

BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1981

PRESENTED BY THE GOVERNOR TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31 MAY, 1982

ROME

PRINTING OFFICE OF THE BANCA D'ITALIA

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I – THE INTERNATIONAL ECONOMY

World economic trends

In the course of the adjustment process that followed the 1979-80 oil crisis the international economy was subjected to a new shock resulting from the rise in interest rates in the United States and the ensuing gradual appreciation of the dollar on the foreign exchange markets; the rest of the world broadly responded to this circumstance by further tightening its already restrictive economic policy stance.

Overall, 1981 was characterized by a further slowdown in growth and an easing of the inflationary pressures in the world economy. In the industrial economies the rate of increase in the gross national product was very modest (1.2 per cent against 1.3 per cent in 1980; Table 1), while the inflation rate declined, thanks to the gradual working through of the effects of the rise in oil prices and the moderation of domestically generated cost increases. In the non-oil developing countries the rate of growth slowed from 4.8 per cent in 1980 to 2.5 per cent in 1981; in some of them, the limited increase in the value of exports and the impact of high interest rates on debt-servicing obligations made it necessary to take adjustment measures designed to contain the unfavourable development of current external balances. In the oil-exporting countries a reduction of 4.5 per cent in gross national product (following one of 2.8 per cent in 1980) was, on the other hand, a reflection of the sharp drop in oil production (15 per cent) in the face of world demand that was held down significantly by the recessionary conditions prevailing in the importing countries, the process of oil destocking, significant oil savings and the use of alternative sources of energy. These developments also influenced world oil prices, which grew only modestly and showed a tendency to slacken from the summer onwards.

According to OECD estimates, the total amount of current balance-of-payments deficits remained unchanged at approximately 140 billion dollars, the increase in the developing countries' deficit having offset the reduction in that of the industrial countries.

A comparative examination reveals notable differences between the two oil crises of the last decade, the second of which, in various respects, has proved less traumatic for the industrial economies. First and foremost, the increase in the price of oil in 1979-80 was not accompanied, as it had been in 1973-74, by substantial rises in the

Table 1

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

Year	Industrial countries	Oil-exporting countries	Non-oil developing countries (3)
<i>Gross national product at constant prices (1)</i>			
1979	3.6	2.9	5.0
1980	1.3	-2.8	4.8
1981	1.2	-4.5	2.5
<i>Consumer prices (1)</i>			
1979	9.0	10.5	24.7
1980	11.8	12.6	32.1
1981	9.9	11.8	31.4
<i>Export volumes (1)</i>			
1979	6.7	3.0	9.4
1980	4.7	-12.8	5.6
1981	2.8	-16.3	3.2
<i>Import volumes (1)</i>			
1979	8.4	12.3	11.3
1980	-1.3	14.9	3.5
1981	2.3	19.8	2.6
<i>Balance on current account (2)</i>			
1979	-29.9	61.8	-47.9
1980	-67.0	106.0	-73.3
1981	-25.4	60.8	-89.1

Source: IMF.

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

dollar prices of other raw materials; in addition, the world economy's ability to adjust to the second oil crisis was greater, partly because of the importing countries' more effective response in reducing their consumption and, above all, their imports of energy products, and partly because of the producer countries' enhanced absorption capacity. Within the industrialized world, finally, the behaviour of management and labour and the conduct of economic policy helped to ensure that the sharp increase in the share of gross national product accounted for by wages and salaries that had been witnessed in 1974-75 did not recur, so that the pace of investment suffered less from the effects of the crisis.

In the industrial countries as a whole inflation slackened, partly because the direct effects of the oil shock had worked themselves through and partly because most of the industrial countries managed to prevent domestically generated secondary repercussions from prolonging the inflationary pressures. Price trends were influenced both by the fairly modest growth in unit labour costs and by the general weakness of the dollar prices of raw materials on the international markets; however, in all the major Western European countries the latter phenomenon was offset by the appreciation of the US currency.

The data for the first few months of 1982 do not bely the forecasts of a recovery in productive activity in the industrial countries; nonetheless, they leave room for a considerable degree of uncertainty concerning both the point in time when the recovery will commence and its strength. As was the case last year, the uncertainty derives principally from the development of interest rates and monetary policies, and from the volume of trade with the oil-exporting countries. More specifically, the evolution of trade flows between the developed and oil-exporting countries constitutes a factor of uncertainty, given the rapid, and partly unexpected, reduction in the current payments disequilibrium between the two areas that occurred in 1981. It seems probable that some of the oil-producing countries will restrain import demand, thereby reducing the stimulus the industrial world derives from trade.

Finally, world inflation seems likely to abate further in the course of the next few months. This forecast is based on the assumptions that labour cost increases will be moderate, which seems probable given recent trends in wage negotiations in a number of countries, and that the nominal price of oil will not increase.

Economic policies in the industrial countries

Economic policies in the industrial countries generally maintained, and at times accentuated, the restrictive stance previously adopted, continuing to give priority to the problems of reducing inflation and, in various countries, of restoring external balance, notwithstanding the prevailing conditions of stagnating economic activity and high unemployment. Monetary policies, which in almost all countries bore the brunt of the fight against inflation and, outside the United States, of the support of the exchange rate, were particularly restrictive. Although in most countries the authorities were intent on

restoring balance to the public sector's finances in the medium term, the budget deficit turned out to be higher than forecast virtually everywhere. A decisive contribution to the increase in the deficits was made by the adverse effects on budget receipts and outlays of the low levels of activity and of the ever-higher interest payments on the public debt. Given the prevalence of a restrictive monetary stance, the rise in the budget deficit in turn accentuated the upward trend in interest rates, which last year reached all-time highs, occasionally causing private sector credit demand to be crowded out.

In individual countries, the general stance described above was implemented through monetary and fiscal policy mixes which were not, however, always consistent with attainment of the ultimate targets of the national authorities; moreover, in some cases they also had significant international repercussions. In the United States the expansionary fiscal measures so far introduced by the new Republican Administration suggest that the Federal budget deficit could increase further in the next few years, even if that tendency would be counteracted, at least partially, if certain corrective steps currently under discussion were to be adopted. The conflict between a policy of rapid deceleration in the monetary aggregates and the development of public sector finances therefore seems destined to persist. This could impede a decline in US interest rates, and hence delay the recovery in economic activity and reinforce the external constraints that condition the management of economic policy in other countries. Problems of quite the opposite kind seem to be presented by the economic policy mix in Japan: the gradual relaxation of monetary policy and the highly restrictive stance of fiscal policy have been responsible for the moderate growth in domestic demand and for the yen's tendency to weaken vis-à-vis the US dollar in the first few months of the current year, despite a substantial improvement in the balance of payments on current account. These developments have contributed to the generation of protectionist pressures in other countries. Finally, among the Western European countries France is unique in the priority it attaches to sustaining domestic demand and employment, to which end it is combining the expansionary use of fiscal instruments with a cautious easing of monetary conditions.

International trade and current account balances

According to IMF staff estimates, the volume of world trade showed no change in 1981 as compared with the previous year. This

fact reflected the reduction in trade in oil (14 per cent), the volume of trade in other goods having increased by 2.5 per cent (as against 4.5 per cent in 1980).

The growth in the exports of the industrial countries (2.8 per cent) outstripped that in world trade, thanks to the rapid development of exports directed outside the area (10.5 per cent), in particular to the OPEC countries. Although it picked up in the course of the year, trade between the industrialized economies showed a slight contraction on average (0.8 per cent), owing to the sharp fall that had taken place in the second half of 1980.

The imports of the industrial countries, continuing the trend of the previous year, declined by 2.3 per cent, in particular as a result of the slump in purchases from OPEC countries (14.5 per cent), which followed an already marked drop (13 per cent) in 1980.

Having already fallen sharply in 1980 (by 12.8 per cent), the oil-producing countries' exports again contracted strongly (by 16.3 per cent) in 1981. On the other hand, imports, which had risen at a very fast rate in 1980 (14.9 per cent), increased by 19.8 per cent.

The volume of the developing countries' trade increased by less than in the previous year, mainly as a result of a slackening in the rate of growth in exports, which fell from 5.6 per cent in 1980 to 3.2 per cent. Imports increased by only 2.6 per cent, their growth having likewise been modest in 1980 (3.5 per cent). The momentum of imports was primarily sustained by the high rate of growth (11.6 per cent) in those of countries that are net exporters of oil. If the latter are excluded, the increase in the area's purchases from outside is far lower (0.6 per cent).

According to IMF staff estimates, the dollar prices of goods traded on world markets declined by 0.5 per cent. This reduction reflects that in the prices of manufactures (5 per cent) and of non-oil primary commodities (15 per cent), whereas oil prices rose by 11 per cent.

For the industrial countries, export and import prices declined by 3.9 and 3.2 per cent respectively. The terms of trade, calculated as the ratio of export prices to import prices, thus deteriorated only quite modestly (by 0.7 per cent), and by far less than the previous year (7.6 per cent).

The industrial countries achieved considerable success in reducing their trade deficit, which declined from 64.5 billion dollars in 1980 to 17 billion in 1981. The reduction, which was entirely due to the

development of trade flows in volume terms, by means of which a massive transfer of real resources to the OPEC countries was effected, did not, however, concern the North American countries, whose trade balance in fact showed a slight deterioration. A large part of the adjustment hence stemmed from the exceptionally large increase in the surplus of Japan, which climbed from 2 to 20 billion dollars between 1980 and 1981, and from the decline of 27 billion dollars in the deficit of the EEC countries (from 30 to 3 billion dollars).

Mainly as the counterpart to the improvement in the trade balances of the industrial countries, the surplus of the oil-exporting countries (121 billion dollars in 1981) declined by approximately 46 billion dollars. The contribution of the countries with a high absorption capacity was decisive, the large surplus they had recorded in 1980 (45 billion) being reduced by 36 billion. The 1981 figure for these countries is the lowest since 1974. On the other hand, the surplus of the low absorbers declined by only 11 billion dollars, thus remaining at a fairly high level (112 billion).

The tendency towards the restoration of foreign trade equilibrium did not extend to the developing countries, whose trade deficit increased further, rising from almost 72 billion in 1980 to over 80 billion in 1981. This phenomenon was entirely due to the deterioration in the terms of trade and principally concerned the middle-income countries and the net oil exporters, whose deficit nonetheless remained fairly modest (approximately 8 billion dollars).

The difference of behaviour between the industrial and oil-exporting countries, on the one hand, and the developing countries, on the other, with regard to the trade account is magnified in the balance of payments on current account. The reductions in the industrial countries' deficit, which fell from 67 to 25.4 billion between 1980 and 1981, and in the oil-exporting countries' surplus, which shrank from 106 to 61 billion dollars, had as their counterpart a further increase in the deficit of the developing countries, which climbed to 89 billion dollars in 1981, representing a rise of almost 16 billion.

International financial flows

While the worldwide financing requirement did not change compared with 1980, the volume of funds provided by the interna-

tional banking system continued to expand, with an increasing tendency for lending terms to vary according to risk. The stagnation in world trade, high interest rates and the appreciation of the US dollar aggravated the balance-of-payments difficulties of both developing and Eastern European countries, so that in some cases their foreign debt had to be rescheduled. Capital flows between the major countries were heavily influenced not only by current account developments but also by interest rate differentials, and in certain periods caused considerable exchange rate instability.

The overall deficit of the industrial countries was financed almost entirely with official reserves. The net outflow of capital (6 billion dollars) was, in fact, roughly equal to the financing granted by international organizations. The substantial reduction in official reserves was mainly attributable to the Western European countries, which used more than 16 billion dollars of official assets held in the United States for exchange market interventions to curb the appreciation of the US currency.

This general situation is the result of widely divergent developments in the major countries. On the one hand, those with large current account surpluses – the United Kingdom, the United States and, to a lesser extent, Japan – were net suppliers of funds. In particular, the United Kingdom's current surplus of around 16 billion dollars was coupled with a 5 billion dollar reduction in its official reserves. On the other hand, the Federal Republic of Germany, Italy and many of the smaller industrial countries had current account deficits for most of the year and were net borrowers.

The oil-exporting countries, whose current surplus shrank considerably, continued to prefer investments on the leading national financial markets. Those of them with structurally large surpluses showed a greater propensity for longer term investments, while some of the others increased their borrowing on the Euromarkets to offset the sharp fall in their oil revenues. In aggregate, therefore, the net flow of funds from these countries to the Euromarkets declined substantially. Indeed, for the first time since 1978 they returned to being net borrowers in the third quarter.

Of the 102 billion dollar deficit of the non-oil developing countries, 13 billion was financed by official transfers and more than 19 billion by loans from official organizations, a substantial increase compared with 1980. Capital transactions led to a net inflow of 66 billion dollars, with a large increase in direct investment to 14 billion. The rest of the deficit (approximately 4 billion) was covered by a

Official reserves and international liquidity

At the end of 1981 official reserves – defined as the total of convertible currencies (excluding ECUs created against deposits of gold), special drawing rights and reserve positions in the IMF – amounted to 357 billion dollars, a decline of 4 billion compared with the previous year; expressed in SDRs they showed an increase, mainly as a result of the appreciation of the dollar. The decline in official reserves, the first since 1959, occurred primarily in the second and third quarters of the year and chiefly reflected the above-mentioned fall in the dollar reserves of the major industrialized countries.

With regard to the form in which the convertible currencies were held, there was a negligible increase in the official liabilities of reserve currency countries and a substantial decline – 14 per cent – in bank deposits. These developments are ascribable to the OPEC countries' preference for long-term investments in national markets.

The liabilities of the IMF rose by more than 7 billion dollars as a result of increases of 4 billion in SDRs and 3.3 billion in the reserve positions of member countries.

The market value of the gold component of official reserves declined from 610 billion dollars at the end of 1980 to 406 billion at the end of 1981 owing to the fall in the gold price from 590 to 400 dollars an ounce. If this component were included, total official reserves would have amounted to 763 billion at the end of 1981.

As for the country distribution of official reserves, the increase in the proportion held by oil-exporting countries (which rose to 24 per cent) was matched by a decline in that held by industrial countries; the developing countries' share remained almost unchanged at about 21 per cent.

Total international liquidity – defined as official reserves excluding gold plus the banks' international liabilities to non-banks – rose by about 11 per cent during the year to stand at 762 billion dollars. Private liquidity continued to account for an increasing proportion of the total, rising from 47 to 53 per cent during 1981.

Exchange rates

In 1981 and the first quarter of 1982 the foreign exchange markets were again characterized by large movements in the US

dollar. In contrast to its behaviour in 1980, however, the American currency showed a marked upward trend against all other major currencies.

During the fifteen months under consideration the dollar appreciated against the yen, the group of currencies belonging to the European exchange rate mechanism and the pound sterling by 22, 31 and 34 per cent respectively; the appreciation against the Deutsche Mark, the French franc and the lira came to 23, 37 and 42 per cent respectively.

The rise in the dollar rate was particularly sharp in the first eight months of 1981, when short-term interest rates showed large differentials in favour of the American market. It may also be ascribed in part to expectations generated by the US current account surplus, particularly during the first quarter, and more generally by the change in the economic and financial climate in the United States that occurred when the new Administration took office. The sudden fall in short-term US interest rates in the late summer and the consequent narrowing of nominal differentials in relation to other major countries caused the dollar to lose some ground. Towards the close of 1981 and throughout the first quarter of 1982 the pattern of interest rate differentials again changed under the combined influence of a renewed rise in US rates and slight reductions in Japan and Europe, thus putting further strong upward pressure on the dollar. In spite of the large size of the fluctuations in exchange rates in relation to the need for external adjustment in the major countries, and, during certain periods, the marked instability of currencies, the US authorities have adhered strictly to their declared policy of non-intervention in exchange markets since May 1981.

The bilateral exchange rates among the currencies belonging to the European exchange rate mechanism were subject to wide movements as a result of three realignments of central rates. Over the fifteen-month period under review the Deutsche Mark and the Dutch guilder appreciated strongly against the other participating currencies. The fluctuation of the pound sterling vis-à-vis the participating currencies ranged from a maximum appreciation of 8 per cent to a maximum depreciation of 11 per cent in relation to the end-1980 rates. The movements described above are nonetheless smaller than those recorded on the dollar market, making the EMS a zone of relative stability in the world constellation of exchange rates. That

stability was undermined however, during the periods when the Mark was strengthening against the dollar.

The two-year period originally set for the initial phase of the EMS came to an end in March 1981, but the planned transition to the "institutional" phase was postponed for a further two years. During the early months of 1982 the Committee of Governors, the Monetary Committee and the EEC Commission undertook, at the request of the Council of Ministers for Economic and Financial Affairs, an overall analysis of the operation of the system since its entry into force in order to assess the advisability and feasibility of making "non-institutional" amendments to the existing rules. Four specific areas were examined: the process of convergence among economies and economic policies, the system's relations with the outside world, the private use of the ECU and the exchange-rate, intervention and credit mechanisms. A unanimous first conclusion was that the system had functioned well on a technical level, thanks partly to the setting of realistic initial central rates, the protracted periods of weakness of the Mark and, more generally, the high degree of cooperation among the central banks involved. However, the insufficient progress made in strengthening the convergence of economic policies and performance indicated the need to redouble efforts in this direction and to give them priority in order to lay the foundations for significant development of the EMS. The Committee of Governors also considered possible technical adaptations to certain parts of the system's mechanisms that fall within its jurisdiction; these relate to intra-marginal interventions in Community currencies and their financing, the procedures for the creation of ECUs and their degree of acceptability in settlements between central banks. The Committee has decided not to make such adaptations for the moment, however, although it stands ready to make any modifications that might become appropriate as the situation evolves.

Community institutions

During the past year, which saw the entry of Greece into the EEC, Community activities were conditioned by the need to find a solution to the problems raised by the planned revision of the budget and of the common policies, as requested in the "mandate" conferred by the Foreign Ministers on the Commission on 30 May 1980.

In mid 1981 the Commission presented a report setting out possible solutions to the problems covered by the mandate; the report raises the prospect of relaunching the drive for European integration rather than merely adjusting the budget mechanisms. These guidelines, which were subsequently taken up and expanded in the preamble to the fifth medium-term economic policy programme, provide for the development of new common policies, modification of the common agricultural policy and restructuring of the budget. The Commission's proposals did not meet with the approval of the member states; neither the European Council held in London in November 1981 nor that held in Brussels in March 1982 led to agreement on the problems covered by the mandate.

In 1981 Community loans came to ECU 4,600 million, 2.3 per cent less than in 1980. The decline was the result of a fall in ECSC interventions from ECU 1,026.9 million in 1980 to ECU 387.6 million last year owing to the stringent criteria applied to the granting of loans for restructuring the steel industry.

The Community's budget appropriations amounted to ECU 18,434 million, an increase of 13.9 per cent over 1980. The largest share of expenditure was applied to intervention in the agricultural market, which absorbed ECU 11,612.5 million, 63 per cent of the total; the proportion was lower than that recorded in 1980 (71.1 per cent), mainly as a result of savings made in the milk and dairy products sector, which is in structural surplus. On the receipts side, member states' payments of VAT to the Community came to ECU 9,190.2 million in 1981; they thus represented 0.79 per cent of the VAT tax base, compared with the ceiling of 1 per cent.

II - THE ITALIAN ECONOMY

INCOME FORMATION AND ECONOMIC DEVELOPMENTS

Overall results

Against an international background characterized by the slow absorption of the disequilibria triggered by the rise in oil prices in the two-year period 1979-80 and the appreciation of the dollar in 1981, the development of the Italian economy reflected the stabilization policy embarked upon during the last few months of 1979.

Gross domestic product remained at very much the same level as in the previous year (-0.2 per cent, compared with a reduction of 0.5 per cent for the EEC countries as a whole and an increase of 1.1 per cent for the OECD area). Its stagnation caused unemployment to rise substantially between 1980 and 1981 (from 7.6 to 8.4 per cent excluding and from 8.3 to 9.8 per cent including workers covered by the Wage Supplementation Fund). The balance-of-payments deficit on current account was higher than in 1980 (9,225 as against 8,300 billion), although its rate of growth slowed in the course of the year.

The persistence of the external payments deficit, notwithstanding a surplus on trade in manufactures more than double that recorded the previous year (19,500 as against 8,500 billion), was attributable to the oil component (which deteriorated by almost 8,000 billion) and the abrupt contraction of the structural surplus on invisibles. The high level of the Italian economy's gross external indebtedness (41 billion dollars at the end of 1980 and 48 billion as of December 1981), combined with the upward trend in interest rates and the appreciation of the dollar, produced a deterioration of some 3,000 billion in net investment income.

The scale of the foreign payments imbalance was aggravated by the persistence of structural differences, as compared with the other industrial countries, with respect to the inflation rate and the public sector deficit. At 19.0 per cent, the average increase in consumer prices in 1981 was only one percentage point lower than in the previous year, and it compared with an inflation rate of 11.2 per cent for the EEC countries as a whole and 9.6 per cent for the OECD area; net public sector indebtedness increased from 8.4 to 11.9 per cent of gross domestic product and the current account deficit more than doubled.

The slowdown in inflation, which emerges more clearly from a twelve-month comparison, essentially reflected the narrowing of profit margins that resulted from the continuous decline in domestic demand. The rate of increase, over a twelve-month period, in the wholesale prices of manufactured goods declined from 19.7 per cent in December 1980 to 15.9 per cent in December 1981, despite the fact that the rise in the production costs of industry excluding construction, expressed as an average for the year as a whole, was more than 3 percentage points faster than in 1980, owing partly to the appreciation of the dollar on the international exchanges (33 per cent vis-à-vis the lira) and partly to the effects of the wage indexation mechanism. While the appreciation of the US currency meant that the drop in raw material prices and the slight slackening of crude oil prices in the second half of 1981 were not reflected in the lira prices of imported goods and services, the wage indexation mechanism, prolonging the initial impact on the price system, gave rise to an automatic change in per capita labour income that was higher in percentage terms, albeit only slightly, than in the previous year; the implementation of the wage increase already provided for in labour contracts and the operation of other automatic mechanisms were such that the overall increase in gross remuneration per worker amounted to approximately 22 per cent. However, the competitive edge gradually created on foreign markets, and in the dollar area in particular, permitted manufacturing firms to increase their export prices by more than their domestic ones, thereby limiting the reduction in profit margins.

The control of domestic demand and the defence of the exchange rate against speculative transactions were essentially entrusted to monetary policy. Interest rates on bank lending recorded an average increase of approximately 3 percentage points, while the rise in real terms between the beginning and the end of the year was even larger.

The level of interest rates prompted firms to reduce the cost of holding working capital. The introduction at the end of May of the obligation to make a non-interest-bearing deposit in respect of payments for imports of goods and services and the considerable drain on liquidity in which that obligation resulted represented an additional incentive to reduce stocks of raw materials, which in many firms declined to minimum levels as compared with the requirements of the productive cycle. Variations in stocks of finished products were, for their part, restricted by industrial management that sought to absorb short-term variations in orders through changes in the level of

production rather than of stocks, making use of the greater elasticity of factor utilization allowed by the ease of recourse to the Wage Supplementation Fund and by the improved organization of productive capacity brought about by the sustained investment activity of the last few years.

According to the national accounts, which include errors, omissions and statistical discrepancies, stock variations were nonetheless positive, although expressed at 1970 prices they declined from 3,124 billion in 1980 to 510 billion in 1981.

The reduction in imports, equal to over 5 per cent on average for the year as a whole and directly associated with inventory management, and the sizable increase in exports (6 per cent on average for the year as a whole) brought about an improvement in the trade balance in real terms that more than offset the deterioration in the terms of trade.

The gradual decline in domestic demand and the increased international competitiveness of Italian goods resulting from the development of the dollar exchange rate enabled Italy to regain some of the share of international trade it had lost in 1980. Sales to countries outside the OECD area played a particularly important role; Italian exports to the OPEC countries showed a year-on-year increase of 74 per cent while those to developing countries increased by 39 per cent, bearing witness to the efforts made by Italian producers to find alternative outlets to their traditional European markets. In addition, there was a reversal of the slackening trend in Italian exports to the United States observed in recent years. Despite the two realignments of the central rate of the lira that took place in 1981, Italian competitiveness nonetheless deteriorated by about 2 per cent as compared with the other countries that are signatories to the European exchange rate agreements, and Italy's trade deficit with these countries increased by approximately 900 billion lire.

Following the strong increase that occurred in 1979-80, domestic consumers' expenditure remained virtually static in real terms (showing a rise of 0.2 per cent). Similarly, their disposable income showed very little change at constant prices (+0.3 per cent), the considerable increase in gross remuneration and government transfers being offset by fiscal drag and, above all, by the adverse development of non-labour income. For the year as a whole, the propensity to consume was very close to that seen in 1980.

Turning to gross fixed investment, the essentially unchanged average performance for the year (-0.2 per cent in volume terms)

reflected a slight increase in public sector investment (+1.2 per cent) and a moderate decline in private sector investment (-0.7 per cent).

With regard to gross domestic product at constant prices, investment in plant, equipment and means of transport remained at the high levels recorded in 1980, demonstrating that firms, despite the slackness of demand and the high level of both nominal and real interest rates, further pursued the trend towards capital formation predominantly directed towards increasing their capital intensiveness rather than expanding their size.

With enterprises' gross savings virtually static and with restrictive ceilings on the growth of bank lending, the financing of investment was to a large extent assured through recourse to medium and long-term funds raised from the special credit institutions and from abroad.

In the construction sector the decline in households' demand for homes curbed the adoption of new initiatives; investments in dwellings rose by 0.7 per cent at constant prices, essentially because of the implementation and completion of projects started in the previous two-year period.

The stagnation of gross domestic product in 1981 reflected a drop in productive activity in agriculture (-1.6 per cent) and in industry excluding construction (-1 per cent) and rises (of 1.3 per cent, 1.0 per cent and 0.5 per cent respectively) in the construction sector and the private and public services sector.

Demand for labour, which increased by 0.4 per cent overall, reflected the divergent productive trends in the different sectors. Employment expanded in the construction and services sectors, while in agriculture and industry excluding construction it declined. In the latter sector firms again had considerable recourse to the Wage Supplementation Fund (the number of hours in respect of which wages were supplemented increased by more than 100 per cent in 1981), which permitted an increase of about 3 per cent in hourly productivity in a year of diminished production. Labour costs rose by 22.2 per cent per hour worked, but per unit of production the increase was held down to 18.9 per cent.

The distribution of income in the industrial sector experienced a shift in favour of wages and salaries; the ratio of the latter to value added at factor cost increased from 61.1 per cent in 1980 to 64.3 per cent in 1981. The private sector as a whole was affected by a shift in the same direction, with the change in relative shares

virtually cancelling out the effects of the rise in profits in the two-year period 1979-80.

There was a further decline in the ratio of the total volume of saving in the economy to gross domestic product, partly because of the low growth in the saving of non-financial enterprises, and partly because the current deficit of the public sector increased from 3.7 to 7.1 per cent of GDP between 1980 and 1981; by contrast, the financial intermediaries and households accounted for the same percentage shares (around 4 and 19 per cent respectively).

With the propensity to save remaining more or less unchanged, the reduced advantage attaching to purchases of durable goods, the levels reached by the relative prices of dwellings and the fact that interest rates were positive encouraged households to invest in financial assets. Subsequently, as a result of the monetary authorities' policy with respect to the structure of interest rates, the public's preference gradually shifted towards longer-term maturities.

Economic developments during the year

During the early months of 1981 economic activity remained at the relatively high level it had reached at the close of 1980. Businessmen's short-term forecasts during that period showed a steady move away from the generally pessimistic tone of public opinion. The continuous appreciation of the dollar on international foreign exchange markets gave rise to fresh expectations of higher inflation at home and thus helped sustain demand for durable consumer goods and capital goods; Italy's improved competitiveness in relation to countries within the dollar area and a fall in the capacity utilization rate favoured a recovery in exports.

In the first quarter gross domestic product at constant prices thus rose by 0.8 per cent over the preceding quarter and exceeded the average for 1980 as a whole by 0.9 per cent. The inflation differential vis-à-vis other industrialized countries did not decline and the deterioration in the terms of trade, which had been caused mainly by the appreciation of the dollar, led to a sharp increase in the balance-of-payments deficit in spite of an improvement in the real component of the balance; the shortfall in the current account amounted to more than 3 per cent of gross domestic product on a seasonally adjusted basis.

The economy's spending power was boosted by the size of the public sector deficit, which was expanding because of the different effects indexation mechanisms had on revenue and expenditure and as a result of the discretionary measures taken during 1980 and at the beginning of 1981. In these circumstances rapid balance-of-payments adjustment became essential in view of the danger that the economic cycle in Italy would again get out of step with the international one and that inflationary expectations and the prospect of a devaluation of the currency would feed upon one another.

At the end of January restrictions were placed on all loans in domestic currency irrespective of amount and on some of those in foreign currency. In March the discount rate was raised from 16.5 to 19 per cent, the reserve requirement coefficient was increased from 15.75 to 20 per cent and the central rate of the lira within the EMS was adjusted downwards by 6 per cent. At the same time the Government announced a package of measures designed to hold down the public sector deficit by reducing current expenditure.

In the second quarter the further monetary restrictions and the level to which real interest rates had risen caused a reversal of the trend in businessmen's expectations and in economic activity; the index of industrial production declined only slightly (by 0.8 per cent) but there was a very large fall in the use of labour.

Uncertainty about economic prospects and firms' growing recourse to the Wage Supplementation Fund had repercussions on private spending, so that consumption remained at the level reached in the first quarter of the year. The implementation of investment programmes suffered a setback as a result of the rising cost of finance, only part of which manufacturers passed on to final prices in view of the expected level of demand and their desire to increase the competitiveness of their products. The rise in the cost of money also accentuated the rundown in stocks of raw materials and intermediate goods that had begun earlier in the year, thus reducing firms' credit requirements and causing a fall in the volume of imports; in seasonally adjusted terms the current account deficit in the second quarter was similar to that recorded in the first.

The scale of the persistent disequilibrium in the external accounts, the growing public sector deficit and the Government's delay in making the cuts in current expenditure nevertheless encouraged speculative transactions on the foreign exchange market.

Instead of narrowing the differences among the Government and the two sides of industry, the wide-ranging debate on possible

changes in the working of the wage indexation mechanism led to a hardening of positions, while acrimonious industrial disputes in a great many service sectors cast a pall over the general climate. At the international level, the series of increases in prime rates in the United States accentuated the capital outflow from European markets from mid April onwards.

In the second half of May daily interventions on the foreign exchange market were substantial and the official reserves in convertible currencies declined further, after having fallen from 10.9 to 6.6 billion dollars between the end of 1980 and the end of April. The need for a rapid tightening of control over the liquidity of the economy was met at the end of May by the introduction of compulsory non-interest-bearing deposits.

The impact of the deposit requirement, which absorbed liquidity totalling about 2,000 billion lire a month in the quarter following its introduction, was reinforced by a series of decree laws aimed at holding down health spending, state administrative expenditure and transfers to public sector agencies, and at increasing social security contributions. However, the government crisis at the end of May prevented the adoption of more far-reaching economic measures to sustain the efforts to reduce inflation and balance-of-payments disequilibria that had begun with the introduction of a more restrictive monetary policy.

The measures taken in May accelerated the process of stabilization in the third quarter. The seasonally adjusted balance-of-payments deficit on current account was one third lower than in the preceding quarter in spite of a sizable increase in the deficit in the oil component. The increase in consumer prices slowed down considerably, from about 4.5 per cent in the second quarter to 3 per cent.

The further decline in domestic demand, which was most pronounced in the capital goods sector, was partly offset by the steady growth in exports, but it caused a fall of 5.2 per cent in industrial production. The unemployment rate was more than one percentage point higher than in the same period of 1980.

Changes were made in the Banca d'Italia's participation in Treasury bill auctions in order to give better control over the liquidity of the economy. So that the measures for curtailing public expenditure that had been adopted in May should not lapse, the new Government presented them to Parliament again pending the formulation of a more comprehensive policy for reducing the current deficit that was to be embodied in the Finance Bill.

At the end of September the deposit on foreign payments was prolonged at gradually falling rates so that its abolition should not flood the economy with the liquidity previously sterilized. In the same month the Government achieved an agreement among the main sectors involved to control the prices of certain staple food products for a period of two months, which was later prolonged.

At the beginning of October the realignment proposed by some of the countries participating in the exchange rate mechanism within the European Monetary System led to a further modification of the central rates of the lira; the resulting adjustment on the foreign exchange markets caused the lira's effective nominal exchange rate to fall by 3.1 per cent against the currencies of Italy's five main EEC partners between September and October. The index showing the price competitiveness of Italian goods, which is based on the prices of manufactured goods in the markets of Community countries, thus moved back to the levels recorded at the beginning of 1980; the real exchange rate vis-à-vis the currencies of Italy's most important competitors was much more favourable as a result of the sharper depreciation of the lira against the dollar.

Exports benefitted from this situation; in the final quarter of 1981 they were already slightly higher at constant prices than the previous peak recorded towards the end of 1979. The recovery in the terms of trade made it possible to hold the current account deficit below 1,000 billion lire in spite of a small rise in the volume of imports.

The stimulus provided by export demand was insufficiently strong, however, to bring about a revival in economic activity. Industrial production rose by 4.5 per cent over the previous quarter in the last three months of 1981, but activity was still below the average levels of the months immediately preceding the summer break.

Final domestic demand, on the other hand, showed equivocal signs of a recovery. Households' spending power was depressed by the weakness of production, which was reflected in the level of unemployment and the large-scale recourse to the Wage Supplementation Fund. Fixed investment in machinery, equipment and vehicles, however, staged a particularly sharp recovery (8.2 per cent over the previous quarter) in spite of the high cost of money, the low plant utilization rate and uncertainty about economic prospects.

The gradual slowdown in prices continued during the closing months of 1981; in the final quarter consumer prices stood 18.3 per

cent higher than in the same period a year earlier, compared with 19.2 per cent in the preceding quarter. The slowdown was attributable partly to the weakness of demand and partly to the price restraint exerted from the early summer onwards by the introduction of agreed prices for certain foodstuffs; the effects were especially clear in the trade union index, whose trend rate of increase slowed down by about one and a half points between the third and final quarters.

The difficulties encountered in financing the growing public sector deficit caused yields on short-term government securities to rise further in spite of a fall in interest rates on international markets. Real yields reached their highest levels for the last four years as a result of the continued slowdown in inflation and the decline in inflationary expectations.

Prospects for 1982

The prospect of slow growth in the world economy and the need to persist with the economic measures aimed at gradually eliminating the disequilibria in the external accounts and reducing the inflation differential vis-à-vis other industrialized countries limit the scope for expansion of the Italian economy in 1982.

In particular, the gradual reduction of inflation in Italy to the levels obtaining elsewhere in Europe requires appropriate agreements between the representatives of employers and workers, careful control of domestic demand and tangible progress towards solving the problems of the public sector deficit.

In the first quarter of 1982 the rate of inflation, calculated on the twelve-month basis in terms of the consumer price index, was more than three percentage points below that recorded in the same period of the preceding year (17 as against 20 per cent). However, the slowdown in the rate of price increases seems to be attributable more to the squeezing of profit margins than to the success of policies designed to bring costs under control, particularly labour costs.

In larger industrialized economies, where the rate of price increase is below two figures, employers and workers in industry have renewed or are in the process of renewing agreements that presuppose a reduction in labour costs in real terms. In Italy the only uncertainty is that surrounding the size of the increase, while revision of the existing indexation mechanisms seems to have been shelved.

At the beginning of 1982 domestic demand seems poised for a gradual recovery from levels which, at constant prices and net of variations in stocks, are higher than those prevailing at the end of 1979, when the balance of payments was already in a precarious state and the change in relative prices had still not exerted its full effects on the terms of trade.

Loan applications accepted by the special credit institutions in 1981 suggest the existence of fairly substantial investment plans, which is confirmed by the annual survey of manufacturing companies carried out by the Banca d'Italia; it should be stated, however, that this conclusion is uncertain owing to the difficulty in interpreting the shift of credit demand from short to medium term in view of the ceilings on short-term lending. The high cost of money, the low plant utilization rate and the decline in profitability do not seem to be preventing at least the major companies from continuing the restructuring begun in recent years.

Private consumption is subject to opposing forces; on the one hand uncertainty about the maintenance of the current levels of employment induces households to be cautious in their spending decisions, while on the other the alleviation of fiscal drag by the Government and the vast amount of financial assets accumulated in 1981 are boosting purchases of durable and non-durable goods and services.

Surveys conducted both among companies and among other economic agents in the first few months of this year point to an improvement in the climate of opinion. In the first quarter industrial production was 2 per cent higher than in the preceding quarter and the level to which economic activity has risen holds out the prospect of an increase of around 2 per cent in gross domestic product in 1982 as a whole, in other words a higher rate than that in the other EEC countries for the fourth consecutive year. While price developments in world markets should permit an annual average rate of inflation of 16 per cent, which is in line with the Government's plan, the balance-of-payments deficit on current account is likely to amount again to about 1.5-2 per cent of GDP.

The size of the structural disequilibrium indicates that, in contrast to the situation in the major industrialized countries, the process of economic adjustment in Italy is still far from completion and does not allow production to expand persistently faster than in competitor countries. A high level of domestic demand would also entail a reduction in industry's efforts to win a larger share of foreign

markets just at a time when the sluggishness of world demand is limiting the growth in Italian exports. Moreover, the persistence of the inflation differential is eroding the competitiveness gained in 1981. All these circumstances, combined with the heavy burden of debt servicing, are tightening the balance-of-payments constraint.

Even if the level of production had remained unchanged, the improvement in the external accounts that occurred in 1981 would have been limited by the impossibility of reducing stocks further; the improvement in economic activity in the first quarter of 1982 led to an increase in imports and a further substantial rise in the trade deficit, which was approximately 1,000 billion lire higher than that recorded in the same period of the previous year.

Whether the process of capital formation by firms can be strengthened without accentuating the balance-of-payments disequilibria will depend on whether the public sector's current account deficit can be reduced significantly and households' consumption contained. If this does not happen, the continuation of the recovery will be placed in doubt and the burden of gradual economic adjustment will again fall mainly on monetary policy.

Domestic demand

Consumers' expenditure

National consumers' expenditure expanded by 0.5 per cent in real terms, compared with a rise of 4.8 per cent the year before (Table 2). The increase in domestic consumers' expenditure was smaller however (0.2 per cent), owing to the increase in residents' expenditure abroad (7.7 per cent) and the decline, for the second year running, in that of foreign tourists in Italy (-7.1 per cent).

Households' gross disposable income rose by 19.3 per cent but, since the deflator of national consumers' expenditure rose by 19 per cent, households' purchasing power hardly changed in real terms. After recovering sharply in 1979-80 from the low point recorded in 1978, the average propensity to consume (77.6 per cent) was virtually the same as in 1980 and equal to the average for the period 1970-74.

The income-induced stimulus to consumers' expenditure was offset by other factors. In the first place, there was a reversal of the expected course of real interest rates during the year as a result of

the combination of high nominal rates and expectations of a slowdown in the rate of inflation. This weakened the incentive to buy hedge goods and bring forward purchases of durable and semi-durable consumer goods, which in 1979-80 had taken the income elasticity of

Table 2

**CONSUMERS' EXPENDITURE, DISPOSABLE INCOME AND
PROPENSITY TO CONSUME**

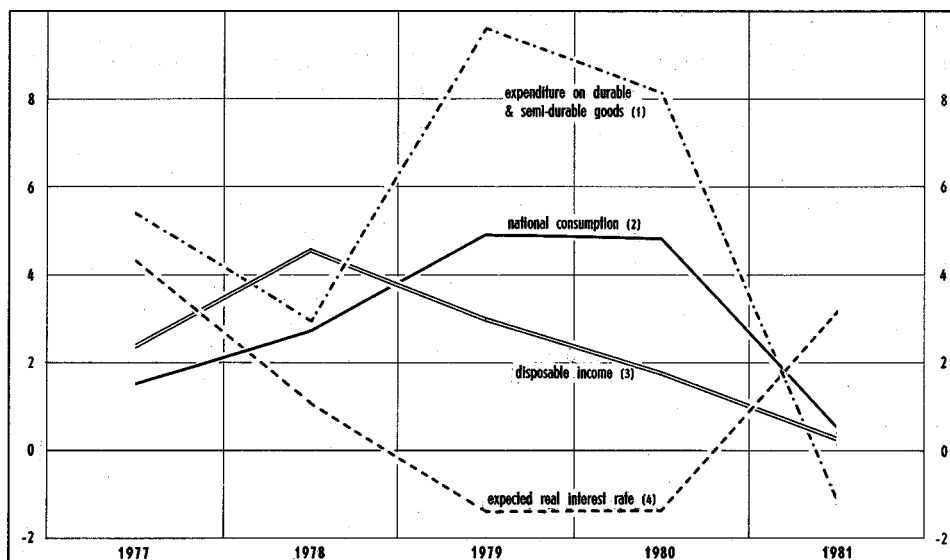
	1981 (billions of lire)	Percentage changes			
		$\frac{1978}{1977}$	$\frac{1979}{1978}$	$\frac{1980}{1979}$	$\frac{1981}{1980}$
Durables (1):					
current prices	26,614	20.7	34.4	29.7	17.0
1970 prices	4,684	3.6	14.2	8.2	1.6
Services (1):					
current prices	74,288	16.1	20.2	23.8	22.3
1970 prices	15,885	2.4	4.3	3.3	1.4
Other goods:					
current prices	152,450	15.7	19.5	25.5	18.2
1970 prices	33,911	3.2	4.6	4.2	-0.5
Domestic consumers' expenditure:					
current prices	253,352	16.3	21.1	25.4	19.2
1970 prices	54,480	3.0	5.3	4.3	0.2
National consumers' expenditure:					
current prices	246,998	16.0	20.8	26.2	19.6
1970 prices	52,957	2.7	4.9	4.8	0.5
Gross disposable income (1):					
current prices	318,347	18.1	18.5	22.4	19.3
1970 prices (2)	68,254	4.6	3.0	1.8	0.3
Average propensity to consume: (per cent)		73.8	75.1	77.4	77.6

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 consumers' expenditure.

consumers' expenditure above its medium-term unitary values (Chart 1). Furthermore, unlike the previous year households' total wealth failed to produce a positive effect: the ratio of net financial assets to income was unchanged and, confirming the shift in inflationary expectations, the increase in house prices gradually came to a halt.

Chart 1



Expected real rate of interest and rates of change in consumers' expenditure and gross disposable income
(percentages)

(1) Expenditure on durable and semi-durable goods at 1970 prices. — (2) National consumers' expenditure at 1970 prices. — (3) Gross disposable income, deflated by the implicit prices of national consumers' expenditure. — (4) The effective compound deferred rate on Treasury bills (the average weighted for the various maturities of the auction adjudication rate) less the expected rate of consumer price inflation on an annual basis (the average of the Mondo Economico "Forum" six-monthly value at the beginning and the middle of the year).

Investment

After two years of substantial growth, gross fixed investment declined by 0.2 per cent in volume while net fixed investment fell by 4.0 per cent. Though positive according to the national accounts, the change in inventories (510 billion at 1970 prices) was only one sixth of that recorded in 1980. The outcome was a 14.6 per cent fall in total gross investment at constant prices.

At current prices fixed investment increased by 20.6 per cent because implicit prices continued to rise (20.9 per cent compared with respectively 16.0 per cent and 20.3 per cent in 1979 and 1980). When the change in inventories (3,610 billion at current prices) is included, total investment showed a slight decline in value (-0.6 per cent).

The ratio of fixed investment to GDP at constant prices remained practically unchanged in 1981, both for total capital formation (20.1 per cent) and for just machinery, equipment and vehicles (8.7 per cent), the goods most directly involved in the

Table 3

**PUBLIC AND PRIVATE GROSS FIXED DOMESTIC INVESTMENT
BY BRANCH OF ECONOMIC ACTIVITY**

	Billions of lire (at current prices)	Percentage breakdown (at 1970 prices)			Percentage changes				
					at current prices			at 1970 prices	
		1979	1980	1981	$\frac{1979}{1978}$	$\frac{1980}{1979}$	$\frac{1981}{1980}$	$\frac{1980}{1979}$	$\frac{1981}{1980}$
AGRICULTURE	5,146	7.7	7.2	6.5	13.9	23.9	8.4	1.3	-9.4
Private enterprises	4,830	7.4	6.7	6.1	16.2	19.9	9.7	-2.0	-8.3
Public enterprises (1)	316	0.3	0.5	0.4	-21.6	115.0	-8.1	77.3	-23.1
INDUSTRY	22,135	27.2	28.6	27.0	25.8	34.9	14.0	14.9	-5.7
Private enterprises	15,884	20.0	20.8	19.4	30.2	33.9	12.2	14.0	-7.1
Public enterprises	6,251	7.2	7.8	7.6	15.1	37.7	18.6	17.4	-1.9
MARKETABLE SERVICES (2)	23,326	30.6	31.3	32.5	21.5	33.6	23.3	12.1	3.5
Private enterprises	17,573	22.3	23.3	24.5	27.9	36.6	24.7	14.7	4.7
Public enterprises	5,753	8.3	8.0	8.0	7.1	25.4	19.4	5.2	0.3
HOUSING	22,223	25.0	23.9	24.2	22.6	30.6	24.0	4.9	0.7
Private enterprises	21,108	22.8	22.5	22.9	20.1	34.3	25.3	7.8	1.7
Public enterprises (3)	1,115	2.2	1.4	1.3	58.0	-8.5	3.5	-26.5	-15.7
TOTAL	72,830	90.5	91.0	90.2	22.5	32.2	19.4	10.0	-1.1
Private enterprises	59,395	72.5	73.3	72.9	24.5	33.4	20.0	10.6	-0.7
Public enterprises	13,435	18.0	17.7	17.3	14.6	27.8	16.7	7.6	-2.7
GENERAL GOVERNMENT	8,006	9.5	9.0	9.8	25.4	24.9	33.1	3.3	9.0
GROSS FIXED INVESTMENT	80,836	100.0	100.0	100.0	22.7	31.6	20.6	9.4	-0.2
Public sector	21,441	27.5	26.7	27.1	18.1	26.8	22.4	6.1	1.2

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.

rationalization and reorganization of production. With the exception of Ireland, the capital formation process slowed down in all the other EEC countries with a sharp fall in the share of resources allocated to investment.

Classified by branch of ownership, investment declined in agriculture and industry, which together account for about one third of total capital formation. On the other hand, all the branches of services recorded increases (Table 3). Classified by producer branch, investment rose in construction and vehicles (respectively by 0.8 per cent and 11.1 per cent in real terms), while in machinery and equipment it declined (-5.3 per cent).

The fixed investment of private and public firms followed different courses, the first declining by 0.7 per cent and the second rising by 1.2 per cent. The latter result was due to the growth in the construction and infrastructure works undertaken directly by general government (9.0 per cent), since the reduction in subsidized housing investment continued and the capital formation of the state-controlled corporations appears to have stagnated. In the private sector, on the other hand, increases in investment in housing and services were coupled with large reductions in agriculture and industry (Table 3).

The contraction in the value of total gross investment was accompanied by a larger fall in domestic saving: the rise in private sector saving did not offset the massive increase in the general government deficit on current account. The outcome was the lowest ratio of the gross formation of saving to GDP for the last twenty years (18.9 per cent) and a balance-of-payments current account deficit equal to 2.3 per cent of GDP.

Domestic supply

Agriculture

The persistence for the second year running of lower returns for farms than for firms in the other sectors of the economy and the uncertainty surrounding legislative and financial developments, as well as the usual climatic and cyclical problems, appear to have halted the recovery and subsequent expansion of production in the previous four years. In fact, compared with 1980 the sector's gross marketable production declined at constant prices by 1.8 per cent (Table 4).

Table 4

MARKETABLE PRODUCTION AND VALUE ADDED IN AGRICULTURE
(billions of lire)

	1981				Percentage changes			
	Absolute values		Percentage breakdown		Quantity		Prices	
	Current	1970	Current	1970	1980 1979	1981 1980	1980 1979	1981 1980
Marketable production ...	33,985	8,013	100.0	100.0	3.6	-1.8	14.1	13.8
Field and fodder crops ...	11,160	2,591	32.8	32.3	1.3	0.2	17.8	15.5
Tree crops	7,865	1,840	23.2	23.0	7.7	-9.4	7.6	9.4
Livestock	13,564	3,344	39.9	41.7	2.7	1.2	14.2	15.5
Forestry and fisheries ...	1,396	238	4.1	3.0	7.7	-0.4	26.7	16.9
Intermediate consumption (-)	10,833	2,280	31.9	28.4	2.5	-2.3	20.9	23.7
Current transfers (+)	1,332	652	3.9	8.1	23.4	-12.2	-6.6	27.4
Value added at factor cost	24,484	6,385	72.0	79.7	5.9	-2.8	9.4	11.3

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

The reduction in agricultural and livestock production was coupled with a widespread fall in the volume of means of production employed (land, machinery and labour). Fixed investment at constant prices fell to just above the 1975 level and was substantially below that recorded in 1980, with roughly equal percentage falls for the reclamation and improvement of land and farm restructuring (-9.3 per cent) and for machinery, equipment and vehicles (-9.5 per cent).

The exodus from agriculture accelerated somewhat compared with the previous year (105,000 units as against 80,000) and there was a nearly threefold increase in the outflow of employee labour (from 15,000 units to 40,000), while that of self-employed workers was much the same as in 1980. For the first time for many years farms also reduced the volume of their purchases for intermediate consumption (-2.3 per cent), but this did not prevent the value added at factor cost from declining in real terms by more than production (-2.8 per cent as against -1.8 per cent) because of the substantial contraction in the volume of current transfers (-12.2 per cent).

Primarily because of natural factors, the worst results were recorded by tree crops (-9.4 per cent on average compared with 1980). Forestry production also declined (-3.5 per cent), while field and fodder crops remained virtually unchanged (0.2 per cent) and

livestock recorded only a small increase (1.2 per cent). The pronounced slowdown in the more than ten-year expansionary trend of livestock production, which diminishes its role as locomotive and stabilizer of agriculture as a whole, needs to be emphasized in view of the structural gap between domestic output and demand for these products. In this connection, another new development in 1981 was the slight downturn recorded, for the first time since 1970, in the production of beef and veal, cow's milk and poultry (down respectively by 0.6, 0.9 and 0.5 per cent). This reflects the worsening of the economic conditions of livestock farmers, many of whom, though they did not actually decide to run down their herds completely, did reduce them despite the fact that domestic consumption of livestock products continued to expand, albeit more slowly than in previous years.

The average increase in the producer prices of gross marketable agricultural production was virtually unchanged (13.8 per cent as against 14.1 per cent in 1980). It should be noted, however, that there was a larger negative differential compared with the increase in the prices of raw materials (23.7 per cent as against 20.9 per cent in 1980), that the increase in the prices of investment goods (19.6 per cent as against 22.3 per cent in 1980) was nearly six percentage points higher, and that the gross wages of agricultural workers, though they rose more slowly than in 1980 (17.4 per cent as against 22.1 per cent), nonetheless continued to rise on average at a rate more than three and a half percentage points above that of agricultural prices.

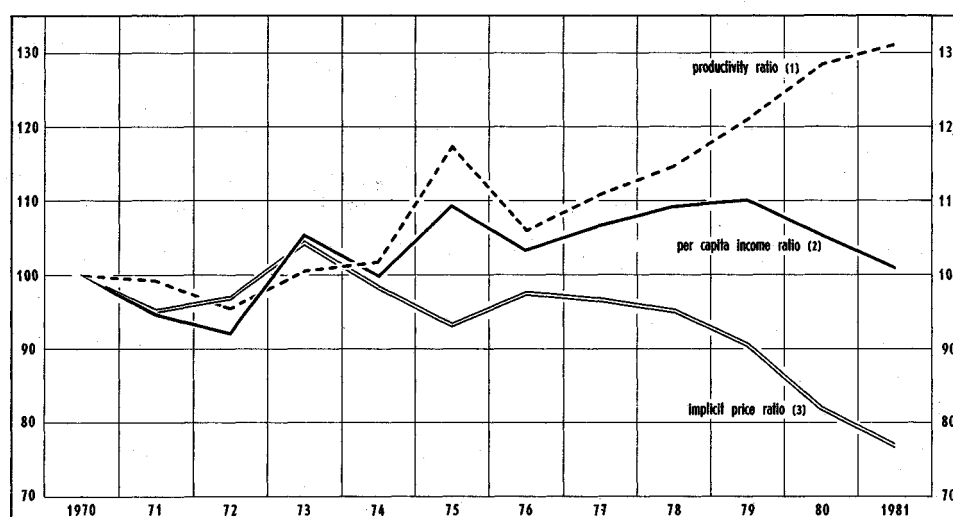
The rise in the deflator of agricultural value added at market prices was much smaller than those of the other productive sectors. In 1981 it was less than 10 per cent, whereas in industry it was 14.7 per cent and in marketable services 18 per cent.

Between March and April 1981 there was first a 5.6 per cent devaluation of the green lira and then an average increase of 9.4 per cent in the prices regulated by the EEC, giving a total increase of 15.9 per cent, which turned out to be about 2 percentage points more than the general average of agricultural prices. At the end of November, furthermore, there was an additional 2.5 per cent devaluation of the green lira, though this can have had little effect on average prices for the year.

Mainly owing to the larger exodus from agriculture, the ratio of productivity in that sector to that in the rest of the economy continued to rise, though more slowly than in the four previous years

(Chart 2). As a result of the further worsening in the ratio of agricultural to non-agricultural implicit prices (from 81.8 per cent in 1980 to 76.9 per cent in 1981, with 1970 = 100) agricultural incomes also declined in relative terms, with the previously mentioned risk of production being abandoned.

Chart 2



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 those in the rest of the economy.

Despite the downturn in primary production, the high level of stocks at the beginning of the year and the stagnation of domestic demand permitted a certain reduction in Italy's food and agricultural deficit at constant prices. As a result of the further deterioration in the terms of trade, the agricultural deficit at current prices nonetheless increased from 5,591 billion in 1980 to 6,145 billion. In view of the continued rapid growth in the quantities exported by the food and tobacco processing industries, their deficit fell from 3,289 to 2,659 billion. Consequently, the total deficit of the food and agricultural system declined slightly compared with 1980.

At the international level the improvement in the food and agricultural trade balance was entirely due to extra-Community trade, while within Italy — partly because of the fall in public and private

investment – the changes made in crops and methods of production do not appear to have been on a sufficient scale to be regarded as evidence of a process that will eliminate the weaknesses and structural dualisms of Italian agriculture once and for all.

At the Community level, the memorandum on “Guidelines for European Agriculture” sent by the Commission to the Council in October 1981 recognized the disadvantages of a policy of price guarantees which, since it is organized in terms of geographically homogeneous product groups, has certainly not promoted the correction of the economic and productive imbalances between continental and Mediterranean areas. It also recognized that structural policy needs to be implemented with greater continuity of finance, on the basis of integrated development plans covering comparable areas and containing quantitatively controllable targets.

The limits of the agricultural, or more exactly food and agricultural, policy pursued by the central authorities and the regions since the agricultural planning law was passed in December 1977 (Law No. 984, known as the “four-leaf clover” law) are set out in the first report to Parliament on the implementation of the national agricultural plan. The report was approved by the Interministerial Committee for Food and Agricultural Policy last February and explicitly admits that it had proved impossible to respect the spirit of Law No. 984 in full and hence to overcome “the practice of earlier agricultural plans, whose unselective sprinkling of finance failed to ensure the best use of the resources available.” In addition to the ways of getting round its guidelines, the report also notes the inherent weaknesses of the law, which, by failing to make basic choices and lay down precise control mechanisms, defines methodologies rather than the contents and aims of regional and coordination plans. Hence this task is left to the bodies responsible for their implementation. It is against this background and the well-known difficulties of public finance that one has to set the steady reduction in the funds allocated in the budget compared with those, already considerably eroded by inflation, foreseen under Law No. 984. Nor does it appear appropriate to transfer them to refinance previous laws – such as Law No. 403 of 1977 – that are even less selective and oriented towards the achievement of specific objectives.

Industry

Industrial value added fell by 0.7 per cent after five years of uninterrupted growth at an annual average rate of around 5 per cent

(Table 5). The decline was attributable to reductions of 0.7 and 1 per cent in the level of activity in the energy and manufacturing sectors respectively; in the construction industry, on the other hand, the completion of projects begun in earlier years helped produce an expansion of 1.3 per cent.

Table 5

INDUSTRIAL VALUE ADDED AT MARKET PRICES

	Values at 1970 prices (billions of lire)			Percentage breakdown 1981	Percentage changes		
	1979	1980	1981		1979/78	1980/79	1981/80
VALUE ADDED:							
including construction	34,910	36,525	36,281	100.0	5.6	4.6	-0.7
excluding construction	29,845	31,259	30,949	85.3	6.1	4.7	-1.0
Manufacturing	25,400	26,999	26,710	73.6	6.7	6.3	-1.0
Energy	4,445	4,260	4,230	11.7	3.2	-4.2	-0.7
Construction and public works .	5,065	5,266	5,332	14.7	2.6	4.0	1.3

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

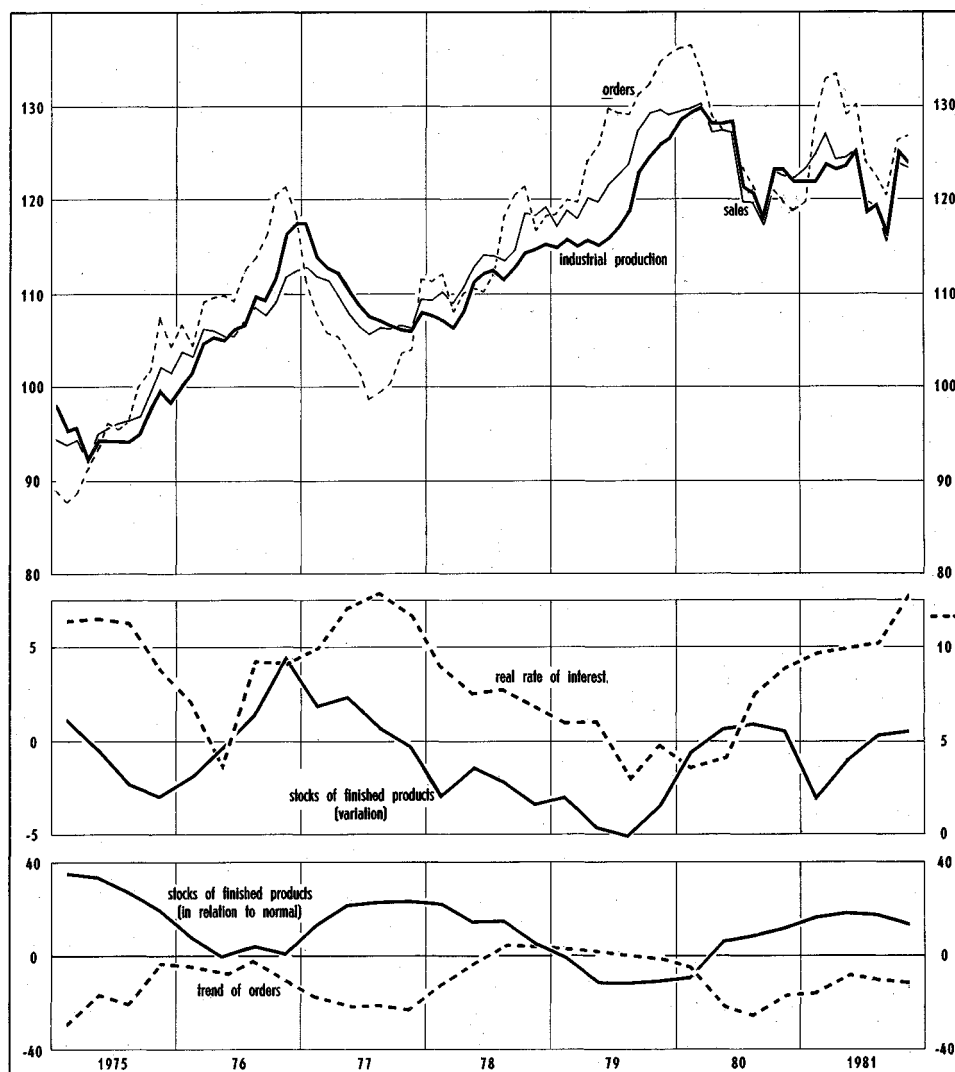
The decline in industrial production (2.3 per cent) was larger than that in the value added of industry excluding construction (1 per cent) as it reflected a rundown in stocks of raw materials and intermediate goods following an increase in 1980. Not all sectors were affected by the downturn, however; capital goods showed an increase of 6.4 per cent following one of 14.1 per cent in the preceding year, whereas the output of final consumer goods and that of intermediate goods and materials declined by 4.1 per cent.

The production capacity employed by these two sectors reached a very high absolute level in the first quarter in 1980, but it has declined steadily since then, so that in the third quarter of the year under review it was lower than in any period except the third quarter of 1975. On the other hand, the capacity utilization rate was particularly high in the capital goods sector; it rose to a record level in the first quarter and remained well above the average throughout 1981, as it had in 1980.

In contrast to the situation in 1980, orders received from abroad constituted the most dynamic element of industrial demand, with exports of industrial goods rising by 6.7 per cent. Although the inflow of domestic orders declined, total demand for industrial goods

was higher on average than in the preceding year (Chart 3). However, production stagnated at the level reached at the end of 1980 as adverse forecasts of demand and high and rising real interest rates induced firms to pursue a cautious stocks management policy. In

Chart 3



Production, sales and orders in manufacturing industry

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

particular, the fluctuations in stocks of finished goods from the second quarter of 1980 onwards were smaller than in previous recessions; the largest absolute variation was the rundown in stocks in the first quarter of 1981, followed by a further reduction and thenceforth by small increases. This cautious management of inventories coincided

with greater fluctuations in levels of production, which recorded a sharp decline in August similar to but more marked than that which had occurred twelve months earlier.

The crisis that began to afflict certain traditional sectors of Italy's manufacturing industry in 1980 deepened in 1981, with particularly sharp falls in the durable consumer goods sector, where output fell by 10.5 per cent, and in ancillary materials, which declined by 5 per cent. The output of the capital goods sector was boosted mainly by the production of vehicles, which rose by 17.3 per cent after having increased by 21.4 per cent in 1980.

The rapid decline in orders that had begun in the second quarter of 1980 came to an abrupt halt in the first quarter of 1981, when foreign demand staged an exceptionally strong recovery after having fallen for more than a year and domestic orders also rose above the average level of the preceding two quarters.

Just as they had let production follow the decline in demand in 1980 instead of pursuing a resolute policy of stock building in order to counteract the recessionary tendencies, firms did not adjust their production plans to match the unexpected rise in orders. Industrial production therefore remained at the level reached at the end of 1980; in the first quarter there was an increase of less than 1 per cent that was mainly due to the good trend in the production of final capital goods. Stocks of finished products thus began to diminish again, while orders in hand rose after the not unusual decline recorded in the preceding quarter (Chart 3).

The rundown in stocks and the rise in unfilled orders did not, however, indicate that firms had resumed a policy of actively stabilizing production levels at a time of swift variations in demand. Industrial output continued to show the wider month-to-month fluctuations that had first appeared in the summer of the previous year, but the general level remained largely unchanged. In the second quarter there was a slight recovery in the final consumer goods sector following an improvement in short-term expectations, but the output of capital goods declined in line with a deterioration in demand forecasts. Production remained static overall and although stocks of finished goods had declined slightly, they were still higher than the level firms now considered normal in view of the prospects of a prolongation of the recession and a period of tight credit evidenced by the high real cost of money, which had been rising steeply from the second quarter of 1980 onwards.

In the third quarter the inflow of orders contracted sharply, as did industrial production, which fell by 5.2 per cent. Production declined in August, as it had in the same month of the previous year, but this time the decrease was more pronounced. Firms continued to display greater flexibility in their production plans and a reluctance to increase inventories of finished goods in order to stabilize production at a time when demand and interest rate expectations led them to regard even the existing level of stocks as excessive. This changed production policy was successful, partly because on this occasion firms encountered fewer obstacles to reducing labour inputs. As will be seen below, an important factor in this respect was the recourse to the Wage Supplementation Fund, which was used increasingly for countercyclical purposes.

Table 6

INDICES OF INDUSTRIAL PRODUCTION (1)

(1970 = 100)

Period	General index	By sector of destination			By branch of activity		
		Intermediate goods and materials	Final capital goods	Final consumer goods	Mining and quarrying	Manufacturing	Gas and electricity
1979 - average	134.0	129.4	130.8	142.1	101.1	133.2	154.5
I qtr.	130.5	128.0	123.3	137.5	100.8	129.1	157.9
II »	129.8	125.6	124.0	138.2	99.2	128.7	153.0
III »	135.3	130.7	132.4	143.2	102.8	134.5	154.8
IV »	140.5	133.1	143.6	149.6	101.4	140.5	152.4
1980 - average	141.5	132.5	149.3	150.5	96.9	141.2	158.3
I qtr.	146.2	138.5	147.7	156.5	100.6	146.3	159.3
II »	144.9	136.2	152.6	153.8	100.7	145.0	158.4
III »	134.8	125.4	144.1	143.8	89.2	134.1	157.2
IV »	139.9	130.0	152.9	148.0	97.0	139.5	158.2
1981 - average	138.2	127.1	158.9	144.4	92.8	138.0	154.4
I qtr.	141.2	130.4	161.4	147.2	96.5	141.1	155.5
II »	140.0	129.5	154.7	148.2	89.0	140.2	152.7
III »	132.7	121.3	157.0	137.8	93.6	132.0	153.7
IV »	138.7	127.2	162.3	144.3	92.2	138.5	155.9
1982 - I qtr. (2) ..	141.5	129.8	159.6	149.5	101.8	140.8	161.8

Source: Based on Istat data.

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

As in the preceding year, in the final quarter industrial production made good the ground it had lost in the summer, thus

following the recovery in orders, which nevertheless remained lower than the average of the first two quarters. The level of production, which was more or less the same as in the fourth quarter of 1980, was almost identical to that of sales and only slightly below the volume of new orders received. The output of final capital goods rose by more than 6 per cent on a twelve-month basis to stand at a new record level; by contrast, the output of final consumer goods and of intermediate goods and materials was still two percentage points below the level recorded in the final quarter of 1980 (Table 6).

In the first quarter of 1982 industrial output continued to rise, mainly on account of the substantial recovery in industries producing final consumer goods. Uncertainty remained, however, about the strength of the recovery in production in spite of generally brighter demand expectations; wide fluctuations in production were still evident from one month to the next.

Services

The usual countercyclical role played by marketable services was less marked in 1981: the increase in value added at 1970 prices did not exceed 1 per cent, compared with 4.2 per cent in 1980 and an annual average of around 3.5 per cent in the seventies.

This weaker expansionary trend was largely sustained by the credit and insurance sector (with a 2.8 per cent increase in value added, against 6.8 per cent the previous year) and miscellaneous services (2 per cent compared with 4.2 per cent), since a period of stagnation was experienced by transport and communications (0.5 per cent compared with 4.4 per cent) and, in particular, by distributive trades, hotels, catering and entertainment (0.1 per cent as against 4.3 per cent). This was a direct result of the decline in domestic demand (-2.7 per cent) and notably of the stagnation of households' final consumption (0.2 per cent), with a slight downturn in real terms of expenditure in hotels and on catering and entertainment (-0.3 per cent).

The private services sector also played a stabilizing role as regards fixed investment and employment, although in the case of the former the increase (2.3 per cent compared with 8.9 per cent in 1980) was not sufficient to offset the substantial decrease in other productive sectors. On the other hand, the increase in the number of employees in the sector not only maintained but actually slightly

increased employment in productive activities as a whole, thus offsetting both the outflow of workers from agriculture, which has been under way for the past 30 years, and the decline in industrial employment in 1981.

These developments led to a decrease of 1.9 per cent in output per employee in services excluding lettings. Money incomes per employee, on the other hand, increased 17.1 per cent, and the services sector (with a 19.4 per cent increase in the implicit prices of value added at factor cost) was again more inflationary than either industry (14.3 per cent) or, more particularly, agriculture (11.3 per cent).

Among the individual branches, transport and communications registered the highest rise in prices (22.6 per cent in terms of value added at market prices) owing to the raising of charges, while the increase in rents was relatively smaller (12.7 per cent) as the Fair Rent Act gradually came into full operation.

In the distributive trades, modern methods of organization are still slow to penetrate in Italy (at the beginning of 1981 there were 24 supermarkets per million inhabitants, compared with 71 in France and 84 in the Federal Republic of Germany), with adverse effects on the inflation differential vis-à-vis other developed countries, especially those in Europe. During the year under review, the gradual process of fragmentation continued in this sector, with increases in the number of both individual shops and employees despite the virtual stagnation of consumption. Faced with this deterioration in the situation, in November 1981 the Ministry of the Budget and Economic Planning published a draft Plan for the distributive trades linked to the Three-Year Plan, and in the following January the Ministry of Industry tabled a bill for the reform of the regulations governing this branch of activity, aimed primarily at lowering the barriers to innovative competition and forms of association in the sector.

As to tourism and hotels, which are equipped with more modern facilities, results were modest for the second year running, with a fall of about 3 per cent in the number of overnight stays following the standstill of the previous year. Arrivals and overnight stays of foreign visitors continued to decline, while Italian tourism in the country increased quite substantially.

Energy

Domestic demand for primary energy declined by 3.1 per cent, after having fallen by 1.5 per cent in 1980. This was a significant

contraction, particularly in view of the fact that gross domestic product grew by 3.8 per cent during the two-year period. It was due to an appreciable decrease in the consumption of oil products and a smaller reduction in that of natural gas, which were partly offset by an increase in the use of coal. Net imports of solid fuels, which have been steadily rising since 1979, increased by 8.8 per cent while those of oil and its derivatives fell by 7.1 per cent (compared with a decline of 2.2 per cent in 1980) as a result of a reduction in imports of

Table 7

SOURCES AND USES OF ENERGY
(millions of TOE)

Sources and uses	1980					1981				
	Solid fuels	Natural gas	Oil	Electric power (1)	Total	Solid fuels	Natural gas	Oil	Electric power (1)	Total
Production	1.1	10.3	1.8	11.5	24.7	1.3	11.3	1.5	11.3	25.4
Imports	11.9	11.9	109.7	1.8	135.3	12.9	11.5	105.8	2.5	132.7
Exports (—)	0.5	—	11.9	0.4	12.8	0.5	—	14.9	0.4	15.8
Changes in stocks (2)	—	+0.6	—0.8	—	—0.2	—0.5	—0.7	+1.4	—	+0.2
Domestic uses of primary sources (3)	12.5	22.8	98.8	12.9	147.0	13.2	22.1	93.8	13.4	142.5
Percentage breakdown	8.5	15.5	67.2	8.8	100.0	9.3	15.5	65.8	9.4	100.0
Transformation into electric power	—4.2	—1.9	—22.9	+29.0	—	—5.0	—1.9	—21.5	+28.4	—
Consumption and losses (—)	2.3	0.4	6.8	6.6	16.1	1.9	0.3	6.7	6.8	15.7
Domestic uses of final sources (3)	6.0	20.5	69.1	35.3	130.9	6.3	19.9	65.6	35.0	126.8
Percentage breakdown	4.6	15.6	52.8	27.0	100.0	5.0	15.7	51.7	27.6	100.0
Industry	4.7	9.1	16.0	20.7	50.5	4.9	8.7	13.9	19.9	47.4
Transport (3)	—	0.3	28.7	1.0	30.0	—	0.3	28.6	1.0	29.9
Other energy uses ...	1.0	9.0	19.0	13.6	42.6	1.1	9.2	18.0	14.1	42.4
Non-energy uses	0.3	2.1	5.4	—	7.8	0.3	1.7	5.1	—	7.1

Source: Figures are based on data from the *Relazione generale sulla 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 (2,181 in 1980 and 2,178 in 1981) is offset under "consumption and losses". — (2) Minus (—) shows an increase in stocks; plus (+) a reduction in stocks. — (3) Including international maritime bunkers (4.2 million TOE in 1980 and 3.8 million TOE in 1981).

crude oil and a small recovery in exports of oil products. There was also a contraction of 3.4 per cent in imports of natural gas, although this was outweighed by an increase in domestic production (Table 7). The energy account closed with a total shortfall of 29,352 billion

lire, equivalent to 7.4 per cent of GDP, most of which was attributable to the deficit on oil account; as the volume of oil imports declined, the deterioration in the latter was due to a further rise in the price of crude (13.4 per cent) and above all to the appreciation of the dollar against the lira (33 per cent). The fall in spot prices did not have a significant effect on the oil account since almost all of Italy's supplies are purchased under medium and long-term contracts with the producing countries.

As in the preceding year, the demand for final sources of energy declined in all sectors except transport. Net of bunkers, the consumption of the transport sector rose by 1.2 per cent owing to the further increase in the demand for diesel oil (3.3 per cent), which greatly outweighed the decline in that for petrol. Industrial consumption, including that of the petrochemical sector for non-energy uses, declined by as much as 6.5 per cent after having fallen by 1.5 per cent in 1980, leading to a further reduction in the energy use per unit of value added in spite of a decline in industrial production. The fall in consumption, which concerned almost all fuels but particularly oil (where the decline was 13 per cent), was the result of more forceful measures to conserve energy and rationalize production processes on the one hand and a decline in production in energy-intensive sectors on the other. The consumption of energy by the other sectors (residential, agricultural and commercial) declined only slightly (0.5 per cent) because the contraction of 6.6 per cent in the demand for heating fuels was almost entirely offset by an increase in the use of other energy sources, especially electricity. Nevertheless, the total consumption of electricity declined, albeit by only 0.8 per cent, mainly on account of the adverse economic climate.

There was a fall of 2.5 per cent in the quantity of electricity generated. This decrease, which was without precedent in recent years and exceeded the fall in demand, was due to the cheapness of imported electricity in 1981; net imports rose by 57.4 per cent. Hydroelectric plant again contributed less to the total owing to a fall in water levels, but the decrease was partly offset by a rise in the production of nuclear power due to the start-up of the Caorso power plant. Thermal power stations generated 2.5 per cent less electricity; the amount of coal burned rose by 25.6 per cent, thus reducing their consumption of oil products by 5.3 per cent.

Over the eight years from 1973 to 1981 demand for primary sources of energy rose by 2 per cent while gross domestic product increased by 21 per cent. The proportion of total demand met by oil

fell from 75 to 66 per cent. If the 1973-74 crisis is compared with that of 1979-80, it will be seen that both the overall energy requirements and the oil component were more effectively curbed during the latter period. This development, which was also evident in the other industrialized countries, reflected on the one hand the greater determination of governments to pursue pricing policies more closely in line with the trend increases in the cost of oil and on the other the public's growing expectation of a continued rise in oil prices. The policy of diversification mainly consisted in encouraging the use of natural gas, whose share of total consumption rose from 10.2 per cent in 1973 to 15.5 per cent in 1980-81, and, in the last two years, that of coal, whose contribution to total requirements rose by 2 percentage points (from 7.3 to 9.3 per cent). In view of the traditional rigidity of domestic supply, the Italian economy's dependence on imported energy remained at the level of 82 per cent. Although quite considerable, Italy's efforts to achieve a greater diversification of energy sources still appear inadequate when measured against the initial disequilibria.

The composition of final consumption has changed substantially since 1973. The proportion consumed by industry – including the petrochemical sector, which also uses oil products as a raw material – has fallen by 5 percentage points; conversely, there has been a clear increase in the share of the transport sector and an even larger one in that of the residential, commercial and agricultural sectors.

In industry as a whole energy consumption fell by an annual average of 0.6 per cent between 1973 and 1981, while industrial production rose by an average of 2.6 per cent. The direct incidence of oil and oil products in total energy consumption fell by 14 percentage points. The decline in the use of oil products was offset by an increase in the consumption of natural gas (18 per cent) and to a greater extent by a further expansion in the use of electricity, which now accounts for 42 per cent of the total; in the last two years there has also been an increase in the demand for solid fuels. The trend towards a less intensive use of energy has gained considerable momentum in the last three years.

Energy consumption for residential, commercial, craft and agricultural purposes has shown almost continuous expansion, although the rate of growth slowed down considerably after the first oil crisis (an annual average of 1.6 per cent compared with about 10 per cent previously). At present this sector accounts for more than one third of total consumption, the greater part being used for heating. Here too

the consumption of oil products has been reduced; between 1973 and 1981 the share of petroleum derivatives, mainly heating oil, fell by more than 18 percentage points, while those of natural gas and electricity rose by 11 and 9 points respectively.

In the transport sector energy consumption also increased almost continuously during the seventies, although at a slower rate than in earlier years. The sector's consumption as a proportion of the total has risen, so that it now stands at 23.6 per cent; in evaluating this figure it should be borne in mind that oil products account for about 96 per cent of the sector's requirement. Road transport has always accounted for the bulk of energy consumption in this sector (about 90 per cent in 1980).

The seriousness of the energy constraint is illustrated by the rapid growth in the deficit on oil account, particularly since the second wave of increases in crude oil prices; in the period from 1976 to 1978 it averaged 7,000 billion lire, but in the last three years it has risen to 10,000, 17,600 and 25,350 billion lire respectively.

The switch from oil to other fuels, mainly coal and natural gas, has led to an expansion in net imports of these products. Coal and gas prices also rose considerably during the period under review, although they remained lower than those of oil in thermal terms. In the last three years the energy account as a whole therefore recorded deficits of 11,380, 19,740 and 29,350 billion lire respectively. Measured as a proportion of total exports, the deficit rose over the period 1973-81 to stand at about 34 per cent. As exports already account for more than one fifth of national income, a policy of balance-of-payments adjustment acting almost exclusively on the non-energy component obviously imposes a heavy burden.

The policies of energy conservation and diversification therefore take on fundamental importance. The new National Energy Plan approved by the Interministerial Committee for Economic Planning last December is directed towards achievement of these objectives. The guidelines for the conservation and efficient use of energy involve all aspects of industrial policy. They consist mainly in the provision of investment incentives (in the form of capital grants and subsidized loans) for the introduction of new technology in place of existing techniques and also pay due attention to the medium and long-term need to modify the structure of industry both between and within sectors in order to encourage production processes and sectors with a lower energy requirement per unit of value added. The budget allocation for the period 1981-90 has been set at 2,300 billion lire, which should give rise to total investment of about 9,000 billion lire.

The measures on the supply side aim at increasing the capacity for producing all forms of energy that can be used as substitutes for oil. This entails the use of all national resources, however small, the most intensive possible exploitation of renewable sources of energy and diversification of the forms and countries of origin of imported energy in order to reduce the overall energy deficit and give greater security of supply. Special attention is devoted to electricity generation; ENEL has a large-scale investment programme for the construction of nuclear and coal-fired power stations and the conversion of some oil-fired plant to burn coal. Part of the necessary finance will be provided from contributions to ENEL's endowment fund and by raising money on the capital market, but most of it will come from the revenue accruing as a result of the fundamental revision of electricity charges that is now being undertaken.

The new National Energy Plan differs from previous ones, which remained largely unimplemented, in that it establishes a better balance between demand management and supply-side policies and within the latter provides for greater diversification among the various sources of energy. By 1990, when the Plan's objectives should have been fully achieved, the relative shares of the various primary sources of energy should be less burdensome for the economy; that of oil products should fall to 51 per cent of the total.

Employment, wages, prices and the distribution of income

Employment

Notwithstanding the drop in productive activity, employment grew further (by 0.4 per cent), albeit at a slower rate than in recent years (Table 8). Labour demand gradually diminished in the course of the year, however, and there was also a very steep increase in the number of underemployed (+20.4 per cent as compared with the previous year).

One of the most significant developments was the sharp decline in employment in agriculture (-3.8 per cent), the scale of which was larger than in any year in the second half of the seventies and which affected employees and self-employed workers equally.

In the services sector, on the other hand, employment continued to expand (350,000 additional jobs), the rate of growth in marketable services again exceeding that in non-marketable services

Table 8

EMPLOYMENT IN ITALY
(percentage changes on previous year)

Sector	Total employment				Employees			
	1978	1979	1980	1981	1978	1979	1980	1981
Agriculture	-1.1	-2.7	-2.8	-3.8	-2.3	-1.6	-1.4	-3.7
Industry	-0.3	0.2	0.7	-0.7	-0.6	0.2	0.4	-1.0
<i>of which: energy products</i>	-0.1	0.5	1.6	1.0	-0.1	0.5	1.5	1.0
<i>products of industrial processing</i>	-0.8	0.3	0.6	-1.5	-1.0	0.5	0.2	-1.9
<i>total industry excluding construction</i>	-0.7	0.3	0.6	-1.5	-1.0	0.5	0.3	-1.8
<i>construction</i>	1.1	-0.2	1.1	1.8	0.8	-0.5	0.8	1.6
Marketable services	2.2	3.0	2.3	3.0	2.4	4.4	2.4	2.8
<i>of which: distributive trades, hotels, catering and entertainment</i> ...	1.8	3.1	1.7	2.9	1.4	5.3	0.7	2.3
<i>transport and communications</i> ..	0.6	0.6	1.6	1.8	0.4	1.1	1.6	1.6
<i>finance and insurance</i>	3.7	4.2	5.8	2.6	3.6	4.3	5.9	2.5
<i>miscellaneous services</i>	4.5	4.4	3.8	4.2	6.1	6.4	5.0	5.1
Marketable goods and services	0.5	0.7	0.8	0.3	0.2	1.4	0.9	—
Non-marketable services	1.8	1.9	1.1	1.4	1.8	1.9	1.1	1.4
TOTAL ...	0.7	0.9	0.8	0.4	0.5	1.5	0.9	0.3

Source: Istat.

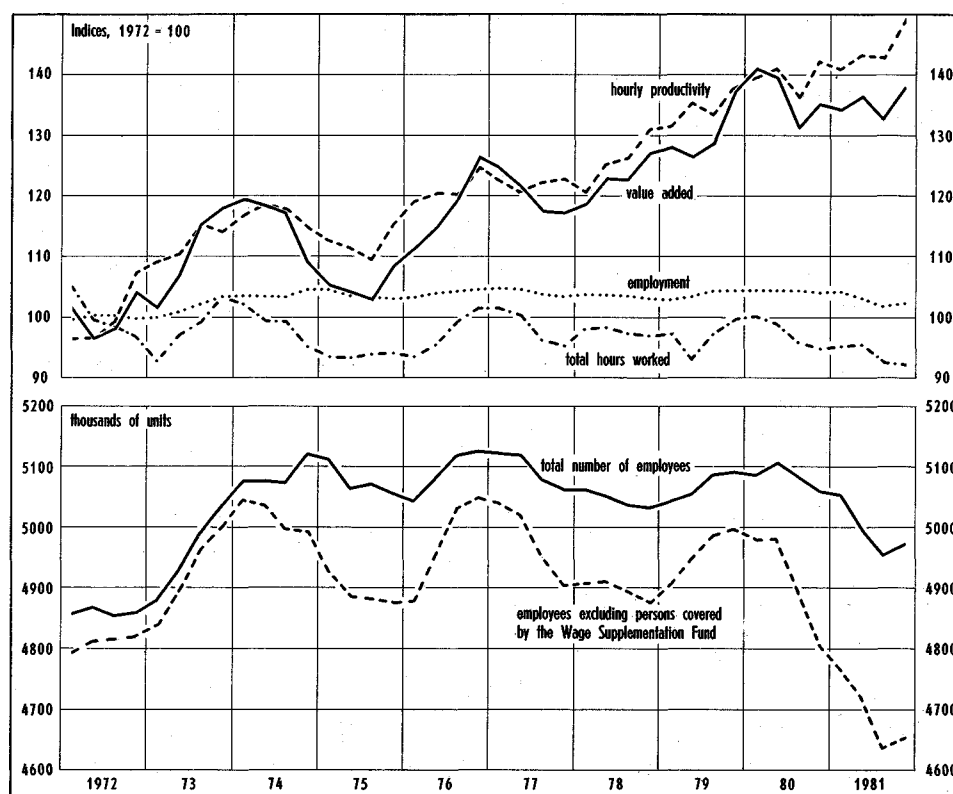
(3.0 and 1.4 per cent respectively). Confirmation was thus provided of the services sector's role in absorbing members of the labour force and of its limited responsiveness, at least in the short term, to the various phases of the business cycle.

In industry as a whole there was a fall in the number of workers employed (-0.7 per cent), which was entirely due to industry excluding construction (-1.5 per cent). The contraction was even sharper in firms with a labour force of over 500 (-3.2 per cent), which was particularly significant given that the level of employment in such firms has always been stable in recent years. The deterioration on the employment front began in the second half of 1980 and gradually gained in intensity until, by the fourth quarter of 1981, the decline over the year worked out at 4.5 per cent.

However, the most striking feature of 1981 was the increase in firms' recourse to the Wage Supplementation Fund. The number of hours authorized in industry excluding construction doubled by comparison with the previous year, climbing to levels never witnessed before, even at times of a far steeper fall in output. If the

employment figures are adjusted to exclude the number of workers corresponding to hours paid by the Wage Supplementation Fund (3.8 per cent), the fall in labour demand in industry emerges as being even larger, and steeper than at any point in the previous decade (Chart 4). The sharp rise in the number of hours paid was largely due to the increase in extraordinary interventions, which have expanded uninterruptedly in the course of recent years. Recourse to the Supplementation Fund has made it possible to recover a substantial degree of flexibility in the management of labour, by

Chart 4



Value added, employment and hourly productivity in industry excluding construction

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

contrast with the limitations that emerged in the course of the seventies in respect of in-house mobility, dismissal and recruitment. The use of wage supplementation has become a further method for absorbing cyclical fluctuations, providing support, and to some extent a substitute, for the management of inventories and orders on hand. It should, however, be pointed out that although the mechanism of the Fund has largely positive effects in respect of the greater labour

flexibility it affords, its medium-term implications are disturbing. The unlimited duration of the extraordinary interventions, the absence of effective retraining courses for workers and of penalties for those refusing posts requiring equivalent skills are all shortcomings which it would be expedient to eliminate.

The marked contraction in the input of labour and the impact of the high volume of investment in the last two years were mirrored in the favourable development of productivity. By contrast with what happened in other recessionary phases, there was an increase, albeit only a modest one (0.5 per cent), in output per worker in industry excluding construction. The rise in productivity adjusted to take account of the impact of the Wage Supplementation Fund was higher (2.9 per cent), and very close to that in hourly productivity (3.1 per cent). The latter was hence only very slightly affected by the recession, which confirmed the slackening of the customary tendency of hourly productivity to move pro-cyclically.

The labour force expanded by approximately 300,000 units (1.3 per cent) over the year, bringing the activity rate up to 40.2 per cent. The rise was partly due to the higher number of people in the central age groups and partly to the increased entry into the labour force of young people and women of between 25 and 60 (the activity rate for these two groups rose from 45.3 to 45.9 per cent and from 39.9 to 40.9 per cent respectively). The activity rate of males of 25 years and over remained virtually unchanged.

The surge in the labour force helped to push the unemployment rate up from 7.6 per cent to 8.4 per cent. The adverse trend is even stronger when the unemployment rate adjusted for the Wage Supplementation Fund is considered; on that basis the rate stood at close to 11 per cent at the end of 1981. However, as has already been stressed, the trend is partly attributable to the considerable expansion of the labour force. In terms of the employment rate, defined as the ratio of employed persons to total population, labour market conditions improved between 1976 and the first quarter of 1981 when, partly because of the massive exodus from agriculture, the unemployment situation gradually began to worsen.

The number of first-time job seekers rose particularly strongly (12.4 per cent), but the share of total unemployment accounted for by young people of between 14 and 29 years of age nonetheless declined slightly, falling from 76.3 to 75.3 per cent. There was also a strong increase (16.8 per cent) in the number of other job-seekers whereas the rise in the number of unemployed in the narrow sense

was far smaller (2.4 per cent). The development of total unemployment was particularly adverse in the months around mid-year, although the rate of increase slowed in the last quarter.

The worsening of labour market conditions affected the whole of Italy. In the North the unemployment rate for male workers came to 3.5 per cent, the highest level since 1977, and it would have been even higher had account been taken of the number of workers covered by the Wage Supplementation Fund, who are mainly concentrated in the North. Regional differences nonetheless remain marked, with a further exacerbation of the conditions in the South where, despite only modest growth in the labour force, the unemployment rate has risen to extremely high levels, especially for women.

Wages and salaries

Against a background of fewer negotiations, lower inflation and a worsening labour market situation, union-negotiated wages and salaries advanced at a steady pace in 1981, the rate of increase being higher in almost all sectors of the economy than that recorded in 1980.

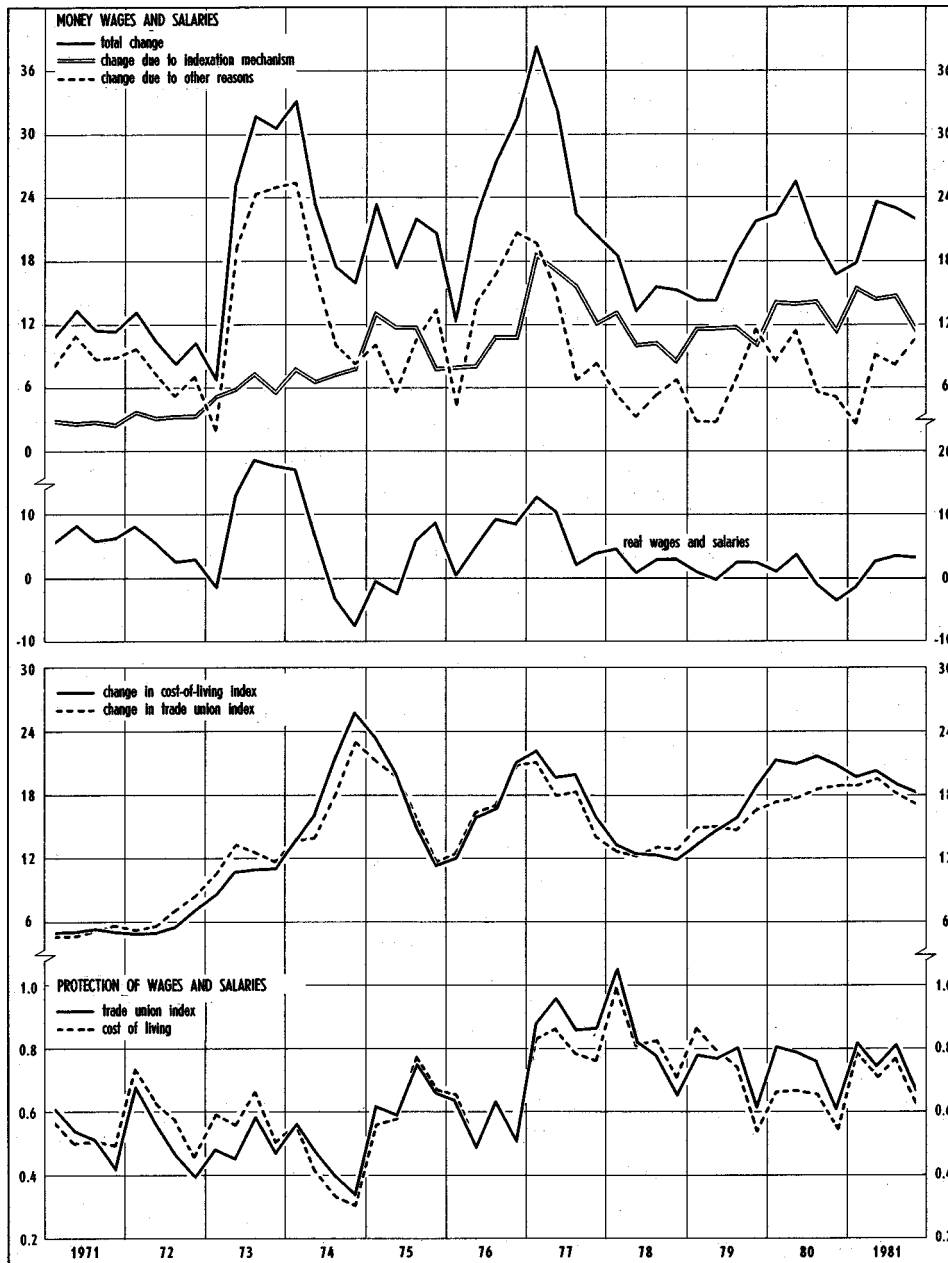
In the industrial sector the rate of increase in union-negotiated wages increased from 21.7 to 23.1 per cent between 1980 and 1981. In real terms the acceleration was faster, rising from 0.5 to 3.7 per cent. In the food, textile, engineering and metal industries the increase was higher than average, owing to the implementation of certain clauses included in the contracts signed in previous years.

In the services sector the purchasing power of the incomes of employees of banks and insurance companies was eroded further, owing to the reduced protection provided for higher wages and salaries as a result of the uniform increases currently granted under the indexation mechanism.

For the second year in succession, the salaries of public sector employees increased, in both money and real terms, at a rate substantially faster than that recorded in the other sectors of the economy. This development was due to improvements following the implementation of the public sector employment contracts for the period 1979-81.

An analysis of the quarterly data for gross labour incomes in industry excluding construction shows that in the course of the year there was a gradual increase in the "autonomous" component of wage growth, which includes all wage increases not connected with

Chart 5



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

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

the wage indexation mechanism (Chart 5). The gradual slowdown in inflation helped to boost the purchasing power of wages in the course of the year.

Finally, given the time lag with which the indexation mechanism works, the slackening of the inflation rate caused an increase in the percentage protection of gross labour incomes. Between 1980 and 1981 the latter rose from 73.5 to 75.7 per cent on the basis of the trade union index and from 63 to 72.1 per cent on the basis of the cost-of-living index.

The slowdown in productivity per worker, albeit less marked than in corresponding phases in earlier business cycles, went hand in hand with a particularly sustained surge in wages, resulting in a sharp rise in unit labour costs. In the private sector the average change during the year came to 20.8 per cent, the fastest rate in the past five years and four points higher than that recorded in 1980.

In industry excluding construction the rate of increase in unit labour costs has virtually doubled in the past three years (from 10.1 per cent in 1979 to 18.9 per cent last year) on account of the divergent development of labour costs (the growth rate of which went up by about three percentage points) and of productivity per worker (which is gradually slowing).

Prices

The persistence of high rates of inflation was again one of the principal features of the economic situation in Italy. There were, however, considerable declines in rates of increase compared with the previous year, which in the case of wholesale prices of manufactures amounted to over 6 percentage points on average (16 per cent in 1981 compared with 22.5 per cent in 1980) and to around 4 percentage points year-on-year (15.9 and 19.7 per cent respectively in December 1981 and 1980). The inflation gap, measured in terms of these prices, between Italy and the nine leading industrialized countries thus narrowed from 9.7 per cent in 1980 to 6.7 per cent in 1981 (and from 10.5 to 6.5 per cent vis-à-vis the entire EEC).

With the rate of increase in world market prices of both oil and basic commodities slackening considerably during the year, the main factor that prevented greater progress in the fight against inflation was the steep appreciation of the dollar. The dollar's appreciation

considerably increased the lira cost of firms' purchases of basic materials, although it did, on the other hand, also exert downward pressures on world market prices.

The general wholesale price index recorded an average increase of 16.6 per cent in 1981, which was over three points less than the previous year (20 per cent). During the year, however, the gradual slowing of the annual growth rate that had begun in the second quarter of 1980 (21.6 per cent) was interrupted in February (15.0 per cent). In the months that followed, with the strong appreciation of the dollar, the rate increased rapidly, and in December wholesale prices were 18.2 per cent higher than a year earlier (Table 9).

Table 9

WHOLESALE PRICES

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

Indices	1980	1981	Dec. '80	Dec. '81	Mar. '82	June '81	Dec. '81	Mar. '82
	1979	1980	Dec. '79	Dec. '80	Dec. '81	Dec. '80	June '81	Dec. '81
Istat						(composite rates on an annual basis)		
General index	20.0	16.6	17.1	18.2	2.8	21.0	15.3	11.7
Classification by sector:								
Agricultural	10.8	12.5	8.9	18.5	2.3	23.7	13.5	9.5
of which: imported	7.5	0.7	-4.2	7.2	7.3	16.7	-1.6	32.6
Non-agricultural	21.3	17.2	18.2	18.0	2.9	20.7	15.4	12.1
Classification by product category:								
Food	12.4	15.0	11.7	18.5	3.2	20.5	16.7	13.4
vegetable	8.9	11.3	8.4	18.4	1.4	29.9	7.9	5.7
animal	14.5	15.0	9.8	18.7	4.1	11.7	26.2	17.4
food manufactures	13.5	16.9	13.8	18.5	3.8	18.1	18.9	16.1
Industrial raw materials	24.4	19.8	18.0	22.4	2.7	30.5	14.8	11.2
oil	66.6	50.1	58.6	35.6	0.2	77.2	14.8	0.8
non-oil	14.4	12.7	7.1	18.9	3.4	19.1	18.6	14.3
Industrial products	22.5	16.0	19.7	15.9	2.6	17.0	14.9	10.8
of which: industrial products exclu- ding oil products	19.9	14.9	17.0	14.9	3.4	16.1	13.7	14.3
Classification by use:								
Consumer goods	17.1	14.9	16.3	17.0	2.4	17.1	16.9	10.0
Capital goods	18.3	19.4	17.3	17.9	4.3	22.3	13.7	18.3
Ancillary materials	22.8	17.5	17.7	18.9	2.8	24.0	14.0	11.7

Source: Based on Istat data.

The main factor contributing to this trend in wholesale prices was the increase in prices of industrial raw materials: 22.4 per cent between December 1981 and December 1980 (19.8 per cent on

average), with a sharp rise in the first six months, when the annual rate equalled 30.5 per cent. The largest increases were recorded for energy sources (50.1 per cent on average and 35.6 per cent year-on-year), while those of other basic materials were much lower (12.7 per cent and 18.9 per cent respectively; Table 9).

This increase in industrial raw material prices went hand in hand with one of similar magnitude in unit labour costs (18.9 per cent in industry excluding construction), whereas the average yearly rise in prices of manufactures was only 14.9 per cent (16 per cent if oil products are included), which represents a slowdown in the year-on-year increases from 17 per cent at end-1980 to 14.9 per cent at December 1981 (19.7 and 15.9 per cent including oil products; Table 9). Thus, slack demand and the need to regain competitiveness on the domestic market, so as to stimulate import substitution, limited the adjustment of output prices in industry.

After two years during which they had exerted a distinctly dampening effect on inflation, food prices increased very much in line with the general wholesale price index in 1981 (15 and 18.5 per cent on average and year-on-year respectively; Table 9). The development of these prices – especially those of processed food (16.9 and 18.5 per cent) and livestock products (15 and 18.7 per cent) – was affected by the decisions of EEC bodies regarding both regulated prices (up 9.4 per cent in EUAs in April 1981 after a 5 per cent increase in May 1980) and the devaluation of the green lira (5.6 and 2.5 per cent in April and November 1981 respectively).

Consumer prices for the entire country and those paid by blue and white collar workers' households (the latter being those used to measure the cost of living) increased at a higher average rate than wholesale prices in 1981, as they had done the previous year: 17.8 and 18.7 per cent respectively (compared with 21.2 and 21.1 per cent in 1980). By contrast, their year-on-year rate of increase slowed considerably, unlike that in the general wholesale price index, with a decline from 21.3 per cent at end-1980 to 18.1 per cent at December 1981 for consumer prices and from 21.1 to 17.9 per cent for the cost of living (Table 10).

Throughout the first six months of the year the annual rate of increase of consumer prices remained at around the 20 per cent level. The upward pressures stemmed both from the production side (especially foodstuffs, with an annual increase of 21 per cent in that period) and from further increases in prices of public services and administered prices. In the first two quarters, in fact, prices of public

Table 10

CONSUMER PRICES AND COST OF LIVING

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

Indices	1980	1981	Dec. '80	Dec. '81	Mar. '82	June '81	Dec. '81	Mar. '82
	1979	1980	Dec. '79	Dec. '80	Dec. '81	Dec. '80	June '81	Dec. '81
(composite rates on an annual basis)								
CONSUMER PRICES								
General index	21.2	17.8	21.3	18.1	3.8	20.2	16.1	16.1
Food	15.6	16.3	17.0	18.2	3.6	21.0	15.3	15.2
Non-food products and services	24.7	18.6	23.8	18.1	3.9	19.6	16.6	16.5
non-food products	28.1	17.1	24.7	16.7	2.7	17.2	16.2	11.2
services	20.6	20.6	22.6	20.1	5.5	23.1	17.1	23.9
clothing and footwear	20.7	17.1	19.7	16.7	2.8	13.7	19.9	11.7
housing, fuel and electricity	33.8	20.3	29.3	20.6	3.6	25.8	15.6	15.2
housing and water	20.3	15.6	20.7	14.6	4.9	12.6	16.7	21.1
rent	20.3	15.7	20.8	13.6	5.1	11.1	16.0	22.0
fuel and electricity	51.1	25.9	39.2	27.7	2.2	42.3	14.5	9.1
liquid fuel	61.5	23.3	38.8	32.0	1.0	34.0	30.0	4.0
gas	36.9	27.2	33.1	23.9	1.6	42.8	7.5	6.6
electricity	45.0	28.8	44.4	24.6	4.7	54.5	0.4	20.2
furniture, furnishings, equipment and services for domestic use	20.7	18.4	21.3	16.9	3.6	19.7	14.2	15.2
medical care and health	20.7	22.8	26.6	19.3	5.1	23.5	15.3	22.0
transport and communications	24.4	17.8	21.0	16.4	3.1	15.7	17.1	13.0
cars	15.7	11.4	11.7	13.7	4.8	12.7	14.6	20.6
State Railways	20.6	7.5	10.1	11.3	—	0.2	23.6	—
petrol and lubricating oil	32.8	25.8	38.9	17.0	-2.8	13.4	20.7	-10.9
recreation, entertainment, education and cultural services	18.6	15.8	21.5	17.3	3.1	16.1	18.5	13.0
other goods and services	29.9	19.8	27.0	19.4	5.6	24.0	14.9	24.4
COST OF LIVING								
General index	21.1	18.7	21.1	17.9	3.6	19.4	16.4	15.2
Food	14.7	16.3	16.4	17.5	3.5	19.8	15.4	14.8
Clothing	19.5	17.2	18.9	18.5	2.9	17.5	19.5	12.1
Electricity and fuel	51.4	26.6	38.3	28.9	2.2	44.6	14.9	9.1
Housing	19.1	16.3	18.7	15.8	4.4	13.9	8.5	18.8
Miscellaneous expenditure	25.7	20.6	24.6	18.1	3.9	19.6	16.7	16.5

Source: Istat.

services rose at an annual rate of 39 per cent and those of administered goods by 21.7 per cent with a peak of 29.4 per cent for oil products.

In the second half of the year, when discussions began between management, labour and the Government to formulate a policy that would allow the average rate of inflation in 1982 to be brought down to 16 per cent, the rate of increase in prices of public services and administered prices slowed considerably (9.7 and 20 per cent expressed at an annual rate). The agreement on the regulation of the prices of a specified range of food products, which came into force in September, led to a further downturn in the annual rate of consumer price increase, which stood at 18 per cent at the end of the year.

The largest consumer price increases, both average and year-on-year, were recorded in services, respectively 20.6 and 20.1 per cent (Table 10). Among non-food products the highest price rises continued to be in liquid fuels (23.3 and 32 per cent) owing to the many increases decided by the Interministerial Price Committee during the year, largely prompted by the lira's depreciation vis-à-vis the dollar. For the third year running the large rises in final domestic prices of energy sources caused a substantial increase in their respective real prices.

The rises in consumer food prices were the lowest on average (16.3 per cent), and year-on-year they were close to those of wholesale food prices (18.2 and 18.5 per cent respectively; Table 10).

The distribution of income

The limited slowdown in economic activity and the strong thrust in wages brought about a shift in the distribution of income in favour of labour incomes (Table 11). In the private sector their share in total value added at factor cost, adjusted for changes in the structure of employment, increased from 79.2 to 82.3 per cent, thus bringing to an end the rise in the share of profits that had followed the gradual expansion of production since 1977.

The change in income distribution occurred in all sectors except construction and was in the main due to large increases in real unit labour costs, with peaks in services (5.6 per cent) and agriculture (4.3 per cent). In the latter sector the decline of the same magnitude

Table 11

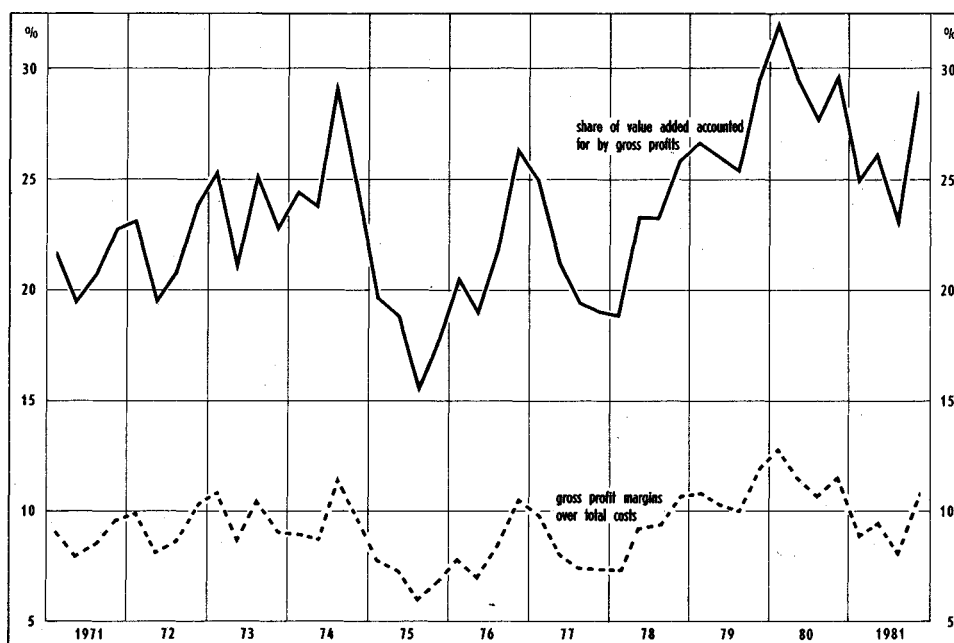
DISTRIBUTION OF INCOME

Sector	Labour's share of value added at factor cost (1) (percentages)			Percentage changes 1981/80		
	1979	1980	1981	Real labour costs per unit of output (2)	Relative prices (3)	Labour's share of income
Agriculture, forestry and fisheries	84.2	87.6	95.4	4.3	-4.3	9.0
Industry	73.8	70.8	74.0	2.6	-1.7	4.5
excluding construction	73.0	70.2	74.1	2.3	-3.1	5.6
construction	76.6	72.8	72.7	3.7	3.8	-0.1
Services (4)	83.7	83.0	85.4	5.6	2.7	2.9
Private sector (5)	81.3	79.2	82.3	3.9	—	3.9

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.

Chart 6

**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. All the data are seasonally adjusted.

in relative prices (4.3 per cent) raised labour's share of income by at least 8 percentage points, to an unprecedented peak. In the services sector, on the other hand, in which relative prices increased, the shift away from capital and entrepreneurial incomes was the least marked.

In industry excluding construction the increase in real labour costs was smaller (2.3 per cent). Nonetheless, gross operating profits continued to decline, as they had been doing since the first quarter of 1980 when the share of gross profits in value added and of profit margins over costs had reached their highest levels for a decade (Chart 6). The development in profits again coincided with a gradual slackening of productive activity, but by contrast with earlier recessions the sharp decline in the input of labour made it possible to contain the deterioration in firms' profitability. The share of profits and profit margins both reached their lowest point in the third quarter of 1981, although neither of them sank as low as they had in 1975 and 1977. A pronounced recovery occurred in the fourth quarter, when their levels exceeded the averages recorded during the period 1979-80.

THE BALANCE OF PAYMENTS

The overall balance of payments moved back into surplus in 1981, the deficit of 6,258 billion recorded in 1980 being transformed into a surplus of 1,533 billion (Table 12). The deficit of 9,225 billion recorded on the current account represented an increase of 934 billion compared with the previous year's outturn. Capital movements resulted in net inflows of 11,737 billion (2,749 billion in 1980), while in the errors and omissions item there was a deficit of 979 billion. The banks' transactions gave rise to a net outflow of much the same size as the overall surplus, so that official reserves, corrected to eliminate the effects due to fluctuations in exchange rates and the gold price, remained virtually unchanged.

Table 12

BALANCE OF PAYMENTS ON A TRANSACTIONS BASIS (1) (billions of lire)

	Credit		Debit		Balance	
	1980	1981	1980	1981	1980	1981
CURRENT ACCOUNT (2)	94,261	119,349	102,552	128,574	-8,291	-9,255
Goods (f.o.b.)	65,823	85,042	79,814	97,044	-13,991	-12,002
<i>of which: oil and oil products</i> ..	3,680	5,257	19,703	28,382	-16,023	-23,125
Services	24,175	29,266	19,514	27,277	4,661	1,989
Transfer payments	4,263	5,041	3,224	4,253	1,039	788
CAPITAL MOVEMENTS	39,286	58,855	36,537	47,118	2,749	11,737
short-term	24,564	31,598	24,869	29,768	-305	1,830
medium and long-term	14,722	27,257	11,668	17,350	3,054	9,907
ERRORS AND OMISSIONS					-716	-979
TOTAL					-6,258	1,533
MONETARY MOVEMENTS (3)	37,127	20,339	30,869	21,872	6,258	-1,533
Banca d'Italia-UIC	23,006	1,212	24,952	3,416	-1,946	-2,204
Banks	12,846	16,931	4,960	15,612	7,886	1,319
Exchange rate adjustments ...	1,275	2,196	957	2,844	318	-648
<i>of which: Banca d'Italia-UIC</i> .	1,275	2,196	—	—	1,275	2,196
Banks	—	—	957	2,844	-957	-2,844

(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 1980 and 1981 amounts respectively to -15,716 and -13,760 billion lire. — (3) Balance with minus sign indicates increase in assets or decrease in liabilities.

The terms of trade deterioration, for which the dollar's appreciation was mainly responsible, had an adverse effect on the trade balance, the favourable trend in volumes (import volumes dropped by 8.5 per cent and export volumes increased by 8.8 per cent) thereby being virtually cancelled out.

The surplus on services and transfers dwindled from 5,700 to 2,777 billion, the reduction being due virtually entirely to the burden imposed by interest payments on the country's foreign debt, which pushed up the deficit on capital income to 3,069 billion.

With the exception of a few large investments, foreign loans and short-term trade credits accounted for the bulk of capital movements, giving rise to net inflows of 12,144 billion and 1,830 billion respectively.

Goods

The trade deficit, measured on the basis of customs data (c.i.f.), came to 17,604 billion lire in 1981, against 18,845 billion the previous year. The oil component showed a deficit of 25,355 billion (17,586 billion in 1980), while for other goods there was a sizable surplus (7,751 billion, as against a deficit of 1,259 billion in 1980). Average unit values of total exports and imports rose by 18.6 and 32.4 per cent respectively, while for goods other than oil the increase came to 17.8 and 24.5 per cent. There was consequently a deterioration in the terms of trade that virtually cancelled out the positive trend in volumes, namely the increase of 8.8 per cent in exports (after a sharp fall in 1980) and the reduction of 8.5 per cent in imports.

On a seasonally adjusted basis the trade deficit declined in the course of 1981: at current prices its level in the final quarter amounted to little more than half that recorded in the first. At 1970 prices the balance likewise improved gradually in the course of the year.

The combination of a downswing in domestic demand and the competitive edge with respect to prices gained from the fourth quarter of 1980 onwards resulted in an upsurge in Italian exports that enabled foreign market shares to be regained. At constant prices, Italy's share of total world markets rose from 6.8 to 7.1 per cent in 1981, while at current prices it declined, Italian export prices expressed in dollar terms, having fallen faster than those of the other

industrial countries (Table 13). Italy's performance in its major export markets was not uniform: measured at constant prices its share fell in the industrial countries as a whole and within the EEC, whereas it increased in the United States, the developing countries and, most sharply of all, in the oil-producing countries, thus reversing the fall registered in 1980.

Table 13

ITALY'S SHARE OF WORLD EXPORTS

	1976	1977	1978	1979	1980	1981
Current prices	6.4	6.9	7.1	7.5	6.9	6.5
1975 prices	6.8	7.0	7.3	7.5	6.8	7.1

Source: Statistics drawn from IMF data. The shares are calculated with reference to all the industrial countries, except the United Kingdom, for which 1981 data are not available.

The decline in the volume of imports was mainly attributable to the slackening of domestic demand. An additional factor was the destocking of goods not destined for final consumption (raw materials, energy sources, intermediate products), which held down imports. In particular, the propensity to import raw materials, calculated as a ratio to industrial output, sank to lower levels than at any point in the previous decade.

The terms of trade deteriorated by 10.4 per cent overall, but by only 2.3 per cent for manufactured goods alone. In the case of the latter, the deterioration had as its counterpart an improvement in the competitiveness of Italian exports. The drop (12.4 per cent on average for the year as a whole) in the effective exchange rate, calculated on the basis of the geographical distribution of Italy's trade with its nine principal competitors, more than offset the faster rate of increase in the price of Italian manufactures, the net result being a gain in export competitiveness that may be estimated at some 4 per cent. This gain was predominantly attributable to the dollar's appreciation; calculated vis-à-vis the EEC countries only, the index of competitiveness shows a drop of some 2 per cent.

Looking at the volumes of imported goods, classified according to their economic purpose, purchases of raw materials slumped sharply (-13.6 per cent). Imports of consumer goods declined faster than those of capital goods (-8.3 per cent as against -4.6 per cent). On the export side, foodstuffs and semi-finished goods recorded above-

average rises (27.6 and 10.4 per cent respectively). The production technology for these two sectors is standardized and they are particularly sensitive to changes in relative prices, so that they benefitted from the competitive edge gained by Italian industry in the course of the year.

Geographically, the shift in Italy's trade was dominated by the upsurge in exports to the oil-producing countries (74 per cent) and to the United States (64 per cent). Market share rose from 13 to 17 per cent in the case of the former and from 5 to 7 per cent in the case of the latter.

Services and transfer payments

The transport deficit was larger than in 1980, amounting to 1,440 billion. There were increases in both the surplus on air transport and the deficits on shipping and land transport.

Italy's total payments for shipping expanded by some 14 per cent, amounting to 5,540 billion, compared with 4,865 billion the previous year. The modest growth in outlays was attributable to the reduction in import volumes. Under the influence of the dollar's appreciation during the period, freight rates did, in fact, show a steeper upward trend, rising from around 26,800 lire a ton in 1980 to 32,700 a ton in 1981. The Italian merchant navy's receipts from the transport of goods for export and between third countries totalled some 2,900 billion lire, as against 2,639 billion in 1980. The limited rise in revenues, despite the increase in unit freight rates in lire, reflected the reduction in the fleet and the fact that more of its capacity was used to transport imports.

The surplus from tourism increased from 6,000 billion in 1980 to 6,693 billion in 1981. In nominal terms, inflows expanded by 12 per cent and outflows by 16 per cent.

The small increase in receipts reflects both the squeeze exerted on tourist spending in all the main tourist-exporting countries as a result of the stagnation of disposable incomes, and the delayed effects of the loss of Italian competitiveness. Overnight stays declined by 12 per cent, whereas for the OECD area as a whole the decrease is estimated to have been only some 3 per cent. The consequent reduction in Italy's share of total OECD tourism was connected with an above-average rise in consumer prices in Italy, as compared with those in a group of its major competitors, in the period 1979-80.

The rate of increase in foreign currency outflows for foreign travel was only half that recorded in the previous year, being influenced both by the stagnation of households' disposable income and by the deterrent constituted by the non-interest-bearing deposit on foreign payments.

Labour income and workers' remittances from abroad yielded a net foreign currency inflow of around 3,000 billion, representing an increase of 16 per cent over 1980. The deficit on capital income climbed sharply, rising to 3,630 billion from 561 billion in 1980. Outflows, up from 5,126 billion in 1980 to more than 10,000 billion, reflected not only the surge in Euromarket interest rates but also the banking system's higher level of foreign liabilities and, in particular, the steep rise in medium and long-term loans negotiated by Italian residents on international financial markets. The expansion in receipts was attributable to the increases in the banks' foreign claims and loans granted abroad, and to the rise in average yield rates on assets of this kind.

The surplus on transfers was smaller than in the previous year (788 billion as against 1,039 billion); the sharply higher deficit on contributions to international organizations was a major factor in this development.

Capital movements

The surplus on capital movements and flows via the banks showed very little change overall, working out at around 10,000 billion, but by contrast with the previous year it was predominantly attributable to its medium and long-term components. The surplus of 11,737 billion lire on capital movements represented an increase of some 9,000 billion over the year. The inflow of foreign capital, primarily in the form of loans and short-term trade credits, increased from 7,257 billion to 19,216 billion, while the outflow of Italian capital climbed from 4,508 billion to 7,479 billion, mainly reflecting trade credits and investments. Bank capital movements, on the other hand, shifted from an inflow of 6,929 billion in 1980 to an outflow of 1,525 billion (Table 14).

New foreign loans to the private sector climbed from 3,998 billion to 9,184 billion, while repayments totalled 2,297 billion as against 1,604 billion. The surplus hence increased virtually threefold,

from 2,394 billion to 6,887 billion. This very large inflow of funds reflected both the restrictiveness of domestic credit conditions and the abundant availability of funds on the international market.

Public sector loans (issued or guaranteed by the State) rose from 3,696 billion to 5,772 billion. Repayments increased from 415 billion

Table 14

CAPITAL MOVEMENTS

(billions of lire)

	Credit		Debit		Balance	
	1980	1981	1980	1981	1980	1981
FOREIGN CAPITAL	21,494	36,832	14,237	17,616	7,257	19,216
Investment:						
direct	816	1,629	313	326	503	1,303
portfolio	1,203	2,281	1,645	2,103	-442	178
other	123	159	126	152	-3	7
Loans:						
private	3,998	9,184	1,604	2,297	2,394	6,887
<i>of which: tied</i>	362	371	337	190	25	181
granted or guaranteed by the government	3,696	5,772	415	515	3,281	5,257
Trade credits:						
medium and long-term	569	860	540	1,043	29	-183
short-term	10,865	16,552	9,323	10,865	1,542	5,687
Other capital	224	395	271	315	-47	80
ITALIAN CAPITAL	17,792	22,023	22,300	29,502	-4,508	-7,479
Investment:						
direct	250	918	896	2,514	-646	-1,596
portfolio	560	668	911	1,306	-351	-638
<i>of which: unit trusts</i>	102	244	529	825	-427	-581
other	7	9	6	33	1	-24
Loans:						
private	720	587	1,064	1,034	-344	-447
<i>of which: tied</i>	659	298	861	933	-202	-635
granted or guaranteed by the government	28	47	228	212	-200	-165
Trade credits:						
medium and long-term	2,528	4,748	3,049	5,500	-521	-752
short-term	13,699	15,046	15,546	18,903	-1,847	-3,857
Other capital	-	-	600	-	-600	-
BALANCE					2,749	11,737
Bank capital					6,929	-1,525
<i>(net of exchange rate adjustments)</i>						

to 515 billion, so there was a positive balance of 5,257 billion, compared with one of 3,281 billion in 1980.

The total net flow of long-term financing for imports, in the form of loans and trade credits, showed very little change. The negative balance of trade credits was due almost entirely to advance payments for deliveries of nuclear fuel.

Net export financing resulted in an outflow of 635 billion for buyer credits and one of 752 billion for supplier credits (compared with 202 and 521 billion respectively in 1980). By contrast, earlier operations that had been the object of direct financing by the UIC gave rise to a net inflow of 200 billion, there having been no new interventions. Overall, medium and long-term export financing resulted in a negative balance of 1,187 billion as against one of 755 billion in 1980.

The inflow in respect of short-term trade credits received from abroad increased from 1,542 billion to 5,687 billion, while the outflow relating to those granted by Italian companies rose from 1,847 billion to 3,857 billion. There was consequently a net inflow of 1,830 billion, compared with near-equilibrium the year before. The sharp increase in trade credits received would seem to have been due less to the usual factors than to the requirement, introduced in May, that a non-interest-bearing deposit be lodged in advance of foreign payments, which prompted Italian firms to defer their payments. In fact, the growth in imports was relatively modest, interest rate differentials, albeit still high, were on average lower than in 1980 and in some periods a lira devaluation was widely expected. In addition, quarterly data indicate that inflows were bunched in the third quarter (over 3,000 billion), towards the end of which the measure's full effects began to be felt and deposits hence reached their maximum level.

Net of disinvestment, direct foreign investment in Italy and Italian direct investment abroad rose from 503 to 1,303 billion and from 646 to 1,596 billion respectively. Some of the sizable increase in inflows and outflows was attributable to cross shareholding operations. The outflow of Italian capital was influenced by a number of large contributions to Swiss and Luxembourg financial companies, which enjoyed exemption from the deposit requirement in respect of capital outflows, as well as by the increase in the volume of funds allocated for geological prospecting.

Foreign portfolio investments swung from a negative balance of 442 billion to a positive balance of 178 billion, purchases and sales amounting to 2,281 billion and 2,103 billion respectively, a rise of more than 50 per cent over the year. Almost one half of the increase was accounted for by short-term Italian Treasury bills, mainly because of the high returns they offered.

Italian portfolio investments occasioned a net outflow of 638 billion in 1981, following one of 351 billion in 1980. Net purchases of investment trust shares accounted for 581 billion of the total.

In the course of 1981 there were net outflows of bank capital amounting to 1,525 billion lire. In its countervalue in lire, the banks' net external indebtedness nonetheless increased, by 1,319 billion lire, as a result of the lira's depreciation against the other main currencies (Table 15).

Table 15

**FOREIGN CURRENCY FINANCING TO RESIDENTS,
BANKS' NET EXTERNAL POSITION AND INTEREST RATES**

(billions of lire)

Month	Foreign currency financing to resident customers				Banks' net external position	Italian prime rate	Three- month Eurodollar rate (1)
	for exports	for imports	other	total			
1980 - December	5,745	8,308	853	14,906	-14,750	21.3	19.5
1981 - January	5,567	9,632	1,025	16,224	-15,399	20.2	18.4
February	5,871	9,627	985	16,483	-16,016	20.3	17.4
March	5,884	8,452	1,066	15,402	-14,731	20.3	15.6
April	6,384	8,701	1,089	16,174	-15,241	21.4	15.9
May	6,746	8,824	1,249	16,819	-16,080	21.6	19.2
June	6,783	8,730	1,198	16,711	-15,848	21.6	17.9
July	7,007	8,374	1,311	16,692	-15,979	21.7	18.5
August	6,589	8,313	1,343	16,245	-15,222	21.9	18.8
September	6,399	7,381	1,601	15,381	-14,301	22.0	17.9
October	6,743	7,805	1,500	16,048	-15,014	22.1	16.2
November	6,568	8,093	1,662	16,323	-15,282	22.1	13.5
December	6,590	8,546	1,691	16,827	-16,069	22.2	13.3

(1) This is the deposit rate, to which the current spread should be added to arrive at the rate on loans.

The development of the banks' net external liabilities mainly reflects the behaviour of foreign currency financing for resident customers, any analysis of which needs to take account of the effects of exchange rate fluctuations. Firms' foreign currency debt, expressed at 31 December 1980 exchange rates, declined in the course of 1981, owing both to autonomous factors and to administrative measures (Table 16). Repayments were bunched in March and in

June-September, while in the final quarter residents again had recourse to foreign currency financing, albeit on only a limited scale.

The operation of the provision which, with effect from 31 March, limited the expansion of the banks' foreign currency lending for import financing purposes to the amounts outstanding at the end of 1980 was a major factor in the liquidation of debtor positions that occurred, towards the end of the first quarter of the year, exclusively for this category of borrowing. Subsequently, the volume of restricted financing declined steadily, and by the autumn months there was an unused margin of around 2,000 billion. The expectations of a lira devaluation presumably held down recourse to foreign currency borrowing during virtually the whole of the year.

Table 16

RESTRICTED AND UNRESTRICTED FOREIGN CURRENCY FINANCING

(countervalue in billions of lire at exchange rates prevailing on 31.12.80)

Period	Restricted	Unrestricted (1)	Total
1980 - December	8,614	6,157	14,771
1981 - January	9,411	5,803	15,214
February	9,238	6,072	15,310
March	7,992	6,008	14,000
April	7,913	6,346	14,259
May	7,786	6,630	14,416
June	7,500	6,512	14,012
July	7,156	6,781	13,937
August	7,147	6,705	13,852
September	6,426	6,642	13,068
October	6,572	6,686	13,258
November	6,787	6,798	13,585
December	7,172	6,411	13,583

(1) Data estimated on the basis of a sample equal to more than 95% of the total.

A final factor that contributed to the reduction in the foreign currency financing of imports was the non-interest-bearing deposit on foreign payments; although this did not affect the renewal of outstanding financing, it made economic agents prefer indebtedness vis-à-vis their trading partners, which did not require a deposit to be lodged. In the latter part of the year, after the deposit requirement had been renewed until 28 February 1982, the need to finance some of the previously deferred payments caused a certain upturn in bank foreign currency lending.

In December, when the ceilings on lira credits were renewed, the provision on the restriction of foreign currency financing for imports was modified, with an increase of 12 per cent in the total outstanding at 31 December 1980 being authorized in their case, too.

At the end of the year, total foreign currency financing, at current exchange rates, amounted to more than 16,800 billion lire, of which about 6,600 billion lire was accounted for by export financing. This type of short-term foreign currency financing would seem to have reached virtual saturation at the end of 1980, and its growth in the course of 1981 therefore primarily reflected the development of exports. Recourse to this category of borrowing in fact remains limited to the foreign currency portion of short-term trade credits; given the stability of the maturity and currency structure of settlements, the level of the foreign currency borrowing under examination would seem unlikely to exceed a ceiling equal to around 90 per cent of average monthly export flows, barring the possibility of advance financing for future exports.

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

During 1981 the net official reserves of the Banca d'Italia and the Italian Foreign Exchange Office increased from 55,416 billion to 58,770 billion lire (Table 17). Virtually the whole of the rise of around 3,400 billion was attributable to the revaluation of gold and to the accounting effects of the reduction in the external value of the lira, particularly vis-à-vis the dollar. Expressed in dollar terms, net official reserves fell from 59 to 49 billion.

As in previous years, convertible currencies were the most volatile component of the official reserves; from June onwards their performance partly reflected the operation of the non-interest-bearing deposit on foreign payments. The level of rapidly realisable reserves fell sharply in the first five months of the year to stand at 6,320 billion lire at the end of May, but it subsequently rose, amounting to around 11,000 billion at the end of August. It then dropped during the autumn months before returning to around 11,700 billion at the end of the year (against 10,152 billion at the end of 1980).

The number of months' imports covered by official reserves showed little change between the beginning and end of the year. Excluding the gold component, official reserves continue to be

Table 17

**EXTERNAL POSITION OF THE BANCA D'ITALIA,
THE ITALIAN FOREIGN EXCHANGE OFFICE (UIC) AND THE BANKS**
(end-of-period amounts in billions of lire)

	December			March 1982 (1)
	1979	1980	1981	
Banca d'Italia-UIC				
Gold (2)	16,141	34,170	34,792	32,093
Special drawing rights (3)	476	618	940	990
ECUs (4)	5,974	9,982	10,684	10,222
Foreign currencies	7,931	10,152	11,656	7,380
<i>of which: US dollars</i>	6,230	7,102	8,720	4,542
IMF reserve position	250	766	881	928
Total gross official reserves ...	30,772	55,688	58,953	51,613
Short-term liabilities	-132	-272	-183	-150
Total net official reserves ...	30,640	55,416	58,770	51,463
Medium and long-term position				
Assets				
Foreign securities in foreign currencies and in lire	1,225	1,260	1,310	1,403
Italian securities in foreign currencies	79	83	98	107
Consolidated accounts	21	18	15	12
Liabilities				
Special drawing rights account ...	-473	-683	-981	-1,034
EEC account	-952	-1,059	-1,201	-1,004
Total ...	-100	-381	-759	-516
BALANCE: BANCA D'ITALIA-UIC	30,540	55,035	58,011	50,947
Banks				
Assets	24,237	29,197	44,809	....
Liabilities	31,101	43,947	60,878	....
BALANCE: BANKS	-6,864	-14,750	-16,069	-15,801

(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.

sufficient to pay for more than two and a half months' imports (Table 18). However, given the rising level and the enhanced volatility of short-term capital movements, a more important factor to consider in any evaluation of the adequacy of official reserves is the level and stability of bank and commercial indebtedness. In the course of 1981 the sharp rise in trade credits reduced the ratio of official reserves net of gold to the maximum potential outflow of short-term capital, although it nonetheless remained close to unity.

Table 18

**OFFICIAL RESERVES, SHORT-TERM DEBT
AND MONTHLY IMPORT FLOWS**

(billions of lire)

	1979	1980	1981
Official reserves net of gold	14,499	21,246	23,978
<i>of which: ECUs against gold</i>	<i>4,062</i>	<i>8,614</i>	<i>8,747</i>
Imports (1)	7,100	8,000	9,500
Banks' net external indebtedness	6,864	14,750	16,069
Short-term commercial debt (2)	9,400	10,900	16,600

(1) Averages of monthly data for last quarter of the year. — (2) Partly estimated data.

As a result of the rise in net official reserves and the deterioration in the medium and long-term position, the nominal increase in the overall external position of the Banca d'Italia and the Italian Foreign Exchange Office totalled 2,976 billion lire. Net of exchange rate adjustments (2,196 billion) and the revaluation of gold holdings and of the gold transferred to the EMCF (772 billion), the increase amounts to only 8 billion lire.

The external debt and Italy's financial position

In the course of the 1970s external indebtedness was a fundamental factor in the financing of balance-of-payments deficits. Medium and long-term indebtedness, of both the private and the public sector, rose from a level of just over 4 billion dollars at the

beginning of the last decade to around 33 billion at the end of 1981. The balance-of-payments deficits were also partly financed by the liabilities of the monetary authorities, above all between 1974 and 1976, and by the net short-term indebtedness of the banking system, in particular from the second half of the 1970s onwards. The first, which had risen as high as around 7 billion dollars by the end of 1976, currently amounts to around 2 billion, while the second has risen from 4 billion to over 13 billion.

Total indebtedness at the end of the year thus amounted to some 48 billion dollars, equal to around 15 per cent of gross domestic product and 100 per cent of official assets. Loans and other financing operations for trade flows are also a component of total external assets; the total volume of net credits granted was 14 billion at the end of 1981. Disregarding the gold component of reserves, total assets outstanding amounted to 35 billion. The net external position hence showed a negative balance of 13 billion, compared with near-equilibrium the previous year (Table 19). In the past few

Table 19

ITALY'S EXTERNAL FINANCIAL POSITION

(billions of dollars)

	1976	1977	1978	1979	1980	1981
LIABILITIES						
Banca d'Italia and UIC	-7.5	-6.9	-3.3	-2.0	-2.2	-2.0
<i>of which: SDR account</i>	-0.4	-0.4	-0.4	-0.6	-0.7	-0.8
Banks: net debtor position	-4.0	-8.1	-7.1	-8.6	-15.9	-13.4
Other agents: foreign loans	-13.8	-14.1	-16.6	-17.6	-23.6	-33.2
<i>of which: granted or guaranteed by the</i>						
<i>government</i>	-3.3	-3.6	-5.5	-7.7	-11.2	-15.3
Total . . .	-25.3	-29.1	-27.0	-28.2	-41.7	-48.6
ASSETS						
Banca d'Italia and UIC (1)	4.1	9.3	12.6	19.9	24.6	21.3
Other agents: foreign loans	2.7	2.6	3.0	3.4	3.6	3.6
net trade credits	8.7	9.9	12.1	16.1	14.8	10.3
Total . . .	15.5	21.8	27.7	39.4	43.0	35.2
Balance	-9.8	-7.3	+0.7	+11.2	+1.3	-13.4

(1) Net of the gold reserves which equalled 29 billion dollars on 31.12.1981. From 1979 onwards the figures include ECUs created against transfers of gold.

years Italy has increased its external indebtedness faster than all other countries apart from the socialist and developing countries. However, within the Community, Ireland, Denmark and Greece have a higher debt to GDP ratio than Italy.

The lira exchange rate

The average depreciation of the lira, weighted on the basis of the geographical distribution of Italian trade, works out at 13 per cent for the year as a whole. The fall in the Italian currency was particularly sharp vis-à-vis the dollar (24.8 per cent) whereas vis-à-vis all the EMS currencies it came to 5.7 per cent. In 1980 the effective exchange rate had depreciated by 3.6 per cent, while the fall vis-à-vis the dollar and the Community currencies had worked out at 2.9 and 4.3 per cent respectively.

The upsurge in the dollar rate, which had begun in 1980, was the most striking feature of developments on the main foreign exchange markets throughout 1981. It also exerted a considerable influence on bilateral exchange rate relationships between the currencies of the various countries in the European Monetary System.

The constant weakness displayed by the lira within the EMS stemmed primarily from the higher levels of inflation and domestic demand prevailing in Italy, which persisted during 1981 despite the restrictive stance of monetary policy. In addition, incidental factors of a technical or speculative nature played a part at certain points during the year, triggering pressures on the lira and thus requiring the Banca d'Italia to intervene heavily to support the exchange rate.

PUBLIC FINANCE

The budget deficit returned to a fast rate of growth, rising to 50,270 billion, or almost two thirds more than in 1980 (31,260 billion; Table 20). As a ratio to GDP, the deficit rose from 9.2 to 12.6 per cent. This was the highest value for the last twenty years and was mainly attributable to the development of the current account balance. The increase in the borrowing requirement was less pronounced (from 37,570 to 53,400 billion and from 11.1 to 13.4

Table 20

PUBLIC SECTOR: CASH OPERATIONS (1)

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

	1980	1981	% increase
R e v e n u e s			
Fiscal revenues	114,782	140,146	22.1
<i>of which: direct taxation</i> (2)	38,045	50,694	33.2
<i>indirect taxation</i>	34,128	39,071	14.5
<i>social security contributions</i> (3)	42,609	50,381	18.2
Sales of goods and services	6,452	8,046	24.7
Transfers	4,012	4,634	15.5
Income from capital	3,285	3,369	2.6
Total, current account . . .	128,531	156,195	21.5
Capital account revenues (4)	553	972	75.8
Total . . .	129,084	157,167	21.8
D i s b u r s e m e n t s			
Staff wages and pensions	47,698	62,267	30.5
Purchases of goods and services	17,797	22,382	25.8
Interest payments	21,513	30,218	40.5
Transfers (3)	55,620	70,962	27.6
Total, current account . . .	142,628	185,829	30.3
Capital account expenditure	17,714	21,611	22.0
<i>of which: direct investment</i>	13,094	16,978	29.7
<i>transfers</i> (5)	2,973	3,573	20.2
Total . . .	160,342	207,440	29.4
Deficit on current account	14,097	29,634	
Total deficit (5) (6)	31,258	50,273	

(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) Change in the financial situation, i.e. in borrowings less lendings.

per cent of GDP) owing to the reduction in the balance of financial operations resulting mainly from the policy of recovering part of public bodies' bank deposits (Table 21).

This budget outturn was primarily due to the full effects of the discretionary measures taken in 1980 to raise expenditure and reduce revenue coupled with the working of automatic stabilizing mechanisms. The former can be estimated to have increased the deficit by around 5,000 billion in 1980 and by 10,000 billion last year. The latter produced much smaller but still significant effects in 1981 owing to the slower rise in receipts and the increase in outlays for unemployment and wage supplementation benefits connected with the downturn in economic activity, as well as to the longer lags with which expenditure adjusts to the slowdown in prices compared with revenue; finally, the rise in interest rates caused an increase in debt servicing charges.

The package to reduce the deficit that was introduced at the time of the foreign exchange crisis in March 1981 served only to offset the increases in expenditure approved during the year. In practice, the restrictive measures produced results that fell a long way short of those planned (less than 2,000 billion instead of 5,000 billion), partly because some were not passed by Parliament while others were watered down considerably.

The ratio of fiscal revenues (including social security contributions and the quota pertaining to the EEC) to GDP went up from 34.5 to 36.0 per cent as a result of the large increase in direct tax revenue – the steps taken at the end of 1981 to offset fiscal drag having started to take effect in the early months of this year. However, complete elimination of fiscal drag presupposes greater control over the growth in public expenditure in order to avoid a further surge in the deficit. As a ratio to GDP, indirect tax revenues remained virtually unchanged even though the restructuring of VAT rates approved in the second half of 1980 produced its full effect. This result was primarily due to the very large reimbursements of VAT and to the fact that the most important excise taxes, apart from those on the production of mineral oils, were left unchanged for the greater part of the year. The GDP ratio of social security contributions also remained virtually the same despite the full effect of the July 1980 action to curb labour costs through a reduction in health contributions. The loss in revenues this caused was offset by the substantial increase in wages and the larger contributions the self-employed were required to pay.

Table 21

FINANCING OF THE PUBLIC SECTOR BORROWING REQUIREMENT

(on a cash basis; billions of lire)

	1980	1981				
		Year	Quarters			
			I	II	III	IV
Medium and long-term securities, excluding BI portfolio	-2,219	5,883	1,023	1,618	322	2,925
Treasury bills, excluding BI portfolio	26,218	28,627	3,331	3,820	9,350	12,126
P.O. funds	2,029	2,641	569	-415	53	2,434
Lending of credit institutions (1)	686	-35	300	375	137	-847
to: local authorities	191	1,519	289	227	180	823
social security institutions	444	-1,375	139	173	1	-1,688
autonomous agencies	-100	-84	-80	-1	-	-3
hospitals	-43	-60	-29	-8	-18	-5
other central government bodies	146	-70	-23	-11	-29	-7
municipal companies	48	35	4	-5	3	33
Other borrowings (2)	136	74	-10	22	44	18
Total . . .	26,850	37,195	5,213	5,420	9,906	16,656
Borrowing from BI-UIC	9,930	13,691	6,453	2,343	2,563	2,332
Borrowing abroad	787	2,515	99	1,245	662	509
TOTAL BORROWING REQUIREMENT	37,567	53,401	11,765	9,008	13,131	19,497
of which: domestic - short term	38,431	45,185	10,359	5,939	11,800	17,087
- medium and long term	-1,651	5,701	1,307	1,824	669	1,901
FINANCING OF ENEL	3,143	1,619	741	145	147	586
of which: domestic - short term (3)	198	460	358	-175	246	31
- medium and long term (4)	684	-762	-282	-38	-120	-322
foreign	2,261	1,921	665	358	21	877
BORROWING REQUIREMENT OF THE ENLARGED PUBLIC SECTOR	40,710	55,020	12,506	9,153	13,278	20,083

(1) Lending of the banks and special credit institutions. — (2) Treasury currency in circulation, loans of insurance institutions to local authorities, and stockpiling bills not yet rediscounted. — (3) Advances of credit institutions (as given by the Central Risks Office) and securities with the Banca d'Italia. — (4) Long and medium-term securities excluding BI portfolio, net purchases by bodies in the same sector, and long-term loans from credit institutions (as given by the Central Risks Office).

Public expenditure, excluding financial items, went up from 160,340 to 207,440 billion. After remaining at the same level for two years, it again rose as a proportion of GDP (from 47 to 52 per cent). This was mainly due to the above-mentioned discretionary measures approved in 1980 and 1981 and, in particular, those to improve social security benefits, those contained in the 1979-81 labour contract for public employees and those providing assistance to the areas struck by natural disasters.

The further growth in the benefits disbursed by the social security system (from 48,280 to 62,800 billion) was the result of the switch from six-monthly to four-monthly cost-of-living indexation increases, the raising of the salary ceiling for pensions, larger Wage Supplementation payments to certain categories of beneficiaries, and other minor changes. The effects of the measures introduced in 1980 and 1981 caused social security expenditure to go up by 30 per cent and to rise further in relation to GDP, from 14 to 16 per cent.

The 1979-81 labour contract for public employees confirmed the policy designed to restore the relative position this category had enjoyed vis-à-vis the private sector at the beginning of the seventies. This tendency was not, however, set within the framework of a comprehensive plan to reintroduce some kind of link between output and earnings.

Interest payments rose by about 40 per cent from 21,510 to 30,220 billion owing to the previously mentioned development of interest rates and the surge in the public debt. While the restrictive stance of monetary policy caused most new issues of government securities to carry positive real rates, those on other debt instruments remained well below the rate of inflation, with the result that there was considerable inequality of treatment among the holders of various types of securities.

On capital account, the outlays for investment in public works again increased substantially, especially in the case of the autonomous government agencies and the local authorities. Besides reflecting the start of the reconstruction of the earthquake-stricken areas, the activity of the local authorities was also influenced by their large surplus deriving from the particularly generous system of calculating central government grants and the greater availability of finance from the Deposits and Loans Fund.

When account is taken of ENEL's cash shortfall, which actually proved to be small owing to the deferment of large amounts of payments to suppliers and the receipt of substantial

allocations from the Government, the total borrowing requirement of the enlarged public sector amounted to 55,020 billion, as against 40,710 billion in 1980.

The public sector debt rose to 274,570 billion at the end of 1981, compared with 221,460 billion a year earlier – an increase of 24 per cent in nominal terms and of 5 per cent in real terms. The increase was even larger (28 per cent at current and 9 per cent at constant prices) on the basis of the balance between debits and credits because of the fall in the bank deposits of the decentralized spending bodies.

The policy designed to lengthen the maturity of the debt through the improvements made to the indexation of Treasury credit certificates countered the tendency for short-term borrowing to expand: net sales of medium-term securities amounted to 5,890 billion (2,210 billion net of those for the funding of public bodies' bank borrowing), as against net reimbursements amounting to 2,220 billion in 1980 (approximately 3,160 billion net of the above funding operations). Nonetheless, there was a further increase in the share of short-term debt: outstanding Treasury bills at the end of the year amounted to 98,750 billion, compared with 70,120 billion a year earlier, and their share of total debt rose from 32 to 36 per cent. On the other hand, there was a pronounced slowdown in the growth of Post Office deposits as a result of the widening of the differential between their rates and those of other financial assets.

Borrowing from the central bank increased from 9,930 to 13,690 billion. However, whereas in the first half of the year out of a total of 8,800 billion the Banca d'Italia purchased Treasury bills for an amount of 5,600 billion, in the second half under the new auction procedures the Bank ran down its holdings of Treasury bills by 140 billion. During this latter period the Treasury drew 3,400 billion from its current account with the Bank so that by the end of the year it was overdrawn almost to the permitted limit. The Bank's portfolio of medium and long-term securities (net of those held in connection with repurchase agreements) expanded by 1,500 billion, as against 710 billion in 1980. By contrast with the previous year, this was the result of larger net purchases of Treasury bonds coupled with net sales of Treasury credit certificates.

The growth in Post Office resources was small and derived from an increase in Post Office current accounts of 680 billion and the crediting of interest amounting to 2,140 billion on Post Office

savings accounts. The latter were again depressed in 1981 by the raising of interest rates on bank deposits and government securities, recording an outflow net of interest payments of 170 billion, compared with an inflow of 1,500 billion in 1980.

The increase in foreign borrowing (2,520 billion as against 790 billion in 1980) was partly due to the policy of curbing the public sector's recourse to the domestic market. ENEL continued to raise a large proportion of its funds abroad (1,920 billion compared with 2,260 billion in 1980).

The centralization of the public debt proceeded both through the reduction in the scope for decentralized spending bodies to borrow and through further operations to fund the debts of the health institutions and the public sector corporations.

THE MONEY AND FINANCIAL MARKETS

The degree of monetary stringency had to be increased in 1981 in view of the persistence of a large balance-of-payments deficit on current account and a high rate of inflation. The central bank's task was made more difficult by the sharp rise in the exchange rate of the dollar, which had repercussions on the balance of payments and on inflation, and by the lack of support from other economic policy instruments. The expansion in the Treasury borrowing requirement by more than had been foreseen gave rise to severe strains within the money and financial markets.

At the beginning of the year new regulations on the limits to the growth in bank lending were issued which provided for the abolition of almost all the exemptions that had been granted hitherto. When the lira was realigned against the currencies participating in the European Monetary System in March, the discount rate was raised to the unprecedented level of 19 per cent and the reserve requirement on increases in bank deposits was raised from 15.75 to 20 per cent; the interest rate on Treasury bills rose by two points and at mid year was more than 3 points higher than in the preceding December.

In spite of these stern monetary measures, official reserves of convertible currencies fell from 10.9 billion dollars at the end of 1980 to 5.5 billion at the end of May; the deterioration in the balance of payments was such that problems could arise in financing the current account deficit. Tighter control was imposed on liquidity, especially that of the corporate sector, by introducing the non-interest-bearing deposit on payments abroad, which was designed to defend the official reserves and the exchange rate so that an appropriate budget policy could be set in motion.

In the second half of the year the balance of payments on current account improved owing to the fall in domestic demand, the revival in exports and the effects of the compulsory deposit on payments abroad, which was prolonged at gradually falling rates until February of this year.

At the beginning of October the realignment of central rates within the EMS led to a further devaluation of the lira. The need to contain the depreciation of the currency and a renewed surge in the Treasury borrowing requirement induced the authorities to raise the yields on 3 and 6-month Treasury bills still further.

The limited availability and high cost of domestic credit led to an increase in foreign borrowing; the vast inflow of foreign loans (equivalent to about 12,000 billion lire) and the increase in trade credit for imports as a result of the non-interest-bearing deposit financed the balance-of-payments deficit on current account and offset the reduction in the banks' foreign indebtedness. Time was therefore gained in order to carry out a gradual adjustment of the underlying economic disequilibria, which make full employment of the country's resources incompatible with the external constraint. However, payments for servicing foreign debt doubled, thus exacerbating the current account deficit.

Whereas in the first half of the year monetary base worth 6,246 billion lire was created via domestic channels, and an amount of 3,638 billion lire was destroyed via the external sector, in the second half the composition of monetary base creation changed substantially – the creation of liquidity via domestic channels, which fell to 2,422 billion lire, was augmented by an amount of 3,663 billion deriving from the increase in official reserves.

In 1981 the central bank placed increasing reliance on changes in interest rates to achieve its monetary policy objectives. The dissolution of the agreement whereby the Banca d'Italia undertook to acquire any Treasury bills not taken up at the auctions loosened the link between the creation of monetary base and the size of the Treasury borrowing requirement. As a result, money market rates have reacted more rapidly to events in the foreign exchange market and changes in the Treasury borrowing requirement.

The increase in money market rates spread rapidly to other interest rates; in particular, the yield on long-term securities rose by about 5 percentage points during the year. The widespread use of financial indexation overcame many of the obstacles to the transmission of higher rates to the long-term end of the market. The demand for securities therefore strengthened and the securities investment requirement on banks could be maintained at a low level.

These institutional innovations made monetary policy better able to respond through the use of market instruments. Nevertheless, administrative intervention mechanisms were also strengthened last year, but not to take the place of control of the monetary base; they were designed to achieve the specific aims of controlling inventories and short-term capital movements that indirect blanket measures would have achieved only over a longer period and at the cost of greater movements in interest rates.

In the course of the year real interest rates on Treasury securities returned to positive values and those on bank lending rose, partly owing to the sharp increase in nominal rates and partly as a result of the slowdown in inflation; this development had important effects on the behaviour of households and enterprises. The propensity to invest in financial assets rose towards the levels of the seventies after the sharp fall in 1980 caused partly by negative real interest rates. In addition, the increased cost and reduced availability of credit contributed to the decline in stocks, which was reflected in a decrease in imports and in the tendency for firms to keep production levels under closer control to prevent a build-up of stocks of unsold goods. Corporate credit demand nevertheless remained firm, mainly on account of the squeeze on firms' cash flow.

The large increase in the public sector borrowing requirement and the restrictive monetary policy reduced the amount of funds available for the economy, in particular loans included in the definition of total domestic credit, which are more directly subject to the control of the central bank. The growth in domestic credit to sectors other than the State (28,120 billion lire net of borrowing to finance the non-interest-bearing deposit on payments abroad) was kept below the increase foreseen in the financial programme drawn up at the beginning of the year.

Bank lending was more severely restricted owing to the low growth rates permitted by the ceiling, a fact that was reflected in high interest rates. Whereas in 1980 the ceiling had caused an abnormal expansion in exempt lending, in 1981 its extension to almost all loans led first to an increase in the use of bankers' acceptances and then, when these became subject to regulation, to an expansion in lending by the special credit institutions.

In the financial market the widespread use of floating rates and the adjustment of securities' yields to market conditions ensured that finance continued to be available from longer term sources, which had previously tended to dry up in times of rising interest rates, and thus permitted the financing of a volume of investment that was still relatively large in spite of the decline in production.

The public sector's domestic borrowing requirement amounted to 45,000 billion lire, 33 per cent more than in 1980. The expansion was partly due to the recession and the increase in interest charges, which was magnified by the size and short-term nature of public debt. The growth in the net indebtedness of the public sector was even larger than that in the borrowing requirement, as bank deposits

held by public sector agencies fell by more than 4,000 billion lire during the year.

The amount by which the public sector's domestic borrowing requirement exceeded the forecast was so large (about 9,000 billion lire) that it could not be offset by reducing domestic credit to the economy, with the result that total domestic credit was higher than predicted. The increase in the public sector deficit also further exacerbated the imbalance between the financial resources available for productive activity and those absorbed by public expenditure; the former fell to 38 per cent of the total flow of domestic credit, compared with 46 per cent in 1980.

The growth in total domestic credit and the improvement in the balance of payments on a settlements basis were reflected in the formation of a greater volume of financial assets, which was absorbed by the economy owing to the above-mentioned increase in the propensity to save as a result of the increase in real interest rates.

The proportion of the economy's assets held in the form of Treasury bills has substantially increased, thus consolidating the change in the composition of financial wealth that had begun in the preceding two years. There was also an appreciable revival in purchases of medium-term securities, especially variable rate Treasury credit certificates but also Treasury bonds. The special credit institutions' sales of medium-term securities and certificates of deposit to the public benefitted from the removal of tax discrimination against them and the wider use of financial indexation. Investment in shares also increased.

Bank deposits comprised only 36 per cent of the financial assets created in 1981, compared with 49 per cent in 1980; the rate of growth in the money supply on the M₂ definition fell to 11.8 per cent, the lowest figure for several years.

The decline in the monetary component of the financial assets held by the public was caused partly by the combination of a restrictive monetary policy and a large expansion in the public sector deficit and partly by the increasing acceptance of Treasury bills and indexed securities, which made it possible to mop up the excess bank deposits created in previous years. These developments do not bring the role of the banking system in the credit market into question; in this instance the "crowding-out" of the banks reflects that of the productive sector by the public sector.

However, in 1981 the banking system's share of lending to the economy also shrank appreciably for the first time. This form of disintermediation raises a number of problems, particularly as it entails a shift towards intermediaries subject to less rigorous control. The rapid expansion in special credit was only partly caused by the restrictions imposed on bank lending. It was also due to the high level of investment activity in 1980 and the first half of 1981 and to the institutions' increasing ability to raise funds in the market by issuing certificates of deposit and indexed securities, thus freeing themselves from the need to obtain loans from the banks. The better adjustment of the special credit institutions' activities to rapid inflation therefore marked the opening of a new phase in their relations with the banking system; whereas in the seventies the virtual disappearance of the bond market forced them to borrow from the banks and the securities investment requirement institutionalized this dependence, today the special credit institutions are tending to compete ever more directly with the banks, thus drawing benefit from the controls to which the latter are subject.

The prospects for 1982

In the first few months of 1982, during which time the Treasury borrowing requirement was moderate, there was a fall in interest rates on Treasury bills followed by a smaller one in the cost of bank credit which coincided with confirmation of a slowdown in inflation. The decline in the interest rates on 3 and 6-month Treasury bills was encouraged, thus cancelling out the rise witnessed in the second half of 1981. By contrast, the rate on one-year Treasury bills was left unchanged at its level of the previous December so as to promote a shift in the composition of savings towards the longer end of the market by restoring a rising yield curve.

The strains on the international markets, which brought the Eurodollar interest rate close to that on 3-month Treasury bills, the caution required in view of the exchange rate effects of abolishing the foreign payments deposit – which were connected both with the repayment of trade credits and with the rebuilding of stocks following the rundown witnessed in 1981 – and the readjustment of the central rates of certain EMS currencies meant that the easing of short-term rates observed in the first quarter had to be corrected in the second half of March.

An artificial lowering of interest rates would not be credible and hence, by creating expectations of subsequent rises, would drive the public away from the securities market; this would result in wider fluctuations in interest rates which, by aggravating market uncertainty, would give rise to higher average interest rates for a given volume of securities sold.

The containment of public sector credit demand and an easing of the external constraints are essential preconditions for a reduction in interest rates; a new alienation of savers from financial assets, which would have adverse effects on inflation, the balance of payments and the allocation of resources, can be avoided only by maintaining positive interest rates in real terms.

Last September the total increase in domestic credit to sectors other than the State was set at 30,000 billion lire for 1982: this figure should be compatible with the financing of a modest recovery in production, while being sufficiently small to prevent speculative stockbuilding and outflows of capital.

To this amount should be added about 2,500 billion lire in bank loans used in 1981 to finance the deposit on payments abroad, which became available in the early part of the year for financing productive activity; hence the overall flow of credit to the productive sector should be 4,500 billion lire more than last year, an increase of 14 per cent as against one of 13.5 per cent in 1981. Moreover, repayment of the deposits in the first few months of this year enabled firms to use the portion they had put up from their own funds, about 1,300 billion lire.

The figure for the growth in total domestic credit in the forecast of financial flows was based on the assumption that the public sector borrowing requirement would be held below 48,000 billion lire (43,000 billion net of foreign loans, funds transferred to credit institutions and funding operations) and that the total requirement of the enlarged public sector would not exceed 50,000 billion lire.

In December the central bank renewed the ceiling on bank lending for 1982; it set the limit for the growth in loans in lire at about 12 per cent and raised the limit on foreign currency loans for financing imports. The growth in lending foreseen by the ceiling is consistent with the above-mentioned expansion in domestic credit to the productive sector and accounts for about one half of the total.

In the twelve months to March 1982 domestic loans to sectors other than the State rose by about 29,000 billion lire, an increase of

almost 14 per cent; the public sector borrowing requirement in the year to April came to more than 58,000 billion lire, following a trend that is substantially higher than the target originally set for this aggregate, which it would therefore seem difficult to achieve.

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

Monetary base policy, which had been restrictive since the end of 1979 and throughout 1980, was tightened further in 1981. At the beginning of the year, against a background of accelerating inflation and a high balance-of-payments deficit, the central bank set a moderate target for growth in bank reserves. To this end, it relied

Table 22

MONETARY AGGREGATES AND INTEREST RATES

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
PERCENTAGE INCREASES (1)										
Monetary base (2)	13.6	18.6	15.4	18.6	16.4	18.9	25.1	13.8	13.6	13.3
Monetary base, adjusted (2) (3)	13.4	18.0	15.7	20.5	12.0	17.9	23.4	15.0	12.5	11.7
Bank reserves	13.9	18.2	17.9	20.3	20.2	23.5	28.7	13.7	12.1	10.4
Bank reserves, adjusted (3)	13.2	17.1	18.2	23.4	12.6	21.8	25.8 (*)	15.6 (*)	10.5	7.9
Bank deposits	22.1	20.1	16.8	25.0	22.0	23.2	23.1	20.0	13.2	9.2
INTEREST RATES (4)										
Interbank sight deposits (5)	5.18	6.93	14.57	10.64	15.68	14.04	11.49	11.86	17.17	19.60
Treasury bills (6) . . . . .	....	....	14.12	11.01	16.63	15.20	12.21	12.51	15.90	19.71
Bank loans	7.88	8.31	14.22	15.08	17.33	18.58	16.00	15.43	19.41	21.83
Industrial bonds	7.40	7.48	10.20	10.82	13.39	14.56	13.34	13.58	15.39	19.68

(*) When corrected for the random movements at the end of 1979, the increases become respectively 12% and 15% 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.

on a special instrument (the non-interest-bearing deposit on foreign payments) as well as on traditional open market operations and the raising of the discount rate. The compulsory reserve ratio was also increased. In the second half of the year price pressures abated and

external constraints became less pressing, whereas the Treasury deficit expanded; the abolition in July of the requirement that the Banca d'Italia take up all unplaced Treasury bills made it possible, from that point onwards, to control the monetary base more accurately, thereby avoiding an unwanted acceleration in the monetary aggregates similar to that seen at the end of 1980.

In the course of 1981 the monetary base (excluding Post Office deposits) expanded by 8,693 billion lire or 13.3 per cent, while the increase in bank reserves equalled 4,127 billion and 10.4 per cent. This further reduction in the rates of increase from the already low rates recorded in 1980 was accompanied by a slowdown in the growth of bank deposits (Tables 22 and 23), which was partly influenced by the drop in the deposits held by the public sector agencies, in compliance with legal requirements.

The slowdown in the monetary base and reserves emerges more clearly if the series are corrected for the distortions in banks' liquidity that were caused by the December 1979 strikes. The rates of increase in the monetary base and reserves in 1980 would then come to around 16 per cent.

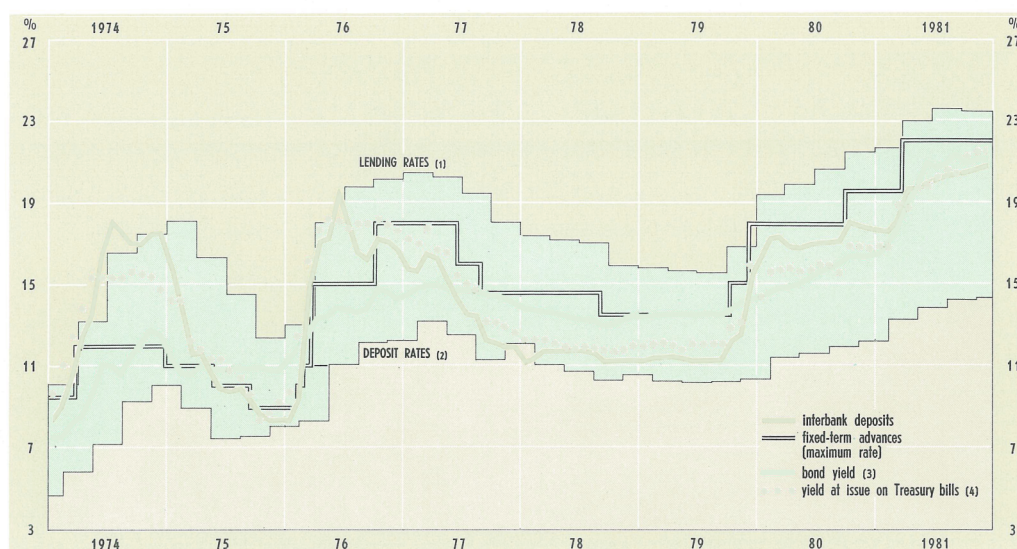
The slower growth in the monetary aggregates implied a strong, steady rise in interest rates. Allowing for effective inflation, the second half of the year saw the first return to positive real Treasury bill yields since 1978.

The rise initially affected the entire yield curve, which remained virtually horizontal. This facilitated the placement of medium-term paper, for which there had been net disinvestment in 1980. In the last few months of the year the further rise in rates, which was viewed as temporary, was limited to yields on three and six-month Treasury bills so as to minimize the interest charges incurred by the Treasury. The result was a substantial shortening of the average maturity of the paper issued. At the end of the year the covered interest differential vis-à-vis the Eurodollar virtually disappeared, after having widened substantially in the second and third quarters.

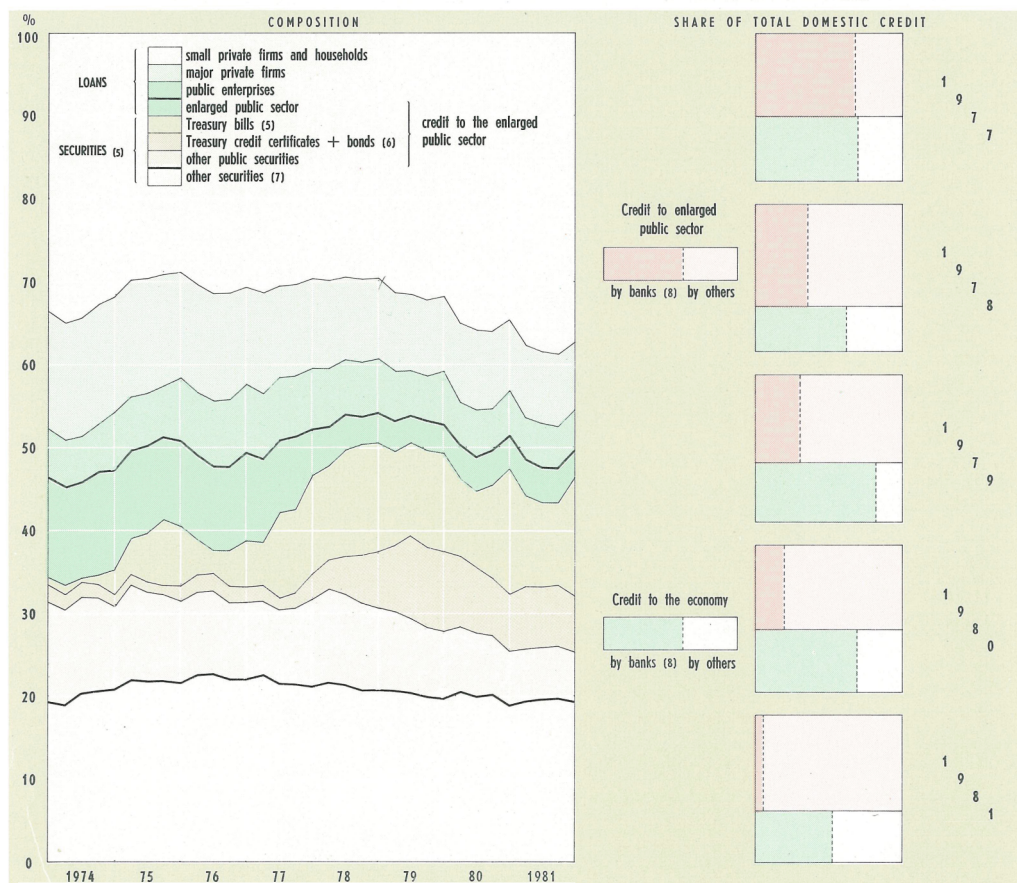
The rise in official rates and in those at which the Banca d'Italia intervenes on the open market had immediate repercussions for the entire structure of bank interest rates (Table 22; Chart 7). It caused an increase in both the cost of holding compulsory reserves and the penalty for failing to respect the ceiling, which accentuated the differential between lending and borrowing rates and was a factor in curbing the growth of bank intermediation.

Chart 7

INTEREST RATES



CREDIT INTERMEDIATION BY THE BANKING SYSTEM



(1) Quarterly average of the rates on loans of at least 50 million as recorded by the Central Risks Office. — (2) Average end-of-quarter rate on deposit and current accounts of at least 20 million as recorded by the Central Risks Office. — (3) Average yield of the bonds of the special credit institutions on the secondary market. — (4) Weighted average of the yields of three, six and twelve-month Treasury bills. — (5) Including temporary holdings of banks' securities grouped with Treasury bills. — (6) Variable coupon Treasury credit certificates and Treasury bonds. — (7) Bonds of the special credit institutions and enterprises (excluding ENEL) and foreign securities denominated in lire. — (8) Bank credit (loans and securities) to final users of resources (the economy and the enlarged public sector). Shares are calculated on the basis of annual flows of credit.

MONETARY BASE
(changes in billions of lire)

Table 23

	1979	1980	1981				
			Year	Quarters			
				I	II	III	IV
SOURCES							
Foreign sector (1)	2,868.1	704.9	24.8	-4,628.4	1,064.9	2,384.8	1,203.5
balance of payments (2)	3,888.1	-5,908.8	1,901.9	-3,297.3	1,078.0	4,119.8	1.4
compensatory loans	-2,064.0	-349.0	-369.0	-110.0	-49.0	-161.0	-49.0
net foreign position of banks	1,054.2	6,928.6	-1,547.9	-1,249.2	29.6	-1,573.5	1,245.2
Treasury	465.1	9,942.0	13,773.6	6,803.2	2,921.9	1,718.5	2,330.0
Treasury, including Post Office deposits	7,207.4	11,884.3	16,496.4	7,467.1	2,520.6	1,762.8	4,745.9
total borrowing requirement	30,222.4	36,912.9	53,190.0	11,847.5	9,205.6	12,110.9	20,026.0
financing from banks and the public (3)	-29,757.3	-26,970.9	-39,416.4	-5,044.3	-6,283.7	-10,392.4	-17,696.0
Refinancing	2,925.8	-2,810.2	554.7	225.7	362.8	-67.4	33.6
Other sectors	725.1	-24.9	-5,659.8	-1,504.2	-2,637.9	-3,647.2	2,129.5
of which: tied foreign currency deposits (4)	2,180.8	32.2	-	-19.8	-55.1	62.9	12.0
non-interest-bearing deposit on payments abroad	-	-	-3,822.2	-	-2,057.4	-3,093.0	1,328.2
TOTAL	6,984.1	7,811.8	8,693.3	896.3	1,711.7	388.7	5,696.6
Total, including Post Office deposits	13,726.4	9,754.1	11,416.1	1,560.2	1,310.4	433.0	8,112.5
USES							
The Public	2,694.5	3,525.5	4,566.0	-911.8	1,806.4	-72.0	3,743.4
the public, including Post Office deposits	9,436.8	5,467.8	7,288.8	-247.9	1,405.1	-27.7	6,159.3
Banks	4,289.6	4,286.3	4,127.3	1,808.1	-94.7	460.7	1,953.2
compulsory reserves	5,508.1	3,046.4	2,946.4	3,211.6	-821.7	-255.7	812.2
non-interest-bearing deposits against excess lending	-	623.3	821.4	258.1	564.0	-341.9	341.2
excess reserves	-1,218.5	613.6	359.5	-1,661.6	163.0	1,058.3	799.8
COMPONENTS OF TOTAL MONETARY BASE (5)							
Domestic component (6)	1,935.2	7,074.7	8,668.5	5,544.5	701.9	-2,059.0	4,481.1
Foreign component (7)	5,048.9	737.1	24.8	-4,648.2	1,009.8	2,447.7	1,215.5
FACTORS OF CHANGE IN BANK RESERVES							
Autonomous (8)	25,761.2	33,251.6	46,338.8	7,689.4	8,244.5	15,367.1	15,037.8
Intervention (9)	-21,471.6	-28,965.3	-42,211.5	-5,881.3	-8,339.2	-14,906.4	-13,084.6
TOTAL BANK RESERVES . . .	4,289.6	4,286.3	4,127.3	1,808.1	-94.7	460.7	1,953.2

(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 the consolidated balance sheet of BI-UIIC and to the inclusion of the convertible currencies of banks. — (2) Autonomous balance. — (3) P.O. deposits, foreign debt and 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.

The innovations in the arrangements for the central bank's participation in the government securities market made it possible to maintain continuous and close control over the monetary aggregates, even in the very short term. From April 1981 onwards repurchase agreements were no longer placed by accepting market bids at a rate announced by the central bank in advance. Instead, with priority being given to the quantitative rather than the rate target, the competitive bid method was adopted, under which the amount to be placed is announced and every bid is satisfied on the yield terms proposed by the purchaser. The Banca d'Italia in all cases reserves the right to refuse bids made at yields that are considered excessive given the market situation. From May onwards provision was made for the possibility, of which the authorities availed themselves on a few occasions, of extending the method to outright sales as well.

Of great importance, both because of its direct consequences for the technical arrangements governing intervention on the markets and because of its longer-term impact on the relationship between the monetary authorities, was the redefinition of the rules for the Banca d'Italia's participation in Treasury bill auctions. From the July auction onwards the Bank, in agreement with the Treasury, ceased to guarantee the placement of the entire volume of Treasury bills offered. Since that time, therefore, the central bank has been in a position to fix the volume of its own purchases of Treasury bills at issue in such a way as to reflect more closely than in the past the requirements associated with control of monetary base creation.

The new rules have weakened the link between the development of the public sector borrowing requirement and monetary base creation and have enhanced the correlation between the magnitude of the PSBR and the level of rates, which needs to be such as to enable the necessary finance to be found on the market. The Treasury's task has been facilitated by the introduction of Treasury bill auctions in the course of the month which have made it possible to disperse the distribution of, and hence to alleviate, the sudden changes in liquidity provoked by the post-auction settlements, to adjust yields more frequently and to offset promptly any unfilled subscriptions at the month-end auctions.

From July onwards the Banca d'Italia's intervention techniques on the secondary market were further modified, in line with the new institutional set-up, in order to foster participation in the auctions. Outright sales of Treasury bills, which in the past largely represented

a kind of deferred placement, were limited and were made at yield terms that were less favourable than in the past as compared with those on the primary market. The goal of repurchase agreements became that of absorbing any liquidity surpluses until the subsequent auction, in order to reduce the unevenness caused by the post-auction settlement; there were 44 such operations in the second half of the year compared with 15 in the first, and the gross totals were 21,121 and 6,528 billion lire respectively. In some cases, moreover, the Banca d'Italia partially refinanced Treasury bill subscriptions at issue, informing the market beforehand of its readiness to do so. As a result of these changes, the volume of purchases of paper at issue made by the market exceeded that of repayments; in the last quarter net placements on the primary market accounted for a sizable share of total placements.

The reform of the techniques for Treasury bill auctions, which is scheduled for the near future, will complete the series of changes. Under the present procedure for non-competitive auctions the yield paid to the marginal purchaser is also paid to purchasers who have expressed their readiness to accept lower rates. The introduction of the competitive method, under which every purchaser will receive the yield he himself proposes, will make it possible to keep the average below the marginal rate; the interest charges incurred by the Treasury should hence be lower, particularly at times of substantial shifts in demand or supply.

The new rules for the Banca d'Italia's participation in Treasury bill auctions had less of an influence on the final level of yields, which would in any case have had to be quite high in order to reconcile the effects of the public sector's deficit spending with the desired increase in the monetary base, than on the speed with which that level was reached; the rapid adjustment of yields and maturities made it possible to place a very high volume of government paper in the last six months of the year (24,436 billion, or approximately as much as was placed in the whole of the preceding year). By contrast with what happened in 1980, the increase in the borrowing requirement (32,137 billion in the second half of the year as against 21,053 billion in the first) did not provoke a faster rate of growth in the monetary base, which instead slowed down: on an annual basis and seasonally adjusted, the rates of increase were 17 and 9.6 per cent in the first and second halves of the year respectively. Overall, therefore, the monetary authorities were able to exercise a greater degree of control over the monetary base than they had in the past.

The creation of monetary base

Despite the high current account deficit, external operations did not give rise to any absorption of monetary base; there was, in fact, a slight inflow amounting to some 25 billion lire (705 billion in 1980). The current account deficit on a cash basis, which was lower than that recorded the previous year (7,675 billion against 10,145 billion in 1980), was, in fact, more than offset by capital inflows (9,761 billion). In 1980, by contrast, around 40 per cent of financing had been assured by non-bank capital movements and the remainder by the increase in the banks' net external liabilities. The latter fell by 1,548 billion in 1981 (after adjustment for exchange rate variations) despite the shortage of lira-denominated bank credits and the slack available under the ceiling on foreign currency financing for imports (Table 24).

The Treasury's monetary base financing, excluding Post Office deposits, amounted to 13,774 billion (against 9,942 billion in 1980), compared with a borrowing requirement of 53,190 billion (36,913 billion in 1980). Excluding repurchase agreements, net placements of government paper, which were made possible by the sharp rise in yields, equalled 35,240 billion against 21,998 billion in 1980.

As in 1980 the increase in Post Office deposits was fairly modest, amounting to 2,723 billion or the equivalent of 5.1 per cent of the deficit (5.3 per cent in 1980). Sight deposits rose by 758 billion while postal savings, on part of which yields for holding periods of over three years were increased as from 1 September, expanded by 1,965 billion.

The average residual life of government paper held by the market declined from 16.2 months at the end of 1980 to 11.4 months at the end of 1981. Despite the recovery in net placements of medium and long-term paper (8,236 billion net of repurchase agreements, as compared with net disinvestment of 4,518 billion in 1980), the proportion of the total non-monetary debt for which they accounted fell from 41 to 35 per cent between the two years.

A shortening of average maturities was also seen in the case of short-term paper, especially in the second half of the year. The residual life of Treasury bills fell from 4.02 months in December 1980 and June 1981 to 3.5 months at the end of the year.

The importance of refinancing as an instrument for regulating bank liquidity diminished further in 1981. There were virtually no

increases in the credit lines granted for ordinary advances and there were only 25 fixed-term operations (as against 114 in 1980), for a total value of 3,587 billion (28,977 billion in 1980) and with an effective utilization period of 46 days (123 days in 1980).

The reduction was mainly attributable to the development of spot/forward operations, both purchases and sales, which meant that the system's liquidity could be distributed more evenly in the course of the month than had been the case previously.

During the year "Other Sectors" absorbed 5,660 billion of monetary base, of which 3,822 billion was due to the compulsory deposit on purchases of foreign currency. In evaluating the deposit's overall effect on monetary base creation it has to be considered that it caused an inflow of trade credits from abroad which was partially offset by the reduction in the banks' external liabilities; in addition the deposit would seem to have been partially financed by the non-renewal or reduction of investment in Treasury bills, despite the rise in rates seen at the end of May.

Table 24

CREATION OF MONETARY BASE: EXTERNAL SECTOR

(changes in billions of lire)

	1979	1980	1981				
			Year	Quarters			
				I	II	III	IV
Balance of payments (1)	3,888.1	-5,908.8	1,901.9	-3,297.3	1,078.0	4,119.8	1.4
current account	934.0	-10,144.8	-7,675.3	-4,504.3	-2,748.2	3,286.9	-3,709.7
capital movements, items in transit, counter-entries and arbitrage	2,954.1	4,236.0	9,577.2	1,207.0	3,826.2	832.9	3,711.1
Banks' net foreign position (increase -)	1,054.2	6,928.6	-1,547.9	-1,249.2	29.6	-1,573.5	1,245.2
Compensatory loans	-2,064.0	-349.0	-369.0	-110.0	-49.0	-161.0	-49.0
OVERALL EFFECT (2)	2,868.1	704.9	24.8	-4,628.4	1,064.9	2,384.8	1,203.5
in lire: net foreign position of BI-UIC	10,878.1	24,530.1	2,990.3	-520.0	2,420.3	-1,371.0	2,461.0
exchange rate adjustments (3)	-8,008.8	-23,823.9	-2,967.8	-4,109.1	-1,357.2	3,756.1	-1,257.6
in foreign currency: banks' convertible currency holdings	-1.2	-1.3	2.3	0.7	1.8	-0.3	0.1

(1) Autonomous balance. - (2) Including accounting differences between the balance sheet of the BI-UIC and the balance-of-payments statistics. - (3) Including the revaluation of gold and of ECU holdings.

Uses of monetary base

Currency in circulation increased by 4,383 billion lire, at a rate which, on the basis of end-period data, equalled that seen in the previous year (17.3 per cent in 1981 against 17 per cent in 1980). However, the average of daily data indicates a slight acceleration, from 17 per cent in 1980 to 18.4 per cent in 1981. The latter rate of increase, which was higher than that in GDP at current prices (17.4 per cent) and slightly lower than that in private consumption (19.2 per cent), would seem to confirm the slowdown in, and possibly the reversal of, the downward trend observed since 1975 in the ratio of currency in circulation to the real aggregates that explain its behaviour. The ratio of currency in circulation to the quarterly data for GDP, which fell from 33.7 per cent on average in 1975 to 24.5 per cent in 1980, rose slightly in 1981 (24.7 per cent). The ratio of currency in circulation to consumption, which fell from 51 per cent in 1975 to 39 per cent in 1980, remained at that level in 1981.

As a result of the restrictive policy pursued by the monetary authorities and despite the increase in the compulsory reserve ratio the growth in total bank reserves was limited to 4,127 billion or 10.4 per cent, as against 4,286 billion (12.1 per cent) the previous year.

These results reflect the impact on the centralized accounts of the strikes among Banca d'Italia staff. By making it more difficult to offset credit and debit balances between banks' branches, these strikes temporarily inflated liquidity at the end of 1979 and the beginning of 1980 and also, to a far lesser extent, in December 1981. Had it not been for the above-mentioned disruption, the growth in reserves would have been higher in 1980 (around 16 per cent) and slightly lower in 1981.

On the basis of end-of-period data, liquidity increased by 360 billion lire in 1981, against 614 billion in 1980. A more meaningful assessment, although this is also distorted by the anomalous upsurge in January 1980, may be arrived at by comparing the annual averages of the daily data. These indicate fundamental stability at around 3,500 billion lire, compared with an increase in the average volume of deposits that equalled 10.4 per cent. The average level of liquidity was particularly low in the second quarter (3,100 billion), when the difficulties on the exchange markets prompted the monetary authorities to pursue a policy of controlling free reserves, on a day-to-

day basis, by offering a substantial volume of outright sales and repurchase agreements at the fairly high rates prevailing from the end of March onwards.

Despite the larger fluctuations at the end of the month, the behaviour of liquidity was on the whole considerably more regular than it had been in the previous years; the standard deviation calculated on the basis of daily data fell from 33 per cent of the mean in 1979 to 28.2 per cent in 1980 and 20 per cent in 1981.

The rate of increase in compulsory reserves also decelerated. It dropped from 9.7 per cent (3,046 billion) in 1980 to 8.6 per cent (2,946 billion) in 1981, and compared with a deceleration in deposits from 10.4 per cent for the twelve months ending November 1980 to 8.0 per cent for the same period of 1981. The ratio of the flow of compulsory reserves to the lagged change in the total deposit base net of increases in capital and reserves equalled 20.02 per cent. The explanation for this lies in the measure of 22 March 1981, which provided that the compulsory reserve ratio on increases in deposits should be raised to 20 per cent, while leaving unchanged (at 15.75 per cent) the ratio for withdrawals in the case of declines in the total deposit base or of increases smaller than those in capital and reserves.

The deposit required of banks exceeding the ceiling on loans increased by more than in 1980 (821 as against 626 billion lire); the average rate of the deposit was increased from 42.5 per cent in 1980 to 59.2 per cent in 1981.

Banking

The main feature of banking operations was a further appreciable slowdown in the inflow of funds accompanied by a sharp fall in the rate of growth in lending. These developments were due to the combination of the large increase in the public sector borrowing requirement and the more restrictive stance of monetary policy; a rapid rise in interest rates and a tightening of the direct controls on lending were needed in order to sell a vast quantity of Treasury securities and to stem the growth in bank lending to the private sector. The decisions taken by the banks themselves, particularly with regard to lending and borrowing rates, were also partly responsible for the slowdown in the expansion of banking operations, which occurred in spite of the fact that financial

saving by the private sector began to pick up and credit demand declined only slightly.

As in 1980, disintermediation mainly consisted in the substitution of government securities for bank deposits among the public's assets, a shift that was stimulated by the increase in the disparity between rates of interest on Treasury bills and the yield on deposits. Moreover, the slowdown in the inflow of funds to the banks was accentuated by the special measures taken by the Minister of the Treasury to channel the bank deposits of public sector agencies back into the Treasury.

In 1981 the financial intermediaries subject to less stringent controls were able to compete more keenly with the banks in gathering deposits and granting loans to the private sector as a result of the

Table 25

THE ACTIVITY OF THE BANKS: INDICATORS

	1977	1978	1979	1980	1981				
					Year	Quarters			
						I	II	III	IV
PERCENTAGE CHANGES (1)									
Bank reserves (2)	21.8	25.8	15.6	12.6	9.8	12.4	13.2	5.6	8.2
Deposits	23.2	23.1	20.0	13.2	9.2	7.7	4.1	4.2	21.5
Credits	24.8	18.1	18.7	14.7	8.9	-10.8	6.6	9.6	32.4
Lending (3)	14.8	12.2	21.8	19.5	12.2	13.3	11.7	11.4	12.6
Treasury bills (4)	165.8	30.5	7.0	40.0	5.9	-71.7	-26.1	20.9	396.9
Long-term securities (5)	19.9	23.5	18.5	0.1	6.2	2.2	5.2	8.4	5.5
FINANCIAL RATIOS									
Excess reserves (6)	1.8	1.9	1.7	1.4	1.4	1.3	1.3	1.5	1.5
Deposits									
Deposits (6)	68.8	68.6	66.6	64.7	61.2	62.7	61.3	59.9	60.9
Domestic financial assets (7)									
Loans to the economy (8)	66.8	61.4	81.9	70.1	51.3	12.7	45.2	28.0	71.3
Total domestic credit to the economy									
Credit to enlarged public sector (8)	68.0	35.7	31.0	19.4	4.5	-76.1	-30.4	9.0	61.9
Borrowing requirement of enlarged public sector									

(1) Quarterly data are seasonally adjusted and calculated on an annual basis. — (2) Bank reserves (excess and compulsory reserves and non-interest-bearing deposits on lending in excess of the ceiling) are adjusted for changes in the compulsory reserve coefficient (see also Table 22). — (3) The figures include bankers' acceptances and are adjusted for the effect of the funding of bank loans and changes in the exchange rate. — (4) Net of repurchase agreements with the Banca d'Italia. — (5) Adjusted for the effect of the funding of bank loans and the effect of repurchase agreements with the Banca d'Italia. — (6) Percentage ratio of average values for the period. — (7) Excluding shares. — (8) Ratio of flows.

restrictive measures taken by the central bank, in particular the ceiling on bank lending and the revision of the reserve requirement.

In spite of the slowdown in banking activity, profits rose considerably owing to a further slight widening of the interest margin and, more particularly, to the increase in earnings from new and rapidly expanding activities such as dealings in securities on behalf of customers. The satisfactory level of profits permitted the banks to allocate considerable sums to their reserves, against the increased risks of banking business at a time of recession and wide fluctuations in interest rates.

On the basis of end-of-year data, the rate of increase in deposits declined to 9.2 per cent in 1981 after having fallen from 20.0 to 13.2 per cent between 1979 and 1980 (Table 25). The deposits held by public sector agencies diminished by 4,212 billion lire, but those of the economy rose at a rate only 1.9 points below that of the previous year owing to the recovery in financial saving by the public. The expansion in bank lending slowed down from 19.5 to 12.1 per cent as a result of the sharp decline in foreign currency loans, which had risen by 6,295 billion lire in 1980 but fell by 1,645 billion lire last year, mainly because of the change in exchange rate expectations. The ceiling prevented the fall in foreign currency loans from being offset by an expansion in those in lire, which recorded a slightly larger increase than that of the previous year (15.2 per cent as against 14.5 per cent). The divergence between the growth of loans in domestic currency and that of deposits was offset in the banks' balance sheets by a slowdown in the expansion in their securities portfolios from 10.2 to 7.4 per cent (Tables 25 and 26).

Between 1979 and 1981 the ratio between the flow of bank credit (loans and investments in securities) and that of total finance to the final users of funds fell from 56 to 18 per cent, a decline of 38 percentage points. The State picked up 23 points by attracting savings from the public direct, the special credit institutions 3 points and firms 12 points by placing securities on the market or by raising loans abroad (Table 25 and Chart 7). The withdrawal of bank deposits in favour of investment in government securities, which had begun on a large scale immediately after the first large increases in security yields at the end of 1979, was accentuated in 1981 by an increase of almost three percentage points in the differential between Treasury bill yields and maximum deposit rates. The widening of the differential was partly due to the monetary authorities' choice of instruments to tighten credit restrictions; the fact that the ceiling limited the growth in the most profitable component of

Table 26

BANKS' ASSETS AND LIABILITIES (*)

(amounts and changes in billions of lire)

	Amounts at end of 1981	Changes							
		1979	1980			1981			
			Year	Half-year		Year	Half-year		Year
				I	II		I	II (*)	
ASSETS									
Bank reserves (1)	43,011.5	4,289.6	689.8	3,596.5	4,286.3	1,713.4	2,413.9	4,127.3	
Excess reserves	5,072.6	-1,218.5	-1,471.2	2,084.8	613.6	-1,498.6	1,858.1	359.5	
Compulsory reserves and backing for cashiers' cheques	36,640.7	5,508.1	1,715.6	1,330.8	3,046.4	2,389.9	556.5	2,946.4	
Non-interest-bearing deposit	1,298.2	—	445.4	180.9	626.3	822.1	-0.7	821.4	
Credit	261,898.1	32,368.6	3,845.0	29,831.5	33,676.5	-3,960.0	28,094.1	24,134.1	
Lending (2)	142,486.5	18,842.7	9,255.0	11,756.7	21,011.7	5,504.0	10,293.6	15,797.6	
of which: in foreign currency (3)	15,796.9	1,614.6	2,701.8	4,549.8	7,251.6	1,608.1	-408.8	1,199.3	
Treasury bills (4)	36,788.6	1,573.1	-4,206.6	13,773.6	9,567.0	-10,530.7	13,821.8	3,291.1	
Long-term securities (5)	82,623.0	11,952.8	-1,203.4	4,301.2	3,097.8	1,066.7	3,978.7	5,045.4	
of which: securities to fund debts	8,350.2	-903.4	-668.9	153.5	-515.4	-261.3	2,029.0	1,767.7	
Bad debts and dishonoured bills	7,045.8	1,385.7	1,128.9	526.6	1,655.5	574.8	697.8	1,272.6	
Shares	3,487.5	340.8	266.7	455.4	722.1	373.7	84.6	458.3	
Interbank accounts	72,548.8	6,649.5	-5,006.0	18,463.6	13,457.6	-11,724.2	25,227.8	13,503.6	
of which: deposits with special credit institutions (6)	7,695.3	123.2	300.7	764.0	1,064.7	313.7	1,486.6	1,800.3	
TOTAL ...	387,991.7	45,034.2	924.4	52,873.6	53,798.0	-13,022.3	56,518.2	43,495.9	
LIABILITIES									
Deposits	277,770.9	37,514.5	-2,281.5	31,978.0	29,696.5	-8,123.4	31,553.7	23,430.3	
Saving deposits	124,817.4	13,711.7	-1,596.4	12,905.5	11,309.1	-2,583.9	14,461.8	11,877.9	
Current account deposits	152,953.5	23,802.8	-685.1	19,072.5	18,387.4	-5,539.5	17,091.9	11,552.4	
Other deposits	2,066.2	-272.3	-212.0	-192.8	-404.8	395.5	-229.4	166.1	
Foreign currency accounts of residents ...	792.5	-64.4	-5.6	-26.1	-31.7	87.8	221.9	309.7	
Third parties' funds held in trust	1,273.7	-207.9	-206.4	-166.7	-373.1	307.7	-451.3	-143.6	
Interbank accounts	63,343.4	4,113.5	-4,100.5	16,352.3	12,251.8	-11,660.5	22,206.0	10,545.5	
of which: special credit institutions' deposits (7)	3,944.1	-773.3	382.9	43.6	426.5	-941.0	573.7	-367.3	
Lending by BI-UIC (1)	2,980.9	2,925.8	-2,079.5	-730.7	-2,810.2	588.5	-33.8	554.7	
Net foreign position (3) (8)	15,185.8	1,003.7	2,904.3	4,981.2	7,885.5	1,075.3	221.1	1,296.4	
Equity capital	16,759.6	2,045.5	2,289.5	377.0	2,666.5	3,487.5	810.3	4,297.8	
Other items	9,884.9	-2,296.5	4,404.1	108.6	4,512.7	1,214.8	1,990.3	3,205.1	

(*) 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 35). 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.

(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) Foreign currency loans and the banks' net foreign position are calculated at current exchange rates. (4) At face value. — (5) Changes in long-term securities are calculated on the basis of market prices during the year. — (6) 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. — (7) Changes are taken from the special credit institutions' accounts. — (8) 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.

assets may have been a factor in the banks' decision not to oppose disintermediation. If deposit rates had been closer to those on Treasury bills, the banks would have attracted a larger volume of deposits, but the added cost would not have been matched by adequate additional earnings, as the presence of the ceiling meant that the only form of lending possible was investment in securities, which would not have been sufficiently remunerative. The burden imposed by the reserve requirement was exacerbated by the raising of the coefficient from 15.75 to 20 per cent and by the rise in interest rates.

The good profit figures indicate, however, that in spite of the constraints imposed on the assets side by the monetary authorities the banks had ample scope to increase deposit rates and that they therefore encouraged the process of disintermediation. Moreover, the erosion of their deposit base did not impair their ability to grant loans as they still held large portfolios of securities that could be mobilized quickly.

At the beginning of the year the Banca d'Italia renewed the ceiling on bank lending until December 1981. In the last few months of 1980 the rapid expansion in foreign currency lending and in loans of less than 130 million in lire, which were both exempt from restriction, caused the growth in bank lending to exceed the targets set and had magnified the distortions between banks with different proportions of exempt lending. In January, when it was realized that the objective of curbing domestic demand would have to be pursued with greater vigour, the coverage of the ceiling was extended to include loans in lire for amounts of less than 130 million lire from April onwards. It was also decided that as from March foreign currency loans to finance imports should not exceed the level recorded in December 1980. The impact of the ceiling was heightened by the rise in interest rates, which increased the cost of making non-interest-bearing deposits on excessive lending. In March the issue of bankers' acceptances was made subject to a limit expressed as a proportion of the capital of the accepting bank in order to contain the risks that would be created by an excessive use of this instrument. The measure brought the growth in acceptances under control after the abnormally large increase recorded in 1980. The introduction of the non-interest-bearing deposit on foreign payments in May also made the ceiling on the growth in bank lending more onerous – 50 per cent of loans granted by banks to finance the deposit were included in lending subject to the ceiling.

The working of the credit ceiling and the maximum permitted growth remained substantially unchanged in the measures taken in December 1981 with respect to this year. On that occasion the penalties

for banks that exceed the ceiling were modified in that the non-interest-bearing reserves to be deposited in respect of minor infringements were reduced and those on larger amounts were increased. In April 1982 the Banca d'Italia increased the penalties in order to curb speculative pressure on the lira caused by the conversion of loans contracted in foreign currency into lire; the ascending scale introduced in the previous December was maintained, but the amount of reserves to be deposited in relation to the excess was raised across the board.

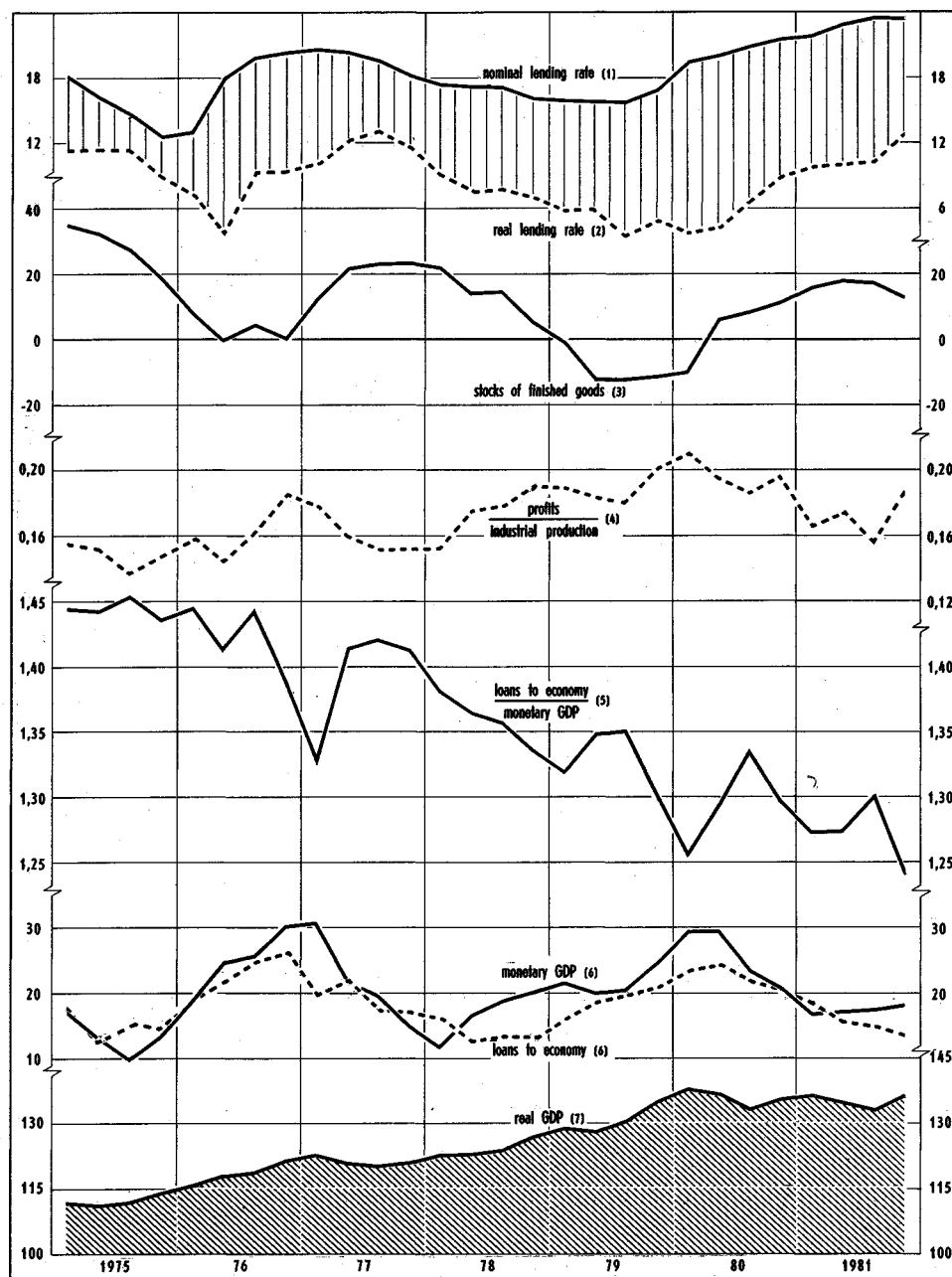
The extension of direct controls on lending to new categories of loans and the low rates of permitted growth diverted part of the unsatisfied demand towards new sources of finance, in particular loans offered by special credit institutions. This notwithstanding, the ratio of controlled loans to the total lending of the banks and special credit institutions rose from 32.0 per cent in December 1980 to 57.6 per cent in December 1981. Moreover, the alternatives to bank loans do not all bypass intermediation by the banks. A large proportion of the credit granted by the special institutions was indirectly financed by the banks, which in some cases also continued to bear the risk of the transaction by granting loan guarantees.

During 1981 the banks began to encounter stronger competition from the special credit institutions in the raising of funds as well as the granting of loans. Competition of this kind had not been unusual before 1974, but in the years that followed it had almost completely disappeared owing to the decline in the demand for bonds on the part of savers in a period of highly volatile inflation. It re-emerged recently as a result of the introduction of new securities with shorter average maturities and bearing financial indexation clauses that reduce the risks inherent in the instability of interest rates.

Bank credit

The tighter conditions on the market in bank credit were reflected in lending rates; having risen by about six percentage points between September 1979 and the end of 1980, they increased by a further two points, with the "normal" rate moving from 23.4 to 25.4 per cent. The increase is even larger if it is corrected for the effective variation in wholesale prices or inflationary expectations (Chart 8).

Chart 8



Bank loans and economic activity

(1) Average rate on loans in lire 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 (deviation from normal); 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 quarterly stock of loans to the economy (including bad debts and acceptances acquired by banks) to gross domestic product. — (6) Percentage rates of increase in the 12 months ending in the reference quarter. — (7) Index of gross domestic product at constant prices, seasonally adjusted; 1970=100.

Lending in excess of the ceiling also reflected the heightened tensions; during the phases of strongest credit demand it equalled the very high figures recorded after the introduction of the non-interest-bearing deposit on excessive lending in March 1980 (in November 1981 it came to 2,604 billion lire, or 2.2 per cent of the maximum credit permitted at that date). Whereas the supply of bank credit was made to contract appreciably in real terms, demand remained high because the slight increase in gross domestic product at constant prices (0.6 per cent between the final quarter of 1980 and the final quarter of 1981) was accompanied by a reduction in the self-financing capacity of firms caused by the fall in profitability in 1981 (Chart 8).

The growth in bank lending including bankers' acceptances acquired by the banks was considerably smaller than in the preceding year (15,343 billion lire compared with 20,598 billion, or 12.2 per cent as against 19.5 per cent) even though in the second half of the year the banking system helped finance the non-interest-bearing deposit on foreign payments; if the figures are adjusted to exclude this item, the growth rate comes down to 10.3 per cent. The foreign currency component, which had increased by 6,295 billion lire or 85.3 per cent in 1980, contracted by 1,645 billion or 13.3 per cent in 1981; lending in lire, on the other hand, increased by slightly more than in the preceding year (by 16,998 billion lire, or 15.2 per cent, as against 14,304 billion lire, or 14.5 per cent) solely on account of the financing of the foreign payments deposit (about 2,400 billion lire); net of this the increase came to 13 per cent.

The regulations governing the ceiling, which were renewed on 31 January and came into effect in April, extended the scope of the controls to almost all loans in lire (only those to borrowers in Campania and Basilicata remaining exempt), thus removing the previous exemption for small loans and certain other categories of lending in lire that the banking system had expanded by an abnormal amount in 1980 (46.5 per cent). From May onwards 50 per cent of bank lending in respect of the deposit on purchases of foreign currency was brought under the ceiling. On 24 December 1981 the credit restrictions were renewed for the following year; the permitted growth in the controlled aggregate was set at 12.4 per cent, a figure which rises to 13.3 per cent if the effect that the abolition of the foreign payments deposit will have on lending is taken into consideration.

The limit on foreign currency loans, in force from March onwards, caused a fall in the amount outstanding in the early months of the year, when demand was stronger. It had no effect in the second half of the

year, however, when demand weakened owing to the rise in rates abroad, exchange rate expectations and the introduction of the deposit on purchases of foreign currency, which encouraged the use of foreign trade credits. On 28 December 1981 the measure was renewed for the present year, with the permitted growth being set at 12 per cent of the amount outstanding in December 1980.

Although real activity remained strong and price increases high in the first quarter of the year, the announcement of the stricter measures on 31 January brought the growth in lending down from the levels recorded in the last few months of 1980 (13.3 per cent on a seasonally adjusted annual basis compared with 22.9 per cent in the final quarter of 1980). Foreign currency loans recorded a fall of 923 billion lire net of exchange rate adjustments, most of it occurring in March in connection with the application of the ceiling on foreign currency loans mentioned above; lending in excess of the ceiling declined from 902 billion lire to 266 billion (net of the unutilized lending margins of certain banks) and the growth in the exempt component in lire came down from 50 to 24.5 per cent in relation to the preceding quarter.

In the second quarter the decline in production and the application of the new limits accentuated the slowdown in bank lending, the growth rate of which fell to 10.1 per cent net of loans to finance the foreign payments deposit introduced in May. The widening of the coverage of the controls led initially to an increase in excess lending which was soon reabsorbed (it fell from 2,390 billion lire in May to 751 billion in June); foreign currency loans rose by 192 billion, thus making good only part of the fall recorded in March.

In the third quarter lending growth diminished to 7.9 per cent net of the effect of the foreign payments deposit as a result of the slowdown in production and in inflation. The fall was particularly marked in the foreign currency component, which fell by 1,748 billion as firms had greater recourse to foreign trade credit and there were growing expectations of a devaluation of the lira on the eve of the realignment of rates within the EMS. Lending in lire in excess of the ceiling touched its lowest level of the year in September (194 billion lire).

The rise in production in the last few months of the year caused a slight acceleration in lending, which rose by 9.7 per cent net of the foreign payments deposit in the final quarter. Foreign currency loans increased by 668 billion lire owing to the widening of the differential between domestic interest rates and those on international markets; in

addition, loans in lire grew by more than the ceiling allowed and the excess began to rise again, so that at the end of the year it came to 1,692 billion lire.

Loan guarantees granted by banks followed the rising trend of previous years, increasing by 6,993 billion lire or 21.6 per cent, compared with 6,239 billion or 23.8 per cent in 1980. The bulk of the expansion occurred in the foreign currency component (5,248 billion lire or 51.6 per cent) and reflected foreign contracts won by firms and the recourse to trade credits abroad.

Securities

The banks' portfolio of securities, at book value and net of those covered by repurchase agreements with the Banca d'Italia, rose by 8,172 billion lire or 7.4 per cent, a smaller increase than the already modest growth recorded in 1980 (10,161 billion, equal to 10.2 per cent). The slowdown from the high rates of growth seen in

Table 27

COMPOSITION OF THE BANKS' PORTFOLIO OF SECURITIES (1)

	Public-sector securities (2)		Bonds issued by special credit institutions		Other securities	
	Percentage share		Percentage share		Percentage share	
	of deposits (3)	of such securities in circulation (4)	of deposits (3)	of such securities in circulation (4)	of deposits (3)	of such securities in circulation (4)
1976	12.9	28.0	19.0	71.5	4.4	55.9
1977	21.5	41.9	18.5	76.0	4.4	60.5
1978	24.6	44.3	17.3	78.4	4.2	61.6
1979	24.4	44.2	16.6	79.9	3.4	61.3
1980	23.5	42.2	16.6	80.1	3.2	61.6
1981	22.8	34.6	16.7	77.9	3.1	62.2

(1) Net of securities covered by repurchase agreements. — (2) Government securities, paper issued on behalf of the Treasury and local authority securities. — (3) Calculated on the basis of end-year figures (securities at book value). — (4) Calculated on the basis of end-year figures (securities at face value).

the seventies involving mainly government securities (the average rate of increase was then about 28 per cent) is an important aspect in the current process of disintermediation and reflects the Treasury's restored ability to attract money from the public direct (Table 27). The most

pronounced slowdown in relation to the preceding year occurred in Treasury bills, which increased by 5.9 per cent during the year.

In spite of the slower growth in the banks' portfolio of Treasury bills, the secondary liquidity of the banking system remained high. The average ratio between holdings of Treasury bills (excluding those covered by repurchase agreements with the Banca d'Italia) to outstanding deposits stood at 10.3 per cent, as against 9.8 and 11.1 per cent in 1980 and 1979 respectively. Moreover, the degree of liquidity of the Treasury bill portfolio was increased both by the shortening of the average maturity from 3.7 to 2.4 months and by the deepening of the market in such paper, thus facilitating sales to the public. However, other conditions remaining equal, the reduction in the differential between the average yield on loans in lire and that on Treasury bills (from 4.58 to 1.85 percentage points) made it less attractive even for those banks that had unutilized lending margins to mobilize Treasury bills in order to grant loans to the economy.

Holdings of special credit institution bonds rose quite substantially, although by less than in the preceding year (4,237 billion lire or 10.1 per cent, compared with 4,757 billion or 12.7 per cent) owing to the advantageous terms they carried in 1981 (such as exemption from taxation), the increasing use of indexed bonds and the scale of operational ties between certain banks and the special credit institutions. Public-law banks and savings banks with their own special credit sections acquired 57 per cent of all special credit institution securities purchased by the banking system (the proportion was 81 per cent in the case of industrial securities alone), in spite of the fact that at the end of the year they held only 28 per cent of total deposits.

In 1981 the securities investment requirement had no impact overall, partly because of the modest increase in deposits and partly owing to the provision that excess holdings accumulated in previous periods could be counted towards the requirement.

As in 1980, the public's greater interest in investment in Treasury bills was accompanied by an intensification in the banks' activities in the management of customers' securities portfolios. The total volume of Treasury bills for delivery and for safekeeping rose by 68.7 per cent during the year and the ratio between this aggregate and deposits increased from 15.1 to 23.3 per cent. The expansion involved all types of bank, but it was more pronounced among small banks and savings banks.

Customers' deposits

Bank deposits increased by 23,430 billion lire, or 9.2 per cent, compared with 29,696 billion, or 13.2 per cent, in 1980. The expansion was about nine percentage points lower than the change in the consumer price index; in real terms total deposits therefore declined by 7.6 per cent, whereas in 1980 the contraction had amounted to 6.6 per cent. General government deposits fell by 4,187 billion lire (22 per cent) whereas in 1980 they had increased by 594 billion, or 3.2 per cent.

The rate of growth in the deposits of the economy slowed down from 14.1 to 11.7 per cent; the ratio between changes in deposits and changes in the financial assets of the economy, which had stood at 61 per cent in 1979 and 52 per cent in 1980, dropped to 31 per cent.

The expansion in the deposits of the economy was not uniform throughout the year; as in 1980, the growth occurred mainly in the second half of the year. The seasonally adjusted monthly rates of increase in this class of deposits were higher on average from August onwards than in the first seven months, mainly as a result of the increase in the deposits of non-financial companies, which had been growing at an annual rate of just over 6 per cent until July. In spite of this recovery, total deposits of the economy were still lower at the end of November than they had been at the beginning of the year, the first time this has occurred. A contributory factor was the introduction of the foreign payments deposit, which firms financed to the extent of about 40 per cent by running down their financial assets. On the other hand, the increase in deposits in December was larger than that recorded in the same month of 1980 (30,699 billion lire as against 25,527 billion), partly owing to the larger amounts of interest credited.

Whereas in 1980 banking disintermediation had had a greater effect on the larger banks, whose customers seemed more receptive to the advantages of investing in Treasury bills, in 1981 it was mainly the small and medium-sized banks and savings banks that were affected. The market share of major and large banks, calculated only in terms of deposits of the economy on the basis of annual averages, therefore rose from 34.2 to 34.7 per cent, thus breaking the trend that had obtained since the beginning of the seventies.

Profit and loss accounts

As in the preceding year, so too in 1981 the slowdown in the growth of banking activity was accompanied by a widening of the intermediation margin, which rose to its highest level since 1974; the increase in this item, which measures the banks' earnings net of interest paid, came to 27.2 per cent compared with 45.3 per cent in 1980. Only a small part of the widening of the intermediation margin from 5.37 to 5.91 per cent of intermediated funds was attributable to revenue from money management (the interest margin); a much larger part derived from the increase in earnings from services (Table 28). Thanks to the virtually unchanged level of unit operating costs, the banking system was able to push up its profits and to make substantial reserve allocations in respect of the fall in the capital value of the securities portfolio caused by the general rise in market interest rates.

The interest margin increased only slightly (from 3.99 to 4.17 per cent of intermediated funds – in 1980 there had been an increase of 0.93 percentage points) in spite of the widening in the differential between the yield on loans and the cost of deposits from 12.12 to 13.43 per cent. The widening of the margin was caused mainly by revenue from loans granted to special credit institutions; the difference between the yield on securities and the cost of deposits, on the other hand, declined slightly (from 1.81 to 1.67 percentage points) and the adverse effects of the reserve requirement were accentuated, the negative differential between interest paid on deposits with the Banca d'Italia and the cost of deposits rising from 4.84 to 6.56 percentage points.

The revenue from services per lira intermediated rose by 45.4 per cent, a larger increase than in any previous year. In relation to intermediated funds it rose from 1.38 to 1.74 per cent; more than half of this increase is attributable to earnings from dealings in securities, which went up from 0.52 to 0.69 per cent of intermediated funds.

Almost two thirds of the improvement in operating profits was absorbed by the increase in reserve allocations, but net profits also rose from 0.26 to 0.36 per cent of intermediated funds in spite of the increase in the incidence of taxes paid by banks from 0.43 to 0.49 per cent.

Thanks to the exceptionally good results of the last two years, the banks' capital expanded by 34.5 per cent in 1981, the largest

Table 28

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	1981
Interest received (2)	10.67	10.93	12.37	12.97	11.57	11.42	13.71	15.49
Interest paid	7.01	6.81	8.50	9.40	8.37	8.36	9.72	11.32
Interest margin	3.66	4.12	3.87	3.57	3.20	3.06	3.99	4.17
Net profit on services	0.78	1.03	1.21	1.25	1.30	1.29	1.38	1.74
<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>0.52</i>	<i>0.69</i>
Intermediation margin	4.44	5.15	5.08	4.82	4.50	4.35	5.37	5.91
Running costs	2.92	3.18	3.31	3.11	2.90	2.84	3.25	3.29
<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>2.63</i>	<i>2.61</i>
Operating profit	1.52	1.97	1.77	1.71	1.60	1.51	2.12	2.62
Depreciation and allocations (3)	1.03	1.39	1.23	1.11	1.01	0.94	1.43	1.77
<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>0.54</i>
<i>of which: 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>	<i>0.68</i>
Gross profit	0.49	0.58	0.54	0.60	0.59	0.57	0.69	0.85
Taxes and fees	0.35	0.43	0.35	0.40	0.38	0.35	0.43	0.49
Net profit	0.14	0.15	0.19	0.20	0.21	0.22	0.26	0.36

OTHER DATA

Number of employees	203,205	216,346	227,338	239,901	249,994	261,505	274,749	289,310
Intermediated funds per employee <i>(millions of lire)</i>	516	559	641	751	883	1,014	1,133	1,248
Cost per employee <i>(millions of lire)</i>	13.08	15.23	18.04	19.26	20.85	23.07	29.83	32.60

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

increase since 1975; as in the preceding year, the greatest improvement was recorded by the cooperative banks (57.9 per cent). The ratio of capital to deposits, which had risen from 4.4 to 4.9 per cent in 1980, reached a new record level of 6 per cent.

The capital market

The rise in interest rates during 1981 enabled the capital market (government securities, bonds and shares) to expand and return

gradually towards a position of equilibrium. The increase in the supply of securities, especially from the public sector, was accompanied by strong growth in the demand of both banks and non-bank investors, in line with the growing expectations of a slowdown in inflation. By contrast with the previous year, the central bank was a net seller, thus confirming the return towards equilibrium on the market for medium and long-term securities.

Despite the recovery in issues of medium-term securities, the average maturity of the public debt shortened again: for medium and long-term securities it was 27 months at end-1981, compared with 34 months at end-1980. The same downward trend continued for

Table 29

NET ISSUES OF BONDS AND GOVERNMENT SECURITIES (1)
(billions of lire)

	Amounts at December		Net issues						
			1979 Year	1980			1981		
	Half-year			Year	Half-year		Year		
								I	II
	1980	1981							
ISSUERS									
Public sector ...	78,955	86,720	9,194	-2,063	246	-1,817	4,179	3,359	7,538
Special credit in- stitutions	61,422	69,368	4,656	2,390	3,257	5,647	2,719	4,789	7,508
Firms and public agencies	14,295	14,868	643	481	-216	265	34	509	543
Total ...	154,672	170,956	14,493	808	3,287	4,095	6,932	8,657	15,589
INVESTORS									
Banca d'Italia and UIC (1) ..	31,030	30,118	-2,772	992	2,148	3,140	120	-947	-827
Banks (1)	86,679	93,641	11,953	-1,523	2,302	779	2,323	5,041	7,364
Other financial in- termediaries ...	8,401	12,110	1,885	638	909	1,547	1,109	2,534	3,643
Firms, households and foreign in- vestors	28,562	35,087	3,427	701	-2,072	-1,371	3,380	2,029	5,409
<i>Shares</i>	<i>53,826</i>	<i>69,009</i>	<i>2,732</i>	<i>1,068</i>	<i>2,017</i>	<i>3,085</i>	<i>3,253</i>	<i>3,933</i>	<i>7,186</i>

(1) Net of repurchase agreements.

(1) Net of repurchase agreements.

the whole public debt. The signs of an improvement in expectations and the favourable reception given to indexed instruments nonetheless suggest that this nearly ten-year trend will be reversed.

The increase in the public sector's net issues in the first quarter of 1982 confirmed the improved performance of the market for medium and long-term securities. The banks and the Banca d'Italia made net sales so that it was non-bank investors who expanded their purchases. Although they did take up more medium and long-term securities, they continued to invest primarily in Treasury bills while also showing increasing interest in the certificates of deposit of the special credit institutions.

The supply of securities

Notwithstanding the growth of the capital market, compared with the past the net issues of bonds and government securities still appear small in relation to GDP (3.9 per cent, as against 1.2 per cent in 1980 and 5.4 per cent in 1979).

The distribution of issuers shifted towards the public sector, which made net issues amounting to 7,538 billion (as against 1,817 billion of net redemptions in 1980 and 9,194 billion of net issues in 1979). The recovery of the public sector's issues was particularly marked for Treasury bonds, with issues in January and July for a net amount of 3,908 billion. This instrument was resorted to again after nearly a year and carried an extremely short maturity (two years) as well as somewhat higher coupons than earlier issues (15 per cent in January and 18 per cent in July). Net issues of Treasury credit certificates amounted to 2,816 billion in 1981, compared with 2,691 billion in 1980.

These Treasury credit certificates incorporated a number of innovations, which were described in last year's Annual Report: an improved mechanism for determining the reference rate (the average yield on six-month Treasury bills calculated on the two months prior to payment of the coupon), a fixed 0.40 per cent addition to the reference rate, the elimination of a minimum value for the coupon, the offer of certificates with maturities of three years at the March, April and June issues and, finally, the increase in the discount at issue from one to two lire for the certificates issued subsequently.

The growth in the fund raising of the special credit institutions went hand in hand with the increase in their assets. In this they

benefitted from the temporary tax exemption of the interest on their bonds and the wider adoption of indexation mechanisms. The greater part of the rise in their net issues was accounted for by the real estate and agricultural credit institutions (4,181 billion as against 2,783 billion in 1980). Smaller contributions came from the industrial credit institutions (2,640 billion as against 2,413 billion), whose results were influenced by a higher rate of redemptions and an expanding market for indexed certificates of deposit, and from the public works credit sections (687 billion as against 452 billion).

The other categories of borrowers doubled their net issues compared with 1980 (543 billion as against 265 billion), but without returning to the levels of earlier years. There were, however, considerable changes in the behaviour of private firms and public agencies. The former increased their net borrowing enormously, from 72 billion to a new record of 708 billion. Factors contributing to this development included: the ceiling on bank credit, tax exemptions, indexation and the fact that convertible bonds were well received. ENEL broke with its tradition of raising funds on the domestic market (862 billion of net redemptions compared with 456 billion of net issues in 1980) and satisfied its substantial financing requirements abroad. On the other hand, ENI and IRI returned to the market after a long absence to take advantage of the temporary tax exemptions and made net issues amounting to 819 billion, compared with 243 billion of net redemptions in 1980. Specifically, IRI made a 360 billion issue of bonds convertible into the shares of the three banks of national interest.

In the early months of 1982 the Treasury made other changes in its issuing policy. In January, March and May Treasury credit certificates were offered with maturities of four as well as two years. The formula for calculating the coupons is the same as for two-year certificates except that the reference rate is increased by 1 percentage point. Improvements taken over from Treasury bonds have also been incorporated in the issuing procedure: a period of several days is set for subscription, underwriters may use the funds from maturing securities and a definite price is fixed for the public. In February an ECU-denominated loan was raised for an amount of 500 million ECUs, corresponding to about 650 billion lire, with a maturity of seven years and an annual coupon of 14 per cent. This loan offers investors the double advantage of portfolio diversification in terms of foreign currency and interest rate conditions in line with those generally obtaining on European markets for long-term securities.

The demand for securities

The public (the economy and the foreign sector) returned to the medium-term sector and made net purchases amounting to 5,409 billion after a withdrawal in 1980 and net disinvestment amounting to 1,371 billion. The large increase in nominal interest rates was coupled with a downturn in the expected rate of inflation, which began to fall slowly in the early part of 1981. This led to an increase in demand that took the public's share of security purchases up to 35 per cent (Table 30 and Chart 9). Broadening the definition of the market to include Treasury bills, the role of the public is

Table 30

NET PURCHASES OF BONDS AND GOVERNMENT SECURITIES (percentage breakdown)

Class of investor	1961	Yearly average 1968-77	1978	1979	1980	1981
Banca d'Italia and UIC (1)	3.8	28.2	22.6	-19.1	76.7	-5.3
Banks (1)	24.5	58.3	52.7	82.5	19.0	47.2
Other financial intermediaries . . .	9.9	2.1	2.8	13.0	37.8	23.4
Firms, households and foreign investors	61.8	11.4	21.9	23.6	-33.5	34.7
Total . . .	100.0	100.0	100.0	100.0	100.0	100.0
Total in billions of lire . . .	931	7,827	25,634	14,493	4,095	15,589

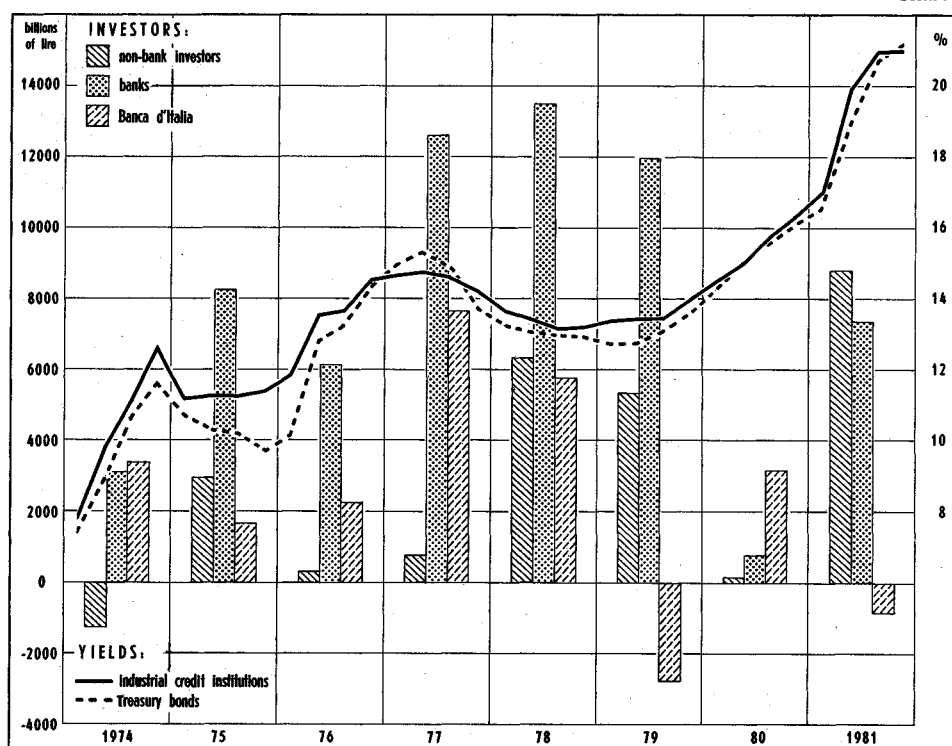
(1) Net of repurchase agreements.

found to have been greater, both in terms of market share (61 per cent as against 49 per cent in 1979 and 1980) and in relation to GDP (7.6 per cent as against 4.4 per cent in 1979 and 4.3 per cent in 1980). The revival of investment in the medium-term sector made little change in the maturity structure of the public's portfolio; purchases were mainly of Treasury bills and the average maturity of the public sector securities held by the public continued to decline up to December 1981. Overall, the renewed interest in medium-term securities was held back by the persistence of widespread uncertainty about the real yields to be expected in the longer run.

The public's purchases of Treasury bills rose from 15,847 billion in 1980 to 24,741 billion. Those of Treasury credit certificates and

bonds, though they also rose significantly, were smaller: respectively 3,265 billion (1,249 billion in 1980) and 1,623 billion (as against disinvestment amounting to 1,269 billion in 1980). The purchases of special credit institutions' securities amounted to 973 billion, compared with net disinvestment of 837 billion the year before.

Chart 9



Bond yields and net issues by class of investor

The success of Treasury credit certificates, which was confirmed and heightened in the early months of 1982, partly reflected investors' favourable reaction to the new formula for calculating the coupon. The public's willingness to invest in these and other indexed securities appears likely to continue and they will contribute decisively to the lengthening of the average maturity of public and private sector debt by freeing investors from the need to make accurate forecasts about how interest rates will develop.

Net of repurchase agreements, the banks' purchases of bonds and government securities rose to 7,364 billion (as against 779 billion in 1980) and accounted for nearly half the total net issues. Excluding consolidation operations, the amount was 5,610 billion (as against 1,294 billion). The share of deposits invested in medium and long-

term securities declined from 31.0 per cent at end-1980 to 29.7 per cent at end-1981. Unlike other investors, the banks concentrated most of their purchases (5,651 billion or more than three quarters) on the securities of the special credit institutions and firms. Their investments in government securities consisted mainly of fixed rate certificates for the consolidation of health agency and IRI loans (2,129 billion). On the other hand, they made only small purchases of Treasury bonds (431 billion) and Treasury credit certificates (183 billion). The institutional links between banks and special credit institutions, the indexation mechanisms adopted by the latter and the tax exemption due to expire in September 1982 help to explain the banks'

Table 31

SHORT, MEDIUM AND LONG-TERM SECURITIES

(billions of lire)

	Amounts at December 1981	Net issues						
		1979 Year	1980			1981		
			Half-year		Year	Half-year		Year
			I	II		I	II	
Public sector	194,257	19,015	8,189	15,494	23,683	17,681	23,640	41,321
Treasury bills	107,537	9,821	10,251	15,249	25,500	13,502	20,281	33,783
Treasury credit certificates	31,130	10,226	685	2,006	2,691	3,450	-634	2,816
Other	55,590	-1,032	-2,747	-1,761	-4,508	729	3,993	4,722
Special credit institutions and enterprises	84,236	5,299	2,871	3,041	5,912	2,753	5,298	8,051
TOTAL ...	278,493	24,314	11,060	18,535	29,595	20,434	28,938	49,372
Banca d'Italia and UIC (1)	39,538	-3,102	2,065	59	2,124	6,029	-77	5,952
Treasury bills	9,420	-330	1,073	-2,089	-1,016	5,910	869	6,779
Treasury credit certificates	7,928	173	1,152	3,297	4,449	-72	-1,105	-1,177
Other	22,190	-2,945	-160	-1,149	-1,309	191	159	350
Banks (1)	129,108	13,526	-5,730	16,076	10,346	-8,515	17,849	9,334
Treasury bills	35,468	1,573	-4,207	13,774	9,567	-10,839	12,809	1,970
Treasury credit certificates	10,463	6,019	-2,814	260	-2,554	587	-404	183
Other	83,177	5,934	1,291	2,042	3,333	1,737	5,444	7,181
The public	109,847	13,890	14,725	2,400	17,125	22,920	11,166	34,086
Treasury bills	62,649	8,578	13,385	3,564	16,949	18,431	6,603	25,034
Treasury credit certificates	12,739	4,034	2,347	-1,551	796	2,935	875	3,810
Other	34,459	1,278	-1,007	387	-620	1,554	3,688	5,242

(1) Net of repurchase agreements.

preferences. Including Treasury bills in the analysis, there was a fall in total investment (from 10,346 to 9,334 billion) as a result of the sharp decline in Treasury bill purchases (from 9,567 to 1,970 billion; Table 31). Faced with a slowdown in the growth of deposits, the banks cut back their investment in securities and gave preference to medium and long-term paper in their portfolio choices.

Excluding repurchase agreements, the Banca d'Italia made net sales amounting to 827 billion, compared with an investment of 3,140 billion the year before. The central bank supported more balanced positions in the market by regulating its interventions as regards both their timing and the type of security involved. Overall, the Banca d'Italia took up 1,712 billion of Treasury bonds, sold 1,177 billion of Treasury credit certificates on the market and disinvested 1,362 billion of other securities mainly when they matured. The pattern of investment was somewhat irregular in view of the objective of causing yields to rise gradually. The large sales of Treasury credit certificates in the first quarter (1,783 billion) were followed by purchases for an almost equal amount (1,711 billion) in the second, when the surge in rates made it temporarily difficult to place issues. In the third quarter the Banca d'Italia purchased 1,327 billion of Treasury bonds and started to sell Treasury credit certificates again in line with investors' preferences.

Interest rates

The yields on medium and long-term securities continued to rise in 1981, reaching a peak in the second half of the year that was above both the current and the expected rate of inflation. This rising phase started in the middle of 1979 and was steeper and longer than the previous ones in 1974 and 1976-77. These phases are part of the general rising trend that developed in 1974 in connection with the structural increase in the rate of inflation. The yields on fixed coupon government securities went up from 16.23 per cent in December 1980 to 21.39 per cent in December 1981, with almost equally large changes in the annual averages (from 15.30 per cent in 1980 to 19.35 per cent in 1981). Bond yields also rose to the same extent to stand at 21.06 per cent in December 1981 (16.42 per cent in December 1980) and, as an annual average, at 19.78 per cent in 1981 (15.65 per cent in 1980). The yields on Treasury credit certificates, calculated on the assumption of stable reference rates, rose

by 5 percentage points from 17.29 per cent in December 1980 to 22.31 per cent in December 1981 (Table 32). These yields were considerably higher than the interest rates on fixed coupon bonds. The differential can be attributed both to investors having been in a learning phase and to the high level of the short-term reference rates.

Table 32

**EFFECTIVE AVERAGE YIELD ON BONDS
AND GOVERNMENT SECURITIES**

Securities	1980 Dec.	1981 Sept.	1981 Dec.	1982 Mar.	Absolute changes between				
					Apr. '77	Sept. '78	Dec. '81	Mar. '82	Dec. '81
					Jan. '76	Apr. '77	June '79	Dec. '81	Dec. '80
Treasury credit certificates . .	17.29	21.83	22.31	20.84	n.a.	n.a.	n.a.	-1.47	5.02
Other government securities .	16.23	21.03	21.39	20.07	5.44	-2.46	8.56	-1.32	5.16
Bonds	16.42	21.28	21.06	20.69	3.77	-1.81	7.41	-0.37	4.64

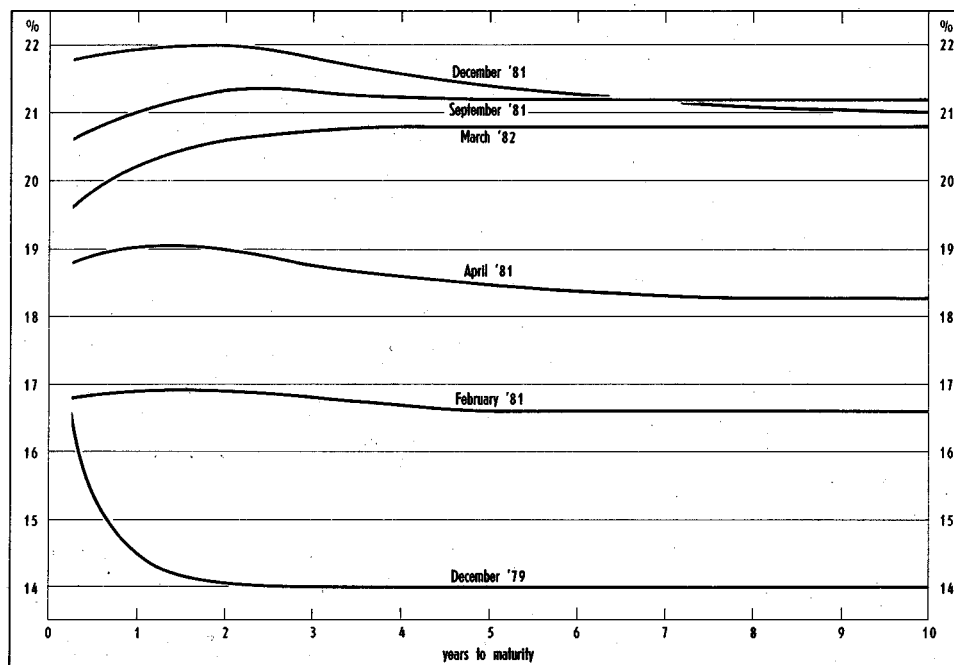
Yields increased rapidly from March to June in parallel with the raising of the discount rate. After a pause during the summer months the yields on bonds peaked in September and those on government securities in November. At the beginning of 1982, in the wake of the slowdown in inflation and the declines in rates on a number of foreign markets, the yields on Treasury credit certificates and other government securities fell quite substantially: for the certificates the fall between December 1981 and March 1982 was 1.47 percentage points, for other government securities 1.32 percentage points and for bonds no more than 0.37 percentage points. However, during the month of April yields started to rise again.

The increase in yields that persisted for two and a half years up to the last few months of 1981 totalled over seven percentage points for bonds and eight percentage points for government securities. It nonetheless did not have the dramatic effect on investors' wealth that might have been feared in view of its size and the experience of past crises. The shift in the distribution of wealth towards short-term and indexed securities successfully countered the reduction in the value of the portfolio.

The yield curve at the beginning of the year was only slightly downward sloping and thus indicated an improvement in expectations that was confirmed by the good reception of the Treasury bond issue

(Chart 10). At the start of the second quarter the increase in rates subsequent to the tightening of monetary restrictions produced an upward shift in the curve without an appreciable change in its slope. In the last quarter the switch by the Treasury to the supply of short-term paper brought about a further increase in rates and the yield curve became slightly downward sloping. In the early months of 1982 conditions favoured a decline in the yields on short and

Chart 10



Time/yield curves

medium-term government securities and the yield curve took on a fairly marked rising slope. For the period as a whole, the persistence of a virtually flat yield curve reflected a much greater rise in long-term rates than on previous occasions of tension on the capital market. This was sufficient to discourage a reduction in holdings of fixed coupon securities, but not to promote an expansion of their share of investors' portfolios.

Share issues

Joint stock companies turned to an instrument of financing that had been little used in previous years and, net of double-counting,

raised 7,186 billion of equity capital (as against 3,085 billion in 1980). Listed companies were extremely active and, under exceptionally favourable stock exchange conditions, issued payable shares to the gross value of 5,380 billion (as against 1,442 billion in 1980; Table 33). About three quarters of this amount was accounted for by state-controlled corporations and specifically by Finsider (2,068 billion), SIP and STET (800 billion each).

Table 33

GROSS SHARE ISSUES

Issuers	Billions of lire				Percentage breakdown			
	1978	1979	1980	1981	1978	1979	1980	1981
Listed	2,028	1,901	1,442	5,380	56.2	48.8	34.9	61.1
State-controlled corporations	1,660	1,548	737	3,979	46.0	39.7	17.8	45.2
private firms: main	349	334	653	1,233	9.7	8.6	15.8	14.0
others ...	19	19	52	168	0.5	0.5	1.3	1.9
Unlisted	1,580	1,993	2,691	3,432	43.8	51.2	65.1	38.9
State-controlled corporations	579	961	920	1,255	16.1	24.7	22.3	14.2
private firms: main	134	356	295	311	3.7	9.1	7.1	3.5
others ...	867	676	1,476	1,866	24.0	17.4	35.7	21.2
TOTAL	3,608	3,894	4,133	8,812	100.0	100.0	100.0	100.0
State-controlled corporations	2,239	2,509	1,657	5,234	62.1	64.4	40.1	59.4
private firms: main	483	690	948	1,544	13.4	17.7	22.9	17.5
others ...	886	695	1,528	2,034	24.5	17.9	37.0	23.1

A large part of share issues was therefore attributable to just a few companies, since no more than three accounted for over 40 per cent of the total gross value. Furthermore, when the large issues of listed companies are analyzed in greater detail, many are of a kind that somewhat reduces the importance of the stock exchange as a means of channelling savers' funds to firms. If, in fact, the data are corrected for double-counting and issues taken up by holding companies or underwriting syndicates when the issue price was above the stock exchange price, the recourse to savers via the stock exchange falls to 263 billion for the state-controlled corporations and to 1,168 billion for private firms.

The issues of smaller unlisted companies (1,866 billion as against 1,476 billion in 1980) repeated the substantial increase of the

year before, though their share of the total actually declined. These issues are nonetheless of considerable qualitative importance since they all represent a flow of resources to productive activity. Numerous operations involved the sale of shares of subsidiary companies, generally to ensure their being adequately spread among the public with a view to subsequent listing. In some cases the operation took the form of a public offer of sale with shareholders renouncing their rights of pre-emption.

Demand for shares and unit trusts.

The annual survey of share ownership conducted on the balance sheets of joint stock companies and public agencies confirmed the predominance of "companies". At the end of 1981 they held 61.7 per cent of outstanding shares (as against 62.1 per cent in 1980 and 58 per cent in 1979; Table 34). Within this category holding companies took on the greatest importance. The proportion of the

Table 34

SHARE CAPITAL BY CLASS OF INVESTOR

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

Investor	Yearly average 1967-77	1978	1979	1980	1981
The public	27.4	14.0	11.8	14.9	14.1
Public agencies	19.6	11.6	12.5	9.0	11.1
Companies	32.0	53.5	58.1	62.1	61.7
Foreign sector	17.0	15.9	12.8	10.2	8.9
Banking system	2.1	3.0	3.2	2.3	2.5
Other financial intermediaries	1.9	2.0	1.6	1.5	1.7
Total ...	100.0	100.0	100.0	100.0	100.0
listed	30.1	26.5	20.4	16.2	17.1
unlisted	69.9	73.5	79.6	83.8	82.9
Total share capital at market value	23,498	52,019	77,591	203,193	205,923

shares owned by the large state holding companies, included under the heading "public agencies", showed the largest increase. These developments reflect a high level of financial and productive reorganization activity coupled with a considerable expansion of share issues. The resident "public" confirmed its interest in purchasing shares while the share of non-resident investors continued to decline.

The net assets of the nine unit trusts making up the Banca d'Italia sample rose substantially from 1,127 billion at end-1980 to 1,725 billion at end-1981. This surge was due primarily to purchases of "other securities" (bonds and government paper), holdings of which increased from 297 to 695 billion (shareholdings rose from 708 to 868 billion). Liquid assets rose from 122 to 162 billion. Consequently, the proportion of net assets consisting of shares fell from 63 to 50 per cent, while that of "other securities" jumped from 26 to 40 per cent. The proportion of liquid assets declined slightly from 11 to 10 per cent.

Share prices

At the end of 1981 the share price index was only just above the end-1980 level (rising 0.8 per cent over the period, compared with 73.3 per cent the year before). Performance was very different in the two halves of the year. In the first six months the index rose by 28.6 per cent then fell by 21.6 per cent in the second. The size and frequency of the fluctuations of the share price index are unmatched in the other major industrial countries and confirm the fragility of the Italian market, which appears to lack mechanisms that would ensure orderly growth by attenuating the exaggerated price movements stemming from the mismatch of supply and demand.

In the first part of the year the flow of funds to the stock exchange, where supply was inelastic, led to a sharp upturn in quotations. At the same time firms approved large increases in share capital that were more than adequate to absorb the available liquidity. The banking, insurance and financial sector enjoyed particularly favourable conditions and profited from a self-generating process connected with the revaluation of its security portfolios and the expansion in its intermediation in securities.

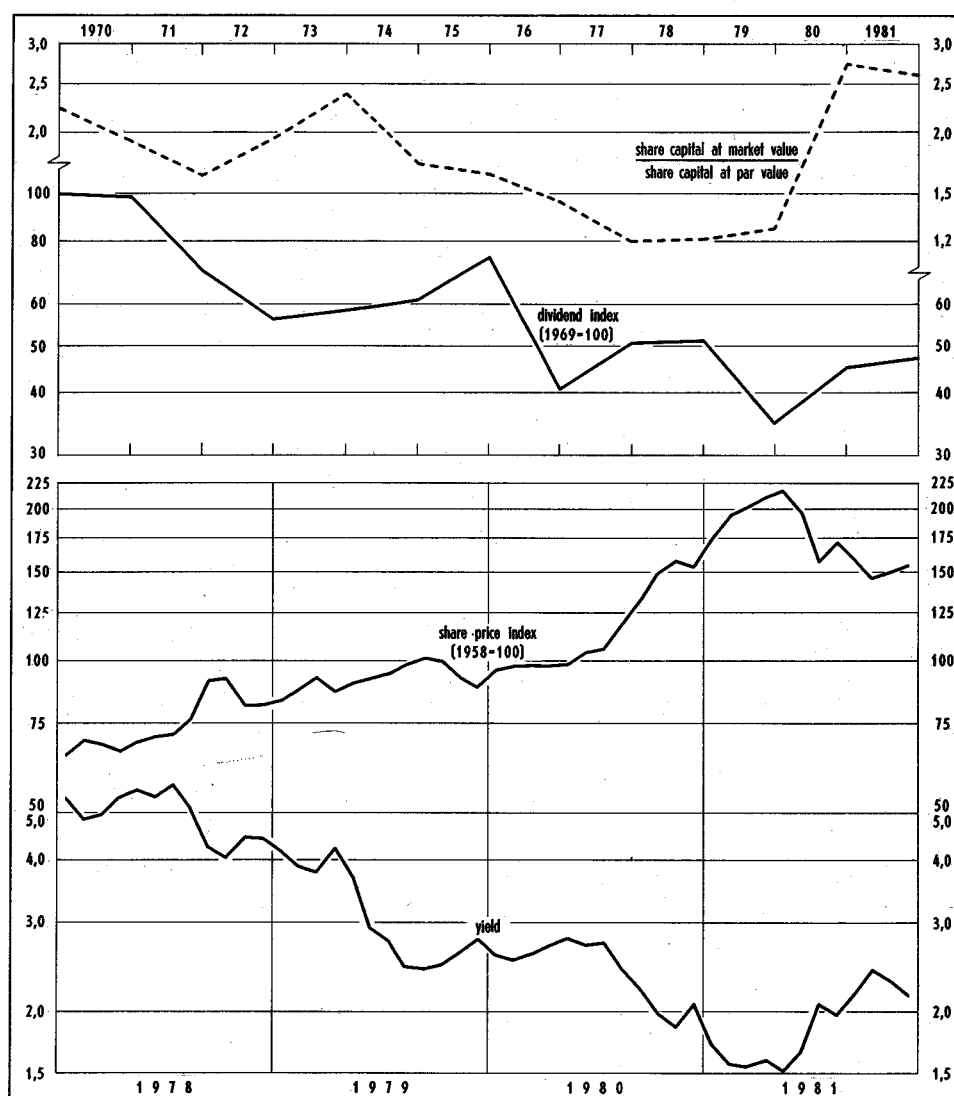
The increased remuneration of other less risky financial assets, the excessive volume of speculative dealings in some segments of the market, the growing conflicts among large financial groups, as well as the substantial and simultaneous issues by listed companies that investors foresaw, led to a sharp reversal of the rising trend of prices in June. In the first fortnight of that month the index fell by 16 per cent and the Consob reacted to the crisis by suspending options trading.

When the options market opened again on 6 July, sales, which had been at a very low level during the preceding fortnight partly

because many shares involved in contango contracts were not available for immediate delivery, flowed in at a heavy rate again. To tackle the serious situation that had developed, the Treasury Minister suspended share dealing on all the stock exchanges for 3 days with a decree dated 8 July 1981. The aim was to control all outstanding positions and study the causes of the disorder on the market.

Subsequently, in order to increase the scope for institutional investors to intervene, a new Ministerial decree was issued on 11 July authorizing banks to invest up to 25 per cent of their staff severance

Chart 11



Prices, yields and other share market indicators

(logarithmic scale)

pay funds in shares. Simultaneously, in order to promote a regular closing of the account period, the Consob brought forward the July technical deadlines and exonerated banks from the margin requirement on option deals that had just been introduced.

When the market reopened, quotations again fell very heavily, but they then recovered at the beginning of the following account period. The issues of shares and convertible bonds were jeopardized and had to be carried by the underwriting syndicates until they were gradually placed, thereby tending to dampen subsequent bullish pressures.

Turnover followed the course of prices, rising to 12,334 billion with a 68 per cent increase compared with 1980, which was itself a year of exceptional activity. 80 per cent of the year's transactions were carried out in the first six months, since dealing was depressed in the second by the margin requirements imposed and the changed mood on the exchanges.

In a year of large swings in prices and volumes little importance was given to the news about dividends. In fact, though they increased by 4.4 per cent on the basis of unchanged capital, they continued to represent a negligible part of total expected yields – the ratio of dividends to the current value of shares in December being 2.1 per cent (Chart 11).

The prices surveyed on the over-the-counter market showed a similar pattern to those of the main market, rising 46.1 per cent in the first six months and falling 16.3 per cent in the second with a net gain of 22.3 per cent. At the end of the year the total value of the 38 shares quoted was 16,873 billion or 33.4 times the total face value. Comparison of this value with that of 2.6 for the main market shows how differently the reserves of the two groups of companies are assessed.

In the first three months of 1982 share prices rose by 7.8 per cent on the main market and by 1.9 per cent on the over-the-counter market and their respective indices to 166.2 (1958 = 100) and 612.9 (18.5.1978 = 100).

The activity of the special credit institutions

The intermediation of the special credit institutions expanded considerably, benefitting not only from the innovatory process under way in the financial markets but also from the effects of monetary

policy restrictions on the banks' operations. Domestic lending increased by 21.1 per cent, compared with 13.9 per cent in 1980.

Outlays amounted to 26,496 billion lire, as against 18,321 billion. This growth is mainly to be attributed to the rise in investment in 1980 and the early months of 1981. Net of export credits, the ratio of outlays to the investment implemented during the year nonetheless went up from 25.7 to 30.8 per cent, thus returning close to the average value of the four years 1972-75 (Chart 12). When short-term loans are also excluded, the ratio becomes 20 per cent, compared with 17 per cent in 1980.

The tightening of the restrictions on bank lending appears to have had several expansionary effects on special credit, including a substitution effect with regard to short-term loans. In fact, there was a further substantial increase in those granted by the industrial credit institutions. One factor contributing to the expansion of the institutions' medium-term credits was the acceleration of the funding of prefinancing granted by banks.

This development was stimulated by a structure of interest rates that resulted in the cost of special credit, despite a considerable increase over the year, remaining well below that of bank credit even in the sectors where the degree of substitutability is highest (Chart 12).

The search for innovatory instruments that help to improve the management of corporate finances also encouraged the special credit institutions to become more involved in supporting the intermediaries of the so-called parabanking sector: the industrial credit institutions' lending to leasing companies took on importance as did that, primarily of a short-term nature, to finance companies.

The growth in special credit was especially pronounced for that at market rates, which is affected more by cyclical developments (outlays of 19,630 billion as against 12,920 billion in 1980). This growth was achieved through the supply of short-term loans amounting to nearly 7,000 billion and of indexed loans, which reduce firms' uncertainty about the real long-term cost of borrowing and allow the lending institutions to offer securities of greater appeal to investors. The variable rate loans disbursed in 1981 amounted to nearly 5,000 billion, or two fifths of all unsubsidized medium and long-term credit (one sixth in 1980). Variable rates were a feature of a large part of the industrial credit institutions' lending.

There was also a large rise in the disbursement of subsidized credit from 5,401 billion in 1980 to 6,866 billion. During the year

there were repeated increases in the reference rate, which was made more responsive to changes in the cost of funds. The upturn in outlays came primarily in the housing, export and agricultural sectors, though industrial investment finance also contributed. The problems of subsidized credit, which derive in part from funds having to be raised with fixed rate bonds, will nonetheless continue to influence the disbursement of incentives until the latter are completely separated from credit. The bill being discussed in Parliament sets out, on the one hand, to increase the effectiveness of public subsidies in the various eligible sectors and, on the other, to improve the efficiency of the allocation of the economy's financial resources.

Government support of the credit institutions involved in the crisis of the large chemical companies continued with the transfer of 1,275 billion of SIR debts to the Deposits and Loans Fund in exchange for securities issued by the Fund in accordance with Law No. 784 of 1980, and with further purchases by the Fund of bonds issued by the institutions.

Funds raised totalled 15,800 billion, which covered the financing of lending and a small increase in liquidity invested in bank deposits and government securities (Table 35). Nonetheless, the ratio of liquid assets to financing commitments declined, continuing the tendency observed in previous years.

Fund raising benefitted from a greater variety of instruments that matched the public's preference for financial assets that prevent heavy capital losses and ensure yields in line with the rate of inflation.

Variable rate securities, with coupons partially linked to money market rates, accounted for more than a third of the institutions' gross bond issues. In view of the temporary tax exemption of these issues, a large proportion of such financially indexed bonds were taken up by the public. The fixed rate securities placed with the banks exceeded the small amounts of their compulsory security investment requirement even though the increases in the maximum allowed yield at issue only partly closed the gap compared with those obtaining on the secondary market. There was also an increase in the funds raised with medium-term certificates of deposit and the rise in own funds continued, mainly in the form of retained profits, which were made possible by the wide margins of intermediation.

Even when account is taken of the increase in short-term finance from the banks, the latter's contribution to the institutions' fund raising declined further and accounted for less than 50 per

Chart 12

OUTLAYS OF THE SPECIAL CREDIT INSTITUTIONS

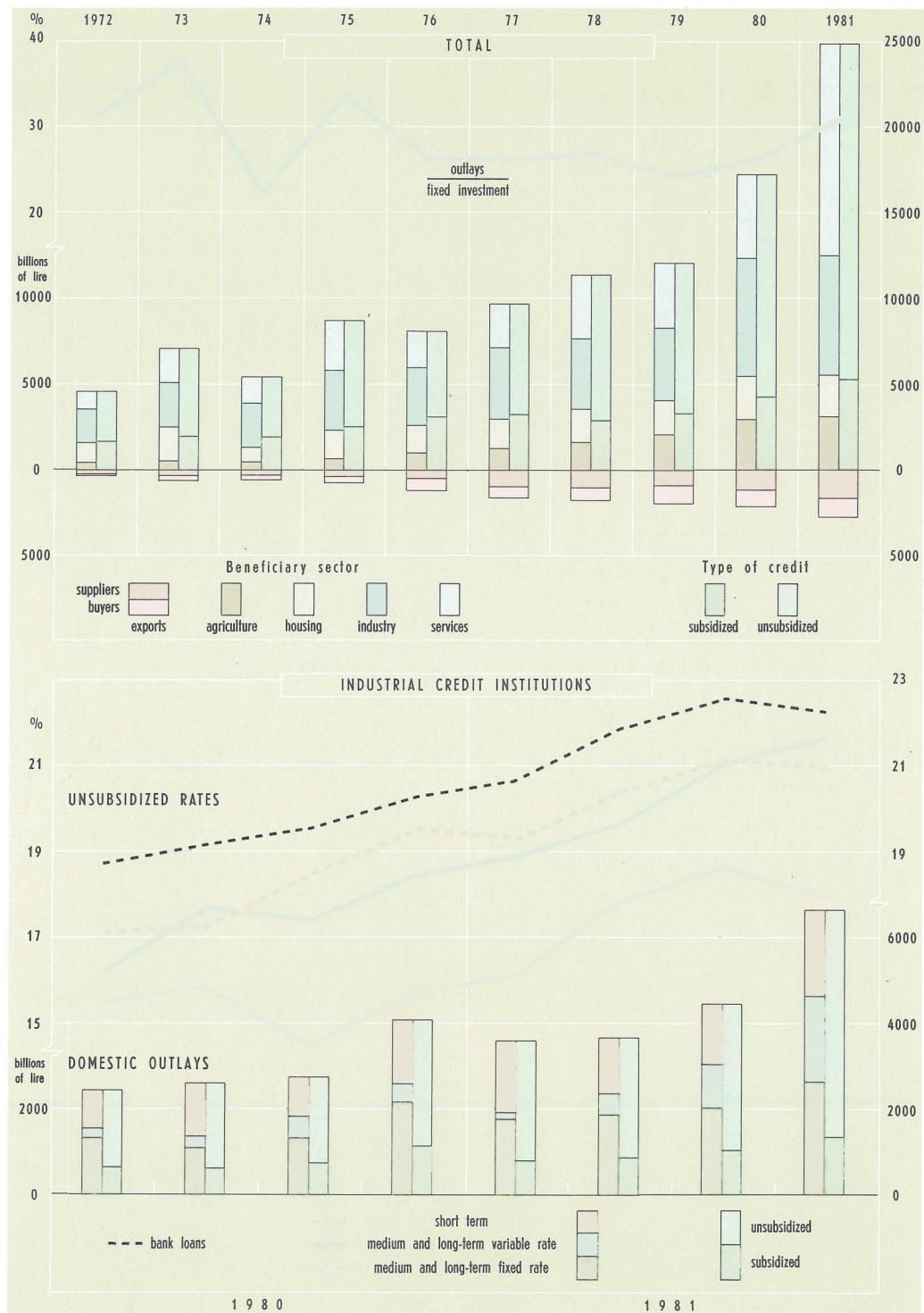


Table 35

ASSETS AND LIABILITIES OF THE SPECIAL CREDIT INSTITUTIONS

(billions of lire)

	Amounts at December 1981	Changes						
		1979	1980			1981		
			Half-year		Year	Half-year		Year
			I	II		I	II	
ASSETS								
Loans: domestic (1)	82,468	5,812	2,662	5,762	8,424	5,212	7,898	13,110
foreign	3,637	69	341	319	660	682	139	821
on behalf of the Treasury	10,572	-611	-263	-393	-656	-307	-525	-832
Security portfolio:	6,006	761	307	-96	211	590	1,759	2,349
<i>of which: Government securities</i>	2,860	469	-210	213	3	631	24	655
<i>Deposits and Loans Fund securities</i> ..	1,275	—	—	—	—	—	1,275	1,275
Cash and liquid assets	4,854	-2,776	230	285	515	-1,130	-138	-1,268
<i>with: B.I. in foreign currency (2)</i>	554	-1,912	-41	6	-35	76	-74	2
<i>B.I. in lire (2)</i>	114	-43	-116	-634	-750	561	-606	-45
<i>banks</i>	4,015	-773	383	44	427	-941	574	-367
<i>others</i>	172	-48	4	869	873	-826	-31	-857
Others (3)	6,706	804	774	-808	-34	600	-553	47
Total . . .	114,243	4,059	4,051	5,069	9,120	5,647	8,580	14,227
LIABILITIES								
Bonds (4): ordinary	69,368	4,656	2,390	3,257	5,647	2,719	4,789	7,508
on behalf of the Treasury	10,981	-691	-293	-196	-489	-463	-347	-810
Deposits and interest-bearing certificates	9,515	176	414	335	749	538	1,533	2,071
Financing by banks	5,034	358	236	628	864	387	1,027	1,414
Public funds (5)	4,337	428	76	207	283	237	179	416
Foreign currency loans (6)	5,952	-2,006	268	665	933	984	962	1,946
Equity capital (7)	8,360	1,117	973	153	1,126	1,210	378	1,588
Rediscounts	696	21	-13	20	7	35	59	94

(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.

cent for the first time since 1973, when restrictions on banks' assets were introduced.

Involvement in the procedure for granting public incentives is not the only factor that has influenced the efficiency of the special credit institutions in the allocation of resources to the economy over the last ten years. The security investment requirement and the regulation of the yields on the institutions' bonds gave rise to distortions in the unsubsidized sector as well, though market mechanisms played a bigger role in 1981. Achievement of a situation – consistent with the replacement of the present system of incentives – in which the cost of long-term credit will help to promote the efficient use of saving depends on a return to a rising yield curve, which the slowdown in the rate of inflation will make possible.

Fund raising

Net of the operations carried out on behalf of the Treasury and the reimbursement of compensatory loans, the funds raised by the special credit institutions increased substantially from 10,381 billion in 1980 to 15,817 billion (Table 36). This growth went hand in hand with large changes in the shares of the various sources. Specifically, that of banks declined further from 62 per cent in 1980 to 47 per cent, while that of the public and companies rose (20 per cent as against –2 per cent), primarily as a result of purchases of certificates of deposit and bonds.

The breakdown by type of liability shows another reduction in the share of bonds from 61 to 50 per cent of total funds raised, in spite of net issues having risen from 6,283 to 7,886 billion. The twelve-month increase in outstanding bonds amounted to 12.9 per cent, compared with 11.5 per cent in 1980. Net purchases of securities by the banks dropped slightly (from 5,182 to 4,947 billion) but were nonetheless well above their compulsory security investment requirement. Within the framework of the support operations that started in 1980, the Deposits and Loans Fund took up about 500 billion of securities, compared with 1,200 billion the year before. The contraction in these two investors' contribution was more than offset by the recovery in the public's investment and the increase in purchases by insurance companies, which were attracted by the larger supply of securities with variable rates and shorter maturities, by the improvement in yields and their exemption from tax.

Table 36

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

Type of liability Sector of origin	1979	1980			1981		
		Half-year		Year	Half-year		Year
		I	II		I	II	
TYPE OF LIABILITY							
Bonds (1)	73.0	56.4	63.8	60.5	45.4	53.0	49.9
Deposits and interest-bearing certificates	2.4	9.0	5.8	7.2	8.3	16.5	13.1
Short-term financing	5.0	5.1	10.9	8.3	6.0	11.0	9.0
Mediocredito centrale funds	0.9	0.6	2.7	1.8	4.6	1.1	2.5
Foreign currency loans (2)	-1.3	6.7	11.4	9.3	13.9	11.1	12.3
Equity capital	15.5	21.2	2.6	10.9	18.6	4.0	10.0
Others	4.5	1.0	2.8	2.0	3.2	3.3	3.2
Total . . .	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SECTOR OF ORIGIN							
The public and companies	-3.2	-3.6	-0.5	-1.8	13.4	24.4	19.9
Banca d'Italia and UIC	0.3	0.2	0.3	0.3	0.9	0.8	0.8
Banks	71.3	59.1	64.4	62.1	37.5	53.0	46.6
Other credit institutions (3)	15.4	26.0	3.5	13.3	20.4	7.0	12.5
Public sector	15.2	11.2	21.0	16.7	12.8	3.0	7.1
Foreign sector (2)	1.0	7.1	11.3	9.4	15.0	11.8	13.1
Total . . .	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (in billions of lire)	7,201	4,603	5,778	10,381	6,501	9,316	15,817

(1) Excluding bonds issued on behalf of the Treasury and by the Mediocredito centrale, the value of which increased by 60 billion in 1981 and by 53 billion in 1980. — (2) Net of compensatory loans held by the Banca d'Italia, which remained unchanged in 1981 and dropped by 32 billion in 1980. — (3) Special credit institutions and insurance companies.

The gross issues of variable rate securities tripled, rising from 1,500 billion in 1980 (100 billion in 1979) to 4,550 billion and accounting for more than a third of total issues.

Among the fund-raising instruments other than bonds, there was a particularly large increase in the contribution of deposits and interest-bearing certificates, which provided 2,071 billion (as against 749 billion in 1980 and 176 billion in 1979). The outstanding value of these instruments rose to 9,515 billion, of which nearly 90 per cent with a maturity of over 18 months. The expansion in the resources provided by certificates of deposit was stimulated by the tax exemption of their interest, a measure that was renewed towards the end of the year, and by its extension to certificates with maturities of between 18 and 36 months. There was also a

substantial increase, in short-term financing, which was provided primarily by the banks (1,414 billion as against 864 billion in 1980 and 358 billion in 1979).

The role of the public sector was much larger, mainly because of the advances made by Mediocredito centrale out of the revolving fund set up to finance the investment programmes of small and medium-sized industrial firms.

The institutions' outstanding foreign currency borrowing, net of compensatory loans, rose by 1,946 billion (965 billion in 1980), nearly half of which was attributable to exchange rate variations. Most of the fund raising abroad was again by the industrial credit institutions, in connection with the growth in export credits, but there was also a sharp upturn in that of the real estate institutions and the public works special credit sections.

The institutions' capital and reserves also expanded by a larger amount (1,588 billion as against 1,126 billion in 1980). This was largely due to the increase in allocations to reserves for loan losses and miscellaneous charges and risks. Thus, in spite of the considerable expansion in lending, there was a further rise (from 8.90 to 9.25 per cent) in the ratio of own funds to the sum of lending, overdue instalments and bad debts.

Lending

The increase in the special credit institutions' lending amounted to 14,508 billion or 21.1 per cent (8,391 billion or 13.9 per cent in 1980). This includes the non-interest-bearing certificates of the Deposits and Loans Fund, which are repayable over ten years and were issued in October in exchange for the institutions' claims on the companies of the SIR group (1,275 billion).

The rate of expansion of medium and long-term lending rose from 12 to 19 per cent, while that of the lending of the banks beyond the short term declined from 27 to 11 per cent. There was thus a reversal of the tendency under way since 1976 for the banks to account for an increasing share of medium and long-term lending.

The lending of the industrial credit institutions with an initial maturity of less than 18 months grew by around 1,600 billion, at a rate of 58 per cent. The share of short-term lending has now been growing rapidly for four years. While it may have been stimulated by the doubling of the tax in lieu of stamp and registration duties on

medium and long-term loans in 1978, it also reflects both the effects of the ceiling on bank lending and the less marked differences between the various categories of intermediaries stemming, in part, from borrowers and lenders preferring shorter maturities in periods of rapid inflation.

The breakdown of lending by type of borrower shows not only a substantial increase in loans to private companies (7,306 billion or 20.4 per cent as against 5,734 billion or 19.1 per cent in 1980) but also a recovery in those to nationalized and state-controlled

Table 37

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

Class of borrower	Subsidized		Non-subsidized		Total			
	1980	1981	1980	1981	1980	1981	1980	1981
	<i>absolute changes in billions of lire</i>						<i>percentage changes</i>	
General government	73	44	649	791	722	835	8.2	8.8
<i>of which: local authorities</i>	59	21	635	752	694	773	9.9	10.0
<i>other public agencies (1)</i>	14	23	14	39	28	62	1.6	3.5
Finance and insurance companies	6	47	302	1,075	308	1,122	36.0	96.6
Non-finance companies	2,627	2,661	3,895	6,833	6,522	9,494	15.5	19.5
public	223	250	565	1,938	788	2,188	6.5	17.0
<i>nationalized</i>	-2	4	51	173	49	177	5.2	17.7
<i>State-controlled</i>	225	246	514	1,765	739	2,011	6.6	16.9
private	2,404	2,411	3,330	4,895	5,734	7,306	19.1	20.4
Households	107	315	732	1,467	839	1,782	9.9	19.1
TOTAL . . .	2,813	3,067	5,578	10,166	8,391	13,233	13.9	19.3
<i>of which: public enterprises and agencies</i>	297	294	1,213	2,729	1,510	3,023	7.2	13.5
<i>households and private companies</i>	2,516	2,773	4,365	7,437	6,881	10,210	17.5	22.1

(1) Including social security institutions.

corporations and a doubling of those to finance and insurance companies (Table 37). This development, together with the sharp rise in the financing recorded under the ancillary activities of the distributive trades sector, which include leasing companies, clearly reveals that a fairly large part of the flow of finance provided by the special credit institutions has served to sustain activity in the

parabanking sector. In view of the major role played by banks in the provision of funds, this implies situations of triple intermediation.

The previously mentioned increase in disbursements (from 18,321 billion to 26,496 billion) mainly concerned lending at market rates to industry and services (Table 38).

Domestic disbursements of subsidized credit rose from 5,401 to 6,866 billion. Even when export credits are excluded, there was still an increase (from 4,275 to 5,257 billion).

Table 38

**DOMESTIC LENDING BY THE SPECIAL
CREDIT INSTITUTIONS BY SECTOR**

(billions of lire)

Type of credit	Agriculture		Housing		Industry		Transport, distribution and misc. services		Exports		Total	
	1980	1981	1980	1981	1980	1981	1980	1981	1980	1981	1980	1981
Outlays												
Subsidized ...	1,763	2,288	432	641	1,547	1,773	533	555	1,126	1,609	5,401	6,866
Unsubsidized .	1,083	1,330	2,166	2,561	5,388	8,112	4,283	7,627	—	—	12,920	19,630
Total ...	2,846	3,618	2,598	3,202	6,935	9,885	4,816	8,182	1,126	1,609	18,321	26,496
Net increases in lending												
Subsidized ...	818	905	336	652	920	171	300	380	439	959	2,813	3,067
Unsubsidized .	301	433	1,800	1,890	1,845	3,458	1,632	4,385	—	—	5,578	10,166
Total ...	1,119	1,338	2,136	2,542	2,765	3,629	1,932	4,765	439	959	8,391	13,233
Percentage increases in lending												
Subsidized ...	24.4	21.5	15.6	26.2	10.4	1.7	12.7	15.0	16.8	31.5	14.5	13.8
Unsubsidized .	27.0	31.3	15.4	14.0	16.0	25.9	9.9	24.2	—	—	13.6	21.9
Total ...	25.0	23.9	15.3	15.9	13.5	15.6	10.2	23.0	16.8	31.5	13.9	19.3

Every sector contributed to the increase, albeit to a varying extent. Specifically, there was a considerable expansion in the flow of credit to housing — which tallies with the rise in this kind of lending to households — while that to industry and services grew only slightly (Table 38).

The cost of finance

The rise in interest rates on the financial market until the third quarter caused a further sharp increase in the overall cost of the special credit disbursed at market rates, which rose as an annual average from 16.90 to 19.80 per cent.

This overall result was the outcome of similar patterns for the different technical forms of lending, even though the range of debt instruments made available to customers was greatly extended. The short-term loans of the industrial institutions were disbursed at the weighted average rate of 20.40 per cent, compared with 18.20 per cent the year before. The cost of variable rate medium-term funds rose from 17.60 to 21.10 per cent; that of fixed rate funds, which remained at lower levels as a result of the administrative control of bond yields, rose on average from 15.50 per cent in 1980 to 17.60 per cent in 1981 (Chart 12).

The average rate charged on subsidized credit also went up slightly (from 6.60 to 7.10 per cent). The upward adjustment to the subsidized rates in the industrial and housebuilding sectors made by administrative order respectively in the middle and at the end of the year had little effect on the widening gap between the market and the subsidized cost of credit (12.70 per cent on average as against 10.30 per cent in 1980).

Credit to industry

Net of export finance, disbursements to industrial firms amounted to 9,885 billion, which was considerably more than in the previous year (6,935 billion). The ratio of disbursements to investment in the sector rose sharply from 35.7 to 44.7 per cent.

Outstanding lending to the industrial sector (including the loans funded with securities) increased by 4,904 billion at a rate of 21 per cent (2,765 billion and 13.5 per cent in 1980).

In manufacturing, substantially more finance was provided to the food processing and engineering industries, which raised large loans at subsidized rates, as well as to the transport equipment sector. Lending to the electricity and gas industries also expanded considerably.

The industrial institutions' short-term lending to the industrial sector expanded by 770 billion or 45 per cent, compared with 680 billion or 65 per cent in 1980.

Credit to services

The large rise in disbursements to the services sector compared with the previous year (8,182 billion as against 4,816 billion) was primarily due to the growth in operations at market rates (7,627 billion as against 4,283 billion). The percentage increase in disbursements considerably exceeded that in the sector's investment, so that their ratio (excluding investment in housing) went up from 19.3 to 26.1 per cent.

In the transport and communications sector there was a further increase in the net flow of finance to air transport in connection with the renewal of Alitalia's fleet of aircraft. At the same time the net lending to telecommunications returned to a high level (618 billion) after the decline recorded in 1980. The credits to other services also increased considerably, especially those to financial and insurance institutions (from 401 to 1,423 billion) and to the distributive trades (from 478 to 1,318 billion).

Credit to housing

The total volume of special credit disbursed to the housing sector amounted to 3,202 billion, compared with 2,598 billion in 1980. The flow of resources for new buildings accounted for a slightly smaller share of investment expenditure than the year before (11.1 per cent as against 11.8 per cent), while the proportion of loans for the purchase of existing houses increased.

The decline in the importance of housing credit in recent years reflects the decline in the demand of middle-income households deriving from the large increase in both house prices and the cost of mortgages, whether at fixed or variable rates.

The willingness of banks to take up securities of the real estate institutions beyond their compulsory security investment requirement and the purchase of variable rate bonds by the public confirm that demand factors have been predominant in the decline in the role of the real estate institutions.

Fund raising with financially indexed instruments (nearly 1,050 billion) represented almost a quarter of their total gross bond issues. Borrowing from international organizations, with the government bearing the exchange risk, expanded by around 180 billion (70 billion in 1980).

The greater volume of activity at variable rates was made possible by the good reception given to financially indexed bonds, though variable rate loans do not solve the problem of the high initial charges borrowers have to bear. The instruments that avoid this difficulty, such as those with real indexation, were not adopted on a wide scale (disbursements amounted to about 140 billion, compared with 60 billion in 1980). This can presumably be attributed both to difficulties on the demand side, deriving in part from fiscal discrimination, and to the cool reception given to the bonds of this kind, which were offered with partial revaluation schemes that appeared insufficiently responsive to changeable inflationary expectations.

The estimate of the forms of financing of private investment in housing was modified in an attempt to make the financial flows more consistent with the underlying real aggregate and confirmed the

Table 39

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	
	1980	1981	1980	1981	1980	1981	1980	1981	1980	1981
Public funds (2)	966	1,038							966	1,038
Loans	111	77			2,832	2,352	2,552	2,802	5,295	5,431
Special credit institutions					314	1,385	418	1,560	1,699	1,978
Banks					2,518	954	2,134	1,168	3,472	3,302
Insurance companies and social security institutions						13		74	13	74
Deposits and Loans Fund	111	77							111	77
Domestic saving			583	313	11,078		15,441		11,661	15,754
TOTAL . . .	1,077	1,115	583	313	16,262		20,795		17,922	22,223

(1) The data for 1981 are provisional. — (2) Outlays of the Deposits and Loans Fund out of appropriations to subsidized housing (excluding mortgages for the purchase of old buildings).

predominant role of self-financing, which rose further in relation to both total private saving and housing investment expenditure, partly as a consequence of the increase in the cost of credit. The smaller share of external finance was due to the reduction for the second year

running in the contribution of the banks, subject to increasingly restrictive ceilings, and to a further slight decline in the share of the special credit institutions (Table 39).

The subsidized loans disbursed to the housing sector amounted to 641 billion, as against 432 billion in 1980. The estimate of the proportion of investment covered by this form of incentive rose from 3.9 to 4.5 per cent. By contrast, the share of public investment declined again (from 6 to 5 per cent) as a result of the further reduction in the proportion of subsidized housing.

Credit to agriculture

The lending of the agricultural credit institutions increased by 1,853 billion, as against 1,684 billion in 1980 (Table 40). Though lower than in 1980, the rate of growth in agricultural credit remained high (19.9 per cent as against 22.1 per cent), especially in comparison with the limited growth of the real aggregates.

Table 40

LENDING BY THE AGRICULTURAL CREDIT SYSTEM

(changes in billions of lire)

	Agricultural special credit institutions		Other institutions		Total	
	1980	1981	1980	1981	1980	1981
Working credit	496	529	622	654	1,118	1,183
Improvement credit	391	500	175	170	566	670
TOTAL . . .	887	1,029	797	824	1,684	1,853
Financing of stockpiling operations	33	-30	31	47	64	17
<i>compulsory</i>	25	26	36	41	61	67
<i>voluntary</i>	8	-56	-5	6	3	-50
Other loans	3	6	-	-	3	6
GENERAL TOTAL . . .	923	1,005	828	871	1,751	1,876

The greater part of the increase in agricultural credit was in the subsidized sector (74 as against 71 per cent). There was a further rise in the already high level of government support to the sector, in part because of the larger differential between the reference rates adopted,

which were raised considerably, and the subsidized rates charged, which remained virtually unchanged over the year.

Outstanding working credit expanded by 21.9 per cent and as a ratio to gross marketable production, which grew at a slower rate than prices, rose from 17.8 to 19.4 per cent. In spite of the special credit institutions having increased their market share, there was also a larger increase in the lending of the banks, especially in the subsidized credit sector where the majority of operations are now provided for under regional laws. Lending to agricultural agencies and cooperatives showed pronounced increases, while that to finance purchases of equipment was on a minor scale.

Disbursements of improvement credit amounted to 913 billion, compared with 760 billion in 1980. As a ratio to investment in the primary sector, which rose slightly in nominal terms but fell sharply in real terms, outlays increased from 16.0 to 17.7 per cent. Outstanding lending at the end of the year amounted to 4,576 billion, of which more than four fifths was at subsidized rates.

A number of innovations regarding the intermediaries' fund raising may have a considerable impact on their lending to the agricultural sector. In particular, the special credit institutions have been authorized to issue bonds as a counterpart to working credit loans with a maturity of five years. This, together with the new regulations concerning shareholders' advances and the issue of certificates of deposit, should make these intermediaries more independent in the financing of medium-term operations.

Export credit

The export credit disbursed by the special credit institutions amounted to 2,714 billion, compared with 2,133 billion in 1980 (Table 41). The rate of increase in lending was equal to that in visible exports, so that the ratio of the two flows remained unchanged at 3.2 per cent. There was, however, a further decline in the ratio of disbursements to the value of exports of final investment goods (from 12.9 to 12.1 per cent). This was partly due to the faster rate of growth of this sector, which is supported by a range of subsidized medium-term credit facilities that goes beyond what the special credit institutions offer and in which the credit granted by non-residents has taken on considerable importance.

Table 41

EXPORT CREDITS (1)*(billions of lire)*

Type of credit	Outlays		Net increases		Loans	Financing commit- ments	Applica- tions to examine
	1980	1981	1980	1981			
	flows				outstanding at end-December 1981		
Supplier credits	1,126	1,609	439	959	4,004	4,312	702
Buyer credits	1,007	1,105	666	607	3,196	4,944	304
<i>of which: tied</i>	929	1,004	618	553	2,933	4,633	304
<i>untied</i>	78	101	48	54	263	311	—
TOTAL . . .	2,133	2,714	1,105	1,566	7,200	9,256	1,006

(1) Excluding refinancing by UIC and compensation payments by SACE totalling, at end-1981, 1,909 billion (1,712 at end-1980).

The amount of supplier credits disbursed rose from 1,126 to 1,609 billion, the main beneficiaries being the engineering, transport equipment and construction industries. The gross flow of buyer credits increased from 1,007 to 1,105 billion. Net of reimbursements and gross of exchange rate variations, the value of outstanding export credit rose by 1,566 billion, compared with 1,105 billion in 1980.

The breakdown of lending by country shows that the developing countries' share of net new lending increased considerably, rising from 45 to 71 per cent. Algeria received nearly a third, mainly in the form of supplier credits. By contrast, there was a fall (from 43 to 21 per cent) in the share of the Eastern European countries, which accounted for nearly half the buyer credits granted.

The cost of public intervention to subsidize medium-term credit went up owing to the widening gap between subsidized rates, which remained unchanged for nearly the whole year, and the reference rate for the operations funded in lire, which followed the sharply rising rates on the domestic financial market. In November increases were made in both the minimum "consensus" rates for strong currency loans (approximately 2.5 percentage points) and the subsidized rates for loans denominated in lire (approximately 3 percentage points).

The value of the applications approved by the special credit institutions was slightly greater than in 1980. At the end of December their financing commitments amounted to 9,256 billion, of which 3,915 billion were signed contracts. In turn, 2,896 billion of the latter amount was for buyer credits. Notwithstanding the

strengthening of the instruments of public support, the prospects for export credit growth in 1982 appear uncertain in view of the political and financial risks attaching to some of the countries that avail themselves of the subsidized deferment of payments.

Total financing and the formation of financial assets

The rise in interest rates and the tighter control exerted on bank credit, in conjunction with a large increase in the net indebtedness of the public sector, acted as a curb on the spending capacity of firms during 1981, while boosting households' demand for financial assets.

Expressed as a ratio to GDP, the public sector's financial deficit rose from 9.6 to 13.3 per cent, over four fifths of the increase being due to the deterioration in the current account deficit caused primarily by the combined effect of the expansionary budget policy decided in 1980 and built-in stabilizers. Firms' borrowing

Table 42

FINANCIAL BALANCES OF DOMESTIC FINAL USER SECTORS

Year	Households	Firms	Public sector (1) (consolidated)	Households	Firms	Public sector (consolidated)
	(billions of lire)			(percentage of GDP)		
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	20,726	-9,686	-15,566	16.5	-7.7	-12.4
1976	22,745	-11,804	-14,459	14.5	-7.5	-9.2
1977	28,089	-9,673	-17,051	14.8	-5.1	-9.0
1978	34,753	-5,946	-23,719	15.6	-2.7	-10.7
1979	39,258	-3,558	-26,989	14.5	-1.3	-10.0
1980	42,191	-23,863	-32,692	12.4	-7.0	-9.6
1981	53,620	-21,058	-53,045	13.5	-5.3	-13.3

(1) Net indebtedness; differs from the item in Table 20 owing to the inclusion of actuarial reserves of the Social Security Institute.

requirements remained large as a result of reduced self-financing, despite a slight decline in fixed investment and the running down of inventories prompted by the tighter monetary conditions. The sector's financial deficit in fact decreased as a percentage of GDP compared with the previous year (to 5.3 per cent from 7 per cent in 1980).

Households' net investments in financial assets rose from 12.4 to 13.5 per cent of GDP in response to the higher real yields offered, thus enabling the increased demand for funds of other domestic sectors to be met without aggravating the current external deficit in relation to GDP (Table 42).

The restrictive policy adopted by the monetary authorities affected the supply of credit to firms; excluding bank loans used to finance the non-interest-bearing deposit on payments abroad, the increase in domestic credit to the non-State sector amounted to 28,120 billion lire, which is lower than the previous year's figure of 29,106 billion and also less than the 28,400 billion projected when the total domestic credit target for 1981 was set. The State sector's

Table 43

TOTAL DOMESTIC CREDIT

	1980	1981				
		Year	Quarters			
			I	II	III	IV
		changes in billions of lire				
State sector borrowing requirement (1)	33,909	45,140	10,512	7,591	10,876	16,161
Lending to the non-State sector (2)	29,106	28,120	3,967	3,837	3,547	16,769
TOTAL DOMESTIC CREDIT ...	63,015	73,260	14,479	11,428	14,423	32,930
<i>TOTAL DOMESTIC CREDIT (3) ...</i>	<i>66,595</i>	<i>78,136</i>	<i>16,623</i>	<i>12,599</i>	<i>17,420</i>	<i>31,494</i>
Borrowing requirement of the enlarged public sector (4)	35,447	46,748	10,505	7,173	12,013	17,057
Lending to the private sector (5)	27,568	26,512	3,974	4,255	2,410	15,873

(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 comprises 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) and for 1981 excludes bank loans to finance the non-interest-bearing deposit on payments abroad. — (3) Including acceptances acquired by the public, bad debts of special credit institutions and financing of the non-interest-bearing deposit under footnote (2). — (4) The borrowing requirement is net of borrowing abroad, of financing to credit institutions and of securities issued to fund debts of firms. — (5) By credit institutions and through bond issues; excluding the non-interest-bearing deposit under footnote (2).

borrowing requirement increased by 45,140 billion lire (against 33,909 billion in 1980) despite the restitution to the Treasury of over 4,000 billion worth of public authorities' bank deposits, and was 9,040 billion higher than initially forecast. The fact that the largest component in the credit aggregate adopted for control purposes was public sector borrowing made it impossible to offset the over-expansion, since a tighter containment of credit to firms would have

had serious adverse effects on the productive system. Consequently, the growth in total domestic credit exceeded the target by 8,760 billion; this represents an increase of 73,260 billion during the year (63,015 billion in 1980), and a rate of growth of outstanding credit of 18.2 per cent, which is slightly lower than the previous year. As a ratio to GDP, the flow of total domestic credit declined marginally, from 18.6 to 18.4 per cent (Tables 43 and 44).

Table 44

**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)
1978	20.4	20.4	19.2	20.9	118.9	85.8	21.4	22.2
1979	21.0	20.6	19.8	18.5	118.5	84.4	21.1	19.6
1980	15.6	13.2	21.4	18.6	111.1	77.5	22.0	18.6
1981	17.2	11.8	23.1	18.2	110.0	74.3	24.4	18.4
1981 (5)	18.1		23.6	18.8	111.0		25.0	19.0

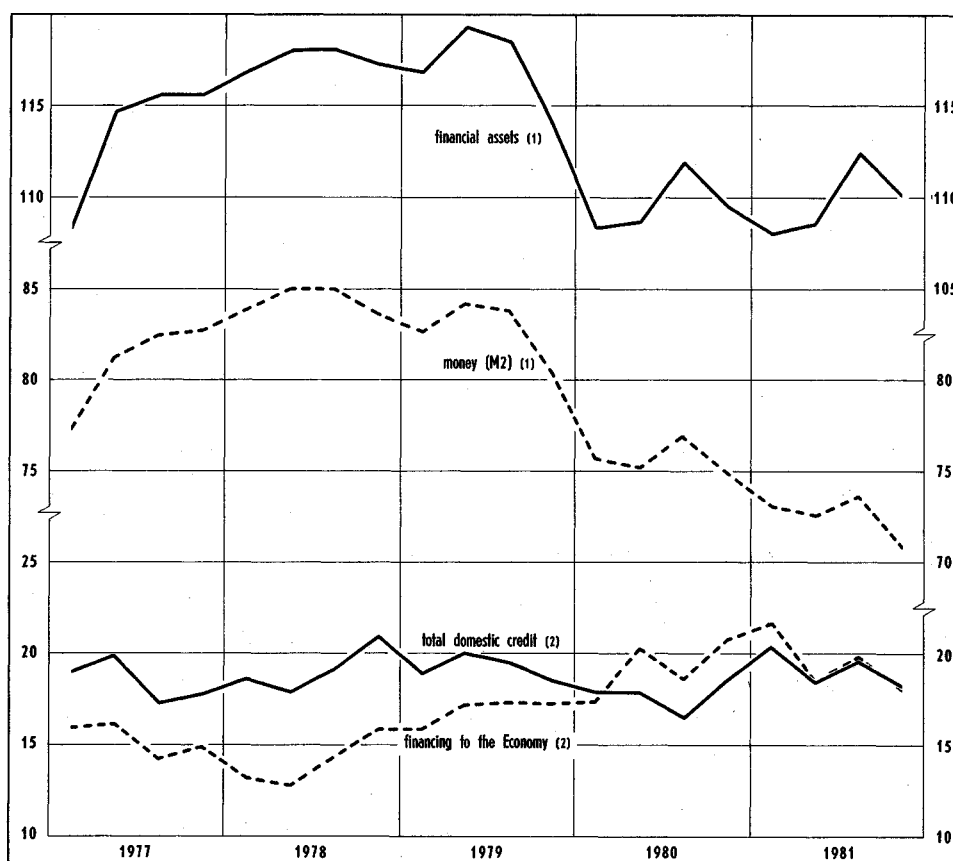
(1) Total financing comprises financing to the Economy (including bad debts of credit institutions) and to the public sector. — (2) Excluding shares. — (3) Average annual amounts. — (4) Annual changes. — (5) Financial assets include the non-interest-bearing deposit on payments abroad; total financing and TDC include the part of the deposit financed by banks.

The crowding out of the productive sector by the public sector took place principally in the credit market. Bank loans granted to the Economy (households and firms) amounted to 15,806 billion lire (adjusted to take account of funding operations and bad debts), compared with 21,103 billion in 1980, while net disbursements by special credit institutions rose from 9,395 to 13,969 billion. Despite an extremely rapid rise in short-term loans by special credit institutions, the composition of the flow of newly granted finance shifted towards the medium-term segment. The overall increase in loans with such maturities was in part the outcome of a change in the type of finance obtained abroad: bank loans in foreign currency decreased by 1,650 billion compared with an increase of 6,300 billion in the previous year, while medium-term loans taken out by firms directly on the Euromarket doubled, from 4,000 to 8,400 billion. In aggregate, foreign borrowing through these two channels fell by one third compared with 1980, from 10,300 to 6,750 billion.

The amount of finance to the Economy raised directly on the domestic capital market was modest. Share issues, excluding those

made to finance purchases of subsidiaries' issues and excluding increases in the endowment funds of state-controlled firms, rose by only a small amount, from 1,918 to 2,239 billion. The expansion of channels other than the traditional ones enabled firms to offset to a limited extent the effects of the tight monetary policy. Bankers' acceptances placed with the public fell to 600 billion, compared with 1,150 billion in 1980. Bank-related intermediaries, in particular leasing companies, rapidly expanded their activity, which is, moreover, often closely allied to that of the special credit institutions and commercial banks, thereby creating instances of triple intermediation. The additional flow of intermediated funds stemming from those raised directly among savers can be estimated at just over 1 per cent of finance to the Economy.

Chart 13



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 and the non-interest-bearing deposit on payments abroad. — (2) Growth rates over 12 months; excludes bank financing of non-interest-bearing deposit on payments abroad. Financing of the Economy excludes shares and includes bad debts and funding operations.

Total finance to the Economy amounted to 44,243 billion lire, compared with 41,903 billion in 1980. Net of shares, the rate of increase dropped from 20.9 to 18.2 per cent, and hence equalled that in GDP during the year (Chart 13).

Including the net indebtedness of the public sector total financing of domestic final user sectors amounted to 97,288 billion lire, compared with 74,595 billion in the previous year; the rate of increase accelerated from 21.4 to 23.1 per cent and the ratio to GDP rose from 22 to 24.4 per cent. The share of total finance used by the Economy dropped by 11 points compared with 1980, from 56 to 45 per cent. This unprecedentedly low value reflected the fact that for the first time in the last twenty years the public sector absorbed over half of total financing (Table 45).

Table 45

FINANCING OF DOMESTIC FINAL USER SECTORS

	Flows				
	1977	1978	1979	1980	1981
<i>billions of lire</i>					
Total financing of:					
Households and firms (1)	19,634	23,823	29,954	41,903	44,243
Public sector (consolidated)	17,051	23,719	26,989	32,692	53,045
Total ...	36,685	47,542	56,943	74,595	97,288
<i>percentage breakdown</i>					
Total financing of:					
Households and firms	53.5	50.1	52.6	56.2	45.5
Public sector (consolidated)	46.5	49.9	47.4	43.8	54.5
Total ...	100.0	100.0	100.0	100.0	100.0

(1) For 1981 the data differ from those in Table 46 since bank loans have been adjusted to exclude credit used to finance the non-interest-bearing deposit on payments abroad.

The large expansion of credit was matched by an increase in households' financial assets as their propensity to invest in these instruments followed the rise in interest rates. Despite the tight monetary policy, firms also slightly increased their liquid assets after the previous year's substantial decline. The acquisition of financial assets by the Economy totalled 76,224 billion, against 57,965 billion in 1980 (Table 46); the rate of increase of these instruments, excluding shares and the non-interest-bearing deposit on payments abroad, rose from 15.6 to 17.2 per cent, while the average stock as a ratio of GDP fell from 111 to 110 per cent, after the decline of over seven points recorded in 1980.

Table 46

THE FINANCIAL ASSETS OF THE ECONOMY AND THEIR COUNTER-ITEMS

(amounts and flows in billions of lire)

	Amounts at end 1980	Flows					
		1980	Year	1981			
				Quarters			
				I	II	III	IV
FINANCIAL ASSETS:							
Domestic	572,646	56,079	75,655	8,543	11,964	16,282	38,866
Currency	24,545	3,545	4,292	-1,086	1,105	755	3,518
Deposits: Post Office & with Treasury	32,432	1,942	2,814	664	-401	44	2,507
bank	235,829	28,719	27,299	-7,120	-933	1,741	33,611
Short-term securities (1)	35,560	17,001	25,345	12,843	6,826	8,149	-2,473
Other deposits and savings certificates	6,193	527	1,351	475	114	-52	814
Fixed-interest securities	27,668	-1,424	5,412	1,450	1,611	1,371	980
Shares (2)	187,379	1,937	1,053	263	522	112	156
Other financial assets (3)	23,040	3,832	4,267	1,054	1,063	1,069	1,081
Deposit on payments abroad	—	—	3,822	—	2,057	3,093	-1,328
Foreign	29,412	1,886	569	-264	863	-3,191	3,161
TOTAL ...	602,058	57,965	76,224	8,279	12,827	13,091	42,027
AGAINST FINANCING OF:							
ECONOMY	422,851	41,903	46,624	8,222	9,375	10,242	18,785
Borrowing from: banks (4)	119,192	21,103	15,806	1,345	2,345	1,646	10,470
special credit institutions (4) (5)	59,789	9,395	13,969	3,184	1,898	3,903	4,984
Public sector loans	3,637	215	353	124	61	87	81
Foreign loans	16,417	3,983	8,434	1,371	2,877	1,034	3,152
Bonds	13,887	231	555	-265	305	591	-76
Shares (6)	191,430	1,918	2,239	559	1,111	237	332
Endowment funds	12,505	3,239	3,358	207	483	2,275	393
Financing by local authorities	3,727	191	708	193	116	132	267
Other financial liabilities (7)	2,267	1,628	1,202	1,504	179	337	-818
FOREIGN SECTOR (8)	38,619	-8,291	-9,225	-3,199	-3,184	-1,969	-873
PUBLIC SECTOR (consolidated)	180,834	32,692	53,045	8,889	11,429	15,061	17,666
UNCLASSIFIED (9)	-40,246	-8,339	-14,220	-5,633	-4,793	-10,243	6,449
TOTAL ...	602,058	57,965	76,224	8,279	12,827	13,091	42,027
ECONOMY'S FINANCIAL BALANCE ...	179,207	16,062	29,600	57	3,452	2,849	23,242

(1) Includes Treasury bills and bankers' acceptances. — (2) Does not include shares issued by state-controlled firms purchased by parent financial companies and holding companies. — (3) Includes actuarial reserves and an estimate of atypical securities. — (4) Flows are adjusted to take account of bad debts of credit institutions totalling 2,266 billion in 1980 and 1,687 billion in 1981. Also includes funding of bank debts of state-controlled firms, totalling 525 billion in 1980 and 672 billion in 1981; for 1981 also includes funding of debts with special credit institutions in the amount of 1,275 billion. — (5) Includes insurance companies. — (6) Net share issues by private companies and third parties' contributions to state-controlled firms. — (7) Acceptances purchased by non-bank investors and atypical securities. — (8) Current account of the balance of payments on a transactions basis. — (9) Includes discrepancies.

...

The move towards a more balanced interest rate structure and the growing prevalence of variable rate securities brought about a shift in the composition of newly created assets, with the share of fixed-interest securities and special credit institution certificates rising back to nearly 9 per cent. Furthermore, the widening of the yield differential between Treasury bills and bank deposits caused the share of the latter to drop to less than half of newly created liquid assets. The result was a further decline in the rate of increase of money (M_2), from 13.2 to 11.8 per cent; the money/income ratio dropped from 77 to 74 per cent. Owing to massive purchases of Treasury bills by the Economy the rate of growth of total liquid assets (M_3) remained stationary at 18.1 per cent, while the ratio to GDP rose from 86 to 87 per cent.

THE SUPERVISION OF CREDIT INSTITUTIONS

The banks responded to the increased supply of Treasury securities, the tightening of the administrative controls on their assets and the resulting slowdown in the rate of growth in intermediation with operating policies designed to restructure their assets and broaden the range of their customer services. The medium and long-term credit institutions were able to increase their fund raising owing to the tax exemption of their securities and the possibility of offering more varied maturities and indexed yields. Consequently, they expanded their lending at market rates.

The changes that have occurred in the structure of the credit intermediaries' balance sheets and the increasing integration of markets raise delicate regulatory problems for the supervisory authorities, whose task it is to prevent the appearance of destabilizing effects as the system develops while respecting the basic principle of companies' freedom of choice. It is therefore necessary to encourage the credit institutions to adjust to the needs the evolution of the market imposes by adopting suitable models of internal organization. On the other hand, it is necessary to improve and broaden the range of the supervisory authorities' instruments for intervention and the collection of information.

During 1981 the performance of this assignment resulted, above all, in action to improve the operating conditions of the credit institutions, though equal commitment was shown in the fields of both authorizations and controls based on prudential returns and inspections.

This is the background to the expansion of the branch network decided in the first quarter of 1982 and the progressive implementation of the project for the revision of banks' articles of incorporation, the two directions in which the gradual increase in the system's competitiveness, and hence efficiency, is being pursued.

The plan to render the rules and regulations governing the medium and long-term credit institutions more uniform proceeded with the issue, in harmony with the provisions of Law No. 23 of 1981, of the regulations regarding new forms of fund raising.

The activities closely related to banking were monitored, partly on the basis of the legislation governing shareholdings, with forms of control that are consistent with the general objectives of supervision

but which did not undermine the positive effects of these activities in terms of greater variety of financial market instruments.

Changes in the operating conditions of the banking system

Size and territorial structure. – On 31 December 1981 there were 1,079 registered banks, compared with 1,069 at the end of the previous year.

The aims of the national branch plan implemented in March 1982 had originally been announced by the Interministerial Committee for Credit and Saving in a resolution of 6 January 1978 and basically reconfirmed at the meeting the Committee held on 12 September 1980. Hence the action of the Banca d'Italia in authorizing the opening and transfer of branches was directed towards supporting the rationalization of banks' territorial networks, promoting the strengthening of banking structures in poorly served areas, stimulating the supply of a broader range of banking services in individual areas and, finally, encouraging a higher and more uniform level of competition.

In order to achieve these objectives, improvements were made to the procedures, already employed for the 1978 plan, that make it possible to determine the conditions prevailing in each area with regard to productivity and competition. In large towns other parameters were also analyzed to obtain a more accurate estimate of the need for additional branches.

In accordance with the guidelines of the Interministerial Committee for Credit and Saving, as a general rule new branches were only authorized in areas considered to be poorly served, where the addition of new operational offices would not reduce the average productivity of the existing branches. When a shortage in the supply of banking services was identified in a large town, the criterion adopted was that of giving preference to the entry of banks with adequate ability to provide more sophisticated services. The needs of newly formed districts and of suburbs were satisfied in part by allowing banks already present in the town to open new branches.

The need for improved selection criteria was also felt in connection with applications to set up offices abroad in view of Italian banks' greater interest in having operational facilities in the form of branches or subsidiaries in the leading international financial centres. In conformity with the guidelines laid down by the Intermini-

sterial Committee for Credit and Saving on 28 January 1981, applications are assessed bearing in mind the size of the applicant bank and the total volume of its foreign business. As of 31 December 1981, 11 banks were authorized to have establishments abroad and they had a total of 61 branches (13 of which in the process of being opened).

As for foreign banks in Italy (27 banks with 37 branches at the end of 1981), a favourable attitude continued to be taken to the entry of leading international banks with the aim of enlarging the supply of customer services and intensifying competition.

Policy regarding banks' articles of incorporation. — Since market forces are not considered sufficient to produce the changes needed in banks' organizational structures promptly enough, it is up to the supervisory authorities to press the intermediaries into making suitable adjustments when it is apparent that their structures are not in line with external needs and prospects. The main directions of this action, which stimulates the independent search for solutions by the banks involved, are the strengthening of their ability to exploit all the various fund-raising and lending opportunities and the rationalization of their organizational structures. This is based on the balance of power between the various organs, the safeguarding of the leadership functions of top management and the enhancement of technical experience in the assessment of loan applications.

These objectives are pursued equally in public and private banks, which have been made to compete and therefore face similar costs and risks, as well as adopting the same criteria in their management choices. Hence their operational structures must develop according to entrepreneurial logic.

The organization of public banks is viable when the elements of public interest do not undermine the autonomy needed to pursue banking ends. Operational efficiency, soundness and autonomy must be features common to all the intermediaries. If public banks — which account for a large proportion of both the short-term and the medium and long-term sectors — based their operations on principles other than those of banking entrepreneurship, distortions would ensue in the actual allocative function of credit activity and the stability of the whole system would be undermined.

Law No. 23 of 1981 has made increases in the capital of banks with their head offices in Southern Italy conditional on the rationali-

zation of their organizational structures. In implementation of this law the Treasury Minister has issued directives designed to encourage the reform of the main aspects of their articles of incorporation.

The directives basically concern the range of banking operations undertaken, the broadening of the right to subscribe capital and the effects of this on the governing bodies of the banks. There is thus an accentuation of the entrepreneurial function that the Southern Italian banks perform in promoting the economic development of the areas in which they operate.

The debate on public credit institutions has spread to the public savings banks, where the achievement of efficiency needs to be based on principles similar to those applied to other banks, albeit in conformity with the special features of this type of bank.

The economic development of the areas in which savings banks are established has led to considerable changes in the demand for credit they receive and to their now having difficulty in satisfying it with traditional forms of lending. In addition to the need to broaden the range of their operations, it is becoming increasingly necessary for savings banks to strengthen their capital bases since the changes in their functions reduce the scope for relying on a watertight system of collateral backing and stable fund raising.

The supervisory authorities have therefore laid down guidelines for the change in the organizational framework of these intermediaries that support the expansion of operations, more extensive contributions to capital and a sharper dialectic among the various organs of the banks. Since the savings banks have developed operational structures that vary considerably in terms of size and geographical spread, each will be able to work out the solutions that best respond to the factors influencing its operations and development.

Medium and long-term intermediation. — Substantial changes were made during 1981 to the legislation regarding the operations of the special credit institutions, and above all to their fund raising.

In conformity with Law No. 23 of 1981, the Treasury Minister issued a decree on 23 December whereby the special credit institutions were authorized in principle to issue certificates of deposit and interest-bearing certificates as well as to receive advances from their shareholders. The autonomous sections for the financing of public works were an exception and were only allowed to have recourse to advances. The aim was to enlarge the special credit

institutions' range of fund-raising instruments and hence provide greater operational flexibility at times of bond market instability. The system of credit intermediaries is thus required to operate under more competitive conditions within a framework of more uniform regulations.

The restrictions on banking operations. – Despite the further reduction in the scope for banks' operations – on account of the stricter limits on the growth of lending, the raising of the compulsory reserve coefficient and the virtually unchanged amount of the security investment requirement – the new slowdown in deposits resulted in a two point rise in the ratio of lending to deposits (from 52.2 per cent in 1980 to 54.2 per cent).

When the ceiling was renewed, it was extended to almost all bank lending by abolishing the exemption of loans of less than 130 million lire.

In practice some banks exceeded their growth ceilings in spite of the non-interest-bearing deposit imposed on excess lending. Even though they paid the deposit, banks that repeatedly overshot the ceiling were invited to eliminate their excess lending in conformity with the original purpose of the deposit, which was designed exclusively to grant intermediaries a certain operational leeway.

In order to further discourage overshooting, the percentages of excess lending to be deposited were raised on 30 April 1982.

The compulsory reserve coefficient was raised in March 1981 from 15.75 to 20 per cent of deposits. The reserves rose during the year by 5,100 billion to a total of 43,323 billion at the end of the year, when their ratio to deposits amounted to 15.1 per cent, compared with 14.6 per cent a year earlier.

Among the interventions designed to further the objectives of credit policy was the renewal of the security investment requirement. The monetary authorities left the share of the increase in deposits to be invested at 6.5 per cent in the first half of the year and then raised it slightly to 8.0 per cent in the second.

Shareholdings. – The resolutions adopted by the Interministerial Committee for Credit and Saving on 28 January 1981 constitute the framework governing shareholdings by banks. The increase in such shareholdings in the past few years has resulted in the strengthening

of cooperation between the credit institutions, the development of activities closely related to banking through companies controlled by the banks and greater interest in international business. For the largest Italian banks the latter has found expression in the taking of direct or indirect shareholdings and the establishment of branches in the leading financial centres.

The above-mentioned resolutions of the Interministerial Committee for Credit and Saving lay down that foreign shareholdings must as a rule be direct and may be taken only in banks or in companies that provide services closely related to banking. The individual authorizations of such shareholdings take account of the scope within the existing regulatory framework for acquiring the data considered essential for control purposes and, in the case of foreign credit institutions, of whether adequate supervisory structures exist in the countries concerned.

In view of the considerable range of *de facto* situations that existed, the banks were invited to bring themselves into line with the resolutions of the Interministerial Committee for Credit and Saving by submitting a programme – gradual enough so as not to exert unwelcome effects on their capital and reserves – for the reorganization and disposal of any shareholdings they already owned that did not correspond to the principles embodied in the resolutions.

The implementation of the new standards, which is still proceeding, has not involved any particular problems for the credit institutions operating at a provincial or regional level, but it has proved more difficult in the case of the major banks, partly because of their more complex structure in Italy and abroad and partly because of the institutional peculiarities of the regulations governing holding companies in certain countries.

In order to increase and improve the flow of information concerning shareholdings, proposals have been put forward under which the supervisory authorities would be entitled to request the banks to consolidate their own data with those relating to their Italian shareholdings. A similar need for information is felt to exist with respect to foreign shareholdings. In the meantime a thorough survey of the end-1981 data has been organized through which more detailed information will be obtained concerning the financial links between Italian banks and their foreign shareholdings and between their foreign subsidiaries and all the companies in which the latter have a sizable shareholding.

Parabanking activities. – There was a further sharp increase in all “parabanking” activities in 1981, both in those that are essentially accessory to banking (data processing, financial consultancy, auditing, etc.) and in those that are more directly related to it (leasing, factoring, etc.) and which, because they represent genuine alternative sources of funds for the productive sector, are of particular interest to the supervisory authorities.

Keen to move into new operational areas beyond those circumscribed by the ceilings on lending, the limits on medium and long-term operations and the competition from the Treasury for savings, the banks participated actively in the spread of the phenomenon, in particular by enlarging the supply of ancillary services provided through specialized companies in certain sectors.

Direct recourse to private savings by companies in the “parabanking” sector also became widespread. It involved the issue of bonds and shares (subject to prior authorization by the Ministry of the Treasury and/or the Banca d'Italia depending on the case), of “atypical” securities (real estate certificates, financial certificates, etc.) which are subject to no controls whatsoever, and of bankers' acceptances. In 1981 the latter increased by far less than in the previous year (50 as against 230 per cent) owing to their having been limited to a maximum of two fifths of the net worth of each bank, and to the tax treatment to which they were subjected by Law No. 692 of 1981.

The authorization of banking operations

The authorizations granted included authorizations relating to lending, investment in real estate and the issue of bonds.

Lending. – The number of authorizations granted to banks in respect of lending was slightly lower in 1981 than in 1980.

The reduction in operations relating to the lending ceiling for individual clients, which reflected the considerable degree of autonomy conferred on the banks by the rules in force, was accentuated in the course of the year by the increase in own funds. Only for the branches of foreign banks was there an increase in specific authorizations, which was due to their increased number and their special operational characteristics.

Investment in real estate. — In view of the links between them and the norms governing shareholdings, the supervisory rules for the banks' real estate operations, which fall within the exclusive competence of the Banca d'Italia, have also been undergoing revision with a view to making them more flexible. Prior notification is no longer required for expenditure relating to buildings intended for functional use, as long as it does not exceed the margin resulting from the difference between net worth and investment in real estate and shareholdings. A similar prior notification requirement has been discontinued for real estate transactions which, subject to the relevant limits and conditions laid down by the Interministerial Committee for Credit and Saving, regard investment of staff severance pay and pension funds.

Authorization of issues on the securities market. — There was a marked increase in the number of applications for authorization to float issues on the securities market.

The volume of index-linked issues was large, on account of the predilection shown for such fund-raising instruments initially by the industrial credit institutions and, more recently, by other types of special credit institutions as well.

The interest in index-linked issues was accompanied by a marked tendency for conditions and the parameters of variability to become more diversified. The supervisory authorities took action to stem this trend, being guided in their decision-making by the principle of guaranteeing the necessary transparency of the market and of reducing the impact of the link between medium and long-term yields and short-term rates.

The diversification process that affected the supply of bonds resulted in greater use of convertible bonds and a gradual shortening of maturities.

The monitoring of banking activity

Inspections. — In 1981 a total of 184 inspections were made, of which 132 were general and 52 sectoral (compared with 143 and 44 respectively in 1980). The general inspections concerned 131 banks with deposits amounting to 22,870 billion lire, or 8.9 per cent of the total for the banking system, and one special credit institution whose liabilities accounted for 3.3 per cent of the borrowed funds of such institutions.

In terms of the volume of deposits controlled, the classes of institution on which the inspections principally concentrated were the ordinary credit banks (joint stock companies and general partnerships), savings banks, rural and artisans' banks and cooperative banks.

Analysis of prudential returns. — The purpose of analyzing bank returns continues to be to gather information of value in forming a reliable impression of the situation of each credit institution. The increase in the quantity, quality and also consistency of accounting and administrative data lent greater accuracy to assessments of the efficiency and technical standard of individual institutions. As a result, many initiatives could be taken with regard to banks whose operations displayed aspects that warranted attention from the supervisory viewpoint. While respecting their autonomy, the authorities encouraged the banks concerned to take appropriate measures to ensure efficient and flexible modes of operation; some of these measures involved technical and administrative reorganization, including the establishment of effective internal auditing arrangements.

In some cases, mostly involving large banks with sophisticated operations, it was necessary to carry out more detailed analyses in order to form an overall opinion of the individual institutions; this entailed carrying out specific enquiries within the limits on the access to information permitted by the current regulations. As far as the branches of foreign banks are concerned, examination of their annual accounts has shown the need for a greater flow of information in order to enhance the analysis.

In order better to identify and coordinate the action to be taken, a system of monitoring has been established that is based on the analysis of financial ratios on the assumption that appreciable divergences from the mean for the sector or group indicate anomalies of one kind or another. This method has provided invaluable information for the analysis of banking returns and permitted the authorities to focus on the more extreme cases of divergence that seemed to warrant particularly close examination.

The supervisory authorities are aware of the advantages that every bank may derive from having a sectoral yardstick against which to measure its performance so that it may make arrangements for internal auditing and improve its operations. Accordingly, they have accepted the banking system's own proposal that appropriate

composite indices of performance be constructed so that all the banks will benefit from the present two-way flow of data.

Careful consideration has been given to the official certification of accounts from the point of view of the delicate legal and technical problems connected with the relationship between supervisory criteria on the one hand and auditing and certification on the other in the light of the different purposes of these activities. Moreover, the fact that there is an overlap in both subject and content between the two kinds of verification opens up the prospect of parallelism between bank accounting practices and auditing criteria. The corollary to this wider issue is the formulation of accounting principles that are considered appropriate.

The capital base of the credit institutions. — Last year saw a strengthening of the tendency for the banks' own funds to increase at a faster rate than intermediation, a trend that has been evident for some years (Table 47).

In the special credit sector the increase in the institutions' capital base (around 1,400 billion lire) enabled them to maintain their capital

Table 47

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

	1977	1978	1979	1980	1981
BANKS (2)					
Own funds/lending	7.7	8.3	8.7	9.1	11.0
Own funds/borrowed funds	4.0	3.9	4.1	4.6	5.9
SPECIAL CREDIT INSTITUTIONS (3)					
Own funds/lending	7.1	7.6	9.1	9.9	9.9
Own funds/borrowed funds	6.3	6.8	8.4	9.3	9.4
CREDIT SYSTEM					
Own funds/lending	7.5	8.1	8.9	9.4	10.6
Own funds/borrowed funds	4.6	4.6	5.1	5.7	6.7

(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 Artigian-cassa.

ratios in spite of the expansion in their operations that occurred in 1981. At the end of the year the ratios of own funds to lending and own funds to borrowed funds stood at 9.9 and 9.4 per cent respectively, as against 9.9 and 9.3 per cent at the end of 1980.

International cooperation. — At the EEC level the supervisory authorities were involved in the harmonization of laws, regulations and administrative provisions relating to the credit sector, while in the wider international context they participated in the formulation of various proposals within standing committees and groups concerned with international cooperation.

Work on the coordination of banking legislation within the EEC is conducted essentially on two levels: first at the level of the Advisory Banking Committee, whose advice has a strong influence on the decisions of the Commission regarding both the implementation of the first Directive and the drafting of new proposals for submission to the Council, and secondly at the technical level, where working parties examine the merits of Commission proposals and the provisions of individual draft directives.

Within the Commission the draft directive on the reorganization and winding-up of credit institutions is in an advanced state of preparation; moreover, in 1981 the proposals concerning the banks' annual accounts and supervision on a consolidated basis were presented to the EEC Council.

The criteria established for the first trial calculation of observation ratios for assessing bank solvency were modified by the Advisory Banking Committee in the light of the report of the Contact Group of EEC Supervisory Authorities, which devoted further attention to the analysis of such ratios in 1981.

The Committee on Banking Regulations and Supervisory Practices, which meets under the auspices of the BIS, concentrated on improving information on international banking activity and strengthening the instruments of banking supervision in accordance with the guidelines laid down the previous year by the Committee of Governors of the central banks of the Group of Ten countries and Switzerland.

The Banca d'Italia carried out a survey on the concentration of country risks based on a sample of the credit institutions most

involved in international business in order to assemble the necessary information on the Italian banking system. The Italian Foreign Exchange Office, for its part, has begun a statistical survey of international assets and liabilities according to residual maturity.

Work within the OECD on the revision of the Arrangement on Guidelines for Officially Supported Export Credits (the "Consensus") led to a temporary agreement, which expired this May, providing for a further increase of 2.50 per cent in minimum interest rates on subsidized export credits (2.25 per cent in the case of loans at more than five years granted to "relatively poor countries"); however, special arrangements apply to countries where market rates are below minimum consensus rates, such as Japan. A new round of negotiations has begun in order to bring about the further adjustment of rates in the light of developments in the financial markets.

In connection with the insurance and financing of export credits, the supervisory authorities continued to assist the bodies responsible for examining technical questions in connection with negotiations of considerable political and economic importance that Italy is conducting at international level.

III - THE GOVERNOR'S CONCLUDING REMARKS

Last January the Government appointed Mario Sarcinelli Director General of the Treasury. His selection for this high office is a recognition of his exceptional moral and professional qualities and is an honour for the Bank, to which he gave twenty-five years of enthusiastic and devoted service. To every sector in which he worked, ranging from economic research to banking supervision, from electronic data processing to monetary policy, he brought an effectiveness that sprang from his great learning, his acute analytical mind, his ability to reach swift decisions and his firm resolve. Our satisfaction at this significant appointment is mingled with regret that the Bank will be deprived of his rare competence, lively intellect and critical spirit; this is felt most acutely by one who over the years had the opportunity to establish a close working relationship with him that began in the Research Department and became even closer in the Directorate, to which he was appointed in 1976. In him the Bank now has a worthy partner in the search for solutions to the grave problems raised by the economic condition of the country.

A few weeks later the Bank lost Alfredo Persiani Acerbo, who died at the age of 49 after an illness that he had faced with calm composure. He continued to work with total dedication until the very end. His professional life was inspired by a very strong sense of loyalty to the Bank, and the various departments he directed benefitted from his profound knowledge of organizational and legal matters. After joining the Directorate in 1978 he concentrated mainly on internal administration, applying to every issue the sound judgement of his fine legal training, which he exercised with the discretion and elegance of style that were his distinguishing marks. For him a respect for form was instrumental in combining new ideas with the best traditions of the Bank, which he viewed as a public asset to be preserved and enhanced.

These voids stemming from such different causes were filled by appointing Antonio Fazio and Carmelo Oteri Deputy Directors General.

The Bank mourns not only the death of Alfredo Persiani Acerbo but also those of Giuseppe Manuti, Head of the Treasury Relations Department, and Franco dell'Uva, Head of the Data Processing and

Information Systems Department, who were likewise in their prime. It is said that institutions have a life transcending that of their members. The Bank has the necessary professional resources within its ranks, even in difficult times of transition. However, this does not lessen our sorrow at the irreparable loss of the human qualities of our departed colleagues.

Last year the work of improving the efficiency of the Bank continued.

The most significant measures adopted were the introduction of a large-scale programme of new accounting procedures, the automation of the management of securities held on deposit, the reorganization of the Cashier's Department, the simplification of branch organization and, in the large branches, the establishment of intermediate levels of management and the creation of research groups to enable operational decisions to benefit from analysis of local economic conditions.

The innovations introduced in internal arrangements are themselves evidence of the commitment of the management and staff of the Bank to serving the interests of the community. We wish to express our warmest appreciation for their contribution.

The world economy

The world economic scene is dominated by a recession that is lasting much longer than initially forecast and by inflation that is still high, though declining. There are now 29 million unemployed in the OECD countries. The rate of inflation has slowed down from 14 to 9 per cent in the last two years; the improvement has been particularly marked in the three main economies. The continuation of the recession and the scale of unemployment underline the cost of curbing inflation if it is not attacked at the roots by means of a consistent set of measures.

The current account balance-of-payments deficit of the OECD countries has contracted sharply, as has the surplus of the OPEC countries. By contrast, the external position of the developing countries has deteriorated and the difficulties facing the centrally-planned economies have become more acute. The problems of international indebtedness have grown worse.

According to current OECD forecasts, economic activity should

begin to pick up in the second half of the year, assuming that domestic demand expands in the United States and Japan. A year ago this was expected to occur towards the end of 1981, but in the third quarter the US economy suffered a relapse and recently Japan's gross domestic product contracted slightly after seven years of uninterrupted growth. In the Federal Republic of Germany the level of production is also continuing to fall.

High US interest rates and the strength of the dollar, fuelled partly by the current account surplus, have created a dilemma for those industrial countries that would be in a position to relax their restrictive stance but for the fear that their economies would come under external pressures that would wipe out their hard-won gains in the fight against inflation. Moreover, in the developing countries, in particular, the burden of indebtedness has been exacerbated by the extremely high interest rates and is in danger of compromising adjustment programmes and the potential for growth, which would have repercussions on the industrial countries as well.

The new US Administration based its economic programme on the achievement of three main objectives: a reduction in inflation, the restoration of a balanced budget and the stimulation of economic growth through the expansion of private saving and productivity. In the choice of instruments, reliance was placed on a monetarist approach on the one hand and on the elasticity of the productive sector's response to cuts in personal income tax, to investment incentives and to a reduction in government regulation on the other. The Administration's confidence in the markets' ability to find equilibrium indicated, as a corollary, that it should refrain from interventions to steer or smooth foreign exchange markets.

Considerable success has been achieved in reducing inflation and changing attitudes in the labour market, where unions have paid greater heed to the employment effects of their wage claims. Business has so far failed to react to the fiscal stimuli and the effects of deregulation. During 1981 a sharp decline in investment and exports was accompanied by the stagnation of private consumption. This helped to inflate the Federal budget deficit, which was initially set at 45 billion dollars for the current fiscal year. The latest official estimates put it at about 100 billion dollars, an amount equal to only 3 per cent of gross domestic

product but which would absorb more than two thirds of households' saving even if the ratio of saving to disposable income rose to 7 per cent, as predicted by the OECD.

Leaving aside the adverse cyclical trend and the question whether the revenue increases and spending cuts at present under discussion will be approved, the objective of balancing the Federal budget within the next few years seems to have been abandoned. Uncertainty about the deficit is affecting market attitudes. In a country in which inflation has been brought down to 7 per cent, a 15 per cent interest rate on long-term debt is bound to have a prejudicial effect on investment and is indicative of the market's doubts about the feasibility of the announced programmes.

While remaining below the peaks recorded in the summer of 1981, short-term rates rose again in the first few months of this year and approached those at long term. With the budget deficit rising sharply, upward pressure on interest rates has resulted from the determination with which the Federal Reserve is controlling the money supply and the use of techniques based on a particular quantitative aggregate at a time when financial innovation and volatile expectations are changing traditional demand relationships.

The achievements in the fight against inflation in the United States have had their counterpart in the adverse effects on the rest of the world caused by the high and fluctuating US interest rates and the inflationary impact of the steep rise in the US currency, even though the latter has been partly offset by the fall in the dollar prices of raw materials.

The interest rate differentials in relation to assets denominated in yen and Deutsche Mark led to an appreciation of the dollar, thus undermining the competitive position of the United States; the recession and the time required for changes in competitiveness to have their full effect have hitherto limited the deterioration in the current account. The difficulties firms are having in withstanding foreign competition are giving rise to protectionist pressures in the United States; Japan's trade surplus is also arousing alarming tendencies of the same kind on both sides of the Atlantic.

The exchange rate movements of recent months, in particular those between the dollar and the yen, have been due largely to the direct consequences of the different policy mixes pursued — a

restrictive monetary stance and an expansionary fiscal policy in the United States and the reverse in Japan.

To those who do not have absolute faith in the ability of market participants always to take uncovered long-term foreign exchange positions of a stabilizing nature, it would seem advisable for the monetary authorities to undertake to carry out concerted interventions in the markets, thereby preventing excessive movements and erratic fluctuations in exchange rates. However, the effects that such interventions would have on the money supply and on interest rate differentials should not be systematically offset.

In a world that rests on delicate economic equilibria and requires profound structural changes, and hence substantial investment, there is an urgent need for coordination of policies. Greater price stability in the United States will tend to have a positive effect on the propensity to invest both there and elsewhere. In the present state of uncertainty, however, the stimulus to a revival in production, investment and trade must come from those countries that have made significant progress towards adjustment. They would thus begin to reduce their unemployment while safeguarding price stability by means of productivity gains, and would bolster demand in countries that are obliged to maintain or even accentuate their restrictive stance because of delay in achieving adjustment.

The stagnation in the world economy together with energy-saving and diversification policies have caused a decline of 15 per cent in the consumption of oil by OECD countries in the last two years. Oil stocks are now falling, whereas previously they were rising, and imports of oil have slumped by more than a quarter. Since the middle of 1981 there has been a buyers' market in oil, thus temporarily easing the balance-of-payments and inflation problems of importing countries. However, the fall in prices will be counter-productive if it causes uncertainty and postpones measures to reduce energy consumption still further and to diversify and expand the sources of supply.

The sudden and excessive increase in oil prices, which was a factor in the stagnation of the world economy, has backfired on the OPEC countries. In the last two years their exports have fallen from 60 to 45 per cent of the oil consumption of the rest of the world. Their current account surplus may amount to only 15 billion dollars this year, compared with 110 billion in 1980. Those countries in

the group able to expand domestic demand considerably are running current account deficits that are unsustainable beyond the short term. As a result, the implementation of their development plans has slowed down.

The reduction in the current account imbalances of the OPEC and OECD countries contrasts with the large and enduring external borrowing requirements of the non-oil developing countries. Although it is difficult to generalize about economies that are often profoundly different, most of them share a common need to step up investment and internal restructuring. However, these are objectives for which it is hard to obtain international finance at present.

Apart from the question of the equitable distribution of resources, the industrial economies must offer tangible support to the strategies of adjustment and balanced growth in the developing countries, which make quite a significant contribution to the formation of world demand. Their imports represent one fifth of the external demand for goods and services from OECD countries and have recorded sustained rates of growth in recent years.

The main contribution that the industrial countries can make to the development of less prosperous countries is to resist and oppose the temptation to resort to protectionism. Furthermore, product specialization and rationalization in sectors that are particularly vulnerable to competition from countries with lower labour costs should be pursued with determination. In order to prevent crises in these sectors it will be necessary to continue to monitor trade relations within international organizations with the aim of encouraging forms of horizontal trade among emerging countries as well.

The Bretton Woods institutions and the regional development banks should be assured of the funds necessary to continue playing their allotted role in the process of international financing. Furthermore, the flow of aid to those parts of the world where poverty is perpetuated by economic stagnation must be intensified, as must efforts to limit assistance that does not serve productive aims.

The increase in the burden of debt and the slowdown in export growth as a result of the world recession have aggravated and hence exposed the inefficiencies in certain centrally-planned economies. In many cases the problem of risk associated with lending to these economies is acquiring political connotations within creditor countries and in their relations with the borrowers.

The management of these credit relations by the banks, supervisory authorities and governments of Western countries is rendered more difficult by the inadequacy of the information available for the purpose of evaluating economic developments and the economic policies pursued. The entry of certain Eastern European countries into the International Monetary Fund must be seen as a positive step, not least from the point of view of improving the knowledge of their economies. The difficulties encountered recently should confirm the international banks in their view that the technical evaluation of a country's ability to service its foreign currency debt represents the main criterion for deciding whether to grant loans.

Against this complex and fragmented background Europe has proved unable to muster either the will or the ability to become a pole capable of taking initiatives commensurate with its size. The divergent budgetary trends, the widening differences in costs – above all labour costs – and the dispersion of inflation rates show that the resolve to achieve economic integration is not being translated into action. Reform of the structure of the Community budget has been impeded by futile disputes and the prevalence of parochial and contingent interests.

Some progress has been made, partly owing to the discipline exerted by the operation of the European Monetary System, but efforts to begin a process of convergence must involve both the budget and production costs in the individual countries. Strains are bound to arise when the major economies pursue different objectives and use quite diverse instruments. The smooth operation and institutional development of the Community's main economic and monetary mechanisms are in jeopardy.

A Europe that is not united in its economic performance and strategy cannot meet the challenge implicit in the creation of a genuine and credible currency unit and the establishment of a true European Monetary Fund with the autonomous power to create ECUs. The lack of fresh initiatives will lead to *de facto* acceptance of the growing role of the Deutsche Mark as a reserve currency. This would cause problems for the working of the EMS and prove a burden for the Federal Republic of Germany that the monetary authorities of that country consider too high. By contrast, the confirmation of the ECU's role as an international currency would give

Europe a greater degree of freedom and would contribute to greater monetary stability.

The cyclical profile of the Italian economy; monetary and exchange rate policies

The stagnation of world trade, the steep appreciation of the dollar and the after-effects of the oil price rise represented a combination of international conditions that were among the most difficult Italy has ever had to face.

The repercussions for the Italian economy gave the currency and the balance of payments a severe buffeting. The upsurge of over 30 per cent in the lira import prices of industrial raw materials lent significant impetus to inflation. The terms of trade deteriorated by 10 per cent, adding some 12,000 billion lire to the trade deficit. Exports of goods showed an increase of 9 per cent in volume terms, of which only around one third was due to the expansion of world demand.

The Italian economy approached the difficult world economic scenario from domestic conditions that were themselves unsatisfactory. Wages were rising strongly, the budget was in increasing disequilibrium, both quantitatively and qualitatively, and despite the cyclical stagnation economic activity was still high compared with that in the other industrial countries, although not in relation to productive capacity. The rise in money incomes was not curbed during the year nor was a start made towards restoring public finances to a sound footing, so that pressures on prices and the external accounts continued to be generated from both these sources.

The gross per capita income of workers in industry rose by an average of 22 per cent in nominal terms and 3 per cent in real terms in 1981. Wages proved impervious to growing unemployment; they were boosted by the indexation arrangements and, to a lesser extent, by previously agreed increases and by settlements at plant level.

The need for rationalization of the wage indexation mechanisms and methods for achieving it were the subject of a debate that was wide-ranging, detailed and rich in interesting ideas, but nonetheless proved sterile. The unions and management have not behaved in a manner consistent with their own approval of the guideline, issued by the Government in Parliament as early as the end of last summer,

that wage negotiations should be directed towards the common goal of setting a ceiling on inflation. In other countries, in which economic equilibria rest on a sounder base than in Italy, agreements providing for real wage cuts have been concluded. In some cases, such as that of the Federal Republic of Germany, the unions have consented to them in the conviction that the resulting decline in inflation will provide job security and, before too long, a lasting recovery in purchasing power.

Events bore out the fears that the economy's spending capacity would be fuelled by the budget deficit as a result of the operation of the so-called built-in stabilizers and the effect of the discretionary budget measures adopted in 1980 and also in 1981, in particular with regard to social security contributions and public sector wages and salaries. There was no lessening of the risk that, nurtured by expectations, the perverse sequence affecting public finances, the balance of payments, the exchange rate and prices would get out of hand.

In 1981 public sector expenditure, excluding financial transactions, increased from 160,000 to 207,000 billion lire and its ratio to gross domestic product rose from 47 to 52 per cent; capital expenditure again declined as a proportion of the total. The tax burden increased from 35 to 36 per cent of gross domestic product, owing chiefly to the faster growth in the revenue from direct taxation.

The deficits began to expand again, with that on current spending jumping from 4 to 7 per cent of gross domestic product. Developments also reflected the fact that in 1980 the increased revenue resulting from the expansion of the economy had been used to step up spending rather than to reduce the deficit. Net indebtedness totalled 50,000 billion lire, compared with 31,000 billion in 1980, bringing its ratio to gross domestic product to 13 per cent, compared with 9 per cent the previous year. This ratio is the highest recorded since the Second World War and it exceeds that for the other major OECD countries by an abnormally large margin.

When pressures were at their height, firstly in March and thereafter in June, the Government reaffirmed its determination to keep the domestic borrowing requirement within the limits of the 1981 forecast of 37,500 billion lire. However, the borrowing requirement expanded further in the second half of the year, despite

the recourse to liquidity operations designed to mop up the deposit balances that the decentralized spending agencies held with the banks.

The international situation, Italy's position in the world economy and the uninterrupted operation of domestic factors of instability made it necessary for monetary policy to maintain a stabilizing course in close coordination with exchange rate policy.

The problem of the compatibility of the economic objectives pursued was particularly manifest in the case of exchange rate policy. The acceptance of a lira depreciation beyond certain limits would have jeopardized the fight against inflation. The line followed has been designed to secure an appropriate trade-off between the need to reduce the current external payments deficit and to oblige companies to seek cost savings and productivity increases. By contrast with the situation in June 1980, the parity changes within the EMS were decided at times when unused productive capacity made it possible to reap immediate benefits from the realignments.

The effective lira exchange rate declined by 13 per cent on average in 1981, primarily on account of its depreciation against the dollar. Vis-à-vis Italy's nine major competitors, the fall amounted to 9 per cent. The competitiveness of Italian goods improved by 3 per cent, thus partially offsetting the deterioration recorded in 1980.

In the course of the year, fluctuations in the lira exchange rate were greatest after the March and October realignments within the EMS. However, even in these particularly crucial, difficult phases exchange-rate-induced changes in competitiveness were not such that firms could count on profit margins being restored by that means. During the first five months of 1982 the lira depreciated by 2 per cent against the other Community currencies and by 7.7 per cent against the dollar.

Alertness to developments has in the various stages made it possible to coordinate monetary and exchange rate policy, to modulate the impact of policy instruments as well as to give a full account of the country's economic situation in the fora for which institutional provision is made. The course of events has confirmed the view that fundamental imbalances have developed, whose resolution on anything more than a temporary basis requires the adoption of forceful, well structured policies.

The preconditions for an easing of the monetary and credit restrictions did not materialize, both because the external difficulties

persisted and because other policies were inadequate. On several occasions the authorities had to respond to the need for prompt countermeasures to hold down liquidity and the pressures on exchange rates and prices, in the knowledge that if intervention were delayed the country would face an exchange rate crisis and rising inflation.

Action to change the ceiling on bank lending was taken in January 1981, and in March the discount rate and the compulsory reserve ratio were modified. At the time of the March parity realignment the blueprint for an economic policy programme involving intervention on a number of fronts was yet again reduced to the use of the monetary and exchange rate instruments, since Parliament had rejected all or part of certain provisions designed to cut the deficit.

In May both credit policy and exchange rate policy were again obliged to rely on an administrative instrument, namely the deposit on foreign payments. When the decision to introduce the scheme was made, the rapidity with which it would delay such payments, its effect on liquidity and hence on companies' propensity to import prevailed over arguments relating to its unequal allocative effects. The scheme was renewed in a less severe form in September and was discontinued in February 1982. It was terminated early so as to reduce the impact of the expectations connected with the anticipation of its expiry at a known date.

In view of the obstacles impeding progress towards concerted control of incomes and the restoration of a balanced budget, the ceiling on bank lending was again renewed in December, on terms that confirmed its restrictiveness. In April, when the foreign exchange markets again came under pressure, measures were adopted to bring export receipts forward and to curb excessive demand for foreign currency; the penalties for exceeding the ceiling on bank lending in foreign currencies were also increased. In recent weeks activity on the Italian exchange market has returned to normal.

Throughout the period under review the rapid and erratic rise in the public sector deficit required the Banca d'Italia to take steps to absorb and to redistribute bank liquidity, which tended to be excessive. It reinforced its efforts when the danger of surplus liquidity undermining the lira's external stability became more acute. The repurchase agreements on the secondary market that had been introduced at the end of 1979 proved to be particularly useful in this connection.

Despite the stagnation of production and the slowdown in inflation, credit demand was sustained by the public sector's greater recourse to borrowing and by the persistence of a rate of capital formation that was relatively high at a time of slimmer profit margins and a reduction in self-financing by companies.

The supply of credit was held down by the ceiling on bank lending as well as by the fact that in 1981 the expansion of the monetary base was kept below 12 per cent. The difficulty of raising funds from the banks resulted in heavy recourse to the special credit institutions and to both the domestic and international capital markets. Overall, the substitution of sources of credit was only partial, and the funds raised were more expensive.

The non-interest-bearing deposit on foreign payments increased corporate demand for funds, thus exerting a restrictive effect at a time when it was particularly imperative to dampen expectations, to curb demand for stocks and to relieve pressures on the exchange rate.

Total domestic credit increased by 73,000 billion lire, as against 63,000 billion in 1980 and the forecast of 64,500 billion made at the beginning of the year. The faster growth was entirely due to the public sector borrowing requirement, which exceeded the forecast and the 1980 outturn by 9,000 and 11,000 billion lire respectively. Credit to the economy was 1,000 billion lire lower than in 1980 and was in line with the forecasts. Even when public sector lending to firms is included, the share of total credit taken up by the economy dropped by 11 percentage points over the year to stand at 45 per cent, thus for the first time accounting for less than half total financing.

The development of interest rates in the course of the year reflected the relative scarcity of credit. The cost of bank loans, which was already high, rose by a further 2 percentage points; the latest data indicate that prime rates are still hovering at around 22 per cent. The rates charged by industrial credit institutions rose by around 3 percentage points, while borrowing on the international markets was also quite expensive. The rise was particularly rapid in the case of medium and long-term securities, the yields on which advanced by 5 percentage points.

The increase in nominal interest rates coincided with inflation rates which were initially stable and which then, from the summer

onwards, showed a gradual decline. Real interest rates followed an upward trend, particularly in the second half of the year.

The restriction of credit, in combination with the management of the exchange rate, was decisive for the curbing of the external imbalance. Helped by the improvement in a number of international factors towards the end of the year, it also made it possible to score a certain degree of success in the fight against inflation.

Despite the adverse influence of an oil import bill that increased by 8,000 billion lire in a year and the general deterioration in the terms of trade, the trade deficit diminished by 1,200 billion lire. The current account deficit rose from 8,300 to 9,200 billion lire, owing principally to the higher cost of servicing the country's external debt, which totalled 48 billion dollars at the end of 1981. At that date Italy's external debtor position, net of financial assets, totalled 13 billion dollars, while its gold reserves were worth the equivalent of 29 billion dollars.

The current deficit declined substantially in the course of the year, falling from more than 3,000 billion lire in the first quarter to under 1,000 billion in the fourth. As the data for the last few months confirm, this figure overstates the shift, since it reflects the partly reversible impact of special measures and factors. Italian companies won back some of the share of world trade they had lost in 1980, but the recovery occurred in the dollar area and above all on the OPEC markets, whose dependence on the vicissitudes of the oil surpluses makes them volatile. By contrast, European markets continued to be difficult to penetrate.

The twelve-month rate of increase in consumer prices slowed gradually, dropping from 21.5 per cent in the fourth quarter of 1980 to 18.3 per cent in the same period of 1981. In the first quarter of 1982 it amounted to 17.0 per cent and by April it was down to 16 per cent. There was a reduction in the role of the cyclical component of inflation, which had been significant in 1980. Inflationary expectations abated, but they remain high. The improvement in the case of the wholesale prices of manufactures was primarily due to a squeeze on profit margins, which occurred against a background of a rise in unit costs that exceeded the 1980 rate by 3 percentage points.

Gross domestic product and industrial output showed small average declines in 1981, although they fell by less than in the

major industrial countries; in the course of the year the profile of economic activity was virtually flat. The propensity to save was buttressed by rising real yields on financial assets, and its tendency to decline was arrested. As far as the composition of demand is concerned, the positive shift in the trade balance reflected the slowdown in investment in stocks, in particular of raw materials and semi-finished products.

The crisis had particularly serious repercussions for the labour market. In the fourth quarter the unemployment rate, adjusted to take account of workers receiving benefits from the Wage Supplementation Fund, was close to 11 per cent, compared with 9 per cent in the last quarter of 1980. The rate represents a peak for Italy, although not for other industrial economies. The rise in unemployment is largely attributable to demographic and social factors, which are causing the labour force to expand. In the course of the year there was, however, a drop of 120,000 jobs in industry, which is the largest decline recorded since the beginning of the seventies.

Developments in the early months of 1982 and the short-term forecasts that can reasonably be made confirm that a more rigorous approach needs to be adopted if there is to be a lasting improvement in Italy's economic situation.

We should not overestimate the progress made so far. Although the economy is in the trough of the cycle, inflation is very high and further attempts to reduce it will come up against the deep-seated structural causes of inflation. The trade deficit has increased again, albeit owing to special factors, and in the first quarter of 1982 it was larger than in the year-earlier quarter. The public sector borrowing requirement for the first five months of the year may be preliminarily estimated at 27,000 billion lire, compared with 20,000 billion for the same period of 1981. In the second half of the year the customary increase in funding needs will be aggravated by factors, in part attributable to recent decisions, that will augment expenditure and slow the inflow of receipts. The borrowing requirement that is building up month by month is not in line with announced economic policy, despite the fact that the Finance Law exercised a moderating effect; this means that, as was the case last year, the quantitative objectives indicated for the growth of total domestic credit, which

were based on a public sector borrowing requirement of 50,000 billion lire, are no longer relevant.

Monetary policy and exchange rate policy have succeeded in steering the economy along a very narrow path. The productive sector is in a position to respond to a world economic recovery. The capital formation of the last three years has established the preconditions for further penetration of international markets. An upsurge in labour costs would negate the contribution that the increased volume of investment has made to the strengthening of Italian competitiveness and would prevent benefits being derived from it at the level of employment.

Balance-of-payments equilibrium could be restored if we can succeed in capitalizing on the upswing in world demand that is expected to materialize in the autumn. If before then domestic demand were to be rekindled by consumer expenditure, fuelled by the public sector deficit and the upsurge in wages, the progress made towards external adjustment would be compromised and the pace of inflation would accelerate again.

The state of the Italian economy demands that the cyclical pattern should correspond to that in the major industrial countries which will require a rigorous budgetary policy and income restraint. The risk that the world economy might stagnate for longer than anticipated makes a commitment follow these guidelines more, rather than less, imperative.

The structural difficulties of the economy

In a difficult year Italian firms once again gave proof of their vitality by making fixed investment and by winning new customers for their exports. The active search for responses to the crisis of the last decade has spread from small firms and the so-called underground economy to medium and large-sized firms, above all in the private sector. The need for a similar approach is also emerging in state-controlled companies; the restructuring programmes that have been developed are designed to achieve adjustment to market conditions and a return to sound cost/price relationships.

However, the progress made to date in the use of the three essential productive resources of capital, energy and labour has been inadequate and uneven. The economy has not yet come to grips with

the structural problems besetting it, on which we have dwelt in the Annual Reports of the past few years.

As a percentage of gross domestic product, fixed investment at constant prices fell virtually without interruption between 1970 and 1978, dropping from 24.4 to 18.9 per cent. The subsequent recovery boosted the ratio to 20.1 per cent in 1980. The rate of capital formation showed no change in Italy in 1981, whereas it declined in the majority of industrial countries. Partly because of the manner in which the credit squeeze worked, the corporate sector's main reaction to it was to run down stocks. The modernization of production was continued through accelerated depreciation, and the capital stock per worker continued to increase, in line with the long-term trend in the industrial economies. The rise in the proportion of fixed investment accounted for by purchases of machinery and equipment is an indirect indicator of the tendency towards the rationalization rather than the expansion of the productive base. This is reflected and further confirmed by the behaviour of hourly productivity, which increased by 3 per cent in industry in a year of recession, to some extent because of the greater flexibility in the use of labour.

These developments bear witness to the corporate sector's efforts to adjust to a structure of prices and costs that changed radically in the course of the seventies. The vitality of firms and their attendant growth prospects are the best guarantee for employment. Under present conditions wage restraint is an essential prerequisite for securing that vitality and for ensuring that investment is once again primarily channelled into additional capacity and is not geared solely towards labour saving.

Information concerning the qualitative development of Italy's industrial fabric may likewise be gleaned by looking at its foreign trade. In the case of trade in manufactured goods, the achievement of a surplus more than twice as large as that seen in 1980 was due in large measure to the growth in export volumes. That growth was concentrated in the textile, clothing and mechanical engineering sectors, but the timber and furniture industry, the skins and leather sector, vehicles and certain branches of the metalworking industry also made a positive contribution. Many firms operating in these markets have shown that they are capable of technical innovation and organizational improvement. On such markets the only way to withstand the effects of the stagnation of world trade and the growing competition from

the newly industrialized countries is to enhance specialization in products and productive processes and to curb costs.

The way in which Italy's foreign trade is showing a continuing bias towards so-called traditional goods is cause for concern. Technologically advanced goods make up the same proportion of exports as they did a decade ago; the gap between Italy and the other main industrial countries has widened.

Since the first oil crisis Italy's energy deficit has escalated dramatically. From 1,600 billion lire in 1973 it climbed to 8,000 billion in 1977, 20,000 billion in 1980 and to almost 30,000 billion last year, when it was equal to 8 per cent of gross domestic product compared with 2 per cent in 1973. From 1979 onwards the group of countries belonging to the International Energy Agency achieved significant successes on three fronts. They stepped up domestic production, brought down the ratio of energy to income and reduced the proportion of their total energy needs met by oil. Italy could not be a party to the first development, but the IEA countries as a group increased their energy production by 8 per cent between 1978 and 1980, with the result that the imported component of their total energy supplies, which at 33 per cent had already been way below the Italian figure of over 80 per cent, was cut to 28 per cent. The reductions in the income elasticity of energy demand and the relative importance of oil did extend to Italy, where the initial imbalances had, however, been far more pronounced. Energy savings were secured by streamlining energy-intensive industries and changing the balance between the factors of production.

In the last three years most of the industrial economies, including Italy, have raised domestic energy prices more closely in line with the oil price rise than they did in the aftermath of the first oil shock. However, the reduction in Italy's energy consumption per unit of output has been only half that recorded in the other IEA countries, although the latter began from a higher initial base. In view of Italy's greater dependence on oil and other imported sources of energy, more forceful, wider-ranging action would have been necessary. Awareness of this delay inspired the recent National Energy Plan for the eighties. Its implementation is now essential.

Weakness in a country's productive sector is reflected not only in its external accounts but also in its performance with regard to prices and employment, particularly when the economy is exposed to external or internal shocks. Such shocks have been the rule rather

than the exception during the last decade, in an economic environment remarkable for the rapid succession and interaction of changes in exchange rates and raw material prices at the international level and in the development of wages and public sector finances domestically. Movements in relative prices are thus set in motion which are influenced by the varying sectoral impact of costs and the differing market power of firms. The asymmetries and rigidities present in the markets foster inflation and aggravate the imbalances in the productive fabric even between units that belong to the same branch or are located in the same region.

Among the manufacturing companies whose balance sheets are surveyed by the Banca d'Italia, the indices of gross profitability and indebtedness are scattered very widely around the mean and their range has been increasing steadily since 1974. The percentage of firms in fragile financial health is extremely high in certain sectors, and the system's internal interdependences are such that some of the sectors concerned are capable of exerting a substantial impact on production and employment throughout the rest of the economy.

These problems can be resolved only through a process of the reallocation of resources that involves the composition of demand and production, the size of companies in all sectors and the balance between the factors of production within individual companies.

It is not for the central bank to take measures relating to the sectoral allocation of resources, even if it cannot remain oblivious to the internal set-up of the productive system. In a mixed economy the restructuring process is the net result of the combined operation of autonomous mechanisms, which are predominantly market based, and of industrial and institutional policy measures, the need for which has been stressed in this forum on several occasions. However, such factors can have their full effect only if certain more general requirements concerning resource mobility are met.

The need for labour mobility has found an outlet in recourse to the Wage Supplementation Fund for purposes transcending its original functions. Since the middle of the seventies the total number of hours for which benefits have been paid by the Fund has followed an exponential growth curve. The trend is essentially attributable to so-called extraordinary interventions, which increased sixfold between 1975 and 1981 in terms of the number of hours involved; the ordinary interventions have performed their institutional role as anti-cyclical stabilizers, relieving firms of a large portion of

the cost of labour for which they temporarily have no need, without depriving them of the skilled personnel they will require when production picks up again.

The extraordinary interventions have also restored the corporate sector's margins of flexibility, which had been eroded by other developments in the industrial relations field, and have maintained the incomes of industrial and office workers. There is, however, increasing doubt about the extent to which the Fund's extraordinary interventions conform with their institutional purpose, which is partly to facilitate the movement of labour into other sectors and firms, in line with the trends prevailing in the productive system but subject to appropriate industrial policies. The interventions have too often consisted merely of transfers of income, degenerating into a permanent subsidy to hidden unemployment, encouraging the underground economy, undermining equitable wage distribution among employees and, ultimately, acting as a brake on mobility. These drawbacks may be put down to the shortcomings of the Fund as well as to the time it takes for industrial policy guidelines to be defined and implemented.

The absence of time-limits on benefits, the cursory examination of the merits of individual cases and the fact that the financing mechanisms are open to abuse by firms are all aspects that need to be corrected. Action on this front is no less urgently required than the reform of the other institutions that regulate the labour market.

Steps also need to be taken, particularly at the level of education, to counteract the growing resistance to certain occupations, both self-employed and otherwise. The vocational guidance initiatives that have already been proposed deserve swift approval.

Housing construction is another central problem of resource allocation. Labour mobility cannot be achieved in practice if the inherent reluctance to move is exacerbated by difficulties in finding new accommodation. Over the years three disturbing phenomena – the shortage of dwellings in the main centres and the increase in the construction of holiday homes, the exceptionally steep rise in property prices and the virtual disappearance of a genuine rental market – have assumed massive proportions. Owners are deterred from renting property by a body of legislation which, despite the removal of rent controls as a result of the Fair Rent Act, tends to recreate earlier limitations on the availability of accommodation.

The housing problem should be attacked both by promoting the supply of new dwellings, which are most sorely lacking in the rental sector, and by fostering the more efficient use of the existing housing stock. Owners should be assured of repossession of their property when leases expire and the tax system should be made more consistent with the need to facilitate property transfers, along the lines of recent tax measures; in addition, the authorities should seek to speed up their administrative procedures in the housing field and to hold down building costs in the public sector.

The precariousness of the frame of reference for economic decision-making is not limited to the housing sector. It stems from the profound changes that have occurred in recent years in the prices of goods and factors, in exchange rates, in interest rates and, more generally, in the institutional context within which the economy operates. Economic agents are obliged to take decisions in more uncertain conditions. One expression of this uncertainty is the occasional tendency for regulative activity to produce legislation which, under the pressure of the urgent need to act, fails to take full account of the systematic links and results at times in unclear rules and ambiguous objectives. The task of interpreting and implementing legislation has therefore become more difficult.

Taken together, these various causes of uncertainty impose additional burdens on the economy and society on account of the "insurance" that has to be taken out against them. Inevitably, the possibility of mistaken choices increases, the time horizon is brought closer and measures already taken have to be revised more frequently. The greater the uncertainty, the more circumscribed production and investment decisions become.

The path to monetary stability

The reinstatement of the government budget as an economic policy instrument may be considered to form the apex of a triangle that represents the elements necessary for the restoration of a sound currency; the other two corners are the consistency of behaviour affecting wage determination and the independence of money creation from the centres of expenditure.

Government spending grew rapidly and indiscriminately in the seventies. Last year for the first time its ratio to gross domestic

product was higher than that recorded in the major European countries, while revenue remained appreciably lower.

It is rightly maintained that Italy's below-average per capita income has to be taken into account when evaluating the ratio of taxation to gross domestic product. However, the same reasoning should also be a *prima facie* argument for curtailing expenditure until per capita income has reached a sufficiently high level.

If the deficit had been caused by an investment drive to expand and strengthen the productive sector and hence to generate future income, it could be assumed that the gap would eventually close. However, the excess of current payments over receipts accounts for more than half of the shortfall; by contrast, the other major industrial countries recorded a current budget surplus in 1981.

The close links between monetary policy, the public sector borrowing requirement and the ways in which it is financed, which have recently been the subject of close theoretical examination, can essentially be reduced to one elementary principle: no economic entity can allow current expenditure to exceed revenue for long. The budget constraint forces individuals and firms to adjust; the State's unique position as a borrower enables it to postpone the day of reckoning, but not to avoid it indefinitely. Any attempt to do so cannot but increase the perverse levy of inflation.

There must therefore be a return to the respect of principles that place direct and binding limits on the systematic absorption of savings by the public sector.

The requirement to balance the current account of the budget would activate mechanisms for verifying the validity and volume of expenditure, thus leading to a direct cost-benefit analysis of the services demanded of the State. This would also avoid the postponement of real solutions to the underlying problems of the economy, which is often encouraged by the ease with which the cost of delay can be shifted to the public sector.

As a first step towards balance, a closer link needs to be forged between the annual and multi-year budgets; the latter should be the outcome of a careful assessment of revenue and expenditure that is consistent with the expected performance of the economy. The first principle that should be established, in the spirit of Article 81 of the Constitution, is the requirement that any current expenditure over and above that for which the multi-year budget already

provides should be fully covered by tax receipts, both in the current year and thereafter.

The task of increasing the total tax burden should certainly not be left to the automatic effects of inflation and fiscal drag, but it would be unthinkable to neutralize the progressiveness of the tax system while at the same time ignoring the overall dimensions of the problem. Not only must the battle against tax evasion be resolutely intensified, but sectors that have managed to obtain exemption should be brought back within the tax net.

Serious financial problems are developing in the social security system and the health service. Unless decisive action is taken, these will place an intolerable strain on resources within a matter of a few years, particularly as the average age of the population increases and the automatic adjustment mechanisms, some of which were introduced only recently, gradually exert their full effect. Control over health service expenditure is being lost as a result of decentralization; the criteria for imposing cash limits on the local health authorities are unclear and the overspending that is accumulating is ultimately being passed on to the central authority, whose power to intervene is limited.

Nothing significant will be achieved unless the pretence that the State can and should supply the citizen's every need is abandoned. Reforms that do more than rectify the present anomalies are essential. They will need to be based on the distinction between essential services, to be borne by the community, and supplementary forms of voluntary health insurance purchased with private savings, as in almost all EEC countries.

Despite the high level of government expenditure, public services in Italy continue to be inadequate or severely deficient. The solution lies not in endlessly increasing the number of staff but in striving for efficiency and improving the services.

Although the public utilities should not be placed under an absolute obligation to cover their operating costs out of receipts, there should be rigorous examination of the cases in which it is in the public interest to allow certain services to be sold at prices below cost; subsidies should form part of current expenditure and they should be clearly identified, defined in amount and linked to the services provided, rather than simply reflect the retroactive financing of a deficit. Credits to state-controlled companies, which are at

present entered in the capital account, relate only partly to true investment – some of them are used to cover operating losses. Here too the books must be set straight.

Interest on debt is the item of public expenditure that has shown the fastest growth in recent years; in 1981 it totalled 30,000 billion lire, having tripled in the space of four years. The increase was caused both by the rise in interest rates and by the expansion in debt, which had risen to 275,000 billion lire by the end of the year.

It is maintained in some quarters that the adjustment should begin with measures to reduce interest payments; one school of thought suggests easing the control on the growth in the money supply while a second holds that public debt should be indexed to price developments in such a way that the burden of servicing charges would be concentrated at the redemption date of the securities.

The answer to the first proposal is to be found in the remarks made earlier regarding the economic situation in Italy and abroad and the reasons for which a strict monetary stance must be maintained. It is important not to confuse the primary causes of the deficit and inflation with their secondary causes nor, worse, to confound cause with effect. Positive real interest rates check domestic demand and encourage the accumulation of financial assets. They too are cost factors, of course, and any increase in rates has undesired effects on inflation, but their impact is much smaller than the opposite effect obtained by controlling demand and supporting the exchange rate. Nor should it be forgotten that negative real interest rates subsidize borrowers at the expense of lenders.

We also remain opposed to the indexation of public debt to the level of prices, although we subscribe to its aim of treating savers fairly. However, fairness must be achieved by ending the erosion of savings, not by promising fruits that will never form on the barren plant of a chronic current budget deficit.

The aims of reducing uncertainty for lenders and borrowers alike and encouraging medium and long-term lending can be pursued without extending indexation to new fields. Floating rate loans, which the Bank promoted and the market then perfected in innovative ways, have made it possible to keep open the medium and long-term sources of finance to the Treasury and the economy, even in the recent difficult climate.

Apart from debt service charges, which will decline as the economy returns to equilibrium, there are other clearly defined factors at work, mainly in the social security system and the health service, that are destroying the structure of the budget. It is imperative that these disruptive forces be neutralized quickly. Such action would lend decisive support to the fight against inflation both directly and through the impact that credible moves towards rehabilitation of the budget would have on expectations and interest rates. These measures are also necessary in order to curb the increase in the budget deficit due to the different responsiveness of expenditure and revenue to the fall in inflation.

It would be a serious mistake to move towards the indexation of public debt to prices without having first eliminated the fundamental causes of budget disequilibrium. The cost future generations have to pay for the present use of resources would be raised and the stimuli to adjustment would be weakened, thereby exacerbating the overall difficulties.

We are well aware that an economy where much is index-linked and where double-digit inflation has been raging for a decade is in a state of contradiction and that the introduction of new mechanisms of this kind may seem a rational move. However, we reject the idea that in an attempt to resolve the contradiction the economy should once again be pushed towards the veritable abandonment of money implied in universal indexation instead of a serious programme of budgetary reform being launched and the existing degree of indexation being reduced.

Other European countries with automatic wage adjustment mechanisms are moving in this direction in order to restore collective bargaining as an instrument of wage determination. This is the second corner of the triangle that leads to the recovery of monetary stability.

There is a growing realization that a rate of increase in labour costs in excess of that in productivity can only result in the coexistence of stagnation and inflation. The unions and management should undertake to devise a new policy with regard to collective bargaining and to reform the mechanisms that changing circumstances have made obsolete. The protection of real wages should be sought by respecting the rules that produce monetary stability and not by means of practices that trigger a wage/price spiral.

The wage indexation mechanisms work to the ultimate detriment

of all: those trying to enter the labour market, who are hampered by the economy's inability to encourage investment designed to expand productive capacity; those in work, who pay for the attempt to protect real income by having to endure increasing uncertainty about the security of their jobs; the trade unions, whose scope for wage claims is reduced by the automatic element of increases and which are suffering the effects of decisions that make the prospect of higher employment more remote.

The third corner of the triangle of conditions for a return to monetary stability consists in restoring the central bank's full autonomy in the creation of money. There are those who believe that the exercise of this autonomy in an uncompromisingly restrictive way is a sufficient condition to ensure stability and contain the budget deficits. That theory may have been valid when markets reflected perfect competition and government played a far more limited role than it does now, but it does not hold good today. There is no invisible hand rapidly and lastingly stabilizing wage growth and the budget deficit in response to monetary control.

A tight credit policy reveals the disparity between demand in money terms and real growth and between the public sector borrowing requirement and the propensity to save. It is therefore of fundamental importance that the central bank be able to exercise full control over monetary and financial flows, particularly when budget deficits are large and growing larger.

An important step forward has been made by terminating the practice whereby the central bank acquired any Treasury bills not taken up at auction. The severance of the link between the Treasury and the Banca d'Italia, which will be completed with the introduction of competitive auctions, does not in itself resolve the underlying problems, but it does permit better compliance with the principle embodied in the Constitution that the direct monetary financing of the budget deficit be subject to precise limits.

The independence of monetary policy decisions from those relating to management of the public debt should not be interpreted as a rigid separation in the performance of the two functions. The composition of financial assets according to maturity and yield characteristics influences the behaviour of economic agents by affecting expenditure and capital movements across the exchanges.

Monetary and debt management policies must be mutually compatible if the optimum trade-off is to be achieved between money supply objectives on the one hand and minimization of the cost and lengthening of the maturity of public debt on the other. Distinct as their tasks are, the Treasury and the Banca d'Italia continued to act in accordance with these criteria even after the Bank had ceased to be obliged to take up newly issued Treasury bills that had not been placed in the market.

Nevertheless, should the destabilizing influence of the budget deficit become particularly strong, the central bank will be obliged to give priority to the objective of controlling the money supply at the expense of the desire to lengthen the maturity composition of public debt. Monetary control is the key factor in curbing inflation and it is only by halting the debasement of the currency that the authorities can attract the public back to long-term securities and comply with the imperative of protecting savers.

The banks and financial intermediation

The rapid decline in the banks' share of total financial intermediation continued in 1981 and is still proceeding. In the course of the year bank deposits rose by 9 per cent, a rate of increase that was not only lower than that in prices but also below average deposit rates.

The attention and, not infrequently, the concern of bankers have been focussed on disintermediation. Until now emphasis has been placed on the quantitative aspects of the development of intermediation in the narrow sense. However, this is only a partial and imperfect measure of banking activity; banking services other than intermediation proper have shown strong growth overall and the composition of both parts is undergoing rapid change.

Empirical analysis based on historical and comparative data has identified a tendency for the role of the banks in overall intermediation to decline, albeit with wide fluctuations, as the economic and financial development of each country advances. In the case of Italy this secular trend has been less distinct and was actually reversed between 1970 and 1977. During that period all the indices of banking intermediation showed continuous and appreciable increases to exceptionally high levels. The subsequent decline has rapidly gathered pace in the last two years. Banking intermediation measured in relation to total financial assets and

liabilities is nonetheless at a level similar to or higher than that recorded in the first half of the seventies.

Although some aspects of the developments in recent years reflect a natural trend towards a better balance between bank and non-bank intermediation and stimulate efforts to achieve greater efficiency in the financial sector, concern is aroused by certain qualitative as well as quantitative features of their causes and effects.

Bank deposits have lost ground in relation to other financial assets held by the public, such as government securities and in particular Treasury bills, holdings of which rose by 70 per cent in 1981. This form of competition inevitably becomes particularly fierce when a rise in the budget deficit coincides with a restrictive monetary policy stance. This has been the case in the last two years. The fall in intermediation by the banks was largely a manifestation of the more general crowding-out of all other activities by the public sector. The banks themselves would be in a position to lend to the State, but their involvement would be more expensive for the borrower than direct access to savings and would seem to have little point, as the maturity and risk transformation by the banks that is required for private credit is much less necessary in the case of public debt.

However, the banks have also been affected by competition from the other financial intermediaries and by the direct placing of corporate debt on domestic and international markets. In particular, the special credit institutions have played an active part in the recent phase of more intensive fixed capital formation, having overcome the problems that beset them in the second half of the seventies. Their activity has recovered significantly, partly owing to their freedom from lending restrictions and partly because of the more varied forms of fund raising.

The banks' market share has been squeezed primarily by the restrictive stance of monetary policy. Official controls and the tax treatment of financial instruments have impeded the banking system's response to competitive pressures. A further constraint has been the slowness with which interest margins have narrowed, caused to some extent by the limited ability of the banks to increase profitability by holding down costs.

The necessity for the ceiling on bank lending derives from the framework of macroeconomic objectives and conditions within which credit policy has to operate. Although it has quite often given the banks both an incentive and an opportunity to rid themselves of less reliable

borrowers, it limits and distorts competition. By restricting and standardizing the expansion in lending, it tends to sap the strength of the most viable component of banking activity.

There are many ways of organizing a money economy and directing savings towards investment projects, but there is essentially only one way of selecting firms that deserve to be given what Schumpeter called the "command" of resources, and that is the assessment of creditworthiness.

In a phase of radical restructuring in the productive sector it is therefore vitally important that the banks should continue to apply sound financial criteria to the granting of loans and, in so doing, to use the best entrepreneurial skills and ample technical facilities.

In order to safeguard the separation between industry and the banks that underlies banking regulations, the assessment of loan applications must be based on the ability of firms to service their debt rather than on the financial intermediaries' predetermined attitudes towards particular sectors. The banks' role is to view individual investment projects primarily as future sources of profit and cash flow for the firm as a whole. Loan diversification within the limits of the banks' competence should be seen not as a form of insurance but as a deliberate portfolio choice based on a prudent attitude towards risk since guarantees play a subsidiary role.

Even the most advanced theories of banking science can give the banker only partial support. The ultimate choice is necessarily the result of a chain of decisions in which he must exercise independent judgement throughout. Assessment of the probability that a loan will have a particular outcome inevitably entails a degree of subjectivity. The risk that the granting of a given loan implies for banks with different characteristics varies according to the degree of correlation between the expected yield on the loan and that on their other assets. A bank's attitude towards the yield and risk characteristics of its loan portfolio is influenced by its size, type, location and operational approach.

In view of such intrinsically subjective factors, any evaluation of banking entrepreneurship has to refer back to the conditions prevailing when the decisions were taken and appraise them in the light of the need to obtain and process information and ascertain the extent to which decision-making conforms with the operating guidelines of the bank in the various markets in which it is engaged.

The various factors to which we have referred prompted the banks to channel funds towards other intermediaries under their control or influence. The phenomenon also extended to the special credit institutions, in particular by means of cash advances. Economic agents not associated with credit institutions also stepped up their fund-raising activities in 1981: the volume of so-called "atypical" securities, excluding shares in investment trusts, increased by 600 billion lire to total 1,600 billion at the end of the year. The overall flow of funds generated in these ways was quite significant, even if not so large as to jeopardize the control of credit to the economy.

It will to a large extent be possible for these activities to continue to develop even in the absence of the favourable conditions they have enjoyed until now. The range of financial instruments and services will thereby be enhanced and the advance of other countries' credit structures over those found in Italy will be reduced. The scale of the phenomenon and some of the features it is acquiring, particularly where "atypical" securities are concerned, call for special rules to protect savers and to guarantee the professionalism of market operators.

The solution to the problems confronting the banks should be sought in the elimination of the root causes of distortions, rather than in measures that offer compensations to the banking system. The general state of the economy does not at present allow an easing of administrative constraints, but in the meantime reforms designed to equalize tax treatment and institutional status would be opportune.

In the highly diverse parabanking sector, the demarcation lines between credit circuits and other activities should be drawn more distinctly. The transparency and orderly functioning of all sectors of the capital market need to be assured, without discouraging new initiatives. These are the goals pursued in the legislative proposals on investment trusts and "atypical" securities now being considered by Parliament.

First and foremost, it is the responsibility of the banking system to increase its own capacity to respond to the competitive pressures to which it is and will continue to be subjected.

The course to follow is that of diversifying the range of services and fund-raising instruments. The necessary preconditions for this are higher productivity, faster internal procedures and interbank communications, the holding-down of costs, which are still relatively

high by international standards, and the establishment of a structure of charges reflecting that of the costs of the various services offered by the banks. The latter need to adopt accounting procedures that ensure a more precise allocation of profits and costs to the various categories of activity. Such procedures have already proved their worth in banking systems abroad and although not easy to apply in an industry that typically specializes in joint products they offer the advantage of making it possible for growth markets to be identified more quickly and entered more easily, so that the spread between borrowing and lending rates does not have to bear each and every burden indiscriminately.

There has been a reduction in the correlation between the different yields offered on the various forms of bank deposits on the one hand and their administrative cost and the various preferences of depositors on the other. The interest the banks have recently displayed in certificates of deposit and, more generally, in a more varied range of fund-raising instruments, taking forms and offering rates that reflect the distinction between savings and liquid balances, could effectively counteract the drop in the demand for bank deposits.

A higher yield could be paid on compulsory reserves lodged against certificates of deposit with appropriately regulated characteristics. The return on true savings would thus rise, the degree of liquidity of financial assets would diminish and the banks would be in a position to make better use on the money markets of their virtually exclusive right to create liquidity.

The extension of the banks' territorial networks, the measures that have been taken with regard to the transparency of the ownership and foreign assets of the banks, and the moves involving the statutes of the credit institutions are all designed to enhance competitiveness and efficiency, as well as the stability of banks' net worth.

At the end of March of this year the opening of new branches was authorized under a programme providing for an increase of 5 per cent in the number of banking establishments. The programme was based on criteria for the efficient organization of the networks of banking services and on predominantly quantitative data; both the criteria and the data have been made public. The purpose of the move is to accept a greater number of the applications submitted by the banks, which will thus be expected to act prudently and responsibly in the delicate area of entry into the banking markets.

The need for the consolidated presentation of the risk assets and own funds of all the units in a banking group has been constantly reaffirmed in international organizations, not least in connection with the constant monitoring of country risk and maturity transformation, and it is also recalled in the new rules governing shareholdings by Italian banks. More recently the Banca d'Italia has indicated which information is needed to illustrate the financial links between banks and their foreign affiliates and between foreign subsidiaries and all the companies in the same group. Work has also begun on the definition of reporting schemes designed to reveal the nature of relationships with third parties and to establish the net worth of each group.

As far as the statutes of the public banks are concerned, guidelines have been proposed that are designed to favour capital increases, in particular by means of the taking of minority shareholdings by, inter alia, investors with entrepreneurial skills. These guidelines are being implemented by the banks, which are applying them in the manner best suited to their particular vocation.

These and other developments form part of a critical review of the functions and operating methods of the credit system. The greater the extent to which this review is conducted jointly by the financial intermediaries and the supervisory authorities, the more fruitful it will be. The developments are founded upon the reaffirmation of the concept of the bank as an enterprise. Despite the difficulties still persisting in certain respects, this cardinal principle has, we feel, gained wide acceptance.

Ladies and Gentlemen,

In the world economy the straitjacket of energy prices has temporarily loosened, raw material prices have fallen and many countries have maintained or regained their grip on inflation. Such sources of comfort are outweighed, however, by concern over economic stagnation, unemployment, the contraction in world trade and the divergences in economic performance and policies. The gap is widening between those industrialized countries that have managed to defeat inflation and eliminate their external deficits and those other countries, which include Italy, that are still far from completing either of these adjustments.

Competition is growing fiercer and there is a danger that it will degenerate into unrestrained trade wars fought by using policy instruments for purposes for which they are not intended, ranging from exchange rate manipulation to the granting of assistance and from regulatory control to official pressure. The system of international cooperation on which economic development and social progress have been based for the past three decades is in grave jeopardy.

The existence of an open international arena is essential for Italy's survival. The well-being we enjoy today was created by accepting and meeting the challenge of free trade, and it needs that freedom if it is to endure and to develop further.

The healthy struggle of competition not only requires the economy to strive for greater efficiency and lower costs and to develop new production techniques and products, but extends to all aspects of society and public life. It is a competition in the ability to carry out research and achieve technological progress, between systems of administration, between educational institutions, between different labour market and social security arrangements, between financial systems and between currencies. For a country to compete on an equal footing, an efficient industrial sector is not enough if it is not supported by a modern state administration; an industrious workforce and managerial talent are not enough if educational and professional training is not appropriate to the needs of an advanced industrial society; a strong and deep-seated propensity to save is not enough if the fruits of that saving are channelled to uses that do not generate resources.

On both the international and national levels the currency is the critical element. The strains and instability of the difficult times in which we live are displayed in the three variables of prices, exchange rates and interest rates, through which the fundamental monetary relationships of an open industrial economy are expressed.

Simplistic diagnoses and dogmatic remedies neither shorten nor ease the difficult road to internal and external equilibrium. By laying the blame on just one factor they absolve the many; they encourage moral and civic laxity by masking the fact that monetary stability is a shared responsibility, a good that is never definitively acquired.

The erosion of the currency is an economic deceit, a social contradiction that could be resolved instantly only if the community as a body could instantly transform itself. This is not a miracle that the monetary authorities can perform with the instruments at their command. It

behoves them not to make dramatic gestures, but to display tenacity and, if need be, severity in pursuit of their objective and pragmatism in the choice of instruments.

On this occasion last year we stated that after a decade of inflation in double figures Italy would not return to monetary stability without real changes in the institutional arrangements that affect the currency. We indicated that central bank autonomy, greater budgetary discipline, criteria for wage negotiations and a reduction in indexation were the prerequisites for a return to monetary stability.

This analysis and the requirements we indicated have not failed to attract support, and some action has been taken jointly with the Treasury insofar as central bank autonomy is concerned. However, many problems have become more complicated rather than simpler: this is true of public finance, indexation and labour costs. Some progress has been made in curbing the balance-of-payments deficit and reducing inflation, but the 15 per cent inflation rate recorded today is twice the average of the other Community countries and three times the rate in the Federal Republic of Germany, while the balance-of-payments deficit remains high for the third consecutive year.

Courageous decisions are needed that will also produce quick results, for the market discounts trends as well as absolute levels. The target of single-figure inflation may seem ambitious, but it is a necessary and not impossible goal.

The appraisal of the state of the public finances on the basis of the preliminary results for the first five months and probable developments in the remainder of 1982 calls for cuts in expenditure and increases in revenue in order to keep the deficit for the rest of the year within the limits originally set. The emergency measures will have to be confirmed by launching a programme of action to improve the structure of the budget.

In view of the recent decision to offset fiscal drag, the new increases in revenue will necessarily involve indirect taxation. In order to safeguard the progress already made on the inflation front, the inevitable repercussions on prices must be limited to the initial impact by cutting the link with wage indexation. This is the minimum modification that must be made to the mechanism if, as we have been proposing for some time, economic policy is to regain full use of the indispensable fiscal instrument.

Wage bargaining at national and company level must demonstrate an awareness that in Italy too the dual imperatives of employment and reorganization of the productive sector leave no room for increases in real wages.

It is sad to have to acknowledge the discrepancy between analysis and subsequent action. The paucity of the results achieved hitherto is due not to the ineffectiveness of the action taken but to the failure to reach decisions and to behave in a way recognized to be necessary. We await those decisions and forms of behaviour, and remain determined meanwhile to persevere with the line of conduct that their absence forces upon the central bank.

IV. - THE BANK'S CAPITAL AND RESERVES

Capital. - During 1981 the number of shareholders in the Bank decreased from 108 to 106 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	7	"	54,500	"	137	"
Banks of national interest	3	"	21,000	"	54	"
Social insurance funds	1	"	15,000	"	34	"
Insurance companies	7	"	31,500	"	91	"
	94	with	299,898	shares and	787	votes

Shareholders without voting rights:

Savings banks and loan offices	12	with	102	shares
Total	106	with	300,000	shares

Reserves. - During 1981 the reserve funds underwent the following changes:

	Ordinary reserve fund	Extraordinary reserve fund
Amount on 31 December 1980	Lit. 139,930,003,241	Lit. 149,499,597,413
increase:		
- allocation of 20 per cent of profits for the year 1980	" 15,606,975,183	" 15,606,975,183
- income received in 1981 from investment of reserves	" <u>18,827,920,194</u>	" <u>21,559,728,666</u>
	Lit. 174,364,898,618	Lit. 186,666,301,262

decrease:

- distribution to shareholders of a part of the income accruing in the course of 1980 (Article 56 of the Statute)	Lit. <u>78,893,865</u>	Lit. <u>83,106,135</u>
Amount on 31 December 1981.	Lit. <u>174,286,004,753</u>	Lit. <u>186,583,195,127</u>

V. - BALANCE SHEET
AND PROFIT AND LOSS ACCOUNT

BALANCE SHEET

AS AT 31 DECEMBER 1981

ASSETS

GOLD					
I on hand	Lit.	2,315,828,433,279			
II on deposit abroad	»	22,919,851,249,901			25,235,679,683,180
GOLD CREDITS (EMCF)					Lit. 8,697,947,130,700
CASH ON HAND					» 2,107,802,355,467
DISCOUNTS AND ADVANCES					
I portfolio discounts:					
- ordinary bills	Lit.	210,887,486,480			
- stockpiling bills	»	1,569,218,144,619	1,780,105,631,099		
II advances:					
- current account	Lit.	277,380,702,258			
- fixed term	»	—			
- under Treasury Decree of 27.9.1974	»	532,127,935,271	809,508,637,529		
III deferred payments in the clearing system	Lit.	—			2,589,614,268,628
BILLS FOR COLLECTION WITH CORRESPONDENTS					Lit. —
EXTERNAL ASSETS IN FOREIGN CURRENCIES					
I ECUs	Lit.	10,731,513,507,518			
II other assets:					
- banknotes and foreign currency bills	Lit.	455,721,016			
- current accounts with correspondents	»	231,140,308,021			
- time deposits	»	1,121,326,357,500			
- other	»	—	1,352,922,386,537		12,084,435,894,055
DOLLAR CREDITS (EMCF)					Lit. 1,945,255,933,690
ITALIAN FOREIGN EXCHANGE OFFICE (UIC)					
I current account	Lit.	14,925,470,312,508			
II special accounts	»	2,273,052,017,727			17,198,522,330,235
TREASURY CURRENT ACCOUNT					Lit. 25,311,950,398,846
SUNDRY CLAIMS ON THE GOVERNMENT					» 255,884,690,258
SECURITIES					
I government and government-guaranteed securities:					
- freely available	Lit.	30,790,074,741,100			
- investment of statutory reserves	»	279,255,343,196			
- investment of staff severance pay and pension fund	»	781,266,253,723	31,850,596,338,019		
II - securities of companies and agencies:					
- investment of statutory reserves	Lit.	10,767,472,245			
- investment of staff severance pay and pension fund	»	242,907,195,095	253,674,667,340		
III shareholdings and participations:					
- in subsidiary companies and agencies					
<i>investment of statutory reserves</i>	Lit.	122,914,100			
<i>investment of staff severance pay and pension fund</i> ..	»	52,632,392,446	52,755,306,546		
- in associated companies and agencies					
<i>investment of statutory reserves</i>	Lit.	729,576,000			
<i>investment of staff severance pay and pension fund</i> ..	»	4,030,611,550	4,760,187,550		
- in other companies and agencies					
<i>investment of statutory reserves</i>	Lit.	32,398,889,257			
<i>investment of staff severance pay and pension fund</i> ..	»	46,202,493,490	78,601,382,747	136,116,876,843	32,240,387,882,202

(assets cont.)

UIC ENDOWMENT FUND	Lit.		500,000,000,000
REAL ESTATE			
I used for the Bank's premises	Lit.	1	
II investment of staff severance pay and pension fund	»	38,219,492,037	38,219,492,038
OTHER INVESTMENTS OF STAFF SEVERANCE PAY AND PENSION FUND	Lit.		20,160,000,000
FURNITURE AND EQUIPMENT			
I furniture and fittings	Lit.	21,191,695,231	
II equipment	»	73,400,822,966	
III coins and collections	»	307,195,088	94,899,713,285
SUNDRY ITEMS			
I banknotes in production	Lit.	2,395,015,601	
II procedures, studies and designs of the technical departments :			
- completed	Lit.	22,591,316,365	
- in preparation	»	4,781,791,103	27,373,107,468
III sundry debtors	Lit.	48,552,286,585	
IV other	»	513,184,917,111	591,505,326,765
ACCRUED INCOME	Lit.		1,437,235,831,812
PREPAID EXPENSES	»		
	Lit.		130,349,500,931,161
MEMORANDUM ACCOUNTS			
I Securities and other valuables:			
- held as collateral	Lit.	4,392,214,688,418	
- other	»	166,672,051,063,046	171,064,265,751,464
II Depositories of securities and valuables:			
- domestic	Lit.	—	
- foreign	»	948,636,052,321	948,636,052,321
III Unused credit limits on advance accounts	Lit.	2,054,700,208,916	
IV Debtors for securities receivable (BI forward sales)	»	83,000,000,000	
V Securities receivable (BI forward purchases)	»	1,404,000,000,000	
VI Debtors for foreign currency and lire receivable (BI forward sales)			
- domestic	Lit.	—	
- foreign	»	1,744,500,000,000	1,744,500,000,000
VII foreign currency and lire receivable (BI forward purchases)	Lit.	1,744,500,000,000	
VIII Exchequer for depreciation allowances	»	238,501,099,501	179,282,103,112,202
TOTAL . . .	Lit.		309,631,604,043,363

Audited and found correct. — Rome 29 April 1982

THE AUDITORS

DOMENICO AMODEO

ALBERTO CAMPOLONGO

VITTORIO CODA

GIUSEPPE GUARINO

LUIGI GUATRI

THE ACCOUNTANT GENERAL

PIETRO SALONICO

THE GOVERNOR

CARLO AZEGLIO CIAMPI

BALANCE SHEET

AS AT 31 DECEMBER 1981

LIABILITIES

NOTES IN CIRCULATION	Lit.		30,658,765,073,000
BANK DRAFTS	»		325,968,495,978
OTHER SIGHT LIABILITIES			
I transfer orders	Lit.	—	
II other	»	1,580,903,456	1,580,903,456
FREE DEPOSITS ON CURRENT ACCOUNT	L.		1,259,041,813,181
TIED DEPOSITS ON CURRENT ACCOUNT	»		1,000,000,000
DEPOSITS FOR CASH DEPARTMENT SERVICES	»		87,117,855,547
SPECIAL ACCOUNTS UNDER LAW No. 386 OF 17.8.1974	»		232,256,509,955
COMPULSORY ACCOUNTS			
I compulsory bank reserves	Lit.	36,987,896,052,762	
II collateral for the issue of banker's drafts and guaranteed personal cheques	»	444,295,805	
III tied accounts in relation to investment abroad	»	97,113,253,423	
IV companies in the process of incorporation	»	76,359,430,678	
V for bank lending in excess of the ceiling	»	1,433,867,885,693	
VI other	»	3,867,849,221,273	42,463,530,139,634
DEPOSITS IN FOREIGN CURRENCY ON BEHALF OF UIC	Lit.		548,693,605,008
EXTERNAL ACCOUNTS IN LIRE ON BEHALF OF UIC	»		1,724,358,412,719
EXTERNAL LIABILITIES			
I deposits in foreign currency	Lit.	2,868,233,281	
II external accounts in lire	»	158,750,600,394	161,618,833,675
ECU LIABILITIES (EMCF)	Lit.		10,643,203,064,390
MISCELLANEOUS LIABILITIES TOWARDS THE STATE	»		1,255,859,231,272
SUNDRY PROVISIONS			
I for gold price fluctuations (under Decree Law No. 867 of 30.12.1976)	Lit.	30,172,180,849,812	
II for exchange rate management loss (under Decree Law No. 867 of 30.12.1976)	»	1,325,092,246,606	
III for loss on bill portfolio	»	234,919,178,078	
IV for loss on foreign exchange	»	1,210,000,000,000	
V for loss on securities	»	1,383,378,479,770	
VI for contingent losses	»	2,070,185,000,000	
VII for insurance cover	»	324,691,685,925	
VIII for building works	»	222,528,712,964	
IX for renewal of equipment	»	46,250,000,000	
X for taxation	»	690,515,300,363	
XI for staff severance pay and pension fund	»	1,463,600,000,000	
XII for grants to BI pensioners and their surviving dependents	»	452,509,656	39,143,793,963,174

(assets *cont.*)

DEPRECIATION FUND FOR FURNITURE AND FITTINGS	Lit.		20,964,091,587
DEPRECIATION FUND FOR EQUIPMENT	»		62,276,814,678
FUND FOR THE DEPRECIATION OF THE PROCEDURES, STUDIES AND DESIGNS OF THE TECHNICAL DEPARTMENTS	»		6,122,649,761
SUNDRY ITEMS			
I sundry creditors	Lit.	10,244,629,293	
II other	»	408,243,113,915	418,487,743,208
ACCRUED EXPENSES	Lit.		62,336,784,523
DEFERRED INCOME	»		776,083,718,161
CAPITAL	Lit.	300,000,000	
ORDINARY RESERVES	»	174,286,004,753	
EXTRAORDINARY RESERVES	»	186,583,195,127	361,169,199,880
NET PROFIT FOR DISTRIBUTION	Lit.		135,272,028,374
	L.		130,349,500,931,161
MEMORANDUM ACCOUNTS			
I Depositors of securities and other valuables	Lit.	171,064,265,751,464	
II Securities and valuables on deposit	»	948,636,052,321	
III Holders of advance accounts for the portion of unused credit limits	»	2,054,700,208,916	
IV Securities for delivery (BI forward sales)	»	83,000,000,000	
V Creditors for securities for delivery (BI forward purchases)	»	1,404,000,000,000	
VI Foreign currency and lire for delivery (BI forward sales)	»	1,744,500,000,000	
VII Creditors for foreign currency and lire for delivery (BI forward purchases)			
- domestic	Lit.	—	
- foreign	»	1,744,500,000,000	1,744,500,000,000
VIII Depreciation allowances	Lit.	238,501,099,501	179,282,103,112,202
TOTAL ...	Lit.		309,631,604,043,363

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THE GOVERNOR

CARLO AZEGLIO CIAMPI

GENERAL PROFIT AND LOSS ACCOUNT

FOR THE YEAR 1981

EXPENDITURE AND LOSSES

ADMINISTRATIVE EXPENDITURE

central and local boards	Lit.	909,720,313	
staff:			
wages and salaries and related costs	Lit.	316,619,878,480	
pensions and severance payments	»	124,504,472,127	441,124,350,607
provision of services	Lit.	37,450,211,590	
other	»	66,326,224,655	545,810,507,165

TAXES AND DUTIES

stamp duty on the circulation of banknotes and demand drafts	Lit.	—	
other taxes and duties:			
current year	Lit.	1,898,353,482	
previous years	»	169,860,814,142	171,759,167,624

INTEREST PAID

on compulsory bank reserves	Lit.	2,049,401,226,768	
other	»	3,075,657,217	2,052,476,883,985

EXPENDITURE ON SECURITIES TRANSACTIONS Lit. 2,822,928,781

EXPENDITURE ON FOREIGN TRANSACTIONS » 45,741,986

LOSSES ON SECURITIES DEALINGS » —

EXCHANGE RATE LOSSES » —

LOSSES ON REALIZATION OF ASSETS » —

CONTRIBUTIONS TO CHARITIES AND SOCIAL AND CULTURAL ACTIVITIES » 848,614,234

TECHNICAL DEPARTMENTS — INITIAL STOCKS » 11,717,410,390

VALUATION LOSSES

on securities	Lit.	298,388,941,534	
on other assets	»	—	298,388,941,534

CONTRIBUTIONS TO THE TREASURY Lit. 189,430,192,000

(expenditure and losses *cont.*)

DEPRECIATION

of real estate used as BI premises	Lit.	24,572,417,178	
of furniture and fittings	»	4,888,090,473	
of equipment	»	18,703,368,177	
of the procedures, studies and designs of the technical departments	»	3,839,892,204	
other	»	31,256,195	52,005,024,227

APPROPRIATION OF THE YIELD ON INVESTMENT TO RESERVES

to ordinary reserves	Lit.	18,827,920,194	
to extraordinary reserves	»	21,559,728,666	40,387,648,860

ALLOCATIONS TO PROVISIONS

for loss on bill portfolio	Lit.	—	
for loss on foreign exchange	»	370,000,000,000	
for loss on securities	»	548,400,000,000	
for contingent losses	»	119,000,103,522	
for insurance cover	»	23,100,000,000	
for building works	»	200,000,000,000	
for renewal of equipment	»	10,000,000,000	
for taxation	»	550,000,000,000	
for staff severance pay and pension fund	»	263,600,000,000	
for grants to BI pensioners and their surviving dependents	»	112,000,000	2,084,212,103,522

NON-OPERATING LOSSES AND EXTRAORDINARY CHARGES	Lit.	—	
	»		5,449,905,164,308
NET PROFIT	Lit.		135,272,028,374
	TOTAL . . . Lit.		5,585,177,192,682

Audited and found correct. —. Rome 29 April 1982

THE AUDITORS

DOMENICO AMODEO
ALBERTO CAMPOLONGO
VITTORIO CODA
GIUSEPPE GUARINO
LUIGI GUATRI

THE ACCOUNTANT GENERAL

PIETRO SALONICO

THE GOVERNOR

CARLO AZEGLIO CIAMPI

**GENERAL PROFIT AND LOSS ACCOUNT
FOR THE YEAR 1981**

INCOME AND PROFITS**INTEREST RECEIVED**

on discounts and advances:

ordinary portfolio discounts	Lit.	13,167,227,824	
stockpiling portfolio discounts	»	15,583,966,407	
advances	»	147,312,113,699	176,063,307,930

on lending to the Treasury	Lit.		242,438,090,125
on lending to the UIC	»		806,104,326,545
on lending abroad	»		495,992,569,912
other	»		11,360,259,429

1,731,958,553,941

INTEREST, PREMIUMS AND DIVIDENDS ON SECURITIES*freely available*

fixed rate:

Treasury bills	Lit.	233,482,349,826	
2 and 3-year Treasury credit certificates	»	406,562,409,187	
other government and government-guaranteed securities	»	1,565,864,347,453	2,205,909,106,466

investment of reserves and staff severance pay and pension fund

fixed rate:

government and government-guaranteed securities	Lit.	105,438,279,015	
other securities	»	17,742,983,817	123,181,262,832

from shares and participations (not represented by securities) in:

subsidiary companies and agencies	Lit.	2,276,596,070	
associated companies and agencies	»	269,535,000	
other companies and agencies	»	7,396,788,436	9,942,919,506

133,124,182,338
2,339,033,288,804**INTEREST ON PARTICIPATION IN THE UIC ENDOWMENT FUND** Lit. 25,000,000,000**PROFITS FROM DEALINGS IN AND REDEMPTION OF SECURITIES** » 124,177,450,660**EXCHANGE RATE GAINS** » 799,390,292,172**COMMISSIONS AND OTHER FINANCIAL REVENUE** » 51,084,567,441**INCOME FROM REAL ESTATE** » 5,050,217,976**PROFITS FROM THE SALE OF**

real estate	Lit.	179,999,999	
other property	»	330,686,935	510,686,934

TECHNICAL DEPARTMENTS - FINAL STOCKS Lit. 15,766,185,923**VALUATION GAINS**

on securities	Lit.	—	
on other assets	»	—	—

(income and profits *cont.*)

WITHDRAWALS FROM PROVISIONS

for loss on bill portfolio	Lit.	—	
for loss on foreign exchange	»	—	
for loss on securities	»	298,388,941,534	
for contingent losses	»	—	
for insurance cover	»	—	
for building works	»	24,572,417,178	
for renewal of equipment	»	—	
for taxation	»	169,860,814,142	
for staff severance pay and pension fund	»	—	
for grants to BI pensioners and their surviving dependents	»	94,157,000	492,916,329,854
NON-OPERATING PROFITS AND EXTRAORDINARY EARNINGS	Lit.		289,618,977
	TOTAL ... Lit.		5,585,177,192,682

PROFIT DISTRIBUTION

TO ORDINARY RESERVES	Lit.	27,054,405,675
TO EXTRAORDINARY RESERVES	»	27,054,405,675
TO SHAREHOLDERS	»	30,000,000
TO THE TREASURY	»	81,133,217,024
	TOTAL ... Lit.	135,272,028,374

Audited and found correct. — Rome 29 April 1982

THE AUDITORS

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LUIGI GUATRI

THE ACCOUNTANT GENERAL

PIETRO SALONICO

THE GOVERNOR

CARLO AZEGLIO CIAMPI

ADMINISTRATION OF THE BANCA D'ITALIA

AS AT 31 DECEMBER 1981

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
Francesco CONTI	Lucio MORODER
Gaetano DI MARZO	Giovanni Battista PARODI *
Luigi FALAGUERRA *	Giulio PONZELLINI
Luigi FANTOLA	

* Member of the Executive Committee.

BOARD OF AUDITORS

Domenico AMODEO	Giuseppe GUARINO
Alberto CAMPOLONGO	Luigi GUATRI
Enzo CAPACCIOLI	

ALTERNATE AUDITORS

Vittorio CODA	Natalino IRTI
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CENTRAL ADMINISTRATION

MANAGERS

Giovanni MAGNIFICO	- ECONOMIC ADVISER
Pietro SALONICO	- ACCOUNTANT GENERAL
Carmelo OTERI	- CENTRAL MANAGER FOR SUPERVISION OF BANKS
Roberto MONTECCHIARI	- SECRETARY GENERAL
Antonio FAZIO	- CENTRAL MANAGER FOR ECONOMIC RESEARCH
Giuseppe UGHI	- CENTRAL MANAGER FOR TECHNICAL DEPARTMENTS
Giorgio SANGIORGIO	- CHIEF LEGAL ADVISER

LIST OF ABBREVIATIONS

BI	Banca d'Italia
BIS	Bank for International Settlements
CD	Certificate of deposit
Consob	Commissione Nazionale per le Società e la Borsa – National Stock Exchange Supervisory Commission –
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
IRI	Istituto per la ricostruzione industriale – Institute for Industrial Reconstruction –
ISCO	Istituto nazionale per lo studio della congiuntura – National Institute for the Study of the Economic Situation –
Istat	Istituto centrale di statistica – Central Institute for Statistics –
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
SIP	Società Italiana per l'Esercizio Telefonico
SIR	Società Italiana Resine
STET	Società Finanziaria Telefonica
TDC	Total domestic credit
TOE	Tons of oil equivalent
UIC	Ufficio italiano dei cambi – Italian Foreign Exchange Office –
VAT	Value added tax