

BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1980

PRESENTED BY THE GOVERNOR TO THE
ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 30 MAY, 1981

ROME
PRINTING OFFICE OF THE BANCA D'ITALIA
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I - THE INTERNATIONAL ECONOMY

World economic trends

1980 was a year marked by a large decline in the rate of growth of the world economy, a sharpening of inflationary pressures, a further rise in unemployment and a worsening of balance-of-payments disequilibria (Table 1).

Behind these negative developments lay the new oil crisis. Besides the direct effect of reducing aggregate demand it added new inflationary pressures to those already at work and increased trade deficits, thereby prompting the developed countries in particular to give economic policy a more restrictive turn.

In the industrial countries as a whole real GNP rose by barely 1.4% compared with 3.7% in 1979 and in the second half of the year even declined slightly (- 0.3% on a yearly basis from the previous six months). The moderate increase recorded on average for the year was due to a large extent to a decline in GNP in the United States (- 0.2%) and United Kingdom (- 2.1%), while in Italy and Japan the rate of increase remained fairly high, although lower than the previous year. During the year all the main countries, to various degrees, entered a recession or greatly reduced their expansion rates, some earlier than others.

In the OPEC countries activity levels dropped (- 2.9% compared with an increase of 2.2% in 1979) in response to a fall-off in production in the oil sector caused not only by the Iran-Iraq war but also by the cut-back in the industrial countries' demand for crude oil. The GNP of the developing countries increased by 4.3%, only 1 point less than the average for the 1977-79 period. As in the previous oil crisis the rate of growth of these economies was less affected by the unfavourable economic trend in the developed countries. Lastly, in the Eastern European countries the rate of increase of productive activity was higher than the previous year, albeit only slightly so (3% compared with 2.4%), but generally below the forecasts of the national plans. This confirms that their rate of growth is tending to slow.

Another characteristic feature of 1980 was the generalized surge of inflation linked to the increase in the price of oil. According to the estimates of the International Monetary Fund, for the OPEC countries as a whole the export price rose by 62% as against 48% in 1979. By contrast, world prices of both non-oil raw materials and manufactures increased less than the previous year, aggravating the decline in the terms

of trade of the industrial and developing countries that had been under way since the end of 1978. In 1980 world prices of non-oil raw materials rose by 18.4% in the Economist index, compared with 21.7% in 1979, while those of manufactures went up by 11 % as against 14.5%.

Table 1

**GNP, INFLATION, TRADE AND BALANCES
OF PAYMENTS IN THE MAIN AREAS**

Year	Industrial countries	OPEC countries	Developing countries (3)
<i>Gross national product (1)</i>			
1978	4.1	1.9	6.5
1979	3.7	2.2	5.1
1980	1.4	-2.9	.4.3
<i>Consumer prices (1)</i>			
1978	7.2	10.2	19.3
1979	9.1	10.8	24.1
1980	11.7	13.6	33.1
<i>Export volumes (1)</i>			
1978	5.9	-3.7	11.2
1979	6.3	2.0	9.4
1980	4.4	-15.3	7.8
<i>Import volumes (1)</i>			
1978	5.4	5.2	7.8
1979	7.9	-12.0	11.9
1980	-1.2	16.0	5.1
<i>Balance on current account (2)</i>			
1978	13.3	-3.7	-29.5
1979	-31.0	61.2	-47.2
1980	-69.4	102.0	-69.5

Source: IMF.

(1) Percentage changes. — (2) Billions of dollars. — (3) Including People's Republic of China.

In the industrial countries the deterioration in the terms of trade linked to the above price rises pushed the rate of consumer price inflation up from 9.1% in 1979 to 11.7% in 1980, despite a slowdown during the year. The rise in the implicit GNP price deflator, which excludes prices of imported goods, was comparatively lower (8.7%; 7.7% in 1979).

The deterioration in the terms of trade of the developing countries, combined with their efforts to maintain high rates of growth, caused a

marked acceleration of inflation, with the rise in consumer prices moving from 19% in 1978 to 24% in 1979 and 33% in 1980. Inflation also increased in the OPEC countries, although less so owing to the more moderate rise in import prices of manufactures. The rate of consumer price increase went up to 13.6% in 1980 from 10.8% in 1979.

The large changes in the terms of trade between oil, other primary products and manufactures greatly aggravated the trade and current account deficits of both the industrial and the developing countries. At the same time the surplus of the OPEC countries swelled to a considerable extent. However, given the way in which the current account deficit was spread among the developed countries and the fact that they attracted most of OPEC's financial investments, no serious difficulties arose in financing the industrial area's deficit. The situation of the developing countries appears to be more worrying, particularly for the future, because of the extent of their indebtedness.

Domestic economic policies

During 1980 the authorities of the major industrial countries pursued increasingly firm policies to curb the rate of monetary expansion as a means of demand control and to induce a downward revision of inflation expectations. A transition period of higher and more variable interest rates was accepted as a necessary consequence.

Overall, most of the European countries kept to the targets set for the monetary aggregates, in spite of the fact that in all, except France and Italy, the public sector borrowing requirement overshot the established limits. The only noteworthy exception was the United Kingdom, where at the end of the year the increase in M3 was about 10% over the upper limit of the pre-set expansion band. In the EEC area as a whole the rate of growth of money was in line with the targets set during the year, amounting to 10.5% compared with 12.2% in 1979. In the United States the growth of M2 was more or less stationary with respect to 1979 and in December was only slightly over the target. During the year, however, the aggregate fluctuated temporarily outside the established expansion limits. In Japan and Canada the rate of growth of money declined respectively from a yearly average of 11.4% to 7.7% and from 19.4% to 15.1%.

Short-term interest rates rose considerably in all the major countries and except for France reached levels above long-term rates. Their trend during the year reflected that of US money market rates. The effects on

exchange rates of movements in US interest rates — given the high sensitivity of short-term capital transfers to changes in nominal interest rate differentials — prompted the central banks of the other countries to raise domestic rates to very high levels. In some cases, notably Western Germany and, in the early months of 1980, Japan, these levels were not justified by the trend of activity and the need to curb inflation.

Although in the major countries taken together the rate of growth of the -monetary aggregates declined to a substantial extent and both short and long-term interest rates leaped upward, monetary policy had on balance only a limited effect on final targets in 1980, partly because of intervening exogenous factors. The persistence of strong inflationary pressures shows that severe monetary policies are a necessary but not a sufficient condition for achieving price stability.

During 1980 a restrictive turn was given to fiscal policies in all the major industrial countries except the United States and to a lesser degree Western Germany. A particularly severe course was adopted in the United Kingdom and Japan.

Owing to the trend of economic activity and the worsening of labour market conditions, the automatic stabilizing mechanisms offset about half the restrictive effect of the discretionary component of the budget in all the major countries excluding the United States. In that country the effect of fiscal policy (measured as the change in the general government balance as a percentage of GNP) was not restrictive.

Among the industrial countries, Japan and the United States have both, in the last two years, introduced rigorous general energy programmes. Important measures to further diversify primary sources were taken by both France and Western Germany; their objective was to increase the share of total consumption satisfied by nuclear energy, in the case of the former, and coal, in the case of the latter. In the United Kingdom, exploitation of the North Sea oil fields allowed the country to become self-sufficient for energy. Italy made considerable progress in the direction of energy conservation but achieved little as regards diversifying primary sources, partly because of difficulties in implementing nuclear programmes.

International trade and current account balances

There was a substantial fall-off during the year in the rate of increase of international trade. According to the IMF's estimates the volume of world trade rose by only 1.5%, compared with 6.4% in 1979. The main factors behind this were the drop in exports by the OPEC

countries (15.3%) and the slower growth rate of those of the industrial countries (down from 6.3% to 4.4%). There was also a decline in the rate of increase of the developing countries' exports from 9.4% in 1979 to 7.8% in 1980.

The rise in exports by the industrial countries can to a large extent be ascribed to sales to the OPEC nations and centrally-planned economies, since the rate of increase in exports within the area declined. Import volumes dropped by 1%, having risen by 8% in 1979. Two reasons for this were the slackening of demand within the industrial area and the sharp cut-back on imports of crude oil (about 11%).

As in 1979 the industrial countries' terms of trade, defined as the ratio of export to import prices, worsened, although the decline in 1980 (7.2%) was more than double that of the previous year (2.9%). While dollar export prices rose by 12.7% (15.4% in 1979) import prices rose by 21.4% (18.8% in 1979).

The fall-off in the industrial countries' demand for crude oil led to a drop in the OPEC countries' export volumes. Their imports, on the other hand, which had declined by 12% in 1979, increased by 16%. The developing countries increased their export volumes by 7.8% compared with 9.4% in 1979. However, the slowdown in the rate of growth of import volumes (from 12% in 1979 to 5% in 1980) was much greater than that in exports. Since GNP was still expanding at a fairly sustained pace, this phenomenon shows just how much effort these countries put into reducing the payments problems raised by the slowdown of exports to the industrial countries and the rise in the price of crude oil.

In the group of developing countries the deterioration in the terms of trade (3%) was less severe than in the industrial countries, notwithstanding a fall in the rate of increase of non-oil raw material prices. This was principally due to the trend of the terms of trade of countries with a strong oil sector, which increased by about 12% per year in the period 1979-1980.

The trade deficit of the industrial countries amounted to 65.4 billion dollars, an increase of 31.1 billion compared with 1979. However, in spite of the decline in the terms of trade, the deterioration was not as large as that between 1978 and 1979 (46 billion). Within the area there was a slight increase in the share of the total deficit ascribed to the seven major countries (from 47.8% to 49.5%). Specifically, Italy's and France's deficits rose by nearly 15 and 10.5 billion dollars respectively, while Western Germany's surplus fell by about 7 billion. The situation in the first two countries appears even more serious if one considers that the

deterioration also involved the non-oil balance, whereas in the case of Germany it was due entirely to the higher cost of imports of crude oil.

By contrast, the trend of the trade balance in the United States and Japan was fairly satisfactory, with respectively a 2 billion dollar reduction in the deficit of the first (from 29.4 billion in 1979 to 27.4 billion in 1980) and practically no change in the other (a surplus of about 2 billion). The trade balance of the OPEC countries reached a figure of 162 billion dollars, which was 50 billion higher than in 1979. The developing countries instead showed a deficit of 63 billion dollars in 1980, with an increase of 15 billion from 1979.

As regards the balance on current account, the industrial countries recorded an overall deficit of about 70 billion dollars (31 billion in 1979; Table 1), which mainly reflects that in the trade balance. The current surplus of the OPEC countries amounted to 102 billion dollars compared with 61 billion in 1979. The current deficit of the developing countries, on the other hand, increased by 22.3 billion dollars, from 47.2 billion in 1979 to 69.5 billion in 1980.

International financial flows

The aggravation of international payments disequilibria (the world total of current deficits, excluding official transfers, rose from 90 to 140 billion dollars) and of the gaps between inflation rates and nominal interest rates in the main countries was accompanied in 1980 by less stable world capital market conditions, wide exchange rate fluctuations and a large increase in official intervention.

The enlarged borrowing requirement of the group of industrial countries was met in the amount of about 52 billion dollars by capital transfers. Financing by international institutions reached a figure of around 7 billion dollars, 2.9 billion of which consisting of SDR allocations at the beginning of the year and the rest of loans by the EEC and other Community organizations to member countries.

In Western Germany the accumulation of a large current deficit and the increase in official transfers led to a substantial reduction in official reserves (13 billion dollars, over 4 billion of which consisting of official liabilities to oil-exporting countries). The deficit was covered to only a limited extent by capital transactions, owing to the large negative interest differentials on deutschmark investments and expectations of a fall in the exchange rate. Japan, on the other hand, found it easier to finance its current deficit on the market owing to the rapid improvement in its trade

balance during the year and to expectations of a rise in the yen's exchange rate, which counteracted the adverse interest differential with the dollar area. The country's financing requirement was met in part through abundant inflows of capital from the OPEC countries, either in the form of deposits with the official authorities or, for an exceptionally large amount, of purchases of domestic financial market securities.

In the United States the renewed surplus on current account was accompanied by a substantial increase in official liabilities (up 14 billion dollars), mainly vis-a-vis oil-producing countries, and a small deficit on capital transactions. Lastly, the United Kingdom's current surplus was partly offset by a deficit on capital account, particularly in the long-term items, given net inflows of bank capital. As a result official reserves remained more or less stationary.

On the whole, movements of private capital, especially short-term, accompanied rather than offset the trends in current account balances, causing large changes in the external position of monetary institutions and massive intervention on exchange markets.

The deficit of the developing countries (on goods, services and private transfers), which reached a figure of 80 billion dollars, was financed in the amount of 11 billion with official transfers and of 12 billion with international organization financing. Direct foreign investment remained unchanged from 1979 at around 8 billion dollars and market finance rose to 50 billion, about half of which consisting of trade and euromarket credits. On the other hand, official reserves, which had increased considerably the previous year, were practically stationary.

At the end of 1980 the external long-term debt of the developing countries had reached 370 billion dollars, or one fifth of the aggregate national product and 115% of total exports. The servicing of the debt alone (interest and principal) is estimated to have amounted to 75 billion dollars during the year, which represents a substantial increase from the previous year, mainly attributable to higher interest rates. Moreover, a considerable share of the debt is concentrated in a small number of countries, some of which already appear unlikely to be able to meet their current commitments given the poor prospects of an improvement in their external accounts.

These trends indicate that in 1980, too, the predominant role in the recycling of oil surpluses was played by private markets, and especially by the banking system. Banks continued to expand their international business at a fast pace (19%), albeit less so than in the previous year, stimulated by the deficit countries' demand for credit and by the flow of deposits from the oil-producing countries; international securities issues remained

steady at the values recorded in 1979 (42 billion dollars). On the whole, despite high interest rates, the supply of credit was raised to meet increased demand, while the expected widening of spreads occurred only in part; on the other hand, the average maturity of the loans shortened. Tighter conditions were applied to heavily indebted countries.

International financial markets

These markets recorded a slight slowdown in disbursements and were marked by considerable interest rate instability, which was mainly attributable to developments on US markets. Despite the high degree of risk concentration, banks — with the partial exception of US banks — continued to increase their exposure vis-a-vis developing countries. There was, however, a certain shortening of maturities. Overall, the international banking system still appears to underrate the dangers inherent in their exposure to certain countries which continue to borrow large amounts, albeit at increasingly high costs and stringent conditions.

The total flow of publicly-announced eurocredits and eurobonds amounted to 120 billion dollars, compared with 124 billion in 1979. The small reduction, which occurred primarily in the early part of the year, was attributable to eurocredits (down from 83 to 78 billion dollars).

Notwithstanding the difficulties stemming from the high levels and instability of interest rates, there was a slight increase in the volume of new bond issues. As in the past, the majority of these (78%) were made by industrial countries, with the United States, Japan and Sweden the largest issuers. Dollar-denominated issues continued to represent the largest share, those denominated in French francs recorded a rise while there was a sharp fall in the share of deutschemark issues.

Publicly-announced eurocredits to the industrial countries rose sharply from 27 to 40 billion dollars. The largest borrowers were the United States (6.7 billion), Italy (6.6 billion) and Spain (5.5 billion).

The publicly-announced credits granted to developing countries amounted to 24 billion, a substantial fall compared with the previous year. However, according to BIS data, total new lending (including unannounced loans) by banks to this group of countries amounted to 38 billion dollars, an increase of around 2 billion compared with 1979. In view of the simultaneous slowdown in new deposits, there was an even larger increase in the net exposure of this group of countries vis-a-vis the international banking system (35 billion as against 23 billion in 1979). Furthermore, the risks appear to be highly concentrated: at end-1980 by

far the greater part of lending (94 out of 102 billion) was to Brazil (39 billion), Mexico (32 billion), Argentina (12 billion) and South Korea (11 billion).

Finally, the eurocredits granted to countries with centrally-planned economies amounted to 2.6 billion, a reduction of 1.3 billion compared with 1979. In fact, partly as a result of the political uncertainties surrounding events in Poland and Afghanistan, the market was reluctant to increase significantly its exposure to this group of countries. Poland also encountered considerable difficulty in servicing a net foreign debt that amounted by the end of 1980 to around 25 billion dollars.

Loan conditions gradually became more stringent during the year, especially as a result of more frequent adoption of the US prime rate (which on average was above LIBOR) as the basis for the determination of interest rates and of an average shortening of maturities to around seven and a half years.

Official reserves and international liquidity

At the end of 1980 official international liquidity — defined as the total of convertible currencies (excluding ECUs created against gold), SDRs and reserve positions in the IMF — amounted to 362 billion dollars, an increase of 31 billion or 9% compared with end-1979. The rise in official reserves was mainly attributable to the convertible currency component, which, after falling by 19 billion dollars in the first quarter owing to the substantial sales of dollars by the monetary authorities of the major industrial countries, rose in the following nine months by nearly 45 billion dollars.

The proportion of the non-dollar bank deposits of official monetary institutions rose by nearly 3 percentage points to 37% at the end of the year despite the strengthening of the dollar on exchange markets. Furthermore, there was a relatively new development in that the greater part of the increase consisted of deposits in domestic markets and, in particular, in those of Japan, Western Germany and the United Kingdom.

The gold component of the official reserves (including the amounts contributed to the EMCF) remained virtually unchanged in physical terms (rising from 1,015 million ounces at end-1979 to 1,022 at end-1980). The change was primarily the result of the fourth (and last) restitution of gold by the IMF to member countries. On the basis of the end-year market prices, the value of the gold in the official reserves rose from 520 to 603 billion dollars at the end of 1980. The narrowness of the gold market and

the great variability of its price mean that this component of the reserves is not fully liquid, even though recourse can be made to forms of partial mobilization, of which the mechanism for creating ECUs in the EMS is a recent example.

As for the country distribution of international reserves (excluding gold), the 2 percentage point increase in the share of the oil-exporting countries was matched for the first time in the last three years by a substantial fall in that of the developing countries from 22.5 to 20%. On the other hand, the share of the industrial countries remained virtually unchanged at around 57%.

Total international liquidity (defined as the sum of official liquidity and banks' international liabilities vis-à-vis private investors) rose during the year by nearly 18% to 662 billion dollars. The rising trend of the share of private liquidity also continued: from being virtually negligible at the beginning of the 1960s, it rose to 35% at the end of 1970 and to 45% at the end of 1980.

Exchange rates

The exchange rate developments of 1980 and the first quarter of 1981 were marked by the wide fluctuations of the dollar and the substantial depreciation of the currencies adhering to the European Exchange-rate Mechanism (EEM) within the EMS against those of the other major countries.

Compared with end-1979, the dollar at the end of March 1981 was 23% up against the deutschemark, virtually unchanged against the pound sterling and 12% down against the yen. On the other hand, the EEM currencies were down 19% against the dollar and the pound sterling, and 29% against the yen.

In effective exchange rate terms, the dollar showed an overall rise of 2% (though there were much larger fluctuations during the fifteen months in question); the pound sterling and the yen rose much more (respectively 14% and 16.5%). The effective exchange rate of the deutschemark, instead, moved in the opposite direction to that of the dollar and recorded a fall of 6%.

During this period exchange rates were considerably influenced by uncovered interest rate differentials and balance-of-payments considerations.

Interest rate movements in the United States increasingly affected the monetary policies of the other industrial countries, and especially that of

Western Germany, where domestic developments made a more expansionary stance desirable. On the other hand, the policy pursued by the German authorities did not prevent a depreciation of the mark as the interest rate differential vis-a-vis the US market and the current account deficit progressively widened. Only in the second half of February 1981, after a further decline in the value of the mark on foreign exchange markets, was the decision taken to give priority to external equilibrium by raising interest rates. The fluctuations of the mark in 1980 were amplified by both long and short-term flows of private capital.

As regards Japan and the United Kingdom, the effect on their exchange rates of the negative interest rate differential vis-a-vis the US market was progressively offset from the summer onwards by the rapid improvement in their external accounts. In the case of the United Kingdom, an additional favourable influence was the slowdown in the expected rate of inflation.

Overall, the bilateral rates between the EEM currencies were largely stable in 1980 and the first quarter of 1981. These currencies responded to the wide fluctuations of the dollar, the yen and the pound sterling by moving in harmony, with the partial exception of the lira.

The exchange rate movements within the EMS in this period can usefully be observed in relation to the dollar. In the first three months of 1980 the dollar rose by 12% against the EMS currencies despite large-scale official interventions. The deutschemark and the Danish crown dropped towards the lower limit of the narrow fluctuation band in opposition to the French franc. The lira, instead, remained in the upper part of the narrow band. The pound sterling, which was not bound by the exchange rate agreements, appreciated against the EEM currencies by about 9%.

In the following quarter there was a sharp reversal of the upward trend of the dollar and a temporary improvement in the cohesion of the EEM currencies, with a large reduction in the divergence between the currencies fluctuating within the narrow band. The values of the divergence indicator were also far from the threshold ones. The lira showed greater weakness, especially in June, when it entered the lower part of the fluctuation band, notwithstanding substantial support by the Banca d'Italia. In view of the wider range of permitted fluctuation, it did not reach either its bilateral intervention limits or the divergence threshold. During this quarter the pound sterling hardly moved against the EEM currencies.

In the second part of 1980 and in January 1981 the new rise in the dollar (19% vis-a-vis the EEM currencies) also depressed the

deutschemark against the other European currencies. In October the German currency was once more at the lower limit of the fluctuation band in opposition to the Dutch guilder. Towards the end of February the large rise in interest rates in Western Germany caused the deutschemark to recover against both the dollar and the other EMS currencies, thus pushing the Belgian franc down close to its divergence threshold.

The lira, which had hardly moved against the other EEM currencies between July 1980 and February 1981, suddenly lost ground towards the middle of March 1981 -- notwithstanding heavy support interventions -- until it diverged from its central rate against the deutschemark by nearly 5% and crossed its alarm-bell threshold. On 22 March the central rates of the lira were devalued by 6%. In the days that followed, the lira only used a part of the leeway it had been given, depreciating by a little more than 2% compared with its pre-realignment quotations and settling close to the centre of the fluctuation band.

March 1981 was also the end of the two-year period originally fixed for the so-called "transitional" phase of the EMS, which was to have been followed by the "institutional" phase with the setting up of a European Monetary Fund (EMF). The complexity of the technical and political problems associated with the construction of a similar body, as well as the changed world economic situation after the second oil shock, led the Community countries to extend the "transitional" phase for a further two years and to continue with the present mechanism of renewable quarterly swaps between the European Monetary Co-operation Fund (EMCF) and the central banks of the countries participating in the EMS. The Committee of Governors and the EEC Monetary Committee have meanwhile proceeded with the technical studies started in 1979 in relation to the setting up of the EMF by exploring the three options that have been identified: an embryonic European central bank, an institution similar to the IMF and an organization *sui generis*. Particular attention has been paid to the analysis of the role and characteristics to be assigned to the ECU.

Community institutions

At a time of sharp cyclical recession, growing unemployment and high inflation, the Council of Europe reaffirmed at its meeting last December the need for concerted economic policy action to be based not only on traditional instruments of demand management but also on a medium-term strategy designed to increase fixed investment's share of GDP and to improve supply conditions, especially in the industrial and energy sectors and in the labour market.

In order to achieve these objectives, the hope was expressed that countries would adopt policies to encourage, specifically through a higher level of financing, the production and saving of energy and the development of industries offering the best prospects for future growth. Furthermore, it was decided that restructuring measures were necessary in sectors, such as steel, shipbuilding and textiles, which have been suffering from excess capacity for several years now. The financing of the related projects will require a combined effort on the part of member countries and the Community, the resources of which should be devoted above all to the programmes involving the less prosperous regions in order to promote their convergence towards the levels of development of the rest of the Community.

The lending of the Community's financial organs in 1980 was consistent with these aims. Loans amounting to 4.7 billion EUAs were approved, an increase compared with 1979 (20%) that was well above the average rate of inflation in the EEC (12%).

The contribution of the Community budget to the solution of the European economy's structural problems was less satisfactory: in 1980 more than 70% of its resources were again used for current expenditure on intervention in agricultural markets. The long and acrimonious debate on the budget in 1979-1980 only resulted, in practice, in a reduction in the large net financial contribution of the United Kingdom.

The total expenditure of the 1980 budget amounted to 16.2 billion EUAs, an increase of 12% compared with 1979. The allocations of the 1981 budget exceed 19 billion EUAs, a substantial rise compared with the previous year (19.4%), which is due primarily to the outlays associated with the reduction in the contribution of the United Kingdom and the entry of Greece into the Community. However, if the expenditure corresponding to these items is excluded, there is still a reduction in the share of resources devoted to structural interventions.

II - THE ITALIAN ECONOMY

FORMATION OF INCOME AND ECONOMIC DEVELOPMENTS

Overall results

For the second year running the Italian economy grew faster than the average for the industrial countries. The expectations of a cyclical turnround at the beginning of the year were not fulfilled, and it was only in the second quarter that productive activity started to weaken.

GDP rose by 4% in real terms compared with 1979 and domestic demand by 7%, whereas the corresponding figures for the other industrial countries were 1.4% and close to zero.

As during the first oil crisis, the high rate of growth, the delay with which domestic demand slowed down compared with that of the rest of the world and the deterioration in the terms of trade tightened the constraints on rapid growth that the events of 1978-79 had relaxed, at least as far as the country's external position was concerned.

The current account of the balance of payments recorded a deficit of 8,500 billion, with a swing of 13,000 billion compared with the previous year. This was larger, as a proportion of GDP, than that of 1973-74. More specifically, the oil deficit on an f.o.b. basis rose from around 8,000 to 16,000 billion. The large differential between domestic and foreign interest rates, the limits set on lira-denominated bank lending and the compulsory foreign currency financing of a proportion of short-term credits encouraged an inflow of capital from abroad that made it possible not only to finance the current account deficit but also to increase official reserves slightly.

The acceleration of the rate of inflation in Italy resulted in a further widening of the differential compared with the OECD average (consumer prices rose respectively by 21.2% and 11.7%). The exchange rate policy pursued during the last two years was heavily conditioned by international events and was only able to limit imported inflation to that caused by the continuous increases in the price of oil. The effects of the latter on prices were amplified by the existing indexation mechanisms, by the leapfrogging of domestic incomes and relative prices and by the behaviour of economic agents in a period of widespread cyclical overheating.

Expectations of a high rate of inflation and the actual increases in prices caused a surge in domestic demand, which, together with the further decline in the competitiveness of Italian goods on foreign markets,

produced a 4.3% fall in the volume of exports. The decline in Italy's share of world markets — after six years of uninterrupted expansion — amounted to approximately half a percentage point overall, but was larger for "mature" products, which account for an important part of Italy's international trade and are more price sensitive.

The acceleration of inflation, the worsening of the terms of trade and the automatic withholding of direct taxes caused the real increase in households' disposable income to be small (1.9%). However, the reaction of consumers to the steady erosion of the purchasing power of nominal incomes was to increase their expenditure in real terms by reducing their propensity to save. Consequently, households' consumption again rose by nearly 5%. More specifically, demand for consumer durables grew by 9% and that for other goods by 4%.

Fixed investment rose by 10% in real terms and, for the first time in the last nine years, showed a substantial increase in relation to GDP. The spread of inflationary expectations led firms to boost capital formation, already strengthened by the record level of capacity utilization, and, by stimulating households' demand for housing, supported activity in the construction sector. The increase in investment in the latter was also due to the larger volume of works undertaken by the public sector.

Investment in plant, equipment and means of transport showed a particularly large increase, partly as a result of the high level of firms' profits and liquidity at the beginning of the year, which reduced the restrictive effect of the direct controls on bank credit and of high interest rates (about 2 percentage points above the end-1979 levels). For the whole year, the effects of monetary policy on investment were mitigated by the strength of the share market, which enabled a larger volume of equity capital to be raised, and by the substantial increase in the medium and long-term finance provided by the special credit institutions. Finally, there was a large volume of foreign borrowing, which was facilitated by the liquidity of international markets. At the short end of the market, firms reacted to the limits set on bank lending both by borrowing amounts that were exempt from the ceilings and by issuing corporate paper that was accepted by the banks and then sold to institutional investors and private savers.

The increase in stocks — the largest in real terms of the whole post-war period — can also be attributed in part to the high level of firms' liquidity at the beginning of 1980. Finished goods made a decisive contribution to the increase in the first half of the year, while expectations of a devaluation of the lira between June and September were the principal cause of the build-up of raw materials in the second half.

Imports increased by 7.9% with an elasticity with respect to GDP that was in line with the long-run value. The high rate of capacity utilization and the continued strength of domestic demand (even after the cyclical downturn) combined with the greater competitiveness of foreign goods to produce a large increase in imports of finished products: imports of investment and consumer goods rose respectively by 28% and 18% in real terms. Only net imports of oil declined, both as a result of energy savings stimulated by the higher relative prices of oil products and, more importantly, because of a shift to alternative sources of energy.

As for domestic sources of income, all the main sectors contributed to the 4% increase in GDP to roughly the same extent. The value added of agriculture at constant prices rose at a relatively fast rate (3%), albeit more slowly than in the two previous years. Services recorded a rise of 4.1 %, which was primarily attributable to the credit and insurance, wholesale and retail trade, and catering and entertainment sectors. Finally, industry's value added rose by 4.8%, with similar rates in industry excluding construction (5.0%) and in construction (4.2%).

Total employment increased on average by 180,000, of which 80% was accounted for by the steady rise in employment in the services sector over the year. Industry excluding construction only recorded a small rise, the result of an initial increase followed by a reduction and greater recourse to the Wage Supplementation Fund, which paid 24% more hours than in 1979. Productivity per unit of labour in industry excluding construction rose by 4.3% but, since there was an increase in the average number of hours worked, hourly productivity only rose by just over 3%.

The supply of labour expanded more than the population of working age, rising by 1.3% compared with the previous year. On the other hand, the unemployment rate remained virtually unchanged at 7.6% (7.7% in 1979).

Fiscal policy, as originally established by the Budget Law, was conceived in the light of the forecast that 1980 would be recessionary throughout and was intended to offset a restrictive monetary policy. In practice, however, it produced effects that varied considerably during the year: very restrictive in the first half, it then became strongly expansionary in the second and continued this trend in the first few months of 1981.

Compared with 1979, the average ratio of the general government current account deficit to GDP declined by 2 percentage points and the composition of total domestic credit shifted in favour of the private sector. The limits set by the monetary authorities on credit expansion, the balance-of-payments deficit, the private sector's lower propensity to save

and the preference of both households and firms for real investments reduced the amount of outstanding domestic financial assets.

Economic developments during the year

In the early months of 1980 the economy continued along the strongly expansionary trend that had begun in the second half of the previous year. Between June 1979 and April 1980 industrial production rose by 16.5%, stimulated by an expansion of domestic demand without precedent in the last twenty years.

In the first quarter, the fast and uninterrupted increase in domestic uses of income, combined with the effects of opposite sign on imports and exports produced by the deterioration in price competitiveness, caused exports to drop by 1% compared with the previous quarter and imports to rise by 4.4%. This led to an increase in both the trade deficit and the deficit in the current account of the balance of payments of respectively 3,700 and 2,350 billion lire on a seasonally adjusted basis.

The gradual erosion of households' real spending capacity and the rise in interest rates did not have a sufficiently powerful impact on the dynamics of investment and consumption. Additional capital accumulation was encouraged by the extremely high degree of capacity utilization and by the improvement of firms' profit margins obtained through continual increases in prices. The new surge of inflation, partly due to increases in the prices of oil and of many public services, prompted households to delay bringing consumption into line with the reduced purchasing power of their money incomes.

The substantial increase of nominal domestic demand sustained that of credit, and the banks overshot the ceilings on the growth of lending fixed in the early months of 1980. Delays in approving the budget made it necessary to resort to a provisional extension, thereby curtailing spending and reducing the Treasury's borrowing requirement.

In the middle of March, the monetary authorities' decision to take stronger measures to combat inflation and contain the growing balance-of-payments deficit led to a tightening of the constraints on credit with the introduction of a compulsory non-interest-bearing deposit proportional to the amount of lending in excess of the ceiling.

Nevertheless, these measures did not succeed in slowing the expansion of bank lending in the second quarter. However, as domestic demand gradually slackened and could no longer offset the further decline in foreign demand, firms experienced a heavy drop in orders as well as,

from May on, a fall-off in productive activity. Industrial employment continued instead to increase, showing the usual lag with respect to the turning point of the cycle.

The rate of increase in prices, both wholesale and consumer, began to slow down in response to the early signs of the cyclical turnaround and to the fall in world raw material prices as the main industrial countries entered a recession. Imports decreased by 5% in volume, which was nevertheless not enough to counterbalance the sharp fall in exports and in the terms of trade: the trade deficit remained large.

The effects on the exchange rate of the rapid deterioration in the external accounts were mitigated by an inflow of short-term funds through the banking system with the result that the volume of foreign currency reserves remained more or less constant until May. In June the exchange market came under strong pressure: the trade deficit was compounded by outflows of short-term capital fostered by rapidly worsening expectations as to the exchange rate. In order to prevent speculative operations originating from repayments of foreign currency loans taken out by Italian firms and to tighten control on the overall spending capacity of the economy, at the end of June the ceiling on lending was renewed before expiry, with monthly checks replacing the previous two-monthly ones and a higher non-interest-bearing deposit for banks going over the limit.

Furthermore, at the beginning of July the government issued a series of measures to channel resources from consumption to investment and exports. Specifically, taxation was increased, industrial firms' social security contributions were further reduced and tax exemption was granted until December 1981 on bonds issued by special credit institutions.

During the summer quarter the index of industrial production fell by 7.2%. The reduced availability of credit and high level of interest rates, combined with a decline in expected inflation, discouraged firms from building up their stocks of finished goods. Hence the gradually slackening demand was met by reducing stocks and cutting down production programmes.

However, fears of changes in the lira exchange rate, fed by the debate under way in June on whether or not there should be a devaluation to offset the loss of competitiveness of Italian goods, maintained imports, especially of raw materials, at a higher level than declining production and demand warranted. The further fall-off in exports and reduced inflow of foreign currency from tourism brought the current balance-of-payments deficit to 2,500 billion in the third quarter. At the end of September Parliament's rejection of the decree originally

presented in July and later resubmitted in a slightly modified form in August led to the fall of the government.

Thus, since it had become impossible to control the cycle through fiscal policy, the monetary authorities decided to take new action: the official discount rate was raised by 1.5 points and restrictive measures were adopted regarding the maturity of foreign currency accounts, the compulsory financing in foreign currency of part of export credits and the advance repayment of foreign loans for imports and optional foreign currency bank finance.

Meanwhile the performance of the lira was benefitting from the operation of the monetary and foreign exchange measures taken at the start of a period of extreme instability on world foreign exchange markets, caused by abrupt transfers of capital to exploit the increased interest rate differential between the United States and the other industrial countries.

In September the rate of inflation began to accelerate again after a lull during the spring and summer months, mostly fuelled by increases in the prices of many public services. Moreover, when the government's measures reducing the number of different VAT rates expired, no drop occurred in selling prices to match the increase that had taken place in July when the measure was introduced.

Domestic demand, although declining compared with the first half of the year, continued to be higher than the average for the second half of 1979, mainly because of the effect of public sector action. In the second half of 1980 the ratio of the public sector's total deficit to GNP reached a peak for the past five years (13.9%) and three times the value for the first two quarters (4.1%).

The raising of pensions and in particular the related twice-yearly payment of sliding scale increases, the measures taken to limit the effects of fiscal drag, the increase of family allowances, and the payment to public employees of an advance on their rises in contractual pay combined to increase households' disposable income towards the end of the year. The effects of these changes were only partly offset, however, by the tax measures which the government managed to pass in October, when it resubmitted most of the provisions of the July decree. Although consumption continued to decline the effect of these increases in some components of households' disposable income was nevertheless favourable. Investment also remained buoyant. This was due, in the construction sector, to the duration of the production process, that tends to keep the cycle out of step with that of the economy as a whole, and in industry to the fact that, given continuing expectations of high rates of inflation for

capital goods prices, the completion of projects was hastened by using the increased financial resources raised by the special credit institutions after the tax exemption of their bond issues.

Exports, which had declined uninterruptedly during the first three quarters of 1980, began to respond to the weakened pressure of domestic demand and picked up in the last two months of the year. Their volume was nevertheless below that of the end of 1979. The accompanying fall in imports helped to reduce, albeit only to a limited extent, the large deficit, seasonally adjusted, in the current account of the balance of payments.

Gross national product increased by 2% over the level of the previous quarter. It appeared that changes in production programmes made by firms in the third quarter had been excessive in relation to actual demand, with the result that in the closing months of 1980 productive activity recovered from the low levels recorded in the summer. Nevertheless considerable recourse was made to the Wage Supplementation Fund, with an increase of 142% over the previous quarter.

Demand for credit, boosted by the upturn in production at the end of the year, was met, owing to the existence of the ceilings on lending in lire, by a massive inflow of external funds through the banks, which made it possible to finance the balance-of-payments deficit but had potentially destabilizing effects in terms of liquidity control. Consequently, in order to limit the volume of these funds, the monetary authorities abolished the requirement to finance part of deferred payment exports in foreign currency.

Prospects for 1981

After the increase in oil prices of 1979-80, the prospects for a rapid stabilization of the Italian economy should be assessed principally on the basis of current forecasts of the trend of energy prices and the rate of growth of the world economy.

It seems increasingly unlikely that there can be a repetition of the experiences of the period after the 1973-74 oil crisis, when world prices of manufactures gradually picked up against oil prices, thereby assisting the industrial countries to adjust -their balances of payments. The second oil crisis, on the other hand, seems to have led throughout the world to a new political and economic order which makes it seem likely that the disequilibria in relative prices will be more lasting. This will affect growth in all the non-oil producing countries, more so in those which are most heavily dependent on foreign sources of energy.

Italy's current balance-of-payments deficit of 10 billion dollars in 1980 is partly the outcome of an energy deficit of 19 billion, which, given the same volume of net imports of oil, is expected to rise to 23 billion in 1981 taking into account the increases in crude oil prices decided by the OPEC countries at - the Bali conference. These figures alone suffice to demonstrate clearly that the combinations between levels of foreign and domestic demand need to be very different from those of 1980 if the external accounts are to be rapidly readjusted through net exports of resources to offset the decline in the terms of trade. As 1981 opens, therefore, the prospects for the balance of payments continue to be poor, with a large deficit compounding the already sizeable one for 1980. Italy again faces the constraint of its external accounts, which must be restored to equilibrium as a necessary condition, in the medium term, for reducing the rate of inflation and ensuring continued growth, since a further deterioration in the terms of trade is likely.

At the international level, persistent balance-of-payments disequilibria, disturbances on foreign exchange markets and continuing high rates of inflation tend to make policies for a generalized improvement of economic activity impossible. In the United States the recovery at the end of 1980 and early months of 1981 seems to have given way to a lull of uncertain duration. In Europe, the indices of productive activity have for the time being settled at the low levels recorded towards the end of the previous year. The moderate rate of increase in world demand forecast for 1981 may well jeopardize Italy's chances of achieving a large and rapid reduction in the current balance-of-payments deficit by substantially increasing exports. In addition, the indexation mechanisms, both open and concealed, existing in the Italian economy amplify initial price shocks and increase the time required to absorb them. As past cyclical experiences have taught, this makes the rate of inflation remain high when it is already falling in other countries, with adverse effects on the competitiveness of our exports. In these circumstances, the tendencies displayed by the economy at the beginning of 1981 are not consistent with the need to contain disequilibria and reduce pressures.

In the early months of the year consumer prices have risen by about 20% compared with the same period of the previous year and in view of the large appreciation of the dollar on world markets it is likely that the cost of imported goods will rise dramatically. The monthly trade deficits are still between 1,000 and 1,500 billion, the index of industrial production, which has been stationary in the first quarter of 1981, indicates that demand is still relatively strong, and firms now consider short-term prospects to be more promising.

The behaviour of the public sector has not been consistent with the need to bring the rate of growth, the rate of inflation and the current balance-of-payments deficit into line with those of the other industrial countries. Mention has already been made of the discretionary measures decided during 1980, which strongly sustained households' disposable income towards the end of the year and hence have led to an expansion of consumption in 1981. Account must also be taken of the expenditures, only partly covered by increased taxation, for assistance and reconstruction after the earthquake in southern Italy last November, the additional spending decisions made at the beginning of 1981, and the increase in the general government current deficit produced by the automatic budget mechanisms connected with revenues and disbursements. The growth of the public deficit is fuelling unabated inflation expectations and so sustaining a high propensity to consume among households.

The monetary policy measures taken during the year, first in January and then in March, can only offset part of the consequences of the action taken so far by the public administration. Unless a more effective policy is adopted with regard to public spending and the mechanisms of resource allocation, monetary policy will have serious difficulty in preventing the rate of inflation, in terms of consumer prices, from reaching similar levels to 1980 and a large balance-of-payments deficit persisting despite the stagnation of economic activity.

Domestic demand

Consumption

Consumption of resident households increased for the second year running at a rate close to 5% (Table 2). The rise in domestic consumption was lower however (4.4%) owing to the large gap between the trends of consumption related to tourism in Italy and abroad: in fact, residents' spending abroad rose by 11.8% in real terms, whereas spending by non-resident tourists in Italy fell by 7.2%. During the year, the stimulus to consumption imparted by disposable income was only moderate, with a real rate of growth (1.9%) well below that of the previous year (3.5%). Hence the propensity to consume again increased as in the previous year, reaching the highest level of the past five years (77.1%; Table 2).

Following the strong upward trend of the last months of 1979, final domestic consumption continued to increase until the beginning of the summer despite the gradual decline in the purchasing power of households'

incomes caused by inflation. The subsequent decrease was fairly limited, which prevented an excessive cut-back in productive activity in the second half of the year.

Table 2

HOUSEHOLDS' CONSUMPTION, DISPOSABLE INCOME AND PROPENSITY TO CONSUME

	1980 (billions of lire)	Percentage changes			
		<u>1977</u> 1976	<u>1978</u> 1977	<u>1979</u> 1978	<u>1980</u> 1979
Durables (1):					
current prices	22,888	32.2	20.7	34.4	30.5
1970 prices	4,649	10.2	3.6	14.2	9.0
Other goods and services:					
current prices	189,875	19.9	15.8	19.7	25.0
1970 prices	49,757	1.7	2.9	4.6	4.0
Total final domestic consumption:					
current prices	212,763	20.9	16.3	21.1	25.6
1970 prices	54,406	2.3	3.0	5.3	4.4
Total final national consumption:					
current prices	206,825	20.0	16.0	20.8	26.2
1970 prices	52,715	1.5	2.7	4.9	4.9
Gross disposable income:					
current prices	268,149	21.0	17.9	19.1	22.5
1970 prices (2)	68,345	2.4	4.5	3.5	1.9
Average propensity to consume:		75.1	73.8	74.9	77.1
(per cent)					

Source: *Relazione generale sulla situazione economica del paese.*

(1) Banca d'Italia estimates. — (2) Gross disposable income has been deflated using the implicit prices of final national consumption.

The strong trend of consumption must be ascribed to a large extent to the considerable worsening of price expectations, which caused spending decisions to be brought forward. In addition, the increase in purchases of durables (9%) was also due to the decline in the real interest rate on households' financial assets and to the fact that, with the exception of jewelry, the rises were below the average for consumer prices. Expenditure on non-durables and services (up by 4%) was boosted by the trend of

households' wealth, which, having already increased considerably in 1979 in relation to disposable income, showed a further large rise in the real component (housing and real-estate).

Investment

During the year fixed investment rose by 10% in volume. There was also an unprecedented build-up of stocks (which rose by 2,936 billion lire at 1970 prices) with the result that the volume of total investment went up by 19.7%. In value terms the increase in fixed investment was 32.4%. Including the change in stocks (16,459 billion lire at current prices) the value of total investment rose by 46%.

The ratio of fixed investment to GDP showed a further increase, rising to 20.2% at 1975 prices and pulling Italy up from one of the lowest positions among the EEC countries. The incentive to capital accumulation, which in many sectors stemmed from a need for reorganization as well as poor productive capacity, was particularly strong in the case of plant, machinery, equipment and means of transport (an increase of 17.3% in volume from 1979), with a higher gross flow than at any time in the past. The volume of resources allocated in Italy to this type of investment has therefore risen back to levels similar to those recorded before the oil crisis and now the only European country in which it appears to be significantly higher is Germany. In the construction sector the increase in investment was less marked (3.8%) equally in housing and non-residential building and public works.

Unlike previous years, the increase in fixed investment in real terms did not diverge very greatly between private and public firms. After three years of stagnation, public sector investment (up 9.1%) expanded in all sectors and groups of firms with the exception of housing. Specifically, in industry there was a particularly large increase (18.3%), while the rates of growth of investment in market services (9.7%) and of direct investment by general government (7.4%) were more moderate (Table 3).

The formation of domestic saving was insufficient to allow the large volume of fixed investment and the change in stocks to be covered with domestic resources. Notwithstanding the decline in the general government current deficit, private sector saving increased to a much smaller degree than income; as a ratio of GDP the balance on foreign transactions moved from + 1.6% in 1979 to - 2.5% in 1980.

Table 3

**PUBLIC AND PRIVATE GROSS FIXED DOMESTIC INVESTMENT
BY BRANCH 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	
		1980	1978	1979	1980	$\frac{1978}{1977}$	$\frac{1979}{1978}$	$\frac{1980}{1979}$	$\frac{1979}{1978}$	$\frac{1980}{1979}$
AGRICULTURE	4,725	8.3	7.7	7.1	16.8	13.9	23.3	-1.8	1.1	
Private enterprises	4,381	7.8	7.4	6.6	16.9	16.2	19.3	0.2	-2.2	
Public enterprises (1).....	344	0.5	0.3	0.5	15.3	-21.6	115.0	-33.3	77.3	
INDUSTRY	19,536	25.9	27.2	28.8	7.8	25.8	35.7	11.4	16.2	
Private enterprises	14,253	18.4	20.0	21.0	9.9	30.2	34.8	15.3	15.5	
Public enterprises	5,283	7.5	7.2	7.8	3.2	15.1	38.1	1.9	18.3	
MARKETABLE SERVICES (2)	19,319	31.3	31.1	31.8	11.0	22.0	34.0	5.4	12.4	
Private enterprises	14,295	21.8	22.8	23.5	7.8	28.5	35.1	11.0	13.4	
Public enterprises	5,024	9.5	8.3	8.3	19.2	7.1	30.8	-7.5	9.7	
HOUSEBUILDING	17,880	25.6	25.0	23.5	15.3	22.6	30.3	3.0	3.8	
Private enterprises	16,802	23.9	22.8	22.1	19.4	20.1	33.9	0.9	6.7	
Public enterprises (3)	1,078	1.7	2.2	1.4	-22.5	58.0	-8.4	32.4	-26.9	
TOTAL	61,460	91.1	91.0	91.2	11.7	22.6	32.5	5.8	10.2	
Private enterprises	49,731	71.9	73.0	73.2	13.1	24.7	33.1	7.6	10.3	
Public enterprises	11,729	19.2	18.0	18.0	6.7	14.6	30.2	-0.9	10.0	
GENERAL GOVERNMENT	5,968	8.9	9.0	8.8	9.5	23.8	31.1	6.5	7.4	
GROSS FIXED INVESTMENT	67,428	100.0	100.0	100.0	11.5	22.7	32.4	5.8	10.0	
Public sector	17,697	28.1	27.0	26.8	7.6	17.5	30.5	1.4	9.1	

Source: *Relazione generale sulla situazione economica del paese*.

(1) State investment expenditure for land reclamation, improvement of mountain land and forests and intervention in cases of natural catastrophes. — (2) Excluding housing. — (3) Subsidized housing.

Domestic supply

Agriculture

The marketable production of the agricultural sector increased again, despite the return to conditions of low returns similar to those in which Italian farmers had had to operate in earlier periods. There was, however, a slowdown in the expansion of the previous three years: the growth rate recorded was less than half that of 1979 (2.7% compared with 6.1% for gross marketable production at constant prices; Table 4). Consequently, in 1980 agriculture failed to maintain its share of total output as it had succeeded in doing, instead, in the two previous years. In addition to bad weather at crucial moments of the crop cycle, uncertainty about market prospects caused by foreign competition (and especially that of the other EEC countries) was the main reason why better results were not achieved.

Table 4

MARKETABLE PRODUCTION AND VALUE ADDED IN AGRICULTURE

(billions of lire)

	1980				Percentage changes			
	Absolute values		Percentage breakdown		Quantity		Prices	
	Current	1970	Current	1970	1979 1978	1980 1979	1979 1978	1980 1979
Marketable production ...	30,149	8,096	100.0	100.0	6.1	2.7	11.6	14.1
<i>Field and fodder crops</i> ...	9,732	2,610	32.3	32.2	5.1	2.2	12.2	17.8
<i>Tree crops</i>	7,684	1,957	25.5	24.2	11.7	3.7	10.2	8.1
<i>Livestock</i>	11,570	3,290	38.4	40.6	3.9	2.3	11.0	14.3
<i>Forestry and fisheries</i> ...	1,163	239	3.8	3.0	4.3	7.7	18.0	23.0
Intermediate consumption (-)	8,788	2,327	29.1	28.7	6.3	2.2	10.9	18.9
Current transfers (+)	1,213	693	4.0	8.5	6.7	15.1	7.2	2.0
Value added at factor cost	22,574	6,462	74.9	79.8	6.1	4.1	11.5	11.0

Source: *Relazione generale sulla situazione economica del paese.*

The rise in real value added at factor cost (4.1% compared with 6.1% in 1979) was greater than that in marketable output as a result of the substantial increase in current transfers (15.1% at constant prices), which was primarily attributable to those of the EEC. In fact, this increase more than offset the much smaller one in intermediate consumption (2.2%). Investment at constant prices rose even less (by 1.1%, after

falling by 1.2% in 1979). Whereas purchases of machinery, equipment and means of transport rose again (by 2.9% compared with 1.7% the year before), expenditure on land reclamation and improvement and the restructuring of farms declined once more (by 0.8%, after a fall of 4% in 1979). The exodus from agriculture was of much the same size as in 1979 (80,000 units) and its composition was also similar, with the proportion of self-employed workers accounting for respectively 81.2% and 77.2% of the total exodus in the two years.

The growth in the production of all the branches of agriculture, except for forestry and fisheries, slowed down considerably compared with the outstanding results recorded in 1979. The largest falls were those of field and fodder crops and tree crops (respectively from 5.1% to 2.2% and from 11.7% to 3.7%). The growth rate of livestock production, already inadequate in relation to domestic demand, also declined (from 3.9% to 2.3%). There was therefore a further widening of the gap between domestic production and households' consumption of meat, since the latter grew even faster than in previous years (4.3%) and came to account for nearly a third of the total expenditure on food and beverages.

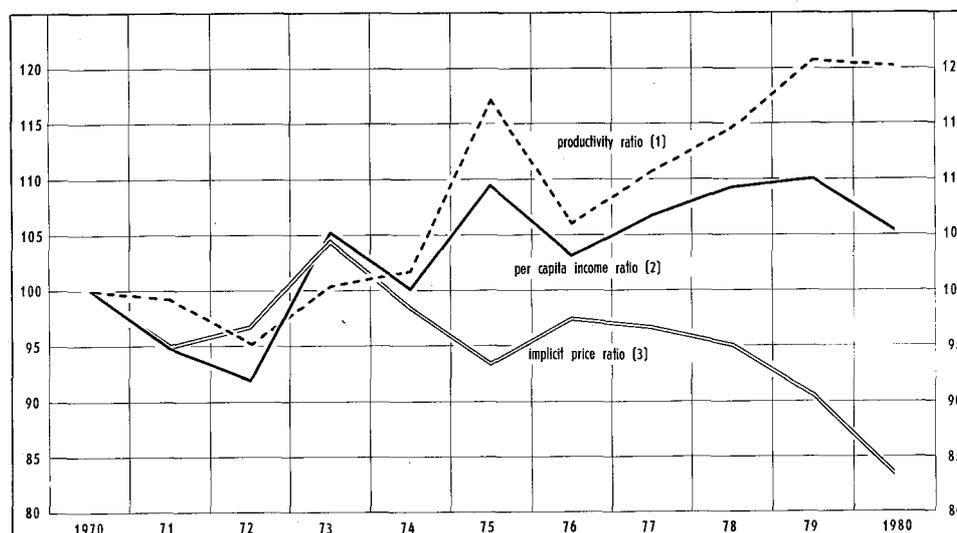
Agricultural producer prices once again made an important contribution to dampening the rising inflation in all the other productive sectors (the rise in the general level of prices, measured by the implicit price deflator of value added, exceeded 20%). When it is considered that the prices of intermediate agricultural consumption (principally feedstuffs, fertilizers, fuel, seeds and pesticides) rose on average by 18.9% (8 points more than in 1979) and those of investment by 22% (6 points more), the increase in the price of gross marketable agricultural production (14.1%) was relatively small, albeit two and a half points more than in 1979.

The curbing of agricultural prices was primarily the result of the price policy pursued by the European Community. On the one hand, the annual negotiation of the prices of the main traded products led to an average increase of less than 5%. On the other hand, partly because the last devaluation of the "green" lira in 1979 (5%) was in December, there was only one relatively small devaluation in 1980 (3.5%). This was in May and closed the residual gap between the agricultural exchange rate and the central EMS rate. Overall, therefore, regulated agricultural prices rose in Italy by not more than 12% on average.

In relative terms the incomes of agricultural workers declined considerably compared with those in the rest of the economy (by more than 4.5 percentage points; Chart 1), whereas the ratio of productivity remained virtually unchanged (- 0.6 points). As for the comparison between implicit prices, which had been unfavourable to agriculture

throughout the 1970s except in 1973, after falling to a record low in 1979 (90.6%), the ratio of agricultural to non-agricultural prices fell by more than ever before (7.3 points).

Chart 1



Ratio of agricultural to non-agricultural income and its components

(indices, 1970 = 100)

Based on Istat data

(1) Ratio of per capita value added at factor cost (at constant prices) in agriculture to that in the rest of the economy. — (2) Ratio of per capita value added at factor cost (at current prices) in agriculture to that in the rest of the economy. — (3) Ratio of the implicit prices of value added at factor cost in agriculture to that in the rest of the economy.

The total trade deficit on agricultural and processed food products at current prices rose from 7,690 billion lire in 1979 to 8,870 billion (more than half the oil deficit) in 1980, thus confirming the structural inadequacy of Italy's food and agricultural system.

In the case of agricultural products, which accounted for nearly two thirds of the total deficit (5,590 billion), domestic production again covered slightly more than 84% of domestic demand, i.e. about six points less than the government's target for the early 1980s. In itself, this target is not exaggerated in the light of Italian agriculture's potential, but nonetheless appears difficult to achieve under present conditions. It should, in fact, be noted that, despite the rapid growth of agricultural production in the last three years, the proportion of demand covered by domestic supply has remained virtually unchanged with no sign of a tendency to improve. Furthermore, the 16% of effective demand that has to be covered by imports increases much more rapidly in lire than in volume.

It will only be possible to raise the degree of the sector's self-sufficiency if there is greater urgency in the implementation of a larger volume of both public and private investment designed to improve production and marketing conditions in the branches of chronic deficit and in those that traditionally fuel exports. Both the central and the regional public authorities can contribute to this process by improving the environment in which farms operate or, in other words, by creating external economies within the agricultural sector through better infrastructures and technical services that will be able to exert a positive influence on costs and on both producer and final prices without the drawbacks that are often inherent in merely financial assistance.

Owing to the historical delay in implementing an organic territorial policy (geological and hydric disasters, pollution and widespread unplanned depopulation, etc.), in changing the institutional framework (land ownership and the systems under which land is farmed, vocational training, technical assistance and forms of association) and in restructuring distribution, these external economies appear to have decreased instead of increasing.

The public authorities must, therefore, show themselves capable of implementing the plans that have already been drawn up, especially by accelerating the completion of the changes foreseen in Law 984 of 1977, the specific purpose of which is to reorganize agriculture at the central and, above all, the regional level. At present, instead, there are difficulties and delays in actually disbursing allocations and, amongst other things, these result in a considerable reduction in the real value of the sums set aside.

Industry

After recording a high rate of growth in 1979, value added in industry again rose substantially — by 4.8% at constant prices (Table 5). This increase was mainly attributable to the manufacturing sector, which expanded by 6.5%, a rate that was very much the same as that of the year before.

The pattern of industrial output in 1980 was, however, different from that of the last few years in two ways. There was a shift on the demand side in the roles played by domestic consumption and exports: the 4% fall in exports of industrial products was more than offset, in fact, by the high level of orders from the domestic market. As for the economic breakdown of production, the supply of investment goods was the fastest growing component and expanded at a rate that was two and a half times that of final consumer goods and six times that of intermediate goods.

Table 5

VALUE ADDED AT MARKET PRICES IN INDUSTRY

	Values at 1970 prices (billions of lire)			Percentage breakdown 1980	Percentage changes		
	1978	1979	1980		1978/77	1979/78	1980/79
VALUE ADDED:							
including construction	33,054	34,910	36,602	100.0	2.1	5.6	4.8
excluding construction	28,118	29,845	31,323	85.6	2.3	6.1	5.0
Manufacturing	23,811	25,400	27,063	73.9	1.8	6.7	6.5
Energy	4,307	4,445	4,260	11.7	5.5	3.2	-4.2
Construction	4,936	5,065	5,279	14.4	0.8	2.6	4.2

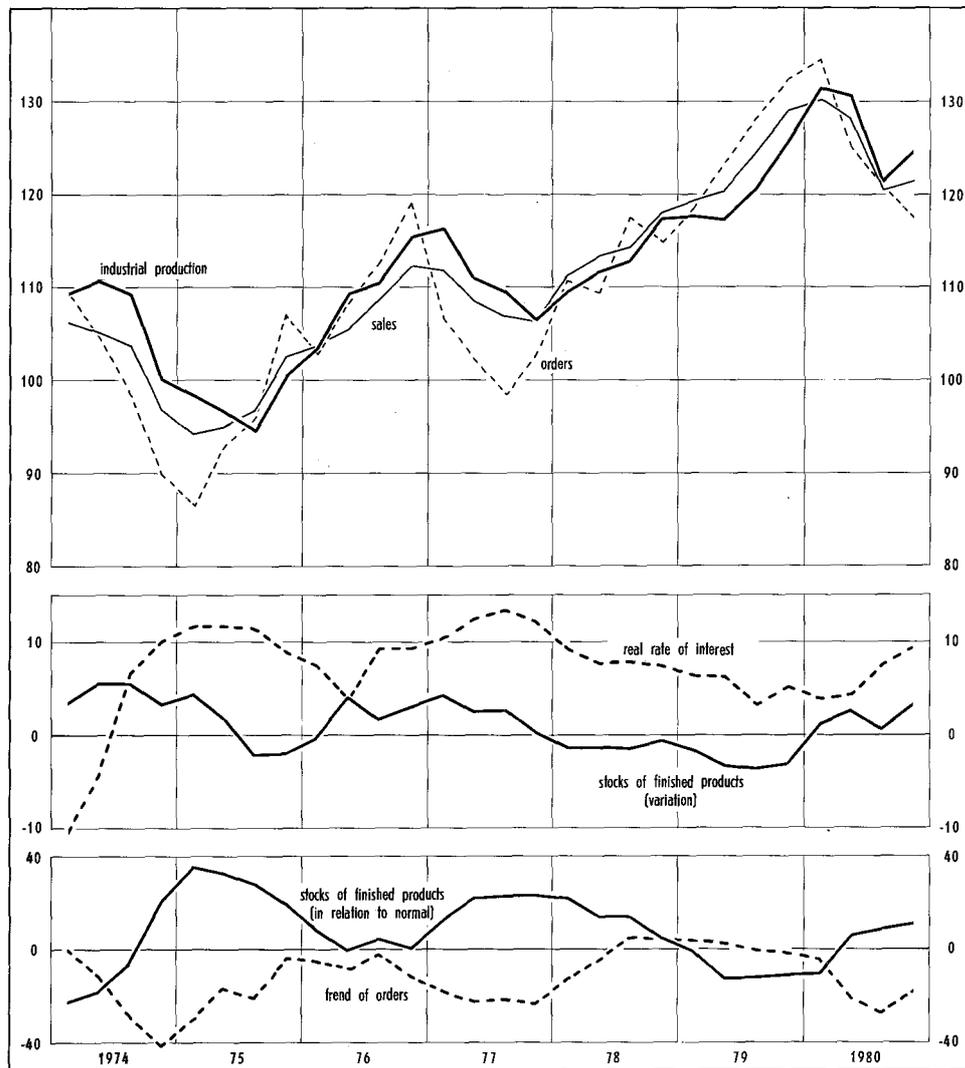
Source: *Relazione generale sulla situazione economica del paese.*

The continuous rise in production recorded in the previous year was also interrupted: the exceptional increase in industrial output that had started in the second quarter of 1979 came to an end in the first quarter of 1980, by which time capacity utilization had risen to a very high level, especially in the consumer goods sector. The second quarter saw the start of a decline in output in every sector except that of investment goods, and this accelerated sharply in the third quarter. There was a partial recovery in the fourth quarter, but the level of productive activity was nonetheless below not only that of the first two quarters of 1980 but also of that of the corresponding period in 1979. During 1980 stocks rose to a higher than normal level and there was a reduction in the backlog of orders, the large growth in which between the second quarter of 1979 and the first quarter of 1980 helped to sustain productive activity and sales for the rest of the year (Chart 2).

During the expansionary phase of the cycle (from 1977-1V to 1980-I), industrial output was not supported to any great extent by a build-up of stocks of finished products as it had been in the previous upturn (from 1975-111 to 1977-I). While orders grew at a very fast rate, firms only raised production gradually so that there was considerable destocking. This can be attributed in part to the strikes of the second quarter of 1979 and in part to the tendency for firms to stabilize the level of production at times of large fluctuations in demand. On the other hand, the exceptional drop in output in August, and more generally in the whole of the third quarter, can be seen as indicating that in the present recessionary phase firms were quicker to match production to rapidly falling demand. The build-up of stocks of finished products by firms

during the recessionary phase in 1980 was probably also slowed down by the rising real cost of money.

Chart 2



Production, sales and orders in industry excluding construction

Source: Based on Istat, ISCO, Banca d'Italia and Mondo Economico data.

The overall increase in production was primarily attributable to that in investment goods (14.4%), with transport equipment recording an especially large rise. The 5.8% growth in consumer goods production was mainly due to the output of durable goods, which rose by 7.3% and confirmed the good results obtained at the level of individual branches in 1979. As for intermediate goods, the overall increase of 2.4% was the result of a 1.8% fall in output for consumption and an .8% rise in that for investment.

After the strikes of the second quarter of 1979, the level of productive activity rose in every sector in an attempt to keep up with the substantial increase in orders and counter the reduction in stocks. Nonetheless, up until the end of the first quarter of 1980, stocks of finished products remained considerably below normal levels and the volume of new orders was much greater than not only output but also sales (Chart 2).

The turning point of the cycle came in the first quarter of 1980. Compared with the low point of 1977, the increase in industrial production was equal to 23.5%. Especially large rises were recorded by consumer goods (29%) and investment goods (32.8%, or 36% if the comparison is extended to the second quarter of 1980, when production in this sector peaked). Unlike previous expansionary phases, the increase in the production of intermediate goods was less marked (16.8%).

The sharp drop in orders in the second quarter gave rise to only a small fall in sales and production, with the latter 0.6% below the level of the first quarter. A rise in stocks and a reduction in the backlog of orders accumulated in the previous quarters combined to limit the fall in productive activity. Investment goods, on the other hand, recorded a further large increase in production and a high level of demand, so that it was the only sector with a below normal level of stocks.

Firms reacted rapidly to the continued decline in demand in the third quarter by reducing production, which, though slightly above the level of the corresponding period of 1979, was 7.2% below that of the second quarter. The expectations of a further fall in orders and the rise in real interest rates resulted in firms lowering the levels of stocks they desired. The size and rapidity of the reduction in productive activity also resulted in a slowdown in the build-up of stocks, which settled, in relative terms, at a lower level than in previous recessionary phases. The fall in output was concentrated in the month of August (- 13.4% compared with July). The partial recovery recorded in September (+ 11.3%) was the first of a series of widely varying monthly results that continued into 1981.

In the last quarter of 1980 industrial production rose by 2.8% compared with the previous quarter, even though the volume of orders again declined. Sales, on the other hand, stabilized at the third quarter level and thus enabled firms to reduce the backlog of orders. Stocks of finished products recorded the largest, albeit not exceptional, increase of the year and, particularly in the case of consumer goods, rose to levels well above those considered normal (Chart 2). This was how firms reacted to the improved short-term expectations regarding demand and offset part of the reduction in productive activity recorded during the

summer. Output was nevertheless below that of the last months of 1979, except for the investment goods sector, which returned to the peak level of the second quarter.

Table 6

INDEX OF INDUSTRIAL PRODUCTION (1)

(1970 = 100)

Period	General index	By sector of destination			By branch of activity		
		Intermediate goods	Final investment goods	Final consumer goods	Mining and quarrying	Manufacturing	Gas and electricity
1978 - average	125.7	123.5	122.4	130.2	94.3	124.6	149.3
I qtr.	122.1	121.2	118.7	124.8	98.5	120.7	146.7
II »	124.5	121.9	121.7	129.5	87.0	123.6	147.7
III »	125.5	122.9	121.9	130.8	92.4	124.5	148.3
IV »	130.5	128.0	127.2	135.5	99.2	129.4	154.7
1979 - average	134.0	129.4	130.8	142.1	101.1	133.2	154.5
I qtr.	131.0	128.3	124.7	137.7	101.5	129.6	157.7
II »	130.4	126.2	124.6	139.2	98.9	129.4	152.9
III »	134.5	130.1	131.4	142.2	102.2	133.7	154.9
IV »	140.1	132.8	142.6	149.4	101.6	140.1	152.5
1980 - average	141.5	132.5	149.7	150.4	97.0	141.2	158.5
I qtr.	146.3	138.3	149.3	156.2	101.2	146.4	158.9
II »	145.5	136.6	153.0	154.7	99.4	145.6	158.0
III »	135.1	125.9	144.4	143.9	90.1	134.4	157.7
IV »	138.9	129.0	152.0	146.9	97.5	138.3	159.5
1981 - I qtr. (2) ..	138.8	128.3	156.8	142.0	100.8	136.9	158.5

Source: Based on Istat data.

(1) Corrected for the different number of working days per month and seasonally adjusted. — (2) Sectoral data refer to January-February.

In the first three months of 1981 the level of productive activity remained virtually unchanged: the increase in the production of investment goods was offset by the decrease in that of consumer goods, while the output of intermediate goods varied only slightly (Table 6).

Services

The almost uninterrupted expansionary trend of the supply of marketable services continued in 1980. Though the rate of growth recorded was higher than the average for the 1970s, it declined slightly compared with the previous year both in terms of value added (from

4.8% to 4.1%, as against an average of close to 3.5% in the seventies; Table 7) and of employment (from 3.0% to 2.4%, as against an average of 1.5%).

Table 7

VALUE ADDED AT MARKET PRICES OF MARKETABLE SERVICES

(billions of lire)

Branch	1980				Percentage changes			
	Absolute values		Percentage breakdown		Quantity		Prices	
	Current	Prices 1970	Current	1970	1979 1978	1980 1979	1979 1978	1980 1979
Distributive trades, lodging, catering and entertainment	51,542	14,095	38.3	40.3	5.9	4.6	16.4	20.2
Transport and communications	21,106	5,907	15.7	16.9	5.2	4.2	16.8	31.3
Finance and insurance ...	20,118	3,737	15.0	10.7	6.6	6.8	10.8	31.3
Miscellaneous services ...	22,377	6,343	16.6	18.1	4.1	3.3	13.7	19.7
Marketable services, excluding lettings	115,143	30,082	85.6	86.0	5.4	4.5	15.1	24.0
Lettings	19,314	4,878	14.4	14.0	1.4	1.8	19.9	18.8
TOTAL ...	134,457	34,960	100.0	100.0	4.8	4.1	15.8	23.2

Source: *Relazione generale sulla situazione economica del paese.*

The value added at market prices of services excluding lettings grew in 1978 and 1979 at very much the same rates as households' consumption (respectively 5.4% and 4.5%, compared with 5.3% and 4.4%), thus confirming the influence exerted by the latter. Employment in private services showed a larger increase for the self-employed (86,000) than for employees (72,000), above all because self-employment in the distributive trades, lodging, catering and entertainment branch expanded considerably.

This change in the size and composition of employment had a negative effect on the sector's average productivity, which rose by less than 2.0% (2.5% in 1979), compared with industry's 4.8% and agriculture's 2.3%. There was, on the other hand, a marked improvement in the sector's investment performance, both because the overall rate of growth doubled (from 4.3% to 8.6%) and, above all, because of the upturn in the transport and communications branch (+ 9.6%, as against - 5.0% in 1979), where the scope for applying technical progress is greatest.

Households' domestic consumption rose less than total domestic demand and only boosted final demand in the case of health services (+ 10.6%) and communications (+ 7.2%).

The rate of increase in prices nonetheless showed no signs of slowing down; on the contrary, there was a sharp acceleration compared with the already fast pace recorded in 1979, both for the sector as a whole (from 15.8% to 23.2%, up 7.4 percentage points) and to an even greater extent for services excluding lettings (from 15.1% to 24.0%, up no less than 8.9 points). The gap between the rate of inflation in the services sector and those in the other two major sectors thus grew even larger: the increase in the implicit prices of value added rose from 15.1% to 19.4% in industry and only from 11.8% to 12.3% in agriculture. The largest rises occurred in the transport and communications and finance and insurance branches (31.3% in both), as a result of large increases in utility charges and bank lending rates respectively. Rents rose relatively less rapidly (18.8%) because they are only partially indexed under the terms of the "fair rent" law of 1978. The other branches of services recorded increases that were only slightly below the average for the whole sector (20.2% the distributive trades and 19.7 % miscellaneous services).

Owing to the increase in prices, which more than offset the poor improvements in productivity, total and per capita incomes rose more than in 1979 (28.1% and 24.9% compared with 22.4% and 18.9%) and more than in industry (24.4% and 23.5%).

Growth in the largest branch of services (distributive trades, lodging, catering and entertainment) slowed down from 5.9% to 4.6% in terms of value added at constant prices. This was due to the rather poor results of the tourist and hotel trades rather than to any weakening in the wholesale and retail trades. Transport and communications also registered an, albeit slight, downturn in their rate of expansion from 5.2% to 4.2%. Insurance services showed no real growth, but benefitted from the 22% increase in prices. Because of the limited increase in the stock of residential and non-residential buildings, and despite the pressure of demand, the lowest rate of growth was that for actual and imputed rent (1.8%).

Energy

After increasing at an annual average rate of 3% in the two preceding years, domestic demand for primary sources of energy decreased in 1980 by 1.5%. This result was achieved despite an increase in GDP (4%) that was similar to the average for 1978 and 1979. The fall was mainly due to the reduced consumption of oil products, which was partly offset by greater recourse to coal. Net imports of solid fuels rose by 14.3%, those of oil and oil products fell, instead, by 3.4% as a result of a decline in imports of oil, despite a sharp contraction in exports of oil

products (Table 8). The substantial increase in the price of oil (around 70%) that came on top of the already large one recorded in 1979 (34%) caused the oil balance to show a deficit of 17,573 billion lire (4.1% of GDP, compared with 2.9% in 1979).

Table 8

SOURCES AND USES OF ENERGY

(millions of TOE)

Sources and uses	1979					1980				
	Solid fuels	Natural gas	Oil	Electric power (1)	Total	Solid fuels	Natural gas	Oil	Electric power (1)	Total
Production	1.1	11.1	1.7	11.7	25.6	1.1	10.3	1.8	11.5	24.7
Imports	10.3	12.1	122.9	1.7	147.0	11.7	11.9	108.8	1.7	134.1
Exports (—)	0.5	—	22.9	0.5	23.9	0.5	—	12.2	0.4	13.1
Changes in stocks (2)	+0.4	—0.3	+0.4	—	+0.5	+0.2	+0.6	+0.4	—	+1.2
Domestic uses of primary sources (3)	11.3	22.9	102.1	12.9	149.2	12.5	22.8	98.8	12.8	146.9
<i>Percentage breakdown</i>	<i>7.6</i>	<i>15.4</i>	<i>68.4</i>	<i>8.6</i>	<i>100.0</i>	<i>8.5</i>	<i>15.5</i>	<i>67.3</i>	<i>8.7</i>	<i>100.0</i>
Transformation into electric power	—3.5	—2.4	—21.9	+27.8	—	—4.2	—2.1	—22.8	+29.1	—
Consumption and losses (—)	2.1	0.3	8.0	6.4	16.8	2.2	0.3	7.1	6.6	16.2
Domestic uses of final sources (3)	5.7	20.2	72.2	34.3	132.4	6.1	20.4	68.9	35.3	130.7
<i>Percentage breakdown</i>	<i>4.3</i>	<i>15.3</i>	<i>54.5</i>	<i>25.9</i>	<i>100.0</i>	<i>4.7</i>	<i>15.6</i>	<i>52.7</i>	<i>27.0</i>	<i>100.0</i>
Industry	4.5	9.3	17.0	20.5	51.3	4.8	9.0	16.3	21.0	51.1
Transport (3)	—	0.3	29.4	1.0	30.7	—	0.3	29.0	1.0	30.3
Other energy uses ...	0.9	8.4	20.4	12.8	42.5	1.0	9.0	18.7	13.3	42.0
Non-energy uses	0.3	2.2	5.4	—	7.9	0.3	2.1	4.9	—	7.3

Source: Figures are based on data from the *Relazione generale della situazione economica del paese*.

(1) Calculated on the basis of a conventional and constant thermoelectric input of 2,200 Kcal per kWh; the difference between this and actual input (2,173 in 1979 and 2,175 in 1980) is offset under "consumption and losses". — (2) Minus (—) shows an increase in stocks; plus (+) a reduction in stocks. — (3) Including international maritime bunkers (5.1 million TOE in 1979 and 4.3 million TOE in 1980).

The demand for final sources of energy declined in every sector except transport. Excluding maritime bunkers from the calculation, the consumption of this sector rose by 1.5% as a result of the greater demand for petrol (1.2%) and diesel oil (2.5%). The absolute fall in industry's consumption was small (0.4%), but was considerable in relative terms in view of the substantial (5.5%) increase in production in 1980. In fact, the 6.7% increase in production in 1979 was accompanied by a 3.4% rise in energy consumption. The energy consumed by the other

sectors (households, agriculture and services) fell by 1.2% (+ 1% in 1979), mainly as a result of the contraction in the demand for oil products for heating (- 8.3%), which was due in part to a shift to natural gas. Both in these sectors and in industry there was an increase in the consumption of electricity, albeit smaller than that of the year before (2.9% as against 4.6%).

Production of electricity expanded by 2.7%, compared with 3.5% in 1979. The contribution of primary sources such as hydro and nuclear power declined further, the former because of the lower level of water supplies and the latter because of maintenance work at two power stations. The increased demand for electricity was satisfied through an increase in traditional thermoelectric production, with greater use of both coal and oil, as well as through greater net imports (up 13%).

Between 1974 and 1980 there was an overall reduction in the energy demand elasticity with respect to GDP. Total consumption increased at an average rate of 0.7% per year, compared with a GDP growth rate of 2.9%, so that the energy elasticity was equal to 0.24, as against 1.6 in the period 1960-1973. The consumption of oil products declined considerably (- 1.7% per year on average) as a result both of the steps taken, mainly spontaneously, to reduce waste and of the policy aimed at replacing oil with other forms of energy, primarily natural gas.

Industry is the energy-consuming sector that reacted most effectively in the period 1974-1980: its consumption increased on average by 0.3% per year and its production by 3.2% (in the period 1967-1973 the corresponding values were respectively 6.2% and 5.5%).

The shares of energy consumption accounted for by the transport sector and that made up of households, the distributive trades and agriculture increased, respectively by 1.2 and 2.1 percentage points compared with 1973, to a total of 55.3%. Nonetheless, both these sectors recorded lower rates of growth in the period 1974-1980 than in the years before the first oil crisis (approximately 2% per year, as against 7%).

The curbing of the consumption of energy and especially the reduction in the use of oil products have been encouraged by the substantial rise in their domestic prices. According to OECD estimates, the final user price of energy in Italy more than doubled between 1973 and 1980 compared with the general price index, whereas in the other major industrial countries it only rose by 60%. The actual size of the increase varied from fuel to fuel: the prices of diesel oil and petrol rose by 22.8% and 39.1% respectively, while those of oil for heating and fuel oil for industry rose by 265.2% and 225.9%. The rise in prices did not take place gradually since it was primarily due to the large increases in 1974 and 1979-1980. In the

intervening period the price of diesel oil actually fell (by 9.1% per year on average), while those of petrol, oil for heating and fuel oil only rose moderately (respectively by 0.9%, 3.8% and 5.8%). The much larger increase in the price of energy in the industrial sector was due in part to the lower incidence of tax on the price of fuel oil, which makes the domestic price more sensitive to changes in the import price of oil.

The domestic production of primary sources of energy remained at the same level throughout the period, except for a peak in 1977 caused by a record production of hydroelectricity. Less progress was made in diversifying the country's sources of energy than had been foreseen in the successive national energy plans that were drawn up. The proportion of consumption accounted for by oil did decline by 7 percentage points as a result of the shift to natural gas and, in the last two years, to coal. It is nonetheless still over 67%, a figure that inevitably implies growing balance-of-payments deficits as the price of oil is increased. Furthermore, the Italian economy's dependence on imported energy is still around 81%, virtually unchanged compared with the early seventies, since the alternative sources of primary energy that have been adopted also have to be imported.

The 7.6% reduction in net imports of oil between 1973 and 1980, compared with a 74% increase in the seven previous years, is proof of the effort made by the Italian economy to adjust to the new energy situation. To date the adjustment has been mainly on the side of demand, which has been influenced both by the slowdown in growth and, above all, by the large increases in the relative prices of energy. Compared with other countries, and bearing in mind the lower initial level of per capita consumption, a considerable, albeit not sufficient, curbing of consumption has been achieved.

On the other hand, very little progress has been made on the supply side. The policy of diversification has so far been limited to increasing imports of natural gas. These have now reached a very high level but only represent a partial solution to the security, cost and balance-of-payments problems associated with oil supplies. The plans for the development of nuclear energy and greater use of coal are still in their early stages, whereas in other countries with less critical energy positions they are being actively implemented.

Since Italy possesses neither the oil and natural gas resources of the United Kingdom and the Netherlands nor the industrial strength of Japan and Western Germany, the country that can most usefully serve as a model is France. The scope for economic growth therefore depends to a

large extent on the rapidity with which past delays are made good and the plans for developing alternative sources and promoting conservation implemented. With regard to the latter, various estimates show that there is still considerable potential for energy saving in Italy, as in the rest of Europe, in view of the scope for widespread adoption of behaviour patterns and available technologies that allow consumption to be minimized for a given standard of living and level of production. In this way it would be possible to achieve savings of up to 25% in the industrial sector, up to 40% (15% in the short run) in the household and distributive services sector, and up to 30% (15% in the short run) in the transport sector. Among the objectives of the new national energy plan shortly to be submitted to Parliament is the achievement of energy savings of 20 million tons of oil equivalent per year by 1990, through measures to curb and control consumption, fiscal provisions and financial incentives, for which allocations of the order of 1,000 billion lire are foreseen.

Realization of the plan's aims will require both a consistent price policy, so as to encourage the necessary changes in the demand for and supply of energy, and effective intervention by the State in the major sectors in which it is directly or indirectly involved. The huge volume of public and private investment that will be necessary offers the possibility of supporting growth in a non-inflationary manner, since it will reduce dependence on imports and strengthen the country's productive structure by improving its technological content. However, since the effects of this investment will only be felt in the long run, so that the Italian economy will continue to be dependent on oil for a long time to come, it is necessary that Italy should act in the international organizations of which it is a member, to promote the security and stability of oil supplies and to keep down their cost.

Employment, wages, prices and the distribution of income

Employment

During the year employment rose by 183,000 units, one of the largest increases since the beginning of the 1970s (Table 9). The growth in productive activity led to an increase in labour demand that continued throughout the year but the start of the cyclical downswing caused a large rise in the number of underemployed in the third and fourth quarters (5.6% and 16.5% compared with the previous year).

Again in 1980, the upward trend of employment was largely attributable to the services sector (up 209,000 units or 2.1%). The rate of

increase in marketable services was higher than in non-marketable services (2.4% and 1.5% respectively) owing to the fact that the public administration's recruitment policy since the mid-1970s has greatly curtailed the expansion of employment in the latter, with annual growth rates declining from close to 4% in 1970-75 to between 1.5% and 1.8%.

Table 9

EMPLOYMENT IN ITALY

(percentage changes on previous year)

Sector	Total employment				Employees			
	1977	1978	1979	1980	1977	1978	1979	1980
Agriculture	-2.3	-1.1	-2.7	-2.8	-1.1	-2.3	-1.6	-1.4
Industry	-0.1	-0.3	0.2	0.7	-0.2	-0.6	0.2	0.4
<i>of which: energy products</i>	-0.2	-0.1	0.5	1.6	-0.2	-0.1	0.5	1.5
<i>products of industrial processing</i>	0.1	-0.8	0.3	0.6	0.1	-1.0	0.5	0.2
<i>total industry excluding construction</i>	0.1	-0.7	0.3	0.6	0.1	-1.0	0.5	0.3
<i>construction</i>	-0.8	1.1	-0.2	1.1	-1.3	0.8	-0.5	0.8
Marketable services	2.0	2.2	3.0	2.4	2.4	2.4	4.4	2.0
<i>of which: distributive trades, lodging, catering and entertainment</i> ...	1.6	1.8	3.1	2.0	2.2	1.4	5.3	0.7
<i>transport and communications</i> .	1.0	0.6	0.6	1.6	0.8	0.4	1.1	1.7
<i>finance and insurance</i>	5.0	3.7	4.2	4.4	4.9	3.6	4.3	4.5
<i>miscellaneous services</i>	3.5	4.5	4.4	3.7	3.5	6.1	6.4	3.8
Marketable goods and services	0.3	0.5	0.7	0.8	0.5	0.2	1.4	0.7
Non-marketable services	1.8	1.8	1.5	1.5	1.8	1.8	1.5	1.5
TOTAL ...	0.5	0.7	0.9	0.9	0.8	0.5	1.4	0.9

Source: Istat.

In agriculture the employed labour force continued to decrease at a similar rate to 1979 (2.8% instead of 2.7%). However, the number of employees declined less than that of self-employed workers (1.4% and 3.7% respectively), thus emphasizing the link between income and employment in other sectors of the economy and the outflow of self-employed workers from agriculture.

In industry as a whole employment rose by 54,000 units (0.7%), being the result of divergent trends in the various branches. In industry excluding construction the increase of 0.6% was about half that in construction (1.1%). Divergences were even greater during the year: in construction there was an intake of labour throughout the whole of 1980, while in the rest of industry the number of employed began to fall, albeit to a limited extent, in the second quarter. The main effect of the reversal

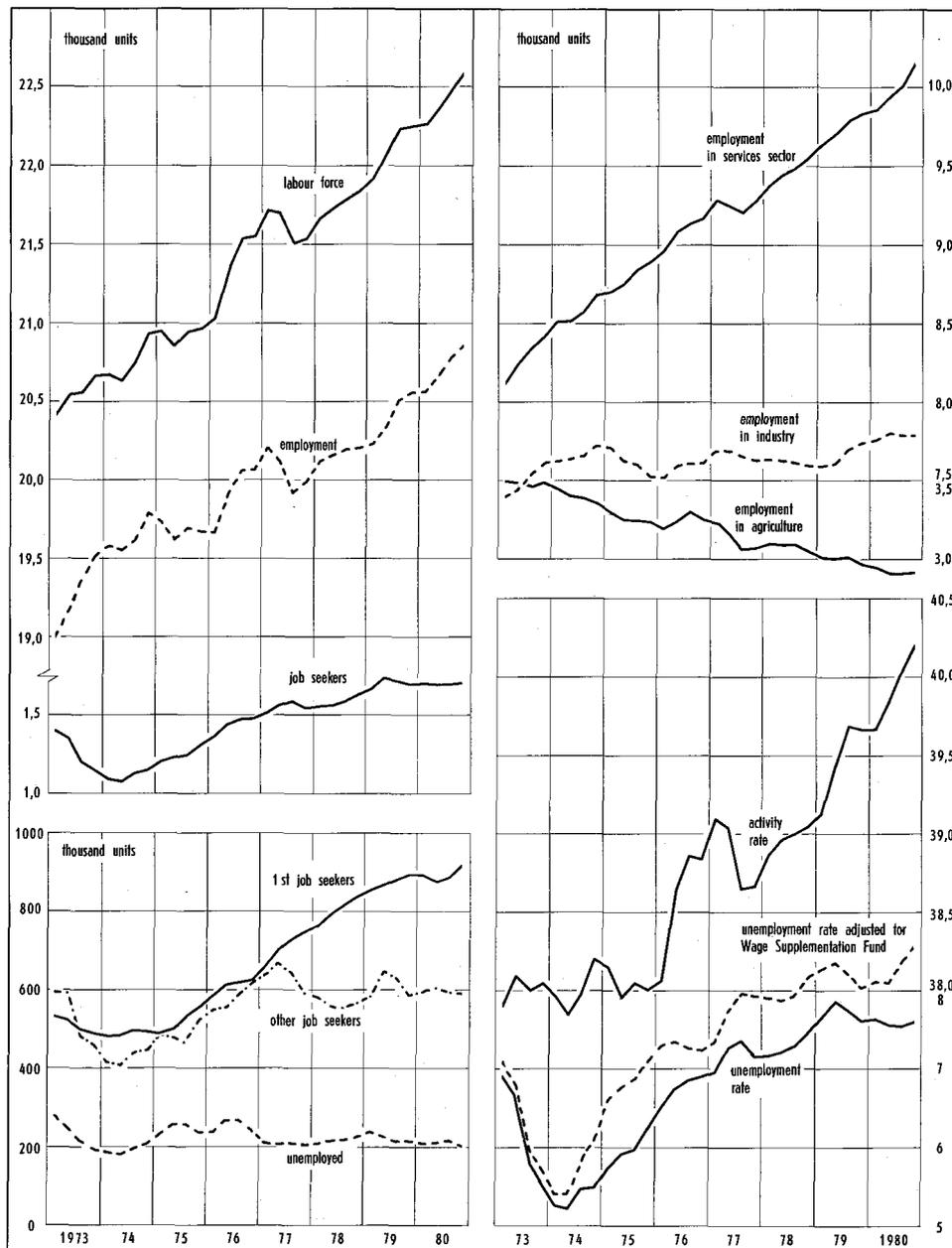
of the cycle was an increase in the number of hours paid by the Wage Supplementation Fund: in industry (excluding construction) the number of hours paid, which had fallen by 42% in 1980-I compared with 1979-I, increased one and a half times in the last quarter of the year. In construction, on the other hand, recourse to wage supplements decreased considerably, showing the usual lag with which this sector follows the cycle of the rest of the economy.

Per capita productivity in industry excluding construction increased by 4.3%, a rate only slightly below that of 1979. The increase was instead equal in the two years (about 5%) if calculated in terms of the number of workers actually engaged in production, being the difference between total employment and the estimated number of full-time workers corresponding to the hours paid by the Wage Supplementation Fund. In fact, in the last two quarters the number of workers corresponding to the hours paid was about 190,000 and 220,000 respectively, which is equivalent to 3.7% and 4.4% of total employment. These peaks were above even the exceptionally high levels recorded in 1975, during a much deeper and more lasting recession.

The increase in hourly productivity was little over 3%, about half that of the previous year, largely due to a moderate rise in the first half-year, as is usual in periods of heavy pressures on capacity utilization. In the second half the fall in productivity was curbed by the considerable reduction in hours worked, which nonetheless, on average for the year, increased slightly in all firms with over 50 employees.

The labour force, calculated on the basis of the Istat survey, increased by around 300,000 units (1.3%), raising the activity rate from 39.4% of the total population to 39.9%. This phenomenon had little connection with demographic factors, as demonstrated by the fact that the increase in the labour force between 14 and 70 years old was larger than that in the population of the same age group (1.4% and 0.6% respectively). Despite the growth of the labour force, the unemployment rate showed no increase at around 7.6%, although in the second half of the year there was a rise in the number of job seekers (Chart 3).

Although the unemployment rate remained stationary in Italy during a year when employed labour was declining throughout the main Western countries, it continued to be considerably higher in the South and among young people and women. Notwithstanding the great improvement in female employment figures since 1973, the unemployment rate among this section of the population is still nearly three times that for men, even though the participation rate is about 50% lower. The proportion of job seekers in the 14-29 age group has been increasing rapidly in recent years and in 1980 represented over three quarters of the total. In the South the



Labour force, sectoral employment and job seekers

Source: Based on seasonally adjusted data from Istat, Ministry of Labour and National Social Security Institute

unemployment rate reached 11.5% (20.2% for women), compared with 5.1% in the North and 7.4% in the central regions, having increased since 1978, during the very years in which the growth in income and employment was greatest. The problem is made worse by the fact that

while the population growth is declining sharply in other parts of Italy, in the South it is still high and only falling slowly.

Among those seeking employment there was a drop in the number of unemployed in the narrow sense (6.6% compared with the previous year) and in other job seekers (1.3%), while the number of people seeking their first job increased again, albeit at a lower rate than in previous years. Hence there was a further decrease, to 12.5% of the total, in the percentage of unemployed in the narrow sense, the number of which has varied only very slightly in recent years. These trends were confirmed in the last two quarters of 1980: notwithstanding a considerable fall in output, unemployment did not increase to any large extent and the adjustment was made instead in the number of hours worked. If the number of workers corresponding to the hours paid by the Wage Supplementation Fund is added to that of job seekers, the unemployment rate shows a rapid increase in the fourth quarter, 1 point higher than the rate as usually calculated (8.6% instead of 7.6%).

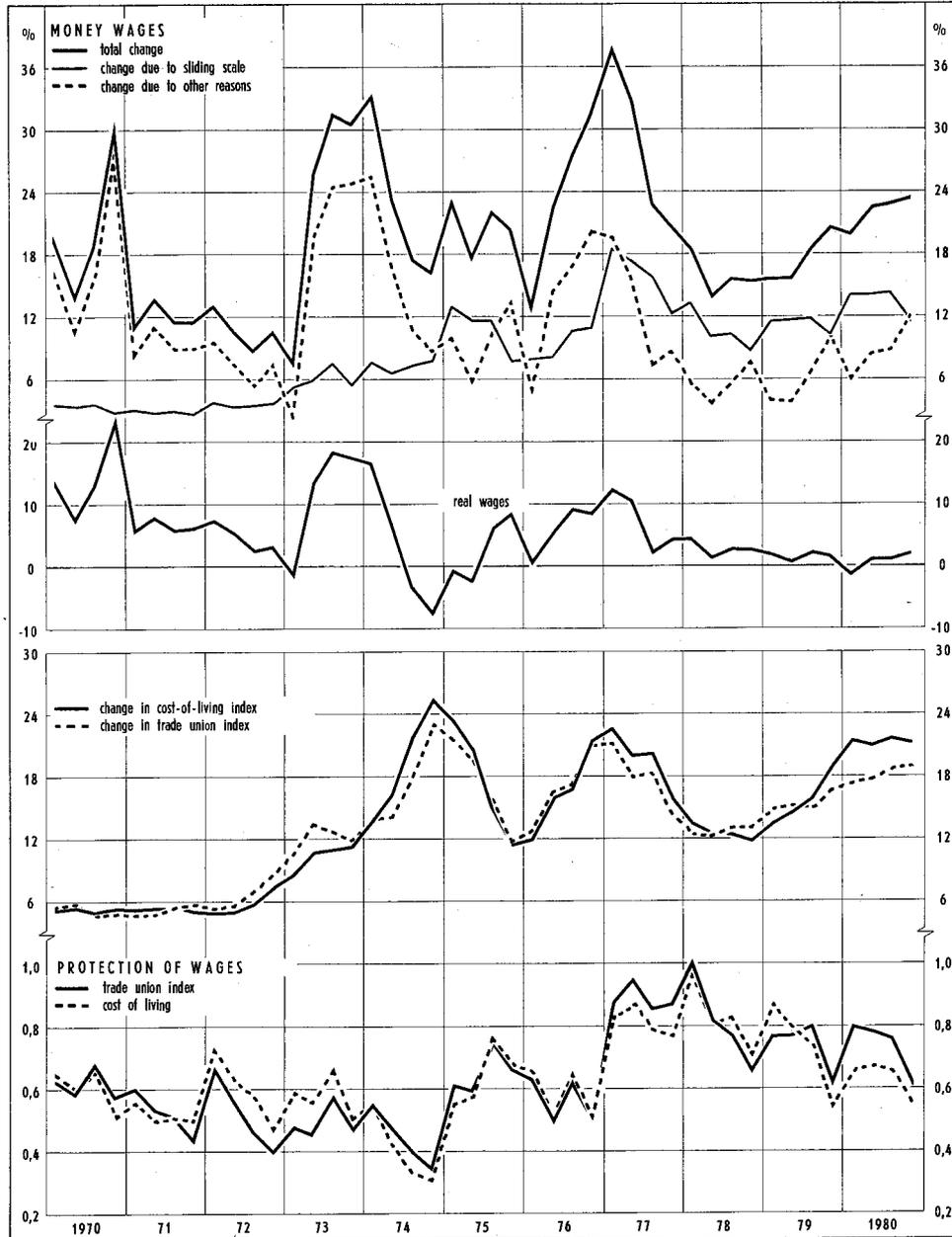
Wages

After the renewal in 1979 of the labour contracts for the main sectors of industry (except foodstuffs, which always has a lag of a few months), in 1980 trade union activity was concentrated in the transport sector, craft industry and the public sector and on the renewal of supplementary company contracts. Overall, a total of 5.5 million workers were affected by the national labour negotiations under way. The number of hours lost through strikes was little over 75 million, compared with 159 million in 1979, the only exception to the generalized decrease being the foodstuffs industry and electricity, gas and water companies. Supplementary company-level contracts were concluded in the early part of the year without excessive strife, probably owing to the favourable cyclical phase. These contracts granted wage increases of between 40,000 and 60,000 lire per month.

Greater difficulties were encountered in the renewal of the 1979-81 contracts for employees in the public sector (including hospitals, local and regional authorities, schools, the civil service and State monopolies) and in the Post Office and telephone company (for the period 1976-79). In the sectors in which provisional agreements were reached, the effects were staggered up to 1982. In most cases the pay rises awarded during the year amounted to about 10,000 lire per month back pay for 1979 and about 40,000 lire per month for 1980. In addition, public sector employees also obtained payment of sliding scale increases on a three-monthly basis.

Following the trend that had emerged in 1979, contractual wage rates continued to rise at an increasingly fast pace. This can be ascribed both to the surge in the rate of inflation, and consequently larger cost-of-living

Chart 4



Per capita money and real wages, cost of living and protection provided by the sliding scale in industry excluding construction
(percentage changes from same quarter of previous year; percentage protection)

Note: Real wages are calculated as the ratio between money wages and the cost-of-living index. The protection of wages is calculated as the ratio between the change in wages due to the working of the sliding scale and the change in the corresponding price index.

increases awarded (38 points compared with 28 in 1979), and to the implementation of certain clauses of the contracts signed in 1979 and 1980. Whereas in industry as a whole the rise in wages was 21.7% (0.4% in real terms) and in agriculture 22.9% (1.4% in real terms), the highest increases were granted in the services sector, and in particular in the public sector. In fact, the average increases in the earnings of employees in education and general government were 2.4% and 2.9% respectively in real terms, while hospital workers received an average rise of 2.1%, or 8.4% from December 1979 to December 1980. On the other hand, in the sectors not involved in the contract renewals real wages remained unchanged or even declined. Specifically, white-collar workers in industry, finance and insurance, lodging and catering and blue-collar workers in the electricity and gas industries experienced decreases in real contractual pay of between 2.5% and 3.5% (Chart 4).

The extent to which gross annual earnings are protected by the sliding wage scale, measured as the ratio of their percentage increase due to the cost-of-living allowance to the percentage increase necessary to keep them unchanged in real terms between 1979 and 1980, was 73.5% in industry excluding construction on the basis of the trade union index; if the change in the cost-of-living index is used instead, the degree of protection falls to 63%. The degree of protection of 1980 earnings in 1981 will depend on the trend of prices during the year; assuming that the annual average rate of increase is similar to that in 1980, the protection of earnings in industry excluding construction should be more or less the same as in the previous year, thus breaking off the decline of the last few years caused by rises in real earnings and, more importantly, the upsurge of inflation.

The cost of labour per unit of output in the private sector increased by 17.1%, a rate over two fifths higher than in 1979. This upswing can be put down to a fall in the growth rate of productivity per worker (from 4.7% in 1979 to 3.6%) and to a marked rise in that of labour costs per worker (from 17.1% to 21.3%). Unlike 1979, it was industry that recorded the smallest rise in the cost of labour per unit of output, nonetheless up from 10.7% to 16%. In manufacturing, in particular, a 20.8% rise in labour costs per worker and a 5.9% improvement in productivity per worker pushed the unit labour cost up by slightly over 14%. In agriculture labour costs per unit of output rose by 17%, while the services sector (excluding lettings) recorded the highest increase (19%) for the second year running.

Prices

The average yearly increase in wholesale prices in 1980 was 20% (17.1 % during the year), one of the highest of the past thirty years with the exception of 1974 and 1976 (respectively 40.7% and 22.9%; Table 10). It had, in fact, been accelerating since the beginning of 1979, when the effects of rises in the price of oil and other industrial raw materials, in a period of buoyant demand, had led to widespread inflation expectations.

Table 10

WHOLESALE PRICES

(percentage changes in indices, until 1980, 1976=100, from 1981, 1980=100)

Indices	1979	1980	Dec. '79	Dec. '80	Mar. '81	June '80	Dec. '80	Mar. '81
	1978	1979	Dec. '78	Dec. '79	Dec. '80	Dec. '79	June '80	Dec. '80
Istat	(on a yearly basis)							
General index	15.5	20.0	21.1	17.1	4.9	19.3	13.6	19.6
Classification by origin:								
Agricultural	12.3	10.8	16.1	8.9	6.8	3.3	14.3	27.2
<i>of which: only imported</i>	-0.2	7.5	14.1	-4.2	4.3	-0.8	-7.7	17.3
Non-agricultural	15.9	21.3	21.8	18.2	4.6	21.4	13.5	18.4
Classification by product:								
Food	10.5	12.4	13.7	11.7	4.9	7.2	15.6	19.5
vegetable	13.4	8.9	14.1	8.4	8.6	6.1	10.4	34.6
animal	10.3	14.5	20.0	9.8	3.1	-2.1	22.0	12.5
food manufactures	9.2	13.5	12.0	13.8	3.5	10.0	16.7	13.8
Industrial raw materials and manufactures	17.5	23.0	24.1	19.2	4.9	23.9	12.9	19.6
raw materials	25.0	24.4	33.1	18.0	6.6	25.0	9.9	26.6
manufactures	14.4	22.5	20.4	19.7	4.1	23.4	14.3	16.5
manufactures (excluding oil products)	14.5	19.9	19.1	17.0	4.0	19.9	12.9	15.8
Classification by use:								
Consumer goods	11.7	17.1	16.1	16.3	4.1	15.3	16.1	16.3
Capital goods	12.4	18.3	14.8	17.3	5.6	20.5	12.8	22.3
Producer goods	19.5	22.8	27.0	17.7	5.2	22.2	11.9	20.8

Source: Based on Istat data.

In the early months of 1980 inflationary pressures were aggravated by a further rise in the price of crude oil and by steep increases in quotations of industrial raw materials on all the main exchanges, while the continuation of the cyclical upswing allowed firms to pass their increased costs rapidly and more than proportionately onto final prices. Wholesale prices rose by 3.3% in January and an average 6.6% in the first quarter.

During those same three months the prices of industrial raw materials increased by 8.9% and of manufactures by 6.1%.

Subsequently, as the rises in raw materials prices and in unit labour costs began to slow down, the latter mainly owing to satisfactory productivity gains, the rate of increase of wholesale prices began to slacken: from 29.1% on an annual basis at the beginning of the year it dropped to 9.5% in the summer, although for manufactures it remained three points higher. The slowdown ended in the last quarter of the year, when the lira's progressive depreciation against the dollar and the slackening of domestic activity placed new pressures on firms' unit costs and led to another surge of inflation. In the winter months wholesale prices, of all goods as well as of manufactures alone, again began to record rates of increase of around 1.5% per month.

The average yearly increase in the prices of industrial materials was 24.4%, which is close to the figure for 1979 (Table 10). The downward movement during the year (25% and 9.9% on a yearly basis in 1980-I and 1980-II), reflected the timing of changes in world market prices. The largest increases occurred in crude oil (72.5% on average) and oil products (44.9%).

The prices of manufactures increased by an average of 19.9% for the year (22.5% if oil derivatives are included) and by 17% in the twelve months (19.7%; Table 10). As already mentioned, owing to the favourable cyclical phase firms were able to base their pricing policies on profit maximization on the domestic market, particularly during the first half of the year. For the second year running, food prices had a dampening effect on inflation. They in fact increased by little more than half (12.4%) the rise in the general index of wholesale prices, mostly in the second half of the year at the beginning of the marketing seasons for EEC-regulated products. The rise in food prices, therefore, was equal to the maximum permitted increase in agricultural incomes, in accordance with the decisions taken by the Community authorities concerning the devaluation of the green lira (5% and 3.5% respectively in December 1979 and May 1980) and increases in agricultural prices in EUAs (5% in May 1980).

Since the period immediately after World War II there had not been such a large increase in consumer prices in Italy as that recorded in 1980: the average yearly increase was 21.2% (21.3% during the year; Table 11), which is two points higher than in 1974. The fact that the impact of the second oil crisis on consumer prices was both severer and more immediate was due to the prompter adjustment of public utility charges and administered prices and to the particular demand conditions which allowed gross profit margins on retail goods to be increased.

Table 11

RETAIL PRICES AND COST OF LIVING

(percentage changes in indices, until 1980, 1976 = 100, from 1981, 1980 = 100)

Indices	1979	1980	Dec. '79	Dec. '80	Mar. '81	June '80	Dec. '80	Mar. '81
	1978	1979	Dec. '78	Dec. '79	Dec. '80	Dec. '79	June '80	Dec. '80
	(on a yearly basis)							
RETAIL PRICES								
General index	14.8	21.2	18.8	21.3	5.3	19.7	20.8	21.3
Food	13.3	15.6	14.4	17.0	5.0	15.0	17.7	20.0
bread and cereals	13.9	26.7	19.3	24.2	5.7	28.8	17.1	22.8
sugar	11.7	15.7	15.9	11.8	0.4	1.7	21.9	1.5
meat	11.1	19.0	14.2	19.2	3.8	19.0	17.7	15.3
fish	16.7	22.3	20.1	21.3	7.3	23.2	17.4	29.1
Non-food products and services	15.8	24.7	21.6	23.8	5.5	22.4	22.6	21.9
clothing and footwear	13.9	20.7	18.6	19.7	3.2	16.9	20.7	12.9
medical care and health	12.6	20.7	14.1	26.6	8.9	17.4	32.9	35.7
furniture, furnishings, equipment and services for domestic use	12.7	20.7	16.5	21.3	4.8	22.7	17.8	19.2
fuel and electricity	18.5	51.1	36.7	39.2	6.9	43.5	28.7	27.6
<i>liquid fuel</i>	26.3	61.5	58.3	38.8	7.1	55.7	17.2	28.4
<i>gas</i>	14.5	36.9	24.6	33.1	11.7	32.8	28.7	46.7
<i>electricity</i>	10.6	45.0	17.0	44.4	2.2	30.0	51.2	8.6
housing	27.8	20.5	33.0	20.9	3.7	22.9	17.0	15.0
<i>rents</i>	28.6	20.3	33.9	20.8	3.4	22.7	17.1	13.4
transport and communications	15.4	24.4	24.5	21.0	4.4	21.0	18.9	17.7
<i>cars</i>	18.0	15.7	18.9	11.7	3.3	16.5	6.4	13.1
<i>State Railways</i>	15.3	20.6	21.3	10.1	0.1	—	20.3	0.4
<i>petrol and lubricating oil</i>	8.6	32.8	21.1	38.9	2.3	32.8	38.7	9.2
recreation, entertainment, education and cultural services	13.2	18.6	17.1	21.5	5.9	16.6	24.4	23.8
Non-food products	15.0	28.1	23.4	24.7	3.9	24.1	22.6	15.6
Services	16.6	20.6	19.5	22.6	7.7	20.4	22.6	30.8
COST OF LIVING								
General index	15.7	21.1	19.8	21.1	5.2	19.4	20.7	20.7
Food	13.7	14.7	14.2	16.4	5.0	13.4	18.3	20.0
Clothing	14.1	19.5	18.2	18.9	5.2	15.8	20.4	21.0
Electricity and fuel	19.7	51.4	38.7	38.3	7.6	42.4	28.3	30.6
Housing	25.4	19.1	31.1	18.7	4.8	19.2	16.6	19.1
Miscellaneous expenditure	16.7	25.7	22.9	24.6	5.8	23.9	22.6	23.0

Source: Istat.

After the strong inflationary pressures of 1979 prices accelerated further in the early months of 1980, when the rises in the prices of oil products and in telephone and electricity charges decided by the Interministerial Price Committee were added to those in rents and a large range of widely consumed articles such as bread, pasta and meat. Consumer prices rose in the first quarter by 28.6% on an annual basis, compared with 24.4% in the previous quarter. However, owing to fewer increases in administered prices as well as to seasonal factors, the rate of growth of retail prices slowed slightly in the second quarter.

As a result of the introduction of the requirement for hotels, restaurants and other catering establishments to provide customers with a fiscal receipt, the continued revision of public utility charges, the repeated increases in oil products and the inflationary effects of the reduction in the number of different VAT rates and increase in production taxes (on petrol, LNG, and alcoholic drinks) decided at the beginning of July, the rate of consumer price increase, unlike wholesale prices, did not slow down in the second half of 1980. On the contrary, the annual rate of increase went up from 19.7% in the first six months to 20.8% in the rest of the year (Table 11).

Among the single goods categories, the highest rate of increase was recorded for non-food products (24.7% during the year) and services (22.6%). Breaking these two items down, the peak increases occurred in liquid fuels (38.8%), gas (33.1%) and electricity (44.4%; Table 11). The extremely steep rises in final domestic prices of energy, which were made in several stages from mid-1979 on, caused real prices to leap upward after a long period of stability and in some cases even of decreases. Transport and communications tariffs rose by 24.4% on average and by 21% during the twelve months (Table 11). The rise in retail food prices was less marked (an average of 15.6% for the year and 17% during the year) but still well above that in wholesale prices (12.4% and 11.7% respectively), confirming that firms managed to widen their gross profit margins in this sector too (Tables 10 and 11).

The cost-of-living index rose by 21.1% compared with the previous year. The increases in the various items of expenditure, however, differed considerably, from 51.4% for energy and fuel to 14.7% for food. In 1980, the second year of application of the fair rent law, expenditure on housing went up by 20.3% owing to the operation of the in-built indexation mechanism, thereby directly causing 1.2% of the total average increase in the index.

The distribution of income

The combined trend of production, wages and prices led, on average for 1980, to a shift in income distribution away from employee incomes, as had occurred in the previous year. In the private sector, the share of these incomes in value added at factor cost, adjusted for changes in the structure of employment, dropped from 81.2% to 79.4% (Table 12).

Table 12

THE DISTRIBUTION OF INCOME

Sector	Labour's share of value added at factor cost (1) (percentages)			Percentage changes 1980/79		
	1978	1979	1980	Real labour costs per unit of output (2)	Relative prices (3)	Labour's share of income
Agriculture, forestry and fisheries	85.8	84.3	87.8	-3.0	-6.9	4.2
Industry	77.7	73.8	72.1	-3.3	-1.0	-2.3
excluding construction	77.1	73.0	71.6	-3.6	-1.7	-1.9
construction	79.9	76.6	73.7	-1.6	2.3	-3.8
Services (4)	84.9	83.4	81.1	-0.2	2.6	-2.8
Private sector (5)	84.1	81.2	79.4	-2.2	-	-2.2

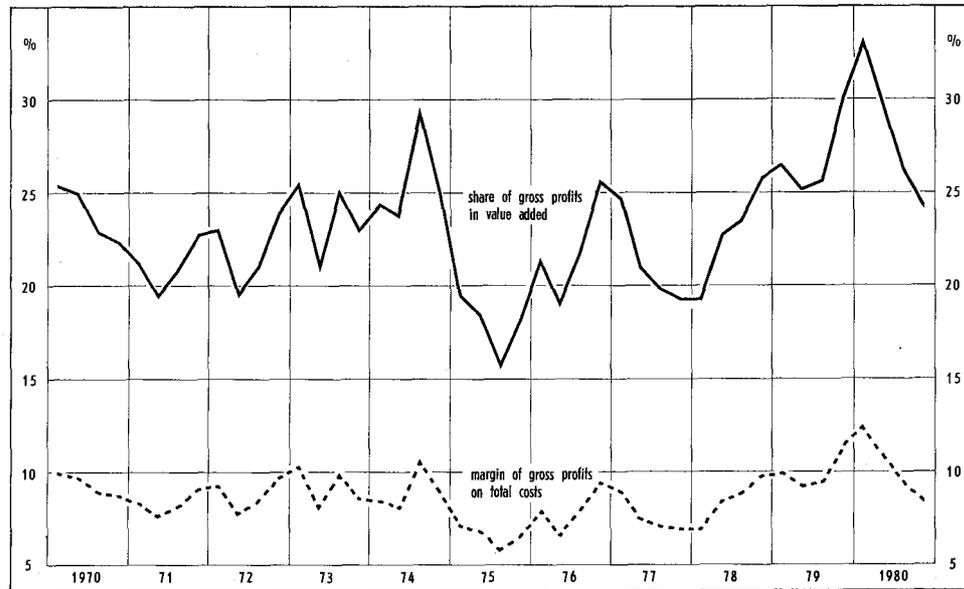
Source: Based on Istat data.

(1) Value added is gross of imputed bank services. The share is divided by the ratio of employees to total employment. — (2) Obtained by dividing labour costs per unit of output by the implicit price deflator of the value added at factor cost of the private sector (excluding lettings but including "other" non-marketable services). — (3) Ratio of the implicit price deflator of the value added at factor cost of each sector to that of the private sector as defined in footnote (2) above. — (4) Marketable services, excluding lettings but including "other" non-marketable services. — (5) Excluding lettings but including "other" non-marketable services.

The trend, however, was not uniform throughout the various sectors: specifically, the shares of industry and the services sector declined, while that of agriculture, forestry and fisheries increased considerably. In the last sector, in fact, combined with a drop in the real cost of labour per unit of output of similar proportions to that in industry but higher than that in the services sector, there was a marked deterioration in relative prices (down by 6.9%), with the result that the total share of capital and entrepreneurial incomes, already lower than in any other sector, declined even further. In the services sector the result was the opposite: the slight fall in the real cost of labour per unit of output was matched by an increase in relative prices (2.6%), leading to a 2.3% shift in income distribution in favour of gross profits. In industry, the decline in the share of labour incomes in construction was double that in the rest of industry (3.8% compared with 1.9%). This was due to a change in relative prices that benefitted construction (2.3%) and was unfavourable to the rest of industry (- 1.7%) as well as to a much larger decline in the cost of labour per unit of output in this sector (3.6% against 1.6%).

The shift in income distribution in favour of non-labour incomes in industry excluding construction (their share increased by 5 percentage points between 1978 and 1980) appears to have been linked to the economic cycle, which in the last three years has allowed a large increase in gross margins on unit production costs (Chart 5). Since 1977-IV the

Chart 5



Profit margins and income distribution in industry excluding construction

Source: Based on data from Istat and the Ministry of Labour and Social Security

Note: The labour income used to estimate the share and margin of gross profits was obtained by multiplying employee income by the ratio of total employment to total employees.

share of capital and entrepreneurial incomes has increased continuously, with the sole exception of 1979-II, in parallel with gross margins, reaching a peak for the past decade in the first quarter of 1980. However, the downturn in production that began in the second quarter heralded a rapid fall in both unit margins and the share of gross profits. Nonetheless, at end-1980 the share of gross profits was still high compared with previous periods of declining productive activity, and higher than the average for 1970-80. On the other hand, the fall in profit margins was relatively sharper than in the past.

THE BALANCE OF PAYMENTS

The balance of payments closed with a deficit of 6,388 billion lire, compared with a surplus of 1,824 billion in 1979. This deterioration was entirely due to the balance on current account and in particular on trade: the former, in fact, went from a surplus of 4,552 billion lire to a deficit of 8,367 billion and the second from a deficit of 791 billion to one of 13,815 billion. The current balance was in part financed by capital movements, which closed with a net inflow of 2,825 billion lire as against an outflow of 2,404 billion in 1979. External borrowing by the banking system, which increased by 7,059 billion, more than covered the remainder of the deficit. As a consequence, the net external position of the Banca d'Italia and Italian Foreign Exchange Office, excluding exchange rate adjustments and the revaluation of gold, improved by 671 billion lire (Table 13).

Table 13

BALANCE OF PAYMENTS ON A TRANSACTIONS BASIS (1)

(billions of lire)

	Credit		Debit		Balance	
	1979	1980	1979	1980	1979	1980
CURRENT ACCOUNT (2)	81,979.7	93,933.2	77,427.2	102,300.0	4,552.5	-8,366.8
Goods (f.o.b.)	59,278.1	65,825.1	60,069.2	79,640.0	-791.1	-13,814.9
<i>Oil and oil products</i>	3,882.0	3,680.0	12,463.0	19,703.0	-8,581.0	-16,023.0
Services	19,694.3	24,046.2	14,727.4	19,503.1	4,966.9	4,543.1
Transfer payments	3,007.3	4,061.9	2,630.6	3,156.9	376.7	905.0
CAPITAL MOVEMENTS	30,482.6	40,798.6	32,887.0	37,973.5	-2,404.4	2,825.1
Compensatory loans	—	—	2,064.0	349.0	-2,064.0	-349.0
Others	30,482.6	40,798.6	30,823.0	37,624.5	-340.4	3,174.1
ERRORS AND OMISSIONS					-324.0	-846.5
TOTAL					1,824.1	-6,388.2
TOTAL (excluding compensatory loans)					3,888.1	-6,039.2
<hr/>						
MONETARY MOVEMENTS (3)	10,057.8	31,304.1	11,881.9	24,915.9	-1,824.1	6,388.2
Banca d'Italia-UIC	9,054.1	22,970.4	11,679.7	24,915.9	-2,625.6	-1,945.5
Banks	1,003.7	8,022.5	—	—	1,003.7	8,022.5
Exchange rate adjustments . . .	—	311.2	202.2	—	-202.2	311.2

(1) For some items the figures in this table, approved by the balance-of-payments committee, differ from those published in the *Relazione generale sulla situazione economica del paese* since they are based on more recent data and estimates. — (2) Calculated using the normal IMF scheme. According to the ESA scheme the balance on goods and services for 1978 and 1979 amounts respectively to 1,537 and -1,828 billion. — (3) Balance with minus sign indicates increase in assets or decrease in liabilities.

The extent of the deterioration in the trade balance was due to the combined effect of several factors: the worsening of the terms of trade caused by the series of increases in the price of oil, the persistence of high domestic activity levels, together with a wide divergence from the cycle in the other major countries, and the acceleration of Italian export prices, probably connected with larger profit-making opportunities permitted by the current cyclical phase.

The balance on invisibles closed with a surplus almost equal to that of the previous year (5,448 billion), partly attributable to the modest contribution of tourism and increased burden of interest payments on external debt.

As for medium and long-term capital movements, the main inflow consisted of foreign loans, fostered by the abundant supply of funds and the more advantageous interest rate conditions on foreign markets. Other capital movements continued to record negative balances.

The differential between domestic and foreign interest rates and especially the tightening of the ceilings on domestic credit in lire led to a net inflow of foreign currency funds through the banking system which more than offset the net outflow of short-term trade credits. Moreover, short-term capital movements were fairly erratic, particularly in the summer months, owing to speculation connected with exchange rate expectations. The foreign currency and monetary measures introduced in September helped to mitigate these phenomena in the following months.

The effective exchange rate of the lira declined by an average 4.3% during the year vis-a-vis the EEC currencies, by 2.9% vis-a-vis the dollar and by 3.6% overall. In fact, the exchange rate not only reflected the underlying weakness of the current account but also came under pressure connected, in the early and closing months of the year, with the international position of the dollar and, in the central months, also with the speculative movements of short-term capital mentioned above.

Goods

The trade deficit, measured on the basis of customs data (c.i.f.), was four times the figure for the previous year, amounting to 18,666 billion lire (Table 14). This deterioration reflected large differentials between the rates of increase in imports and exports, respectively of 32.2% and 11.3%, which were the result of widely differing trends for volumes (7.3% and - 5.1 %) and less divergent increases in average unit values (23.2% and 17.3%). Italy's share of total exports by the industrial

Table 14

FOREIGN TRADE

(billions of lire)

	1979	1980	Percentage changes 1980/1979		
			Values	Prices	Volumes
<i>Istat customs data (1):</i>					
Exports (f.o.b.)	59,926.3	66,724.3	11.3	21.7	-8.5
Imports (c.i.f.)	64,597.2	85,390.0	32.2	29.5	2.1
Balance	-4,670.9	-18,665.7			
<i>ISCO customs data (2):</i>					
Exports (f.o.b.)	59,926.3	66,724.3	11.3	17.3	-5.1
Imports (c.i.f.)	64,597.2	85,390.0	32.2	23.2	7.3
Balance	-4,670.9	-18,665.7			
<i>B.o.p. on a transactions basis (3):</i>					
Exports (f.o.b.)	59,278.1	65,825.1	11.0		
Imports (c.i.f.)	60,069.2	79,640.0	32.6		
Balance	-791.1	-13,814.9			

(1) Source: Istat, *Statistiche mensili del Commercio con l'estero*. — (2) Source: ISCO, *Quaderni analitici*. — (3) Source: Banca d'Italia.

countries decreased with respect to 1979 from 6.8% to 6.3% at current prices and from 7% to 6.4% at constant prices (Table 15). The combination of an expansionary domestic cycle in the first half of 1980 and losses in price competitiveness during 1979 and the first quarters of 1980 led to a decline in exports at a time when the volume of trade of the industrial countries and the markets for Italian goods were increasing considerably.

Export volumes, seasonally adjusted, followed a declining trend during the year in line with world demand, but picked up in the fourth

Table 15

ITALY'S SHARE OF WORLD EXPORTS

	1975	1976	1977	1978	1979	1980
Current prices	6.1	5.9	6.3	6.5	6.8	6.3
1975 prices	6.1	6.3	6.5	6.8	7.0	6.4

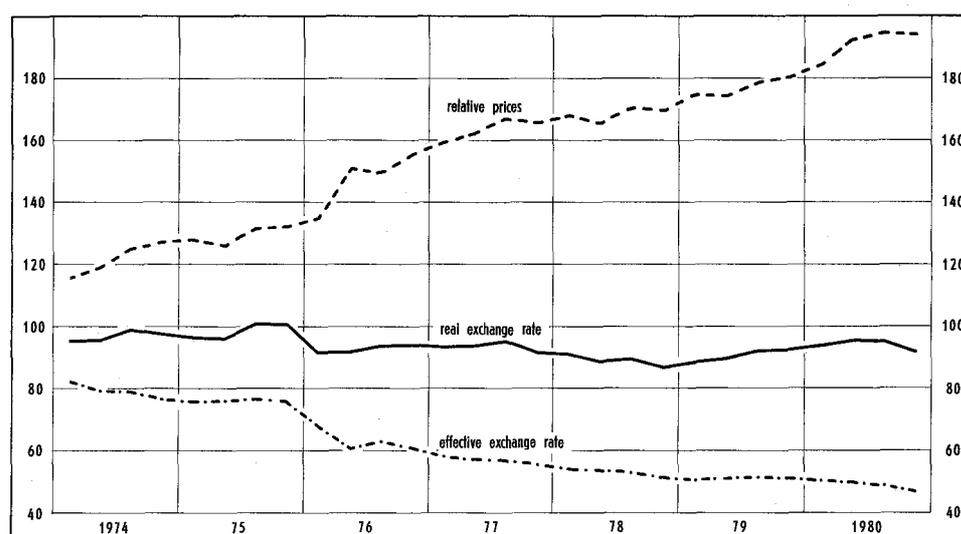
Source: IMF, *International Financial Statistics*. The shares are calculated with respect to the total of industrial countries.

quarter under the impetus of a downturn in the domestic economy. Import volumes, which rose by 7.3%, were boosted by the strong performance of domestic demand and loss of competitiveness on the domestic market (8% during the year). On the other hand, a dampening effect was exerted by firms' liquidity, which decreased as a ratio of GNP during 1980.

Italy's terms of trade deteriorated in 1980 by an average 5% for all goods but improved by 1.6% in the case of manufactures alone. This development reflected the sharp increase in import prices caused by the rise in the cost of oil, the unit lira price of which, weighted on the basis of the country of origin, went up by 75% on average in 1980.

The improvement in the terms of trade of manufactures was matched by a deterioration in the relative competitive position, measured in terms of the average unit export values of manufactures. The decline in the effective exchange rate of the lira, weighted on the basis of the geographical distribution of Italy's trade with the nine major competitor countries, was smaller than the increase in the relative prices of Italy's manufactures (8%) thus leading to a loss of competitiveness estimated at an average 4%

Chart 6



Relative prices and effective and real exchange rates

(indices, 1970 = 100)

Source: Banca d'Italia

for the year. This development occurred between 1979 .II and 1980 III; subsequently, the decline in competitiveness was brought to a halt in the fourth quarter by the large depreciation in the exchange rate and by the fact that relative prices remained stable at the levels reached in the third quarter (Chart 6).

Services

The transport deficit amounted to 1,265 billion lire, which was higher than that recorded in the previous year (1,073 billion). Breaking this figure down, it appears that the surplus on air transport increased, while the deficits on shipping and land transport deteriorated.

The net surplus generated by tourist flows declined, on a settlements basis, from 5,564 billion in 1979 to 5,401 billion in 1980. Foreign currency receipts went up by 3%, from 6,816 billion to 7,034 billion, while there was a large increase in outflows (30%).

The moderate growth in foreign tourism in Italy was attributable to the effects of the loss of competitiveness on both the number of foreign tourists in Italy and their average expenditure, as well as to a resurgence of the illegal capital outflows through tourism that had been a feature of the mid-seventies. Indeed, the increase in the share of foreign tourism in Italy financed in lire must be related to outflows of this nature during 1980, prompted by expectations of a depreciation of the exchange rate.

In the light of this development, it was decided to resume the correction to data on foreign tourism in Italy that had been discontinued in 1977. The correction was recorded in the balance of payments on a transactions basis, in which adjusted receipts amounted to 7,634 billion lire, with a 12% increase from the previous year. The surplus thus totalled around 6,000 billion lire.

The net inflow from worker earnings and emigrants' remittances rose by about 10% to a figure of approximately 2,600 billion lire.

Capital movements

Capital movements closed with a surplus of 2,825 billion lire, compared with a deficit of 2,404 billion in the previous year. The inflow of foreign capital increased from 2,880 billion to 7,827 billion, basically owing to a larger inflow from borrowing, while the net outflow of Italian capital was slightly less than in the previous year (5,002 billion compared with 5,285 billion; Table 16).

Loans taken out abroad by the public and private sectors rose from 4,373 billion to 7,693 billion, while repayments declined from 3,411 billion to 2,018 billion. The outcome was a total net inflow of 5,675 billion, compared with 962 billion in 1979. Trade credits and import-

Table 16

CAPITAL MOVEMENTS

(billions of lire)

	Credit		Debit		Balance	
	1979	1980	1979	1980	1979	1980
FOREIGN CAPITAL	15,922.5	22,016.7	13,042.2	14,189.9	2,880.3	7,826.8
Investment:						
direct	559.3	816.3	259.3	312.8	300.0	503.5
portfolio	968.0	1,203.0	916.6	1,644.7	51.4	-441.7
other	127.7	123.3	83.2	126.5	44.5	-3.2
Loans:						
private	2,798.1	3,997.6	3,107.4	1,603.6	-309.3	2,394.0
<i>of which: tied</i>	400.2	362.1	263.8	336.9	136.4	25.2
granted or guaranteed by the government	1,575.3	3,696.0	303.7	414.8	1,271.6	3,281.2
Trade credits:						
medium and long-term	376.7	553.4	477.4	512.5	-100.7	40.9
short-term (1)	9,323.0	11,293.0	7,690.0	9,323.0	1,633.0	1,970.0
Other capital	194.4	334.1	204.6	252.0	-10.2	82.1
ITALIAN CAPITAL	14,560.1	18,781.9	19,844.8	23,783.6	-5,284.7	-5,001.7
Investment:						
direct	1,014.6	250.3	1,466.7	896.5	-452.1	-646.2
portfolio	517.4	559.7	476.8	910.9	40.6	-351.2
<i>of which: unit trusts</i>	93.6	101.6	159.8	529.0	-66.2	-427.4
other	10.7	6.7	7.7	6.0	3.0	0.7
Loans:						
private	777.0	719.4	1,110.7	1,063.7	-333.7	-344.3
<i>of which: tied</i>	384.5	659.6	822.0	861.2	-437.5	-201.6
granted or guaranteed by the government	32.0	27.7	118.8	227.6	-86.8	-199.9
Trade credits:						
medium and long-term	2,280.4	3,519.1	2,965.1	2,513.9	-684.7	1,005.2
short-term (1)	9,928.0	13,699.0	13,699.0	17,565.0	-3,771.0	-3,866.0
Other capital	-	-	-	600.0	-	-600.0
BALANCE					-2,404.4	2,825.1

(1) New series.

linked loans remained largely in equilibrium, with a total balance of 66 billion, compared with 36 billion in the previous year.

As regards export finance, buyer and supplier credits as a whole gave rise to disbursements and repayments amounting, respectively, to 3,375

billion and 4,179 billion, compared with 3,787 and 2,665 billion in the previous year. As a result the balance moved from a deficit of 1,122 billion to a surplus of 804 billion. The Italian Foreign Exchange Office, which is gradually abandoning this type of operation, made interventions amounting to 55 billion net.

Short-term trade credits produced an outflow of 1,896 billion lire, almost equal to the figure for the previous year (2,138 billion). Net debts contracted abroad closed with an inflow of 1,970 billion, while the balance on credits granted abroad closed with an outflow of 3,866 billion.

Foreign direct investment increased from 300 to 503 billion, being the result of a growth in investment from 559 to 816 billion and in disinvestment from 259 to 313 billion. Italian direct investment abroad, net of disinvestment, increased from 452 to 646 billion: the new operations were largely related to increases in the capital of holding companies of industrial corporations.

Foreign portfolio investment in Italy produced a net outflow of 442 billion, almost entirely due to sales of Italian Treasury bills by foreign institutional investors. Italian portfolio investments abroad continued to be subject to the compulsory non-interest-bearing deposit introduced in 1973, unlike direct investment which is generally exempted. As a result the effective yield declined so far as to cause net disinvestment.

During 1980 there were large net inflows of bank capital, amounting to over 7,000 billion lire. The banks' net foreign debt more than doubled as a result, rising between the beginning and the end of the year from 6,887 billion to 14,910 billion. The inflows took place throughout the year, with the exception of June and August, when speculation prompted operators to reduce their foreign currency indebtedness.

In the last quarter of the year there was an over 3,600 billion increase in foreign currency lending to residents, which was in part due to the foreign exchange measures introduced in September with the chief objective of preventing speculative outflows of short-term capital. In fact, the measures taken on 29 September 1980:

- required exporters to finance in foreign currency 50% of deferred payment exports
- prohibited the advance repayment of foreign currency bank financing
- prohibited the advance payment of imports and the deferral of the collection of export receipts beyond the time established by contract
- reduced from 15 to 10 days the maturity of foreign currency and ordinary suspense accounts.

These measures not only forced an expansion in export finance but also, by calming expectations of a depreciation of the lira, produced an indirect expansionary effect on total foreign currency lending.

The external position of the Banca d'Italia and the Italian Foreign Exchange Office

During 1980 the net official reserves of the Banca d'Italia and Italian Foreign Exchange Office increased by over 24,700 billion lire and amounted at the end of the year to 55,415 billion (Table 17). More than 90% of the increase was attributable to the revaluation of gold holdings (18,039 billion) and of gold made over to the EMCF (4,510 billion) in exchange for ECU-denominated assets.

Convertible currency reserves totalled over 10,100 billion lire at the end of the year, which represents an increase of 2,221 billion, mostly due to the appreciation of the dollar vis-à-vis the lira (about 16% during the year). The authorities, however, continued to diversify these reserves and shift into Community currencies.

Owing to the decline in dollar-denominated reserves, the foreign currency share of the swap operations provided for in the EMS agreements decreased. Of the 2,340 billion dollars deposited with the EMCF at the end of 1979 little more than two thirds were exchanged for ECUs at the October swap, the last of 1980. The units of account outstanding at the end of the year amounted to about 10,000 billion lire, 86.3% of which obtained through sales of gold (Table 18). Fluctuations in the price of the metal, however, are fully reflected in ECU-denominated assets so that it is also necessary to calculate the amount of official reserves net of the gold component: thus, at the end of March, ECUs received in exchange for gold accounted for about half the official liquid reserves, an increase of about 5,400 billion from the end of 1979.

The medium and long-term position of the Banca d'Italia and Italian Foreign Exchange Office deteriorated by 281 billion lire, chiefly owing to the movement in the lira exchange rate and to the entry on the liabilities side of the contra-item to the SDR allocation.

As a consequence of the increase in the net official reserves and the deterioration in the medium and long-term position, the overall external position of the Banca d'Italia and Italian Foreign Exchange Office showed an improvement of around 671 billion, net of the revaluation of gold holdings (22,549 billion) and exchange rate adjustments (1,275 billion).

Table 17

**EXTERNAL POSITION OF THE BANCA D'ITALIA,
THE ITALIAN FOREIGN EXCHANGE OFFICE (UIC) AND BANKS**

(end-of-period amounts in billions of lire)

	December			March
	1978	1979	1980	1981 (1)
Banca d'Italia-UIC				
Gold (2)	11,893.3	16,140.5	34,169.5	36,408.0
Special drawing rights (3)	244.0	475.9	618.3	833.6
ECUs (4)	—	5,973.8	9,981.5	11,173.6
Foreign currencies	8,711.8	7,930.9	10,152.1	5,996.4
<i>of which: US dollars</i>	7,701.7	6,230.2	7,102.0	3,530.4
IMF reserve position	262.2	250.5	766.1	831.1
Total gross official reserves ...	21,111.3	30,771.6	55,687.5	55,242.7
Short-term liabilities	-151.4	-132.0	-272.1	-146.1
Total net official reserves ...	20,959.9	30,639.6	55,415.4	55,096.6
Medium and long-term position				
Assets				
Foreign securities in foreign currencies and in lire	1,166.2	1,224.8	1,260.3	1,386.9
Italian securities in foreign currencies	90.3	79.5	83.2	92.7
Consolidated accounts	23.3	21.0	18.0	15.0
Liabilities				
Special drawing rights account ...	-343.8	-473.4	-683.5	-904.3
IMF accounts (oil facility)	-951.2	—	—	—
EEC account	-1,291.8	-951.5	-1,058.9	-1,178.8
Total ...	-1,307.0	-99.6	-380.9	-588.5
BALANCE: BANCA D'ITALIA-UIC	19,652.9	30,540.0	55,034.5	54,508.1
Banks				
Assets	19,233.1	24,213.6	29,037.0	....
Liabilities	25,116.8	31,101.0	43,947.0	....
BALANCE: BANKS	-5,883.7	-6,887.4	-14,910.0	-14,846.5

(1) Provisional data. — (2) From 31 December 1976 to 28 February 1979 the gold reserves were valued with reference to a market-based price less 15 per cent. After March 1979 they were valued, in accordance with the EMS agreements, on the basis of the quotation on the London market. Since December 1979, the valuation has conformed to the Ministerial Decree of 23 March 1979, according to which the price to be employed, at the end of every quarter, is that "fixed in the last swap operation conducted in the quarter" with the EMCF. — (3) The SDRs are valued on the basis of the market SDR-dollar, dollar-lira rates obtaining on the last working day of the period considered. — (4) The ECUs were activated at the end of March 1979 by means of a swap with the EMCF of 20 per cent of the official gold and dollar reserves obtaining at the end of February. For statistical purposes the forward part of this swap is not recorded.

**OFFICIAL RESERVES AND SHORT-TERM DEBT
OF MONETARY INSTITUTIONS**

(billions of lire)

Period	Official reserves excluding gold		Net foreign position of banks
		of which: ECUs received against gold	
1979 - March	13,471	3,113	-6,983
June	15,549	3,114	-8,148
September	14,837	3,522	-7,191
December	14,499	4,062	-6,887
1980 - March	17,083	5,239	-9,888
June	17,146	7,411	-9,868
September	18,633	8,447	-10,834
December	21,246	8,614	-14,910
1981 - March	18,689	9,437	-14,847

The lira exchange rate

The average depreciation of the lira, weighted in terms of the geographical distribution of Italy's foreign trade, amounted to 3.6% (Table 19). However, during the year the decline was more marked (7.2%). Between December 1979 and December 1980 the exchange rate of the lira fell by 13.3% vis-a-vis the dollar and 3.9% vis-a-vis the group of EEC currencies. Specifically, the depreciation amounted to 1.4% against the deutschemark, 2.5% against the French franc and 18.6% against the pound sterling.

Throughout the year, the performance of the dollar's exchange rate against the mark was a determining factor in the entire exchange rate structure on all the main foreign exchange markets. In Italy too, therefore, the movements in the dollar/mark exchange rate represented an exogenous factor in exchange rate management and, combined with the constraints imposed by membership of the EMS, greatly influenced the exchange rates of the lira.

Following the repeal of the currency regulations and the introduction of new monetary and foreign exchange measures in January, the deficit in the external accounts deteriorated further. The lira's position within the EMS worsened, although the currency remained within the lower divergence threshold as a result of support intervention by the central bank.

TRADE-WEIGHTED EFFECTIVE EXCHANGE RATE OF THE LIRA (1)
VIS-A-VIS QUOTATIONS ON 9 FEBRUARY 1973
(monthly averages of the daily rate)

Month	Weighting: geographical distribution of Italy's foreign trade in 1977								
	1973	1974	1975	1976	1977	1978	1979	1980	1981
January	—	-12.8	-21.4	-24.0	-39.3	-42.3	-44.4	-44.3	-49.1
February	-3.1	-15.6	-21.4	-30.7	-39.3	-41.8	-44.4	-44.2	-50.3
March	-5.0	-15.0	-21.1	-34.9	-39.7	-42.1	-44.5	-45.6	-51.0
April	-7.2	-15.9	-20.6	-38.9	-39.9	-42.5	-44.2	-46.2	
May	-8.2	-16.6	-20.5	-36.9	-40.0	-42.3	-44.3	-45.7	
June	-12.6	-17.9	-20.5	-36.1	-40.0	-42.1	-44.3	-45.8	
July	-13.9	-17.4	-20.7	-35.0	-40.5	-42.1	-43.9	-46.1	
August	-10.6	-18.0	-21.0	-35.1	-40.1	-42.5	-43.6	-46.3	
September	-9.1	-18.2	-21.3	-36.1	-39.9	-42.5	-43.6	-46.6	
October	-9.8	-19.9	-21.8	-37.1	-40.4	-43.1	-44.5	-47.2	
November	-10.6	-21.0	-21.9	-38.0	-40.7	-44.0	-44.6	-48.0	
December	-11.4	-21.4	-21.7	-38.5	-41.8	-44.2	-44.5	-48.5	
YEAR . . .	-9.2	-17.5	-21.2	-35.1	-40.1	-42.6	-44.2	-46.2	

(1) Geometric mean of two effective lira exchange rates vis-à-vis the 16 main currencies weighted on the basis of import shares and of export shares.

The appreciation of the deutschemark on all the main foreign exchange markets, gradually gaining impetus from the beginning of March, found the lira in such a weak condition that it reached a spread of close to 5% over the central rate with the mark. Hence, at the end of the third week of March, after heavy intervention, the monetary authorities decided to reduce by 6% the central rates between the lira and the other EMS currencies, thus re-establishing a lower fluctuation margin for the lira after its depreciation. In the following ten days, the market rates of the lira showed a depreciation, compared with rates ruling prior to the realignment, of about 2% vis-a-vis the EEC currencies and about 3.6% vis-a-vis the dollar.

PUBLIC FINANCE

The net borrowing of the public sector amounted to 29,250 billion lire, compared with 27,110 billion in 1979 (Table 20). As a ratio to GDP it declined from 10.1% to 8.7%, owing to the reduction in the current

Table 20

PUBLIC SECTOR: CASH OPERATIONS (1)

(general government and autonomous government agencies; calendar years; billions of lire)

	1979	1980	% increase
Revenues			
Fiscal revenues	86,915	114,692	32.0
<i>of which: direct taxation (2)</i>	26,478	37,887	43.1
<i>indirect taxation</i>	25,490	34,131	33.9
<i>social security contributions (3)</i>	34,947	42,674	22.1
Sales of goods and services	5,666	6,819	20.3
Transfers	3,056	3,843	25.8
Income from capital	2,550	3,143	23.3
Total, current account . . .	98,187	128,497	30.9
Capital account revenues (4)	267	547	104.9
Total . . .	98,454	129,044	31.1
Disbursements			
Staff wages and pensions	37,302	47,429	27.1
Purchases of goods and services	13,999	17,314	23.7
Interest payments	16,040	21,060	31.3
Transfers (3)	44,958	55,433	23.3
Total, current account . . .	112,299	141,236	25.8
Capital account expenditure	13,262	17,056	28.6
<i>of which: direct investment</i>	9,610	12,334	28.3
<i>transfers (5)</i>	2,349	3,454	47.0
Total . . .	125,561	158,292	26.1
<i>Deficit on current account</i>	14,112	12,739	
<i>Net borrowing (5) (6)</i>	27,107	29,248	

(1) Based on the accounts of the *Relazione generale sulla situazione economica del paese*. — (2) Direct tax revenue includes that deriving from death duties and gift taxes. In the general government accounts of the *Relazione generale sulla situazione economica del paese* this revenue is included, instead, in the capital formation account. — (3) Respectively net of imputed social security contributions and of State pensions to civil servants and outlays by other public bodies to supplement the pensions of their staff. — (4) Excluding the direct taxes of footnote (2) and capital consumption. — (5) Including repayment of debts. — (6) Changes in the financial situation, i.e. in borrowings less lendings.

deficit. The total borrowing requirement of the public sector increased rather more, from 31,850 to 37,650 billion, as a result of the outcome for the financial items, and thus declined less in relation to GDP (from 11.8% to 11.2%). If account is also taken of ENEL, the total borrowing

requirement of the "enlarged" public sector amounted to 40,660 billion, as against 33,080 the previous year.

The automatic stabilization effects related to the high level of production and the acceleration in the rate of inflation were to a large extent offset by the additional expenditures and reductions in revenues introduced during the year. The action of the restrictive measures approved in July only neutralized a part of the expansionary pressure deriving from discretionary legislation. The ratio of net borrowing to GDP, which fell in the first half of the year to a level considerably lower than any recorded in the last five years (4.1%) rose to an exceptionally high level in the second half (13.9%).

Budget policy was decidedly restrictive in 1979 up to the end of the year, when it began to take on a more expansionary stance: in December agreement was reached on the change from half-yearly to quarterly cost-of-living increases for public servants (at an additional cost of approximately 1,000 billion in 1980); in February 1980 pensions were raised and the calculation of cost-of-living increases put on a half-yearly instead of a yearly basis (the corresponding cost of approximately 2,400 billion was covered by higher social security contributions — 700 billion charged to firms and 460 billion to the self-employed — and by expanding the deficit; in April higher family allowances were approved (+ 50% from 1 July and + 100% from 1 October, at an additional cost of 900 billion in 1980) together with higher personal income tax deductions (resulting in a 1,300 billion loss of revenue). In July, a package was introduced to curb domestic demand and encourage exports. It consisted of: measures to increase direct and indirect tax revenues through a revision of VAT rates (that also reduced their number), increases in the advance payments of direct taxes, the introduction of special conditions to hasten the settlement of contested stamp and death duties, and steps to reduce evasion; a lowering of the cost of labour by charging an additional amount of manufacturing firms' social security contributions to the budget; and increased allocations for interest subsidies on export credits. Measures were also introduced to make public bodies return a part of their bank deposits to the Treasury and to tackle the crises in several sectors of industry. Most of these provisions were contained in the decree laws submitted to Parliament at the beginning of July, but then not approved within the sixty days prescribed. They were resubmitted in a new decree law at the end of August, but this was not approved either. After the government crisis had been resolved, they were resubmitted again with a number of amendments and finally approved in the last months of the year.

In 1980 the package can be reckoned to have produced an increase in fiscal revenues of around 2,500 billion, a 1,800 billion reduction in social

security contributions, increases in expenditure amounting to approximately 650 billion, and the return to the 'Treasury of public agencies' bank deposits totalling several hundred billions.

Towards the end of 1980 budget policy again became expansionary, a trend that was to become more marked in the early months of this year. Public servants were paid advances on their 1979-1981 contract wage and salary increases (approximately 1,000 billion for civil servants alone) and special measures were taken for the areas struck by the November earthquake (these involved outlays of approximately 100 billion and the deferment of revenues of the order of 500 billion).

The ratio of fiscal revenues (including the EEC quota) to GDP rose to 34.5% after remaining virtually unchanged at around 33% in 1978 and 1979. This increase was due not only to the automatic mechanisms in force and the fiscal measures described above, but also to the fact that some revenue flows had dried up in 1979 as a result of extraordinary advance payments in 1978 and to a certain reduction in evasion.

Tax revenues rose by 32% or nearly 1.3 times the rate of GDP. Indirect taxes recorded an increase of 31%, compared with 17% in 1979, while direct taxes accelerated even more (43% as against 16%) as a result of both important legislative changes and fiscal drag, which was partly offset, however, by the increase in tax deduction allowances. On the other hand, the increase in gross indirect tax revenues was due to the raising of some rates (principally those of the production taxes on mineral oils and VAT). The latter produced nearly 21,500 billion (gross of reimbursements and the EEC quota), an increase of 37.5%. This result was largely attributable to the above-mentioned restructuring of VAT rates in July, which led to extra revenues of several hundred billion lire. Social security contributions rose by 22%, in line with the rise in wages.

Public expenditure (excluding financial items) rose, albeit modestly, in relation to GDP (from 46.6% to 46.9%), even though the increases deriving from the automatic mechanisms linking some categories of expenditure to rises in prices and wages were comparatively small because of the lags involved. The expansion was primarily the consequence of the very large additional burden imposed by the legislation described above. There was also a surge in interest payments as a result of both the growth in the public debt and higher interest rates.

The borrowing requirement of the public sector was mainly covered by sales of Treasury bills on the market: 26,220 billion, as against 9,930 billion in 1979. Medium and long-term securities recorded net reimbursements amounting to 2,200 billion, whereas in 1979 there had been net sales (primarily in the first half of the year) totalling 12,080 billion. There

was a sharp downturn in the volume of P.O. deposits, caused in large part by the poor performance of current accounts. Central bank financing showed a very substantial increase, rising from 340 to 9,930 billion: more specifically, recourse to the Treasury's current account with the Banca d'Italia amounted to 8,940 billion, compared with 3,480 billion in 1979. ENEL raised most of the finance it needed on the international capital markets in view of the more favourable conditions they offered. These changes represented a reversal of the pattern of public borrowing since 1977.

Table 21

THE STATE SECTOR BORROWING REQUIREMENT AND ITS FINANCING (1)

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

	1978	1979	1980		1981 1st qtr.
			Ist qtr.	Year	
TOTAL BORROWING REQUIREMENT (net disbursements —)					
Budget	-33,419	-30,291	-303	-40,521	-1,489
Minor Treasury operations	3,405	2,474	-3,333	7,255	-9,700
P.O. Deposits and Loans Fund, autonomous government agencies and the Southern Italy Development Fund	-4,234	-2,250	-275	-3,728	-1,061
Total	-34,248	-30,067	-3,911	-36,994	-12,250
<i>of which: repayment of public agency debts in securities</i>	<i>-1,836</i>	<i>-58</i>	<i>-4</i>	<i>-939</i>	<i>—</i>
Borrowing requirement less repayment of debts in securities	-32,412	-30,009	-3,907	-36,055	-12,250
<i>of which: repayment of public agency debts in cash</i>	<i>-3,375</i>	<i>-756</i>	<i>-14</i>	<i>-193</i>	<i>—</i>
FINANCING OF TOTAL BORROWING RE- QUIREMENT					
Medium and long-term bonds excluding Banca d'Italia portfolio	14,369	12,100	-2,604	-2,177	1,014
Treasury bills, excluding Banca d'Italia port- folio	9,482	10,152	4,543	26,516	3,330
Post Office savings	4,850	6,598	657	2,027	1,000
Borrowing from BI-UIC	5,024	343	1,233	9,930	6,526
<i>of which: current account</i>	<i>1,910</i>	<i>3,476</i>	<i>-192</i>	<i>8,944</i>	<i>1,631</i>
Borrowing abroad	273	581	29	787	2
Other borrowing	250	293	53	-89	378
Total	34,248	30,067	3,911	36,994	12,250
<i>of which: domestic financing</i>					
<i>short-term</i>	<i>19,600</i>	<i>17,324</i>	<i>6,545</i>	<i>38,279</i>	<i>11,319</i>
<i>("Treasury" monetary base crea- tion)</i>	<i>10,283</i>	<i>7,085</i>	<i>2,072</i>	<i>11,872</i>	<i>7,990</i>
<i>medium and long-term</i>	<i>14,375</i>	<i>12,162</i>	<i>-2,663</i>	<i>-2,072</i>	<i>929</i>

(1) For the 1st quarter of 1981 some figures are estimated.

The borrowing requirement of the State sector (the Treasury, the P.O. Deposits and Loans Fund, autonomous government agencies and the Southern Italy Development Fund) amounted to 36,990 billion, compared with 30,070 billion the year before (Table 21). Net of the repayments of debts in securities, the corresponding amounts were 36,060 and 30,010 billion.

At the end of 1980 the public debt amounted to 221,400 billion, an increase of more than 20% compared with the end of the previous year. As a result of the consolidation of strong inflation expectations and the consequent difficulties for the capital market, the downward trend of the average residual life of outstanding government medium and long-term securities continued. A similar pattern also developed on the Treasury bill market. There was a further centralization of the public debt owing to the lower level of the local authorities' and health and social security institutions' recourse to bank borrowing and the progress made in funding their debts.

MONEY AND FINANCIAL MARKETS

Continuing the action started at the end of 1979 with the aim of curbing the deterioration in the balance of payments and the rise in the rate of inflation, monetary policy became increasingly restrictive during 1980 and the first few months of 1981. This slowed down the rate of growth of the monetary aggregates and pushed up interest rates.

Demand for credit remained at an extremely high level throughout the year. In the early months this was due to the fast rate of growth of output and investment; in the second quarter to the increase in stocks of finished goods that accompanied the slowdown of economic activity, though the increase was less marked than in previous cyclical downturns. After declining slightly in the third quarter as a result of the sharp fall in production, demand for credit then picked up again. Domestic demand continued at a high level, fuelled by public expenditure and inflation expectations. Furthermore, in the second half of the year the contraction in firms' internal cash flows and the rise in their stocks of raw materials increased the Economy's need for credit.

Monetary policy resisted the corporate sector's heavy demand for credit: the control of bank reserves was reinforced by interventions designed to make the ceiling on bank lending more effective.

In the early months of 1980 the expansion of bank lending exceeded the administrative limits that had been set. The monetary and credit aggregates were therefore controlled primarily by regulating the monetary base, which also grew more slowly as a result of the public's swing from bank deposits to Treasury bills — behaviour that was stimulated by the large yield differential that appeared after the sharp rise in the official discount rate at the end of 1979. The lack of bank reserves in the form of monetary base, accentuated by the reduction in the Treasury borrowing requirement, was attenuated by the Banca d'Italia providing refinancing through fixed-term advances and repurchase agreements.

The banking system nonetheless succeeded in partially circumventing the central bank's action to control the expansion of lending to firms by offsetting the fall in deposits by expanding their net foreign borrowing and varying the composition of their assets in favour of lending. Despite the limited growth of monetary base reserves, the banks responded to the pressure of demand with a sharp increase in their lending coupled with a reduction in their holdings of short-term Treasury securities. The banks' large holdings of Treasury bills and the fact that it would not have been profitable to push deposit rates up in line with the substantial rise in the yields on government paper explain why they did not counter this

disintermediation by paying higher rates on borrowed funds. The cost of bank credit, on the other hand, rose rapidly in both nominal and real terms: the most frequently applied, or so-called "normal" rate on current account overdrafts rose from 17.5% in September 1979 to 21.9% at the end of April 1980.

In the months that followed, tight control of bank reserves became more difficult, both because the Treasury deficit grew larger and because the public's preference for Treasury bills declined. A part of the liquidity created by the Treasury was destroyed through the foreign sector: in June and August the Banca d'Italia had to intervene heavily on the foreign exchange market to combat speculative pressures on the lira. In order to absorb the short and sharp liquidity peaks that appeared, the Banca d'Italia had recourse to reverse repurchase agreements. The interest rates on these operations, the volume of which rose in parallel with the surge in cash outflows from the Treasury, were rapidly brought into line with the objectives of monetary policy.

The whole structure of interest rates was not raised in the central part of the year, partly because the government introduced a package of fiscal and public utility charge measures designed to reduce households' disposable income and slow down the growth in consumption. When these measures expired at the end of September, new monetary and foreign currency restrictions had to be introduced to prevent an exchange rate crisis. One of the measures was the raising of the official discount rate by one and a half points. In October the "normal" rate on bank loans rose to 23.5%.

In the last few months of 1980 the short-term expectations of exchange rate stability, the return to a positive differential between domestic and international interest rates and the curbing of lending in lire produced an inflow of short-term capital from abroad which made it possible to keep the lira stable. In fact, the official reserves rose despite the large deficits recorded on the current account of the balance of payments. The banks' liquidity position became less tight and they were able to increase their holdings of Treasury bills compared with both the immediately preceding period and the beginning of the year.

The direct control of credit became more effective after non-interest-bearing penalty deposits with the central bank had been imposed as from March on banks that exceeded their lending ceilings and the frequency of the controls increased as from June. Lending in excess of the administrative limits was gradually reduced, but the effectiveness of the ceiling continued to be undermined by the rapid expansion of exempt lending. While lending

subject to the ceiling increased by only 4% in 1980, lira-denominated exempt lending rose by 31 % and foreign currency loans by 101 %.

The banks also reacted to the curb on lending by taking advantage of current fiscal regulations and the wide spread between their deposit and lending rates to place acceptances with non-bank investors.

The effects of the monetary restrictions imposed were also mitigated during 1980 by firms having had abundant liquidity at the beginning of the year, the high level of self-financing, and greater use of instruments other than bank credit. The upturn in investment, the fact that long-term rates were below those on bank loans and the increase in the supply of subsidized credit contributed to the expansion of the lending of the special credit institutions. There was also a substantial increase in the volume of medium and long-term funds that firms raised directly on international markets. Finally, the flow of funds from the public sector to firms was very large and considerably in excess of that recorded in 1979.

An important consequence of the steps that banks and firms took to offset the effects of monetary policy was that the latter acted primarily through the cost of credit and, with high inflation expectations, produced its results more slowly.

Domestic credit to firms and households expanded much faster in 1980 than had been expected, though less than GDP. When bankers' acceptances, shares, transfers from the State sector and medium and long-term loans raised directly on international markets are included, the total flow of credit to the Economy rises to 43,200 billion lire.

The growth of GDP and the higher rate of inflation, which led to negative real interest rates on the public debt, helped to curb the public sector borrowing requirement. In the second half of the year the effects of earlier measures tending to expand the disposable income of households were the main cause of the large rise in the public sector borrowing requirement, which continued in the first few months of 1981. In 1980 the PSBR amounted to 37,600 billion or 11.2% of GDP (11.8% in 1979), though it remained below the level that had been forecast in April 1980. When foreign loans, funding operations and the finance supplied to financial intermediaries are excluded, the borrowing requirement of the public sector amounted to 34,700 billion and that of the enlarged public sector to 35,600 billion.

Total domestic credit — credit to the Economy plus the PSBR — expanded by 63,450 billion, which was 4,000 billion more than had been forecast in April 1980. The rate of increase (18.7%) was nearly the same as that of the previous year and slightly more than one point higher than

had been expected, even though GDP at current prices grew by nearly 5 points more than forecast. However, as a result of the developments described above, the division of total domestic credit expansion between the public sector and the Economy was rather different from what had been expected.

The rapid deterioration in the balance of payments was reflected in the divergence between the growth in total domestic credit and that in the Economy's financial assets: the rate of growth of the latter (net of shares) fell from 21.6% to 15.3% both as a result of the restrictive monetary policy pursued and because of the fall in the propensity to save, which was not sufficiently countered by the average level of "real" rates on financial assets. This was fairly substantially negative.

There was also a considerable change in the composition of financial assets: the slowdown in the rate of growth of the money supply was much sharper than that of total domestic financial assets. The growth rate of the Economy's money supply (M2) fell from 20.6% in 1979 to 12.8%. In particular, there was a steady absorption of the liquidity firms had held at the end of 1979. The reduction in the money supply nonetheless overstates the degree of restriction since, as already mentioned, it also reflects the fall in the propensity to save and the shift in favour of short-term Treasury securities.

The decline in the demand for medium and long-term fixed-interest securities led to a large rise in their yields. This was countered in part by shifting supply towards shorter term securities and encouraging recourse to foreign markets. In this way the increase in medium and long-term rates occurred gradually, thus permitting orderly conditions to be maintained on financial markets.

The Treasury bill market absorbed the tensions that appeared: the convergence on this market of the flows of demand of operators reluctant to buy medium-term securities and invest in bank deposits made it possible, within the limits previously mentioned, to curb the monetary financing of the Treasury while leaving sufficient room for the fund-raising of the special credit institutions. This benefitted from the increase in the supply of variable rate instruments and, in the second part of the year, from the tax exemption of the interest on their new bond issues.

The change in the central bank's policy towards regulating the financial market compared with the mid-seventies can be seen in the amount by which after-tax yields were raised and in the decision not to increase the banks' security investment requirement. Furthermore, the Banca d'Italia's market interventions were negligible, especially when compared with those made in earlier periods of tension on the financial market. The yield curve, after becoming downward sloping in December

1979, rose progressively — especially at the longer end — so that by the end of 1980 it was only slightly falling. It retained this slope after the rise in interest rates subsequent to the measures introduced on 23 March 1981.

The prospects for 1981

When the ceiling on bank lending was extended into 1981, the central bank included loans of less than 130 million since their exemption had reduced the effectiveness of the ceiling and caused distortions. In addition, a limit was set on foreign currency loans serving to finance imports, so as to increase their cost and slow down the inflow of short-term funds. The exemption of foreign currency loans used to finance exports is intended to support firms oriented towards the international market, which are those that have suffered most from Italy's loss of competitiveness, and represents a degree of flexibility in the administrative control of lending. In compliance with a directive issued by the Interministerial Committee for Credit and Saving, the bank supervisory authorities fixed a ceiling — related to each bank's capital and reserves — on bankers' acceptances.

This tightening of direct controls was followed at the end of March — together with a correction of the exchange rate that was less than the change in central rates — by a further two and a half point increase in official interest rates. This action was taken in response to the large increase in the public deficit, the signals coming from the foreign exchange market and the acceleration of the rate of inflation. In addition, the marginal compulsory reserve coefficient was raised from 15.75% to 20%. Treasury bill rates rose by approximately two points and the cost of bank credit by a point and a half to 24.5%.

Continued uncertainty about the future course of inflation and interest rates led the monetary authorities at the beginning of 1981 to shorten the maturities of fixed interest securities (Treasury bonds) and to pursue the consolidation of the public debt through the issue of variable rate securities (Treasury credit certificates). The conditions at which two-year Treasury bonds were offered and the revision of the Treasury credit certificate indexing mechanism explain the good reception of the first issues of these two new instruments. The poor result of the second issue of Treasury credit certificates in April was due to its having been made when the market was adjusting to the increase in the discount rate.

The present very high level and only slightly downward slope of the yield curve constitute favourable initial conditions for a revival of investment in medium and long-term securities, which could include those

at fixed rates if expectations of a reduction in the rate of inflation continue. An adequate demand for securities on the part of the public is a necessary condition for a further slowdown in the rate of growth of the monetary aggregates and a reduction in the liquidity of the economy. The lengthening of the average maturity of the Treasury securities held by the banks is, in turn, a necessary condition for the control of credit to be more effective. Experience in 1980 showed, in fact, that the limits on bank lending can be undermined when the banks have large holdings of Treasury bills so that they can increase their lending in lire beyond the intermediate objectives of monetary policy by running them down.

Although it is expected that productive activity will continue at much the same level as the average for 1980, there is still a high rate of inflation and a large balance-of-payments deficit. The central bank must therefore act in 1981 to counter inflationary pressures and expectations, an aim that is closely linked to the objectives on the external front of defending the exchange rate and improving the balance of payments. In order to achieve these final objectives, the level of short-term interest rates will have to be high enough to regulate bank reserves and the expansion of bank lending. On the other hand, the extension of the ceiling on bank lending to all lira-denominated loans and the introduction of the ceiling on foreign currency loans to finance imports should make it possible to increase the effectiveness of the administrative controls on the short-term component of bank lending. The demand for alternative forms of finance will be regulated by the high cost of borrowing. In view of the large public deficit that will have to be financed, the level and structure of interest rates will also have to overcome the negative influence of inflation on the propensity to invest savings in financial assets.

The expansion of total bank lending in 1981 will therefore have to be limited to approximately 16,500 billion lire — a sharp fall compared with the 20,900 billion recorded in 1980. There is greater scope, on the other hand, for the expansion of medium-term lending, both through the intermediation of the special credit institutions and through firms borrowing directly on the capital markets. Total finance to the Economy, including public sector transfers and foreign borrowing, should not — on the basis of the assumptions made with regard to the factors beyond the control of the central bank — exceed 30,000 billion (33,000 billion in 1980). The restrictive effect of tight credit is expected to be greatest in the early part of the year.

The amount of finance available for the Economy in 1981 was calculated on the assumption that the domestic borrowing requirement of the enlarged public sector will be kept down to 37,500 billion and,

therefore, that the reduction in expenditure will make it possible to bring it back below the trend value of the early months of the year. The expansion of total domestic credit in 1981 should, therefore, be around 64,500 billion with a reduction, compared with 1980, of 2 percentage points in the GDP ratio.

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

The central bank pursued a restrictive monetary base policy throughout the year. Especially in the early months a sharp slowdown in the growth of bank reserves was considered necessary, partly because the controls on bank lending had become increasingly ineffective. In the months that followed, even though productive activity had started to weaken, the continued high level of domestic demand, the pressure that developed on the exchange rate and the unsatisfactory progress in curbing inflation led the Bank to keep a tight control on bank reserves. To this end use was made not only of open market operations and the discount rate but also of money market interventions through reverse repurchase agreements that enabled liquidity to be absorbed for periods ranging from a few days to several months. In the second half of the year control of the monetary aggregates was more difficult, principally as a result of the large increase in the Treasury borrowing requirement.

Between the end of 1979 and the end of 1980 the monetary base (excluding P.O. deposits) expanded by 7,802 billion lire (13.6%) and bank reserves by 4,276 billion (12.0%). Even when adjustments are made for the random events that influenced the end-1979 figures and for the introduction of non-interest-bearing deposits in relation to bank lending in excess of the ceiling, these increases were the smallest recorded in the last ten years (Table 22) and were coupled with a marked falling off of bank deposits.

Short-term interest rates rose substantially in the early part of the year but then showed only small variations until September. In October they were pushed up again with a one and a half point rise in the official discount rate. The interbank rate rose from 12.4% in November 1979 to 16.8% in March 1980 and then to a new peak of 17.6% in October. The yield on six-month Treasury bills rose from 13% in November 1979 to around 16% in the middle of 1980 and close to 17% in the last quarter.

The slowdown in the money supply was therefore achieved with an increase in Treasury bill yields that was smaller than that of other short-term rates such as those of interbank deposits and bank loans. This

Table 22

MONETARY AND CREDIT AGGREGATES AND INTEREST RATES

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
	PERCENTAGE INCREASES (1)									
Monetary base (2)	16.4	13.6	18.6	15.4	18.6	16.4	18.9	25.1	13.8	13.6
Monetary base, adjusted (2)(3)	14.9	13.4	18.0	15.7	20.6	12.0	18.1	23.6	14.9	12.6
Bank reserves	21.8	13.9	18.2	17.9	20.3	20.2	23.5	28.7	13.7	12.0
Bank reserves, adjusted (3)	16.4	13.2	17.1	18.2	23.6	12.7	22.1	26.2	(*)15.6	(*)10.7
Bank deposits	18.0	22.1	20.1	16.8	25.0	22.0	23.2	23.1	20.0	12.7
	INTEREST RATES (4)									
Interbank sight rates (5) . .	....	....	6.93	14.57	10.64	15.68	14.04	11.49	11.86	17.17
Rate on Treasury bills (6) .	....	....	....	14.12	11.01	16.63	15.20	12.21	12.51	15.90
Bank loans	9.03	7.88	8.31	14.22	15.08	17.33	18.58	16.00	15.43	19.41
Industrial bonds	8.17	7.40	7.48	10.20	10.82	13.39	14.56	13.34	13.58	15.39

(*) When corrected for the random movements at the end of 1979, the increases become respectively 11.7% and 14.5% for 1979 and 1980.

(1) From end-of-period values. — (2) Excluding Post Office deposits. — (3) Adjusted for changes in the coefficient of the compulsory reserve requirement and for the non-interest-bearing deposit against lending in excess of the ceiling. — (4) Average values for the period. — (5) Average of the interest rates reported by six large banks. — (6) Weighted average of rates at auction.

development was due to the increasing propensity of the public to invest in Treasury bills, which reflected both a process of gradual learning and the behaviour of banks, since the latter decided not to compete head on with matching increases in their deposit rates.

The creation of monetary base accelerated steadily in each quarter, rising from an annual rate of 6.6% in the first to 16% in the fourth (excluding the deposits made against lending in excess of the ceiling).

In the first quarter, as a result of the large increase in interest rates at the end of 1979, purchases of Treasury bills by the public rose to a very high level. Since the Treasury deficit was relatively small in this period, there was a squeeze on bank liquidity and the Banca d'Italia provided assistance through traditional fixed-term advances and with repurchase agreements (Table 23). These operations enabled the banks to weather a phase of rapidly shrinking deposits without difficulty but, in view of their cost, had a restrictive effect on the supply of credit.

The need to ensure that the disintermediation, which was particularly heavy for some categories of banks, proceeded under orderly conditions meant that the monetary authorities had to regulate the supply of three-

Table 23

MONETARY BASE*(changes in billions of lire)*

	1978	1979	1980				
			Year	Quarters			
				I	II	III	IV
SOURCES							
Foreign sector (1)	-5,820.2	2,817.5	1,668.5	1,180.5	-2,323.9	601.2	2,210.7
balance of payments (2)	7,697.6	3,888.1	-6,039.2	-1,729.7	-2,207.8	-264.8	-1,836.9
compensatory loans	-701.0	-2,064.0	-349.0	-91.0	-95.0	-99.0	-64.0
net foreign position of banks	-1,167.5	1,002.4	8,021.2	3,001.5	-21.0	965.0	4,075.7
Treasury	5,473.1	466.2	9,932.6	1,458.7	3,290.3	2,845.6	2,338.0
Treasury, including Post Office deposits	10,282.7	7,084.5	11,872.3	2,071.5	2,157.5	2,148.1	5,495.2
total borrowing requirement	34,248.2	30,067.0	36,994.0	3,911.6	6,986.6	8,025.0	18,070.8
sales of securities (3)	-28,775.1	-29,600.8	-27,061.4	-2,452.9	-3,696.3	-5,179.4	-15,732.8
Refinancing	-242.0	2,925.8	-2,810.2	-1,910.4	-169.1	-287.3	-443.4
Other sectors	-916.9	775.6	-988.5	-1,177.5	627.0	-1,524.0	1,086.0
of which: tied foreign currency deposits (4)	831.0	2,180.8	32.2	-36.8	77.9	15.0	-23.9
TOTAL	10,134.4	6,985.1	7,802.4	-448.7	1,424.3	1,635.5	5,191.3
Total, including Post Office deposits	14,944.0	13,603.4	9,742.1	164.1	291.5	938.0	8,348.5
USES							
The Public	3,169.2	2,694.8	3,526.1	-1,024.0	1,310.8	885.9	2,353.4
the public, including Post Office deposits	7,978.8	9,313.1	5,465.8	-411.2	178.0	188.4	5,510.6
Banks	6,965.2	4,290.3	4,276.3	575.3	113.5	749.6	2,837.9
compulsory reserves	5,076.3	5,508.1	3,046.4	1,808.8	-93.2	589.2	741.6
non-interest-bearing deposits against excess lending	—	—	626.3	—	445.4	268.4	-87.5
excess reserves	1,888.9	-1,217.8	603.6	-1,233.5	-238.7	-108.0	2,183.8
COMPONENTS OF TOTAL MONETARY BASE (5)							
<i>Domestic component</i> (6)	<i>3,483.2</i>	<i>1,986.8</i>	<i>6,101.7</i>	<i>-1,592.4</i>	<i>3,670.3</i>	<i>1,019.3</i>	<i>3,004.5</i>
<i>Foreign component</i> (7)	<i>6,651.2</i>	<i>4,998.3</i>	<i>1,700.7</i>	<i>1,143.7</i>	<i>-2,246.0</i>	<i>616.2</i>	<i>2,186.8</i>
FACTORS OF CHANGE IN BANK RESERVES							
<i>Autonomous</i> (8)	<i>32,258.8</i>	<i>25,678.9</i>	<i>34,298.3</i>	<i>6,501.4</i>	<i>3,788.0</i>	<i>9,279.0</i>	<i>14,729.9</i>
<i>Intervention</i> (9)	<i>-25,293.6</i>	<i>-21,388.6</i>	<i>-30,022.0</i>	<i>-5,926.1</i>	<i>-3,674.5</i>	<i>-8,529.4</i>	<i>-11,892.0</i>
TOTAL BANK RESERVES	6,965.2	4,290.3	4,276.3	575.3	113.5	749.6	2,837.9

(1) The creation of monetary base by the foreign sector does not match the sum of the items indicated owing to differences between the balance-of-payments statistics and consolidated balance sheet of BI-UIC and to the inclusion of the convertible currencies of banks. — (2) Autonomous balance. — (3) P.O. deposits plus net purchases of Treasury securities by the public and banks, at issue and on the open market. — (4) Connected with compensatory loans. — (5) Excluding P.O. deposits. — (6) Treasury (net of P.O. deposits), refinancing and other sectors (net of tied deposits connected with compensatory loans). — (7) Foreign sector net of tied deposits connected with compensatory loans. — (8) Autonomous balance of payments, banks' net foreign position and the Treasury borrowing requirement, *minus* notes and coin held by the public and special credit institution deposits. — (9) Compensatory loans, purchases of Treasury securities by the public and banks (footnote 3), refinancing to banks and other sectors net of special credit institution deposits.

month Treasury bills with great care. Since the characteristics of this instrument are not very different from those of bank deposits, they both compete with the latter more directly and do little to promote the aim of consolidating the public debt. The rate on three-month bills was therefore allowed to fall back from the high point it held in the structure of yields at the end of 1979.

In the second quarter conditions on the money market grew less tight and refinancing gradually became unnecessary. Bank reserves and deposits grew slightly faster than in the previous quarter but still fairly slowly. Greater accuracy in the control of bank reserves, which was particularly important in June when there was an outbreak of speculation against the lira, was achieved through recourse on a small scale to reverse repurchase agreements, which were used for the first time in May and then again in June.

The third quarter opened with a very large Treasury deficit: the 7,400 billion registered in July was a record for a single month. Its effect on the monetary base was neutralized to a large extent through reverse repurchase agreements. In the two subsequent months the deficit returned to lower values, but a downturn in the public's demand for securities made it more difficult to curb the growth in the monetary base in a period when interest rates were held stable until the complicated developments surrounding the government's fiscal decree law came to a head. Consequently, increasing recourse was made to reverse repurchase agreements, which were repeatedly renewed so that their amount continued to rise.

After the government had fallen at the end of September, the discount rate was raised by a point and a half. The Treasury bill rate was also made to rise by about one point, but this was to prove insufficient to restore sales of government securities to a level consistent with the planned growth of the monetary base because of the sharp acceleration of the Treasury borrowing requirement and the inflow of foreign currency through the banking system as a result of the demand for credit being higher than that foreseen by the ceiling. Notwithstanding the exceptionally large volume of sales of government securities in the fourth quarter and the further rise in reverse repurchase agreements up to the middle of November, bank reserves and deposits showed a clear tendency to expand.

At the beginning of 1981 a further upward adjustment of interest rates was made with the issue of two-year Treasury bonds, and this was confirmed by the Treasury credit certificate issue made in February. During the month of March the interest rate on the Bank's open market sales of twelve-month Treasury bills was raised. On 22 March the discount

rate and Treasury bill yields rose by about two and a half and two points respectively, while the coefficient of the compulsory reserve requirement was raised from 15.75% to 20%. In May the yield on Treasury bills rose by another point. The expansion of the monetary base began to slow down, the rate falling back to values similar to those recorded before the acceleration at the end of 1980. Reverse repurchase agreements were used once more, but for small amounts.

Starting in April competitive auctions were used for these agreements, which enables the monetary base to be regulated more accurately, and in May this method was extended to the Bank's definitive sales on the open market.

In conclusion, over a period of several months the effectiveness of the control of the monetary aggregates appears satisfactory, even though in the very short term the central bank's interventions did not always succeed in making the creation of monetary base independent of borrowing abroad and the Treasury borrowing requirement.

The differential between nominal interest rates in Italy and abroad, which was considerable (especially when the rates on lending in lire are corrected to take account of rationing) although less than that between the corresponding inflation rates, generates very large inflows of funds when, as in the fourth quarter of 1980, operators expect the exchange rate of the lira to remain stable, at least in the short term. This is why the monetary authorities partially blocked the inflow of funds via the banking system by laying down on 31 January 1981 that foreign currency loans to finance imports were not to exceed the level of the previous month.

The variability of the Treasury borrowing requirement influences the rate of growth of bank reserves if the yields on government securities are not immediately adjusted so that their sales vary enough to offset the borrowing requirement itself. To achieve this and a clearer definition of the operational tasks and responsibilities of monetary policy and government financing policy, proposals are being considered for a change in the system of central bank Treasury financing that will enable the Banca d'Italia to fix the amount of government securities it takes up at issue in accordance with the needs of monetary base regulation instead of having to absorb all unplaced amounts. This will result in a much closer correlation between the volume of securities sold on the market and the size of the borrowing requirement, as well as meaning that the latter will have to be more stable in order to avoid continual interest rate fluctuations.

Sources of monetary base

The expansion of the monetary base attributable to the foreign sector amounted to 1,669 billion lire and was considerably less than in 1979

(2,818 billion). The reduction was even greater if it is considered that the 1979 figure was influenced by repayments of compensatory loans of more than 2,000 billion, which do not affect the monetary base (since they are offset in the accounts under "other sectors"). The difference between the conditions in the two years is revealed by the breakdown of the overall results: in 1980 the autonomous balance of payments recorded a deficit of more than 6,000 billion, whereas in 1979 there was a surplus of nearly 3,900 billion; the inflow of capital via the banking system exceeded 8,000 billion, compared with 1,000 billion in 1979.

The increase in the latter was caused by the limited availability and higher cost of bank loans in lire, due in part to the penalties imposed on lending in excess of the ceiling. These produced their effect principally at the time they were introduced in March and in the last quarter when there was also the effect of the increase in domestic interest rates following the raising of the discount rate and the foreign exchange measures taken in September (primarily the compulsory financing in foreign currency of 50% of export credits).

The monetary financing of the 36,994 billion Treasury deficit amounted to 9,933 billion (excluding P.O. deposits), whereas in 1979 its share of the 30,067 billion deficit was only 466 billion. The difference between the two years reflects not only the smaller amount of monetary base created through the foreign sector in 1980 but also the change in the composition of the central bank's interventions: at the end of 1979 it was necessary to provide the banking system with nearly 3,000 billion of refinancing, which was entirely repaid in 1980.

The increase in P.O. deposits was particularly small compared with previous years: 1,940 billion, equal to 5.2% of the borrowing requirement, whereas in 1979 it had risen to 6,618 billion and covered 22% of the Treasury deficit. There was a fall in P.O. current account deposits, while P.O. savings accounts, the yields on which were not raised, suffered from the increase in bank deposit rates and rose by 3,527 billion, compared with 4,298 billion in 1979.

Both the Treasury borrowing requirement and sales of government securities to the banks and the public accelerated during the year. The latter, however, did not completely neutralize the expansionary effect of Treasury expenditure and of the inflow of funds from abroad in the second part of the year. For that to have been possible, the yield on Treasury bills would have had to fluctuate in parallel with the changes in the exogenous factors of monetary base creation so as to produce the necessary shift in the composition of the public's and the banks' financial assets. In order to strengthen the control of bank reserves, increasing use was made, instead, of reverse repurchase agreements, the yields and

maturities of which can be adjusted rapidly to money market conditions with only limited repercussions on the markets for bonds and other financial assets.

The need to cover the growing borrowing requirement and the worsening of inflation expectations forced the monetary authorities to shorten the average maturity of new issues. Out of total net temporary and definitive placements amounting to 24,340 billion (22,251 billion in 1979), sales of Treasury bills accounted for 110% (46% in 1979) and temporary sales for 9.5%.

Besides temporary sales, more traditional forms of refinancing (such as fixed-term advances) were used in the early part of the year when conditions on the money market were tighter.

Uses of monetary base

The notes and coin held by the public increased by 3,676 billion or 17%, compared with 2,633 billion or 13.9% in 1979.

The substantial rise in the volume of bank-notes in circulation at the end of 1978 due to the larger than usual number of public holidays caused the value of notes and coin in circulation to rise less in the following year. When account is taken of this random factor, the increase in 1980 was not much larger than that in 1979.

The rate of increase in currency holdings was again lower than those of the real variables that primarily influence their course (GDP and consumption). The rise in bank deposit rates, by nearly two points over the year, caused the public to further reduce its holdings of notes in relative terms, thus continuing the change in the payments system that has been under way for several years now. The ratio of notes and coin in circulation to bank deposits declined from 11.5% at the end of 1976 (a period of comparable bank deposit rates) to 10% at the end of 1980.

Total bank reserves increased by 4,276 billion or 12%, compared with 4,290 billion or 13.7% in the previous year. These values were distorted by irregularities towards the end of 1979 in the working of the system for transferring funds to the accounts of the banks with the Banca d'Italia, which gave rise to a temporary boosting of the refinancing and liquidity of the banks. When account is taken of this, the increase in the banks' reserves in 1980 amounted to about 16%. The 1979 figure does not change significantly since anomalies with a similar effect on liquidity also occurred at the end of 1978.

In addition to the banks' ordinary reserves, from April on there were the non-interest-bearing deposits against lending in excess of the ceiling. These grew up to September in line with the increases in the penalty rates and then fluctuated between 600 and 900 billion in the last three months of the year. The introduction of these deposits resulted in bank's reserves rising faster than their deposits. On their own the traditional reserves grew by 14% after the correction described above.

The increase in compulsory reserves amounted to 3,046 billion or 9.7%, compared with 5,508 billion or 21.3% in 1979. About two thirds of the January payment (related to the rise in deposits in December 1979 and equal to 2.945 billion) were withdrawn in February, and this reduction was only offset at the end of the year. Besides being due to the small rise in bank deposits, the low growth in compulsory reserves was caused by the large rise in banks' own funds, which can be deducted from deposits in determining reserve payments. The effective reserve coefficient thus amounted to 14.35%, compared with a theoretical value of 15.75% (in 1979 the effective value had risen to 15.15%).

Banking

During 1980 the banking system was faced, on the one hand, with a particularly large demand for credit and, on the other, with a sharp drop in the rate of growth of deposits due to a restrictive monetary policy as well as to a decline in the public's propensity to save and growing preference for more remunerative financial investments than deposits.

Banks continued to lend to the economy in large amounts, in some cases exploiting to the utmost the margins permitted by the regulations on lending and at some times even overshooting the established ceilings. On the other hand, by raising deposit rates on average much less than the increase in money market rates, they accompanied the public's tendency to replace part of its money balances with securities. The divergence between the growth of domestic lending and that of deposits was met by the banks raising funds abroad for foreign currency lending and tapping their large portfolios of short-term government instruments, which they mobilized whenever the slump in deposits was most marked.

On the basis of end-of-year data, the increase in deposits in lire went down from 20% to 12.7% between 1979 and 1980, that in lending in lire, including bankers' acceptances, from 20.9% to 13.7% and that in securities portfolios from 15.6% to 12.5%. In the first half of the year, however, when the decline in intermediation was greatest, lending in lire increased by 20.3% on an annual basis and deposits by 9.6%, while securities decreased by 10.3%. Foreign currency loans to residents rose

during the year by 101.6% (28.2% in 1979), bringing the total growth in domestic lending to 19.8% (Tables 24 and 25).

Table 24

THE ACTIVITY OF THE BANKS: INDICATORS

	1975	1976	1977	1978	1979	1980		
						year (*)	Half-year	
							I	II (*)
PERCENTAGE CHANGES (1)								
Bank reserves (2)	24.9	9.9	22.4	27.2	13.6	10.7	8.2	13.2
Deposits	25.0	22.0	23.2	23.1	20.0	12.7	9.6	15.7
Credits	24.2	18.8	24.8	18.1	18.5	16.0	-8.6	21.2
Lending (3)	14.1	22.8	14.2	9.7	21.3	19.8	25.1	14.8
Treasury bills	199.8	-5.2	165.8	30.5	7.0	39.9	-32.1	188.3
Long-term securities (4)	29.1	16.4	21.2	27.2	18.6	2.7	-2.8	9.6
FINANCIAL RATIOS								
<u>Excess reserves</u> (5)	2.5	1.9	1.8	1.9	1.7	1.4	1.5	1.4
Deposits								
<u>Deposits</u> (5)	65.6	66.1	68.0	68.1	66.4	64.4	65.5	64.4
<u>Domestic financial assets</u> (6)								
<u>Loans to the economy</u> (7) .	....	73.6	66.7	61.3	80.4	69.1	73.0	66.8
<u>Total domestic credit to the economy</u> ..								
<u>Credit to enlarged public sector</u> (7) ....	....	15.2	66.3	35.1	31.5	25.7	-63.9	63.0
Enlarged PSBR								

(*) Provisional data.

(1) The half-yearly rates of increase are seasonally adjusted and calculated on a yearly basis. — (2) Bank reserves (excess and compulsory and non-interest-bearing deposit on loans in excess of the ceiling) are adjusted for changes in the compulsory reserve coefficient. — (3) The figures include bankers' acceptances and are adjusted for the effect of the funding of bank loans to hospitals, local authorities and IRI. — (4) Figures adjusted for the effect of the funding of bank loans to hospitals, local authorities and IRI. — (5) Percentage ratio of average values for the period. — (6) Excluding shares. — (7) Ratio of flows.

The expansion of bank lending in 1980 was, together with that in 1979, among the largest recorded in recent years. Yet the supply of credit (measured as the ratio of lending to the economy to gross domestic product at current prices) fell to exceptionally low levels at a time of a considerable upturn in investment (Chart 7). The reduced supply of credit and the increase in its cost prompted firms to cut-back output, particularly in the third quarter, in order to limit the build-up of stocks; in fact stocks of finished products rose less than in similar recessions.

The combination of a faster expansion of credit with signs of severe and increasing restriction was the outcome of the contrast between an exceptionally large growth of real demand and monetary policy action,

BANKS' ASSETS AND LIABILITIES (*)

(amounts and changes in billions of lire)

	Amounts at end of 1980 (**)	Changes						
		1978	1979		1980			
		Year	Half-year		Year	Half-year		Year (**)
			I	II		I	II (*)	
ASSETS								
Bank reserves (1)	39,008.0	6,965.2	71.4	4,218.9	4,290.3	688.8	3,587.5	4,276.3
Excess reserves	4,668.6	1,888.9	-3,339.8	2,122.0	-1,217.8	-1,472.2	2,075.8	603.6
Compulsory reserves and backing for cashiers' cheques	33,748.4	5,076.3	3,411.2	2,096.9	5,508.1	1,715.6	1,330.8	3,046.4
Non-interest-bearing deposit	591.0	—	—	—	—	445.4	180.9	626.3
Credit	237,983.9	26,408.9	13,657.4	18,393.9	32,051.3	3,587.9	29,489.2	33,077.1
Lending (2)	125,775.1	7,680.4	4,957.3	13,560.0	18,517.3	8,998.9	11,424.4	20,423.3
<i>of which: in foreign currency</i>	14,807.5	-841.9	2,091.0	-476.4	1,614.6	2,701.8	4,759.7	7,461.5
Treasury bills (3)	33,487.5	5,217.5	-618.6	2,199.8	1,581.2	-4,207.6	13,763.6	9,556.0
Long-term securities (4)	78,721.3	13,511.0	9,318.7	2,634.1	11,952.8	-1,203.4	4,301.2	3,097.8
<i>of which: securities to fund debts</i>	6,941.7	641.0	-539.3	-364.1	-903.4	-668.9	153.5	-515.4
Bad debts and dishonoured bills	5,752.9	799.8	469.9	915.7	1,385.6	1,128.8	506.3	1,635.1
Shares	3,032.4	365.7	295.5	45.4	340.9	266.6	458.6	725.2
Interbank accounts	58,780.5	9,491.9	-6,387.6	13,037.1	6,649.5	-5,006.0	18,198.9	13,192.9
<i>of which: deposits with special credit institutions (5)</i>	4,721.1	854.7	-347.4	470.6	123.2	300.7	764.0	1,064.7
TOTAL	344,557.7	44,031.5	8,106.6	36,611.0	44,717.6	666.1	52,240.5	52,906.6
LIABILITIES								
Deposits	253,231.2	35,104.9	6,498.9	31,015.6	37,514.5	-2,281.4	30,868.6	28,587.2
Saving deposits	112,550.4	13,771.7	2,386.1	11,325.7	13,711.8	-1,596.3	12,516.4	10,920.1
Current account deposits	140,680.8	21,333.2	4,112.8	19,689.9	23,802.7	-685.1	18,352.2	17,667.1
Other deposits	1,899.8	1,344.9	-430.7	158.5	-272.2	-212.0	-193.1	-405.1
Foreign currency accounts of residents ...	482.8	113.7	-142.5	78.2	-64.3	-5.6	-26.1	-31.7
Third parties' funds held in trust	1,417.0	1,231.2	-288.2	80.3	-207.9	-206.4	-167.0	-373.4
Interbank accounts	52,453.2	7,435.9	-6,713.1	10,826.7	4,113.6	-4,100.3	16,007.6	11,907.3
<i>of which: special credit institutions' deposits (6)</i>	5,347.0	571.5	-452.2	-321.1	-773.3	382.9	43.6	426.5
Lending by BI-UIC (1)	2,426.8	-242.0	1,434.8	1,491.0	2,925.8	-2,079.5	-730.7	-2,810.2
Net foreign position (7)	14,317.9	-1,157.8	2,263.9	-1,260.2	1,003.7	2,980.9	5,041.6	8,022.5
Equity capital	12,450.3	1,231.5	1,732.4	313.2	2,045.6	2,289.5	365.5	2,655.0
Other items	7,778.5	314.1	3,320.2	-5,934.0	-2,613.4	4,068.9	880.9	4,949.8

(*) The changes 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 and 34). Differences may occur between the changes and the stocks of these tables and of other tables on banks either because the statistical source is not the same or because the stocks refer to a sample of banks. — (**) Provisional data.

(1) The figures used for excess and compulsory reserves, lending by BI-UIC and the non-interest-bearing deposit on loans in excess of the ceiling are taken from the consolidated balance sheet of the BI-UIC, which is the statistical source used for calculating the monetary base. — (2) Includes bankers' acceptances. — (3) At face value. — (4) Changes in long-term securities are calculated on the basis of market prices during the year. — (5) Include interest-bearing certificates and certificates of deposit, taken from banks' accounts. The changes in the remaining deposits are calculated from the accounts of the special credit institutions. — (6) Changes are taken from the special credit institutions' accounts. — (7) The net foreign position of the banks, which in this table is taken from the balance-of-payments statistics, does not coincide with the balance between foreign assets and liabilities in banking statistics owing to the different criteria used when recording operations with "non-residents". Also includes the convertible currencies forming part of the excess reserves.

which, in view of the surge in inflation and the deterioration in the balance of payments, aimed at maintaining the credit aggregates within the programmed values.

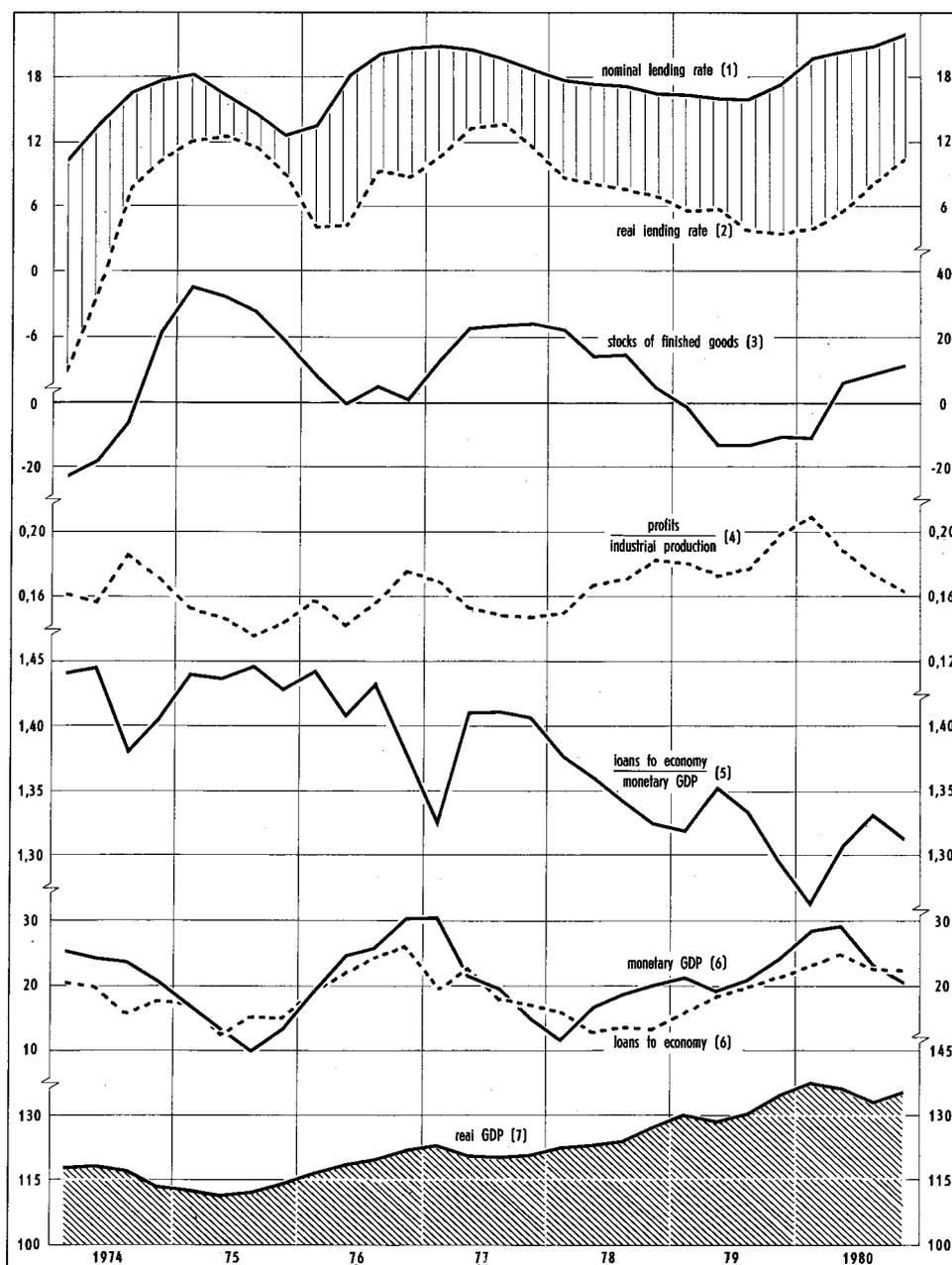
The pressure exerted by the divergence between demand and supply led banks to exceed the ceiling on lending in the crucial months between the end of 1979 and the beginning of 1980 and caused exempt credits to expand far more than in the past. Subsequent measures gradually cut down the various forms in which the targets for credit expansion were exceeded, but were unable to bring that expansion back within the limits set for the year.

Following the March provision requiring banks which had lent in excess of the ceiling to make a non-interest-bearing deposit proportional to that excess, in June the frequency of controls was stepped up from every two months to once a month and the amount of the deposit was raised. After these measures had been taken the amount of lending in excess of the ceiling became negligible from a macroeconomic point of view. However, the divergence between the rates of increase of loans exempt from the ceiling and of those subject to it widened further, thus causing a greater distortion in the distribution of credit among categories of lenders and categories of borrowers. Consequently in January 1981 almost all exemptions were abolished. In March 1981 a limit was also placed on bankers' acceptances, to the effect that they may not exceed a given proportion of the capital of the accepting bank. Although this provision has not immediately cut the number of outstanding acceptances it has made it less likely that they will over-expand as a means of circumventing the ceiling.

Banks made only limited use of changes in lending rates in order to satisfy credit demand in excess of the permitted ceilings. The largest increases were in fact made at the same time and in the same amount as the increases in the discount rate, a practice already adopted for several years but which, although representing a simple criterion for the adjustment of lending terms to changed monetary policy, does not take account of the continuous evolution of the factors that determine market demand and supply (Chart 7). An increase of only half a point, on the other hand, was made in March, after the introduction of the non-interest-bearing deposit had provided a direct incentive to adjust the earnings on loans, and another increase of the same magnitude in July, when the size of the deposit was increased.

The announcements of an increase in the prime rate that the Italian Banking Association made after each rise in the discount rate in 1979 and 1980 were accompanied by much smaller or even no changes in the

Chart 7



Bank loans and economic activity

(1) Average overdraft rate recorded by the Central Risks Office. — (2) Lending rate net of the expected rate of change in wholesale prices in the following six months (calculated by the Banca d'Italia on the basis of Mondo Economico data). — (3) Stocks of finished products in industry: monthly averages obtained from ISCO-Mondo Economico surveys. — (4) Ratio of gross profits to output in industry excluding construction; seasonally adjusted data at current prices (calculated by the Banca d'Italia, from data supplied by Istat and the Ministry of Labour and Social Security). — (5) Ratio of the average monthly stock of loans to the economy (including bad debts and acceptances issued) to gross domestic product. — (6) Percentage rates of increase in the 12 months ending in the reference quarter. — (7) Index number of gross domestic product at constant prices, seasonally adjusted; index, 1970=100.

interest rates on deposits fixed by the interbank agreement. Although the actual interest rates paid to depositors rose more than the cartel rates, the above behaviour suggests that the banks had agreed among themselves not to try to withstand the fall in the rate of expansion of deposits. A larger volume of deposits could not have been lent in any case because of the ceiling, and investing it in securities would probably not have been profitable because depositors' access to the Treasury bill market would have made it difficult to boost deposit-taking while keeping a sufficiently wide spread between its cost and the yield on securities. Anyway, banks could rely on a share of their deposits remaining relatively stable because linked to the various payments services offered or barely affected by the yield on alternative investments so that they could be retained with relatively low rates of return.

In any case the changes that took place in 1980 merely brought the share of deposits in total financial assets back to the levels of end-1974 after an exceptionally large growth in the years between 1973 and 1978 when the lack of financial instruments suited to a period of high inflation had caused a general shift in the public's preferences over to liquid assets (Table 24). Whereas in the past, however, the alternative to deposits had been long-term securities, it now consists basically of Treasury bills, which makes government securities particularly competitive to bank deposits in periods of tight monetary policy.

The shift in the public's demand from deposits to securities did not have any adverse effects on banks' profits since it occurred at a time when the size of the demand for credit and the banks' predominant role in short-term financing of firms allowed them to widen the spread between lending and deposit rates. The difference between interest received and interest paid increased by about 1% of the total volume of funds handled. Adding to this the unit revenues from bank services, also up compared with 1979, the margin of intermediation can be calculated at 5.4%, the highest figure for the last ten years.

The circumstances described above which led to a widening of the spread between bank rates might not recur, however. If they do not, the decline in intermediation will have adverse effects on banks' profits since, unless productivity is improved, operating costs will rise in relation to the volume of funds handled should the latter continue to increase well below the rate of inflation.

The changes taking place in the financial assets market might lead banks to adopt new methods of liability management. In 1980 they already began to accord a very different treatment to large-sized deposits, which were negotiated individually and the interest rates on which closely

followed money market rates, compared with the more stable component: the spread between maximum and normal rates widened considerably as a result. A clear separation between different forms of deposit is still lacking, however. Such a separation would make it possible to distinguish between deposits held as financial investments and deposits kept mainly for transaction purposes and to apply different interest rates to each category, thus improving their competitiveness while containing the increase in interest costs. Higher returns on deposits could also be offset, as far as concerns their effects on bank profits, by rationalizing commissions on services, which at present often do not cover costs.

Domestic credit

The increase of 20,911 billion lire in loans and bankers' acceptances represented a percentage rate of growth that was only slightly lower than the particularly high figure for the previous year (19.8% in 1980 compared with 21.4% in 1979). Over one third of this increase can be put down to a 7,462 billion rise in foreign currency loans, which were exempt from the ceiling on lending. On the other hand, loans in lire, more than half of which were subject to limits, grew by 13.7%, decidedly less than in the previous year (20.9%). Compared with 1979, there was an increase of over 5 percentage points in the rate of expansion of lending to the public sector.

In the first half of the year credit demand rose fairly considerably, partly owing to an increase of around 5% on an annual basis in industrial output and of 20.3% in wholesale prices. This unexpectedly large upturn in demand and the introduction in March of the non-interest-bearing deposit on lending in excess of the ceiling created tensions in the loans market, which led, however, to only moderate increases in lending rates. Since the expansion in bank loans was more than 4 percentage points less on an annual basis than that in output values, the abundant liquidity in the economy at the end of 1979 was reabsorbed.

Between January and July 1980, both deadlines for the ceiling on lending, no increase occurred in loans subject to the limit: whereas in January the ceiling was exceeded by over 3,500 billion, in July a margin of about 300 billion remained. The banks satisfied the demand for credit by resorting primarily to exempt loans: foreign currency loans increased by 103.8% on an annual basis or by 3,289 billion lire while loans for amounts below 130 million rose by 36.2% or 6,324 billion lire.

When the Banca d'Italia renewed the ceiling on 28 June it lowered slightly the maximum permitted expansion of loans from 11.1 % annually for the period September 1979-July 1980 to 10.5% for the months up to March 1981. Economic activity slowed down in the summer months, a trend, however, that did not continue through the last quarter as had been expected. Consequently, there was no let up in credit market tensions, also because in the second half of the year the accumulation of unsold stocks increased firms' external borrowing requirement. The lending rate went up by about one and a half points between June and December 1980, like the discount rate.

The banks attempted to meet demand by increasing loans subject to the ceiling more rapidly than expected, thus exceeding the limit by around 900 billion lire in December. They also continued to expand exempt loans at a fast pace, and between July and December increased those in foreign currency by 3,827 billion (104.9% on a yearly basis) and those in lire for amounts of less than 130 million lire by 28.9%.

In 1980 and the first half of 1981 the Banca d'Italia introduced certain important changes in the ceiling on bank lending. The purpose of the establishment on 14 March 1980 of the non-interest-bearing deposit was to make it more costly for banks to lend in excess of the ceiling while still allowing them a degree of flexibility in the conduct of their credit policy. The new mechanism proved an effective means of reducing the excess lending: between January and December 1980 the number of banks that lent over the limits dropped from more than 450 to 213 and the amount by which they did so from over 4,500 billion to 1,973 billion.

On 28 June the Banca d'Italia stepped up the controls on the ceiling from every two months to once a month and raised the rates of the non-interest-bearing deposit. In fact in the preceding months, and especially following the provision of 14 March, the banks had greatly increased their lending in lire in the months when no controls were made. On 31 January 1981 the Italian Foreign Exchange Office introduced, as of March, a ceiling on foreign currency loans, with the exception of those used to finance exports, to the effect that they should not exceed during 1981 the total amount reached at December 1980. On the same date the Banca d'Italia established that as of April all previously exempt loans in lire, except those to operators in the earthquake regions of Campania and Basilicata, would be included in the ceiling. The share of loans subject to the limits thus rose from 58% of the total to around 93% and the rate of expansion of the new aggregate, set at 16.1% for 1980, has been brought down to 12% for 1981.

Bad debts increased by 1,635 billion compared with 1,386 billion in the previous year and as a percentage of lending rose from 3.9% to 4.6%.

The growth rate was below that for 1979, however, if calculated for the whole of the banking system (39.7% compared with 50.7%) but higher if central credit institutions are excluded (41.4% against 36.3%).

The market for bankers' acceptances developed considerably during 1980 and there was an increased participation on the part of non-bank investors. Acceptances issued by banks rose from 696 billion in December 1979 to 2,343 billion in December of the following year, at which date about half were held by the public (1,187 billion), compared with only 65 billion at December 1979. This market owed its expansion principally to the fact that it allows accepting banks to promote customer relations and increase their earnings from services, without increasing credits subject to the ceiling. For buyers (mostly financial companies, which often resell the instruments to the public) acceptances represent a low risk investment with a return that in 1980 amounted to about 20%.

Since small-sized banks showed a tendency to issue acceptances for large amounts, the Banca d'Italia, at the request of the Interministerial Committee for Credit and Saving, placed a ceiling on such acceptances in the amount of 40% of the capital of the single bank or central credit institution (9 March 1981).

Table 26

BANKS' SECURITIES PORTFOLIO (1)

Type of security	Absolute changes in billions of lire						Securities/Credits in lire (2)	
	1979	1980	Quarters 1980				1979	1980
			I	II	III	IV		
Medium and long-term government securities	7,220.3	-4,303.6	-2,620.9	-1,208.9	-1,972.7	1,498.9	14.3	12.0
Treasury bills	1,573.1	9,557.0	-4,761.8	555.1	773.9	12,989.8	12.2	11.1
<i>of which: major and large banks</i>	-455.7	7,712.1	-1,987.2	155.2	433.1	9,111.0	14.9	13.7
Other securities	4,661.1	4,879.5	624.2	1,809.5	1,176.7	1,269.1	25.1	24.8
<i>of which: major and large banks</i>	2,542.9	4,071.1	736.1	1,111.9	1,290.7	932.4	24.6	25.6
TOTAL ...	13,454.5	10,132.9	-6,758.5	1,155.7	-22.1	15,757.8	51.8	47.9

(1) Adjusted for repurchase and reverse repurchase agreements with the Banca d'Italia. — (2) Percentage ratio calculated on the basis of the average stock in the year.

The increase in the banks' portfolio of securities was extremely moderate: on a balance-sheet valuation and excluding repurchase agreements, purchases totalled 10,133 billion lire, or 10.1% of end-1979 stocks. Both these figures are below those recorded in 1979 (13,454 billion or 15.6%) and in the two preceding years (Table 26). This decline can be ascribed in part to the small increase in bank deposits and in part

to expectations of a rise in yields which prompted banks and non-bank investors alike, especially in the first half of the year, not to renew large quantities of medium and long-term securities.

An examination of the trend of purchases during the year emphasizes the role of residual variable that government securities, and especially Treasury bills, play in banks' balance sheets. In the first three months of the year the larger increase in loans in lire than in deposits led to heavy sales of government instruments (9,235 billion or 17.8%). The situation reversed, however, in the last quarter of the year: the increase in the rate of expansion of deposits and the rise in yields which followed the change in the discount rate at the end of September encouraged banks to resume their investments in Treasury bills. At the end of the year, the share of Treasury bills in banks' portfolios reached a historical peak of 29.8%, compared with 24% at the end of 1979 and 20.7% at mid-1980.

Bonds issued by special credit institutions were purchased in the amount of 84% by banks which slightly increased their share of total outstanding bonds of this type (80.2% compared with 79.9% in 1979). The strong performance of special credit institution bonds, even though not offering higher yields than Treasury credit certificates, should be attributed mainly to the traditionally close links between these bodies and commercial banks, as can also be seen from the concentration of investments among the twelve main banks (Table 26), which have their own special credit divisions or associate institutions. Purchases were also boosted by the provision of July 1980, which exempted until 31 December 1981 (later changed to 30 September 1981) yields on bonds from company and local income tax.

During 1980 the impact of the security investment requirement was almost nil owing to the moderate expansion in the deposits aggregate on the basis of which it is calculated.

Customers' deposits

The increase of 28,587 billion lire (12.7%) in bank deposits in 1980 was not only considerably smaller than in the previous year (37,515 billion or 20%), but was also the smallest since 1969, despite the fact that the growth of GDP was among the highest in recent years. The main reason for this was the moderate increase in the financial assets of the public (15.2% compared with 22% in 1979), which was compounded by a shift in the public's preferences from deposits to securities that had already begun in 1979 (Table 24).

While a further slowdown occurred in general government deposits (from 18.8% to 6.2%; in 1978 they had increased by 58.2%), principally owing to the restitution to the Treasury of social security institutes' funds, those of the Economy increased more than total deposits (13.3% compared with 20.2% in 1979). The decline in the rate of increase in firms' deposits was particularly marked after the considerable expansion in 1979 due to the favourable trend of profits and ample availability of credit: the downturn was extremely sharp (from 26.2% in 1979 to 10.9% in 1980) especially in the first half of the year as firms gradually withdrew previously accumulated liquid assets in order to finance production. The growth of households' deposits also slackened (from 18.8% to 13.7%) owing to a reduced propensity to invest in financial assets and to the competition of government securities.

The decline in intermediation affected most of all the three "major" commercial banks and the two largest savings banks, which operate principally in the large cities and most highly developed areas. Rather than embark on costly attempts to protect their deposits, these banks raised interest rates by the smallest amounts, continuing the policy to limit the cost of fund-raising adopted since 1979. In that year, in fact, the deposit rates applied by the banks in question, which had previously been higher than those of the rest of the banking system, fell to below the average. Together, these five banks have had a reduction in their market share of deposits, calculated on the basis of annual averages, from 22.3% to 21.7%.

Profit and loss accounts

The widening of the margin between interest received and interest paid enabled the banks to cope with a fairly considerable increase in operating costs, particularly for personnel, and to set aside the necessary provisions to meet the exceptionally large increase in bad debts and the devaluation of securities caused by the rise in interest rates. Notwithstanding these financial burdens, banks' profits were very much higher than in the previous year and their capital base was thereby strengthened.

The nearly one point increase (from 3.06% to 4.00%) in the interest margin, calculated as a percentage of total funds handled (Table 27), was achieved through an increase (from 8.55% to 12.24%) in the spread between the yield on loans and the cost of deposits, accompanied by a slight rise in the share of lending in lire in total assets. An opposite effect was exerted, however, by the smaller increase in the yield on securities

than in the interest paid on deposits. The only year in which the interest margin was higher was 1975, following two years of increases caused by similar factors to those at work in 1980, such as a buoyant demand for

Table 27

**PROFIT AND LOSS ACCOUNTS OF THE BANKS:
FORMATION OF PROFIT (1)**

(as a percentage of total intermediated funds)

	1974	1975	1976	1977	1978	1979	1980 (*)
Interest received (2)	10.67	10.93	12.37	12.97	11.57	11.42	13.73
Interest paid	7.01	6.81	8.50	9.40	8.37	8.36	9.73
Interest margin	3.66	4.12	3.87	3.57	3.20	3.06	4.00
Net profit on services	0.78	1.03	1.21	1.25	1.30	1.29	1.39
<i>of which: securities transactions</i>	<i>0.04</i>	<i>0.27</i>	<i>0.26</i>	<i>0.37</i>	<i>0.50</i>	<i>0.50</i>	<i>0.50</i>
Intermediation margin	4.44	5.15	5.08	4.82	4.50	4.35	5.39
Running costs	2.92	3.18	3.31	3.11	2.90	2.84	3.25
<i>of which: personnel costs</i>	<i>2.54</i>	<i>2.73</i>	<i>2.82</i>	<i>2.56</i>	<i>2.37</i>	<i>2.31</i>	<i>2.64</i>
Operating profit	1.52	1.97	1.75	1.71	1.60	1.51	2.14
Depreciation and allowances (3)	1.03	1.39	1.23	1.11	1.01	0.94	1.43
<i>of which: devaluation of loans (3)</i>	<i>0.31</i>	<i>0.44</i>	<i>0.28</i>	<i>0.43</i>	<i>0.42</i>	<i>0.38</i>	<i>0.52</i>
<i>devaluation of securities</i>	<i>0.57</i>	<i>0.59</i>	<i>0.59</i>	<i>0.26</i>	<i>0.08</i>	<i>0.10</i>	<i>0.24</i>
Gross profit	0.49	0.58	0.54	0.60	0.59	0.57	0.71
Taxes and fees	0.35	0.43	0.35	0.40	0.38	0.35	0.43
Net profit	0.14	0.15	0.19	0.20	0.21	0.22	0.28

OTHER DATA

Number of employees	203,205	216,346	227,338	239,901	249,994	261,505	274,749
Intermediated funds per employee (millions of lire)	516	559	641	751	883	1,014	1,132
Cost per employee (millions of lire)	13.08	15.23	18.04	19.26	20.85	23.07	29.83

(*) Provisional data.

(1) Excluding central institutions. — (2) Excluding interest on bad debts. — (3) Excluding allowances for interest on bad debts.

credit and restrictive monetary policy. In 1980, however, the differential between the yield on lending in lire and the cost of deposits was much bigger (12.24% compared with 8.93%). In fact, after 1975 the introduction of limits on the expansion of loans in lire reduced their share

in total funds handled from 41.1% to 32.3%, while the stability of the interest rate on compulsory reserves caused the spread between the unit cost of deposits and the yield on deposits with the Banca d'Italia to widen from 1.9% to 4.9%.

About half of the increase in net revenues from interest receipts and services was taken up by higher operating costs, principally linked to wage negotiations in the banking sector. Between 1976 and 1979 the cost per employee increased at an annual rate of 8.5%, which is much lower than the rise in the value of funds handled per employee (16.5% on average). In 1980 the relation between these two aggregates was reversed and the incidence of personnel costs in funds handled went up from 2.31% to 2.64%.

The satisfactory operating results enabled banks to increase their net profits, despite the fact that taxes paid per lira of intermediation rose from 0.35% to 0.43%. Banks were thus able to increase their capital in 1980 (from 4.1% to 4.6% of deposits) and in the early months of 1981.

The capital market

During 1980 the main feature of the capital market (which covers government securities, bonds and shares) was a marked fall in both demand and supply of fixed-interest securities. In the case of demand this was principally due to increased inflation expectations and to higher interest rates on other financial instruments, while supply was affected by the curtailment of public sector issues, which checked the rise in interest rates. For the first time, banks and non-bank investors taken as a whole did not make net purchases of securities, with the result that over three quarters of issues were taken up by the Banca d'Italia and the rest by the P.O. Deposits and Loans Fund (Table 28).

Although the downward slope of the yield curve became less marked during the year, investors purchased almost exclusively Treasury bills, for an amount greater than the volume of net issues. These securities represented nearly the total net investments of the public and 92% of those of the banks (in 1979 the corresponding shares were 62% and 12%).

The average maturity of securities shortened further during the year under study, reflecting widespread uncertainty regarding longer maturities. This tendency appears even more evident if the broader definition of the capital market is considered (which includes Treasury bills in addition to government securities and bonds). Extensive use of financial indexation mechanisms was able only to limit but not to halt the move away from

medium-term instruments for, although indexed securities offer more advantages than fixed coupon securities, they carry a greater risk of capital losses than three and six-month Treasury bills.

Table 28

NET ISSUES OF BONDS AND GOVERNMENT SECURITIES (1)

(billions of lire)

	Amounts at December		Net issues						
			1978 Year	1979			1980		
	Half-year			Year	Half-year		Year		
	1979	1980			I	II		I	II
ISSUERS									
Public sector . . .	80,707	78,879	19,716	4,422	4,772	9,194	-1,995	106	-1,889
Special credit in- stitutions	55,087	61,422	4,762	2,477	2,179	4,656	2,390	3,257	5,647
Firms and public agencies	13,980	14,295	1,156	923	-280	643	481	-216	265
Total . . .	149,774	154,596	25,634	7,822	6,671	14,493	876	3,147	4,023
INVESTORS									
Banca d'Italia and UIC (1) . .	28,255	31,030	5,781	-6,220	3,448	-2,772	992	2,148	3,140
Banks (1)	85,634	86,679	13,511	9,319	2,634	11,953	-1,523	2,302	779
Other financial in- termediaries . .	6,688	8,419	724	927	958	1,885	639	932	1,571
Firms, households and foreign in- vestors	29,197	28,468	5,618	3,796	-369	3,427	768	-2,235	-1,467
Shares	41,873	55,510	2,985	1,650	1,082	2,732	1,068	1,353	2,421

(1) Net of repurchase agreements.

In the first quarter of 1981 net investments in government securities, particularly by the public, picked up. Expectations of relatively stable interest rates, liquidity conditions, the features of the new two-year Treasury bonds and the revised indexation mechanism applied to Treasury credit certificates aroused the interest of investors, who at the same time resumed heavy purchases of Treasury bills. This move back to medium-term instruments broke off at the end of March, when the interest rate structure leaped upward following a series of monetary policy measures.

The supply of securities

The continued decline in issues of government securities and bonds, net of redemptions and placement losses, appears even more marked when such issues are calculated in relation to GDP. The ratio, in fact, dropped

to 1.2% from 5.4% in 1979 and 11.5% in 1978. Notwithstanding an increased borrowing requirement, the public sector made net redemptions amounting to 1,889 billion lire, compared with net issues to the value of 9,194 billion in 1979 and 19,716 billion in 1978. Only in the case of Treasury credit certificates did issues exceed redemptions (2,691 billion compared with 10,226 billion in 1979), since the Treasury adapted its issuing policy to the changed preferences of investors regarding the time profile of their portfolios by concentrating on Treasury bills (25,500 billion compared with 9,822 billion in 1979).

The special credit institutions met the substantial upturn in lending by increasing net issues (5,647 billion compared with 4,656 billion in 1979), about a quarter of which were financially indexed. The rise in issues by industrial credit institutions (from 1,442 billion to 2,412 billion) and by real estate and agricultural credit institutions (from 2,113 billion to 2,783 billion) was accompanied by a fall in issues by public works institutions (from 1,100 billion to 452 billion). The latter, in fact, were hampered by local finance legislation which forbids local authorities to apply to such institutions for finance without having first approached the Deposits and Loans Fund.

The increase in issues by industrial credit institutions was mainly linked to the measures reducing taxes on interest payments that were decided in the second half of the year. These measures standardized the tax treatment of bonds, first exempting from taxation issues by special credit institutions and then extending this relief to bonds issued by holding companies of State-controlled corporations and by listed joint-stock companies.

Net issues by other categories of borrowers declined again in 1980 (265 billion compared with 643 billion in 1979) despite the considerable growth of firms' borrowing requirements, which were instead increasingly met with bank loans and external finance. ENEL stepped up its net issues compared with 1979 (from 337 billion to 456 billion), partly to compensate a smaller increase in its endowment fund, but these were nevertheless still below the levels recorded in earlier years. Private firms increased their recourse to the market (72 billion compared with 16 billion in 1979), issuing convertible bonds to the value of 51 billion in the hope of attracting savers to forms of investment similar to risk capital. ENI, IRI, EFIM and the Autostrade company made net redemptions, partly as an effect of fiscal discrimination that was only abolished at the end of 1980. An issue was also made by the EIB, for a gross amount of 50 billion.

The demand for securities

The public (economy and foreign sector) made net disinvestments during 1980 amounting to 1,467 billion. The rise in interest rates on alternative financial assets, the spreading of expectations of higher inflation and the continued downward slope of the yield curve caused a fall in demand for medium-term securities. This signalled the end of the gradual move back to the market that had begun in 1978 and continued through 1979, when the public's purchases of medium and long-term securities had risen to 23.6% (Table 29 and Chart 8). However, if

Table 29

NET PURCHASES OF BONDS BY CLASS OF INVESTOR

(percentage breakdown)

Class of investor	1961	Yearly average 1967-76	1977	1978	1979	1980
Banca d'Italia and UIC (1)	3.8	24.4	36.4	22.6	-19.1	78.1
Banks (1)	24.5	57.1	60.0	52.7	82.5	19.4
Other financial intermediaries . . .	9.9	2.5	0.5	2.8	13.0	39.0
Firms, households and foreign investors	61.8	16.0	3.1	21.9	23.6	-36.5
Total	100.0	100.0	100.0	100.0	100.0	100.0
Total in billions of lire . . .	931	5,967	21,017	25,634	14,493	4,023

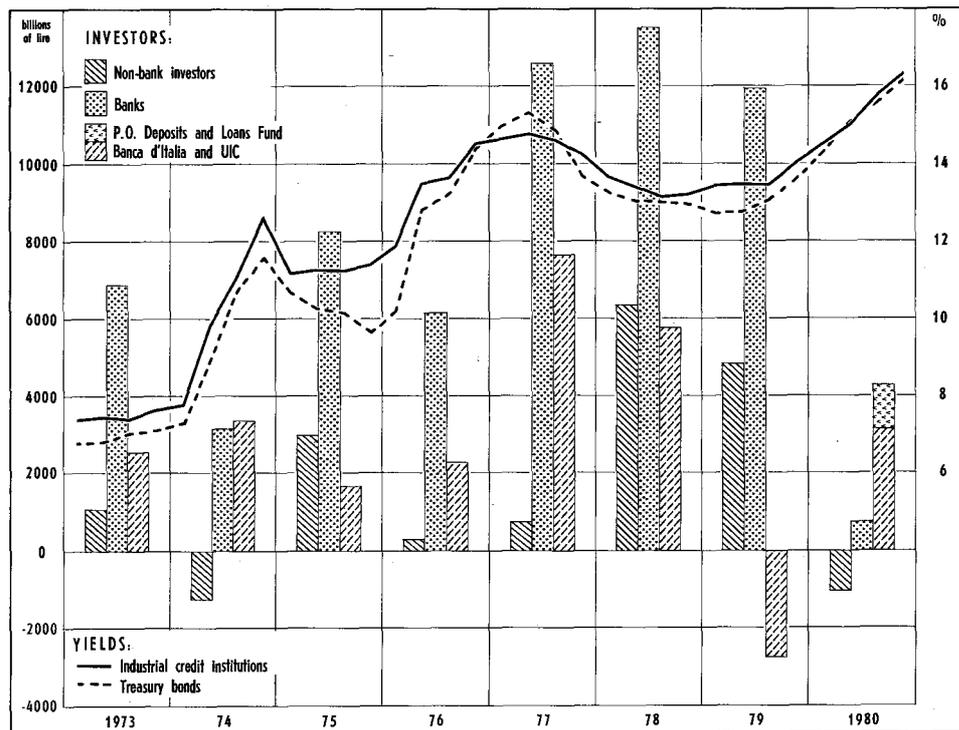
(1) Net of repurchase agreements.

Treasury bills are included, the public's purchases are shown to have remained more stable as a share of the market (49.3% compared with 29.6% and 49.2% in 1978 and 1979) and as a ratio of GDP (4.3% compared with 4.4% in 1979 and 4.2% in 1978). On the other hand, the maturity composition of the public's portfolio changed considerably. Purchases of Treasury bills reached a figure of 15,833 billion compared with 8,532 billion in 1979, representing almost all the public's investments, and purchases of Treasury credit certificates fell to 1,208 billion (3,087 billion in 1979), while Treasury bonds closed with net disinvestment amounting to 1,267 billion, compared with purchases for 1,159 billion in the previous year. The result was a substantial shortening of the average maturity of the public's portfolio.

Among medium and long-term securities the public's net purchases were almost exclusively of Treasury credit certificates, because of their

indexation mechanism, but were much less abundant than in previous years. The continued rise in interest rates on other securities in fact meant that although the six-month coupon rate on indexed securities increased it could not compete with the current yields on other assets. Hence, the difference between coupon rate and current interest rates led to frequent decreases in the prices of Treasury credit certificates, which although not large were enough to discourage investors. In view of this tendency it was decided to adopt, for 1981, a new indexation mechanism, which would bring the coupon rate closer into line with short-term interest rates.

Chart 8



Bond yields and net issues by class of investor

A marked shift also occurred in the distribution of government securities and bonds among categories of holders, with the public's share declining to 18.4% from 19.5%. If Treasury bills are included the share instead shows an increase from 24.1% to 27.5%.

The banks' purchases of government securities and bonds were almost nil if calculated net of repurchase agreements (779 billion compared with 11,953 billion in 1979) and the proportion of their deposits invested in securities also declined, from 33.8% at the end of 1979 to 31.1% at the end of 1980. This small volume of purchases was the result of large sales of public sector securities (4,335 billion), more than offset by purchases of

other issuers' bonds (5,114 billion). As in the case of the public, the banks' purchases also shifted towards Treasury bills. However, total security investment decreased (10,335 billion, compared with 13,534 billion in 1979) owing to the increase in lending and the slowdown in deposits (Table 30). These factors also affected the trend of purchases of

Table 30

SHORT, MEDIUM AND LONG TERM SECURITIES

(billions of lire)

	Amounts at December 1980	Net issues						
		1978 Year	1979			1980		
			Half-year		Year	Half-year		Year
			I	II		I	II	
Public sector	152,633	25,597	8,096	10,919	19,015	8,256	15,355	23,611
Treasury bills	73,754	5,881	3,674	6,147	9,821	10,251	15,249	25,500
Treasury credit certificates	28,180	9,683	4,500	5,726	10,226	685	2,006	2,691
Other	50,699	10,033	-78	-954	-1,032	-2,680	-1,900	-4,580
Special credit institutions and enterprises	75,717	5,918	3,400	1,899	5,299	2,871	3,041	5,912
TOTAL ...	228,350	31,515	11,496	12,818	24,314	11,127	18,396	29,523
Banca d'Italia and UIC (1)	33,671	2,180	-8,221	5,119	-3,102	2,065	59	2,124
Treasury bills	2,641	-3,601	-2,001	1,671	-330	1,073	-2,089	-1,016
Treasury credit certificates	9,131	2,591	-3,641	3,814	173	1,152	3,297	4,449
Other	21,899	3,190	-2,579	-366	-2,945	-160	-1,149	-1,309
Banks (1)	120,166	18,728	8,700	4,834	13,534	-5,731	16,066	10,335
Treasury bills	33,487	5,217	-619	2,200	1,581	-4,208	13,764	9,556
Treasury credit certificates	10,232	4,518	4,990	1,029	6,019	-2,814	260	-2,554
Other	76,447	8,993	4,329	1,605	5,934	1,291	2,042	3,333
The public	74,513	10,607	11,017	2,865	13,882	14,793	2,271	17,064
Treasury bills	37,626	4,265	6,294	2,276	8,570	13,386	3,574	16,960
Treasury credit certificates	8,817	2,574	3,151	883	4,034	2,347	-1,551	796
Other	28,070	3,768	1,572	-294	1,278	-940	248	-692

(1) Net of repurchase agreements.

government securities, leading to heavy sales in the first half of the year and large purchases in the second. Purchases of securities issued by special credit institutions exceeded the previous year's level, partly because of the links between these institutions and the commercial banks and partly owing to the extensive use made of indexation mechanisms.

The Banca d'Italia made net purchases excluding repurchase agreements, amounting to 3,140 billion (78.1% of total issues), compared with net sales to the value of 2,772 billion in 1979; the aim was to spread the increase in medium-term interest rates during the year. Specifically, the Bank made massive purchases of Treasury credit certificates (4,449 billion) in order to take up the excess supply, whereas its purchases of Treasury bonds were modest, partly because almost no issues were made. The volume of intervention in the stock market was moderate: 99 billion worth of purchases and 72 billion of sales, with sales predominating in the second quarter and purchases in the rest of the year. At the end of the year, the Banca d'Italia's portfolio of medium and long-term instruments was larger than in 1979: 31,030 billion compared with 28,255 billion. On the other hand, its stock of Treasury bills had dropped from 3,657 billion to 2,641 billion.

The P.O. Deposits and Loans Fund became very much more active in the market during 1980 with purchases to the value of 1,175 billion (206 billion in 1979), which were the result of investments in bonds issued by industrial credit institutions (1,232 billion) and sales of other categories of securities. Of the other financial intermediaries, insurance companies greatly expanded their purchases of government securities and bonds.

Interest rates

Yields on medium and long-term securities continued to rise as they had been doing since the second half of 1979. Those on government instruments went up from 14.00% in December 1979 to 16.23% in December 1980, with a similar increase in the average value for the year (from 13.12% in 1979 to 15.29% in 1980), while bond yields rose from 14.46% to 16.42% from December to December and from 13.78% to 15.64% as an average annual value (Table 31).

The upward trend developed gradually throughout the year, except for a brief spurt in October after the raising of the discount rate and a period of stability in the subsequent months. In the early months of 1981 yields began to move up again and, after the further increase in the discount rate to 19%, accelerated sharply in March and April, reaching 18.37% on government securities and 19.21% on bonds. In the first four months of 1981 the increase was of the same order of magnitude as in the whole of 1980.

The rising trend of yields- on medium and long-term securities was both sharper and continued longer than the previous upswing experienced

Table 31

AVERAGE MATURITY YIELD ON FIXED-INTEREST BONDS

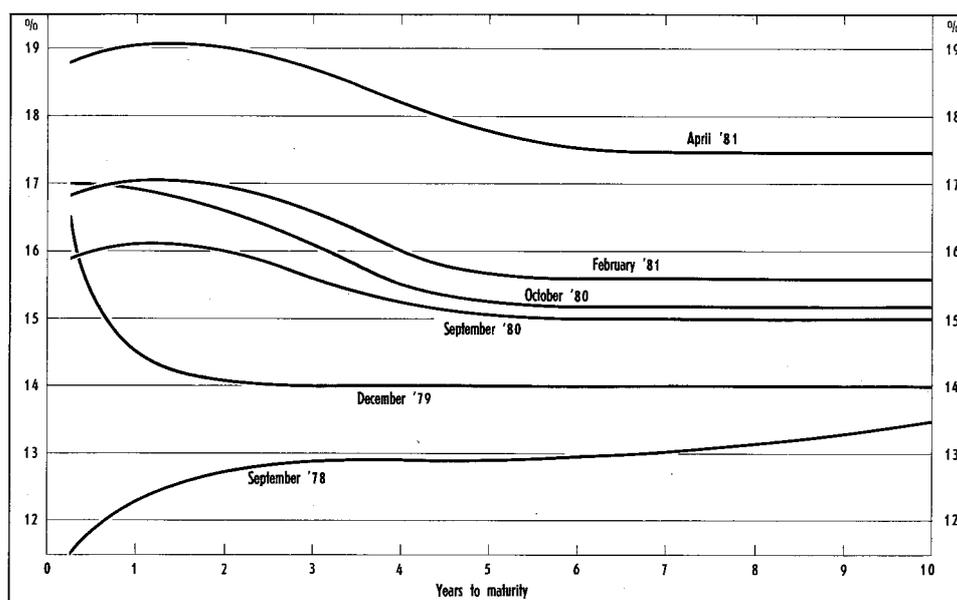
Assets	Apr. 1977	Sept. 1978	June 1979	Dec. 1979	Dec. 1980	Apr. 1981	Changes between			
							Apr.'77 Jan.'76	Sept.'78 Apr.'77	Dec.'80 Dec.'79	Apr.'81 June'79
Government securities	15.37	12.91	12.83	14.00	16.23	18.37	5.44	-2.46	2.23	5.54
Consolidated ...	6.43	6.99	7.48	7.51	8.69	10.26	1.25	0.56	1.18	2.78
Redeemable	15.49	14.02	13.87	15.30	17.85	18.92	4.64	-1.47	2.55	5.05
Treasury bonds .	15.42	12.79	12.75	13.93	16.17	18.36	5.81	-2.63	2.24	5.61
Other bonds	14.94	13.13	13.65	14.46	16.42	19.21	3.77	-1.81	1.96	5.56
On behalf of Treasury	14.99	13.21	14.02	14.62	16.88	20.11	3.42	-1.78	2.26	6.09
Industrial credit institutions	14.92	12.93	13.42	14.27	16.30	18.90	3.68	-1.99	2.03	5.48
Real estate credit institutions	14.51	13.33	13.63	14.53	15.84	18.48	4.60	-1.18	1.31	4.85
ENEL-ENI-IRI .	14.92	13.03	13.52	14.37	16.33	19.13	3.69	-1.89	1.96	5.61
Other companies	15.92	13.57	14.32	15.27	17.36	21.78	4.06	-2.35	2.09	7.46

by the capital market between January 1976 and April 1977. The worsening of inflation expectations that had already begun in 1979 caused a parallel expectation of a rise in interest rates, thus considerably dampening demand for these instruments. The effect on interest rates and the related reaction of the monetary authorities were reflected in the level and shape of the yield curve. In December 1979, following the raising of the discount rate from 12% to 15%, the curve displayed a sharp downward slope in its initial tract, mirroring the authorities' decision to bring short-term interest rates into line with changed expectations (Chart 9). In the months that followed, medium-term rates gradually rose, while the rates on Treasury bills remained more or less stationary, at least until September 1980: the downward slope of the curve thus became less marked and sometimes even reversed at the beginning. The trend of interest rates and of their structure was cautiously directed towards achieving a moderately rising slope that would attract investors back to medium-term instruments, in the belief that the government would take measures to affect the real sector of the economy and improve inflation expectations.

In the autumn, after the fall of the government, it was decided to raise short-term interest rates so as to prevent disturbances on the foreign

exchange market, which sharpened the downward slope of the curve. Lastly, in March 1981, the worsening of exchange market pressures and the government's persistent delay in taking general economic policy measures made a new increase in short-term interest rates necessary; this, however, was accompanied by an equally large rise in interest rates on other maturities. The new yield curve, which has only a slight downward slope, will represent a basis for a recovery of the public's investments as soon as expectations begin to show an improvement, however small.

Chart 9



Time/yield curves

Share issues

Share issues remained at practically the same level- as in the preceding two years, both including issues made to finance purchases of shares issued by subsidiaries (3,470 billion compared with 3,894 billion in 1979) and net (2,421 billion compared with 2,732 billion). On the other hand, their distribution by issuer was very different, with a large fall in issues by listed State-controlled corporations and a marked increase in those by smaller sized private companies (Table 32).

The decline in issues by listed State-controlled corporations is only at first glance surprising for a year of exceptionally high increases in stock market quotations, since the policy they have followed in recent years

regarding increases in share capital has not been affected by current conditions on the secondary market. It should also be borne in mind that some of the extremely large additional share issues made towards the end

Table 32

GROSS SHARE ISSUES

Issuers	Billions of lire				Percentage breakdown			
	1977	1978	1979	1980	1977	1978	1979	1980
Listed	664	2,028	1,901	1,355	28.2	56.2	48.8	39.0
State-controlled corporations	354	1,660	1,548	737	15.0	46.0	39.7	21.2
private firms: main	301	349	334	566	12.8	9.7	8.6	16.3
others ...	9	19	19	52	0.4	0.5	0.5	1.5
Unlisted	1,693	1,580	1,993	2,115	71.8	43.8	51.2	61.0
State-controlled corporations	668	579	961	888	28.4	16.1	24.7	25.6
private firms: main	152	134	356	288	6.4	3.7	9.1	8.3
others ...	873	867	676	939	37.0	24.0	17.4	27.1
TOTAL	2,357	3,608	3,894	3,470	100.0	100.0	100.0	100.0
State-controlled corporations	1,022	2,239	2,509	1,625	43.4	62.1	64.4	46.8
private firms: main	453	483	690	854	19.2	13.4	17.7	24.6
others ...	882	886	695	991	37.4	24.5	17.9	28.6

of 1980 are not included in the statistics for that year since they were only placed in the early months of 1981: this is the case of 426 billion of the Finsider issue, equal to three tenths of a total capital increase of 1,420 billion, of 104 billion of the Snia Viscosa issue and, among the private companies, of 172 billion of the Fiat issue. The increase in issues by smaller sized private companies was connected with the expiry of the period allowed for companies to conform with minimum capital requirements (18 December 1980); this deadline, which was postponed to 31 December 1981 for companies located in southern Italy and to 30 April 1981 for others, also led to a large decline in the number of joint-stock companies as many decided to change to other forms of association.

Share demand and unit trusts

The annual survey of share ownership conducted on the basis of the balance sheets of companies and public bodies provides a basis for a cautious assessment of the evolution that the corporate system has been

undergoing for several years. It would appear, in fact, that the need to reorganize the productive and financial structure has led in recent years to large increases in company capital, either through share issues or through transfers of assets in connection with split-ups of companies into the same branches of production; this has led to a rise in the proportion of shares held by "companies" (Table 33). In 1980 "companies" continued to increase their share (from 58.1% to 59.8%) while there was a reversal of the trend of "the public" (rising from 15.0% to 16.7%), who displayed a renewed interest in share purchases.

Table 33

SHARE CAPITAL BY CLASS OF INVESTOR
(amounts at end-year; percentage breakdown; total in billions of lire)

Investor	Yearly average 1966-76	1977	1978	1979	1980
The public	29.3	15.5	17.4	15.0	16.7
Public agencies	20.9	11.2	11.6	12.5	11.2
Companies	28.7	52.6	53.5	58.1	59.8
Foreign sector	17.2	15.7	12.5	9.6	8.5
Banking system	2.0	2.9	3.0	3.2	2.3
Other financial intermediaries	1.9	2.1	2.0	1.6	1.5
Total ...	100.0	100.0	100.0	100.0	100.0
listed	30.9	25.1	26.5	20.4	15.1
unlisted	69.1	74.9	73.5	79.6	84.9
Total share capital at market value	22,276	35,723	52,019	77,591	123,267

The net assets of unit trusts authorized to operate in Italy more than doubled, from 509 billion at the end of 1979 to 1,127 billion at the end of 1980. This large increase concerned in particular their securities portfolio: shares rose from 304 billion to 708 billion and "other securities" from 116 to 297 billion. The increase in liquid assets, on the other hand, was less marked, from 89 to 122 billion. These trends point to a change in the composition of unit trusts' net assets, the share of liquid assets having declined sharply (from 17% to 11%) and that of shares and "other securities" having increased (from 60% to 63% the former and from 23% to 26% the latter).

Share prices

During 1980 a severe adjustment took place in the stock market evaluation of listed companies as at the end of 1979: a comparison of

quotations for December shows an average increase of 73.3%, which is only lower than the increases of 1944 and 1947.

This upward revision, which in the first half of the year led to a 13.0% rise in share prices, became sharpest in the following four months with a rise of 63.4% that was only partly offset by the decline of 5.2% in the last two months of the year. At the end of the year the Banca d'Italia's share index (1958=100) rose to 157.6, that is back to the levels of 1970. This increase in quotations was accompanied by a large growth of transactions, which on the Milan stock exchange totalled a value of 7,334 billion (compared with 2,875 billion in 1979).

The upsurge of share prices made it possible to revive a form of finance little used by firms in recent years, since additional share issues are either impossible or extremely costly when quotations are low. Conditions were therefore suitable for stepping up recourse to private saving, in line with the aim to improve the structure of firms' liabilities and reduce the excessive risks taken to date by the banking system.

The year under study saw a return of small savers to the share market. The public, whose net flow of saving was extremely large and segmented, generally placed discretionary orders, which, given the small number of listed companies and insufficiently elastic supply, pushed up prices considerably. The continued erosion in recent years of the real value of capital invested in financial assets prompted savers, aware of the extent of their previous losses, to disregard the risk attached to share investment.

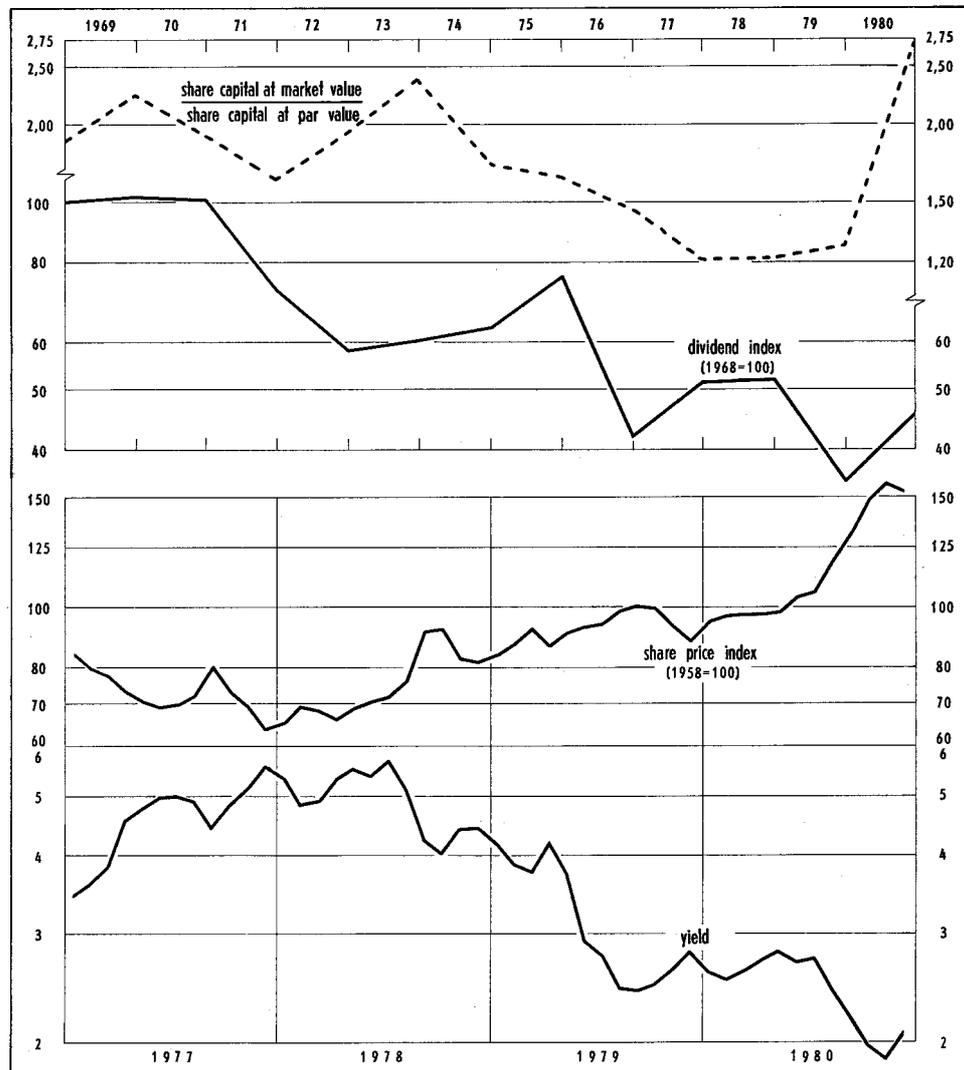
Several other reasons also combined to bring about the revaluation of listed companies, such as the improved profitability of some companies or the correction of over-pessimistic assessments of others, the support provided by a number of companies which purchased their own shares (which in an efficient market should not have any effect on prices), the more active participation of institutional investors such as unit trusts, and the increase in purchases for the purpose of acquiring large blocks of shares giving part control over a company.

Dividends, calculated on the basis of the same amount of capital, increased by 28.4%, but, mainly for fiscal reasons, continued to represent only a very small part of the yield on shares. At December the ratio of dividends to the current value of shares was 2.1% (compared with 2.8% in the previous year), which is much lower than in the other main industrial countries, where the size of distributed dividends has a stabilizing effect on prices (Chart 10).

On the over-the-counter market, set up in May 1978, quotations of listed securities continued to rise for the third year running. The Banca

d'Italia's ex-dividend price index (10 May 1978=100) reached 491.7 at December, an increase of 120.9% from the previous December.

Chart 10



Prices, yields and other share market indicators

(logarithmic scale)

In the first three months of the present year share prices have again risen, by 31.1% on the main market and by 23.1% on the over-the-counter market.

The activity of the special credit institutions

The special credit institutions' share of financing to the Economy turned up sharply, benefitting not only from the ceiling on bank lending

but also from the surge in investment, the partial recovery in subsidized credit and the broader range of fund-raising instruments employed.

Domestic outlays amounted to 18,321 billion, compared with 12,879 billion in 1979. Net of export credits, the ratio to the volume of investment during the year was 25.5%, as against 23.6% the year before. This was nonetheless lower than in 1978 (29.1%). Even when account is taken of the fact that investment was at a relatively low level in 1978, the value of the ratio for last year is in line with the downward trend of the relative importance of special credit, which is attributable to public enterprises turning to other sources of finance, to the difficulties of some large industrial groups, and to the delays in the implementation of new credit incentives.

The recovery in subsidized credit after two years of stagnation was not so much due to the incentives for industrial restructuring or the getting under way of the ten-year building plan as a consequence of the expansion of export and agricultural credit. Public intervention in industry was not curbed, however, but took different forms from subsidized credit in the strict sense, such as funding operations under Law 787 of 1978 and those of the P.O. Deposits and Loans Fund, which were mainly designed to solve the financial problems connected with the crises of large chemical groups. The special credit institutions' fund-raising on international markets also received more public support through the extension of exchange risk guarantees to a broader range of operations.

In a period of rapid inflation and weak preference on the part of customers for longer term fixed rate loans, there was also a tendency, which was particularly marked in the case of industrial credit institutions, to expand less traditional forms of lending in a process of despecialization, principally with regard to maturities, that is affecting the whole credit system.

The short-term operations undertaken by the industrial credit institutions, consisting mainly of advances to industrial firms, rose to a high level with the gross flow amounting to nearly 50% of non-subsidized outlays in 1980.

One of the reasons why the distinction between credit with different maturities has grown weaker is that borrowing beyond the short term is no longer marked, as was once considered to be essential, by being at a fixed cost for the duration of the commitment. Contrary to what happened until 1979, a large proportion of loans, especially to the industrial sector, were at variable rates linked to those on the money and capital markets. The lower risk compared with fixed rate borrowing may have encouraged

the expansion of this form of special credit in 1980 in view of the considerable uncertainty about the future course of prices.

The rate of increase in outstanding domestic loans amounted to 13.9%, compared with respectively 10.7% and 13.6% in 1979 and 1978. After rising faster than this aggregate in the last few years, overdue and bad debts rose at roughly the same rate in 1980.

Table 34

ASSETS AND LIABILITIES OF THE SPECIAL CREDIT INSTITUTIONS
(billions of lire)

	Amounts at December 1980	Changes						
		1978	1979			1980		
			Half-year		Year	Half-year		Year
			I	II		I	II	
ASSETS								
Loans: domestic (1)	69,358	6,638	1,631	4,181	5,812	2,662	5,762	8,424
foreign	2,816	64	13	56	69	341	319	660
on behalf of the Treasury	11,403	-289	-265	-346	-611	-263	-393	-656
Security portfolio:	3,657	618	1,053	-292	761	307	-96	211
of which: Treasury bills	2,204	450	890	-421	469	-210	213	3
Cash and liquid assets	6,122	346	-1,612	-1,164	-2,776	230	285	515
with: B.I. in foreign currency (2)	552	-818	-963	-949	-1,912	-41	6	-35
B.I. in lire (2)	159	531	-117	74	-43	-116	-634	-750
banks	4,382	571	-452	-321	-773	383	44	427
others	1,029	62	-80	32	-48	4	869	873
Others (3)	6,146	-360	1,139	-335	804	699	-809	-110
Total	99,502	7,017	1,959	2,100	4,059	3,976	5,068	9,044
LIABILITIES								
Bonds (4): ordinary	61,422	4,763	2,477	2,179	4,656	2,390	3,257	5,647
on behalf of the Treasury	11,714	-397	-425	-266	-691	-368	-197	-565
Deposits and interest-bearing certificates	7,444	1,326	25	151	176	414	335	749
Financing by banks	3,620	701	-180	538	358	236	628	864
Public funds (5)	3,921	152	141	287	428	76	207	283
Foreign currency loans (6)	4,007	-326	-980	-1,026	-2,006	268	665	933
Equity capital (7)	6,772	747	877	240	1,117	973	153	1,126
Rediscounts	602	51	24	-3	21	-13	20	7

(1) Including financing of compulsory stockpiling. — (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) This balance item also reflects the differences between the items covered by footnotes (2) and (4) and the corresponding items in the institutions' balance sheets. — (4) Only in this table are the changes adjusted for spreads between face value and bid value price. This item includes issues by the Mediocredito centrale. — (5) Includes funds from the regions, the Cassa per il Mezzogiorno (own funds) and the Mediocredito centrale. — (6) Gross of exchange rate variations. — (7) Paid up capital, reserves and since 1980 other own funds.

The special credit institutions' own fund-raising, which benefitted in the second part of the year from the exemption from tax of the interest on their bonds and certificates of deposit, recorded a substantial increase and not only covered the expansion in lending but also permitted a small increase in their liquid assets. As a ratio to their commitments, these nonetheless continued to decline from the high level recorded in the mid-seventies.

Net of redemptions, bond issues rose considerably (Table 34). Temporary difficulties in placing securities occurred during the year, primarily as a result of the rigidity of the yield allowed at issue. In particular, the differentials that developed on these occasions compared with short-time rates tended to bring purchases by the banks to a halt (Chart 11). This was reflected in irregularities in the supply of credit as shown by the pattern of loan application approvals. However, these shortfalls in supply were small and of limited duration, since the potential rationing effect was countered both by administrative means, such as the banks' compulsory security investment requirement and very large purchases by the P.O. Deposits and Loans Fund, and by greater recourse to variable rates on instruments such as bonds and medium-term deposits. In addition, the funds raised through foreign loans and short-term bank borrowing both increased, and the special credit institutions continued to strengthen their capital bases.

The outlook for the activity of the special credit institutions is closely linked to the effects of the legislative and administrative provisions that continue to dominate the special credit market: the definition of a non-discriminatory tax regime for their securities and the possibility of using funds raised at variable rates also for loans at subsidized rates are among the conditions to be satisfied in the immediate future if there is not to be a reduction in the role of medium and long-term credit in the financing of investment. In particular, the need to raise a very large volume of long-term funds, partly in relation to the financing of the reconstruction of the areas devastated by last November's earthquake, makes it more urgent that market instruments should be found that will make it possible to tap households' savings directly in view of the downturn in bank deposits.

A return to the market, helped by a relaxing of administrative controls, will make it possible to strengthen the allocative function that intermediaries should rightfully perform. The reform of the system of financial incentives for industry should promote this aim and it is to be hoped that it will introduce a clear distinction between the granting of subsidies and the assessment of risk.

Fund-raising

Net of the operations carried out on behalf of the Treasury and of reimbursements of compensatory loans, the special credit institutions raised 10,381 billion, compared with 7,201 billion in 1979 (Table 35).

Table 35

FUND-RAISING SOURCES OF THE SPECIAL CREDIT INSTITUTIONS (percentage breakdown of changes)

Type of liability Sector of origin	1978	1979			1980		
		Half-year		Year	Half-year		Year
		I	II		I	II	
TYPE OF LIABILITY							
Bonds (1)	62.4	76.5	69.4	73.0	60.5	63.8	56.4
Deposits and interest-bearing certificates	14.5	0.7	4.2	2.4	7.2	5.8	9.0
Short-term financing	7.7	-5.0	15.0	5.0	8.3	10.9	5.1
Mediocredito centrale funds	0.5	0.4	1.4	0.9	1.8	2.7	0.6
Foreign currency loans (2)	5.4	-0.4	-2.2	-1.3	9.3	11.4	6.7
Equity capital	8.2	24.2	6.7	15.5	10.9	2.6	21.2
Others	1.3	3.6	5.5	4.5	2.0	2.8	1.0
Total ...	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SECTOR OF ORIGIN							
The public and companies	13.5	-1.3	-5.6	-3.5	-1.2	-3.3	1.5
Banca d'Italia and UIC	0.8	0.7	-0.1	0.3	0.3	0.3	0.2
Banks	70.4	65.2	78.1	71.6	61.0	64.4	56.7
Other credit institutions (3)	8.5	19.9	10.8	15.4	12.8	3.3	24.9
Public sector	1.5	11.0	19.4	15.2	17.9	24.1	10.1
Foreign sector (2)	5.3	4.5	-2.6	1.0	9.2	11.2	6.6
Total ...	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (in billions of lire)	9,139	3,616	3,585	7,201	4,603	5,778	10,381

(1) Excluding bonds issued on behalf of the Treasury and by the Mediocredito centrale, the value of which increased by 53 billion in 1980 and decreased by 61 billion in 1979. — (2) Net of compensatory loans held by the Banca d'Italia, which dropped by 32 billion in 1980 and by 1,911 in 1979. — (3) Special credit institutions and insurance companies.

Net of redemptions, issues of securities went up from 5,258 billion in 1979 to 6,283 billion and the volume of outstanding bonds rose by 11.5% compared with the beginning of the year (as against an increase of 10.6% in 1979). After remaining at the relatively low level of 1979 in the first part of the year, security issues picked up in the second in connection with the tax exemption of bond interest and the substantial increases in both issues of variable rate securities and purchases by the public sector.

There was a considerable increase in variable rate issues, which rose from about 100 to about 1,500 billion. These were mainly made in the second half of the year and accounted, in particular, for more than half the net issues of the industrial institutions. This expansion was helped by investors preferring variable rate securities in view of the higher yields they carried at issue and because they are inherently more responsive to changes in the conditions on the money and capital markets.

By contrast, issues of securities partially indexed to the price level, which the real-estate institutions have experimented, remained at the relatively low level recorded in 1979. The misgivings of the institutions themselves and the difficulties they encountered in creating a market for securities offering revaluation of capital were matched by a limited demand for indexed loans.

The banks' net purchases of special credit institutions' bonds went up compared with 1979. The P.O. Deposits and Loans Fund also came to play an important role in the industrial credit sector, where it continued the action it had undertaken in the last part of 1979 and took up nearly half the industrial institutions' net issues.

The contribution of other fund-raising instruments also increased: medium-term deposits provided 749 billion, compared with 176 billion in 1979; short-term borrowing, principally from the banks, also rose substantially (from 358 to 864 billion), this was mainly by the agricultural institutions in connection with the very large increase in the demand for working credit.

Net of compensatory loans, the value of outstanding foreign currency borrowing rose by 965 billion after falling by 95 billion in 1979. About one third of this increase was attributable, however, to exchange rate variations. The greater use of this source of funds, at a time when conditions on international capital markets were relatively favourable, was partly due to the fact that the industrial institutions were able to exploit this channel to grant export credits. Another factor was the extension to the real-estate institutions of the right to borrow from Community organizations with the government covering the exchange risk.

The banks' share of the total funds raised by the special credit institutions fell from 71.6% in 1979 to 61%, the lowest level since 1973. By contrast, the shares of the public and foreign sectors both rose (Table 35). The public again supplied a very small proportion of resources but nonetheless made a positive contribution to the fund-raising of the industrial institutions through purchases of certificates of deposit.

Lending

Outstanding domestic loans increased by 8,391 billion and 13.9% (5,808 billion and 10.7% in 1979; Table 36). Contrary to what happened the year before, subsidized credit grew faster than credit at market rates (14.5% as against 13.6%), not only as a result of the strong expansion of lending to agriculture (most of which is subsidized) and export credits, but also because of the funding operations carried out under Law 787.

Table 36

DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS BY SECTOR

(billions of lire)

Type of credit	Agriculture		Housebuilding		Industry		Transport, commerce and misc. services		Exports		Total	
	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980
Outlays												
Subsidized ...	1,235	1,763	453	432	1,084	1,547	567	533	852	1,126	4,191	5,401
Non-subsidized	914	1,083	1,515	2,166	3,158	5,388	3,101	4,283	—	—	8,688	12,920
Total ...	2,149	2,846	1,968	2,598	4,242	6,935	3,668	4,816	852	1,126	12,879	18,321
Net increases in lending												
Subsidized ...	492	818	343	336	-36	920	408	300	351	439	1,558	2,813
Non-subsidized	333	301	805	1,800	1,401	1,845	1,711	1,632	—	—	4,250	5,578
Total ...	825	1,119	1,148	2,136	1,365	2,765	2,119	1,932	351	439	5,808	8,391
Percentage increases in lending												
Subsidized ...	17.0	24.4	18.9	15.6	-0.2	10.4	21.2	12.7	15.6	16.8	8.7	14.5
Non-subsidized	44.2	27.0	7.4	15.4	13.8	16.0	11.6	9.9	—	—	11.6	13.6
Total ...	22.6	25.0	9.0	15.3	7.2	13.5	12.6	10.2	15.6	16.8	10.7	13.9

There was a further shortening of the average maturity of outstanding loans, primarily because of the increase in short-term lending, which also produced an abnormal rise in reimbursements from around 7,000 to 10,000 billion.

Most of the increase in lending went to households and companies in the private sector (6,881 billion compared with 3,853 in 1979, corresponding to a rate of increase of 17.5%). More specifically, the borrowing of the latter rose by 19.1%. Compared with the previous year, the net flow of credit to public sector companies and agencies rose less than in the previous year (1,510 billion as against 1,955 billion) and at a

lower rate (7.2% as against 10.3%). Not only did credit to the State-controlled corporations grow at a low rate, but so did that to local authorities and nationalized non-finance companies as a result of the restrictions placed on their borrowing from the credit system (Table 37).

Table 37

**DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS
BY CLASS OF BORROWER**

Class of borrower	Subsidized		Non-subsidized		Total			
	1979	1980	1979	1980	1979	1980	1979	1980
	<i>absolute changes in billions of lire</i>						<i>percentage changes</i>	
General government	67	73	1,093	649	1,160	722	15.3	8.2
local authorities	38	59	1,101	635	1,139	694	19.4	9.9
other public agencies (1) ...	29	14	-8	14	21	28	1.2	1.6
Finance and insurance companies	—	6	139	302	139	308	19.3	36.0
Non-finance companies	1,352	2,627	2,708	3,895	4,060	6,522	10.6	15.5
public	417	223	377	565	794	788	7.0	6.5
<i>nationalized</i>	11	-2	149	51	160	49	20.3	5.2
<i>State-controlled</i>	406	225	228	514	634	739	6.0	6.6
private	935	2,404	2,331	3,330	3,266	5,734	12.2	19.1
Households	139	107	310	732	449	839	5.6	9.9
TOTAL ..	1,558	2,813	4,250	5,578	5,808	8,391	10.7	13.9
<i>public enterprises and agencies</i>	485	297	1,470	1,213	1,955	1,510	10.3	7.2
<i>households and private companies</i>	1,073	2,516	2,780	4,365	3,853	6,881	10.8	17.5

(1) Including social security institutions.

The downward trend of large firms' share of non-finance companies' borrowing continued (it fell from 50% to 48.3%). This was attributable to the State-controlled corporations and the other public sector companies, whose share fell from 27.7% to 25.5%, whereas that of the large private sector companies rose slightly, reversing the downward trend it had followed since the mid-seventies.

The cost of finance

The rise in interest rates on the money and capital markets was reflected with a lag of a few months in the rates charged by the special credit institutions.

The average market cost of medium and long-term credit remained below that of short-term credit but nonetheless rose to 16.10% from the 14.60% recorded in 1979.

Variable rate loans, which accounted for most of the industrial credit institutions' lending, were marked by a much higher average initial cost than the institutions' own fixed rate loans (approximately 17.60% compared with 15%). This was due to the higher initial yield paid on the funds raised to provide these loans.

The average rate on subsidized credit was slightly higher than in 1979 (6.7% compared with 6%). The increase was smaller for lending in southern Italy (from 4.8% to 5.2%) than for that in the centre and north (from 6.7% to 7.4%). The difference between the special credit institutions' market and subsidized rates widened to 9.4% after running at around 8.6% in the three previous years.

Credit to industry

Disbursements of credit to industry, net of export finance, rose substantially (from 4,242 billion to 6,935 billion). The ratio of credit to investment also showed a sizeable increase (35.5% compared with 29.5% in 1979), and still went up when short-term loans are excluded.

Among manufacturing industries, engineering and transport equipment recorded large increases in their borrowing, while that of food processing and textiles rose to a somewhat lesser extent. Lending to the construction industry also went up considerably.

There were signs of a recovery in subsidized credit to the industrial sector, but it continued to represent a small and declining proportion of the total, especially when compared with the peak levels of the early 1970s. Outlays of subsidized credit fell from 26% to 22% of total disbursements, though it needs to be remembered that the latter include those of short-term credit, which is usually at market rates.

The system of financial incentives to industry still has not reached a stable state that would enable firms and credit institutions to assess the viability of projects with a greater degree of certainty. While the Fund for Industrial Restructuring and Conversion is only just starting to make disbursements, the so-called National Fund has become fully operative only towards the end of the five years for which it was established under Law 183 of 1976.

Furthermore, the recently submitted bill regarding extraordinary interventions in southern Italy during the ten years 1982-1991 includes proposals for changes in the system of financial incentives. These appear to be of limited scope however. Even though it envisages that subsidies will be paid directly to firms instead of to lending institutions, the reform only apparently cuts the link between credit and incentives. Indeed, in some respects it actually increases the responsibility of the lending institutions since the granting of subsidies is made to depend on their first having agreed to provide finance. Naturally, the uncertainty as to whether projects will be subsidized affects their profitability and hence the assessments and decisions of the financial intermediaries themselves.

Alternative proposals that do not suffer from the drawbacks outlined above are needed whereby investment subsidies would be granted automatically in predetermined circumstances, either as a lump sum or in instalments over several years, independently of financing and interest rate considerations. This would enable the special credit institutions to exercise their selective function by financing the projects they judge to be profitable with account being taken of public subsidies where these were applicable.

Credit to services

After stagnating in 1979, outlays to the services sector rose from 3,668 to 4,816 billion. More specifically, disbursements at market rates went up from 3,101 to 4,283 billion, while those at subsidized rates declined slightly from 567 to 533 billion. The ratio of disbursements to investment (excluding housing) was virtually unchanged (19% as against 19.3%) because the latter also rose substantially.

There were large differences between the requirements of the various branches. Particularly notable were the large volume of finance absorbed by air transport in connection with the huge investments being made and the fall in the rate of increase in credit for land transport services. On the other hand, lending to shipping services, where the proportion of subsidized credit is highest, continued to rise.

Despite the higher level of investment in telecommunications services, outlays were of the same order of magnitude as the year before and were exceeded by reimbursements. This result was due to the cautious attitude of the special institutions towards increasing their already heavy exposure vis-a-vis this sector.

Noteworthy among the other branches of services was the large increase in lending to the distributive trades, which recorded a fall in the share of subsidized credit, as did lodging services.

Credit to housebuilding

The medium and long-term credit disbursed to the housebuilding sector amounted to 2,598 billion, compared with 1,968 billion in 1979. Bringing to a halt the downward trend of the last few years, special credit covered virtually the same proportion of investment as in 1979 (14.5% as against 14.3%), even though the volume of the latter rose strongly. In view of the fact that investment in housing has provided a positive real rate of return even in the recent past, the increase in investment was influenced by the expectations stemming from the widening gap between the rates of increase in the price of houses and the cost of mortgages.

Furthermore, the compulsory security investment requirement kept in force for the bonds of the real-estate and housebuilding credit institutions, coupled with the ceiling on bank lending, tended to increase the level of intermediation and to lower the cost of funds below what it would have been in the absence of intervention. The credit disbursed under this administrative protection, which satisfies the demand of those who can afford the present high initial repayments of fixed rate mortgages may also lead to distortions with regard to the socio-economic aims that the selective measures introduced from as far back as 1973 are intended to promote. In fact, the role played by the special credit institutions in the financing of housebuilding was again fairly limited in 1980, principally owing to the difficulties encountered by middle-income households in making instalment payments in the early years of a mortgage.

The breakdown of the sources of funds for investment in housebuilding shows the relative decline of bank credit and the growth in the importance of private saving invested directly in housing. The latter increased in relation to both the total volume of such investment and gross private saving (Table 38). This result confirms the propensity of households to invest in real goods in periods of high inflation, as in 1974.

The share of subsidized credit declined sharply in 1980 despite the disbursement of close to 100 billion under the terms of Law 457 of 1978. Total disbursements of subsidized credit amounted to 432 billion, which was slightly less than in the previous year. The estimated volume of investment covered by this form of incentive thus fell from 5.1% to 3.7% of the total. The share of government-financed housing also declined so that state-supported investment accounted for around 10% of the total in

1980, thus continuing the downward trend that started in 1977 when the proportion exceeded 15%.

Table 38

FINANCING OF INVESTMENT IN HOUSING (1)

(billions of lire)

Investors ----- Type of financing	Public agencies		Insurance companies and social security institutions		House-holds	Enter-prises	House-holds	Enter-prises	Total	
	1979	1980	1979	1980	1979	1980	1979	1980	1979	1980
Public funds	1,177	1,078							1,177	1,078
Loans					1,609	2,466	2,319	2,531	4,075	4,850
Special credit institutions					449	699	839	1,297	1,148	2,136
Banks					1,160	1,743	1,480	1,217	2,903	2,697
Insurance companies and social security institutions						24		17	24	17
Security market						37		5	37	5
Self-financing			225	566	8,209		11,381		8,434	11,947
<i>of which: repayment of mortgages .</i>					820		462		820	462
TOTAL . . .	1,177	1,078	225	566	12,321		16,236		13,723	17,880

(1) The data for 1980 are provisional.

Extraordinary public building programmes together with a fully operative incentive system should result in the state playing a larger role in 1981, although it cannot be called upon to bear a part of the financial burden of purchases made by households able to afford the full cost. This component of demand could be expanded, moreover, by distributing the repayment of principle more evenly in real terms.

Credit to agriculture

Disbursements of special agricultural credit again expanded substantially: by 1,684 billion or 22.1%, compared with 1,456 billion and 23.6% in 1979 (Table 39).

Special agricultural credit, which consists of the medium and long-term lending of special credit institutions as well as that of authorized

banks and non-bank intermediaries, does not account for all the finance the credit system provides to the sector. This is a larger aggregate (about one and a half times the lending of the special credit system) and accounted for a share of the total outstanding domestic lending of the credit system (around 7% at the end of 1980) that was virtually the same as agriculture's share of GDP.

Table 39

LENDING BY THE AGRICULTURAL CREDIT SYSTEM

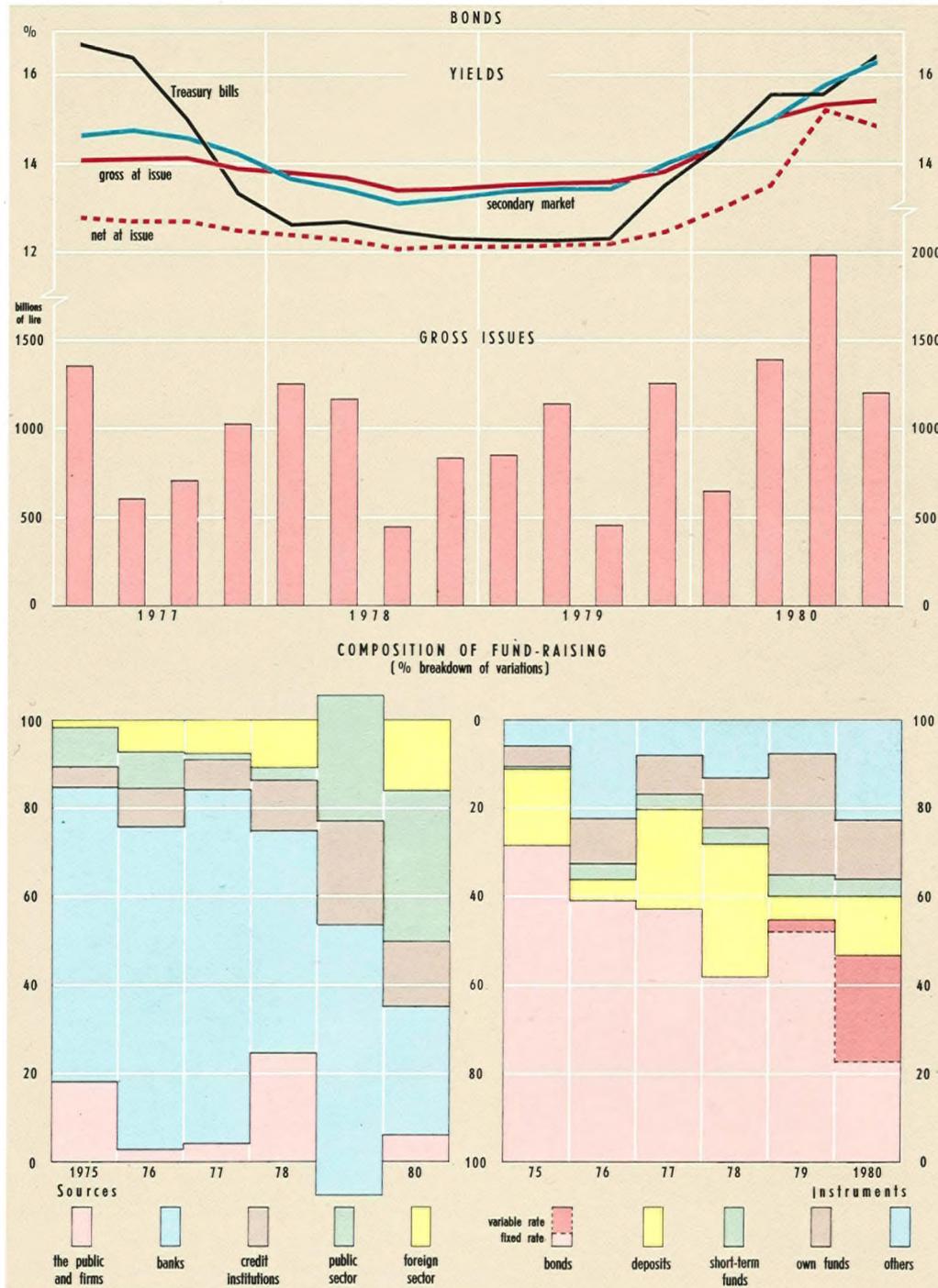
(changes in billions of lire)

	Agricultural special credit institutions		Other institutions		Total	
	1979	1980	1979	1980	1979	1980
Working credit	278	496	708	622	986	1,118
Improvement credit	322	391	148	175	470	566
TOTAL . . .	600	887	856	797	1,456	1,684
Financing of stockpiling operations	5	33	22	31	27	64
<i>compulsory</i>	24	25	31	36	55	61
<i>voluntary</i>	-19	8	-9	-5	-28	3
Other loans	-	3	-	-	-	3
GENERAL TOTAL . . .	605	923	878	828	1,483	1,751

Even though operations at market rates continued to expand faster than those at subsidized rates (especially as regards improvement credit), at the end of the year subsidized loans represented nearly three quarters of total outstanding agricultural credit. This imposes a heavy burden on the budget: the interest subsidy per unit of subsidized credit has almost doubled in the last ten years because reference rates have risen considerably, in the wake of market yields, and subsidized rates much less.

Outstanding working credit rose substantially (by 26.1% from 4,283 to 5,402 billion), though as a ratio to gross marketable production the increase was less marked (from 16.6% to 17.9%). With a reversal of the pattern of the last years the lending of the agricultural special credit institutions increased by more than that of the other authorized institutions, especially in the case of loans to agencies and co-operatives, the average size of which was generally above the limit for exemption from the ceiling on bank lending.

FUND-RAISING OF THE INDUSTRIAL CREDIT INSTITUTIONS



The expansion in improvement credit was facilitated by the high level of the agricultural credit institutions' net bond issues (588 billion as against 394 billion in 1979). In view of the relatively small increase in bank deposits, this was more than the amount that banks had to buy under the compulsory security investment requirement.

Export credit

Disbursements of export credit were slightly larger than in the previous year (2,133 billion as against 1,851 billion; Table 40). While the ratio of the new lending of the special credit institutions to the value of exports remained virtually unchanged (3.2% compared with 3.1%), there was a further fall (from 13.3% to 12.9%) in their share of the financing of exports of final investment goods, which tend to be less influenced by the cyclical downturn in world demand.

Table 40

EXPORT CREDITS (1) (billions of lire)

Type of credit	Outlays		Net increases		Loans	Financing commitments	Applications to examine
	1979	1980	1979	1980			
	<i>flows</i>				<i>outstanding at end-December 1980</i>		
Supplier credits	852	1,126	351	439	3,045	3,850	808
Buyer credits	999	1,007	162	666	2,589	4,967	270
<i>of which: tied</i>	<i>904</i>	<i>929</i>	<i>93</i>	<i>618</i>	<i>2,380</i>	<i>4,686</i>	<i>252</i>
<i>untied</i>	<i>95</i>	<i>78</i>	<i>69</i>	<i>48</i>	<i>209</i>	<i>281</i>	<i>18</i>
TOTAL	1,851	2,133	513	1,105	5,634	8,817	1,078

(1) Excluding refinancing by UIC and compensation payments by SACE totalling, at end-1980, 1,712 billion (1,569 at end-1979).

There was a considerable increase in disbursements of supplier credits (from 852 to 1,126 billion), which continue to go mainly to firms in the engineering and transport equipment sectors. On the other hand, disbursements of buyer credits showed almost no change (1,007 compared with 999 billion), although the value of the outstanding loans of this kind went up more than in the previous year (666 as against 162 billion). This was due both to the increase in the exchange rate and to the smaller volume of reimbursements falling due in 1980. The net increase in supplier credits rose less (439 compared with 351 billion).

The breakdown of the additional lending by beneficiary country shows that supplier credits went primarily to developing countries, particularly Algeria, while industrial countries accounted for more than a quarter. Three quarters of the buyer credits disbursed went to the Soviet Union and the other centrally-planned economies, with a number of developing countries and regions also continuing to receive a share (Tunisia, Yugoslavia and Latin America).

The value of the loan applications received and of those approved rose slightly compared with 1979. At the end of December 1980 the special credit institutions' commitments amounted to 8,817 billion. Of this amount 4,967 billion were buyer credits and one third of these are expected to be disbursed this year. The expansion of subsidized export credit nonetheless poses a problem in that the burden it places on the state tends to grow as market rates rise because of the rigidity of subsidized rates.

Total financing and the formation of financial assets

In 1980 the increase in fixed investment and build-up of stocks caused a large growth in the demand for credit, notwithstanding ample self-financing by firms. The latter's financial deficit in fact rose from 3,130 billion lire to 22,510 billion, or from 1.2% to 6.7% of GDP. The cyclical fluctuation in the sector's net financial balance between 1978 and 1980 was the widest of the past fifteen years, and larger even than in 1971-73 (Table 41).

Table 41

FINANCIAL BALANCES OF DOMESTIC FINAL USER SECTORS

Year	(billions of lire)			(percentage of GDP)		
	Households	Firms	Public sector (consolidated)	Households	Firms	Public sector (consolidated)
1970	6,910	-3,347	-3,640	11.0	-5.3	-5.8
1971	8,779	-3,577	-4,892	12.8	-5.2	-7.1
1972	10,292	-2,561	-6,791	13.7	-3.4	-9.0
1973	14,364	-6,972	-9,114	16.0	-7.8	10.2
1974	14,052	-8,757	-10,827	12.7	-7.9	-9.8
1975	20,897	-9,794	-15,566	16.7	-7.8	-12.4
1976	22,176	-11,374	-14,459	14.2	-7.3	-9.2
1977	27,666	-9,551	-17,051	14.6	-5.0	-9.0
1978	34,891	-6,141	-23,719	15.7	-2.8	-10.7
1979	38,899	-3,134	-26,989	14.4	-1.2	-10.0
1980	38,183	-22,511	-30,554	11.3	-6.7	-9.1

The public sector's financial deficit in relation to GDP was only slightly lower than in 1979 and therefore the decline in households' propensity to save placed additional pressures on domestic resources, thus causing the overturn of the surplus in the current account of the balance of payments, which declined by over 4% of GDP. This deterioration in the current account was more sudden even than in 1974, when the effect of the oil crisis caused a 3% increase in the deficit in relation to GDP.

Owing to the increasingly tight monetary policy, demand for credit was satisfied only in part by the banks and on the capital market. Although the borrowing requirement of the enlarged public sector amounted to 35,610 billion lire, total domestic credit expansion was kept within a figure of 63,460 billion, which represents a rate of increase in outstanding credit of 18.7%, almost the same as in the previous year. As a ratio of GDP, the expansion of total domestic credit fell from 19.6% to 18.8% (Tables 42 and 43).

Table 42

TOTAL DOMESTIC CREDIT

(changes in billions of lire and percentage growth rates)

	1979	1980				
		Year	Quarters			
			I	II	III	IV
<i>changes in billions of lire</i>						
State sector borrowing requirement (1)	28,405	34,074	3,655	6,312	6,767	17,340
Lending to the non-State sector (2)	24,442	29,390	3,671	8,515	1,906	15,298
TOTAL DOMESTIC CREDIT . . .	52,847	63,464	7,326	14,827	8,673	32,638
<i>TOTAL DOMESTIC CREDIT (3) . . .</i>	<i>55,435</i>	<i>66,831</i>	<i>8,213</i>	<i>16,458</i>	<i>10,089</i>	<i>32,071</i>
Borrowing requirement of the enlarged public sector (4)	31,082	35,610	3,882	6,696	6,964	18,068
Lending to the private sector (5)	21,765	27,854	3,444	8,131	1,709	14,570

(1) The borrowing requirement is net of borrowing abroad, of financing provided by the Treasury to credit institutions and of securities issued to fund debts. — (2) The non-State sector includes the Economy (households and firms) and the public bodies not included in the State sector. Financing provided to the sector includes the funding operations under footnote (1). — (3) Including acceptances acquired by the public and bad debts of special credit institutions. — (4) The borrowing requirement is net of borrowing abroad, of financing to credit institutions and of securities issued to fund debts. — (5) By credit institutions and through bond issues.

In view of the growth of the market for bankers' acceptances, the definition of total domestic credit can be broadened to include the public's purchases of these instruments. And a closer estimate of credit flows can

also be obtained by including in TDC bad debts of commercial banks and special credit institutions. The expansion of this wider aggregate was 66,830 billion lire, while the rate of growth was 19.7% (slightly higher than the previous year) and the ratio to GDP dropped between the two years from 20.6% to 19.8%.

Table 43

**THE FINANCIAL ASSETS OF THE ECONOMY,
TOTAL FINANCING AND TOTAL DOMESTIC CREDIT (1)**

Year	Percentage rates of increase				Percentage ratio to GDP			
	financial assets (2)	liquid assets (M2)	total financing (2)	total domestic credit	financial assets (2) (3)	liquid assets (M2) (3)	total financing (4)	total domestic credit (4)
1976	17.1	20.9	19.0	19.7	118.6	85.4	22.4	21.3
1977	18.6	21.6	17.6	17.6	116.0	85.3	20.5	18.7
1978	20.7	20.4	18.7	20.7	118.2	88.3	22.0	22.2
1979	21.6	20.6	19.5	18.5	117.8	87.7	22.2	19.6
1980	15.3	12.8	20.7	18.7	111.5	81.5	21.9	18.8

(1) Total financing comprises financing to the Economy (including bad debts of special credit institutions) and to the public sector. The data for 1976 and 1977 have been calculated inclusive of changes in tied deposits with the Banca d'Italia. — (2) Net of shares. — (3) Annual averages. — (4) Annual changes.

In the first half of the year total domestic credit expansion remained within the targets, for while the large upturn in production increased firms' demand for credit it also boosted fiscal revenues, thereby containing the rise in the State sector's borrowing requirement. The cyclical slowdown that began in the second quarter, combined with a small increase in the borrowing requirement, ensured that TDC expansion remained moderate in the central part of the year as well.

The ratio of the flow of credit to GDP, calculated for the twelve months up to the end of each quarter, gradually decreased from the beginning of the year, reaching a low of 16.2% in September. The build-up of stocks and upturn in production caused bank lending to pick up in the fourth quarter, particularly in foreign currency owing to the ceilings on lending in lire. This trend was compounded by a substantial increase in the State sector's borrowing requirement, which in the last quarter alone amounted to half the total for the year.

The measures taken by the authorities to contain credit expansion through the banking system prompted firms to seek other sources of finance on the domestic money market. The development of other forms of intermediation, such as bankers' acceptances, is the result of prolonged adoption of administrative controls on credit; it has reduced the scope of

the central bank's action and thus impaired the short-term effectiveness of administrative tools.

Total financing of domestic final-user sectors — which includes not only TDC and bankers' acceptances taken up by the public, but also share issues and direct foreign loans — increased by 73,760 billion lire, compared with 59,770 billion in 1979, and amounted to 21.9% of GDP as against 22.2% in 1979. The rate of increase, excluding share issues, was 20.7% (19.5% in 1979), which is equal to that in GDP during the year.

The financial deficit of the public sector rose from 26,990 billion to 30,550 billion, while the flow of funds to the Economy (households and firms) amounted to 43,210 billion, over 10,000 billion more than in 1979. The share of the flow of new credit used by the latter sector therefore increased by 4% compared with the average for the preceding five years, from 54.5% to 58.6% (Table 44).

Table 44

FINANCING OF DOMESTIC FINAL USER SECTORS

	Flows				
	1976	1977	1978	1979	1980
	<i>billions of lire</i>				
Total financing of:					
Households and firms (1)	20,561	21,918	25,297	32,781	43,211
Public sector (consolidated) (2)	14,459	17,051	23,719	26,989	30,554
Total ...	35,020	38,969	49,016	59,770	73,765
	<i>percentage breakdown</i>				
Total financing of:					
Households and firms	58.7	56.2	51.6	54.8	58.6
Public sector (consolidated)	41.3	43.8	48.4	45.2	41.4
Total ...	100.0	100.0	100.0	100.0	100.0

(1) Including bad debts of special credit institutions. — (2) Net indebtedness.

Financing granted by credit institutions to households and firms, adjusted to take account of funding operations and including bad debts, totalled 30,820 billion, compared with 24,780 billion in 1979. The share granted by special credit institutions went up from 22% to 30% owing to the growth in investment and tightening of the ceiling on bank loans in lire. This ceiling, combined with the positive differential with foreign interest rates, also led to a sharp increase in the proportion of bank loans in foreign currency; on the other hand, the flow of lending in lire dropped by over 3,600 billion (Table 45).

THE FINANCIAL ASSETS OF THE ECONOMY AND THEIR COUNTER-ITEMS

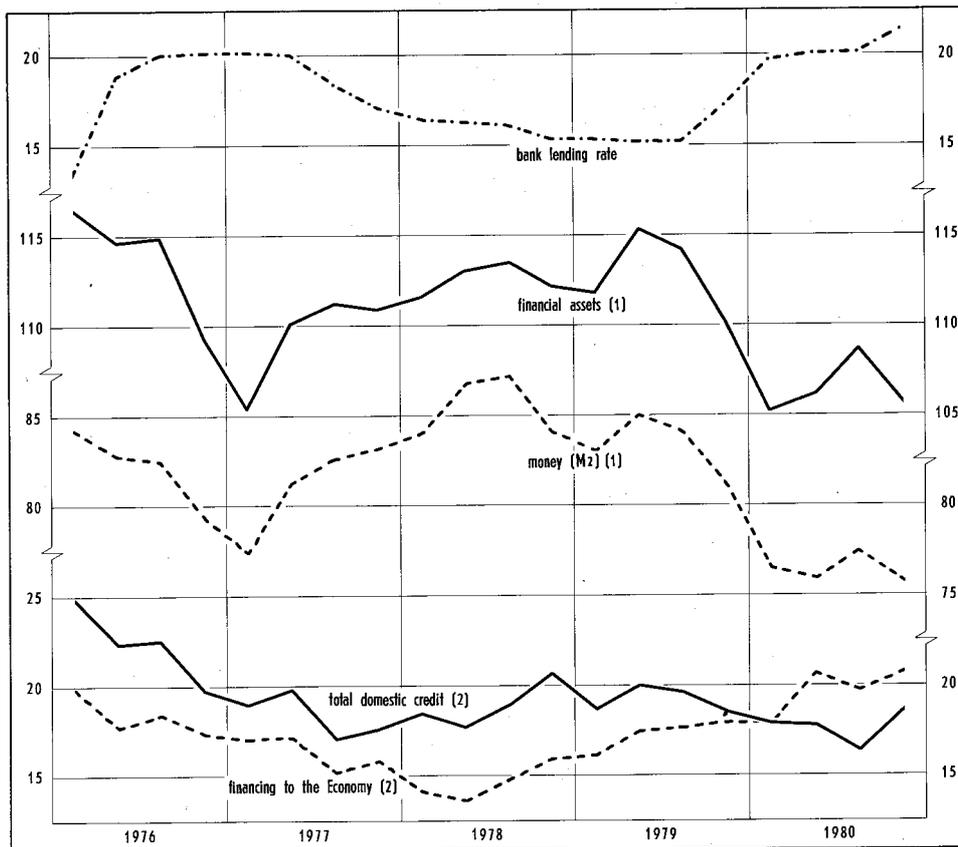
(amounts and flows in billions of lire)

	Amounts at end 1979	Flows					
		1979	Year	1980			
				Quarters	I	II	III	IV
FINANCIAL ASSETS:							
Domestic	395,747	62,438	54,666	4,484	7,567	6,002	36,613
Currency	21,001	2,466	3,546	-1,064	937	302	3,371
Deposits: Post Office & with Treasury	30,490	6,618	1,939	613	-1,133	-698	3,157
bank	207,085	35,143	27,585	-6,542	1,695	4,433	27,999
Short-term securities (1)	18,562	8,532	16,922	10,183	3,665	2,196	878
Other deposits and savings certificates	5,667	422	527	254	158	-369	484
Fixed-interest securities	28,344	2,918	-1,446	-85	978	-878	-1,461
Shares	65,861	3,940	3,215	535	676	419	1,585
Other financial assets	18,737	2,399	2,378	590	591	597	600
Foreign	18,843	3,519	1,971	-1,012	1,113	787	1,083
TOTAL ...	414,590	65,957	56,637	3,472	8,680	6,789	37,696
AGAINST FINANCING OF:							
<i>ECONOMY</i>	255,997	32,781	43,211	6,009	11,852	5,677	19,673
Domestic	238,287	30,017	39,208	5,110	10,964	4,752	18,382
Borrowing from: banks (2)	97,997	19,248	21,435	1,425	8,353	-153	11,810
special credit institutions (2) (3)	50,747	5,529	9,390	1,994	980	2,684	3,732
Public sector loans	3,646	250	453	126	77	183	67
Bankers' acceptances (4)	65	....	1,122	570	232	378	-58
Bonds	12,934	151	231	188	252	-175	-34
Shares	60,621	3,712	3,039	482	677	328	1,552
Endowment funds	8,770	932	3,318	265	357	1,466	1,230
Financing by local authorities	3,507	195	220	60	36	41	83
Foreign	17,710	2,764	4,003	899	888	925	1,291
<i>FOREIGN SECTOR</i> (5)	23,818	4,553	-8,367	-3,620	-1,260	-854	-2,633
<i>PUBLIC SECTOR (consolidated)</i>	155,361	26,989	30,554	1,568	5,418	10,160	13,408
<i>UNCLASSIFIED</i> (6)	-20,586	1,634	-8,761	-485	-7,330	-8,194	7,248
TOTAL ...	414,590	65,957	56,637	3,472	8,680	6,789	37,696
ECONOMY'S FINANCIAL SURPLUS OR DEFICIT ...	158,593	33,176	13,426	-2,537	-3,172	1,112	18,023

(1) Include Treasury bills and bankers' acceptances. — (2) Flows are adjusted to take account of bad debts of special credit institutions totalling 2,588 billion in 1979 and 2,245 billion in 1980. For 1980 operations to fund the debts of State-controlled corporations, amounting to 469 billion, have been included. — (3) Include insurance institutes. — (4) Purchased by non-bank investors. — (5) Balance of payments on current account on a transactions basis. — (6) Includes discrepancies.

Medium-term loans taken out directly by firms on the euromarket also showed a substantial increase; together with foreign currency bank credits they amounted to 11,400 billion and their relative share in total financing of households and firms more than doubled, from 12% to 26%. These capital flows more than offset the deficit in the current account, thus leaving foreign currency reserves untouched, but financed a considerable growth in domestic demand.

Chart 12



Credit, money and financial assets of households and firms

(1) Average quarterly amounts, seasonally adjusted, as a ratio of GDP; financial assets are net of shares.
 — (2) Growth rates over 12 months; financing to the Economy includes bad debts and has been adjusted for funding operations.

The formation of financial assets by households and firms, as the counterpart of the expansion of total financing, was curtailed by the increased propensity to spend of households; in addition, the restrictive monetary policy induced firms to use their liquid balances. Financial assets increased by 56,640 billion, compared with 65,960 billion in 1979, at a rate of 15.3%, excluding shares, as against 21.6% in the previous year. There was also a decline in the average stock of total financial assets as a ratio of

GDP from 117.8% to 111.5%, which reversed the upward trend of the previous three years (Chart 12).

The composition of the flow of financial assets was affected by expectations of inflation and of a rise in nominal interest rates; in fact the share of short-term securities in total newly created assets more than doubled, rising from 13% to 30%, while demand for longer term securities fell sharply. The widening of the differential between bank deposit rates and money market rates also kept the growth in bank deposits extremely low. Since the rate of increase in P.O. deposits also declined, the growth rate of money (M2) slowed from 20.6% to 12.8% compared with 1979 and the average money/income ratio for the year decreased from 87.7% to 81.5%.

The decrease in liquidity remains considerable even when households' and firms' purchases of Treasury bills are taken into account. Liquid assets (M3) rose by 17.7%, compared with 23.5% in 1979, and their average value as a ratio to GDP declined from 93% to 89.4%. The fall in this ratio was particularly marked in the first half of the year because of the small expansion in credit compared with the high level of productive activity. The cyclical slowdown in the second half of the year and the growth in the public sector borrowing requirement in the fourth quarter prevented a further increase in the velocity of circulation of liquid balances.

THE SUPERVISION OF CREDIT INSTITUTIONS

Supervisory activity continued along the lines established over the last ten years with the aim of promoting the objectives of monetary and credit policy and safeguarding the stability and efficiency of credit institutions.

Faced with tighter restrictions on credit expansion and a more uncertain environment stemming primarily from the difficulties in several important industries, the banking system adjusted its operating policies to the changed external conditions by pressing forward with the development of ancillary services (such as leasing and factoring). The supervisory authorities, besides playing a part in the renewal of the governing boards of numerous public credit institutions, took steps both to encourage the growth of longer term foreign currency operations and to revise the regulations regarding participations and bankers' acceptances, culminating in the resolutions of the Interministerial Committee for Credit and Savings at the beginning of 1981.

Particular attention was paid to the special credit sector, where administrative measures were combined with new legislation to facilitate fund-raising, on the one hand, and to reduce the intermediaries' burden deriving from exposure towards large firms struggling with production crises through extraordinary public interventions, on the other. At the same time, the powers of the supervisory authorities with regard to the special credit institutions were made uniform and clearly defined.

As for inspections, while those of a general nature continued, greater recourse was made to those of a sectoral nature designed to monitor compliance with credit policy directives.

The main tasks of the supervisory authorities — the improvement of the operating conditions of the credit system, the granting of authorizations, and the carrying out of inspections and the analysis of prudential returns — are increasingly performed with the help of electronic data processing. Besides providing statistical information based on the banks' accounts, this is now also used, amongst other things, for the records of the credit institutions' governing bodies, the branch network plan and the identification of banks whose operations are marked by special features.

The resulting greater knowledge of the credit system underlying the action of the supervisory authorities is also reflected in the technical advice they are called upon to give on legislative and administrative measures as well as in their contributions to international meetings, the frequency of which is tending to rise in line with the increasingly integrated view of banking that is gaining ground.

Changes in the operating conditions of the banking system

The operations of individual credit institutions are not only a function of their size, territorial structure and operational constraints, but also depend on their having adequate articles of association and fully effective governing bodies.

The size and territorial structure of the banking system. — On 31 December 1980 there were 1,069 registered banks, compared with 1,066 at the end of 1979. On the same date there were 90 special credit institutions, two of which are engaged exclusively in refinancing. At the beginning of this year the setting up of Mediocredito regionale della Calabria was authorized, while Law 23 of 10 February 1981 provided for the takeover of ICIPU by Crediop.

At the end of 1980 there were 12,174 bank branches, compared with 12,134 at the end of the previous year. The branch network served 5,743 localities in 4,664 different communes.

In October 1980 the supervisory authorities announced that they would again consider applications to set up fully operational branch offices and clearly defined the aims they intended to pursue with the new branch plan. These are to balance each bank's network, to strengthen banking structures in poorly served areas, to make competition more equal and to increase the supply of banking services throughout the country.

Bank lending beyond the short term. — At a time of rising demand for medium and long-term finance, a further increase in the banks' scope for lending in lire beyond the short term was judged inadvisable since the regulations in force already offer ample opportunities for such operations.

At the beginning of the 1970s only the savings banks and the public-law banks were allowed to lend beyond the short term. Subsequently the ordinary credit banks and the co-operative banks were permitted to exceed 18 months in an amount, initially equal to between 8% and 10% of their borrowed funds (later raised to between 10% and 15%) depending on the strength of each bank's capital base.

Policy regarding articles of incorporation. — About 20% of all credit institutions revised their articles of incorporation. Although it went up slightly, this proportion is in line with the normal annual average. The regular recourse to such changes confirms how quickly obsolescence

overtakes articles that do not provide a framework which is adaptable to rapidly changing conditions.

Most of the variations proposed were concerned with the two main areas covered by credit institutions' articles: the rules governing their operations, on the one hand, and their organizational structure, on the other.

With regard to the former, in the belief that more flexible rules are conducive to operational efficiency, the supervisory authorities suggested to the credit institutions that submitted variations that they should abandon their rigidly schematic approach to eligible operations by permitting all banking operations and services and then imposing any special restrictions that might be necessary. There are, however, obstacles hindering the achievement of this objective in sectors of the credit system where the constraints imposed by legislation appear to be more binding with respect not only to forms of fund-raising and lending but also to the sectors that may be financed. In this connection, the first sign of change is to be found in Law 23 of 1981, which, amongst other things, broadens the range of fund-raising instruments the special credit institutions may use and that of the lending the southern Italy institutions may undertake.

As for the organizational structure of public banks, the question of the composition and functions of their various organs has been widely debated and requires the creation of a general reference framework within which to make the necessary changes at the level of individual institutions.

In general, as far as the internal organization and regulation of authority is concerned, there was an acceleration of the trend towards the decentralization of decision-making powers through greater recourse to delegated authority.

The governing boards of credit institutions. — 1980 saw an important advance in the filling of the vacancies in the governing boards of the savings and first-class pledge banks. The tasks entrusted to the Governor of the Banca d'Italia in connection with the appointments to the savings banks resulted in a great deal of preparatory work designed to select candidates possessing professional qualifications that satisfied the guidelines laid down by Parliament and the principles set out in Law 14 of 1978. After the detailed criteria to be adopted were agreed at the meetings of the Interministerial Committee for Credit and Savings on 7 and 14 May 1980, 27 appointments were approved at the subsequent meetings on 23 and 28 May. A further 112 appointments were approved at the meetings of 30 December 1980 and 28 January 1981, leaving a

total of 24 chairmanships and vice-chairmanships to be filled on the boards of the savings and first-class pledge banks.

The authorization of banking operations

In addition to authorizations of loans and investments in property and shares, there was a build-up of those regarding funding operations under Law 787 and bankers' acceptances. The granting of authorizations continues to be based on homogeneous criteria that are corrected and improved in the light of experience.

Loans. — The number of authorizations of lending in excess of the limits established for each bank fell by nearly 25%. This is evidence of the ample scope that the banks — except for the rural and artisans' banks, which are subject to special limits laid down by law — enjoy under current regulations. At the end of the year there were only 9 banks with lending in excess of the limits within which they are completely free to make their own decisions, which are related to each bank's own funds/borrowed funds ratio.

There was also a fall in the number of authorizations granted to the special credit institutions. Until the beginning of this year they were subjected to very different regimes since lending limits were only required in the case of specific legislative provisions or when, in addition to Title 6, special institutions were covered by Title 5 of the Banking Law, so that Article 35, which devolves the setting of limits on the bank supervisory authorities, was applicable. This regulatory framework was substantially modified by Law 23 of 10 February 1981, which, while making Titles 5, 6, 7 and 8 of the Banking Law applicable to all the special credit institutions, exempted them from the aforementioned Article 35, on the one hand, and required them to comply with the directives that the Banca d'Italia would issue (pursuant to the resolutions of the Interministerial Committee for Credit and Savings) on the criteria for limiting risk concentration, on the other.

Participations and property investments. — The increase in the authorizations of participations in the credit sector was mainly in connection with the strengthening of the capital bases of two central credit institutions.

The tendency for Italian banks to expand abroad continued. The authorization of such operations was based on the criterion of only

allowing direct participations, with the banks involved being required to supply the supervisory authorities with all the information the latter may consider necessary regarding the activities of affiliates abroad. This procedure complies with recommendations made at the international level and is intended to enable the supervisory authorities of the country of origin to monitor the activities of banks under their control even when they operate through foreign subsidiaries.

Bank participations, which are regulated in general terms by the resolution of the Interministerial Committee for Credit and Savings of 27 November 1970, have expanded considerably in the last few years.

The supervisory authorities' present policy is intended to encourage participations that will promote two objectives: first, the strengthening and improvement of organizational structures through participations in smaller banks and companies providing ancillary services and, second, financial integration at the international level.

The policy course incorporated in the new directive of the Interministerial Committee for Credit and Savings approved on 28 January 1981 foresees, amongst other things, a more detailed definition of the participations that the banks may acquire. Among these, without prejudice to the prohibition to participate directly in the equity capital of industrial firms, under certain circumstances banks will be allowed to acquire interests in financial holding companies set up together with firms and employers' associations with the aim of promoting the development of productive activities on the part of small and medium-sized businesses. As for interests in foreign banks, it is laid down that they may only be acquired directly and not through financial holding companies.

As regards the authorization of participations, an exemption threshold has been introduced, below which they are considered to be unnecessary, and the supervisory authorities have been given the right to lay down special conditions for the acquisition and detention of certain participations.

Little use has been made of consortium companies, both because structural crises require more than mere financial redressment and because firms suffering primarily from financial difficulties have benefitted from the generally higher level of profit margins and from the greater scope for raising funds on the equity market.

In order to keep in force and strengthen this instrument, the government submitted a bill prolonging the applicability of Article 5 of Law 787 for a further three years by extending the deadline for determining the credits to be funded from 31 July 1978 to 28 February

1981. In order to make participation in consortium companies more attractive to the credit system, the bill also provided for the setting up of temporarily tax exempt special reserves. Their size is inversely proportional to the rate of interest charged on the funding operations, since it can reasonably be assumed that the more serious the crisis of the firm to be redressed and, therefore, the greater the risk of capital losses, the lower the rate charged by the credit institutions will be.

Non-bank bond and share issues. — Most authorizations were granted in the second half of the year, when the effects of Decree Law 288 of 3 July 1980 (which exempted the interest on the securities of the special credit institutions from tax) and of the raising in three steps of the maximum allowed yield at issue made themselves felt. Compared with 1979, there was a lower level of applications for bond issues by firms and the state holding companies. This was partly due to their having borrowed more on both foreign and international markets.

In the industrial credit sector various forms of financial indexation were proposed with the aim of providing yields in line with market conditions. Reference was made in the majority of cases to the prime rate for current account overdrafts, to the interbank rate and, in every case, to the yield of the industrial credit institutions' securities on the secondary market. Indexation in the real-estate credit sector was of less importance as regards both the volume of applications (154 billion) and the variety of technical forms adopted. This appears to have been principally due to the reluctance of borrowers to enter into commitments linked to the cost of living at a time of high inflation.

In granting authorizations, the supervisory authorities tried to reconcile the need to make the special credit institutions' operations more flexible with the aim of an orderly development of the bond market by regulating the supply of securities in accordance with conditions on the demand side.

Bankers' acceptances. — The upsurge in this form of financing and the large proportion accounted for by smaller banks caused concern about the possible effects of uncontrolled expansion on the risk incurred by individual accepting banks and the orderly development of money and credit flows. Consequently, the Interministerial Committee for Credit and Savings passed a resolution empowering the Banca d'Italia to fix limits on the amount of acceptance business that banks may undertake. The Bank set the limit at two fifths of each bank's net worth and allowed banks

with outstanding acceptances in excess of this amount until the end of 1982 to comply.

The task of monitoring banking activity

Supervisory activity designed to monitor the overall performance of credit institutions in relation to the objective of preserving the stability of the credit system continued to develop on the basis of the analysis of the data and prudential returns that credit institutions are required to submit to the supervisory authorities.

Analysis of prudential returns. — This permitted the control of individual institutions and, in particular, those found to present divergent features either overall or in specific sectors.

The monitoring of the major credit institutions is also used to obtain information regarding financial developments in the economy since they account for a large proportion of the credit system's total activity. In the case of smaller institutions, the analyses are carried out in greater detail when weaknesses are found, with the aim of avoiding the need for administrative or legal measures by taking suitable remedial action.

Banks that have recently been found to suffer from weaknesses or that have presented irregularities are followed with particular care to check that these are removed, if necessary by prescribing suitable correctives.

In addition to the use of the normal instruments of control, a procedure for the statistical investigation of certain aspects of the banks' operations has been taking on increasing importance. A number of forecasting models have also been used to estimate the future course of the main items of the banks' balance sheets and profit and loss accounts. This serves primarily to assess the extent to which credit institutions can cope with the costs that the banking system is increasingly frequently being required to bear.

Annual accounts continued to be analyzed on the basis of the usual criteria, which are designed to support the monitoring of institutions' financial situations.

In connection with the decisions taken at the EEC level regarding banking ratios, a sample survey of the banks satisfying the ,1 billion ECU size criterion has been started. The banks have had to be asked to supply a certain amount of new information, which will be processed together with

that already in the supervisory authorities' possession and the results communicated to the competent Community organ.

The capital base of the credit institutions. — In 1980 the capital base of the banking system expanded at a faster rate than intermediation. Consequently, the own funds/risk assets ratio rose to 9.4% and the own funds/borrowed funds ratio to 5.7% (respectively 8.9% and 5.1% at end-1979; Table 46). A more detailed breakdown shows that the largest

Table 46

**RATIOS OF CREDIT INSTITUTIONS' OWN FUNDS TO THEIR LENDING
AND BORROWED FUNDS (1)**
(end-of-year percentages)

	1976	1977	1978	1979	1980
BANKS (2)					
Own funds/lending	6.9	7.7	8.3	8.7	9.1
Own funds/borrowed funds	3.9	4.0	3.9	4.1	4.6
SPECIAL CREDIT INSTITUTIONS (3)					
Own funds/lending	6.8	7.1	7.6	9.1	9.9
Own funds/borrowed funds	6.4	6.3	6.8	8.4	9.3
CREDIT SYSTEM					
Own funds/lending	6.9	7.5	8.1	8.9	9.4
Own funds/borrowed funds	4.6	4.6	4.6	5.1	5.7

(1) The lending of the banks includes resident and non-resident direct credits, bad debts and the banks' own unpaid and protested bills. In the case of the banks, borrowed funds include deposits and funds in administration; in that of the special credit institutions, own bond proceeds, customers' deposits, and funds of local authorities, the Southern Italy Development Fund and Mediocredito centrale. — (2) Excluding rural and artisans' banks and the central credit institutions. — (3) Excluding Mediocredito centrale and Artigiancassa.

increase was recorded by loan loss provisions, the item most closely linked to lending activity.

At the end of the year the ratio of loan loss provisions to risk assets had risen to 3% for the banks and to 4.8% for the special credit institutions (respectively 2.7% and 3.2% at end-1979).

Administration of the restrictions on banking business. — The compulsory reserves paid in against the increase in deposits in 1980

amounted to 4,342 billion. After the compulsory reserves connected with the December increase had been paid in, their total corresponded to 14.6% of bank deposits, a proportion that was only slightly less than the marginal coefficient. In March 1981 the latter was raised from 15.75% to 20% by a decree issued by the Treasury Minister in accordance with the resolution of the Interministerial Committee for Credit and Savings passed on 30 January 1975, empowering him to vary the coefficient within plus and minus 5% of the initial value of 15%. In the case of a fall in deposits, the coefficient employed for the release of reserves is 15.75%.

As regards the ceiling on bank lending in lire, the requirement, introduced in March 1980, that banks overshooting the limit should make non-interest-bearing deposits with the Banca d'Italia in relation to the amount of the excess lending produced a gradual reduction in such lending from 4,478 billion in January to 1,973 billion in December.

Developments in the economy resulted in these restrictions being tightened. When the ceiling was renewed for the period August 1980-March 1981, the limits were set on a monthly rather than a two-monthly basis and the maximum penalty deposit raised to 75% of excess lending. Subsequently, for the period April-December 1981 the exemption of loans up to 130 million was abolished and the base level of lending fixed at the amount outstanding at end-December 1980.

The Interministerial Committee for Credit and Savings made virtually no changes in the banks' compulsory security investment requirement in either half of the year (so that it remained 6.5% of the increase in deposits to be invested in the bonds of the agricultural and real-estate credit institutions).

The performance of inspections. — 187 inspections were made in 1980, of which 143 were general and 44 sectoral (compared with respectively 155 and 7 in 1979).

140 of the former were of banks with deposits amounting to 5,544 billion or 2.4% of the total for the banking system and 3 of special credit institutions with liabilities in the form of bond issues and certificates of deposit of 1,242 billion or 1.9% of the special credit institutions' total liabilities. Most of the inspections were of co-operative banks and rural and artisans' banks, both because they are the most numerous (accounting in number for more than 75% of the whole banking system) and because a great many of them had not been inspected for a long time. The proportion of liabilities covered by

inspections was consequently much lower than in the previous year (5,544 billion compared with 17,669 billion).

The sectoral inspections were designed to control specific aspects of banks' operations and, above all, respect of the ceilings on lending (39 out of 44 cases). The latter inspections were mainly of the largest banks and in terms of liabilities covered 71 % of the public-law banks: all the banks of national interest, 31% of the ordinary credit banks, 17% of the co-operative banks and 22% of the savings banks.

Extraordinary administration and compulsory administrative winding up. — Supervisory activity in connection with banks in difficulty was concentrated on small units with the aim of detecting anomalies and preparing rehabilitation plans or other suitable measures as early as possible. However, with our present monitoring systems it appears unlikely that it will be possible to forestall the risk deriving from sudden unfavourable developments, especially in the case of small banks where these may be due to problems with just a few borrowers. This difficulty was countered through closer contacts with the various banking associations as well as individual banks, by putting pressure on their governing bodies and by coordinating the measures that are within the power of the banking system itself.

The contribution of the supervisory authorities to the drafting of legislation and international cooperation

As part of their overall responsibility for the credit system, the supervisory authorities continued to provide information and technical advice to government departments engaged in the drafting of legislation on matters affecting credit. In international fora, and above all in the EEC, they contributed to the harmonization of regulations and to administrative action promoting common goals.

Contribution to drafting legislation. — Article 14 of Law 23 of 1981 provided that the application of Titles 5, 6, 7 and 8 of the Banking Law should be extended to all credit institutions with medium and long-term liabilities. A number of articles of the Banking Law relevant only to institutions with short-term liabilities were excluded and, in particular, Articles 32, 33 and 35 were considered unnecessary for the purposes of an effective control of the special credit institutions. The aforementioned

Article 14 nonetheless empowers the supervisory authorities to issue directives in special cases and envisages orders to limit risk concentration.

As regards the special laws for the areas struck by the earthquake of 23 November 1980, the supervisory authorities' cooperation with government departments consisted primarily in interpreting their provisions at the technical level and drawing up the procedures for their rapid implementation by the credit system.

Particular attention was paid to the examination of bills affecting credit matters. On the question of subsidized credit, the authorities pressed for acceptance of the principle of a clear distinction between the granting of credit and the granting of incentives.

International cooperation. — The coordination of legislative and administrative provisions regarding the credit sector was pursued at the meetings of the Advisory Committee established under Article 11 of the EEC directive of 12 December 1977. These meetings were devoted to the implementation of the principles of the directive itself and to determining the scope for further harmonization.

The Advisory Committee and the "Groupe de Contact" of EEC supervisory authorities contributed to the implementation phase with work on banking observation ratios. These were defined for solvency and are now being applied on an experimental basis.

On the other hand, progress was made in extending harmonization, both through the project on the winding up of credit institutions (with a resumption of the work of the study group on this question along the lines suggested by the Italian delegation) and the drafting of a proposal for a directive regarding supervision on a consolidated basis.

The work of the BIS Committee on Banking Regulations and Supervisory Practices was given new impetus by the firm stand taken by the Governors of the Group of Ten and Switzerland, who, amongst other things, reaffirmed the importance of supervising banks' international operations. Investigations are consequently under way in Italy and the other G-10 countries into the banking systems' maturity transformation in connection with international assets and liabilities, and into exposure vis-à-vis individual countries (country risk).

The study group set up at the OECD to revise the export credit consensus also continued its work. There was a general call for the minimum rates on subsidized credit to be raised through a mechanism based on a market indicator. For the initial phase a technical proposal was

put forward that would attenuate the automatic nature of the mechanism. However, since no solution was found that satisfied the OECD countries with interest rates below the consensus level, it was not possible to draw up an agreement.

Officials of the Bank Supervisory Department attended meetings at the EEC and the OECD on problems connected with export credit finance and insurance. These matters, together with the question of aid to developing countries, were also discussed with French, Swedish and World Bank delegations.

III. — THE GOVERNOR'S CONCLUDING REMARKS

To review developments which, although close at hand like those of 1980, have been pushed to the back of our minds by the swift march of events is right and proper, not only in order to fulfill the traditional task of the Banca d'Italia at this annual meeting but also because analytical knowledge of our condition stimulates and supports the act of will that leads to action.

I wish first to stress that we continue to pursue the objective of functionality within the Bank through innovations in internal organization, the provision of a staff that comprises many new members and is well qualified as a result of training programmes and through an awareness of the essential link between the institution and the public interest to be served.

The interaction between central bank and banking supervisory activities on the one hand and economic and legal research on the other has intensified. As it increasingly becomes a part of everyday operations, research usefully disseminates its demands for rigorous analytical method and thoroughness and is, in turn, greatly stimulated.

In the present financial year the Bank's accounting system was improved and the overhaul of operating procedures was continued, particularly with regard to the provincial departments of the Banca d'Italia acting for the Treasury and in relation to the money and capital markets; the project to equip the Bank with new and more sophisticated data-processing systems is in the course of implementation; an advanced stage has been reached in the study of other innovations in the cashiers' departments and in the devolution of tasks to the branches.

Improvements have been sought in staff organization. Partly as a result of the agreements concluded last year with the representatives of the trade unions, a complete framework for negotiations and the exchange of information has been laid down and changes have been made in the career structure to enhance the functional qualification of each individual position and to bring about a closer correlation between grade, responsibilities and remuneration.

The progress made with regard to these administrative aspects suggested amendments to the organization of the departments in the Head Office of the Bank to take account of the growing importance of planning and training methods.

To the staff of the Bank, with whom I share a bond formed in the course of my entire professional career, I wish to address my sincere and

affectionate gratitude for their conscientious work, which both expresses and reinforces a style that is a heritage of the Bank and the country, whereby the effectiveness of action to regulate the currency is also enhanced by discretion.

The world economy

In 1980 the world economy first recorded very slight growth and then showed a contraction, albeit a small one. The recessionary impact of the second oil shock was compounded everywhere by the effects of restrictive economic policies.

The rate of growth in the gross domestic product of OECD countries fell from 3.5% in 1979 to 1.3%. The unemployment rate, which was equal to 5.1% of the labour force in the final quarter of 1979, exceeded 6% at the end of last year, when the number of unemployed came to 23 million; there was a further rise in the first few months of 1981.

The leap in the prices of crude oil in 1973-74 had been followed by a sharp increase in nominal wages and a rise in the personal saving ratio. In view of the generally restrictive stance of monetary policy, businesses had reacted to the contraction in profits and consumption by destocking on a substantial scale and reducing their fixed investment. Expansionary fiscal measures had followed, aimed at attenuating the adverse impact that the increase in oil prices had had on production.

Wage demands have been moderate in this second crisis; this response has been accompanied by a decline in the saving ratio, and economic policies have concentrated on containing the secondary repercussions on costs and prices.

A contributory factor in the wage restraint is the realization gaining ground among governments, managements and the unions that the real transfer of resources connected with the increased oil burden has to be accepted and that no demands should be made to offset the rise in prices caused directly by the increase in the cost of energy. In some of the countries in which wage indexation exists incomes policies have partly neutralized its operation.

In spite of the impact of oil prices, the holding-down of domestic costs meant that in the OECD countries as a whole the rate of increase in the consumer price deflator fell to 10.5% in the second half of 1980 after having reached a peak of 12% in the first half of the year. Before the new oil crisis hourly earnings were rising at an annual rate of 9% and the

consumer price deflator at 7 %; in the second half of 1980 earnings increased at an annual rate of 11%, the same as that of consumer prices.

The cost in terms of unemployment and inflation was smallest in those countries where the policies designed to slow down the growth in monetary and credit aggregates operated in conjunction with guidelines drawn up jointly by the government, management and unions and with more centralized collective bargaining.

The sustained level of consumption and productive investment, combined with the fact that the stock cycle was rather less pronounced than in the first oil crisis, prevented as sharp a fall in production as in 1974-75 in spite of the smaller cyclical disparities between countries.

In the early months of 1980 the United Kingdom, Canada and the United States were already moving towards recession; in the United States the cyclical downturn came almost a year later than had been widely predicted. In Japan, Italy, France and the Federal Republic of Germany economic expansion continued during the first half of the year. In the six months that followed, the decline affected all the major countries except Japan and Canada. In the early months of this year the world economy has shown a resumption in growth, fuelled mainly by the United States and Japan.

The short-term effect of US economic policy is uncertain, however. The new Administration has drawn up a medium-term programme whereby the reduction in the role of the public sector is to be brought about by encouraging private initiative and saving and curtailing existing forms of regulation. Such action would encourage productive investment and growth, while at the same time reducing the need for government assistance to ailing sectors of the economy. On the monetary front, the deceleration in the aggregates would ensure a progressive decline in inflation.

In the immediate future the burden of stabilization falls predominantly on monetary policy. As the demand for credit is failing to slow down, the Federal Reserve's quantitative targets are leading to high and rising interest rates. This places European countries in a dilemma: they must either accept higher inflation due to exchange rate changes or pursue monetary policies that are more restrictive than would be necessary on purely domestic grounds.

Even if economic policy is formulated with due regard to the need to avoid a renewed fall in production, in the foreseeable future the scope for expanding domestic demand and employment in countries heavily dependent on imported energy will be even narrower than in recent years.

The constraints will be all the more severe in those economies that are slow to encourage the quest for greater efficiency, higher productivity and the expansion and restructuring of productive capacity.

International trade had the effect of transmitting rather than amplifying the cycle in 1980. The fall from 6.5% to 1.5% in the growth of the volume of goods traded was due largely to the decline of about 10% in oil exports, which had, by contrast, increased by 3.5% in 1979. In particular, imports of crude oil by industrialized countries contracted by 14%, with a peak of 20% in the United States.

Declines of between 5% and 8% in the volume of total imports were recorded by the United States, Japan, Canada and the United Kingdom. Moreover, the first two of these countries displayed exceptional export growth, with volume increases of 8% and 18% respectively, owing to the previous depreciation of their currencies. The United Kingdom benefitted from the increased production of oil, although its market share in manufactured goods declined. Mainly as a result of these movements, the current accounts of the United Kingdom and the United States returned to surplus, that of Canada approached equilibrium and the increase in the Japanese deficit was relatively small.

The deterioration in the current accounts of the major industrialized countries was concentrated in the Federal Republic of Germany, France and, especially, Italy, where it amounted to 15 billion dollars. In absolute terms, but not as a proportion of domestic product, the largest deficit was that recorded by the Federal Republic of Germany; it amounted to 16 billion dollars, three times the level of 1979. In France there was a deficit of 7 billion dollars, against a surplus of 1 billion in 1979.

These changes occurred in spite of the fact that the greatest absolute deteriorations in the energy balance were recorded by the United States and Japan; their deficits increased by 15 and 20 billion dollars respectively to stand at about 70 billion in both cases. The increase in the energy deficit was of the order of 10 billion dollars in the Federal Republic of Germany and France and 8 billion dollars in Italy.

The worsening of the German deficit, the attainment of surpluses in the United States and the United Kingdom and the new monetary policy stance in these two countries affected the exchange rates among the principal currencies, the recycling arrangements and the mechanisms for the creation and absorption of international liquidity.

The rise in interest rates had begun in 1979 in the Federal Republic

of Germany; last year and this, the rigid control of the monetary aggregates by the Federal Reserve has led to unusually high and extremely volatile nominal rates on financial assets denominated in dollars. Real rates have been correspondingly high; those on DM assets have even exceeded real US rates, notwithstanding the steady worsening in the economic situation.

In effecting short-term international movements of capital, businessmen focus their attention on interest rate differentials and their variations, but also take account of exchange rate developments expected in the period for which the funds are to be held. In 1980 a depreciation of the dollar against the mark was scarcely plausible, given the prevailing and foreseeable relative current account positions of the United States and the Federal Republic of Germany. Investors therefore preferred assets denominated in dollars, thus pushing up its external value. The favourable reception accorded to the new President's economic programme accentuated the rise in the currency's exchange rate.

At least part of the depreciation of the mark against the US dollar — and, indeed, against the Canadian dollar, the pound sterling and the yen — may have appeared to the German authorities as the price to be paid for regaining a competitive edge; between the beginning of 1980 and today the change in relation to these four currencies has been between 25 % and 30%, a movement that cannot fail to have a significant effect on the pattern of current account balances.

In February of this year the need to combat imported inflation led the German monetary authorities to give the defence of the external value of the mark priority over maintaining the level of economic activity. A tightening of central bank credit caused substantial increases in interest rates and the dollar/mark exchange rate stabilized temporarily. The increase in German rates was followed by similar movements in all the major industrialized countries except Japan. In spite of the slowdown in inflation, which is now running at about 10% in terms of consumer prices, US interest rates have recently risen further, with prime rate touching 20.5 %. This has induced a further strengthening of the dollar and an accentuation of the restrictive stance adopted in the other countries.

Interest rate escalation is bound to delay recovery and to sap its strength; hence from this point of view, too, a high price attaches to the current predominant reliance on monetary policy as a means of curbing inflation.

In spite of the size of the OPEC surplus, which rose from 65 to 120 billion dollars, no serious strains developed in the recycling mechanism, partly owing to the distribution of the deficits among the industrialized countries. In particular, the obtaining of direct finance from OPEC countries to the value of more than 10 billion dollars by the Federal Republic of Germany, Japan and, to a smaller extent, Switzerland relieved the pressure on international markets and, at the same time, confirmed the trend towards a multi-currency reserve system, including composite units such as the SDR and the ECU. This new structure is not necessarily unstable, but the problems are greater and call for closer co-ordination of monetary policies in the major countries.

The net financing of balance-of-payments disequilibria by official agencies rose from 13 billion dollars in 1979 to 20 billion last year, mainly as a result of the action taken by the International Monetary Fund to assist less developed countries. On the other hand, the total net flow of credit intermediated by the markets remained almost unchanged at around 150 billion dollars.

The less developed countries also continued to increase their net indebtedness towards the market. However, they had to resort increasingly to direct borrowing from individual credit institutions rather than from syndicates of banks and to pay wider spreads and higher commissions; some accepted a contraction in their gross reserves deposited in the euro-markets. These are clear signs of strain pointing to the need for better surveillance of international banking operations in order to prevent an over-concentration of risks.

The problems seem considerable, particularly when viewed in perspective — those due to the increase in the price of oil and the stagnation of international trade are augmented by those deriving from the strength of the dollar and high interest rates. Between 1979 and 1980 the twelve largest developing countries saw their total oil bill rise from 14 to 39 billion dollars and their interest burden from 7 to 18 billion. In certain large economies interest payments on external debt have risen to between 20% and 35 % of their export earnings.

It is necessary to prevent the financial burden from becoming intolerable. The initial responsibility lies with the less prosperous countries themselves to do all in their power to promote internal adjustment, partly by ensuring more favourable conditions for the inflow of direct investment. The OPEC countries will have to play a fundamental role and, indeed, they are substantially increasing their aid and credits to countries with lower incomes. Nor may the industrialized countries shirk this same responsibility, even in times of deficit; in

particular, they must, either directly or through multilateral institutions, maintain an adequate volume of aid designed to bring about a strengthening of the LDCs' economic structures.

The international organizations have already taken steps towards the provision of more effective, longer-lasting support that pays closer heed to the development of supply capabilities, particularly in the energy field, while confirming their commitment to maintain their primary purpose, which in the case of the IMF is to monitor the economic policies and external disequilibria of all member countries and the channels whereby international liquidity is created.

Although the possibility of IMF recourse to the market should not be precluded, it is advisable that it be held at a level that would not distort the structure of its fund-raising based on quotas. It would be preferable to follow the path of direct financing of the Fund by member countries; the recent agreements with the Saudi Arabian monetary authorities and with a group of central banks from the industrial countries represent a significant step in the right direction.

In the second year of the existence of the EMS the currencies linked by the intervention mechanism showed a high degree of cohesion, aided by the underlying weakness of the mark against the dollar. However, the effect of convergence on the performance of prices was outweighed by the different inflation propensities in the various countries, so that the shifts in competitiveness were substantial. These movements were accentuated by the differing importance of non-member currencies in the external trade of the individual countries.

The pound sterling, which belongs to the EMS but is not bound by the exchange rate agreement, was buoyed up by the interest rate differential and the current account surplus, so that it appreciated by 30% in relation to the other Community currencies between the end of 1979 and January 1981; it subsequently declined when the differential was reversed, but it remained 27% higher than at the end of 1979. Inflation moderated, but as it remained above the average for the other industrialized countries, the United Kingdom's loss of competitiveness was greater than the effective appreciation of the pound.

Among the currencies bound by the exchange rate agreement the lira showed the largest change in terms of nominal exchange rates, moving in the opposite direction to the pound sterling.

The decision of the Deutsche Bundesbank to intensify its restrictive stance caused the mark to strengthen from 20 February onwards; it

returned to the upper edge of the band and forced the lira below its lower divergence threshold. The lira, whose bilateral margins in relation to the mark and the French franc diminished to about 1.5 %, became vulnerable to speculative attacks. As the trend of the underlying variables made it unlikely that the lira would rise above the divergence threshold, the necessary room for manoeuvre was regained by reducing the currency's central exchange rates within the EMS by 6%. The depreciation of the lira on the market after the parity change has been small in relation to the currencies linked by the exchange rate agreements; yesterday it amounted to less than 2%.

All the other currencies in the system showed small bilateral fluctuations and improvements in their competitiveness, albeit to varying degrees. Until the spring of this year the French franc was constantly in the upper half of the band of fluctuation, whereas the Belgian franc was permanently in the lower half; the two currencies frequently reached their bilateral limits, giving rise to intervention on a substantial scale. The movements of the deutschemark reflected inversely the phases of strength of the dollar; considerable support purchases were made, partly with dollars and partly with Community currencies. As a result of the elections in France the franc has come under strong pressure in recent weeks, a development that has led to the introduction of severe foreign exchange and monetary restrictions; in particular, short-term interest rates have risen to 22%. Although the mark has been weak in relation to the dollar, it remains the only currency in the exchange rate mechanism to be consistently divergent in an upward direction.

All in all, the combination of external pressures and internal difficulties in the first five months of this year have caused serious tensions within the EMS.

Apart from the need for closer co-ordination of economic policies among member countries and more effective support from both the budget and other Community financial instruments, the role and scale of which should be expanded, the system's cohesion suffers from the lack of both a common policy towards the dollar and agreement with the US monetary authorities on suitable action. Moreover, in accordance with the new direction of economic policy, the latter have recently expressed the desire to abstain from intervention in the foreign exchange market save in exceptional circumstances.

The Resolution of the European Council establishing the EMS spoke of the need to consolidate the initial arrangements on a precise institutional basis through the creation of a European Monetary Fund capable of

sustaining the process of monetary stabilization; this was subsequently reaffirmed by the Heads of State and Government.

It may prove difficult to maintain and strengthen the EMS without setting up a Fund able to utilize ECUs as a reserve asset and means of settlement, establish them in less precarious forms and provide for their creation in accordance with actual liquidity needs. This entails a qualitative leap that can be achieved only if it is supported by an act of firm political will, directed not only and not primarily towards solving institutional problems but above all to inducing behaviour consistent with the commitments undertaken at the inauguration of the system. A primary requirement will be a greater determination to control the autonomous stimuli to inflation on the part of countries such as our own that are furthest from stability.

The domestic economy

The moderate expansion of the Italian economy following the recession of 1977 developed, between June 1979 and April 1980, into a growth in domestic demand without precedent in the last twenty years. The subsequent downturn led to a brief period in which production declined but remained higher than before the expansionary phase.

Inflation also soared in the six months preceding the peak of the cycle; the deterioration was due to the concurrence of a dramatic rise in costs, in particular those of energy, demand pressures and an intensification of supply bottlenecks in some sectors. A slowdown in the middle quarters of 1980 was followed by a renewed acceleration to an annual rate in excess of 20%.

The cyclical turnaround in Italy came a few months later than predicted, lagging behind developments in the other major industrialized economies, while the strength of domestic demand was much greater. Within a short space of time a large balance-of-payments surplus on current account gave way to an even larger deficit.

The recovery from the recession had been stimulated during 1978 first by exports and then by private consumption. The latter continued to grow in the first half of 1979, being sustained by the increase in disposable income, which it later surpassed in terms of the rate of growth. In the second half of 1979 the vigorous expansion in exports and consumption triggered off a strong recovery in investment, particularly in machinery and equipment. In the first quarter of 1980 the capacity utilization rate in industry indicated that a state of excessive demand was

becoming widespread. For nine months from the beginning of the acceleration in the upswing, gross domestic product had been rising at an annual rate of 10%. Domestic demand was still at a record level in the second quarter; the increase in relation to a year earlier came to 10% overall, private consumption rising by 6% and investment in machinery and equipment by 26%.

The reversal of the cycle was heralded by a decline in the volume of exports in the first quarter. Owing to the time lags between changes in relative prices and their impact on trade flows, the effect of the uninterrupted loss of competitiveness from mid-1979 onwards was particularly strong during the expansionary phase and carried over until the summer. The reduced ability to compete in foreign markets was reflected in a decline in Italy's share of world trade in manufactured goods, which was itself contracting from the spring onwards. The initial recessionary influence stemming from the external sector was reinforced by the decline in the rate of growth of consumption caused by fiscal drag and by the deterioration in the terms of trade. Fixed investment remained relatively strong until the third quarter, when it fell by 3%. The build-up in stocks of finished products came to an end in the summer. The fall in production in that period, when firms took the opportunity to extend the holiday closure, may signal a greater readiness on the part of businesses to adjust their production plans to the decline in demand; the reduced availability of credit and its rising real cost provided further incentive to do so.

In the months around mid-year inflation and the external deficit moderated slightly but remained high, in spite of the easing of the pressure on productive capacity and the pause in the rise in the world prices of primary products. The aim of improving the composition of demand and encouraging a trend towards stabilization prompted the measures introduced on 3 July, which increased taxation on consumption, reduced firms' social security contributions and granted tax exemption for the interest on new bond issues. These proposals had to be resubmitted with certain modifications in August; they expired at the end of September but were re-introduced and passed into law in the three months that followed.

In June and August the Banca d'Italia parried attacks on the external value of the lira. Restrictive monetary and foreign exchange measures introduced at the end of September prevented destabilizing expectations from being encouraged by the current account deficit and a government crisis that had arisen precisely over the management of the economy.

Inflation began to accelerate once again. In the final quarter of 1980 the economy thus demonstrated clearly that the cyclical change had been

followed by a sharp break: the transition to a phase of stagnation combined with more virulent inflation.

The appreciation of the dollar from the autumn onwards was one of the factors preventing the desired behaviour in prices. Above all, the further expansion in public expenditure and in the public sector deficit not only had a direct impact but also gave an impression of laxity that aroused the expectation of further price rises and leapfrogging wage increases. In addition, the immediate inflationary impact of measures capable of preventing growth in the public sector deficit and the expansion of loss-making areas — such as increases in utility charges, fares, regulated prices and indirect taxes — was concentrated in those months.

So ended a two-year period in which the gross domestic product and private consumption grew by just under 10% in real terms, investment in machinery and equipment by 30% and domestic demand by 13%; these rates are twice or three times as high as those recorded in the OECD area. The Italian economy surpassed the other countries insofar as the rate of growth of income and even employment is concerned, but paid the price in terms of external disequilibrium and inflation.

The 175 % increase in the import price of oil between November 1978 and December 1980 did not reduce the peak of the cycle but had serious consequences for inflation and the external accounts. The immediate impact and indirect effects of the increase in the cost of oil were responsible for about one third of the increase in the industrial value added deflator and around one quarter of that in the private consumption deflator, which averaged 18% and 20% respectively in 1980.

The deterioration in the current account balance of payments that began in the third quarter of 1979 amounted to 5% of GDP over the two years; almost two thirds of this can be ascribed to the increase in the oil-related deficit, which was itself due entirely to price, as the volume imported declined. In addition to the higher price of oil, and more generally the unfavourable trend in the terms of trade, there was a fall of 5% in the volume of exports and an increase of 7 % in that of imports in 1980. These changes were caused mainly by the strength of domestic demand in relation to both demand from abroad and available productive capacity and by the decline in competitiveness, which amounted to 2% in 1979 and 4% in 1980.

In the absence of significant improvements in price competitiveness, an easing of the external disequilibrium had been prevented even before the end of last year by the relatively high level of domestic demand, the recessionary trend in the world economy, the appreciation of the dollar and the further worsening of the terms of trade. Credit demand had begun

to increase again and had been met, though at increasing cost, thanks to the flexibility of the ceiling and the use of exempted forms of lending, particularly loans in foreign currency. In view of these developments, the Banca d'Italia announced the renewal of the ceiling in advance and on more restrictive terms at the end of January 1981.

In the first few months of the year the situation showed no sign of improvement. The spiral fuelled during 1980 by pricing policies geared in many cases towards short-term profit, by indexing mechanisms that transmit and amplify inflationary pressures and by rising public sector expenditure threatened to spin out of control in a welter of sectoral demands for higher wages and speculation on the foreign exchange, securities and commodity markets. The lira sank to its divergence threshold within the EMS.

These circumstances, which are adverse in the present situation and disquieting for the future, caused the authorities to adopt a package of stabilization measures that would operate in three areas — public sector current expenditure, the growth of money incomes and the supply of credit.

This led to the decisions of 22 March. The Government undertook to reduce the deficit, adjourned the wage negotiations with public employees and called for wage restraint in the private sector. The discount rate was raised from 16.5% to 19% and the marginal reserve requirement from 15.75% to 20%. The parity of the lira in the EMS was adjusted in order to protect the currency from speculation, bringing the rate back to the centre of the band of fluctuation.

There was a delay in implementing the declared intentions, thus using up the room for manoeuvre gained as a result of the emergency measures, which had implied that broader and more decisive economic action would swiftly follow. It was not until the new government crisis arose that measures to reduce the deficit were approved by means of a decree law. The authorities had to introduce a further emergency measure in the form of a non-interest-bearing deposit of 30%, frozen for 90 days, on foreign payments.

The necessary adjustment of the trade balance, which showed a deficit of 19,000 billion lire in 1980 and has to bear an added burden of about 4 billion dollars this year solely on account of the increases in oil prices that have already occurred, has not yet got under way. Total imports have declined in volume, but the small improvement is outweighed by the appreciation of the dollar, and it is proving difficult to expand exports in view of the worldwide weakness of demand. In the first quarter of this year the trade deficit came to about 5,000 billion lire, compared with 3,800 billion in the same period of 1980. In the first four

months the current account on a settlements basis recorded a deficit equal to more than half that for the entire preceding year.

These figures are a stark indication of the size of the change in the relationship between domestic and foreign demand required to set in motion a process of adjustment through the net exportation of resources to offset the past and continuing deterioration in the terms of trade.

The level of domestic demand continues to be influenced by the Treasury borrowing requirement, which has amounted to about 4,000 billion lire for several months running, thus frustrating the effects and expectations associated with monetary management and obliging the continuous use of the latter to mop up excess liquidity. Economic surveys among businessmen carried out at the beginning of April indicate a recovery in the inflow of orders and an expectation that production will not decline; at the same time, the demand for bank loans shows no sign of slowing down. Inflation persists at an annual rate of around 20%, sustaining the differential between Italy and other countries. In manufacturing industry the increase in unit production costs is tending to exceed that in final prices.

This disturbing development is partly due to the worsening of external factors; however, this observation should itself arouse awareness of the pressing need for more decisive action with regard to the economic variables that Italy has the power to control.

The speed with which the expansion in demand reached the limit of productive capacity in the early months of 1980, the high levels of activity that continued to prevail subsequently in spite of credit restrictions, the persistence of a high balance-of-payments deficit even after the peak of the cycle had been passed — all this can be better understood if one considers not only the cyclical factors and exogenous domestic and international stimuli but also some of the underlying conditions of our economy.

The growth and modernization of productive capacity had been suffering since 1974 as a result of the stagnation in fixed investment, which slowed down the restructuring necessitated by the large changes in relative prices and in the distribution of income and wealth. In a situation such as this the expansionary phase of the investment cycle was extremely vigorous; the available plant was soon fully utilized, so that the pressure to expand capacity complemented the need to adopt techniques more consistent with the new structure of prices and costs.

Companies were not in a strong financial position to cope with this revival in investment. In the decade from 1969 to 1978 borrowing had

increased to almost 60% of total assets and short-term debt had risen from 37% to 44% of the total. The proportion of earnings required for the payment of interest, which had amounted to 3% in 1973, had doubled by 1978, with peaks of 12% in some sectors. Under such conditions capital formation needs could only be met by counteracting the steady deterioration in balance-sheet ratios. The normal and prevalent relationship between profits and investment is a causal link running from the former to the latter; in those firms that were more acutely aware of the urgency of restructuring, this became overlaid by another relationship dictated by the need to widen their profit margins in order to limit the financial risk. Expectations of a depreciation of the lira probably reduced companies' concern about the danger of losing their market shares, on the assumption that they could rapidly offset the decline in competitiveness.

Gross profits in manufacturing industry benefitted from both the expansion in sales and the rate of increase of 19% in producer prices, which just exceeded the increase in overall unit costs. Within the latter, unit labour costs increased by an annual average of 14%, taking into account the further partial relief from social security contributions; costs per person employed in fact rose by 21% and labour productivity by 6%.

The urgent need for investment in the restructuring of industry, which was long overdue, and the higher self-financing required to achieve this reduced firms' sensitivity towards the high cost of credit inflicted by monetary policy.

The intensification of investment coincided with the emergence of a disturbingly high level of consumer spending that was incompatible with overcoming the present difficulties. The prolonged erosion of the domestic purchasing power of the lira accompanied by a highly distorted structure of relative prices for goods and capital assets and by the elimination of lags in the replacement of durable consumer goods was reflected in households' propensity to consume, which rose by 4.5% between 1978 and 1980. The rise in the value of the real assets element of wealth may have more than offset the erosion of the financial component, thus stimulating consumption. Above all, the time required for consumers to take note of developments and to react has shortened in view of the persistence and accentuation of inflation. There is a danger that the high average saving ratio of Italian households will diminish as inflation takes root.

The interweaving of cyclical movements and fundamental deficiencies has become apparent not only in capital accumulation but also in foreign trade in manufactured goods.

The import content of investment goods, which has always been high in Italy, was accentuated by the slower growth in industrial capacity

between 1975 and 1978, which primarily affected capital goods. In addition, world demand has been directed towards investment goods rather than consumer goods and, within the latter, towards products other than the so-called mature ones, such as textiles and clothing, the traditional preserve of Italian exporters. In these sectors competition from less developed countries, especially those in the Far East, has grown keener.

Trend figures show that, unlike other industrialized countries, Italy has increased its specialization in mature industries, where price competitiveness is more important. This orientation creates the danger that Italy will slip into the group of second-rate economies, which have little by way of advanced industries and are being hard pressed by the newly industrialized countries, which employ cheap labour that is not protected by extensive social legislation.

The intensity of the phase of capital formation constitutes the most valuable legacy of the expansionary cycle of the last two years and is a precondition for a recovery in competitiveness, the emergence of which is linked to greater flexibility in the use of the factors of production, which will itself be the outcome of improvements in industrial relations and of economic policy measures.

Management of the currency and of the exchange rate

In a situation in which the spontaneous trend of the international cycle and the economic policies pursued in the major countries were both tending to depress trade, domestic demand restraint and the maintenance of a substantial degree of stability in the external value of the lira were the only means of resisting the pressure on prices. The desire to curb inflation, the knowledge that defence of the exchange rate would become more difficult if the deficit in the current account of the balance of payments reached large proportions, the aim of overcoming the cyclical problems in a short space of time in order to concentrate the country's resources on strengthening the productive sector — these should have been the co-ordinates for the formulation of economic policy.

The objective of holding down aggregate demand while safeguarding investment and exports would have required measures to limit the public sector deficit, thereby supplementing the automatic effects of the prevailing rise in nominal incomes, and to slow down the escalation in companies' costs and in households' disposable incomes.

Instead of this, as the rise in tax receipts began to reduce the deficit, increases in expenditure and reductions in revenue were decided that

largely neutralized the automatic stabilizing effects. In December 1979 the sliding wage scale for public employees was placed on a quarterly footing; in February 1980 pensions were improved; in April personal income tax allowances and family benefits were increased; it was agreed that arrears and advances in connection with the new contracts for public employees would all be paid in 1980. In the year as a whole expenditure rose by 26% and the overall borrowing requirement of the enlarged public sector remained as large as in 1979 in proportion to gross domestic product.

The fiscal measures decided at the beginning of July went in the right direction, but the events that accompanied them impaired their effectiveness, adversely affecting prices.

The provisions adopted in 1980 began to exert an influence on the budget in the second half of the year, creating a net burden of about 6,000 billion lire; in that period the ratio between the public sector deficit and GDP reached its highest level for five years. At the end of 1980 and in the opening months of 1981 not only was the public employees' contract for the period 1979-81 concluded, but other measures with expansionary consequences were decided or agreed with the trade union organizations, including the adjustment of pensions every four months, new personal income tax allowances and rates and the renewal of agreements with hospital staff. The problems relating to the balance of payments and inflation thus grew more acute, partly as a result of the announcement of these measures.

Monetary policy had already assumed a restrictive stance in the final quarter of 1979 with the 4.5 point increase in the discount rate and the renewal of the credit ceiling, which limited the growth in non-exempt bank lending to an annual rate of 11% in the period up to July 1980.

Interest rates rose, those at the short end of the market increasing at a particularly rapid pace. Bank lending rates rose from 17.5 % to 22% between the beginning of October 1979 and April 1980. An even faster increase would have jeopardized the equilibrium of the financial system and especially that of the business sector, where debt ratios were high and very varied.

The exceeding of the limits on credit expansion in the autumn of 1979 and the first few months of 1980, which reached a peak of 4,000 billion lire in January, facilitated the increase in production and investment but also contributed to the worsening of inflation and the balance-of-payments deficit. The indirect control exercised via the banks' reserves and by raising interest rates was therefore supplemented in March by the

tightening of direct controls through the introduction of a non-interest-bearing deposit on amounts in excess of the ceiling.

In the first half of the year the rise in interest rates and the change in their structure was reflected in a shift in public preference towards Treasury bills, for which subscriptions came to 13,300 billion lire, at the expense of deposits and, to a lesser extent, medium-term securities. During that period the banks' total deposits recorded a decline of 2,300 billion lire. Faced with a phenomenon that was familiar but unprecedented in scale and with credit demand strong, the banking system chose to respond not by pushing up deposit rates but by reducing its own holdings of Treasury securities by 7,700 billion lire; in this way it was able to increase exempt lending in lire by much more than had been predicted.

In the months around mid-year pressure on the lira further complicated the task of stabilization by means of monetary policy. At the end of May the lira moved the full breadth of the narrow EMS band of fluctuation. In June came the first assault on the currency; in view of the width of the band of fluctuation, part of the pressure could be absorbed by allowing the exchange rate to slip further by almost 2% against the other Community currencies. The wave of speculation was stemmed by the signal of firmness given to the market by the advance renewal and tightening of the credit ceiling. The flow of short-term capital reversed in July, permitting the replenishment of reserves. In August, however, fresh rumours of devaluation made it necessary for the authorities to give substantial support, which continued on a smaller scale in September.

The day after the government crisis, which jeopardized the effectiveness of the fiscal measures taken in July, the official discount rate was raised by one and half points and exchange control measures were introduced to curb speculative movements of capital.

After the crisis had been overcome the authorities were faced with a conflict between the need to finance the external deficit and the necessity of restricting credit; it was considered that the special emphasis placed on the former had to be reduced, and accordingly in December the foreign exchange controls introduced at the end of September were removed.

Partly as a result of these controls, the banks' external liabilities rose by 4,000 billion lire in the final quarter, permitting the financing of the overall balance-of-payments deficit of 1,900 billion lire and an increase in the reserves. The banking system's net external liabilities rose to 15,000 billion lire, more than double the figure recorded at the end of 1979.

If the figures on financial aggregates and interest rates together are set against the trend of incomes and prices, it is apparent that liquidity

conditions in the economy and on the credit markets were tight throughout the year, and particularly in the second and third quarters.

The rate of growth of the monetary base was 13.6%, practically the same as in the preceding year in spite of the pressure exerted by the Treasury borrowing requirement; the increase of a further 3 points in the average interest rate on Treasury bills helped to tilt the public's portfolio preference in favour of short-term securities and reduced the banks' demand for monetary base.

The economy's financial assets as a proportion of gross domestic product fell by an average of 5% in relation to 1979; the liquidity ratio of businesses declined by the same amount; bank lending rates rose by more than 4 points to stand at 23.5 % at the end of the year.

The ratio between total domestic credit expansion and GDP had fallen from 22.2% to 19.6% between 1978 and 1979; in 1980 it decreased further to 18.8%. The reduction was particularly severe until the third quarter — in the twelve months ending in September the ratio fell to 16.2%. In the final quarter credit expanded at almost twice the rate recorded in the preceding nine months owing to the growth in the public sector deficit, which in that period accounted for almost half the increase for the entire year, and to the expansion in foreign currency lending.

Even if a broader concept of financing is used which includes medium-term borrowing abroad, bankers' acceptances and shares, it is still evident that there was a reduction in the ratio until September, though this was almost entirely neutralized by the acceleration in overall lending in the fourth quarter.

In the new year the problems were magnified; in the late autumn of 1980, when the statistics were indicating the progressive worsening of the trade deficit and the renewal of acute pressure on prices, warnings had already been given about the need to tighten the credit restrictions. Bank reserves were regulated by making extensive use of repurchase agreements on securities and the technique of the competitive auction.

At the end of January the renewal of the credit ceiling was announced; the provisions were extended to include loans of less than 130 million lire and at the same time a freeze was imposed on the foreign currency financing of imports. Greater use had been made of the exemptions than had been predicted, facilitating an increase in bank lending to medium and large firms as well; this was mainly achieved through an abnormally large growth in multiple credits, with the risk that individual banks might become less prudent and selective in granting loans.

In the first three months of 1981 the public sector borrowing requirement amounted to 12,000 billion lire and the increase in total domestic credit exceeded 17,000 billion; in the same period of the preceding year the shortfall had come to 4,000 billion lire and total credit expansion only slightly over 7,000 billion. The borrowing requirement has remained high in the last two months.

In order to counteract the expansionary effects on liquidity and to tackle the problems that had arisen on the foreign exchange market, some of which were due to international tensions, it became necessary to increase the discount rate and the reserve requirement coefficient in March and to introduce a non-interest-bearing deposit on foreign payments on 27 May.

Greater control over the creation of monetary base and stricter adherence to the quantitative targets for this variable, particularly with regard to bank reserves, might be obtained if the system of Treasury financing were modified. The Banca d'Italia would cease to take up all Treasury bills not placed in the market at the auctions, acquiring only amounts consistent with monetary policy objectives. The Treasury would thus try to raise the required finance in the market, partly by increasing the frequency of the auctions.

We are aware of the problems raised by the co-existence of direct and indirect methods of control; during the past year we have made adjustments to both in order to preserve the effectiveness of their joint operation in this situation. Direct controls produce their greatest impact when they are introduced or modified; they are then eroded by forms of evasion that are costly for the banks, distorting for the economy and difficult for the authorities to counter.

In the prevailing economic conditions — in particular, the persistence of expectations of high and variable inflation, the inadequacy of policies other than monetary policy and the need to moderate the rise in interest rates — it would be inadvisable, however, to relax direct controls.

The smallness of the increase in bank deposit rates, which was partly due to the ceiling on lending, was a major contributory factor in holding the nominal yield on financial assets well below the rate of inflation; the shift in the composition of wealth towards real assets was impeded to only a small extent by the higher level of interest rates. One positive feature was the resumed flow of savings into the direct financing of companies, particularly in the form of equity capital; on the other hand, consumer spending and the demand for shelter goods increased.

Clearer differentiation between the various categories of deposits in accordance with their stability and term might mitigate the penalization of financial saving and bring about greater transparency in the markets. The banks should be encouraged to amend their policies in order to achieve this objective.

The experience of 1980 confirmed that in times of great market uncertainty about the future development of interest rates it is difficult and sometimes inadvisable to resist the shift towards short-term securities. By offering them, the authorities can cover the public sector deficit while containing the creation of monetary base, even if the degree of liquidity of financial assets remains high. When the repetition of periods of instability strengthens the aversion of savers towards long-term financial instruments, the range of short-term issues widens, increasing the possibility of switching between assets and reducing the significance of the growth in the monetary aggregates as an indicator of overall liquidity.

In such circumstances particular importance attaches to the policies for the non-monetary financing of the public sector borrowing requirement and to the lengthening of the maturity of the debt.

The change in the terms for Treasury credit certificates in 1981, including the payment of a premium over short-term rates, promises to encourage this process and, in addition, to reduce the debt servicing burden when the rise in prices slows down. This is the direction in which we should proceed, especially if we wish to be able to count on a broad and flexible money market; the indexation of interest rates meets the needs of lenders and borrowers alike in the present climate of uncertainty about the time-scale for the easing of inflation, as was shown by the growth in the variable rate bonds issued by the special credit institutions in 1980.

It appears inadvisable for the state to issue traditional fixed-interest securities for periods longer than the medium term. The very high yield that would be necessary to overcome the public's reluctance could undermine expectations of a lasting reduction in inflation. Furthermore, when such a slowdown did occur, the servicing of the debt would prove an excessive burden.

On the other hand, the generalized indexation of public debt in terms of prices might be regarded as a capitulation to the debasement of the currency and a demonstration of the inability to eliminate or attenuate the mechanisms that perpetuate and amplify inflationary pressures in our economy. In the case of indexation of the principal, there would be the added fear that a further immediate easing of the budget constraint might

make it even more difficult for the government to resist pressures for still higher expenditure.

In the past we have spoken in favour of financial institutions issuing bonds linked in capital value to the ECU, in accordance with the prospect of monetary convergence in Europe and a strengthening of the lira within the EMS. If the issuer were the state, however, the danger that this would be regarded as an abandonment of the will to stabilize our own currency should not be underestimated. Not even the use of the auction method for issues indexed in this manner could avoid causing disequilibrium in the domestic capital market, unless the right to purchase the securities were restricted to well defined sectors.

The situation would be different if the floating of government securities linked to the ECU were coupled with economic measures agreed with the employers and the unions aimed at eradicating the structural causes of inflation. The link with the ECU could be a symbol of the country's and the government's defiance towards inflation and of the commitment to act entirely in keeping with membership of the EMS.

The question of the rationalization of the various forms of taxation on financial assets also arises in this context. With the erosion of such assets owing to inflation, nominal yields often do not provide any real remuneration but represent an advance repayment of principal. Changes in the system of taxation, which would be valid in a situation of monetary stability, would undermine the confidence of savers, which must, instead, be regained.

Total domestic credit expansion for 1981 has been set at 64,500 billion lire; it should decrease to 16.5% as a proportion of gross domestic product. Credit to the economy, including funds received from the public sector and from abroad, should also decline by 2 percentage points in relation to GDP. These targets are based on the commitment, repeated in recent government publications, to prevent the domestic borrowing requirement of the enlarged public sector from exceeding 37,500 billion lire; in view of the figures for the first five months of the year, this necessitates a large reduction during the remainder of 1981.

The pursuit of these credit objectives is essential if price stability is to be re-established; however, to be successful it must be accompanied by a programme of measures relating to the budget, the allocation of resources and to incomes.

Monetary and credit policies can curb and slow down inflation, but they cannot eradicate it unless far-reaching changes are made in the way

our society behaves. If these policies have a decisive effect it will not be in making such changes unnecessary but in hastening their adoption in a society that has become convinced of the need for them.

The complement to such a restrictive monetary policy is action aimed at reducing imported inflation by means of an exchange rate strategy, although the scope for this is limited when the dollar is strong, as at present.

The fact of having resisted the downward pressures on the lira within the EMS in the circumstances in which they arose in 1980 not only contributed directly towards containing inflation but also induced reactions and behaviour within the economy that themselves promoted greater price stability. Once the easy option of devaluation had been rejected, many firms improved the organization of production by agreement between the management and the unions in order to resist cost pressures.

This does not mean that formal parity adjustments within the EMS should be ruled out in all circumstances. They are consistent with the rules and the spirit of the system. That was what occurred on 22 March of this year. It was a necessary act, dictated by reality, but it was the bitter reality of a failure that could have been avoided in an efficient economy and society; room for manoeuvre was regained, but only by taking a retrograde step. The day of the devaluation was a day of realism; it certainly was not an auspicious one.

Aspects of state intervention in the economy

The last decade has seen a further increase in the community's demands upon the public sector. A critical point has been reached in the trend that sprang from the crisis of the thirties and led all countries to give economic and social policies a central and permanent role in the pursuit of growth and prosperity. The intention underlying that trend, which was to strengthen and stabilize the economy's investment potential, has become blurred and the task it prefigured has often degenerated into passive support. In a large number of cases transfer payments to families have become permanent subsidies rather than a temporary substitute for lost income; state grants to companies have redistributed value added rather than directing investment and its location; the growth of employment in the state machine has served to absorb manpower rather than to expand its capacity to provide services.

The speed at which the ratio between public expenditure and national income has risen and the extremely high levels it has reached, in some

countries around 50%, testify to the stimulus to which the public sector has been subjected, giving rise to expectations that were bound to prove excessive as demands multiplied.

Awareness of the crucial importance of the reallocation of resources in the current crisis has been slow to develop. It has increased of late, however, as has the conviction that today the main task of economic policy is to accelerate -this process by means that do not further magnify the state's role in the economy. The need for the public to abandon, or to be persuaded by positive measures to abandon, the attitude that every want should be met in the first instance by the state; the necessity of preventing excessive growth in public functions other than those essential for the operation of society; a preference for measures that would indicate solutions to the private sector while maintaining a fair balance between this and the public sphere — these are the guiding principles of action aimed at attacking the roots of the crisis rather than alleviating its consequences.

In Italy public expenditure has increased at an extremely rapid pace and in ways determined by the succession of often uncoordinated and sometimes conflicting measures that have been introduced. The scale of action required to induce essential changes in the productive sector and in the composition of demand necessitates immediate decisions regarding the use of the state's share of resources, which cannot be expanded further. The fact that such action is bound occasionally to take a direct form means that society must exercise restraint in the other demands it makes on the state and requires efforts to increase the operational capability of the government machine and the efficiency of state action.

The pursuit of the latter aim requires on the one hand an organizational reassessment of the general government sector as a supplier of services to the community and, on the other, an increase in the sector's capital endowment. In Italy the share of investment in total public expenditure is lower than in most other countries and insufficient to nurture technical advance within the state machine or to supplement capital formation in other sectors, thereby increasing productivity.

Greater investment would be to no avail, however, if it were not accompanied by a stricter commitment to minimize costs and improve the service provided.

The fundamental criterion from a strictly economic point of view continues to be the need to strengthen competition outside the public sector and to kindle similar stimuli within it. If this is to happen, the budget constraint must once again exert a disciplinary force both as a regulatory instrument and as a standard of ethics. By long tradition it has

become the linchpin holding together a heterogeneous society and an economy with a perennial temptation to hide behind subsidies.

Clear priorities in the choices to be made are necessary not only in order to ensure the efficiency of the state in providing essential services but also in view of its ability to direct the allocation of resources in the rest of the economy.

The links between various types of economic activity as well as the particular nature and intensity of the problems involved place the energy sector and the agricultural and food sector at the top of the scale of priorities. It is here, in particular, that supply deficiencies are evident, holding back growth and imposing a burden on the balance of payments. This has come about since the beginning of the seventies; in the course of the last decade the constraints have appeared at levels increasingly below full utilization of the economy's production potential.

Italy cannot continue to bear the balance-of-payments deficits of these two sectors without slipping down the slope of protectionism. The problems of agriculture have obvious social importance, when one considers that it provides a livelihood for about one-tenth of Italy's population; they are also of great economic complexity, ranging from relationships within an enlarged EEC to those with manufacturing industry, from the distribution and marketing of produce to the size of farms and the spread of technical progress. Only a concerted attack on all fronts can open the way to solution of the sector's problems.

In the energy field the measures to be taken are determined by technology and the relative costs of the various energy sources. In spite of the fall in the income elasticity of energy consumption in recent years, the potential for energy conservation remains high. Some savings can still be made at no cost at all; others require substantial investment coupled with a broad restructuring of production and a change in the patterns of consumption. Both types of saving should be encouraged and sustained by specific incentives, appropriate regulations, modifications in relative prices and improved information.

In view of the likely increase in per capita consumption, which is comparatively low, and the need to reduce the country's dependence on imported energy, efforts should not be restricted to energy-saving but should also be directed towards the expansion of domestic supply. The course to follow is indicated by the need for the diversification of energy sources — oil now accounts for two-thirds of total requirements — and by the cost of energy generated in oil-fired power stations, which is one and a half times that of energy produced from coal and more than twice that of nuclear energy.

In other basic industries, including chemicals and steel, a state of international crisis is interwoven with the specific problems afflicting large companies in Italy — problems of management, industrial relations, finance and their role as public or private entities.

In the chemical industry these factors have had a disruptive effect, causing the break-up of some large groups. The reallocation of plant according to specialization presupposes the strict assessment of their potential viability. The new structure would be placed on a sounder footing if the overlapping of public and private in the two leading chemical groups were gradually eliminated. Internal difficulties have made the Italian steel industry, especially the part under state control, more sensitive to the slump in the market in spite of the viability of a good proportion of the plant.

In the case of both industries, financial measures that will absorb vast resources diverted from other uses must be strictly linked to the thorough rationalization of plant and the restoration of operating conditions that make it possible to eliminate inflexibility in the use of the factors of production and to conduct a rigorous test of economic efficiency.

In more general terms, attempts to solve the entire question of ailing companies, which have engaged the efforts of politicians, trade unionists, businessmen and financiers for years, have made little progress so far in relation to the cost involved, partly owing to slowness in casting off the constraints of prejudice, such as the insistence on equating the rescue of a firm with its nationalization.

State intervention to save a firm that the market would allow to go bankrupt can be justified on the grounds of the common good and is even practiced in economies with a strong market orientation. Nationalization is not a necessary corollary of such an operation. It is not the only way of preventing the dispersion of resources that it is considered useful to maintain as a unit and of safeguarding the principle that the incompetent entrepreneur is removed from the firm and that the consequences of the voluntary assumption of risks fall upon the proprietor and creditors, according to the nature of their respective positions. The community's money is intended not for rescuing these parties, but for saving whatever goodwill and plant can be salvaged. State intervention might be limited to restoring the conditions necessary for finding someone prepared to assume a new risk. If no-one can be found, it means that more resolute action is required to revive the firm or that capacity must be reduced.

These thoughts reflect an attitude based on two assumptions — first, that the size of the state's role in Italy's productive sector is without

parallel in any Western country and is approaching the point at which the system ceases to be a market economy and, secondly, that the need has grown for collective choices affecting the behaviour of individuals and firms.

Experience in Italy and elsewhere forces us to conclude that, once the essential priorities have been established, intervention is generally more effective if it bears upon the structure of supply indirectly rather than directly. Instead of regimenting business decisions by means of an administrative apparatus of directives and controls, it is preferable to introduce measures to affect the flow of information, institutional structures and the network of constraints and incentives by which decisions are shaped.

Increasing the internal efficiency of the government sector, setting clear priorities for the allocation of resources and improving the means of implementing the latter are the paths to be followed, bearing constantly in mind that Italy is alone among the major industrialized countries in still having an acute development need in a large part of its territory. The development of the South remains the central problem facing Italian society. The earthquake of 23 November raised the question afresh in a dramatic way. The reconstruction and economic development of the affected areas in Campania and Basilicata could initiate a new trend in which state intervention did more than increase transfer payments still further. Resisting the understandable sectoral and municipal pressures, the authorities should calculate the financial requirement with great care, distinguishing clearly between funds for the repair of material damage and those for development. Moreover, reconstruction should be co-ordinated with the policy of attracting industry to the area, as far as the existing infrastructure permits, and should be able to rely on sound entrepreneurial skills, which need to be nurtured.

The extent to which the suggestions and principles recalled here were applied last year was inadequate in relation to the urgency of the problems. The government's three-year plan demonstrates the will to bring about a change. In a macro-economic setting that for methodological reasons disregards the cyclical development of demand, the plan re-affirms the need to improve the composition of the budget with the aim of reducing the size of the deficit on current spending and increasing the proportion of capital expenditure. These are two intermediate objectives to be pursued separately within a predetermined budget constraint that precludes any trade-off between the two. These requirements coincide to a large extent with the need to modify the institutions and decision-making bodies in general government that generate less essential or less productive expenditure. Such a modification presupposes a policy for the allocation of

resources that consists in the clear definition of priorities and the direct verification of each programme's ability to achieve the objectives set.

Towards better order in the financial system

Last year there was an intensification in the factors tending to reduce the portion of total new financial assets and liabilities reflected in the balance sheets of credit intermediaries, especially those of the banks, and to increase the share transacted directly between savers and final users of funds.

In a financial system with a strong historical bias towards use of the intermediaries rather than the capital markets in the narrow sense, a tendency for the relative size of the latter to increase may help bring about a permanent improvement in the balance, efficiency and stability of the entire credit system. However, the reduction in the portion accounted for by the intermediaries, and especially by the banks, must be gradual to ensure that it benefits their overall assets position, operating results and capital base and, hence, that the process takes place in completely stable conditions.

Last year and in the first few months of 1981 the change was occasionally too rapid, owing in some instances to factors that were accidental and in some respects disquieting. The in some ways improper intermediation carried out by the public sector continued to exert pressure to take over the activity of the credit institutions, often with adverse effects on the allocation of resources. The special credit institutions' growth was hampered by the obstacles that a high and variable rate of inflation places in the way of the issue of medium and long-term securities, by the delicate phase of reorganization and managerial change and by the wait for clarification of the institutions' legal position. Partly as a result of the better opportunities for profits that characterized a year in which the cycle reached its peak and the monetary policy stance was restrictive, the banks' interest rate spread widened for the first time in four years, thus contributing to disintermediation.

The controversy about so-called excessive bank profits was consequently rekindled by arguments of a conflicting nature. Although the Italian banking system is not highly concentrated, competitive conditions differ according to the type of activity and the region of the country, as can be observed in the lack of uniformity in bank charges and rates of profit. Furthermore, the banks' interest rate spread reflects the composition of balance-sheet assets, which is inflexible on account of the administrative requirements that the monetary authorities are constantly obliged to impose;

the tightening of the credit ceiling has come on top of the securities investment requirement and the low, invariable interest paid on compulsory reserves. The latter causes a transfer of resources from households and firms via the banks to the coffers of the state, especially when interest rates rise. Operating costs in a sector that is still labour intensive cannot fail to be affected by an inflationary trend in which the wages component tends to be large. Last year the substantial rise in the banks' costs per employee was not matched by significant and widespread increases in productivity.

However, the process of disintermediation was also influenced by positive factors that were not accidental. Italian financial intermediaries were exposed to increased competition: the segments of the money market dealing in government securities, bankers' acceptances and trade credits broadened and deepened; activity on the stock market showed a significant recovery; links with the international financial system were intensified and the flow of funds from abroad to Italian businesses was particularly large. The increase in the banks' earnings was partly due to the spread of policies aimed at maximizing profits through a close scrutiny of risks rather than pursuing growth at all costs. This development should be assessed favourably from the point of view of the more careful selection of borrowers; moreover, the banks' reserve funds and depreciation provisions had been contracting in recent years, and the capital base of Italian banks is still below the international average.

The special credit institutions took the opportunity to strengthen their capital and reserves; this was especially true of those whose first priority was to reduce their exposure towards sectors in structural difficulties. Favourable results were achieved through higher operating profits and by the injection of fresh capital, extension of the scope for lending, differentiation in the types of deposits and the definition, in Law 784 of 1980, of the procedures for converting loans to insolvent firms into government securities, albeit without the payment of interest.

In 1980 the capital base of the special credit institutions rose from 8.4% to 9.3% of ordinary liabilities and that of banks increased from 4.1% to 4.6%. This process continued in the first few months of 1981, partly owing to public injections of capital; in particular, Law 23 of February 1981 provided for subscriptions of about 500 billion lire.

The government's decision to inject fresh capital into the publicly-owned intermediaries confirmed the validity of a wide variety among suppliers of credit and fulfilled the need to exploit the stimulus that a plurality of competing intermediaries gives to the growth of the financial system. While due regard should be paid to this institutional requirement,

the structure of the public-sector credit institutions should be modified in the knowledge that autonomy presupposes and fosters efficiency and that the latter must find expression in operational and organizational arrangements that safeguard and strengthen the institutions' capital and reserves position.

The action taken by the credit institutions complements the commitment of the Banca d'Italia to identify the factors, some of them organizational, that raise the cost of intermediation. In fulfilling that task, last year's Report asserted the need to correct the disparity between public and private intermediaries by making changes in their statutes that would enhance the entrepreneurial aspects of the latter and bring about closer adherence to the principle of profitability. This approach was closely examined in the light of academic debate in order to ascertain the operational and legal implications of possible organizational solutions.

The principles that sprang from this have already become the basis for exercise of the supervisory authorities' powers with regard to statutes and have thus been adopted by some public intermediaries that have recognized their potential advantages. In the legislative sphere the injection of capital into large public banking institutions was linked by Law 23 to the amendment of their statutes, thus ensuring that confidence in the institutions would be restored and that guidelines for future behaviour would be based on past experience.

The nature of its activities, the regulation of external contributions to its capital and the structure of internal controls — these are three aspects of a bank with public legal personality that require further appraisal.

Its statutory aim can be none other than credit intermediation, and this fundamental task should be laid down in the statutes; amendment of the public banking institutions' sphere of operations by the deletion of conditions that are now superseded and hinder their activities demonstrates clearly that the only practices permitted are those which accord with the principles of profitability and competition.

The state-owned bank should also have access to the market in order to attract investors wishing to share the risks of banking; the terms should be such that they do not remove the institution from majority state control exercised under the present forms of shareholding or, therefore, alter its institutional setting. In some cases the use of organizational forms that resemble the joint stock company and which already occur in the banking system would permit the raising of capital in the market, subject to appropriate limitations, and resolve the problems of the representation of risk capital in administrative bodies. The maintenance of a variety of company forms, such as that used for the savings banks, entails devising

ways of raising capital other than endowment funds by issuing marketable securities that would entitle the holder to share in the institution's operating profits and risks but not in its management.

The publicly-owned bank should be compelled by its constitution to make internal assessments of the viability of management policies and individual transactions. The overall effectiveness of banking supervision is highly dependent on the continuous and precise execution of such assessments by the bank itself.

It is also essential that powers be correctly apportioned between the governing bodies and managements of banks. The public appointment procedures, insofar as appointees are chosen from among candidates with suitable professional qualifications, are designed to ensure such a division of powers.

Last year the abnormal situation in a large number of savings banks, where the highest positions were vacant or in abeyance, was resolved. In response to a request based on the interpretation of the relevant legislation both in Parliament and elsewhere, I provided the Minister of the Treasury with lists of candidates chosen according to strictly professional criteria, which served as the basis for the Minister's decisions after consultation with the Interministerial Committee for Credit and Savings. In the few cases in which the government decided to appoint other candidates, a completely separate procedure was followed in which the Governor's role consisted, as in the case of pledge banks, in giving a professional opinion that was binding if it was unfavourable. The appointments, which have received parliamentary approval, have eliminated problems that had become extremely complicated and have restored the full powers of the governing bodies.

In a market situation in which the stimuli to extend the range of financing mechanisms are increasing, especially in the international field, the supervisory authorities must encourage the evolution of both private and public intermediaries and safeguard their stability. One aspect of this problem, namely the interests banks may acquire, was the subject of a recent directive of the Credit Committee, which laid down the conditions for possible acquisitions by establishing the principle that investments in equity may be made only if they will promote a better structure in the credit system and increase its efficiency and viability. Under this ruling banks may acquire interests in other credit institutions or in companies providing services linked to banking activities. As a further reinforcement of the limitations to which the sector will be subject, interests acquired in order to recover loans will have to be sold within set time limits.

In view of the more complex and risky conditions on international markets and the need for transparency, the directive also forbids Italian banks to acquire interests in foreign holding companies. As the various establishments of an international bank are required to conduct their business according to different sets of regulations, it was also laid down that authorization to establish affiliates abroad would depend on the ability to obtain the necessary information and on the supervisory arrangements operating in the countries involved.

The most reliable technique for ascertaining the solvency of a company is consolidated accounting; its use presupposes the flow of information between subsidiaries and parent companies in different countries and will be fostered by agreements between supervisory authorities. Pending legislation to introduce the consolidated balance sheet, the banks must henceforth lend their assistance in providing systematic information on their financial links with foreign subsidiaries.

In the special credit sector the task of reorganization was pursued not only by increasing the institutions' capital but also by widening their field of operations and the possibilities for the diversification of risks and by deciding to incorporate the Public Utilities Credit Institute into the Credit Consortium for Public Works, which has also been authorized to grant loans to industry. Above all, the instruments of supervision in this sector have been revised by making all institutions subject to the same requirements with regard to reporting and authorization to establish new branches and to the same provisions relating to administrative sanctions and liquidation.

The discussions that have been held in various circles have provided useful information on the limits for credit subsidies and demonstrated the advisability of making government departments directly responsible for the administration of incentives designed to promote industrial investment and to correct the uneven development of our economy. However, during the drafting of new legislation there was even a tendency to increase the financial intermediaries' responsibility for administering public-sector grants. This is the case of the proposal that the Southern Italy Development Fund should decide on the request for a subsidy solely on the basis of the information given in the loan contract. Hence the link between credit and subsidy is cut in appearance only, and the fact that there is absolutely no guarantee the subsidy will be granted affects the assessment of the profitability of loan applications and thus, by extension, the decisions to be reached by the credit institutions.

The law governing aid for the reconstruction and development of areas in the South stricken by the earthquake pays greater regard to the distinction in roles between the state and the financial intermediaries. It provides that

subsidies to firms that suffered damage shall be distributed by public bodies with responsibility in the area, so that any loans granted will carry interest at normal rates.

The increased capital base of the credit institutions, the legislative changes with regard to special credit institutions, the senior appointments in publicly-owned intermediaries and the amendment of institutions' statutes are improving credit intermediation in a delicate economic situation in which the interest of the productive sector calls for a more stable and efficient financial system.

Ladies and Gentlemen,

This attempt to recount recent economic events in full and to report on the work of the Bank will not have concealed the tension felt as these events unfolded nor our concern at the difficulties facing the economy, which are exacerbated by occurrences elsewhere.

Besides the valuable legacy of a growth in investment not seen for many years and signs of a renewed sense of commitment on both sides of industry, the year 1980 also left a grave situation for the currency, which is the property of us all, a possession essential for expressing the economic and civil ties that mould us into a society.

Inflation is no longer tolerable when its underlying component rises continuously and alienates us from the countries with which we are linked by history and culture.

Nine years of inflation at not less than 10%, and the last two at around 20%, have not only caused vast and unintended transfers of wealth and created the forms of inefficiency that are due to unpredictable and volatile relative prices; they have also changed the very essence of the currency by largely stripping it of its function as a store of value and leaving it only a humble role as a unit of account and medium of exchange.

A complex trading economy cannot function without a unit of value that is reliable both in the present and with regard to the future. In order to avoid the delusion caused by a currency that is eroding at a rapid and unpredictable rate, such an economy adopts as its yardstick the total of the goods and services it produces, employing a multitude of practices and institutions to do so. In these circumstances even the successes scored by traditional monetary management may prove to be tactical gains

incapable of preventing the strategic defeat represented by the consolidation of inflation.

When such a process has been under way for years, it is not by applying the brake of tight liquidity or an unaccommodating exchange rate that equilibrium will be restored. The return to a stable currency requires a real change in the monetary constitution, involving the functions of the central bank and the procedures for determining public expenditure and the distribution of income.

The first condition is that the power to create money should be completely independent from the agents that determine expenditure. There was a time when this requirement arose in relation to the private sector, and it was then that the public law character of central banks and the separation between finance and industry were laid down. Today this requirement should be met primarily in relation to the public sector by freeing the central bank from a situation that allows budget deficits to stimulate an abundant creation of liquidity that is inconsistent with the objectives of monetary growth.

The means by which the central bank finances the Treasury in our system — the overdraft in the Treasury current account, the Bank's practice of acquiring unsold Treasury bills and the subscription of other government securities — should therefore be re-examined. In particular, there is a pressing need for the Banca d'Italia to cease purchasing Treasury bills not placed at the tenders.

However, in a democratic society undergoing rapid change, where aspirations to a higher standard of living are strong, where the social dialectic is intense and where inequalities are still widespread and pronounced, the pressures for the creation of liquidity drive the currency almost irretrievably beyond the limits of stability unless defences are erected in the areas where demand is formed.

The second condition is therefore the existence of rules of procedure that subordinate major expenditure decisions to the need for monetary stability. A fundamental principle of economic and political liberty prohibits the withdrawal of such decisions from the discretion of households, companies and the entire community represented in Parliament and in the government. The very existence of money, a non-specific purchasing power, is an expression of that liberty. Nevertheless, society should order its affairs in a way that prevents expenditure decisions being reached by preying on the common heritage that is monetary stability. To do this, it should lay down the means of choosing without prescribing the choice itself, just as other laws establish the means of action, and hence the very possibility thereof, without laying down its objective.

On the one hand there are household decisions that apportion income between saving and consumption and determine the composition of the latter. Fiscal tools can shape these choices in such a way that they fit into a compatible whole. However, the cause of the destruction of monetary stability lies not so much in households' accounts as in the expenditure decisions of the public sector and decisions concerning the distribution of income within companies. It is here that the relationship between uses and resources is stretched to the point where the increase in prices and the devaluation of debts becomes a necessary perverse instrument of adjustment.

Public expenditure decisions must be made subject to rules that compel substantial respect for the need to match new expenditure by additional revenue. There was a time when consistency between expenditure, the prerogative of the sovereign, and taxes, borne by the people, was guaranteed by the dialectic between the executive and Parliament. The people then became sovereign, and the budget constraint operated for many years according to the rigid rule of balance. The weakening of this constraint has led to a situation in the public finances in which economic equilibrium has no anchorage other than the community's ability to govern itself. The intention of Article 81 of the Constitution was to strengthen this guarantee, but the way in which it has been applied has shown only too often that, far from exerting a stabilizing influence, it has been incapable of preventing expenditure from shaking off the budget constraint. It is necessary to research and define means, such as the requirement to balance current receipts and expenditure, whereby practical expression may be given to the principle embodied in the Constitution.

The expenditure decisions of companies should also be subject to methods and points of reference. In a processing economy, which imports raw materials and exports manufactured goods at international prices, the main cost factor to be controlled is that of labour, with its dual facets of wages and productivity. Our system entrusts control over this factor to management and the trade unions through the system of collective bargaining.

In view of its economic and monetary effects, the immensity of the interests involved and the powers of representation and delegation exercised through it, collective bargaining at national and company level is a true economic force comparable to the mechanism by which public sector expenditure is determined; it is in equal need of criteria that prevent the drift towards monetary instability.

In the same way as any expression of the right to engage in economic activity, the right to negotiate contracts cannot be exempt from

the limitations imposed by the interest of the community. Today the very machinery of negotiation, its fragmentation and the failure to accept macro-economic guidelines that would operate as a constraint of general compatibility make it extremely difficult for negotiators to reach decisions that reflect both a fair distribution of income and respect for monetary stability. Institutional arrangements must be sought and defined which restore collective bargaining to its role as an instrument for the determination of wage increases and working conditions rather than for the destruction of the currency.

Less and less faith should be placed in automatic mechanisms that reduce the ability of the negotiating parties to reconcile their aims and prove insensitive to changes in economic and social conditions. When the acceleration in inflation is at its most rapid, it is believed that a surrogate for stability is to be found in the use of indexation; in fact, it is the spread of indexation that endorses and seals the ruin of the currency.

Monetary stability is too precious and fragile a possession for the forces defending it to be weakened by granting individuals and groups the safe-conduct of automatic protection, particularly if such protection is frequent and indifferent to the origin of the inflationary pressures.

In the country of the Community that has been best able to hold prices stable in recent years, the law expressly prohibits any form of indexation, not only in labour contracts but also by means of clauses in individual contracts that would link the pecuniary obligations of the parties to an index of any kind. In the same country this stability, thus confirmed and defended, is also expressed in the ability to transfer money freely across the borders.

Central bank autonomy, reinforcement of budgetary procedures and a code for collective bargaining are prerequisites for a return to monetary stability.

Ten years ago, when even the indirect link with gold via the convertibility of the dollar and fixed exchange rates was cut, the lira, along with the other currencies, became an even more intangible and abstract good, whose value was guaranteed by nothing but the strength of the economy and society's ability to organize itself and to govern.

A monetary code is indispensable for the re-establishment of a stable yardstick by which to measure all present and future goods and as a guarantee against the danger of relapsing into situations that did not help us combat inflation, when they were not actually fuelling it.

These are the problems that the gravity and urgency of the economic situation require us to confront fully in all their complexity. The recent

debate shows that the choices are clear in our minds and that positive steps can be taken immediately in the direction indicated. As a matter of urgency, that debate should be translated now into the will for action before it loses momentum. What is required is not so much technical refinements but the ability to cast off prejudices, distrust and the short-sighted defence of individual interests. This ability has its roots in the sense of community, the final irreplaceable defence of a stable currency, as it is that of every other institution in a free and just society.

IV. - THE BANK'S CAPITAL AND RESERVES

Capital. — During 1980 the number of shareholders in the Bank decreased from 109 to 108 and the distribution of the 300,000 shares at 31 December 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	7	»	<u>31,500</u>	»	»	<u>91</u>	»
			95	with	299,898	shares	and 791 votes

Shareholders without voting rights:

Savings banks and loan offices	13	with	<u>102</u>	shares
Total ...	<u>108</u>	with	<u>300,000</u>	shares

Reserves. — During 1980 the reserve funds underwent the following changes:

		Ordinary reserve fund		Extraordinary reserve fund
Amount on 31 December 1979	Lit.	113,106,674,913	Lit.	119,145,619,448
increase:				
— allocation of 20 per cent of profits for the year 1979	»	13,217,544,802	»	13,217,544,802
— income received in 1980 from investment of reserves	»	<u>13,685,419,161</u>	»	<u>17,218,797,528</u>
	Lit.	140,009,638,876	Lit.	149,581,961,778
decrease:				
— distribution to shareholders of a part of the income accruing in the course of 1979 (Article 56 of the Statute) .	Lit.	<u>79,635,635</u>	Lit.	<u>82,364,365</u>
Amount on 31 December 1980	Lit.	<u>139,930,003,241</u>	Lit.	<u>149,499,597,413</u>

V. - BALANCE SHEET
AND PROFIT AND LOSS ACCOUNT

BALANCE SHEET AS

ASSETS		
Gold	Lit.	24,784,537,968,592
EMCF swap line: gold	»	8,542,452,734,226
Cash	»	1,349,221,219,416
Domestic bills of exchange:		
<i>discounting for the banks</i>	Lit.	84,370,320,287
<i>discount on Treasury bills and coupons</i>	»	—
Advances:		
<i>current account</i>	Lit.	340,336,807,735
<i>under Treasury decree of 27 September 1974</i>	»	96,335,230,250
<i>fixed term</i>	»	—
Deferred payment at the clearing system	Lit.	—
Foreign currency external assets:		
<i>ECU reserves at EMCF</i>	Lit.	9,981,468,307,066
<i>EMCF assets against dollar assets</i>	»	1,350,705,140,309
<i>other assets</i>	»	1,102,553,330,651
Italian Foreign Exchange Office (UIC):		
<i>ordinary current account</i>	Lit.	15,159,948,091,017
<i>special accounts</i>	»	1,992,251,369,206
Extraordinary advances to the Treasury	Lit.	—
Discounting for financing stockpiles	»	1,498,656,279,570
Treasury current account	»	19,125,585,383,069
Miscellaneous services on behalf of the government — debit balance	»	122,676,673,282
Investment in government or government-guaranteed securities	»	23,623,906,754,359
Treasury credit certificates under Law 386 of 17 August 1974	»	89,597,273,812
Investment of reserve funds and other funds set aside:		
<i>government or government-guaranteed securities</i> ...	Lit.	1,367,203,088,628
<i>other assets</i>	»	369,350,796,685
Office buildings	Lit.	1
Other assets	»	3,451,574,095,518
Commitments:		Lit. 114,432,730,863,679
<i>unused part of credits on advance accounts</i>	Lit.	1,965,581,552,771
Deposits:		
<i>guarantee</i>	Lit.	3,596,789,710,918
<i>others</i>	»	122,126,849,253,316
Securities and other valuables on deposit	Lit.	1,467,737,140,717
Items written off in past years	»	3,152,126,708
TOTAL . . .	Lit.	243,592,840,648,109

Audited and found correct. — Rome, 27 April 1981

THE AUDITORS
DOMENICO AMODEO
ALBERTO CAMPOLONGO
ENZO CAPACCIOLI
GIUSEPPE GUARINO
LUIGI GUATRI

THE ACCOUNTANT GENERAL
PIETRO SALONICO

AT 31 DECEMBER 1980

EIGHTY - SEVENTH YEAR

LIABILITIES

Notes in circulation	Lit.		26,317,231,156,000
Bank drafts and other sight liabilities	»		259,038,625,595
Free deposits on current account	»		777,773,108,739
Tied time deposits on current account	»		1,000,000,000
Special accounts under Law 386 of 17 August 1974	»		233,260,611,903
Compulsory deposits on current account:			
<i>compulsory bank reserves</i>	Lit.	34,037,682,583,597	
<i>others</i>	»	630,466,269,432	34,668,148,853,029
Foreign currency deposits:			
<i>on behalf of UIC</i>	Lit.	548,961,038,294	
<i>others</i>	»	2,135,888,790	551,096,927,084
Foreign lira accounts:			
<i>on behalf of UIC</i>	Lit.	1,443,290,330,912	
<i>others</i>	»	260,943,785,328	1,704,234,116,240
Foreign currency external liabilities: ECU liabilities against EMCF	Lit.		9,893,157,874,535
Miscellaneous services on behalf of the government — credit balance	»		653,886,625,507
Treasury services for various agencies	»		147,142,625,824
Other funds set aside	»		36,635,485,963,939
Other liabilities	»		2,223,509,898,715
Capital	Lit.	300,000,000	
Ordinary reserves	»	139,930,003,241	
Extraordinary reserves	»	149,499,597,413	289,729,600,654
Net profit for distribution	Lit.		78,034,875,915
	Lit.		114,432,730,863,679
Commitments	Lit.		1,965,581,552,771
Depositors	»		125,723,638,964,234
Securities and other valuables	»		1,467,737,140,717
Items written off in past years	»		3,152,126,708
TOTAL . . .	Lit.		243,592,840,648,109

THE GOVERNOR
CARLO AZEGLIO CIAMPI

GENERAL PROFIT
FOR THE

EXPENDITURE			
Administration:			
<i>staff emoluments</i>	Lit.	362,029,196,381	
<i>miscellaneous services</i>	»	24,244,483,386	
<i>other expenditure</i>	»	36,879,104,613	423,152,784,380
Note-printing and note-destruction	Lit.	38,194,868,568	
Computerized data processing	»	38,966,783,856	
Expenditure and commissions for security transactions	»	1,628,480,859	
Expenditure and commissions for exchange transactions	»	65,468,315	502,008,385,978
Circulation tax on notes and demand drafts	Lit.	48,534,819,500	
Income and company taxes	»	200,000,000,000	
Sundry taxes	»	1,559,977,069	250,094,796,569
Interest paid out {			
on the compulsory bank reserve	Lit.	1,851,888,772,376	
other	»	5,568,340,406	1,857,457,112,782
Contributions to charities and social and cultural activities	Lit.		1,735,813,299
Depreciation and allowances	»		1,382,702,773,530
		Lit.	3,993,998,882,158
Net profit for distribution	»		78,034,875,915
		TOTAL ... Lit.	4,072,033,758,073

PROFIT

To ordinary reserves	
To extraordinary reserves	
To shareholders	
To the Treasury	

Audited and found correct. — Rome, 27 April 1981

THE AUDITORS
DOMENICO AMODEO
ALBERTO CAMPOLONGO
ENZO CAPACCIOLI
GIUSEPPE GUARINO
LUIGI GUATRI

THE ACCOUNTANT GENERAL
PIETRO SALONICO

ADMINISTRATION OF THE BANCA D'ITALIA

AS AT 31 DECEMBER 1980

BOARD OF DIRECTORS

Carlo Azeglio CIAMPI	— GOVERNOR AND CHAIRMAN OF THE BOARD
Lamberto DINI	— DIRECTOR GENERAL
Mario SARCINELLI	— DEPUTY DIRECTOR GENERAL
Alfredo PERSIANI ACERBO	— DEPUTY DIRECTOR GENERAL AND SECRETARY TO THE BOARD

DIRECTORS

Gaetano CARBONE *	Paolo Emilio FERRERI
Giovanni CASTELLANI	Callisto GEROLIMICH
Carlo d'AMELIO *	Giuseppe GIOIA
Danilo de MICHELI	Lucio MORODER
Gaetano DI MARZO	Giovanni Battista PARODI *
Luigi FALAGUERRA *	Giulio PONZELLINI
Luigi FANTOLA	

Member of the Executive Committee.

BOARD OF AUDITORS

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LIST OF ABBREVIATIONS

BI	Banca d'Italia
BIS	Bank for International Settlements
CD	Certificate of deposit
Crediop	Consorzio di Credito per le Opere Pubbliche — Credit Consortium for Public Works —
ECU	European currency unit
EEC	European Economic Community
EEM	European Exchange-rate Mechanism
EFIM	Ente partecipazioni e finanziamento industria manifatturiera — Shareholding and Financing Agency for Manufacturing Industry —
EIB	European Investment Bank
EMCF	European Monetary Co-operation Fund
EMF	European Monetary Fund
EMS	European Monetary System
ENEL	Ente nazionale energia elettrica — National Electricity Agency —
ENI	Ente nazionale idrocarburi — National Hydrocarbon Agency —
ESA	European System of Integrated Accounts
EUA	European unit of account
GDP	Gross domestic product
GNP	Gross national product
IMF	International Monetary Fund
ICIPU	Istituto di Credito per le Imprese di Pubblica Utilità — Public Utilities Credit 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 —
LNG	Liquified natural gas
LIBOR	London interbank offered rate
OECD	Organization for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries

PSBR	Public sector borrowing requirement
SACE	Sezione speciale per l'assicurazione del credito all'esportazione — Special department for the insurance of export credits —
SDR	Special drawing right
TDC	Total domestic credit
TOE	Tons of oil equivalent
UIC	Ufficio italiano dei cambi — Italian Foreign Exchange Office —
VAT	Value added tax

