector (public enterprises and General Government), where the rate of increase dropped from 25.8 per cent in 1975 to 10.9 in 1976, while it declined from 16.3 to 14.8 per cent for the private sector (Table 38). The distribution of the credit flow between these two

Table 38

DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS BY CATEGORIES OF CUSTOMERS

Categories of customers	Subsidized		Non-subsidized		Total			
	1975	1976	1975	1976	1975	1976	1975	1976
	absolute changes in billions of lire						*percentage changes*	
General Government	**148**	**135**	**736**	**458**	**884**	**593**	*23.7*	*12.8*
local authorities	23	12	592	400	615	412	*19.2*	*10.8*
other public bodies (1)	125	123	144	58	269	181	*51.3*	*22.9*
Finance and insurance companies	**–37**	**19**	**266**	**177**	**229**	**196**	*66.9*	*34.2*
Non-finance companies	**1,422**	**1,914**	**2,877**	**1,977**	**4,299**	**3,891**	*20.8*	*15.6*
public:	409	266	1,240	484	1,649	750	*27.2*	*9.7*
nationalized	9	7	–90	36	–81	43	*–11.5*	*6.7*
state-controlled	400	259	1,330	448	1,730	707	*32.3*	*10.0*
private	1,013	1,648	1,637	1,493	2,650	3,141	*18.1*	*18.2*
Households	**117**	**150**	**470**	**176**	**587**	**326**	*9.3*	*4.7*
TOTAL ...	**1,650**	**2,218**	**4,349**	**2,788**	**5,999**	**5.006**	*19.3*	*13.5*
public enterprises and bodies	557	400	1,974	948	2,531	1,348	*25.8*	*10.9*
households and private enterprises	1,093	1,818	2,375	1,840	3,468	3,658	*16.3*	*14.8*

(1) Including social security institutions.

sectors thus shifted heavily in favour of the latter (73.1 per cent as against 57.8 in the previous year). This reflects the different trends of investment by the two sectors, as well as the greater availability of subsidized credit for private enterprises during the year. Households increased their operations at subsidized rates, but nonetheless their total indebtedness for the year suffered from the high cost of non-subsidized mortgages, which further raised the minimum income level necessary to bear the cost of buying a house.

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

The fall-off in lending only affected operations at market rates: outlays of subsidized credit in fact were 1,000 billion higher than in 1975, and represented 45 per cent of special credit operations (34 per cent the previous year). The expansion of subsidized credit was possible owing to the availability of interest-reducing subsidies allocated in the second half of 1975, together with the profitability of the reference rates applied to the institutions ensured by the two adjustments made in 1976. During the year subsidized credit showed a relatively steady performance, and in particular did not suffer from the slackening in the demand for credit in the middle half of the year.

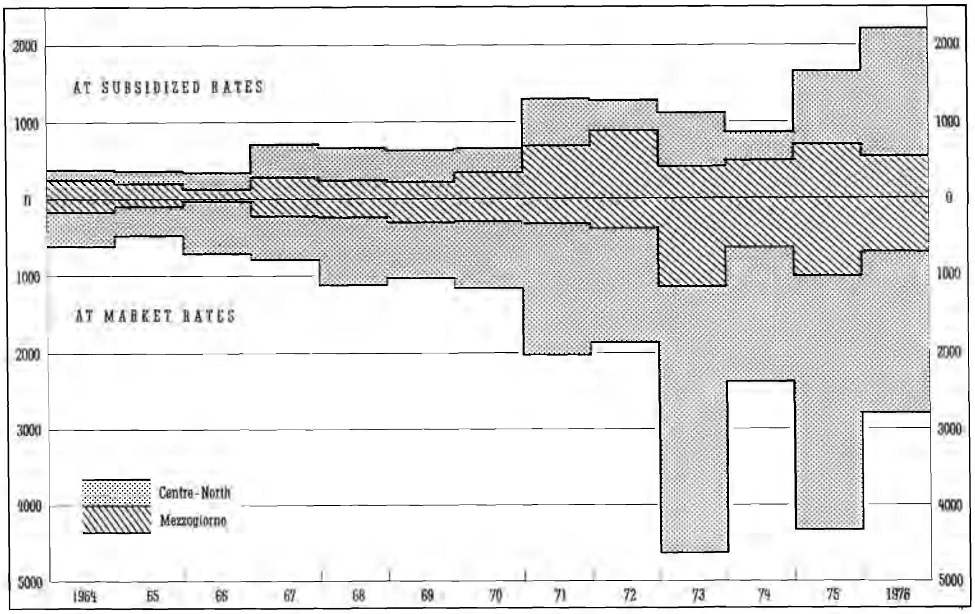
From a geographical point of view, the increase in subsidized credit chiefly concerned initiatives in the central and northern regions. In fact the South received a smaller volume of credit at subsidized rates than the year before, and consequently the share of additional indebtedness at subsidized rates in favour of the South and the Islands was heavily reduced, falling to 24.7 per cent of the total flow, as against 43.1 per cent in 1975 and almost 50 per cent in the previous decade (Chart 17). As already mentioned, this was caused by the scarce amount of credit subsidized by the Cassa per il Mezzogiorno as the funds allocated by the law for the industrialization of the Mezzogiorno dried up, together with the slowness in implementing the new regulations introduced by Law n. 183 of 1976.

The distribution of subsidized credit by categories of customers concerned all sectors of economic activity. In 1976, besides loans to industry, there was a considerable expansion in lending to agriculture and construction, partly as a result of regional measures granting subsidized credit.

In parallel with the growth of the cost of fund-raising by bond issues, interest rates on ordinary medium- and long-term financing rose during 1976 to particularly high levels (14.45 per cent on average for industrial credit in 1976, as against 13.66 per cent in 1975). However, as in the previous two years, they remained below the rates practised by the banks (Chart 16).

The cost of loans was much lower than the rate of inflation. However, the slackening of inflation in the middle of the year led borrowers to expect an increase in the real cost of indebtedness in the not too distant future.

Chart 17



Lending by special credit institutions by geographical areas and categories of operations
(changes in billions of lire)

Despite the increase in market rates, the average cost of industrial credit was lower in 1976 than in the year before, given the increased share of subsidized credit in total medium- and long-term loans. The average weighted rate on outlays by the industrial credit institutions was in fact 10.60 per cent, as against 11.10 per cent in 1975.

Financing of industry

The outlays of credit to industrial enterprises by the special credit institutions slightly exceeded the figure for the previous year (3,811 as against 3,752 billion). Considering the larger repayments, the sector's indebtedness increased by 2,012 billion, equal to a rate of 14 per cent, compared with 17.7 per cent in 1975 (Table 39).

Table 39

DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS BY SECTOR

(billions of lire)

Categories of operation	Agriculture		Housing		Industry		Transport, commerce and misc. services		Total	
	1975	1976	1975	1976	1975	1976	1975	1976	1975	1976
					Outlays					
Subsidized	569	728	145	224	1,825	2,196	275	403	2,814	3,551
Non-subsidized . . .	200	252	1,451	1,370	1,927	1,615	2,618	1,725	6,196	4,962
TOTAL . . .	769	980	1,596	1,594	3,752	3,811	2,893	2,128	9,010	8,513
					Net increases in lending *(absolute values)*					
Subsidized	319	354	128	194	1,027	1,364	176	306	1,650	2,218
Non-subsidized . . .	–3	76	1,156	909	1,129	648	2,067	1,155	4,349	2,788
TOTAL . . .	316	430	1,284	1,103	2,156	2,012	2,243	1,461	5,999	5,006
					(percentage breakdown)					
by region:										
Northern	*48.8*	*52.9*	*40.6*	*48.7*	*40.3*	*52.9*	*69.6*	*63.7*	*51.8*	*55.0*
Central	*22.2*	*21.8*	*35.2*	*30.1*	*17.7*	*17.7*	*11.6*	*16.1*	*19.4*	*20.4*
Southern and islands	*29.0*	*25.3*	*24.2*	*21.2*	*42.0*	*29.4*	*18.8*	*20.2*	*28.8*	*24.6*

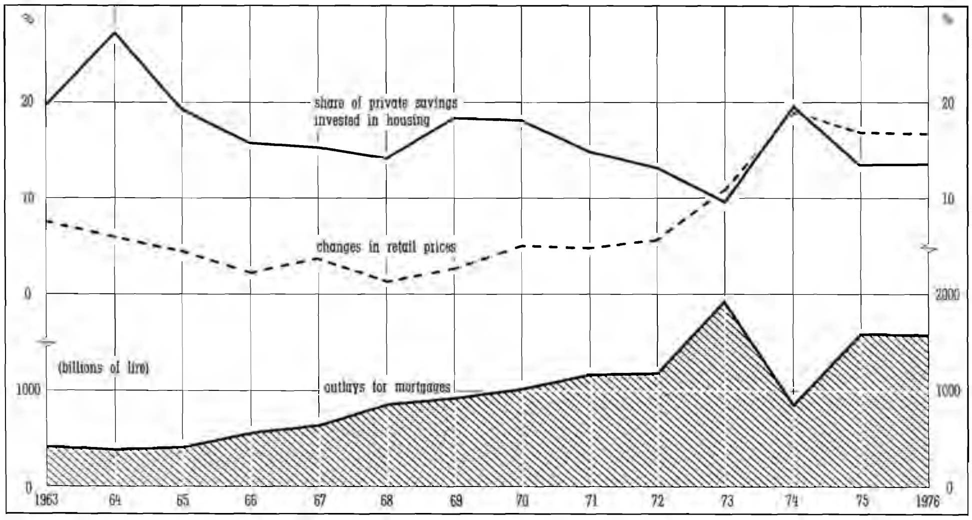
Taking into account the time-lag in outlays of credit, it can be seen that financing of industrial investments with medium- and long-term credit did not vary from the figure for recent years. In fact, it must be borne in mind that precisely in the industrial sector the level of investment had been particularly low in 1975, with a decline even in monetary terms, and that in 1976 the increase was small.

Outlays of subsidized credit, including export credits, accounted for almost 58 per cent of medium-term credit to the sector (51 per cent in the 1973-75 three-year period), offsetting the reduction in credit at market rates.

Financing of housing

The gross flow of special credit to investments in housing stayed at the same level as the year before (1,600 billion) since it was possible to place bonds issued by the real-estate credit institutions in banks' portfolios (Chart 18). In the face of high inflationary pressures, the inflow of private funds to the real-estate securities market remained modest, partly because these securities have a longer life than others.

Chart 18



Financing of private investments in housing

As a ratio of the value of investments in housing effected in 1976, the share of loans granted by the special credit institutions was smaller than in 1975, and even the ratio to investments of the previous year showed a slight decline. By contrast, the share of short-term financing granted to building firms by the banks grew. In view of the high rates on the mortgages to be transferred to the buyers, the building firms may have deferred the funding of their prefinancing with the banks, even though it was at very high rates.

The simultaneous rise in the cost of housing and of the mortgage necessary to finance the purchase of a house is excluding ever broader categories of users from the possibility of home ownership. For private building, long-term financing that is index-linked, say, to the cost of building, would — without risk to the intermediary — enable the real value of saving for house purchases to be safeguarded. Moreover the mortgage-holder would be relieved of part of the burden of the first instalments, which in times of high interest rates weigh far too heavily on household budgets.

Saving by the households and enterprises sector invested in housing financed about two-thirds of private investments in 1976, a slightly larger proportion than in 1975. The same aggregate accounted for about 14 per cent of the sector's total gross saving, practically the same as the year before (Chart 18). Unlike 1974, when the public had found it profitable to sell securities and invest a large share of their savings directly in housing, in 1976 the effects of inflationary pressures on the composition of the public's wealth were weakened by the difficulty of disinvesting portfolio securities without suffering heavy capital losses. The uncertain prospects as to the income obtainable from an investment in housing not for personal use had a similar effect.

Subsidized building began to benefit from the expansionary measures enacted in 1975. Building totally financed by the State gained importance in 1976, while wholly and partly subsidized building represented about 12 per cent of investments in housing. Despite the results achieved through public intervention, better conditions must be created for private building if the sector is to expand. Foremost among these is the prospect of being able to obtain a real positive income from investment in housing, within the framework of a new law on rents.

Financing of agriculture

Lending to agriculture, continuing the trend of the previous year, showed a strong growth: total agricultural credit, net of stockpile financing, grew by 702 billion or 21.3 per cent (607 billion, 22.6 per cent in 1975; Table 40).

Working credit registered a lower growth rate than in 1975 (19.4 as against 24.1 per cent). However, the ratio of this aggregate at year-end to the value added of agriculture rose from 16.9 per cent in 1975 to 17.2 per cent in 1976. The increase can be ascribed not only to a greater availability of public funds for subsidized credit, but also to the financing of mechanization (included in working credit) which was considerably enlarged as part of the policy of capitalizing agricultural enterprises in order to cope with the increased cost of labour. Outlays of improvement credit reached 472 billion (386 billion in 1975), increasing by 22.3 per cent. The growth of this type of credit, which unlike working credit is mostly granted by the special institutions, relied on the continued obligation for banks to buy a minimum amount

Table 40

LENDING BY THE AGRICULTURAL CREDIT SYSTEM

(changes in billions of lire)

Items	Agricultural special credit institutions		Other institutions		Total	
	1975	1976	1975	1976	1975	1976
Working credit	79	112	236	203	315	315
Improvement credit	247	311	45	76	292	387
TOTAL ...	326	423	281	279	607	702
Financing of stockpiling system operations	72	15	55	42	127	57
compulsory	*15*	*16*	*25*	*31*	*40*	*47*
voluntary	*57*	*–1*	*30*	*11*	*87*	*10*
Other loans	2	2	–	–	2	2
GENERAL TOTAL ...	400	440	336	321	736	761

of agricultural bonds. Securities of this type issued by the institutions in 1976, net of repayments, amounted to 345 billion as against 361 billion in 1975, the first year when the institutions were able to make ample recourse to fund-raising by bond issues.

Financing of exports

Outlays of credit by the industrial credit institutions to support deferred payment exports amounted to 1,047 billion (678 billion in 1975), which was 3.4 per cent of the total value of goods exported, or 13.8 per cent if referred to final capital goods alone (respectively 3 and 11.9 per cent in 1975; Table 41). With respect to the category of operations, financial credits to foreign countries (614 billion as against 363 in 1975) increased more than credits granted to Italian exporters (433 billion as against 315 in 1975) which were essentially for the products of the engineering industry.

Net of repayments, amounting to 499 billion, export credits rose by 548 billion (314 in 1975). Taking into account the interventions of the Italian Foreign Exchange Office (UIC) and the National Insurance Institute (INA), net resources transferred abroad by these operations totalled 803 billion.

The increase in export credits benefited in particular the developing countries, which took more than half of the increase in special institution loans. In particular, most of the credits granted to exporters were for exports to those countries, while a considerable part of the increase in financial credits, as in 1975, went to the East European Socialist countries and notably to the Soviet Union.

Table 41

EXPORT CREDITS (1)

(billions of lire)

Categories of operations	Outlays		Repayments		Net increase		Loans	Financing commit-ments	Applica-tions to examine
	1975	1976	1975	1976	1975	1976			
	Flows						*Outstanding at end-December 1976*		
Exporters	314.8	432.5	221.7	273.2	93.1	159.3	1,244.2	1,342.1	900.4
Financial	362.8	614.3	141.9	225.4	220.9	388.9	1,425.5	2,660.6	300.7
tied	*356.0*	*571.4*	*101.7*	*154.5*	*254.3*	*416.9*	*1,279.1*	*2,562.3*	*282.6*
untied	*6.8*	*42.9*	*40.2*	*70.9*	*–33.4*	*–28.0*	*146.4*	*98.3*	*18.1*
TOTAL . . .	**677.6**	**1,046.8**	**363.6**	**498.6**	**314.0**	**548.2**	**2,669.7**	**4,002.7**	**1,201.1**

(1) Excluding refinancing and funding by UIC and INA totalling, at end-1976, 719 billion (464 at end-1975).

The need for strong credit support for exports of capital goods must however be considered in the light of the fact that the currency situation makes it preferable to grant financial credits only if the credit instruments denominated in foreign currency are negotiable. The possibility of obtaining refinancing on the international market could equally well reduce the load of interest subsidies borne by the State, given the lower rates at present practised on that market. Moreover, the high level of indebtedness of certain importer countries may encourage greater caution in granting loans.

The persistence of balance-of-payments disequilibria in capital-goods exporting countries may give rise to a distorsion of international competition if export credits are granted on more favourable conditions, despite the existence of agreements among the industrial countries on interest rates and on the maximum duration of loans. The creation of a body for international cooperation in this field, like the European Export Bank, appears to be encountering some difficulty.

The formation of financial assets and the financing of investment

The formation of financial assets by the Economy (households and enterprises) slowed down in 1976 after the expansion of the previous year. During the year total formation amounted to 30,643 billion, corresponding to a 16.9 per cent growth rate, compared with 28,273 billion and 18.2 per cent in 1975. The slackening of the formation of financial saving is reflected in the fall of the ratio of financial assets to the gross domestic product, which dropped to 21.6 per cent from 24.8 in 1975, when it had approached the peaks of 1972-1973 (Tables 42 and 43).

Table 42

THE ECONOMY'S FINANCIAL ASSETS AND TOTAL FINANCING (1)
(percentage ratio to GDP and growth rates)

Years	Changes in financial assets / GDP	Total financing / GDP	Percentage growth rates: financial assets	liquid assets	total financing
1965	15.3	11.6	12.4	15.2	9.4
1968	17.4	13.7	11.8	12.8	9.7
1969	17.0	14.1	11.7	11.6	10.2
1970	16.6	16.4	11.1	14.0	11.7
1971	20.4	20.5	13.8	16.1	14.5
1972	25.2	23.3	16.8	18.4	16.3
1973	26.2	28.3	17.7	19.9	19.9
1974	16.1	22.1	11.2	16.7	15.7
1974 (2)	*14.9*	*20.9*	*10.4*	*16.7*	*14.9*
1975	24.8	28.5	18.2	23.6	20.4
1975 (2)	*25.8*	*29.6*	*19.0*	*23.6*	*21.2*
1976	21.6	24.4	16.9	22.3	18.0
1976 (2)	*20.6*	*23.4*	*16.1*	*22.3*	*17.3*
Average 1964-1973	*19.2*	*18.0*	*11.9*	*14.2*	*11.7*

(1) Total financing includes financing to the Economy and the public sector. — (2) Net of compulsory deposits at BI.

The composition of the flow of total financial assets was affected by the performance of yield differentials which shifted in favour of short-term assets and by persistent inflationary expectations: liquid assets increased at a faster pace than total assets, although slower than in 1975 (22.3 per cent as against 23.6). Excluding ordinary Treasury

Table 43

THE ECONOMY'S FINANCIAL ASSETS AND THEIR COUNTER-ITEMS

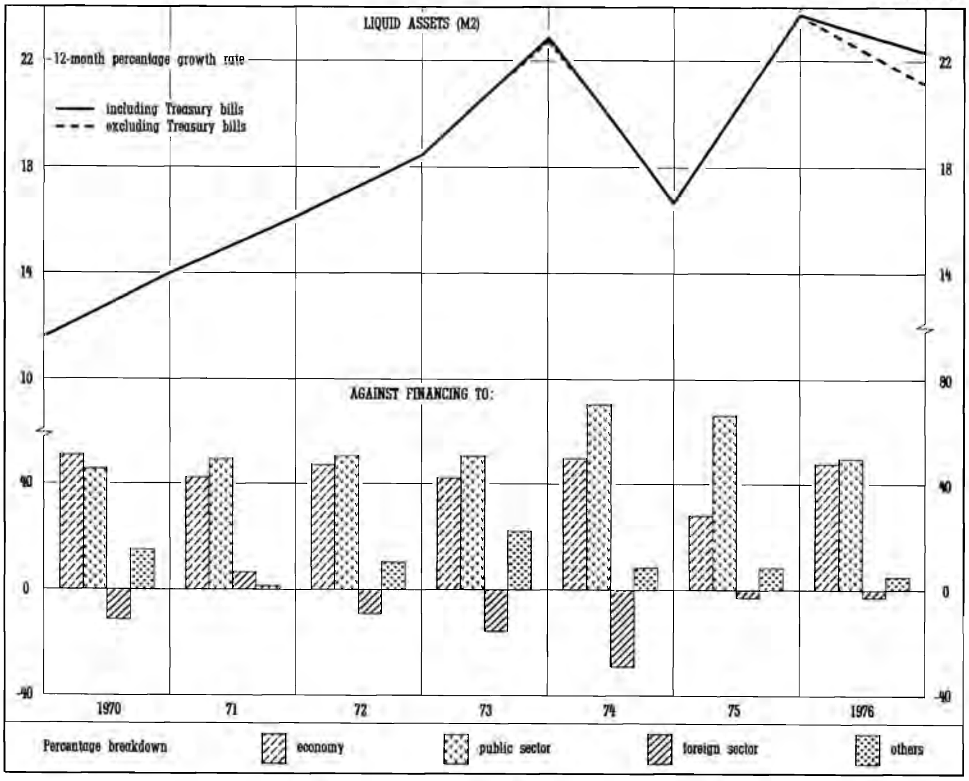
(amounts and flows in billions of lire)

Items	Amounts at end-1975	Flows 1975	Flows 1976 Year	1976 Quarters I	II	III	IV
FINANCIAL ASSETS:							
Domestic	165,733	27,495	32,346	5,462	6,547	5,352	14,985
Currency	12,304	1,705	1,644	–443	892	–309	1,504
Deposits: Post Office & with Treasury	13,320	2,309	2,608	893	130	325	1,260
bank	96,289	19,284	21,583	3,309	2,004	3,218	13,052
Other deposits and savings certificates and Treasury bills	3,968	782	1,355	4	524	299	528
Fixed-interest securities	17,223	2,345	707	984	–118	–90	–69
Shares and equity capital	12,134	961	1,509	337	429	241	502
Compulsory deposits with B.I. (1)	–	–1,237	1,427	–	2,308	1,290	–2,171
Other financial assets	10,495	1,346	1,513	378	378	378	379
Foreign	15,342	778	–1,703	–176	–222	–81	–1,224
TOTAL . . .	**181,075**	**28,273**	**30,643**	**5,286**	**6,325**	**5,271**	**13,761**
AGAINTS FINANCING OF:							
ECONOMY	126,506	17,664	20,741	5,490	3,102	5,336	6,813
Domestic	115,415	16,744	20,724	5,536	3,083	5,242	6,863
Indebtedness to: Banks (2)	52,954	7,138	11,657	2,632	1,877	3,454	3,694
Special credit institutions	32,211	4,998	4,147	1,321	239	913	1,674
Bonds	9,111	1,410	1,027	681	–65	259	152
Shares and equity capital	11,712	1,083	1,768	401	493	305	569
Endowment funds	3,600	510	832	213	74	42	503
Financing by local authorities	1,681	426	284	71	71	71	71
Other financial liabilities (3)	4,146	1,179	1,009	217	394	198	200
Foreign	11,091	920	17	–46	19	94	–50
FOREIGN SECTOR (4)	–562	–377	–2,340	–1,124	–1,198	698	–716
PUBLIC SECTOR (consolidated) (5)	65,647	14,886	13,911	2,365	2,782	4,452	4,312
UNCLASSIFIED (6)	–10,516	–3,900	–1,669	–1,445	1,639	–5,215	3,352
TOTAL . . .	**181,075**	**28,273**	**30,643**	**5,286**	**6,325**	**5,271**	**13,761**
ECONOMY'S FINANCIAL SURPLUS OR DEFICIT	**54,569**	**10,609**	**9,902**	**–204**	**3,223**	**–65**	**6,948**

(1) For 1976 these deposits are adjusted for the share financed directly by the banks. – (2) Includes operations to fund in securities the debts of the health insurance bodies with hospitals (amounting to 1,709 billion in 1975, 173 billion in 1976 and 25, 110, 30 and 8 billion respectively in the four quarters of 1976). – (3) Includes operations to fund in cash the debts of health insurance bodies with hospitals (to repay suppliers) and clinics (amounting to 537 billion in 1975, 231 billion in 1976 and 9, 181, 16 and 25 billion respectively in the four quarters of 1976). – (4) Balance of payments on current account on a transaction basis. – (5) Net of funding operations under notes (2) and (3). – (6) Includes lags.

bills which increased considerably during the year and are less liquid than the other components, the growth rate of liquid assets appears to have decreased more sharply, falling to 21.2 per cent (Chart 19).

Chart 19



Liquid assets and their counterparts

The slowdown of the formation of financial assets occurred both in the households sector and, if one excludes the compulsory deposit on purchases of foreign exchange, in the enterprises sector. In the case of households, this behaviour is linked to the drop in the share of disposable income in GDP, to a slight decrease in the propensity to save after the heavy increase of 1975, and to a change in saving allocation which favoured investment in real goods over financial assets. As for the enterprises, the marked improvement in demand expectations and the high level of interest rates, led them to increase the velocity of circulation of liquid balances accumulated during 1975.

The formation of financial assets by the Economy described above was the result of a 34,652 billion expansion (32,550 in 1975) in total financing to domestic final user sectors (Economy and public sector) and a balance-of-payments deficit on current account of 2,340 billion (377 in the previous year). Total domestic credit, according to the definition agreed upon with international organizations, increased by 33,272 billion during the year compared with 30,867 in 1975, at rates of 19.8 and 22.5 per cent respectively. Excluding cash requirements for the compulsory deposit on purchases of foreign currency, the growth rate of credit dropped from 23.6 per cent in 1975 to 18.9 in 1976 (Table 44).

Table 44

TOTAL DOMESTIC CREDIT IN 1976

(changes in billions of lire and percentage growth rates)

Items	Quarters				Year
	I	II	III	IV	
	(changes in billions of lire)				
Cash requirements of the State sector (1)	2,310	2,753	4,337	4,122	13,522
BI-UIC financing to the Treasury (2)	*2,426*	*3,260*	*1,148*	*2,219*	*9,053*
Financing to the non-State sector (3)	5,129	2,694	5,235	6,692	19,750
Total domestic credit	7,439	5,447	9,572	10,814	33,272
	(percentage growth rates)				
Cash requirements of the State sector					
in the quarter	*3.9*	*4.5*	*6.8*	*6.0*	
in the 12 months ending at end-quarter	*30.4*	*27.6*	*27.6*	*22.9*	
Financing to the non-State sector					
in the quarter (4)	*7.9*	*2.5*	*5.0*	*1.6*	
in the 12 months ending at end-quarter	*22.4*	*20.0*	*19.9*	*18.1*	
Total domestic credit					
in the quarter (4)	*6.5*	*3.2*	*5.7*	*3.2*	
in the 12 months ending at end-quarter	*25.1*	*22.6*	*22.5*	*19.8*	

(1) The State sector includes the Treasury, Central Post Office Savings Fund and Autonomous Agencies. The cash requirements of the sector are net of Treasury financing to the special credit institutions and of operations to fund the debts of local authorities and health insurance bodies. — (2) Net of the cash component of the funding operations mentioned in note (1). — (3) The non-State sector comprises the Economy and the public bodies not included in the State sector. Financing to the sector includes the funding operations under note (1). — (4) Seasonally adjusted data.

The adoption of total domestic credit as intermediate target of monetary policy makes explicit the constraint placed on domestic expansion by the balance-of-payments outcome on current account. Once established the volume of total domestic credit that is compatible with the performance of economic activity and investment and with the desired balance on current account, negative shifts of the actual balance away from that desired are immediately reflected on enterprises' liquid assets, and hence on interest rates and capital movements. Then they affect inventories and fixed investment, again with direct and indirect effects on the balance on current account, as well as on the level of economic activity. Moreover, changes in income and interest rates affect households' demand for financial assets and its composition, thus further altering the supply of funds to the enterprises.

The adoption of a wider aggregate, such as total credit, in place of a narrower one such as bank credit is justified by the substitutability of the liquid and non-liquid components of financial assets and by the instability of the respective composition during the cycle.

During the year under study the expansion of total domestic credit exceeded by 3,770 billion the 29,500 billion ceiling agreed with the EEC in connection with its medium-term support. This overshooting is due entirely to the non-State sector, and can be ascribed to the larger expansion of economic activity than expected and the introduction of the compulsory deposit on purchases of foreign exchange.

The ratio of total financing to GNP, net of the effect of the compulsory deposit, equalled 23.4 per cent in 1976 compared with 29.6 the previous year. On seasonally adjusted data the ratio equalled 34, 11 and 25 per cent respectively in the first three quarters of 1976. The impact of the restrictive measures adopted early in the year produced a slowdown in the growth rate of credit in the second quarter, after an unusual expansion in January, before gradually fading during the summer. In the fourth quarter the ratio of total financing to GDP dropped slightly to 23 per cent as a result of the ceilings on bank loans, although these were in part offset by net repayments of the compulsory deposit on purchases of foreign exchange and by the fact that the banks took over from the enterprises part of the financing of the new deposits.

The distribution of total financing between the Economy and the public sector, which had shifted increasingly in favour of the latter in recent years, became slightly more balanced towards the Economy during the year under study: credit received by this sector amounted to 20,741 billion (17,664 in 1975) or 59.9 per cent of the total (54.3 per cent the previous year). This figure, however, is still below the average for the period 1966-1974 (63.7 per cent). Even more marked was the increase in the share of financing to the private sector of the Economy; this was due to the fact that public enterprises cut down their recourse to external financing and thus its relative importance dropped from 18.6 to 16.4 per cent of total financing. The public sector — net of operations to fund the debts of the health insurance bodies with hospitals and clinics — received less funds than in 1975 (13,911 billion compared with 14,886) largely owing to the reduction of the current deficit achieved through heavier taxation.

The composition of financing to the Economy reflects the difficulties of obtaining medium- and long-term funds on the bond market, either directly or through the special credit institutions: the share of medium- and long-term debts in the total funds obtained by the Economy in fact dropped from 41.5 per cent in 1975 to 32.5 per cent in 1976. The worsening of the sector's debt structure contrasted with the increase of enterprises' own resources with respect to total liabilities, which was due to both the recovery of share issues and the improvement in their self-financing.

Given the upturn in production and investment at current prices, the financial balance of the Economy dropped from 10,609 billion in 1975 to 9,902 in 1976, or 9.3 and 7 per cent respectively of the gross domestic product. This performance can be ascribed to a slight decrease in the enterprises' financial deficit with respect to GDP and to a large reduction in households' surplus.

On the other side, the public sector deficit, which dropped in absolute value compared with the previous year (13,911 billion as against 14,886 in 1975), lost weight as a ratio to GDP, decreasing from 13 to 9.8 per cent, while the balance-of-payments deficit on current account again worsened (2,340 billion as against 377 in 1975), rising from 0.3 to 1.7 per cent of GDP.

III. – THE GOVERNOR'S CONCLUDING REMARKS

During the course of last year the Deputy Director General, Antonino Occhiuto, and the Director General, Rinaldo Ossola, both left the Bank, the first at the end of June and the second at the end of July. They both belonged to a group of young men appointed as a result of a rigorous process of selection that was specifically designed to reinforce the structures of the Research Department and Supervisory Authority after the enactment of the Banking Law and the establishment of the Inspectorate for Credit. Other members of that group have left the Bank at various times to pursue brilliant careers in the academic world and in banking.

Rinaldo Ossola spent part of his career in the Bank's representative offices abroad and part in the pursuance of economic studies until he was appointed to the Board of Directors in 1969, at the same time as Occhiuto. The unifying thread running through the various periods of his career was the contribution he made to the reform of the international monetary system through his outstanding ability to develop and realize new concepts. Many ideas that had sprung from his mind have been discussed in international fora and set down in documents which have represented important steps towards the conclusion of international agreements. This ability to further the course of international monetary cooperation found its highest expression in the drafting in 1965 of the report which bears his name on the creation of special drawing rights.

Antonino Occhiuto devoted the first twenty-one years of his career to economic research in close and friendly collaboration with one who now has the honour of paying tribute to his work. A distinguished scholar of the social sciences, in his demographic and statistical research he developed his exceptional ability to extend forecasting and planning far into the future and then applied this ability fruitfully during the remainder of his career at the Bank, first in administration (the Secretariat, the Personnel Department and the Inspectorate) and then as a member of the Board of Directors itself. Alert to the formal and legal aspects of problems, within the framework these provided he applied his tireless intellect and moral commitment to seek and find solutions which were right and at the same time consistent with the criteria of both public service and a spirit of enterprise and in which administrative severity did not preclude sympathy and understanding for the human aspects involved. His appointment as Honorary Director General is due recognition of his dedicated work, in which he not only remained faithful to the values of the Bank, but also enhanced them.

We extend our warmest best wishes to these two honourable men in the high offices to which they have been called.

The vacancies left in the Board of Directors were filled, after rapid but thorough consultations had been held at all the appropriate levels of responsibility, by appointing Mario Ercolani Director General and Carlo Ciampi and Mario Sarcinelli Deputy Directors General. Within the span of just one year, between August 1975 and August 1976, three-quarters of the membership of the Bank's Board of Directors has changed. The nominees have come exclusively from within the Bank, and in its new form the Board of Directors is still composed of members who are bound by ties of reciprocal trust and loyalty developed over many years of working together.

The Banca d'Italia

In the last few years the Bank's management tasks have been changing in such a way that they have become at one and the same time more demanding and less gratifying.

This change is first the result of the shift that has occurred in the relative importance of the functions assigned to the Bank and of the instruments employed to perform them.

As far as the institution's role as a central bank is concerned, the change is clearly discernible in the balance sheets of the Banca d'Italia and the Italian Foreign Exchange Office, which show an increase in lending to the State, a contraction in credit to the banking system and, in their relations with the rest of the world, the emergence of a net debtor position in foreign exchange giving rise to capital losses, which I shall describe later. Thus the Bank's task of monetary management has declined in importance, in the sense that it now plays a less effective role in the process by which the creation of monetary base is determined. In accordance with the analysis that I made here last year, and which is still relevant today, money creation is stimulated by the public sector deficit and becomes rooted in the system as a result of the sliding scale mechanism and labour agreements: flexible management of the money stock, especially by means of discounting and advances, is now almost impossible and needs to be given greater scope through more stringent budget and incomes policies. By contrast, the Bank's role in policing the credit system has increased because Italian society has reacted to the slowdown in capital formation by increasing intervention in the financial intermediation system rather than by improving conditions for the formation and investment of savings.

Secondly, the change concerns the Bank as a working community. The added constraints on the Bank in its relations with the economic world and the concentration of monetary creation in a few hands, which is inevitable when it represents the counterpart to a single public debtor rather than a host of private borrowers, weaken the Bank's links with the centres of production and investment.

The task of managing the Bank is also rendered more exacting by the disruptions and tensions in the running of this institution — no less than any other — as a result of the speed with which social values alter and a succession of laws are introduced, sometimes with conflicting aims, thus giving those who are called to take decisions the feeling that the rules of the game are ill-defined. As a consequence, there is insufficient time for reflection and no solid points of reference on which to base one's actions. To give two examples, the vast number of academic degrees granted and the ease with which they have often been obtained are difficult to reconcile with the need for careful selection of Bank staff. Similarly, actual or feared legislative changes have led to an excessively high turnover of staff, especially in the senior positions, and have required internal adjustments which, if they are effected at a rate incompatible with orderly development, lead to the loss of human capital and professional capabilities.

The task of administration is dependent upon the institution's structures, and the Bank is fully aware of the need to refine its internal organization. In the recent past the work of revising regulations and practices has consisted in setting up the machinery for formal coordination between the divisions responsible for the Bank's various activities and establishing departmental working groups at the middle management level for the purpose of consultation and coordination between the various offices. The Bank is proceeding in the same way with regard to staff management and training policy, at this difficult time when almost a whole generation is being replaced by the next.

Mindful of the need to maintain the professional standards of its staff, the Bank has made further changes in its regulations so that all eligible candidates may compete for higher posts irrespective of their original career class. However, it is felt that it would be detrimental to the interests of both the country and the staff if the Bank were to renounce the distinction between career classes, whereby specific tasks and corresponding responsibilities are assigned to more qualified personnel, consistent with a policy designed to avoid damage to the Bank's structures.

It seems especially important to stress these requirements at a time when the rapid and disorderly reduction in wage differentials, the social malaise and the decreasing importance of some of the Bank's major functions may greatly reduce the work motivation of those whose tasks are the least gratifying and most arduous in terms of work load and responsibilities. In expressing appreciation of its staff, the Bank also appeals to it not to abdicate its high responsibilities towards the community.

The Bank tackles the problems facing it with open-mindedness and after careful consideration, as testified by the regular contacts with the political and scientific spheres and the civil service and by the extensive debate within the Bank before decisions are taken. Today's meeting is only one of the occasions on which the management of the Bank is now called to give an account of its activity, both as a whole and in its various aspects, at the governmental, parliamentary and international levels. However, this is the gathering at which the Bank may rely on a greater fund of common experience, and perhaps also understanding, on the part of those who have to judge it.

The international economy

During 1976 the economic situation in the main industrial countries was marked by a continuation of the recovery in production and the slowdown in inflation that were already underway at the beginning of the year.

The annual average rates of real growth in gross national product were concentrated around the 5-6 per cent mark, except in the United Kingdom where the increase was less than 1 per cent. Employment rose everywhere but without producing any substantial reabsorption of unemployment.

Private demand for consumer goods increased by between 3 and 6 per cent and the demand for fixed investment goods continued to recover steadily in most industrial countries. In view of spiralling costs, enterprises carried out investments to increase efficiency, chiefly by substituting machinery for manpower.

Although enterprises' financial structures had been strengthened by the improvement in profit margins and fresh issues of shares, their investment activity lacked sufficient impetus to bring about the necessary degree of resource reallocation forced on the industrial countries by the change in the relative prices of raw materials and finished products. The reasons for the sluggishness of investment should probably be sought in the margins of idle capacity and in uncertainty about movements in demand and prices, in both absolute and relative terms, caused by the greater instability of the world economy. Investment abroad, on the other hand, has most likely suffered as a result of exchange rate fluctuations. In countries where large budget deficits have stood in the way of a successful fight against inflation, investment has also been hampered by the instability of the monetary situation — and sometimes that of the political situation — and by the absorption of financial resources to cover these deficits. In others where restrictive monetary and budget policies have made it possible to slow down inflation considerably and maintain or reinforce a strong external payments position, the increase in the real cost of finance and the containment of domestic demand have together depressed investment demand. The heavy burdens that these countries have sustained during the transition to a state of non-inflationary growth are clearly revealed by the fact that between 1973 and 1976 employment in manufacturing industry decreased by nearly 6 per cent in the United States, 8 per cent in Japan and 11 per cent in the Federal Republic of Germany. The low level of investment aimed at expanding productive capacity, which has lasted for at least three years, partly explains the difficulties in bringing down unemployment. In the OECD area the unemployed number close on 16 million, more than 40 per cent of whom are under 25 years of age.

With many countries recently experiencing inflation side by side with stagnation, the fight against inflation is again the primary target of economic policy everywhere. However, as the vigour with which it has been fought and the obstacles encountered have varied from country to country, there has been wide disparity in the results achieved. In the industrial countries the average rate of growth of consumer prices fell for the second year in succession to stand at 8 per cent, compared with 11 and 13 per cent in 1975 and 1974 respectively. The spread of individual rates was wide, however, with Switzerland and the Federal Republic of Germany at the lower end of the scale (1.7 and 4.6 per cent) and Italy and the United Kingdom at the top (17 per cent). On the other hand, the individual economies, which are unequally endowed with factors of production and industrial capacity, have been affected to different degrees by the imbalance between the resources generated and demands made on them at home by organized social groups and from abroad as a result of the worsening of the terms of trade.

The economic trend in those countries which have given priority to the pursual of stability is marked by a gradual slowdown in the rate of price increase. It also seems to indicate that underlying conditions were such that policies to curb the expansion of monetary aggregates produced a downward revision of inflationary expectations and encouraged behaviour that was consistent with their success.

In the other countries, which include Italy, there was a reversal last year in the tendency for prices to slow down that had emerged in 1975. Tight monetary policies tend to encounter rigidities, which prevent a reallocation of resources in both the public and private sectors and hence delay the process of external adjustment through productive investment.

In some countries adjustment has been particularly difficult because it has not been possible to control wage growth sufficiently to arrive at a ratio of unit costs to prices which, in view of the deterioration in the terms of trade following the oil crisis, would bring the economy close to its line of potential growth. When wage indexation operates formally or de facto and there are rigidities in employment, policies to depress the expansion of monetary aggregates are unable to produce an incisive effect on inflation and instead weigh heavily on real income and especially on investment.

In all countries the monetary situation has affected the inventories cycle, which is gaining weight as a factor of fluctuations in economic activity. Whereas in the industrial countries that have made greater progress towards restoring monetary stability this component of demand is influenced primarily by variations in production, in the other countries its instability has been accentuated by heavy speculation. In Italy inventory demand accounted for more than half the increase in the gross national product in the first half of 1976, while in the second six months its contribution was nil.

In economies based on industrial processing which are closely integrated in the international network of commercial and financial relations, sudden increases in inventory demand immediately push up imports to a level which may, albeit for a short period, be much more than is necessary to provide a steady supply to production. The subsequent adjustment will restore equilibrium among the real economic aggregates but will not remove the monetary distortions. When there are no stabilizing capital movements, as is often the case, or when a lack of foreign currency reserves prevents intervention on the exchange market, the abnormal swelling of imports will lead to a depreciation of the currency.

Persistent balance-of-payments difficulties and factors tending to destabilize foreign trade did not prevent a strong recovery in international commerce last year. The increase of 11 per cent more than made up for the fall recorded the previous year, and foreign demand again acted as a stimulus to economic activity in both the industrial countries and those producing raw materials.

The changes in the current account balances of the main areas of the world during the last three years reflect the working of strong cyclical forces. The current deficit of the OECD countries, which had declined from 33 billion dollars in 1974 to 6 billion in 1975, rose again to 24 billion in 1976 as economic activity picked up. At the same time the surplus of the OPEC countries, which had been halved during the 1975 recession, falling from 60 to 32 billion, increased again to 46 billion. Whereas the decline in production in 1975 had caused the deficit of the non-oil developing countries to rise from 21 to 32 billion, the subsequent expansion in the industrial countries and specific measures to limit imports brought it back down to 24 billion in 1976.

Recent balance-of-payments developments show that the elimination of the oil deficit is proceeding more slowly than had been expected. The original estimates of its duration and size have recently been revised upwards in the light of the slower progress made in the importing countries in developing alternative energy sources and methods of saving energy, and in the exporting countries in absorbing their current surpluses. If the OPEC surplus cannot be reabsorbed until the mid-eighties, the problem of its settlement and that of the importing countries' indebtedness, which is its counterpart, may reach critical proportions, particularly if a more satisfactory distribution of current account balances among the importing countries cannot be achieved. If this is to be accomplished, the surplus industrial countries — such as Japan, the Federal Republic of Germany, the Netherlands and Switzerland, whose cumulative current account surpluses for the last three years amount to 28 billion dollars — should adopt economic policies aimed at reducing their surpluses. At the same time the level of trade must be kept high so that the developing countries and the industrial nations in a weak payments position may maintain a large volume of exports and thus fuel the growth of income through an adequate flow of imports.

In the three years following the rise in oil prices, current account deficits were financed mainly with short-term credit obtained through the international banking system and, in particular, through the American banks, primarily because of the marked preference of oil-exporting countries for short- and medium-term investments. There followed an unprecedented expansion in the volume of international bank credit: in the final quarter of last year the gross volume of loans to non-residents by banks operating in the Group of Ten countries and Switzerland increased by 40 billion dollars, from the amount of 433 billion outstanding at the end of September. This expansionary trend became even more marked in the early months of this year.

The present prospect of structural deficits that may persist for another decade emphasizes the urgent need to review the financing approach adopted so far. The foreign debt of the non-oil developing countries amounted to 180 billion dollars at end-1976, while that of many industrial countries has reached, or is approaching, unprecedented levels.

The oil deficit is largely financed through recourse to international credit by the public sector and enterprises of deficit countries. Aware of the danger of excessive growth in international bank credit and of the crisis of confidence that it might cause, the monetary authorities of the countries to which the creditor banks belong have recently impressed upon them the need to exercise greater caution in their relations with countries in structural deficit.

It is therefore necessary to reverse the existing ratio of private to official international credit flows and that of short- to long-term instruments; these two aspects are complementary.

During the intensive international negotiations that began in late 1976, consensus was gradually reached on the need for greater involvement of the International Monetary Fund in financing the deficits. This would necessitate more flexible regulation of the amounts that could be drawn from the Fund's resources than is possible under the rules based on quotas and, in addition, an increase in the resources to which the Fund itself has access.

It was also agreed that credit granted through the Fund should be mainly conditional, in other words subject to the formulation and implementation of domestic adjustment programmes which will lead to a gradual reabsorption of the oil deficit, eliminate the other causes of the current account imbalances and thus obviate the need for administrative restrictions on trade and payments. The increase in the Fund's resources is part of a programme to give the IMF a leading part in assessing the creditworthiness of deficit countries. The Fund's role will thus be strengthened at a time when there is not only the danger of excessive indebtedness, but also the opposite risk, which cannot be evaluated by applying traditional market criteria, that a widespread attempt to absorb the oil deficit rapidly will lead to the collapse of world economic activity.

Agreement in principle on these points was reached at the meeting of the Interim Committee last month: they are part of an overall concept shared by the European Economic Community, which will have to develop its own schemes for long-term financial intermediation.

At the Interim Committee meeting agreement was also reached on the principles and procedures for IMF surveillance over the exchange rate policies pursued by member countries. Although recent debates have undermined the presumption that balance-of-payments equilibrium can be achieved through exchange rate adjustments, it is precisely because of this belief that nothing has yet been done to create suitably large flows of official international liquidity to offset the concentration of the existing volume in a few countries with structural surpluses and compensate for the reduced liquidity of gold, which appears in the balance sheets of the central banks, including those of many deficit countries.

The recent experience in a number of countries, and more specifically in Italy, leads us to conclude that the important role assigned to exchange rate flexibility in the present international context should not be allowed to have the perverse effect of fixing in the price system short-run fluctuations caused by speculative and seasonal factors. In the absence of stabilizing intervention, the short-run exchange rate would not necessarily be the rate that is compatible with the desired balance-of-payments structure over the medium term. The discrepancy between the two values is due to the speed with which international capital movements react, compared with the relatively slow adjustment of the balance on current account, i.e. that of the markets in goods and services. The capital movements that prevail are frequently those of a destabilizing nature, triggered off by expectations: when insufficient reserves are available to neutralize them, they further magnify the exchange rate fluctuations.

In some countries the high degree of wage indexation is another factor which, by interaction with the inventory cycles and destabilizing capital movements, limits the effectiveness of an approach to the problem of external adjustment that relies largely on exchange rate changes. Domestic prices react to depreciation of the currency more rapidly the higher the ratio of imports to income and, by raising the index to which wages are linked, set the wage/price spiral in motion; the resulting maintenance of domestic purchasing power blocks the transfer of resources to exports. Over the long run, the rule that the movement in the exchange rate reflects changes in the purchasing power parity vis-à-vis other currencies will be confirmed, but only because the excessive depreciation will have deflected the trend line of prices and costs as well as that of the exchange rate.

A type of exchange rate management which avoids this chain of effects presupposes the availability of sufficient reserves to make it feasible and credible. When this condition is not fulfilled, the monetary authorities are faced with the cruel dilemma of having either to accept a greater degree of instability or to impose restrictions on monetary and commercial transactions with other countries. They have frequently resolved it by accepting sacrifices in both directions, in order to achieve what is considered the most suitable balance to limit the damage to the economy and soften the reactions of the international community.

The exchange rate

In time, the measures and policies taking shape in international organizations may lead to a more flexible and stable system better able to finance the imbalances which develop in international payments so that the task of maintaining free international trade can be divided more equitably between financing and adjustment. In time, some of the factors which set the depreciation/inflation spiral in motion may be removed, and it is highly desirable that they should be. In present circumstances, however, the balance of payments imposes a severe constraint on the Italian economy, so that any expansion in domestic demand must be restrained and practically suppressed.

Fresh evidence of this was provided last year, when three foreign exchange crises occurred. The first of these, which broke in January with great suddenness and virulence and led to the suspension of all interventions on the exchange market for forty days, was described in detail in last year's Report in an attempt to uncover its immediate and long-standing causes as well as to explain the measures taken to overcome it. In the absence of an effective programme to cure the country's economic ills, these measures soon proved to be no more than a stopgap. Consequently, with persistent political uncertainty culminating in the dissolution of Parliament, the underlying tensions began to reappear and, exacerbated by the self-fuelling process typical of such situations, dragged the lira down at the beginning of May to its lowest rate for the year.

There was no option but to introduce new foreign exchange restrictions in order to reduce the scope for speculation, and to require those purchasing foreign exchange to make a three-month, non-interest-bearing deposit in lire equal to 50 per cent of the amount involved. This requirement not only increased the cost but also made it necessary to raise additional finance, which was particularly difficult in a period of restrictive monetary policy. The erection of this protective barrier, the subsequent renewal of the banks' security investment requirement, more favourable seasonal factors and the passing of the most acute phase of political uncertainty together brought about an improvement in the mood of the market, so that by the end of May the lira had returned to the level of two months earlier.

This respite lasted until about the middle of August, when the reversal of seasonal factors, the influence of currency developments abroad — such as the weakness of sterling and the growing strength of the « snake » currencies — and the absence of coordinated measures to restore the economy to health provoked a new crisis, which made it necessary to impose even more severe foreign exchange and monetary restrictions at the end of September in order to protect the lira. Once again the reserves proved to be too small to withstand the effects of persistent disequilibrium in the current account and the sudden disturbances in the foreign exchange market, caused partly by non-economic factors.

While a comprehensive set of measures to contain domestic demand was being prepared, new defences were erected in the form of a three point increase in the official discount rate and the imposition of a special 10 per cent tax on purchases of foreign currency and payments abroad during a period of two weeks. At the same time the compulsory deposit on purchases of foreign currency was extended for a short interval and arrangements made for it to be phased out gradually, in correlation with the expected growing impact of the measures to curb domestic demand.

The special tax produced the desired effect of a sharp fall in the demand for foreign exchange and put the market into a state of hibernation. During the breathing space this provided another series of foreign currency restrictions was introduced and, most important of all, a ceiling was imposed on the expansion of bank lending.

The reduction in demand for foreign currency was only temporary, however; as soon as the special tax expired it reasserted itself with a vengeance and quickly absorbed the stock which had accumulated in the meantime. The special tax was therefore reintroduced at the lower rate of 7 per cent for a period of four months. This move brought a reversal of the trend of the exchange rate, which stabilized at around 865 lire to the dollar, and also sheltered the Italian market from the disturbances caused by the difficulties of the pound sterling and the French franc and by the general realignment among the « snake » currencies.

The tax continued to produce a positive effect during November and December, when other factors also contributed to the stability of the lira. These included the repatriation of capital as a result of the law regarding foreign currency offences, which also had the effect of checking new illegal exports of capital in their various forms; foreign trade credits granted to Italian importers, who evidently preferred the certain advantage of lower interest rates to the probable depreciation of the lira; the increasing net external indebtedness of Italian banks owing to the larger amount of foreign currency financing needed first by exporters, who had to deposit 50 per cent of the value of deferred payments they granted, secondly by importers, who were required to finance their advance payments in foreign currency and in general by those engaging in foreign transactions, who were forced to fall back on foreign currency loans in view of the limited supply of credit in lire allowed by the ceiling on bank lending. These factors more than offset the outflow of foreign currency produced by the current account deficit.

The improved exchange rate situation and the pressure exerted by international organizations led the authorities to prepare a plan for eliminating the special tax of 7 per cent. In view of what had happened in October, it was decided that it should be phased out gradually in parallel with the compulsory deposit on purchases of foreign currency.

Up until the end of January 1977 the programmes for phasing out the two restrictions proceeded from stage to stage without creating serious upheavals on the foreign exchange market, apart from some disturbances when the larger reductions were made. Hence, the rate of the dollar including the cost arising from the deposit and the special tax fell from a peak of 947 lire in the first week of November to 902 lire at the end of January. Only the expiry of the special tax on 18th February was accompanied by a substantial increase in the demand for foreign currency, indicating that traders had frequently borne this date in mind in determining the length of their trade credits, especially before the gradual reduction in the special tax was announced. However, analysis of data on foreign currency and trade movements together with information from other sources had convinced the Bank, long before confirmation was provided by the market, that the large net purchases of foreign currency effected between the last week of October and the middle of January were due to a massive shift in the terms of payment in Italy's favour, induced by the compulsory deposit on purchases of foreign exchange and the special tax, and that in the absence of these measures there would have been a movement in the opposite direction. The large sales of foreign currency the Bank made after 18th February were consistent with this view and succeeded in keeping the dollar exchange rate stable at around 885 lire. The cost of foreign currency to importers was therefore further reduced in this phase, which nonetheless lasted only a few weeks, despite an uneven patch as a result of serious public disturbances in the middle of March.

During the last ten days of March the situation of the lira started to improve again; not even the final abolition of the compulsory deposit in mid-April, which brought the price and cost of foreign currency to the purchaser back into line with one another, caused any serious disturbance of foreign currency flows, which to date have continued to be in Italy's favour. At the same time the forward discount of the lira has fallen to a level which is more in line with interest rate differentials, while that on the parallel market has disappeared.

The effect on the reserves caused by the current account deficit and the shift in the terms of payment was cushioned by the steady increase in the banks' external indebtedness, which partly took the place of maturing trade debts. At the end of 1976 the banks' net external liabilities were equal to the liquid foreign currency reserves, which amounted to about 3 billion dollars. At the end of April 1977 they exceeded the reserves by 2.2 billion dollars. The impression of precariousness which a comparison of the two figures seems to imply is lessened when it is remembered that residents' financing requirements in foreign currency are rigid owing to the obligations imposed on importers and exporters as well as by the tight domestic monetary policy. Nonetheless, in order to prevent a sudden fall in the banks' foreign debtor position and consequent detriment of the reserves, domestic policies must be pursued that maintain Italy's international credibility.

A flexible international loan policy was also pursued in 1976. The objective in the first half of the year was to protect the level of the official reserves, and in the second half to meet repayment commitments contracted during that and previous years. Thus the EEC loan of about one billion dollars granted in March and April, which had been partially prefinanced by drawing on the reciprocal credit line with the Federal Reserve and recalling in March 500 million dollars of the Bundesbank's crossed deposit of dollars against gold, was followed in the second half of the year by the repayment of the sums received from the Federal Reserve and the Bundesbank as well as the repayment of 486 million dollars which the United Kingdom had contributed at short term towards medium-term EEC support. This repayment gave rise in April of this year to the granting of an EEC loan of the same amount. In the same month, moreover, negotiations were successfully completed with the International Monetary Fund for a credit line of 450 million SDRs.

The extent to which Italy can resort to foreign credit is limited by the fact that each depreciation of the lira causes an increase in the burden of previous loans on the balance sheets of the monetary institutions and by the volatile nature of short-term bank borrowing. The exchange losses on medium- and long-term foreign liabilities in 1976 and those which will be incurred in connection with the loans to be repaid between 1977 and 1985 come to around 3,000 billion lire, calculated at the exchange rates of end-1976. The Bank has increased the endowment fund of the Italian Foreign Exchange Office from 100 million to 500 billion lire to cover the losses that have already been incurred. To provide for future losses it is essential that the

Bank be able to draw on the profits resulting from the revaluation of its gold holdings, which made it possible to include in last year's balance sheet a reserve fund of 2,000 billion lire to cover future exchange losses arising from foreign exchange operations.

The interaction between the rate of exchange and the rate of inflation is extremely rapid in Italy because of the large volume of foreign trade and the high degree of income indexation. In these conditions it is likely that the pressure exerted by excessively pessimistic expectations has at times caused the adjustment to overshoot the mark and that the new rate has only been fully validated later by the rapid adjustment of prices in the continuous catch-as-catch-can between two factors.

The intensification of controls has afforded some relief from the effects of expectations; however, it has not only narrowed the range of alternatives open to business for legitimate commercial purposes, but has brought a burdensome increase in the formalities to be performed at three levels: that of businessmen themselves, that of the foreign exchange departments of the banks and that of the authorization and control functions entrusted to the Italian Foreign Exchange Office. The array of instruments available for such interventions now appear to have been exhausted; the reinstatement of those that have fallen into disuse is forbidden by the international community and the continued application of those that are still valid is onerous.

Towards the end of last year a solution to the problem of external adjustment was once more sought through the control of domestic demand. However, unless it is accompanied by the control of incomes growth and a more efficient allocation of resources, such action also involves a greater sacrifice in terms of the country's productive capacity and employment opportunities both now and in the future. Furthermore, if employment is kept higher than is required by the level of production, the resulting fall in productivity partly nullifies the effect of the regulation of demand. Treatment to prevent the recurrence of emergencies must therefore strike at the roots of the country's ills.

The interventions on the foreign exchange market, which prevented violent exchange rate fluctuations in spite of numerous destabilizing factors, were large in both directions, confirming the fact that a country which is highly integrated in international trade requires sufficient foreign exchange reserves to be able to prevent irreversible movements in the exchange rate. Such movements were limited to the spot market. The forward market in Italy is small compared with the spot market and expectations regarding forward rates directly reflect those of the spot market. In order to control the forward market the ceiling on the banks' net commitments in forward lire were lowered, thereby making forward purchases of foreign currency more expensive. It was also laid down that only transactions with Italian residents would be allowed within the ceiling itself. In these circumstances forward sales of foreign currency against lire by the Banca d'Italia would only have widened the scope for forward transactions within the banks' ceiling, which would have resulted in a weakening of the spot rate since the banks would have had to cover their exchange positions through spot purchases of foreign currencies.

The economic situation

The unexpectedly large increase in world trade together with the reflationary measures taken in the second half of 1975 provided the impetus for an expansion of the Italian economy last year. The inflationary climate in which this occurred encouraged growth but also revealed its precariousness and limits.

The economic cycle had turned up in the autumn of 1975, but no sooner had the recovery begun than the underlying disequilibria had reappeared, with the balance of payments on current account once more registering a deficit. Prices rose sharply, no longer being held down by a low level of demand and a stable exchange rate: in the four months from February to May the increase in wholesale prices was equivalent to 56 per cent at an annual rate and that in consumer prices to 30 per cent.

In the first six months of the year exports rose slightly in volume terms. The measures taken to overcome the foreign exchange crisis, the pessimistic expectations they produced and the drain on disposable income caused by the new system for the collection of direct taxes slowed down the increase in domestic demand for consumption and fixed investment goods. Industrial output continued to expand, sustained by the accumulation of stocks of finished goods. The rate of increase in the volume of imports slackened during the first quarter and there was a decline in the second. Nonetheless, the deterioration in Italy's terms of trade, caused by the depreciation of the lira and the fact that world market prices of raw materials increased by more than those of manufactures, led to a progressive increase in the trade deficit which, seasonally adjusted, came to 1,200 billion lire in the second quarter.

The reappearance of the exchange rate/price spiral, at a time when the recovery was hardly under way and there remained a danger that unemployment would increase, made the task of stabilization extremely arduous. In the first half of the year this objective was pursued primarily by means of monetary measures. By bringing the cost of credit into line with inflationary expectations, speculative investment both in Italy and abroad was discouraged.

Towards the middle of the year forecasts were strongly swayed by the restrictive measures. In June industrial output had begun to decline as the world economic recovery slowed down. In many quarters it was feared that there would be an « autumn frost » with serious effects on employment. The lull was due mainly to uncertainty caused by the situation on the foreign exchange market and to the sudden increase in interest rates.

After the September crisis the use of credit and foreign exchange instruments was more temporary in nature, in keeping with the new economic policy stance that the Goverment was about to adopt with the object of eliminating the real economic disequilibria rather than simply palliating their monetary effects.

Once the uncertainties of the summer pause had been overcome, the recovery regained strength. Exports rose by about 10 per cent in the second half of the year, benefiting from the currency depreciation that had occurred in the spring. Private consumption also began to rise again as a result of the spring and summer wage increases and, indirectly, the higher level of production. The greater degree of capacity utilization led, in turn, to an appreciable revival of investment in plant and equipment.

Industrial output declined slightly in the third quarter but rose by 7 per cent in the fourth to a level 16 per cent above that recorded twelve months earlier. However, the strengthening of the recovery again proved to be unsustainable. Imports rose by 11 per cent and the current account deficit, which had been eliminated in the third quarter, reappeared in the fourth, amounting to 700 billion lire on a seasonally adjusted basis. Once again the economy proved that it was impossible to pursue the aims of stability and growth simultaneously — as was noted in last year's Report — making it necessary to neglect first one and then the other in a damaging seesaw of increasing frequency and amplitude.

In the meantime the stabilization programme was taking shape. After heated debate, fiscal measures and some public sector tariff changes were decided in the autumn; increases were announced in a number of tax rates, postal and telephone charges, electricity tariffs, railway fares and certain administered prices.

The problem of labour costs, on the other hand, was not tackled until February of this year after the negotiations between the trade unions and the employers' associations had failed to produce an agreement commensurate with the gravity of the economic crisis and the country's cyclical situation. Although the undertakings with respect to public and religious holidays, labour mobility, flexible working hours and absenteeism are potentially conducive to increases in production and productivity in an expansionary phase, they will have little effect in the situation of slow growth forecast for this year. Similarly, the cutting of the link between severance and retirement payments and the sliding wage scale will produce tangible results only in the long term, whereas rapid and bold action is needed to check the inflationary spiral.

To supplement this inadequate response to a problem affecting the interest of the whole country the Government decided to assume part of the burden of employers' social security contributions and to finance this measure by increasing the rates of VAT and other indirect taxes. The decree also excluded the increases in indirect taxes from the calculation of cost-of-living increases and introduced tax penalties to discourage supplementary wage agreements at company level. As a result of the abandonment of these two provisions the State has failed to achieve its objective of recovering control over income groups that are at present unaffected by changes in indirect taxes.

The economic events of 1976 led to an increase of 5.6 per cent in national income, which was more than had been expected, but at the same time the trend of both prices and the balance of payments deteriorated. The implicit GDP price deflator increased by 18 per cent and the current account deficit rose to 2,300 billion lire.

In 1975 a series of disequilibria had developed owing to the difference between the impact of market forces and that of administrative measures on wage and price behaviour. At the end of the year not only were industrial prices and the exchange rate too low in comparison with costs, but so too were administered prices and charges for public services. In the same way, effective tax rates were too low with respect to public expenditure and interest rates with respect to inflation. These imbalances were a serious inflationary threat, as the fact that it was impossible to contain cost increases made it necessary to seek to improve enterprises' profit and loss accounts, balance public sector budgets and revive the capital markets through a general increase in prices.

In 1976 the unit cost of labour in manufacturing industry rose by 10 per cent after having risen by 35 per cent in 1975. The good recovery in productivity, favoured by the pick-up in output, offset more than half the increase in earnings, which amounted to 24 per cent compared with 22 per cent the previous year. Nonetheless, the trend of unit costs in Italy again diverged from that in other major industrial countries, with the exception of the United Kingdom: in Japan and the Federal Republic of Germany they actually declined, while in the United States and France the increase was of the order of 1-2 per cent.

Manufacturing industry raised its prices by 22 per cent, which was more than the increase in unit costs. This went some way towards correcting the imbalance of 1975, when the prices of manufactured goods had risen by only 11 per cent, or considerably less than the increase in unit costs.

Although enterprises' profit and loss accounts and the exchange rate appeared to be in a stronger position at the end of 1976, much of the adjustment in the balance of payments still remained to be achieved. In relation to income, the size of the deficit caused by the increase in the price of oil is without parallel in any other industrial country. Although consumption in 1976 was 7 per cent below the level of 1973, the cost of oil imported for domestic purposes was more than 4,500 billion lire higher than it would have been had the price of oil increased over the last four years at the same rate as average Italian export prices.

Between 1973 and 1976 exports and imports of goods and services (including tourism) increased by 26 and 2 per cent respectively at constant prices. As a result, the value of real resources transferred abroad rose during those three years by an amount equal to 4.4 per cent of the gross domestic product. Theoretically, if the whole of this increase were devoted to covering the demand for oil, it would offset the entire added burden due to the price increase; it has, in fact, reduced the current account deficit, net of higher interest payments on foreign debt, to the level recorded in 1973.

The transfer of real resources was therefore considerable, absorbing four-fifths of the increase in resources produced, but it was achieved mainly at the cost of a sharp drop in the rate of economic growth. In fact, over the last three years national income increased by only 5.9 per cent and domestic demand by 1.2 per cent. Fixed investment in particular has suffered as a result, falling from 20 to 18 per cent of total domestic demand.

Since the balance-of-payments adjustment requires an improvement in Italy's competitive position in international markets, it depends on an adequate flow of innovation and investment in the productive sector and a flexible labour policy. In 1976, in contrast, little of the expansion achieved as a result of the favourable international economic situation was directed towards increasing fixed investment, which rose by 2 per cent over the year after falling by 13 per cent in 1975. Moreover, in the industrial sector, where investment had fallen by 22 per cent in 1975, there was a further contraction of 2 per cent.

Productivity moves in line with production during the business cycle owing to the rigidity of employment; the last two years have provided confirmation of this in both directions. Productivity gains independent of cyclical factors require a high rate of capital accumulation which, however, is not easy to reconcile with the maintenance of external balance in view of the large import content of investment. This therefore creates a vicious circle: the low average productivity of the economy tightens the balance-of-payments constraint and makes it necessary to restrict domestic demand; this in turn slows down the rate of capital accumulation, thus preventing structural changes in industry, the expansion of sectors able to increase output per employee and improvement of the trade balance.

To break out of this circle will require the adoption of policies to bring about the substitution of investment for both private and public consumption.

Such a policy could be based on the restriction of wage increases, a reduction in the public sector deficit together with an improvement in the quality of public expenditure, and the allocation of a larger share of private sector income to savings.

If wage controls are linked to explicit growth targets, an economic policy of this kind becomes socially desirable in view of the positive effects that the strengthening of the industrial sector would have on employment.

Between 1973 and 1976 priority was given to protecting the level of employment, thus preventing the decline that accompanied the slowdown in growth in stronger economies such as the United States, the Federal Republic of Germany and Japan. In fact, employment in manufacturing industry remained at the 1974 level while real hourly earnings increased by 18 per cent, compared with a slight fall in the United States and increases of 10 and 7 per cent respectively in Japan and the Federal Republic of Germany.

Italy's relatively better performance in the fields of employment and real wages is illusory, however, as it has been achieved at the cost of a high rate of inflation, a fall in investment and a huge external deficit.

The reduction in the public sector deficit and the improvement of the quality of public expenditure are objectives that are widely accepted, at least in principle; despite the difficulty of ensuring continuity in the policies necessary to achieve them, last year may prove to have been a turning point in this respect. Net indebtedness — which had practically doubled in 1975, rising to 13,900 billion lire — remained virtually unchanged last year and, as a result, declined as a proportion of gross domestic product from 12.2 to 9.8 per cent.

Nevertheless, these figures are still extremely high and incompatible with balanced economic growth. Not only are all public investments and capital transfers financed by borrowing, but since 1971 total revenue has been insufficient to cover current expenditure. This has led to an absorption of savings by the public sector amounting to 7,900 billion lire in 1975 and 5,800 billion lire in 1976. On average over the last two years more than a quarter of gross national savings has been used to cover the public sector's deficit on current account.

The reduction in net indebtedness in 1976 was mainly the result of a 32 per cent increase in tax receipts which, as a percentage of gross domestic product, rose from 31 to 33 per cent. In some countries this ratio is greater, but income levels are also higher.

Action to hold down the deficit should also include measures to check expenditure, which in 1976 amounted to more than 67,500 billion lire, or about half of the gross domestic product. The expansion in public expenditure accelerated rapidly after the middle of the sixties, rising from 33 per cent of gross domestic product in 1954 to 36 per cent in 1964 and 42 per cent in 1974, then jumping to 48 per cent in 1975 and 1976.

The increase in public expenditure was attributable largely to the burgeoning cost of social security, which accounted for nearly half of total current expenditure in 1976, compared with 42 per cent at the beginning of the sixties.

The expansion in social security benefits in recent years, which has been implemented without a rigorous balancing of the means available against the ends to be achieved, is placing an intolerable burden on the Treasury and enterprises that far outweighs the social aims they are intended to achieve. The accumulation of benefits and acquiescence in the granting of assistance without careful verification that a state of need exists have not enabled the system to meet the real requirements of those in need, but have instead led to an indiscriminate increase in family incomes and the wastage of resources. The result has been a worsening of the public sector deficit, an increase in consumption, and the encouragement of irregular employment in small enterprises with precapitalist forms of production that impairs the proper working of both product and factor markets.

Social security expenditure is bound to increase still further over the next few years, mainly as a result of the automatic adjustment of pensions to changes in the level of prices and wages. There is thus an even greater need for stricter discipline in the accumulation of benefits, measures to regulate the demand for health services and restraints on other forms of distribution policy implicit in the low tariffs of public utility services.

Enterprises' financial problems

As a result of the economic events of recent years companies' profit margins have been eroded and their capital requirements have been met increasingly through borrowing. We consider that the credit system should continue to play a role in helping firms to overcome the present difficulties and uncertainties and to implement their programmes.

The distinction between the management of companies and that of banks, which through bitter experience was made the cornerstone of the Italian system, should in practice make allowance for changing circumstances. Without blurring this distinction, the relationship between the banking sector and industry may take on new forms in situations where it is necessary to study and implement ways of restoring their normal pattern of relationships, which has changed to the grave detriment of the credit system itself.

It is not intended here to advocate a policy of indiscriminate rescue operations, which would only cause the entire system to founder, but selective interventions based on sound judgement, a fundamental requirement in the banking profession. Moreover, such interventions are meaningful only within the framework of a rigorous programme of economic stabilization, as has been mentioned above.

In the course of the wide-ranging debate on the financial reorganization of companies it has been recognized that the main problems lie in the inadequacy of risk capital, the excessively high level of indebtedness and the cost and structure of debt.

The increased burden of short-term indebtedness in recent years and its high cost in nominal terms have contributed to the deterioration in the economic and financial performance of the corporate sector. However, these conditions are linked to the current state of the economy and will change with it: success in the fight against inflation will bring about a reduction in interest rates and re-establish a yield curve that will allow the bond market to operate normally again.

On the other hand, the compulsory funding of short-term loans to companies would have serious repercussions on the management of the credit institutions. On the assets side, reserve and security investment requirements already tie up the equivalent of 45 per cent of their deposits. In addition, recent legislation has required the consolidation of loans to local authorities; for some credit institutions that have traditionally supplied funds to these bodies this means that more than 50 per cent of their assets are now subject to constraints. The variable cost of borrowed funds, almost all at short term, contrasts sharply with the fixed yield on the tied portion of banks' assets and it thus tends to be reflected partly in the rates charged on loans to customers and partly in the banks' profit and loss accounts.

If it is accompanied by corresponding legislative changes, as was the case recently with the prohibition on local authorities' taking up further bank loans, compulsory funding may be justified even though it is a drastic measure inasmuch as it alters an existing contractual relationship. Applied to companies that must continue to make use of bank credit, however, it would lead to a deterioration in their relations with the banks and reduce the sense of managerial responsibility on both sides. Furthermore, it would weaken the banks just when it was intended to call upon them, and the credit system as a whole, to help solve companies' primary financial problem, that of undercapitalization.

Above all, enterprises need fresh funds, largely in the form of risk capital that in the present circumstances the market is unable to provide in sufficient quantity. This difficulty stems mainly from the real problems facing companies, aggravated by constraints that the authorities can remove by means of instruments already available, and other problems resulting from agreements between management and the unions that still restrict the flexible use of the factors of production.

The most serious among the former are discriminatory tax arrangements that penalize risk capital and favour debt capital, the cost of which is subsidized further by official intervention, and the lack of a satisfactory network of institutional investors to intermediate the risks and ensure the soundness of investment decisions. Priority should thus be given to fiscal measures to aid both issuers of shares and subscribers. This need would seem to be met by the bill drafted recently by the Ministry of Finance to change the system of company taxation and reduce the current multiple taxation of distributed earnings.

Removal of the more onerous of these constraints will enable the great majority of firms to overcome their present difficulties in raising risk capital, helped by the operations that the banks already carry out under the existing law. These difficulties are particularly acute in the case of a limited number of large companies, the reorganization of which would in turn have a beneficial effect on medium and small companies through an improvement in payment terms and an increase in orders.

In the case of these firms the prerequisite for special intervention by the credit institutions would seem to be the existence of a plan for the reorganization of production activities, backed up by agreements between the firm's management and the unions involved, and the presence of a controlling group, even a minority one, that has a high entrepreneurial reputation and will assume responsibility for managing the firm.

If these conditions are fulfilled, the credit system can help broaden the risk capital of those companies that it recognizes as capable of recovery; this expression of confidence would also encourage individual savers to take a more positive attitude. Intervention by the special credit institutions and the banks should, however, be such that the management of the credit intermediaries is kept distinct from that of the firms and that direct links between individual firms and institutions are avoided. The institutions themselves should observe the existing limit on the proportion of their own funds that may be invested in shares and the restrictions on the concentration of risks.

Measures could be adopted to facilitate the formation of consortia, even in the form of corporations, for the purpose of subscribing temporarily to shares issued by the enterprises which are to receive an injection of risk capital. Another way would be to permit the credit intermediaries to set up finance companies, laying down in their statutes the investment criteria to be followed. In particular, limits on the acquisition of shares should be established in relation both to the net worth of the finance company and the share capital of the firm receiving assistance. This solution would enable the small and medium-sized credit institutions to participate in the replenishment of companies' capital and would also stimulate firms indirectly by reviving the financial hinterland necessary to sustain the share market.

Forms of assistance other than those set out here might be devised on the basis of past experience and with the help of the credit institutions' pragmatic and innovative approach; previous experience in this field may serve as a guide in identifying the most effective institutional forms and determining how the tasks of examining reconstruction plans and granting financial support can best be divided between the banks and the special credit institutions. However, to ensure the stability of the credit system, which is a prerequisite for financial stability in the corporate sector, it is indispensable that the assistance, whatever form it takes, should be temporary, voluntary and conditional. The conditional nature of assistance is also a requirement for correctly identifying those institutions which would receive aid; in order to guarantee that aid is limited to cases in which at one and the same time an actual need exists and the conditions for supervising the implementation of the industrial reorganization plan are fulfilled, specific requirements should be imposed temporarily on the firm.

New financial instruments could also be introduced to emphasize the temporary nature of the assistance, such as issues of both convertible bonds and bonds to be reimbursed with shares of the assisted firm. The bonds would fall due at the time foreseen for completion of the reorganization programme. Provision could be made to pay subscribers the balance in cash should the average price of the share be less than the nominal value of the bond.

Fiscal measures alone might be sufficient to encourage such intervention. First, the principle of transparency, which is obstructed by the multiple taxation of distributed earnings, should be applied in full to those engaged in rebuilding the capital base of companies. Secondly, the credit institutions could be authorized, subject to conditions and limitations, to use their bad-debt reserves and to replenish them more frequently than the present law permits.

It is evident from the situation today that the social cost of company failures is high and that it should be confined to those cases that are truly beyond recovery. But even if a firm survives, there remains the problem of the impartiality of legislation, in this instance as between public and private firms. While rejecting the premise that in granting loans the banks will give systematic preference to public sector enterprises, it cannot be denied that the assessment of risk is strongly influenced if it is known that the final debtor has the power to levy taxes and print money. The resulting easier access to credit and the greater stability of employment in times of operating losses make the nationalization of firms a process that is difficult to reverse, as it guarantees greater security to both management and workers but at a cost borne in various ways by the community at large. Until legislative impartiality has been wholly or partly achieved, for instance by limiting the guarantees that public holding companies may grant in respect of borrowing by their subsidiaries, there are grounds to hope that the financial intermediaries themselves will manage to correct the existing distortions and will avoid making decisions primarily on the basis of companies' public or private status.

Interest rates

It is often argued with regard to monetary policy that measures should be taken to reduce interest rates, particularly bank lending rates, in view of the burden of companies' debt and the low level of investment. Whereas the objectives pursued are valid, the proposed means of achieving them are not if they are implemented before inflation rates decline. There is no need to go back far to find evidence of this — events in Italy in the second half of 1975 and the beginning of 1976 demonstrated once again that even with flexible exchange rates an interest rate policy that is incompatible with internal and external balance rapidly generates countervailing forces.

In contrast, from the spring of 1976 onwards, in spite of expectations of high inflation, the increase in interest rates made it possible to attract funds back from abroad, restrain the speculative elements of demand and discourage the investment of savings in « inflation-proof » goods. It also led to a reduction in firms' liquid balances, thus enhancing the effectiveness of monetary management.

Uncertainty about the duration of high rates of price increase and the course of economic policy before the two-year commitments contained in the « letter of intent » to the International Monetary Fund became known were partly to blame for the shift in the demand for funds towards shorter maturities, which the market matched with supply by rapidly raising rates, particularly at short term, from the early months of 1976 onwards. Although bond yields rose by about three points during the year, the market for new issues of medium- and long-term securities has practically ceased to exist in its own right, reviving only when the security investment requirement falls due.

The question then arises whether it would have been desirable to allow or induce long-term interest rates to rise above short-term rates and whether the relationship that has existed between them since the beginning of 1976 can and should be maintained.

Differences in the upward movement of rates for various maturities reflect first the fact that short-term rates adjust more rapidly to changes in market conditions and secondly that they depend on the rate of inflation expected in the near future; in contrast, an acceleration in inflation affects long-term rates only insofar as it alters the market's expectations regarding the long-term trend of inflation. It is both natural and desirable that short-term interest rates should fluctuate more than long-term ones. Indeed, it is preferable that a given effect on domestic demand and the balance of payments be achieved by influencing the level of inventories and foreign trade credit rather than investment in plant and equipment. The limitation on long-term financing, which is at present the result of the inadequate supply of funds, would eventually derive from a deficiency of demand if the increase in long-term rates were considerable.

The likelihood of a slowdown in inflation, whether gradual or rapid, greatly increases the risk for investors who have to borrow funds at very high nominal rates of interest to finance long-term investment projects such as housing, public works and public utilities. Savers, on the other hand, are unwilling, without appropriate return, to accept the risk that rates of inflation well above nominal long-term interest rates will persist.

From this derives the usefulness of non-traditional financial instruments which, by allowing the nominal long-term interest rate to adapt more easily to changes in the rate of price increase and in credit market conditions, reduce uncertainty regarding the debtor's real burden and the yield accruing to the creditor; the various methods of indexation seem more appropriate to the mortgage loan market, whereas loans with variable rates would appear to have wider application.

Issuers have the talent and feel for the market to offer securities on terms that will appeal to the public; a few notable examples have already appeared and others are expected.

The term structure of interest rates in Italy is distorted by the juxtaposition within the financial market of one segment that has become rigid owing to various administrative measures and another that operates freely. When prices are increasing rapidly the kink between the two ranges of the yield curve represents a critical point which tends to shift. Great harm would result if, as a consequence, the rigid segment shifted towards the short-term end of the market. Steps have recently been taken to bring about a gradual shift in the opposite direction, not only by permitting long-term rates to rise slightly and short-term rates to decline but also by making the reference rates for subsidized credit more responsive to market behaviour.

Hence the Bank cannot endorse suggestions that the nominal cost of short-term credit should be reduced by controlling the banks' deposit rates. Only if deposit rates adapt quickly to changes in conditions on the money and credit markets can the potential instability due to the size of the money supply be reduced.

Quite apart from the possible shift of demand from domestic money towards foreign assets, the allocation of savings would be distorted further if competition between the banks were stifled in the only field in which it still operates fairly freely and if the fees charged by banks for their services were out of line with the cost involved, for the explicit payment of interest would be replaced by either a wider spectrum of free services or, for those firms that are also borrowers from the banking system, easier credit terms. This would most harm those customers who make little use of bank services and bank credit in relation to the size of their deposits; as these are mainly the holders of modest deposits, such a move would result in a new form of discrimination against small savers.

Apart from these economic aspects, there are technical and administrative reasons why such a measure would be very difficult to apply. If the interest paid on current accounts were too low in relation to that on savings deposits there would be a large-scale movement out of a type of deposit that is more modern, less costly for the bank to administer and more convenient for the customer. Moreover, the proposal to penalize holders of current accounts is based on a distinction between this and other forms of bank deposits that will gradually disappear with the spread of electronic payment techniques; when the customer is able to draw on his savings deposit from a distance, the cheque, which is the distinctive feature of the current account, will cease to be the exclusive means of bank payments and discrimination between the treatment of current accounts and that of savings deposits will become irrelevant.

The demand for a reduction in interest rates without regard to the rate of inflation in Italy or interest rates abroad also runs counter to the medium-term objective of increasing and stabilizing the demand for financial assets and attracting foreign capital by creating on the demand side the right conditions for a recovery in corporate profitability.

Treasury financing

Before nominal interest rates can be reduced there must be a relaxation in inflationary tensions, which in turn is impossible without a cutback in the monetary financing of the Treasury. Hence, the question again arises whether this form of financing should be made subject to some kind of rule.

On average over the past five years 162 per cent of the monetary base created has had its counterpart in the Treasury: part of this has therefore been absorbed by lending to the private sector (households and enterprises) and the foreign sector. Increasing amounts of short-term debt have been contracted to meet the share of the Treasury's cash requirement not covered by the central bank: whereas at the end of 1973 Treasury bills represented 6 per cent of the government securities held by banks and the public, at the close of 1976 they amounted to 38 per cent.

The three methods open to the central bank to sustain monetary expansion by the acquisition of claims on the State are governed by legislation. Leaving aside ordinary advances, which are subject to what is now an extremely low limit and have not been used for many years, the Banca d'Italia is required to provide finance via the Treasury's current account up to « 14 per cent of total current and capital account expenditure on the basis of the original budget estimates and subsequent revisions ». No obligations or limits, however, have been placed on the third form of financing, purchases of ordinary Treasury bills and other government securities: the statutes of the Banca d'Italia simply state that « the central bank may invest sums in securities issued or guaranteed by the State ». In doing so, the Bank makes its own assessment of financial market conditions and of the most suitable instruments for pursuing monetary and credit policy objectives. It also maintains its autonomy with regard to securities offered exclusively to the Bank, even when national accounting regulations require announcement by ministerial decree, as in the case of ordinary Treasury bills. Furthermore, it enjoys full discretion with regard to both quantity and price when buying and selling government bills and securities on the secondary market.

It is not therefore as a result of any legal obligation that the central bank's portfolio of public debt securities has increased, but because the Bank has accepted that economic and historical reasons outweigh its own profound conviction that the maintenance of employment and incomes by means of inflation is no more than ephemeral and distortive. Those of the Bank's operations that affect monetary creation are conditioned by the basic choices of society: in particular, operations relating to the Treasury are the outcome of sovereign decisions of Parliament and the Government. In a chain of social and political relations under strain, money is the weak link and monetary financing of the Treasury the breaking point of that link.

Recourse to the central bank is thus the extreme expression of the disparity between the budget of the public sector and its contribution to the economy's efficiency and growth potential. The Government and Parliament have already taken steps to prevent local authorities from obtaining short-term finance from the banks by obliging them to resort exclusively to the Central Post Office Savings Fund, thus laying the basis for closer control over their deficits. Furthermore, the Government has given assurances to international organizations lending financial support to Italy that measures will be taken to restore other parts of the economy to health. A commitment has been undertaken vis-à-vis the International Monetary Fund to reduce considerably the proportion of national income accounted for not only by the Treasury deficit but also by that of the public sector in the broader sense (State sector, social security institutions, local authorities, hospitals and ENEL) by restraining the nominal rise in expenditure appropriations and reducing them in real terms.

In order to prevent excessive monetary financing from compounding the damage that has already been wrought by the size and structure of public sector deficits, action must first be taken at the levels at which expenditure is decided, implemented and controlled. When too many expenditure laws are unable to offer the hope that they will now or in the future give enough stimulus to productivity and efficiency to be self-financing, the conditions are laid for future monetary instability.

Secondly, it would be easier to implement a more orderly public debt policy if the cash flows of the State, and those of the agencies and institutions which either receive allocations from revenue or whose deficits are covered by the State in the last instance, were managed and forecast in a more straightforward manner. A commitment on the part of the Government to reduce the stimulus to monetary expansion stemming from the deficit should be undertaken within a framework for forecasting and regulating cash flows; in fact, a law enacted in 1976 states that a report on these cash flows must be presented to Parliament each quarter. Such a commitment would certainly undermine the discretionary power that the law accords the Bank with regard to purchases of public debt securities if it did not have the same right as any other market agent to state the price at which it is willing to provide the required finance.

Certainly, the most delicate aspect of the problem of covering the deficit concerns interest rates. Efforts to reduce the cost of indebtedness to a minimum, which is a valid criterion of efficiency in the public no less than the private sector, must not degenerate into a system of forced placement. It is not only formal respect of the principle underlying Article 81 of the Constitution that requires the funds for covering the part of expenditure that is not financed by taxation approved by the country's elected representatives in Parliament to be provided at conditions that the community itself directly approves, which only occurs when public debt securities are offered at yields that attract voluntary subscriptions; this holds for any purchaser. If the allocation of resources is not to create distortions, the Banca d'Italia must at the very least undertake not to purchase at issue securities bearing interest rates lower than those at which the public is concurrently subscribing a sufficient amount of its own accord to keep monetary expansion within the desired limits.

During 1976 ordinary Treasury bills were placed almost exclusively at interest rates below the reference rate. The rapid adjustment of domestic monetary conditions to changing pressures on the exchange rate is evidence, on the one hand, of the effectiveness of market instruments as opposed to administrative measures and, on the other, of a good understanding between the monetary authorities. However, in March and October, on two occasions when domestic liquidity control was particularly difficult, the yields on Treasury bills offered were too low to ensure that at least those maturing would be replaced. The Banca d'Italia purchased them at the reference rate, since in the absence of any provision to obtain a discount, the only alternative would have been the grave decision not to purchase at all. However, we should like to express our gratitude to the Treasury Minister for the spirit with which he has imbued his relations with the central bank in making his own difficult choices between conflicting objectives, and for the consideration he has given to our arguments during our periodic, joint reviews of the monetary situation.

In another realm, the German Chancellor recently declared before a formal gathering that « cooperation between the Government and the Bundesbank has been fruitful not in spite of the central bank's autonomy, but because of it » (Bad Godesberg, 11th May).

The size and nominal cost of short-term debt have increased considerably for the State, as they have for all debtors. Over a longer period of time, the burden would probably have been greater had the interest rates on long-term Treasury bonds been high enough to ensure their placement with the public: the inflation of recent years which has become rooted in expectations like an endemic disease of the Italian economy, today tends to rebound upon prospective borrowers instead of penalizing creditors, as has most often been the case. In fact, the ordinary Treasury bill has proved to be a highly flexible instrument at a time of wide interest rate fluctuations, offering many of the advantages of a variable yield security.

Bank investment in Treasury bills is now well in excess of normal cash management requirements owing to a series of factors which we prefer to consider as temporary: firstly, market instability, wider cyclical fluctuations and even the succession of administrative interventions — actual or only feared — have produced a marked preference for liquid assets; secondly, the ceiling on lending has partly closed the banks' most natural outlet for their disposable funds; finally, long-term securities bear lower yields and are less easily placed.

The Treasury's need to restore balance in the structure of public debt, the central bank's desire not to worsen the conditions for controlling the supply of money and the fact that it is preferable for investors to spread their investments in public funds over a wider spectrum of maturities all point in the direction of shifting Treasury financing towards longer-term securities. In determining the methods and timetables for issues of longer-term securities, two closely linked factors must be taken into account: the yield offered and prevailing expectations as to interest rates and the trend of inflation.

Credit flows and the choice of regulatory instruments

Limits on the monetary financing of the Treasury and a wider maturities range in the public debt are also considered a necessary part of any action to increase the effectiveness of monetary control instruments. The intensive and varied use that was made of these instruments throughout 1976 for want of sufficient foreign exchange reserves highlighted contradictions and problems that had been developing over the years.

The measures taken in the aftermath of the exchange crises of January and September included calls for special reserve deposits amounting to 800 and 550 billion lire respectively. On both occasions, as I have already mentioned, the banks refrained from renewing part of the short-term Treasury bills falling due in March and October, thus increasing their liquidity by more than the amount of reserves called in. A similar reduction in their holding of bills in May enabled the banks to recoup part of the liquidity frozen in that month under the compulsory deposit on purchases of foreign currency.

By increasing the rates on refinancing operations by six percentage points at the beginning of the year and by three in September the Bank raised the cost of central bank lending to prohibitive levels and discouraged the banks from using liquidity held in their current accounts with ordinary advance facilities. The increases also met the need to counteract the outflow of foreign exchange by sharply raising short-term rates.

In October the difficulty encountered in containing the growth of credit in the short run by controlling the monetary base led the authorities to re-impose limits on the increase in bank lending.

From the point of view of the techniques of monetary management, the main lesson to be drawn from the past year's events is that the use of administrative measures in addition to market instruments, which has distinguished the policy of recent years, has reached the point at which it becomes progressively counterproductive. In order to maintain an acceptable degree of control it is necessary to lay greater stress on one or other of these two kinds of instrument; moreover, the use of administrative measures to produce a very rapid effect on the monetary base or interest rates is rarely effective and may have harmful repercussions on the financial system.

Increasing the proportion of the Treasury deficit financed by short-term securities has enlarged that section of the market which, by its very nature, is subject to wide fluctuations in rates and enabled bank and non-bank institutions to accumulate reserves of secondary liquidity that they can easily convert into monetary base when they see fit. Moreover, as a consequence of the high inflation of the seventies, the operations departments of the banks and the treasurers' offices of large companies have organized their affairs to take advantage of the frequent changes in interest rates.

In such a situation, in which the money and foreign exchange markets present opportunities for profitable investments over the extremely short term, it would be rash to think that administrative controls over credit could make regulation of the monetary base superfluous or that such regulation could normally rely on prescriptions as to the use of funds, such as variations in compulsory reserve ratios or the compulsory deposit on purchases of foreign currency. Such measures are inevitably slower, less precise and less effective than the interventions that the Banca d'Italia can carry out from day to day as a participant in the market. Moreover, these interventions are all the more successful if they are carried out in an efficient market in which the banks' cash holdings are administered with a view to minimizing the amount of idle funds held and if they are in accordance with the operating practices and rules of the market itself.

Accordingly, in 1976 the Banca d'Italia offered the banks the possibility of centralized settlement of operations with the central bank.

Furthermore, towards the end of the year it adopted more flexible criteria for its own transactions in short-term Treasury bills: whereas previously conditions had been determined by applying a system of fixed margins to the tender prices recorded at the latest auction, they are now adjusted frequently in accordance with short-term monetary targets and market trends. Partly as a result of applying these criteria, the Bank sold short-term Treasury bills throughout January and in February of this year and again, in greater quantities, during April and May, so that excess liquidity could be invested profitably rather than stagnating in the banking system until the next auction.

Such innovations may benefit the banks by removing the need for sudden administrative measures affecting the monetary base but unfortunately they are insufficient in themselves to replace other means of direct credit control that have been tried out in recent years. Although the full range of such instruments is in use today, the Bank remains aware of the serious distortions in banking competition and in the allocation of resources that result from the blanket application of measures to a variety of institutions that should be permitted to develop in their own way. The security investment requirement has the dual disadvantage of standardizing the banks' asset structures and shifting the placement of securities from the public to the banks, thus accentuating the lack of variety in the financial assets held by firms and private individuals. The ceiling on bank lending, on the other hand, has the effect of freezing the individual banks' shares in the bank loan market. Moreover, the pressure towards a uniform asset structure and the rigidity in loan market shares alter the conditions of competition on the deposit market; the two combined can even lead to contradictions within the system of requirements itself.

When the underlying structure of the Italian economy has returned to more stable equilibrium it will be possible to correct the distortions that have built up in recent years. However, opportunities to make improvements in the system of controls while it remains in effect should not be missed. For instance, when renewing the ceilings on bank lending for the period from April 1977 to March 1978, the Bank endeavoured to make greater allowance for the different rates of expansion displayed by the individual institutions by changing the method by which the reference base is calculated and extending the control period from one to two months.

The supervision of credit operations

The extension of administrative constraints to credit operations is one of the conditions which determine the substance of supervisory activity and have made it a more difficult undertaking.

The law entrusts the supervisory authorities with the task of protecting savings, at least in nominal terms, and of ensuring that credit operations are performed in accordance with the regulations and principles which must govern the efficient administration of banks. As other means are lacking, depositors are safeguarded by preserving the individual units that together form the banking system. Every effort should be made to provide this protection without, however, compromising another principle, that of efficient management.

The simultaneous pursuance of stability and efficiency within the credit system, in itself by no means an easy task in that the two objectives are only partially compatible, becomes harder when more general monetary policy requirements make it necessary to regulate credit flows by administrative measures. Interwoven with the ordinary activity of banking supervision, such measures may initially contribute to the stability of the system, but eventually they undermine its efficiency.

The banks' balance sheets reflect an economic system in the grip of inflation: in nominal terms their assets and liabilities are continuing to expand at extremely high rates, but if the price effect is taken into account they are growing slowly, stagnating or even declining. Moreover, the composition of their assets is the image not only of the accumulation of ever more numerous constraints applied at shorter and shorter intervals, but also of the deterioration in the financial structure of enterprises.

The quality of bank lending has declined every time the banks have been obliged to finance industrial losses, which are sometimes the consequence of administrative measures freezing prices at a level well below that of production costs. The principle that the survival of enterprises assisted by the banks must be guaranteed tends, therefore, to result in short-term support being sought in borrowing and a longer-term solution in continued inflation. This leads to a down-grading of the banks' role, reducing it on occasion to a kind of welfare service, and to an apparently flourishing banking system with expanding balance sheets and profit and loss accounts showing profits, some of which are merely book entries in view of the increase in locked-in positions.

Though obliged to register the interest on such loans, the prudent administrator cannot fail to cover them through the provision of special reserves.

In a system with a plurality of decision centres and levels of decision-making, the responsibility for deciding whether or not to grant a given loan rests with the individual bank and must continue to do so. Banks must not be improperly conditioned nor, within the limits dictated by the protection of the public interest, have too many obligations imposed upon them by the supervisory authorities. It therefore appears unjust that they should now be held responsible for loans made to public and private enterprises which are in a bad financial state, without taking into account the limits that have from time to time been placed on discretion of banks in the name of general or particular interests of a long, or more often, short-term nature.

The granting of credit could be conditioned in favour of particular groups of clients insofar as they are able to influence the composition and, in consequence, the views of the banks' governing bodies. In conformity with the principle embodied in the Banking Law that credit activity is of public interest, the supervisory authorities are closely re-examining a number of forms of ownership which could, at least potentially, favour the distribution of credit on the basis of inter-group relationships. This concern underlies the desire expressed by the supervisory authority that the number of banks controlled directly or indirectly by industry should not increase, and that it should be reduced should the opportunity arise.

Similar fears exist with regard to the public sector of the banking system. It would seem that the time has come to revise procedures for appointments in the banking system in order to ensure that the need to uphold banking autonomy will be better respected. The maintenance of a system based on the division of responsibility requires that the banks' management should be completely free to assume risks, subject to the directives issued by the authorities. This will be all the more secure the greater the extent to which bank appointments are based on criteria of professional ability rather than left to the discretion of the bodies responsible for determining policy.

The efficiency of the public sector of the credit system is maintained partly by preventing individuals from holding positions as directors or auditors in a number of bodies that have no capital links among themselves and, above all, by punctually making appointments to administrative and supervisory boards as terms of office expire. Discussion inside and outside Parliament has led to the identification of a number of qualifications that candidates for responsible positions in the public credit institutions should possess, but the number of posts which are vacant or held on the basis of an extended term of office continues to increase. In order to give practical effect to the principle of a regular regeneration of banks' boards, the supervisory authorities could be empowered to nominate a temporary substitute director or auditor whenever the extension of a term of office goes beyond a predetermined period.

As far as the extension of banks' territorial coverage and the establishment of new credit intermediaries are concerned, experience in other countries has shown that complete liberalization gives rise to an increase in costs, which is then reflected in interest rates. In accordance with the policy laid down by the Interministerial Committee for Credit and Savings, the supervisory authority has developed criteria which emphasize the need to increase the productivity of the system and, where necessary, to raise the degree of competition to a more uniform level. The EEC, which is in the process of preparing a directive on the harmonization of banking legislation, is also calling for greater attention to be paid to the degree of competition.

In order to rationalize the geographical structure of the banking system it is necessary above all to modify the distribution of branches, which could be increased slightly in number in line with the economic development of individual areas and the corresponding rise in demand for banking and payment services. This restructuring could provide an opportunity to meet the requests of those members of the banking system whose growth necessitates expansion beyond their traditional local confines or a presence in the country's main financial centres.

As far as banks in particular are concerned, the above-mentioned needs have now taken precedence over that of providing banking services throughout the country, although the latter has not been overlooked; they are evaluated on the basis of quantitative parameters in considering applications to open new branches or establish new local banks.

Special attention has been paid to strengthening the capital base of credit intermediaries. In the special credit sector this policy has been pursued on the one hand by extending the right to raise long-term funds to all types of institution, thus establishing a better maturities match between assets and liabilities, and on the other by setting maximum limits for the ratio of deposits to own funds. In the ordinary credit sector, banks have been encouraged to strengthen their capital bases by making this a condition of greater operational autonomy.

The specialized credit intermediaries have been treated in a similar way by extending the geographic area they serve, particularly with regard to housing credit where social needs are greatest, and by relaxing administrative constraints.

A step was taken towards the rationalization of subsidized credit with the implementation of a mechanism for automatically adjusting the rates paid to institutions that avoids breaks in the granting of credit and satisfies enterprises' need to be supplied with funds as work proceeds. Furthermore, in order to ensure that the security investment requirement gave the maximum support to investment, preference in granting authorization was given to issues that were necessary in the short term to enable the banks to meet their commitments.

The task of promoting and implementing the objectives of monetary and credit policy is complemented by that of verifying that the regulations have been observed and evaluating individual banks' capital bases, profitability, and financial and organizational situations. This function is performed, though not exclusively, by means of inspections aimed solely at protecting depositors through a careful assessment of the amount and quality of the loans granted and, more generally, of the bank's assets.

In the course of supervision facts may accidentally come to light that are in apparent violation of the law and which the Governor is obliged to report to the judicial authorities. The intrinsic delicacy of the subject has led the supervisory authority to set up machinery at the highest level of technical and juridical responsibility to scrutinize jointly all irregularities that emerge in this way. The decision is taken to inform the magistrature if the case in question is found to correspond to the abstract provision of the law.

In accordance with its obligations, the Bank works in collaboration with the judiciary, providing experts to carry out technical enquiries for the courts in the fields of money and credit, as well as providing information and data in its possession to assist the courts in taking criminal proceedings.

The Bank's task of supervision is greatly eased by the sincere cooperation of the credit institutions, particularly at the time of inspections. A climate of mutual trust and a recognition of the respective spheres of responsibility are essential if the purpose of the visits to the banks is to be achieved. Such occasions also provide the opportunity to pass on experience and new ideas which, despite the stimulus of competition, do not percolate through rapidly enough, at least among the smaller institutions. Among the many direct and indirect links that the central bank maintains with the credit institutions, this exchange of experiences is one which has gained increasing prominence in recent years.

Gentlemen,

I began by stressing the differences between the results that the various industrial countries have achieved in combatting inflation and restoring external balance in the years since the oil crisis. The process by which these two objectives have been achieved or approached has been painful everywhere, involving delays and reversals in the movement towards a higher standard of living and higher levels of employment. In Italy the process has been even more difficult than elsewhere; it has been fitful and, everything considered, slower, mainly but not entirely as a result of the worsening of the country's terms of trade. Accepting balance-of-payments equilibrium as a constraint, the problem facing the country over the next few years is, I believe, that of bringing inflation under control by means of a policy mix which will not weaken the flow of real resources, but rather will strengthen it in comparison with that which would be generated in times of inflation.

The need to focus economic policies on this aim also derives from the prominence it has been given among the range of objectives pursued by other industrial countries. When the strongest economy in western Europe aims soon to enter a 3 before the decimal point as the annual percentage increase in prices, Italy cannot continue to record a figure five times as large without jeopardizing the country's continued openness to international movements of goods and finance and the stability of its currency.

Unfortunately, the additional real resources available for eliminating the external deficit and subsequently expanding the share allocated to domestic uses will be more limited in coming years than it was in the fifties and sixties. This increases the difficulty of controlling inflation, since it lowers the threshold above which the demand for higher money incomes cannot be met out of the additional resources available for domestic uses and therefore swells the excess purchasing power to be absorbed through higher prices.

Whereas in the decade from 1964 to 1973, several years of which were marked by severe cyclical difficulties, the real rate of growth of the economy was just under 5 per cent, over the last three years it has fallen to 2 per cent. In view of the rigidity of labour costs, it must be presumed that pursuance of the objectives of reducing the rate of inflation to the average of the other OECD countries and achieving first a balanced current account and then surpluses with which to repay part of the foreign loans we have contracted will not, at the prevailing terms of trade between manufactured goods and raw materials, allow the annual growth rate to rise above 3 per cent in the next few years.

The rate of growth I have just envisaged is that which the external constraint will allow. It is lower than the rate that could be sustained with the available factors of production. The discrepancy between forecast actual growth and potential growth is the price that must be paid as long as no permanent adjustment is made in the country's import propensity and ability to export. Changing these parameters implies considerable determination in implementing structural policies to put public finance back on a sound footing and to encourage and direct the formation of capital. Such policies are fraught with difficulty and will take time to achieve their objective. There are, however, no alternatives consistent with the decision to preserve the openness and market character of the economy, features which are themselves a precondition for innovation and growth.

In the phase of gradual reabsorption of the external deficit that has now begun, the role played by the banks has been such that since last autumn neither the reserves nor the exchange rate have come under pressure from the deficit. In fact, the foreign exchange reserves are now about 2.5 billion dollars higher than they were in October.

The large volume of finance raised abroad by the Italian banking system has also had indirect effects that are no less significant: the creation of lire which it brought about provided an ample flow of funds for the subscription of Treasury bills, so that at a given interest rate the monetary financing required to cover the public deficit was reduced. It also prevented the initial impact on prices of the increases in indirect taxation and public service tariffs from being magnified by a fall in the exchange rate.

At the beginning of this year there was reason to fear that a dangerous situation would develop on the foreign exchange market during the spring, particularly after the removal of the special tax on purchases of foreign currency. It was expected that the demand stemming from the current account deficit and the settlement of trade debts incurred in previous months would be reinforced by the funds released upon expiry of the compulsory deposit on purchases of foreign currency. Instead, from April onwards the foreign currency deficit was more than covered by the increase in banks' external liabilities, and most of the liquidity created by the net inflow of foreign exchange and the release of the compulsory deposits was channelled towards the Treasury. Between the end of March and 27th May the amount of Treasury bills held by the banks and the public rose by nearly 6 thousand billion lire, primarily as a result of sales by the Banca d'Italia totalling more than 18 thousand billion lire on the secondary market. The mechanisms for regulating liquidity through the market therefore proved to be highly effective.

I believe that in view of the close parallel between medium-term projections and the events of the recent past I can legitimately conclude my remarks with an appeal and an acknowledgement.

Along the path towards greater financial stability to which we are committed the banks have built a bridge, consisting of the short-term indebtedness passing through their hands: the debt of the Treasury and enterprises towards the banks, and that of the banks themselves towards creditors abroad and the public. The country's external and internal monetary situation both depend upon the breadth and adequate stability of this structure. In such circumstances the credibility of the banking system becomes a question of overriding general interest. This requirement is heeded by the Banca d'Italia, but it must also receive the highest possible attention from all other authorities that in various ways determine the manner in which the country's banks and credit institutions are managed, the state of their balance sheets and the results shown in their profit and loss accounts.

The creditworthiness of the banks also depends on their own behaviour and the image they project. By preserving and improving this image both in Italy and abroad while at the same time rendering a service to the community, the banks have deserved the country's recognition in a critical phase of its development.

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 1976 the reserve funds underwent the following changes:

	Ordinary reserve fund	Extraordinary reserve fund
Amount on December 31, 1975	Lit. 48,897,079,954	Lit. 47,270,358,095
increase:		
– allocation from profits for the year 1975 . .	» 7,877,670,898	» 7,877,670,898
– income received in 1976 from investment and reserves	» 3,395,757,393	» 4,900,336,806
	Lit. 60,170,508,245	Lit. 60,048,365,799

	Ordinary reserve fund	Extraordinary reserve fund
decrease:		
– distribution to shareholders of a part of the income accruing in the course of 1975 (Article 56 of the Statute) . .	Lit. 81,568,527	Lit. 80,431,473
Amount on December 31, 1976	Lit. 60,088,939,718	Lit. 59,967,934,326

V. – BALANCE SHEET
AND PROFIT AND LOSS ACCOUNT

BALANCE SHEET AS

ASSETS

Gold	L.		6,429,479,563,004
Cash	»		440,548,530,179
Domestic bills of exchange:			
discounting for the banks	L.	17,389,052,038	
discount on Treasury bills and coupons	»	—	17,389,052,038
Advances:			
current account	L.	724,182,166,975	
under Treasury decree of September 27, 1974	»	232,496,250,000	
under Treasury decree of July 5, 1976	»	61,330,159,863	
fixed-term	»	—	1,018,008,576,838
Deferred payment at the clearing system	L.		—
Foreign currency external assets	»		4,127,905,394
Ufficio italiano dei cambi:			
ordinary current account	L.	—	
special accounts	»	9,744,329,014,587	9,744,329,014,587
Extraordinary advances to the Treasury	L.		339,000,000,000
Discounting for financing stockpiling	»		1,258,775,514,995
Treasury current account	»		5,215,876,292,396
Miscellaneous services on behalf of the Government - debit balance	»		91,611,856,289
Investment in government or government-guaranteed securities	»		28,027,288,198,373
Treasury credit certificates under Law n. 386 of August 17, 1974	»		16,962,162,345
Investment of reserve funds and other funds set aside:			
government or government-guaranteed securities	L.	544,662,728,570	
other assets	»	280,413,491,739	825,076,220,309
Office buildings	L.		1
Other assets	»		1,240,107,732,852
	L.		54,668,580,619,600
Commitments:			
unused part of credits on advance accounts	L.		1,359,116,889,488
Deposits:			
— guarantee	L.	3,631,664,135,918	
— others	»	82,487,787,487,080	86,119,451,622,998
Securities and other valuables on deposit	L.		354,823,777
Items written off in past years	»		2,152,333,016
TOTAL	L.		142,149,656,288,879

Audited and found correct. - Rome, April 28, 1977

THE AUDITORS

DOMENICO AMODEO
MICHELE BENEDETTI
ALBERTO CAMPOLONGO
GIUSEPPE GUARINO

THE ACCOUNTANT GENERAL

TINUCCIO ROVIDA

EIGHTY - THIRD YEAR

OF DECEMBER 31, 1976

LIABILITIES

Notes in circulation	L.		14,589,809,687,000
Bank drafts and other sight liabilities	»		88,936,110,373
Free deposits on current account	»		718,309,011,511
Tied time deposits on current account	»		1,000,020,000
Special accounts under Law n. 386 of August 17, 1974	»		50,026,198,081
Compulsory deposits on current account:			
compulsory bank reserves	L.	16,747,234,084,350	
others	»	138,341,764	16,747,372,426,114
Foreign currency deposits:			
on behalf of UIC	L.	5,829,957,500,000	
others	»	3,758,534,198	5,833,716,034,198
Foreign lira accounts:			
on behalf of UIC	L.	3,532,529,815,041	
others	»	72,321,900,885	3,604,851,715,926
Ufficio italiano dei cambi - ordinary current account	L.		42,273,041,575
Miscellaneous services on behalf of the Government - credit balance	»		916,578,550,415
Treasury services for various agencies	»		130,016,997,000
Other funds set aside	»		6,342,003,271,571
Other liabilities	»		5,438,044,343,800
Capital	L.	300,000,000	
Ordinary reserves	»	60,088,939,718	
Extraordinary reserves	»	59,967,934,326	120,356,874,044
Net profit for 1975	L.		45,286,337,992
	L.		54,668,580,619,600
Commitments	L.		1,359,116,889,488
Depositors	»		86,119,451,622,998
Securities and other valuables	»		354,823,777
Items written off in past years	»		2,152,333,016
TOTAL	L.		142,149,656,288,879

THE GOVERNOR

PAOLO BAFFI

GENERAL PROFIT

FOR THE

EXPENDITURE

Administration	L.	212,814,338,741	
Emoluments of Directors, etc.	»	475,865,690	
Transport of notes, coin and other valuables	»	1,374,581,591	
Note-printing and note-destruction	»	18,931,726,381	
Computerized data processing	»	20,439,984,532	
Expenditure on premises	»	4,724,100,818	258,760,597,753
Circulation tax on notes and demand drafts	L.	46,511,290,200	
Income and company taxes	»	2,000,000,000	
Sundry taxes	»	6,330,848,655	54,842,138,855
Interest paid out — on the compulsory bank reserve	L.	817,173,088,626	
Interest paid out — other	»	3,958,469,474	821,131,558,100
Charity and social and cultural aid contributions	»		698,664,196
Depreciation and allowances	»		672,189,255,466
	L.		1,807,622,214,370
Net profit for distribution	»		45,286,337,992
TOTAL	L.		1,852,908,552,362

PROFIT

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

TOTAL

Audited and found correct. – Rome, April 28, 1977

THE AUDITORS

DOMENICO AMODEO
MICHELE BENEDETTI
ALBERTO CAMPOLONGO
GIUSEPPE GUARINO

THE ACCOUNTANT GENERAL

TINUCCIO ROVIDA

AND LOSS STATEMENT

YEAR 1976

RECEIPTS

Discounts	L.	14,278,112,291	
Interest on advances	»	142,476,698,555	
Interest on accounts with the Treasury	»	56,452,851,296	
Interest on other assets	»	8,790,341,944	
Commissions and other fees	»	9,420,000,203	
Other revenues	»	87,467,381,282	
			318,885,385,571
Interest on Treasury bills at the compulsory bank reserve rate	L.	669,618,396,186	
Interest and premiums on other securities	»	861,925,784,994	
Revenue from real estate	»	2,478,985,611	
			1,534,023,166,791
Total	L.		1,852,908,552,362

DISTRIBUTION

L.	9,057,267,598
»	9,057,267,598
»	30,000,000
»	27,141,802,796
L.	45,286,337,992

THE GOVERNOR

PAOLO BAFFI

ADMINISTRATION OF THE BANK OF ITALY

AS OF DECEMBER 31, 1976

BOARD OF DIRECTORS

Paolo BAFFI – GOVERNOR AND CHAIRMAN OF THE BOARD
Mario ERCOLANI – DIRECTOR GENERAL
Carlo CIAMPI – DEPUTY DIRECTOR GENERAL
Mario SARCINELLI – DEPUTY DIRECTOR GENERAL AND SECRETARY TO THE BOARD

DIRECTORS

Alessandro BARNABO'
Guido BORSELLINO CASTELLANA
Gaetano CARBONE *
Umberto CARUSO * (1)
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.
(1) Deceased 23.4.1976

BOARD OF AUDITORS

Domenico AMODEO
Michele BENEDETTI
Alberto CAMPOLONGO
Giuseppe GUARINO
Arturo LISDERO

ALTERNATE AUDITORS

Antonio CONFALONIERI
Luigi GUATRI

CENTRAL ADMINISTRATION

MANAGERS

Tinuccio ROVIDA – ACCOUNTANT GENERAL
Giancarlo ULIVIERI * – GENERAL INSPECTOR
Giuliano MONTERASTELLI – CENTRAL OPERATIONS MANAGER
Giovanni MAGNIFICO – ECONOMIC ADVISER
Pietro SALONICO – CENTRAL MANAGER FOR TECHNICAL DEPARTMENTS
Alfredo PERSIANI ACERBO – GENERAL SECRETARY
Rocco QUATTRONE – CENTRAL MANAGER (Milan Branch)
Carmelo OTERI – CENTRAL MANAGER FOR SUPERVISION OF BANKS

* Retired 1.1.1977

LIST OF ABBREVIATIONS

BI	Banca d'Italia
BIS	Bank for International Settlements
CIP	Comitato interministeriale per i prezzi – Interministerial Price Committee –
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 –
GDP	Gross domestic product
GNP	Gross national product
ICCRI	Istituto di credito per le casse di risparmio italiane – Credit Institute for Italian Savings Banks –
IMF	International Monetary Fund
INA	Istituto nazionale delle assicurazioni – National Insurance Institute –
INAM	Istituto nazionale assistenza malattia – National Health 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	Organization of Petroleum Exporting Countries
SDR	Special drawing rights
TOE	Tons of oil equivalents
UIC	Ufficio italiano dei cambi – Italian Foreign Exchange Office –
UNO	United Nations Organization
VAT	Value added tax