BANCA D'ITALIA

ABRIDGED VERSION OF THE

REPORT

FOR THE YEAR

1982

PRESENTED BY THE GOVERNOR TO THE

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31 MAY, 1983

R O M E
PRINTING OFFICE OF THE BANCA D'ITALIA
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I — THE INTERNATIONAL ECONOMY

The slowdown in economic growth that came in the wake of the second oil shock worsened in 1982 to the point of stagnation in both industrial and developing countries (Table 1). Unemployment rose further, so that by the end of the year it stood at more than 10 per cent of the labour

Table 1

GNP, INFLATION AND BALANCES OF PAYMENTS
IN THE MAIN GROUPS OF COUNTRIES

	Industrial	countries	Oil-exporting	Non-oil developing	
Years		Seven major countries	countries	countries (1)	
	Cross	national produc	t at constant pri	200 (2)	
	Gross	national produc	t at constant pric	265 (2)	
1979	3.4	3.5	3.1	5.0	
1980	1.3	1.1	-2.3	4.8	
1981	1.2	1.5	-4.3	2.5	
1982	-0.3	-0.4	-5.4	1.4	
	Consumer prices (2)				
1979	9.1	9.3	10.9	24.6	
1980	11.9	12.2	12.7	31.8	
1981	9.9	10.0	12.9	31.0	
1982	7.5	7.1	9.8	32.8	
		Balance on cur	rent account (3)		
1979	-25.3	-10.7	68.6	-49.5	
1980	-63.1	-33.5	114.3	-76.6	
1981	-21.2	-2.2	65.0	-93.9	
1982	-24.8	-6.5	-2.2	-73.6	

Source: IMF

(1) Including the People's Republic of China. - (2) Percentage changes over the previous year. - (3) Billions of dollars; including official transfers.

force in some industrial countries, in many cases as a result of the combination of an increase in the working population and a fall in the number of persons employed. Inflation declined suddenly and rather unexpectedly owing to the restrictive policies pursued, particularly in the monetary field. The rate of price increase in countries such as the United

States and the United Kingdom fell to levels that were last recorded in the mid-sixties; this provided scope for a reduction in nominal interest rates from the summer onwards, but real rates remained very high.

World trade declined by 2 per cent in volume terms, the first contraction in six years, and appears to be threatened by the growing temptation of protectionism. The current account payments disequilibria among major areas of the world became less pronounced; in particular, the large surpluses recorded by oil-exporting countries in 1980 and 1981 were not repeated. Non-oil developing countries were hit by the effects of world stagnation and depressed commodity prices, with the result that their growth slowed down further and is now insufficient to maintain per capita income. These countries also had to cope with the serious problems raised by the level of their external indebtedness and by high interest rates; the institutions and mechanisms for international financial cooperation were consequently called upon to make unprecedented efforts to safeguard the stability of the system. In spite of the increased debt service burden, the current account deficit of this group of countries contracted slightly.

Last year it was emphasized that the second oil shock had had less traumatic consequences than the first, partly because of the timely policies of adjustment introduced in the industrial countries. However, taking the events of 1982 together with those of the two preceding years, it must now be acknowledged that, although the crisis appeared to have a fairly limited impact, its overall effects have been profound and persistent and the recessionary influence is the dominant element.

During the four half-years from mid-1973 to mid-1975 the first oil crisis sent a shock-wave through the main macroeconomic aggregates of the industrial countries; expressed as an average for the seven major countries in this group, the annual rate of change in real gross national product tumbled from 8 to — 3 per cent, inflation rose to a peak of 15 per cent after having fluctuated around the 5 per cent mark during the early years of the decade and the unemployment rate rose by two percentage points to 5-6 per cent. Nevertheless, economic activity could be described as having returned to normal by the end of 1975 with the resumption of growth in the region of 5 per cent, partly as a result of the swift return to expansionary fiscal and monetary policies. Serious current account disequilibria remained for the next four years, however; inflation stabilized at an average of 8 per cent, considerably higher than the rate prevailing before the crisis, and the view began to form that this could be due to permanent changes in economic behaviour.

When the second oil crisis broke, the governments of the industrial countries therefore shaped their economic policies with greater prudence and kept them restrictive for a long period. This eventually brought inflation down below the levels that had obtained between the two crises, but it also played a major part in depressing output, though less abruptly than had happened six years before, and in keeping it depressed even after the direct recessionary impact of the increase in energy costs had spent itself.

The persistence of recession throughout 1982 in spite of the reduction in nominal interest rates in the summer disproved the forecasts of a recovery in the second half of the year. The dampening effects on domestic demand induced by consumers' cautious behaviour in the face of adverse labour market conditions, by low capacity utilization rates and by high real interest rates had been underestimated; moreover, insufficient regard had been paid to the interaction between trade imbalances, financial flows and exchange rates and to their repercussions on foreign demand in industrial countries.

Economic policies

The complex situation that had arisen after a period in which monetary policy had been the mainstay of stabilization efforts made it particularly difficult in 1982 to find a more balanced mix of economic policies that could bring about non-inflationary growth.

As inflation slowed down and the recovery failed to materialize, signs of a relaxation in monetary policy became evident. Nevertheless, the low levels of economic activity and the high rates of unemployment affected government revenue and expenditure and thus helped magnify the budget deficits even in countries where the objective was to reduce them.

In the United States the partial easing of monetary conditions was accompanied by serious doubts about whether it would last. Interest rates, which reflected businessmen's changing perceptions of the overall stance of economic policy, continued to be extremely volatile, although the trend was downwards. The difficulties encountered by the Administration in gaining approval of the budget and the doubts about attainment of the medium-term objective of eliminating the deficit had repercussions on the money and capital markets, thus putting temporary upward pressure on nominal interest rates, while real interest rates remained at exceptionally high levels.

In view of this situation and the continual appreciation of the dollar, the conflict between domestic and external objectives induced the other industrial countries to be especially cautious about modifying their monetary policy stance in order to avoid exacerbating the tendency for their currencies to weaken against the dollar.

Against the background of high capital mobility, the objective of exchange rate stability became an imperative not only for those countries that continued to record huge current account deficits. In Japan, for example, the original approach whereby fiscal policy was assigned the task of containing aggregate demand and monetary policy was used to stimulate it was modified in the course of the year. The sustained outflow of both long and short-term capital and the consequent repercussions on the exchange rate of the yen prevented further progress in the relaxation of monetary conditions that had begun in the second half of 1980. At the same time, however, the restrictive stance of fiscal policy was modified slightly by the adoption of measures designed to increase certain public expenditure programmes. In the Federal Republic of Germany the depreciation of the Deutsche Mark against the US dollar was accompanied by a reduction in interest rates, though a smaller one than that recorded in the United States, thus bringing a reduction in the negative differential between domestic interest rates and those paid on dollar funds.

Exchange rates

In the fifteen months from the beginning of 1982 to March 1983 events on the foreign exchange markets were characterized by a further strengthening of the US dollar against all other major currencies and by repeated periods of tension within the European Monetary System which culminated in three realignments of central rates in February and June 1982 and March 1983; the Nordic countries, Spain and Greece also devalued their currencies by substantial amounts against those of the EEC. The severe constraint on growth imposed in many countries by external payments deficits, the high level of the dollar and the stagnation in world demand fuelled growing protectionist pressures; in some cases governments showed a tendency to make aggressive use of the exchange rate for the purposes of external adjustment.

The US dollar continued to appreciate until the beginning of November, by which time the effective exchange rate had risen by 20 per cent since the beginning of the year. In the next two months it fell by about 7 per cent and then fluctuated around a firmer trend in the first quarter of 1983. In the early months of 1982 the dollar was driven upwards by the rise

in interest rates in the US market and by the continuing large current account surplus. It strengthened further during the summer and early autumn in spite of the deterioration in the current account and the narrowing of interest rate differentials vis-à-vis major foreign markets. At least part of the explanation for this phenomenon can be found in political factors of a general nature, such as the revival of hostilities in the Middle East and fears of an international financial crisis later in the year. In addition, the reversal of exchange rate expectations was delayed by the tendency of monetary authorities in the other major countries to go at least part way towards matching the reductions in US interest rates. Finally, expectations concerning the future course of monetary policy in the United States probably also played an important role, for the dollar weakened markedly after the Federal Reserve had announced that it would place less emphasis on money supply targets, whereas it strengthened again following official reaffirmation of the priority accorded to control of the monetary aggregates in the early part of 1983.

The appreciation of the dollar coincided with a period of marked weakness of the yen, even against the European currencies. From the beginning of January to the beginning of November the yen declined by 21 per cent against the dollar and by about 10 per cent against the Deutsche Mark. However, in less than two months it then made good more than three-quarters of the previous decline against the dollar and almost the entire depreciation against the Mark. Given Japan's large and growing current account surplus and relatively low inflation, these pronounced exchange rate movements are largely attributable to capital flows, apart from the factors mentioned above with regard to the dollar; in fact, at a time when interest rate differentials continued to favour dollar assets, the depreciation of the yen was accentuated by the progressive dismantling of controls on capital movements.

In the first ten months of 1982 the European currencies fluctuated jointly against the dollar, with the Mark and the pound sterling showing a tendency to appreciate against the other currencies. From the end of October onwards sterling weakened considerably, partly in response to the less favourable prospects in the oil market. The Deutsche Mark, by contrast, began to strengthen, regaining about half the ground previously lost against the dollar.

During the period under review severe pressures developed within the European Monetary System which resulted in the three realignments of central rates mentioned above. Besides factors outside the system — primarily the performance of the dollar — the divergences in the balance of payments and in inflation rates in member countries exerted a growing influence. In particular, the current external deficits of France and Denmark

continued to worsen and those in Belgium, Ireland and Italy narrowed slightly but remained large in relation to GNP; on the other hand, large surpluses were recorded in the Federal Republic of Germany and the Netherlands. The dispersion of inflation rates remained considerable, with Ireland and Italy above 16 per cent at one extreme and Germany and the Netherlands below 5 per cent at the other.

Over the entire period of fifteen months under review the Dutch guilder and the Danish krone recorded modest depreciations of 2.9 and 8.6 per cent respectively against the Jdeutsche Mark; there were larger depreciations, however, in the Italian lira, the Irish pound, the Belgian franc and the French franc (10.7, 11.4, 14.4 and 15.4 per cent respectively).

In spite of the difficulties experienced during this period, an overall assessment of the operation of the EMS since its inception reveals a number of positive results. Member countries have achieved some degree of monetary policy coordination; this has been particularly evident in the concerted movements in interest rates during periods of tension. The failure to reduce divergences in real economic performance reflected both the different impact of the second oil shock on the various countries and the differences in fiscal and incomes policies. Over the short term the system has helped stabilize expectations and reduce the volatility of the foreign exchange market; the variability of the effective rates of all participating currencies has decreased considerably since the inception of the EMS and is consistently lower than that for freely floating currencies. Finally, the system has imposed an element of discipline on the internal policies of member countries owing to the fact that since March 1979 average exchange rate changes within the EMS have not fully offset inflation differentials on a consumer price basis.

The pronounced volatility of exchange rates formed one of the main subjects of discussion at the Versailles summit of the seven major industrial countries; it was therefore decided to set up a working group to examine the causes of such phenomena on the basis of individual countries' experience and various empirical studies and to analyze in greater depth the effectiveness of interventions in foreign exchange markets. The report of the working group was submitted to the Ministers and central bank Governors of the seven countries for approval and its main conclusions were accepted at their meeting on 29 April last.

The communiqué from the Ministers and central bank Governors confirms that exchange rate stability depends mainly on the pursuit of non-inflationary and mutually compatible economic policies in the major countries. Nevertheless, it is recognized that the convergence of economic performance and policies may not be sufficient to prevent instability on the

foreign exchange markets and that intervention is an effective instrument to ensure the orderly conduct of transactions and to reduce exchange rate volatility and movements not justified by underlying economic trends. Finally, the communiqué emphasizes that intervention policies are rendered more effective by coordination among the various countries and expresses the participants' readiness in principle to carry out joint intervention should the need arise.

The performance of developing countries and centrally planned economies

In the oil-exporting developing countries gross domestic product declined by 5.4 per cent, thus continuing the fall recorded in 1980 and 1981 (2.3 and 4.3 per cent respectively). This was the result of the continuous sharp fall in the output of the oil sector (18.2 per cent, compared with a reduction of 15.2 per cent in 1981), which was only partly offset by the growth that occurred in other sectors (3.8 and 5.1 per cent in 1982 and 1981 respectively). The development programmes of many countries in this group have been deferred or radically reduced.

Growth in non-oil developing countries slowed down further to stand at 1.4 per cent, which was the lowest rate for twenty years and led to a reduction in per capita income.

This turn for the worse is attributable to a serious crisis in the mechanisms that generated expansion in these economies until very recently. In the last decade the non-oil developing countries, or at least the more advanced among them, had followed a pattern of development in which their economies were widely open to the outside world; this was based on the one hand on an expanding flow of exports of manufactured goods that would enable them to overcome their traditional specialization in trade in commodities and, on the other, on high import demand, thanks to the massive loans from the international banking system. As their imports consisted mainly of machinery and transport equipment from the OECD area, they sustained the volume of world trade, thus contributing appreciably to adjustment in the industrial countries, and fostered a happy interaction between growth in investment, growth in production and growth in exports.

Until the late seventies such a pattern of development allowed these countries to grow at rates well above those recorded by the OECD area; however, this growth occurred against a background of growing financial risk and weakness that was not taken sufficiently into account in the

programmes of the countries concerned. The process was brought to a halt by the second oil shock, when the precarious situation of the non-oil developing countries that had been caused by their failure to eliminate external disequilibria and by the high level of their indebtedness was further aggravated by the stagnation of the advanced economies and the contraction in world trade.

During 1982 growth slowed down further in the countries of eastern Europe. The gross national product of the Comecon area rose by about 1.5 per cent, compared with 1.8 per cent in 1981 and the planned annual growth rate of 3.5 per cent set for the period 1981-85. However, if Poland is excluded, the results for last year are slightly better (2.5 per cent).

The eastern European governments abandoned or scaled down their programmes for the modernization and reorganization of industry which had been launched at the beginning of the seventies and financed largely with western credit; instead, they planned to hold down investment and curb imports from industrialized countries. The initial results of such a policy appeared at the end of 1982; the trade balance of the Comecon area with OECD countries showed a surplus of \$ 0.7 billion in the ten months to the end of October 1982, compared with a deficit of \$ 2.7 billion in the same period of the previous year. Estimates for the whole of 1982 indicate a surplus of about \$1 billion on the trade account, compared with a deficit of \$ 2.4 billion in 1981. The area's debt position vis-à-vis the West also improved; gross debt in convertible currencies totalled \$ 86 billion in 1982, compared with \$ 92.1 billion in 1981, while net outstanding debt is put at \$ 72.5 billion in 1982, as against \$ 76.8 billion in 1981.

World trade and current account balances

The volume of world trade declined for the second time in less than a decade. According to GATT estimates, the contraction amounted to about 2 per cent (as opposed to 3 per cent in 1975), so that world trade fell back to the level of 1979 after having stagnated in 1981.

The exports of industrial countries contracted by 2.5 per cent in volume owing to the decline in sales to developing countries and the slowdown in shipments to oil-exporting countries. The OECD estimates that exports to countries outside the area decreased by some 5 per cent, whereas they had expanded by almost 11 per cent in 1981. Intra-area trade, on the other hand, probably remained almost unchanged, after having contracted the preceding year; the strengthening of protectionist pressures

from sectors that are most vulnerable to international competition had a prejudicial effect. Such pressures, which are a threat to the prospects of a recovery in world trade, encountered little resistance from the governments of a large number of industrial countries, partly on account of the grave situation in the labour markets.

The oil-exporting countries reduced the rate of growth of their imports from 20 to 5 per cent after two years in which they had made a significant contribution to the expansion in world trade by increasing their purchases from abroad by about 36 per cent.

The non-oil developing countries had to reduce their imports appreciably; the size of the reduction, 7.7 per cent, was far in excess of what could have been expected on the basis of the slowdown in income growth. Note should be taken of the efforts towards balance-of-payments adjustment being made by these countries; their exports showed an increase, albeit a small one (0.8 per cent), in a contracting world market.

As economic stagnation persisted, the imports of industrial countries declined by 0.5 per cent. For the third year in succession they reduced their purchases of oil. This had an influence on the exports of oil-producing countries, which fell by 19 per cent after having decreased by 12.3 and 16 per cent in 1980 and 1981 respectively.

The 4 per cent decline in the average dollar unit values of world trade was produced by the fall in the prices of all the main product groups considered. The dollar prices of manufactures and primary commodities other than oil decreased for the second consecutive year, declining by 2 and 12 per cent respectively; oil prices fell by 4.6 per cent, the first decrease since the beginning of the seventies.

The terms of trade therefore shifted in favour of manufactured goods. This is reflected in an improvement of 2.5 per cent in those of the industrial countries following three years of appreciable deterioration. The terms of trade of the oil-exporting countries worsened slightly (by 1.3 per cent), whereas between 1978 and 1981 they had risen by around 100 per cent, an exceptional improvement. Those of non-oil developing countries declined by a further 2.7 per cent, thus continuing the downward trend that had begun in 1978 and bringing the total deterioration to about 16 per cent by the end of last year.

These developments in trade flows and in the terms of trade led to a substantial reduction in the disequilibria in the trade balances of the main areas, which made it possible to achieve further significant success in the process of current account adjustment. Nevertheless, the scale of the phenomenon is difficult to assess owing to large measurement errors that

lead to substantial discrepancies between the assets and liabilities of the broad areas — about \$ 100 billion in 1982.

Last year saw the complete elimination of the large surplus accumulated by the oil-exporting countries during the second oil crisis. Indeed, they recorded a small deficit of \$ 2.2 billion, the first since the beginning of the seventies, when accurate statistics on these countries first became available. The swing in the current account balance was due almost entirely to the decline in the trade surplus, which fell from \$121 billion in 1981 to \$ 60 billion in 1982; the deficit on services and transfers, which was already high in 1981, increased by about \$ 5 billion.

The non-oil developing countries reduced their current account deficit by \$ 20 billion, but the total remained very high (\$74 billion); net of the increased burden on account of debt service payments, the reduction came to about \$ 34 billion. The improvement in the trade balance amounted to \$ 28 billion, while the deficit on services and private transfers increased from about \$ 28 to 34.5 billion.

The current account deficit of the industrial countries rose by \$ 3.6 billion owing to the larger deficit on official transfers (\$ 1.6 billion) and services and private transfers (\$ 6 billion). In merchandise trade, by contrast, these countries reduced their deficit from \$ 19.3 to 15.5 billion. The deterioration in the position of the area as a whole reflects that of the seven principal countries, whose deficit rose by \$ 3.6 billion to stand at about \$ 6 billion in 1982 owing to the increase in the deficit on transfers.

The largest deficit was that of France, which came to \$12 billion compared with \$4.7 billion the previous year. The deterioration occurred mainly in merchandise trade, where the imbalance rose by \$4 billion to \$14 billion, but was also due partly to a decline in the surplus on services from \$9.6 to 8 billion and an increase in the deficit on transfers. Another large deficit, \$8.1 billion, was that of the United States. The deterioration of \$12.6 billion in the current account was due to a rise of \$8.5 billion in the trade deficit (to \$36.3 billion) and to a \$3 billion contraction in the large surplus on invisibles, which was affected by a decrease in property income. The deficit on transfers increased by \$1.3 billion. The United Kingdom also experienced a deterioration in its current account balance, in this case a reduction in the surplus from \$12 billion in 1981 to \$7 billion in 1982, owing largely to a decrease in the surplus on services from \$10.4 to 6.9 billion.

The other four major countries, by contrast, all improved their balances of payments on current account. Particular mention may be made of the swing in the balances of the Federal Republic of Germany and Canada, which moved from deficits of \$ 6.5 and 4.5 billion respectively in 1981 to surpluses of \$ 3.5 and 2.2 billion in 1982.

Financial flows, foreign debt and international liquidity

In spite of the reduction in current account disequilibria, serious tensions developed in the international financial system in 1982.

The events in the world economy led to important changes in the structure of intermediation. The elimination of the oil surpluses closed an important source of new deposits with the international banking system; the slowdown in deposits growth was accentuated by the drawing-down of reserves held in this form by developing countries and by a change in the preferences of investors, who had become aware of the risks associated with such assets and increasingly shifted their placements towards securities and real assets in the markets of strong currency countries, in particular the United States. As a result, the share of bank lending contracted and that of lending through the bond market increased. The elimination of the oil surpluses also shifted the burden of providing finance for deficit countries onto the markets of the major industrial countries.

In the last two years the International Monetary Fund has played an important role in safeguarding international financial stability. At the end of 1982 outstanding loans to member countries — almost exclusively developing countries — amounted to \$24.5 billion, compared with \$12 billion at the end of 1979, \$10 billion of which was owed by developing countries.

International capital markets. — The markets were characterized by a fall in new lending and by the difficulties experienced by major borrowers in servicing their external debt.

The total flow of publicly announced bank credits and bond issues on international markets came to \$ 160 billion, compared with \$186 billion in 1981. The contraction reflects a decline in medium and long-term Euro-credits; new international bond issues, by contrast, increased to \$ 76 billion, as against \$ 53 billion in the previous year.

By the end of 1982 the gross external claims in domestic and foreign currencies of banks reporting to the BIS had reached the total of \$ 1,687 billion, thus showing a 9 per cent growth rate over the year, compared with one of 17 per cent in 1981. Excluding the double-counting due mainly to

the redepositing of funds in the international interbank market, the net size of the Euro-market at the same date may be put at \$1,020 billion, 8 per cent higher than in 1981, when it had increased by 17 per cent. Over the year as a whole US banks continued to be net exporters of new funds; the net position of European banks, however, did not change significantly.

The assets of the international banking system are concentrated in a small number of countries. At the end of 1982 70 per cent of the claims on developing countries consisted of loans to fourteen countries; among these, Mexico, Brazil and Argentina accounted for debts totalling \$137 billion. At the same date the system's net exposure totalled \$178 billion, of which 65 per cent was owed by the three countries mentioned.

This development was reflected in the ratio between the gross exposure towards developing countries and the banks' capital, which for the reporting banks stood at 90 per cent at the end of 1981 and at 17 and 15 per cent in the case of claims on Mexico and Brazil respectively. The US banking system has incurred even greater risks; the ratio between claims on developing countries and equity capital had reached 190 per cent by the same date, with the corresponding ratios for Mexico and Brazil standing at 34 and 29 per cent respectively.

The size and concentration of banking claims bear witness to an underestimation of the risks associated with international banking activities. This has been encouraged partly by the habit of small banks of acquiring portions of loans on the interbank market, a practice that weakens the system's ability to assess sovereign risks.

Official reserves and international liquidity. — The persistent strength of the dollar, the difficulties many countries have encountered in borrowing abroad and the elimination of the oil surpluses were reflected in a contraction in official reserves for the second consecutive year. The 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 \$ 341 billion at the end of 1982, having fallen by more than \$20 billion or 6 per cent during the year. Expressed in SDRs, the decline is smaller (0.5 per cent), owing to the depreciation of this currency unit against the dollar.

Total international liquidity — defined as official reserves excluding gold plus the banks' international liabilities to non-banks — rose by about 4 per cent during the year to stand at \$831 billion. Private liquidity continued to account for an increasing proportion of the total, rising from 55 to 59 per cent during 1982.

The value of the gold component of official reserves at market prices rose from \$412 billion at the end of 1981 to \$473 billion at the end of 1982 owing to the increase in the gold price from \$398 to 457 an ounce. If this component were included, total official reserves would have amounted to \$814 billion at the end of 1982.

Community institutions

During the past year the Community's budget allocations totalled ECU 21,984.4 million, an increase of 19.3 per cent over 1981. Expenditure on intervention in the agricultural market represented 60 per cent of the total, a smaller proportion than in the preceding year; the greatest savings were made in the sectors of cereals, dairy products and beef owing to the favourable trend of world prices and the decrease in domestic production. Expenditure on structural policies came to ECU 4,661.4 million, 21.2 per cent of the total; however, if the refunds to the United Kingdom are excluded, the percentage for this item falls to 13.7 per cent. Overall, the refunds to the United . Kingdom accounted for 7.5 per cent of budget expenditure in 1982.

On the receipts side, member states' payments of VAT belonging to the Community totalled ECU 11,998.3 million, representing 0.92 per cent of the standardized VAT tax base, which is subject to an upper limit of 1 per cent.

In February of last year the Commission placed a Green Paper on future methods of financing the Community before the European Parliament and the Council of Ministers. This is an initial analysis of changes that might be made in the Community's own resources system in order to increase budget receipts and, at the same time, to make the Community budget more responsive to the Community's objectives with regard to the equalization of financial burdens among the member states and to the development of new structural policies.

The debate on restructuring the budget and Community policies continued during 1982; this restructuring was intended to resolve finally the problem of certain countries' excessive net contributions to the Community budget.

As no agreement in this regard had been reached, in March of this year the Council of Ministers of the EEC approved refunds of ECU 1,092 and 210 million to the United Kingdom and the Federal Republic of

Germany respectively. These refunds, which are included in the 1983 budget, will partially offset the net contributions recorded by these countries in 1982.

Financial interventions by the Community totalled ECU 5,757.2 million last year, 28 per cent more than in 1981. This favourable result is largely attributable to the increase in loans granted by the ECSC, which were almost twice as high as in 1981, a year in which lending operations were at a very low level. The largest share of Community lending was undertaken by the EIB, which lent a total of ECU 3,453.2 million within the Community, 60 per cent of the total.

In March 1982 the mechanism for loans under the New Community Instrument was renewed with the original objectives and an upper limit of ECU 1 billion (NCI II). At the beginning of 1983 the NCI was renewed again (NCI III) and the ceiling was raised to ECU 3 billion in accordance with the wishes expressed on several occasions by the European Council; in addition, the scope of the instrument was broadened to some extent by according greater importance to investments for technological innovation and making express provision for it to be used in productive sectors other than industry, to the especial but not exclusive benefit of small and medium-sized firms.

II — THE ITALIAN ECONOMY

INCOME FORMATION AND ECONOMIC DEVELOPMENTS

Overall results

In 1982, against an international background characterized by the persistence for the third year running of extensive and growing underutilization of resources, the levels of production achieved in the Italian economy again showed no change over 1980. However, as against the stagnation of overall economic activity (real GDP fell by 0.3 per cent after rising by 0.1 per cent in 1981) and the disappearance of some 200,000 industrial jobs over the last two years, there was no significant reduction of the existing disequilibria in terms of inflation and the balance of payments.

The foreign payments imbalance on current account declined both in value terms (7,400 billion lire in 1982 as against 9,200 billion lire in 1981) and as a percentage of GDP (from 2.3 to 1.6 per cent); however, this ratio is still high, the only major industrial country to exceed it being France. The trade deficit (10,800 billion lire fob) was only 1,200 billion lire less than in 1981, despite an improvement of about four points in the terms of trade. Weak world demand kept Italian exports of manufactures low, while the average propensity to import continued high, at above the average level for the seventies. Gross external indebtedness reached \$ 51 billion. Net of assets but excluding the gold component of official reserves, external indebtedness attained the level of \$ 21 billion.

The Government's inflation target of 16 per cent was only slightly overshot, although the gap between the rate of growth of consumer prices in Italy and that in the OECD as a whole remained over 9 percentage points. The rise in wholesale prices was 13.9 per cent (16.6 per cent in 1981), while the private consumption deflator went up by 16.7 per cent (19.2 per cent in 1981), the difference stemming from the various measures taken in the field of taxes and charges as well as from the fact that margins in the distributive sector held up better. Furthermore, over the year the rate of consumer price increase did not register substantial declines.

Wage indexation, reform of the system of severance payment reserves and further increases in employers' social security contributions resulted — despite the absence of wage settlements — in labour costs per person employed in the private sector advancing by more than 17 per cent; gross

earnings went up by a slightly smaller amount. However, fiscal drag resulted in a decrease of the real purchasing power of wages. In industry excluding construction hourly labour costs rose by 18 per cent and unit labour costs by 16.5 per cent. The increase in labour costs and the sustained appreciation of the dollar were partly offset by lower international raw material prices: for the year as a whole unit production costs in the industrial sector went up by 13.9 per cent, with producer prices rising at virtually the same rate (13.5) per cent). However, enterprises' need to hold onto market share at home and abroad, weak demand and the relative strength of the effective exchange rate, coupled with a steady slow deterioration of relative prices, limited the extent to which the costs were passed on over the year. The caution with which recourse was made to exchange rate adjustment within the EMS — consonant with the spirit of the EMS agreements — and the delays with which the realignments of central rates were implemented, which precluded firms from taking the easy route of immediately passing on cost increases in their prices, provided an incentive for improving competitiveness through rationalization of the production system.

The current general government deficit, which according to the Forecasting and Planning Report for 1982 should have declined to below 5 per cent of GDP, remained at the previous year's level (6.9 per cent in 1982 as against 7.0 per cent in 1981), despite the restrictive impact (12,000 billion lire in 1982) of the measures taken in 1981 and 1982. At the same time, net indebtedness rose from 11.7 to 11.9 per cent and the borrowing requirement of the enlarged public sector approached 17 per cent of GDP. The attempts made to reduce the deficit were based in the main on increasing indirect taxation rather than on expenditure cuts: this had further inflationary effects, which averaged out at around 1 percentage point over the year.

Although the stance of budgetary policy over the last few years has consistently aimed at reducing the public sector deficit, in practice it has failed to prevent it from rising. As a result, it was left chiefly to monetary policy to control aggregate demand by regulating the amount of credit granted to the productive sector and the level of nominal and real interest rates.

As far as households were concerned, the increase in real rates offset the expansionary impact on consumption of the — admittedly small — rise in disposable income; after recording a 0.5 per cent increase in 1981, domestic private consumption remained static in 1982, with the result that the propensity to save went up in both years. The higher level of real rates caused the purchase of durables and semi-durables to slow down, and stimulated the net purchase of financial assets by households, thus encouraging the non-monetary financing of the public borrowing requirement.

Turning to enterprises, the high real interest rates were reflected in both stock levels and capital formation. Already in last year's Report it was pointed out that greater elasticity of factor utilization within firms had enabled them to allow short-term fluctuations in orders to be reflected in production levels rather than in inventories of finished products, and that stocks of raw materials were being kept at very low levels in relation to production requirements. The increase in the real cost of money encouraged this trend in 1982, and according to the national accounts, stock variation, at 1970 prices, was only slightly above the very low levels recorded in the previous year (687 billion lire as against 474 billion lire in 1981).

The increased cost of borrrowing, the extensive underutilization of productive capacity and the uncertain outlook as regards demand resulted in the phase of investment buoyancy which had characterized the previous three years running down at a faster rate; the diminution in aggregate fixed investment worked out at 5.3 per cent, which is not particularly large having regard to the high base figure and the magnitude of the declines experienced in previous recessions. Unlike in 1981, aggregate public investment was countercyclical, increasing by about 2 per cent. The ratio of investment in plant, machinery and vehicles to GDP was consistently higher than the average for the seventies. The protracted stagnation of the housing market was reflected in the construction of new dwellings. At constant prices, investment in this sector declined by 2.7 per cent. Non-residential construction went down by the same amount, although there was no substantial change in investment in public works.

The stagnation of domestic demand (— 0.2 per cent) was accompanied by a modest recovery in exports (1.2 per cent). Yet the average increase in exports for the year as a whole, which was above that of international trade, hides a cyclical pattern that was on a constant downward trend ever since the first quarter. The drop in productive activity in the United States and subsequently in Europe, the worsening of the financial crisis affecting the developing countries and the deterioration of the OPEC countries' import propensity resulted in a fall in international trade. This fall was concentrated principally in those geographical areas in which Italian firms had achieved the greatest market penetration over the previous two years. Between 1981 and 1982 the share of national exports taken up by the OPEC countries fell more in the case of Italy than in the case of its competitors. In contrast, penetration by Italian goods of the markets of the EEC, the United States and the other industrial countries increased, despite the cyclical demand conditions obtaining thereon.

Anomalously, having regard to the (albeit slight) drop in GDP, import volume rose (by 2.1 per cent), which can be attributed principally to the heavy fall in 1981; this precluded a significant reduction in the foreign

payments imbalance on current account. There was a relatively greater increase in imports of basic products and materials (as a result of partial and limited rebuilding of stocks above all in the early part of the year) and in imports of agricultural products. In contrast, crude oil imports declined by around 3 per cent owing to lower demand for oil in almost all the oil-consuming sectors and to proportionately greater use of solid fuels.

The development of demand had an adverse impact above all on the industrial sector, where added value fell by 1.6 per cent; all branches of productive industry were affected by the reduction and the capital goods sector in particular. Turning to the other sectors, the harvest was hit by bad weather, with the resultant fall in output not being offset by the moderately improved output levels achieved in the livestock and fisheries sectors. Only the services sector made a positive contribution to GDP; in real terms the added value of marketable services went up by 0.9 per cent, that of non-marketable services by 0.4 per cent.

The stagnation of production which has been going on for more than two years was reflected in the labour market. Overall employment fell by around 75,000, after a decade of steady increases. The number of unemployed in the various categories exceeded 2 million; the rate of unemployment amounted to 9.1 per cent (8.4 per cent in 1981), or 10.7 per cent including workers covered by the Wage Supplementation Fund.

By sectors, demand for labour dropped sharply in industry (-123,000) and agriculture (-149,000), these declines being only partially offset by the growth of the private and public services sector (197,000). In industry excluding construction extensive recourse to the Wage Supplementation Fund (547 million hours as against 488 million in 1981) enabled an — admittedly only modest — gain (1.5 per cent) to be made in hourly productivity, albeit in a year of lower productive activity.

Economic developments during the year

The stagnation in production and the slowdown in inflation observed in 1981 continued to hold sway in the first few months of last year. In the first quarter the index of industrial production remained at the level recorded in the last three months of 1981. The situation on the labour market showed no improvement; employment remained more or less static and the number of workers covered by the Wage Supplementation Fund continued to increase. The consumer price index showed a twelve-month

rise of 17 per cent, which was lower than the underlying rates recorded throughout 1981.

The rebuilding of stocks of raw materials and semi-finished products, which had fallen below normal production requirements in the second half of 1981, was stimulated by a short-lived recovery in industrial orders; during this period the constraint imposed by the non-interest-bearing deposit on foreign payments was unexpectedly removed almost a month earlier than the set date in order to prevent a dangerous bulge in trade credits.

The trend towards restocking was accentuated by expectations of a further appreciation of the dollar against the lira; in the first quarter the overall volume of imports was 3 per cent higher than in the preceding quarter. The deficit on the current account of the balance of payments therefore increased in spite of a further improvement in the terms of trade and the continued growth in exports, which continued to benefit from the recovery in competitiveness in 1981 and the stagnation of domestic economic activity; seasonally adjusted, the deficit amounted to more than 3,000 billion lire, more than one-third higher than in the preceding quarter.

The worsening of the trade deficit, the massive repayments of trade debts and the expectation of further realignments following the adjustment of the central rates of the Belgian franc and the Danish krone in February triggered expectations of a devaluation of the lira in March and April.

The downward trend in interest rates on short-term government securities was reversed in March to counteract speculative pressure on the exchange rate and the disequilibria in the money markets caused by the rapid expansion in the Treasury borrowing requirement. In April the penalties for exceeding the limits on lending in domestic currency were increased and exchange controls were introduced to restrict payments in foreign currency and speed up collections.

However, these measures represented only a short-term solution to the balance-of-payments disequilibria and were designed to keep the Italian economy in step with the international trade cycle. In April and May the index of industrial production in Italy was on average only 0.6 per cent below the level of the first quarter, whereas the decline was more pronounced in the United States, where it had been in evidence for more than six months; in the rest of Europe too the decrease in economic activity was substantial.

A more pronounced downturn began in June. In the previous month business surveys by the National Institute for the Study of the Economic Situation (Isco) and data collected by the Central Statistical Institute (Istat) on new orders received by industry had indicated a sharp decline in both domestic and foreign orders in all sectors of industry. Confindustria's termination of the agreement of 25 January 1975 with the trade unions on reinforcing the indexation mechanism meant that the problem of wage adjustment could no longer be evaded and also strained industrial relations for a while, making firms more cautious in their investment and production plans. Families behaved in an equally cautious way: consumption was depressed by uncertainty about real incomes and employment and by the highest real interest rates for twenty years on financial assets. The decline in domestic demand was accompanied by a fall in exports; in June industrial production was 3 per cent lower than in the previous month.

The pressures that had built up around the French franc led to a further realignment of parities within the EMS in June, in which the French franc and the Italian lira were devalued and the Deutsche Mark and the Dutch guilder revalued. Movements among the EEC currencies were mutually offsetting in the weeks following the devaluation, so that the effective exchange rate of the lira and the price competitiveness of Italian manufactures were largely unaffected. At the end of the second quarter the current account deficit still stood at about 1,100 billion lire on a seasonally adjusted basis.

In July a series of fiscal measures and increases in public service charges was approved in order to reduce the public sector's current budget deficit. This action checked the slowdown in inflation; the fiscal measures, which entailed a net withdrawal of about 1 per cent of gross domestic product in a full year, consisted mainly in an increase in indirect taxes. The twelve-month increase in consumer prices rose from 15.2 per cent in June to 16 per cent in July as a result of increases in certain administered prices and to more than 17 per cent in August and September.

The restrictive effect of budgetary policy on the public sector borrowing requirement and signs of a slowdown in credit demand provided room for a moderate decline in interest rates; at the end of August the discount rate was reduced by one percentage point.

At the international level the demand for goods continued to fall, in spite of the decline in nominal interest rates; the priority assigned to the fight against inflation in the major countries was a factor in sustaining real interest rates at high levels. The recessionary influences emanating from the international trade cycle and the increased risks of insolvency on the part of certain major debtor countries had an impact on Italy's exports, which declined by more than imports in the third quarter. During the same period there was a reversal of the improvement in the terms of trade that had appeared in the first half of the year; on a seasonally adjusted basis the trade deficit remained high and substantially exceeded that recorded in the preceding quarter.

The decline in exports was accompanied by a fall in the domestic components of demand. In the third quarter industrial production contracted sharply and the capacity utilization rate dropped to a value little higher than the trough of 1975. Recourse to the Wage Supplementation Fund was substantial and the unemployment rate reached 9.1 per cent.

The fall in demand and production continued during the final quarter of the year; the index of industrial production sank to a level about 3 per cent below the average for 1982. The government crisis and the slow progress of the negotiations between management and the trade unions on the renewal of wage contracts and the changes to be made in the indexation mechanism further increased the uncertainty attending expenditure decisions by firms and families. The disposable income of the latter was eroded by a rate of increase in consumer prices almost as high as that recorded at the beginning of the year.

There was a hesitant recovery in exports, but this was not sufficient to produce a substantial balance-of-payments improvement in volume terms. Notwithstanding the weakness of domestic demand, external balance was not achieved.

In the last few months of the year short-term interest rates were increased and a requirement to finance 70 per cent of export credits in foreign currency was introduced to counteract a new wave of speculative pressure on the lira and a further expansion in the public sector deficit, which was accompanied by difficulties in placing government debt in the market. At the end of 1982 the monetary authorities introduced a number of measures in view of the need to gain more effective control over the credit aggregates and to complement the package of economic measures that the new Government was preparing to introduce in order to ease the pressures exerted on the real and monetary variables by the public sector deficit and to curb the nominal rate of income growth; these measures will be examined later in this Report.

The prospects for 1983

The Italian economy seems to be heading towards a third year of stagnation. At home, the policy of stabilization designed to reduce the causes of disequilibrium is curbing demand; at the world level the outlines of the recovery are still hazy.

The reduction in the price of oil and the hesitant recovery in production in the United States, the Federal Republic of Germany and the United Kingdom have to be set against decidedly negative factors, such as the reduced purchasing power of the OPEC countries and the prolongation of policies of adjustment in some industrialized countries and in many non-oil developing countries. In the United States, in particular, the consolidation of the expansionary phase is being hindered by the difficulties of exercising effective control over public expenditure and containing the budget deficit; there is therefore only limited scope for a fall in interest rates and a reduction in the exchange rate of the dollar. Overall, the forecasts for world trade do not make a substantial increase in Italian exports seem likely.

As far as the domestic components of demand are concerned, the budgetary measures aimed at holding down the general government deficit should begin to impinge upon families' spending power in the first half of the year. On the other hand, in view of the need to finance the public sector deficit, monetary conditions will have to be such that real interest rates on financial assets remain high throughout 1983 in order to ensure a high propensity to save.

The investment outlook is bleak, owing to capacity utilization rates close to the low point recorded in 1975, uncertain demand prospects, the high real cost of finance and low profit margins.

Such probable demand trends limit the scope for economic growth in 1983. In the first three months industrial production on a seasonally adjusted basis fell by 2.0 per cent in relation to the preceding quarter and the index was about 5 per cent below the average for 1982. Business surveys are showing cautious signs of an improvement in foreign demand and in domestic consumer demand, although stocks are still much higher than normal; even if industrial production recovers from mid-year onwards, it will be difficult for gross domestic product to record an increase for the year as a whole. The low level of economic activity should allow further progress to be made in the external adjustment of the Italian economy. As last year, the greatest contribution to an improvement in the trade balance and in the current account is likely to stem from the recovery in the terms of trade that is currently taking place in world markets to the benefit of manufactured goods at the expense of industrial raw materials and energy.

The external causes of inflation have weakened, although there is uncertainty about future dollar rates and some sign of recovery in commodity prices, which remained static during the first few months of the year. The domestic components of inflation are less virulent than in recent years, but they offer no guarantee of a significant reduction in price differentials between Italy and other major western countries. The agreement of 22 January between the two sides of industry and the Government curbed the wage indexation mechanism and created the

conditions for an improvement in industrial relations; in view of the reform of severance payments, the terms of the above-mentioned agreement and wage settlements to date, the increase in labour costs is unlikely to slow down appreciably in 1983. The weakness of demand and the constraint imposed by international competition will limit the increase in the prices of manufactures and thus squeeze industrial profit margins.

In the first quarter of the current year the rise in wholesale prices slowed down perceptibly (to 10.6 per cent over the same quarter of 1982), but consumer prices continued to rise by 1.2 per cent a month and showed an increase of 16.1 per cent over the corresponding period of the previous year. This discrepancy was due partly to the increase of 21.8 per cent in public service charges and partly to the price formation mechanism in the distributive sector; the Government's target of 13 per cent for 1983 can be achieved only if the monthly increase in the consumer price index does not exceed 0.4 per cent for the remainder of the year.

Domestic demand

Consumers' expenditure

National consumers' expenditure remained unchanged in real terms, compared with a rise of 0.8 per cent in 1981. The recovery of foreign tourists' expenditure in Italy more than offset the increase in residents' expenditure abroad; as a result domestic consumers' expenditure rose slightly (0.3 per cent) (Table 2).

Households' gross disposable income increased by 17.0 per cent, but, since the deflator of national consumers' expenditure rose by 16.7 per cent, the variation was virtually nil in real terms (0.3 per cent) for the first time since 1970. The average propensity to consume declined further with respect to the previous year (from 76.2 to 76.0 per cent).

General government's contribution to the formation of gross disposable income was less than in the previous year. Gross incomes in the public sector again increased more than those in the private sector, but the momentum of taxation and social security contributions was maintained while social security benefits showed a significant fall in their rate of increase.

Interest income continued to expand at very high rates, albeit lower than in the preceding two-year period: as a result, the ratio of interest income to gross disposable income attained 6.0 per cent, as against oni" 0.2 per cent in 1970 and 3.1 per cent in 1977.

 ${\it Table~2}$ CONSUMERS' EXPENDITURE AND HOUSEHOLDS' DISPOSABLE INCOME

	1980	19	981	19	982
	billions of lire	percentage changes	billions of lire	percentage changes	billions of lire
Gross domestic earnings:					
Private sector	104,622	19.8	125,383	16.4	145,998
General Government	31,088	32.9	41,310	17.2	48,422
Net labour income from abroad	1,488	9.9	1,635	14.4	1,871
Gross profits plus other income from capital .	104,107	14.9	119,609	17.5	140,540
Net interest	11,261	52.0	17,117	34.0	22,940
Social security benefits	58,250	33.3	77,680	19.7	92,985
Employees' social security contributions (-).	8,131	22.5	9,958	37.2	13,663
Self-employed workers' social security contributions (—)	3,228	40.8	4,545	22.5	5,569
Direct taxation (—)	32,435	35.0	43,800	23.7	54,180
Other items	1,136		1,481		1,881
Gross disposable income	268,158	21.5	325,912	17.0	381,225
at 1970 prices (1)	68,383	2.0	69,732	0.3	69,909
National consumers' expenditure	206,561	20.2	248,224	16.6	289,547
at 1970 prices	52,675	0.8	53,110		53,097
Average propensity to consume	77.0		76.2		76.0
Residents' expenditure abroad	1,901	22.9	2,336	27.8	2,895
at 1970 prices	339	4.7	355	9.6	389
Non-residents' expenditure in Italy	7,828	12.1	8,773	31.5	11,540
at 1970 prices	2,032	-6.6	1,898	12.4	2,133
Domestic consumers' expenditure	212,488	19.8	254,661	17.1	298,192
at 1970 prices	54,368	0.5	54,653	0.3	54,841

Sources: Relazione generale sulla situazione economica del paese; for gross disposable income: Banca d'Italia estimates. (1) Gross disposable income has been deflated using the price deflator of final national consumers' expenditure.

The decline in inflationary expectations had two effects of opposite sign on consumers' behaviour: on the one hand, it led to a contraction of the income share deemed necessary to make up for the loss of purchasing power of net financial assets, which stimulated consumption; on the other hand, given the substantial stability of nominal interest rates, it led to a rise in expected real interest rates and so encouraged financial saving.

These factors, together with consumers' reluctance to reduce the standard of living to which they were accustomed and hence the lag with which consumer expenditure reacted to the evolution of income and financial assets, resulted in national consumers' expenditure remaining stable, and this in a year characterized by a decline in levels of employment (the first since 1972), and increased recourse to the Wage Supplementation Fund.

Investment

Fixed investment at 1970 prices, after remaining unchanged in 1981, declined by 5.3 per cent in gross terms and 14.2 per cent net. Given that stocks increased somewhat more than in the previous year, total gross investment fell off by 3.7 per cent.

At current prices, gross fixed investment increased by 10.0 per cent, with the rise in implicit prices (16.2 per cent) almost four points under that recorded in the preceding two years. When the change in inventories is taken into account, total investment increased by 11.9 per cent in money terms.

In value terms, the increase in gross domestic saving outstripped the growth of gross investment in 1982, while the current-account balance of payments, albeit still in deficit, improved. Unlike in 1981, the increased general government deficit on current account did not preclude a rise in domestic saving: however, the ratio of domestic saving to GDP set a new record low (18.8 per cent).

A breakdown of fixed investment by branch of economic activity shows that, with the exception of general government, there was a pronounced reduction in capital formation in all sectors, including the services sector, the only one to record an increase in 1981 (Table 3).

Public investment, unlike in 1981, followed an anticyclical course, increasing by 1.6 per cent. This compares with a 7.9 per cent reduction in private investment. Capital formation by the public sector advanced above all in the housing, marketable services and agricultural sectors; in contrast, public firms' capital formation in the industrial sector declined markedly, following the same course as capital formation in p rivate firms (Table 3).

The contraction in investment affected all types of goods, but was most conspicuous in the case of machinery and equipment (9.5 per cent) and least marked in the case of construction (2.7 per cent) and vehicles (4.2 per cent).

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

	Billions of lire (at current		Percentage composition	1	Percentage changes					
Branch of activity	prices)	(a	at 1970 price	es)	at	current pri	ces	at 1970 prices		
	1982	1980	1981	1982	1980 1979	1981 1980	1982 1981	1980 1979	1981 1980	1982 1981
							:			
AGRICULTURE, FORESTRY AND										
FISHERIES	5,973	7.2	6.8	6.7	23.9	15.0	9.4	1.3	-4.3	-6.6
of which: private	4,529	5.9	5.7	5.1	26.4	17.0	-1.1	3.5	-2.7	-15.6
public (1)	1,444	1.3	1.1	1.6	13.1	5.9	64.1	<i>7.8</i>	-11.7	40.4
INDUSTRY	23,336	28.6	27.5	25.9	34.9	15.7	3.8	14.9	-3.4	-10.5
of which: private	16,364	20.8	19.4	18.2	33.9	12.0	3.3	14.1	-6.5	-11.0
public (2)	6,972	7.8	8.1	7.7	37.7	25.7	5.2	17.3	5.0	9.3
marketable services (3)	25,816	31.3	32.5	32.9	33.6	23.9	10.1	· 12.1	4.4	-4.0
of which: private	18,928	23.3	24.7	24.1	36.6	26.4	6.2	14.6	6.5	-7.4
public	6,888	8.0	7.8	8.8	25.4	16.7	22.5	5.3	-1.8	6.8
DWELLINGS	25,080	23.9	23.9	24.6	30.6	23.2	13.6	4.9	0.7	-2.7
of which: private	23,574	22.5	22.7	23.1	34.3	24.5	12.4	7.8	1.7	-3.7
public (4)	1,506	1.4	1.2	1.5	8.5	3.5	35.1	-26.5	-15.3	15.8
-	·	1		:						
TOTAL	80,205	91.0	90.7	90.1	32.3	20.4	9.2	10.0	0.3	-5.8
of which: private	63,395	72.6	72.5	70.5	34.2	20.8	7.1	11.3	0.5	-7.9
public	16,810	18.4	18.2	19.6	25.2	18.7	18.0	5.2	-0.7	2.3
•	,								···	2.0
GENERAL GOVERNMENT	9,054	9.0	9.3	9.9	24.9	27.8	17.7	3.3	4.3	0.2
GROSS FIXED INVESTMENT	89,259	100.0	100.0	100.0	31.6	21.1	10.0	9.4	0.6	5.3
of which: public	25,864	27.4	27.5	29.5	25.1	21.8	17.9	4.6	0.9	1.6
									ĺ	

Source: Relazione generale sulla situazione economica del paese.

⁽¹⁾ State payments for investment in agriculture. — (2) Including state-controlled companies. — (3) Excluding dwellings. — (4) Subsidized housing.

Domestic supply

Agriculture

The gross marketable production and value added of the agricultural sector declined in real terms for the second year in succession owing to disappointing harvests and the smallness of the improvement in profitability. Gross marketable production decreased by 1.8 per cent, whereas in 1981 the contraction had amounted to 0.8 per cent (Table 4).

Table 4

MARKETABLE PRODUCTION AND VALUE ADDED IN AGRICULTURE

(billions of lire)

		Percentage changes						
	Absolute values		Percentage composition		Volume		Prices	
	at current prices	at 1970 prices	at current prices	at 1970 prices	1981 1980	1982 1981	1981 1980	<u>1982</u> 1981
Marketable production	39,051	7,950	100.0	100.0	-0.8	-1.8	14.3	15.4
Field and fodder crops	12,511	2,542	32.0	32.0	1.0	-2.7	16.1	13.6
Tree crops	9,138	1,791	23.4	22.5	-6.5	-5.7	10.2	18.5
Livestock	15,760	3,376	40.4	42.5	1.2	1.0	15.5	15.0
Forestry and fisheries	1,642	241	4.2	3.0	0.8	-	17.4	<i>15.7</i>
Intermediate consumption (—)	12,004	2,272	30.7	28.6	-2.7		23.3	11.6
Current transfers (+)	1,564	589	4.0	7.4	-7.4	-14.4	20.7	37.4
Value added at factor cost	28,611	6,267	73.3	78.8	-0.9	-3.8	11.7	18.7

Source: Relazione generale sulla situazione economica del paese.

The decline in production was accompanied by a further sharp reduction in the quantities of machinery, labour and land employed. Investment shrank by 6.6 per cent (compared with 4.3 per cent in 1981) to stand at the lowest level since 1975.

The contraction in the agricultural labour force, which had already accelerated markedly to a rate of 3.8 per cent in 1981, gathered further pace last year. 149,000 workers left the sector, 5.6 per cent of the total. Most of these were self-employed farmers (about 111,000, almost 7 per cent of the initial total), whereas the number of employed workers fell by 3.7 per cent.

The decline in output occurred primarily in farm production, where the decreases (2.7 per cent in field and fodder crops, 5.7 per cent in tree crops) were due partly to a long drought in the spring that was particularly severe in the South. Forestry production contracted by 2.4 per cent. By contrast, there were modest increases in the livestock sector and fisheries (1.0 and 1.3 per cent respectively), although in previous years these sectors had shown much higher rates of growth.

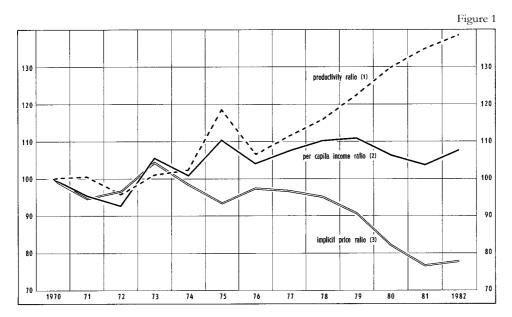
The increase in agricultural producer prices came to 15.4 per cent, compared with 14.3 per cent the previous year. Both the prices of capital goods and the wages of agricultural workers rose by almost two percentage points more (17.1 per cent). On the other hand, the prices of raw materials recorded only a small increase (11.5 per cent) after having risen very sharply in 1981 (23.3 per cent).

The value added price deflator rose at a similar rate to the corresponding measures in other sectors (17.1 per cent in agriculture, 17.5 per cent in industry and 17.1 per cent in marketable services), whereas in 1981 there had been a substantial disparity (10.9 per cent in agriculture as against 14.8 per cent in industry and 18.7 per cent in the services sector).

The rise in agricultural producer prices did not differ much from the average increase agreed within the EEC, which came to 14.4 per cent when expressed in lire and calculated in terms of the "basket" of Italy's agricultural output. This was the result of an average increase of 10.5 per cent in ECU prices, the shift in relative prices described below and a devaluation of 2.5 per cent in the green lira, which was augmented by the delayed effects of a previous devaluation of the same size that had been decided in November 1981 but did not come into effect for certain products until the 1982 crop year. The difference between the parities of green currencies and the reference exchange rates was not eliminated, however; indeed, it began to widen again after the new realignments in central rates within the European Monetary System in June 1982 and March 1983.

Substantial positive Monetary Compensatory Amounts (MCAs) therefore continued to apply in favour of Dutch and German farmers. On the other hand, the structure of Community prices was modified to the advantage of "Mediterranean" products during the year, partly at Italy's urging, thus raising the profitability of certain crops that are typical of Italy. Over the longer term, however, it would not seem desirable for MCAs in favour of northern European countries to be maintained permanently in exchange for occasional adjustments in relative prices, as the latter tend to encourage overproduction in Italy while the MCAs subsidize the importation of products in which Italy is not self-sufficient from continental countries of the Community.

The ratio between average agricultural and non-agricultural productivity (Fig. 1) continued to rise, partly owing to the acceleration in the decline in agricultural employment. At 1970 prices the value added per worker in agriculture was 67 per cent of the figure recorded in other sectors of the economy, compared with 48 per cent in 1970. The ratio between the price indices began to rise again, after having fallen from 1976 to 1981; as a result, there was an increase in the income ratio measured in terms of value added per worker at current prices. In 1983 these favourable trends might help curb the decline in the use of resources that has been a constant feature of agriculture in recent years, although the discrepancy between per capita income in agriculture and that in other sectors remains considerable (11.4 million lire as against 22 million lire).



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 value added price deflator at factor cost in agriculture to that in the rest of the economy.

The improvement in the agricultural and food account of the balance of payments that had occurred in 1981, mainly as a result of the high level of stocks and the stagnation in demand, proved to be short-lived; last year the deficit rose by about 2,300 billion lire to a new record of 8,359 billion lire. Although the 1982 deficit was very large compared with that of the preceding year, in real terms it does not constitute a break in the trend; on

the contrary, it is consistent with the gradual deterioration recorded over the last decade, the 1981 result being the exception.

The cause of the deficit seems to lie in the structural deficiency that has prevented the Italian farm sector from meeting a larger proportion of domestic demand. The preliminary results of the third agricultural census recently released by Istat show that Italian farms are still much more fragmented than those in the major continental European countries. The utilized agricultural area per farm remained unchanged between 1970 and 1982; in 1977 it was approximately half that of Germany and less than one-third that of France. However, averages cannot give a complete picture of the sector, which probably displays growing polarization in the distribution between very large and very small farms; it will be necessary to await publication of the disaggregated figures before a precise analysis can be made.

The slow pace of structural change in the agricultural sector also indicates the lack of effectiveness of the structural policies pursued hitherto, including the "cloverleaf" law (Law No. 984 of 1977), which formally lapsed at the end of 1982 although some of the funds it provided have been transferred to subsequent financial years because of budgetary restrictions. The results produced by the law have been rather unsatisfactory owing to the failure to approve a consistent food and agriculture plan, the insufficient attention paid to the structural problems of technological innovation and farm size and the great slowness in granting allocated funds, which has been particularly marked in the case of the regions and was only partly corrected in the last financial year. Only a few of the planned increases in output have been achieved, and some of these relate to commodities in which there was already surplus production (milk and maize are exceptions). For example, beef production rose by 13 per cent, whereas the intention was that it should double.

Certain structural measures, such as in the livestock sector, may produce the desired effects over the long term. Be that as it may, the experience gained with the "cloverleaf" law will have to be taken into consideration when the funds it provided have been exhausted and work begins on amending the relevant legislation. Procedures should be made less rigid and less complicated; it would also be desirable to set a smaller number of targets, which should concentrate less on individual sectors than on the fundamental problems common to the entire farm sector and should preferably be defined in terms of structural variables (farm size, productivity, degree of mechanization, area under irrigation, etc.) rather than levels of production, not least because these are subject to wide fluctuations due to market factors and the weather.

Industry

Overall results. — The decline in final demand led to a further contraction in industrial activity; value added decreased by 1.6 per cent in relation to the previous year (Table 5). Construction reacted with its customary lag and suffered a larger decline (2.2 per cent) after several years of expansion. The value added of manufacturing industry fell by 1.7 per cent; the decline in the index of production was about one percentage point larger.

Table 5
INDUSTRIAL VALUE ADDED AT MARKET PRICES

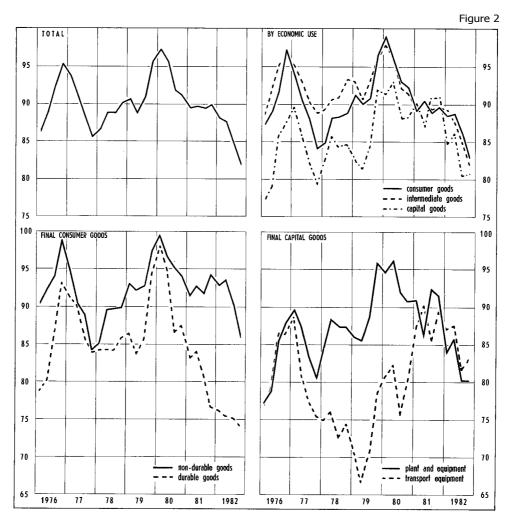
		es at 1970 p billions of lire		Percentage composition	Percentage changes			
	1980	1981	1982	1982	1980/79	1981/80	1982/81	
VALUE ADDED:								
including construction excluding construction	36,525 31,259	36,299 30,981	35,734 30,532	100.0 85.4	4.6 4.7	0.6 0.9	-1.6 -1.4	
Manufacturing	26,999	26,746	26,273	73.5	6.3	0.9	-1.7	
Energy	4,260	4,235	4,259	11.9	-4.2	-0.6	0.6	
Construction and public works .	5,266	5,318	5,202	14.6	4.0	1.0	-2.2	

Source: Relazione generale sulla situazione economica del paese.

The fall in demand was due to a weakening of the domestic component, as foreign sales increased by 1.2 per cent. However, during the year the latter displayed a downward trend owing to the unfavourable world economic climate. Hence exports did not offset the fall in domestic demand to the extent that had been characteristic in previous recessions.

The output of consumer goods declined by only 1.2 per cent, mainly owing to the great stability of the non-durable component, which is less sensitive to cyclical changes than other product groups. The contraction in the capital goods sector was also moderate (2.2 per cent) in spite of the fact that conditions were not favourable to capital formation; it thus reflected the continuation of an important phase in the rationalization and adjustment to new technologies and changes in relative prices. There was a larger decrease, however, in intermediate goods industries (3.1 per cent), which have been the least dynamic component of the manufacturing sector in recent years.

The persistent weakness of demand, which became more pronounced as the year progressed, affected the capacity utilization rate in spite of a significant slowdown in the rate of growth of capacity owing to the increasing concentration on investment for the reorganization of production rather than expansion. In the first half of the year utilization rates were close to the average for the seventies, but in the second half the deepening of the recession depressed them to levels close to the very low values of 1975 (Fig. 2). The operating rate of the capital goods sector was similar to that in the other two branches, in sharp contrast to the situation in



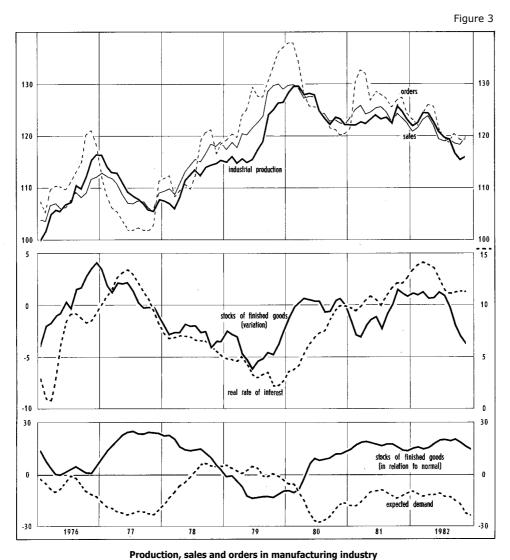
Capacity utilization rate In industry excluding construction

Source: Based on Istat data

Note: The data are obtained by applying the graphic method of the *Wharton School* to the quarterly averages of 35 seasonally adjusted elementary series. The series in question cover 96.18 per cent of the general index of industrial production.

previous periods of falling economic activity, when the sector's rate was well below average.

Cyclical changes in industrial production. — Production showed an uneven trend in 1982. Until May it remained stationary, but declined from June onwards in parallel with domestic and foreign demand. The adjustment of production to the desired levels (Fig. 3) was more rapid than had occurred in the seventies owing to the higher cost of holding stocks, the reduced availability of credit and firms' greater flexibility in the use of labour. The growing recourse to the Wage Supplementation Fund and a



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

sharp fall in employment enabled firms to halt the build-up of stocks of finished goods in the first half of the year and to reduce them substantially in the second, when demand expectations became more pessimistic. Finally, the steady decline in order books was partly to blame for the deepening of the recession, which has now lasted for three years — far longer than in previous cycles, in which the period between successive turning points was no longer than six quarters.

The stagnation in economic activity and the above-normal level of stocks continued into the first quarter of 1982. Domestic and foreign orders remained static, as did expected demand, although the latter was well above the low levels recorded in the third quarter of 1980; the capacity utilization rate also remained largely unchanged at values close to those of recent years.

The fall in domestic and foreign demand during the second quarter led to a small contraction in industrial output (1.5 per cent in relation to the preceding quarter). The decline in sales had little immediate effect on the level of production as companies increased their stocks slightly in the expectation of stable demand.

The fact that short-term growth expectations were not fulfilled was one of the most important aspects of 1982, for in the past movements in expected demand presaged changes in the economic cycle. However, the formation of incorrect expectations about cyclical developments was a very widespread phenomenon which can be explained at least in part by the growing uncertainty about many of the exogenous variables.

In the third quarter the worsening of the downturn was clearly evidenced by a fall of 2.4 per cent in industrial output owing to firms' rapid adjustment of production to the sharp decline in demand and to the need to reduce stocks, which were well above the level regarded as normal. The contraction in output brought a simultaneous fall in the capacity utilization rate to levels approaching the low values recorded in 1975. The entire economy was affected, as all branches of industry were operating well below potential. The only industries in which the use of factors of production remained relatively high were those producing non-durable consumer goods.

In the last quarter of the year the level of orders declined again and economic activity slowed down by a further 2.1 per cent, so that the index of industrial production fell back to the level recorded at the beginning of 1979. Stocks were run down at a rapid rate and the level of inventories regarded as normal also fell sharply in spite of a substantial reduction in expected demand. Unfilled orders, which had been rising at an ever decreasing rate since the beginning of the year, began to fall.

In the first three months of 1983 the recession deepened further, with a fall of 2.0 per cent in the index of industrial production in relation to the last quarter of the previous year. This contraction was due partly to the sharp rise in the number of hours lost as a result of industrial disputes in connection with wage negotiations. However, neither domestic nor foreign orders showed any sign of recovery; only expected demand three or four months ahead indicated a slight improvement.

Services

For the second year in succession the relative insensitivity of marketable services to cyclical developments enabled the sector to grow in real terms while domestic industrial output declined; there was an increase of 0.9 per cent, compared with one of 1.2 per cent in 1981.

In the last two years the increase in the number of workers in the sector has been larger than that in output — 2.7 per cent in 1981 and 2.5 per cent in 1982: this cyclical phenomenon indicates that the services sector once again absorbed excess labour in a time of stagnation. The increase in employment (173,000 jobs in 1982) was spread over all the branches, which have all shown an uninterrupted growth in employment for more than a decade. These developments caused output per employee in services excluding lettings to fall by 1.6 per cent, the second decrease in succession, and to exert pressure on costs.

The differences in the rates of growth recorded by the various branches of the services sector in the year under review were due to the interplay between them and the rest of the economy. Transport and more especially distribution were affected by the decline in the volume of trade. On the other hand, hotels, catering and entertainment and the communications sector were buoyed up by the increase in the final domestic consumption of the relevant product groups by resident households and foreign tourists (3.3 and 4.3 per cent respectively).

Among the remaining branches, miscellaneous services recorded a smaller volume increase than in the preceding year (1.6 per cent, compared with 2.2 per cent in 1981) owing to the stagnation in services provided to the corporate sector, while the finance and insurance sector showed a reduction of 0.5 per cent (as against an increase of 2 per cent in 1981) that was due entirely to a decrease in the credit component. The value added of lettings at 1970 prices rose by 1.5 per cent, which was in line with the moderate growth trend that has prevailed for more than five years.

The medium-term expansion in transport and communications and the increased funds at the disposal of public enterprises in this sector encouraged fixed capital formation; in real terms their investment went up by 1.8 per cent, the only increase among the sub-sectors generating marketable goods and services. Investment by other branches of the services sector declined by 5 per cent.

In recent years the prices of marketable services have risen at a faster pace than the prices of manufactures, which in turn have increased more rapidly than those in the primary sector. In 1982, however, price variations were closely grouped around the average increase of 17.3 per cent recorded in the value added price deflator of market sectors.

Changes in the productive sector in the decade 1971-81

The results of the General Census of industry and services carried out in October 1981 confirm the increasingly rapid growth of the tertiary sector in Italy, as in other western economies; they also reveal that the structure of the industrial sector changed in the course of the decade, with the average size of plant declining and industries with low or average capital intensity gaining greater prominence.

Employment in industry rose by 14.4 per cent over the period to account for 43.4 per cent of the total non-agricultural labour force (Table 6). Employment in manufacturing, mining and quarrying fell from 82.0 per cent of the above aggregate in 1971 to 80.3 per cent in 1981, whereas that in construction rose from 15.0 to 16.8 per cent. Within the services sector the largest employers of labour are the distributive trades (36.1 per cent), public and private services (30.6 per cent) and transport and telecommunications (12.2 per cent).

If the analysis is restricted to those branches for which data relating to the beginning and end of the period are comparable, the growth in the services sector (27.6 per cent) can be attributed to the expansion in services to the household sector and to the growth of independent service companies handling activities directly connected with industrial production and management. Whereas the number of persons employed in the distributive trades, transport and the consumer goods repair sector rose by 22.5 per cent on average, employment in the financial and insurance sectors increased by 79.0 per cent (with a threefold increase in holding companies and investment companies) and that in firms providing services for companies and households rose by 87.8 per cent, with advertising, management consultancy and data processing recording fourfold increases. In the course of the decade certain functions that have traditionally been

Table 6
DISTRIBUTION OF EMPLOYMENT IN INDUSTRY AND THE SERVICES
IN 1971 AND 1981

		Employm	ent	
Sectors	1971	1981	Percentage share	Percentage change 1981/1971
Industry	6,243,534	7,140,326	43.4	14.4
Energy, gas and water	186,415 5,118,602 938,517	210,049 5,731,264 1,199,013	1.3 34.8 7.3	12.7 12.0 27.8
Services	4,305,038	5,492,184	33.3	27.6
Repair of consumer goods Distributive trades Transport and communications Finance and insurance Services to firms and households; renting (2)	270,423 2,758,370 913,267 222,753 140,225	326,899 3,367,339 1,135,950 398,690 263,306	2.0 20.4 6.9 2.4 1.6	20.9 22.1 24.4 79.0 87.8
Other services	****	3,830,212	23.3	
Services to firms (3)		277,488 2,848,990 703,734	1.7 17.3 4.3	
Total		16,462,722	100.0	

Source: Based on the Censimento generale dell'industria, del commercio, dei servizi e dell'artigianato, 1971 and 1981.

performed internally by industrial companies (such as research, accounting and tax operations and business management) were increasingly farmed out to specialist firms which operate on a larger scale and employ qualified staff and modern techniques. In the larger companies this was done by establishing separate service divisions and turning the central administration into a holding company. At the same time, the changes that have been occurring in the organization of labour and the management of companies as a result of the introduction of electronics have created a demand for new services that many firms have found it either impossible or impracticable to satisfy entirely in-house. Hence the forms in which the services sector has developed do not indicate a process of deindustrialization but reflect the evolution of industry and a growing and more complex interweaving of the production of goods and services.

The structure of manufacturing industry changed profoundly during the decade: employment expanded less rapidly than in the past, rising by

⁽¹⁾ Classification of economic activities adopted by Istat for the 1981 Census. — (2) Advertising agencies, data processing and computer services, scientific laboratories, management consultancy, tax-collection agencies, renting of real property, plant and equipment. — (3) Legal, tax, accounting and technical consultancy. — (4) Education, health, research and development, other social services, leisure and miscellaneous personal services. In 1971 data were not collected on all the categories in this item.

12.6 per cent (equal to an increase of 647,000 workers) compared with 17.5 per cent between 1961 and 1971; the number of factories rose by 21.0 per cent (a net increase of 115,000 units), whereas in the preceding period it had increased by less than 4 per cent. The average size of factories came down considerably, from 76.8 to 56.7 workers.

By analyzing the data according to size classes it is possible to identify the phenomena that have contributed to these changes (Table 7). Whereas the number of units with one or two workers showed moderate growth, there was a substantial increase in the number of production units with between 3 and 50 employees: the number of factories in this category rose from 188,000 to 255,000 and the number of employees increased by more than 600,000. As a result, workers in production units of this size accounted for 40.6 per cent of the labour force in manufacturing industry, compared with 33.9 per cent in 1971. The number of medium-sized and large factories (those with more than 200 workers) decreased by 30, with a loss of about 90,000 jobs.

Table 7

MANUFACTURING INDUSTRY: CHANGES IN THE SIZE DISTRIBUTION
OF PRODUCTION UNITS AND IN EMPLOYMENT
BETWEEN 1971 AND 1981 (1)

	Proc	luction units			Е	mployment			Average
Size groups			Per-					Per-	(2) Per-
(number of workers)	1971	1981	centage change 1981/1971	1971	per- centage share	1981	per- centage share	centage change 1981/1971	centage change 1981/1971
1	249,154	282,850	13.5	249,154	4.9	282,850	4.9	13.5	_
2	95,443	108,538	13.7	190,886	3.7	217,076	3.8	13.7	
$3-5\ldots$	93,679	117,912	25.9	347,294	6.8	442,073	7.7	27.3	1.1
6 — 9	39,685	58,316	47.0	286,296	5.6	422,716	7.3	47.7	0.5
$10 - 19 \dots$	32,848	53,131	61.8	439,969	8.6	703,817	12.2	60.0	-1.1
$20-49\ldots$	21,892	26,084	19.2	666,851	13.0	780,653	13.5	17.1	-1.8
50 — 99	7,977	8,385	5.1	550,685	10.7	575,992	10.0	4.6	0.5
$100 - 199 \dots$	3,859	4,195	8.7	535,272	10.4	578,633	10.0	8.1	-0.6
200 — 499	2,175	2,144	1.4	653,941	12.7	640,417	11.1	-2.1	-0.7
500 — 999	560	579	3.4	387,683	7.6	392,867	6.8	1.3	-2.0
1,000 and above	326	308	<i>—5.5</i>	827,053	16.1	744,874	12.9	-9.9	-4.7
Total	547,598	662,442	21.0	5,135,084	100.0	5,781,968	100.0	12.6	<u>6.9</u>

Source: Based on the Censimento generale dell'industria, del commercio, dei servizi e dell'artigianato, 1971 and 1981.

The changes in the structure of industry appear to be linked mainly to two factors. First, the decision taken by many medium-sized and large firms at the beginning of the seventies to decentralize certain production activities

⁽¹⁾ The manufacturing sector is so defined that 1971 and 1981 data are comparable for individual branches of activity and size groups. — (2) Arithmetic mean for individual size groups and for the total.

and entrust them to small units in order to achieve greater labour mobility and curb industrial disputes; secondly, the need to adapt production processes to suit the changed economic environment. In the second half of the seventies growing market instability, uncertainty about the level and composition of demand and rapid changes in relative prices favoured decentralization and the development of multi-purpose plants that were more highly specialized and could respond more flexibly to stimuli emanating from the market. The Census data would seem to confirm that centralized production in large, vertically-integrated plants is giving way to a system in which manufacture is spread over a number of smaller factories, each specializing in a single stage in the production of various goods.

Table 8
INDUSTRY AND SERVICES: CHANGES IN EMPLOYMENT
BETWEEN 1971 AND 1981 BY REGION

		INDU	STRY			SERVI	C E S (1)	
REGION			of which: manu mining and qu				of which: ser firms and hou finance and in	seholds,
	Absolute values 1981	Per- centage changes 81/71	Absolute values 1981	Per- centage changes 81/71	Absolute values 1981	Per- centage changes 81/71	Absolute values 1981	Per- centage changes 81/71
TP: 1 - 4 T7 12 A - 4	070 607	0.0	750.001		470.000		25.210	
Piedmont-V. d'Aosta	870,637	-2.2	752,221	-4.1	473,383	22.2	65,643	85.6
Lombardy	1,840,619	3.5	1,588,146	1.2	1,002,678	26.5	163,394	67.9
Trentino-Alto Adige	108,986	17.9	73,448	14.8	126,512	49.1	10,040	198.2
Veneto	750,082	27.4	605,148	26.1	476,758	38.6	47,570	107.2
Friuli-Venezia Giulia	182,711	9.6	136,555	4.3	145,699	23.8	15,804	97.4
Liguria	181,789	-4.5	139,264	-2.7	248,452	10.6	26,177	75.0
Emilia-Romagna	695,306	26.7	551,745	25.7	489,124	33.5	57,452	110.1
Tuscany	578,974	13.8	485,746	14.7	396,952	27.0	45,772	94.0
Umbria	116,346	37.4	90,202	37.6	68,172	24.6	6,804	93.1
Marches	245,241	51.8	194,077	53.2	138,938	38.6	12,881	92.7
Latium	380,259	28.6	274,408	25.1	556,494	21.2	91,584	70.7
Abruzzi	125,817	47.8	91,841	<i>58.7</i>	100,367	34.2	7,304	75.9
Molise	24,292	67.8	13,856	79.0	20,713	30.6	1,914	84.7
Campania	339,861	25.8	269,322	20.7	357,761	23.0	31,688	89.6
Puglia	266,680	31.1	198,029	33.4	264,028	34.7	24,792	135.0
Basilicata	41,485	38.8	22,398	30.5	35,292	32.9	2,554	87.9
Calabria	71,502	20.9	40,534	10.9	127,131	33.7	8,653	83.1
Sicily	216,163	15.3	139,855	7.4	337,712	28.0	31,864	57.1
Sardinia	103,576	20.2	64,469	25.4	126,018	29.2	10,106	85.6
ITALY	7,140,326	14.4	5,731,264	12.0	5,492,184	27.6	661,996	82.6

Source: Censimento generale dell'industria, del commercio, dei servizi e dell'artigianato, 1971 and 1981.

⁽¹⁾ Repair of consumer goods, distributive trades, transport and communications, finance and insurance and services provided for firms and households (limited to branches for which data for the beginning and end of the period are comparable).

Changes of this kind have been facilitated by technological innovation (above all the introduction of numerically-controlled machines and the development of micro-electronics) and by the standardization of semi-finished goods, which have permitted better coordination between the various stages of production.

In the larger factories the changes entailed replacing fixed capital installations, reducing manning levels and sub-contracting a larger proportion of production; closures of large factories in ailing sectors were counterbalanced by the establishment of others in the same size class in growth industries. The modernization of production facilities was also facilitated by Law No. 576 of 1975 and Law No. 904 of 1977, which provided tax concessions for firms that floated off company divisions before 1981.

The changes in the size structure and sectoral composition of industry and in the relationship between manufacturing and services were mirrored by significant changes in the geographic pattern of the productive sector. The essentially industrial nature of the central and northern regions, where industrial workers account for 47.0 per cent of non-agricultural employment, has been accentuated, as has the clear predominance of the services sector in the South of the country, where it accounts for 68.7 per cent of the work force, excluding those in the primary sector. Grdwth was not uniform in the individual regions, however; while on the one hand some of the disparities have widened, on the other homogeneous economic areas have emerged that blur the traditional geographic distribution (Table 8).

Energy

Domestic consumption of primary energy declined by 2.3 per cent, after having fallen by a similar proportion in 1981 and by 1.5 per cent in 1980 (Table 9). The ratio of energy requirements to gross domestic product fell by a further 2.2 per cent. The contraction was due mainly to a reduction of 4.4 per cent in the consumption of oil, which was partly offset by an increase in the use of solid fuels. Net imports of the latter, which have risen every year since 1979, expanded by 5.5 per cent, whereas those of oil contracted by 4.2 per cent (compared with a decline of 4.7 per cent in 1981), mainly on account of the marked reduction in purchases of crude. Imports of natural gas also recorded a decrease of 3.5 per cent, similar to that of the previous year, but there was a slight increase in domestic production.

The trade deficit in energy products came to 29,944 billion lire; this was slightly more than in 1981 and represented 6.4 per cent of GDP, as against 7.3 per cent in the previous year.

SOURCES AND USES OF ENERGY

(millions of TOE)

										
			1981					1982		
Sources and uses	Solid fuels	Natu- ral gas	Oil	Elec- tric power (1)	Total	Solid fuels	Natu- ral gas	Oil	Elec- tric power (1)	Total
Production	1.2	11.6	1.5	11.3	25.6	1.2	11.9	1.8	11.8	26.7
Imports	13.2	11.5	108.1	2.5	135.3	13.8	11.1	105.0	2.2	132.1
Exports (—)	0.5	_	14.9	0.4	15.8	0.4	_	15.7	0.7	16.8
Changes in stocks (2)	-0.4	-1.0	-0.1	_	-1.5	-0.1	-0.9	-0.7	_	-1.7
Domestic uses of primary sources (3)	13.5	22.1	94.6	13.4	143.6	14.5	22.1	90.4	13.3	140.3
Percentage composition	9.4	15.4	65.9	9.3	100.0	10.3	15.8	64.4	9.5	100.0
Trasformation into electric power	-4.9 2.2	-1.8 0.3	-21.8 6.8	28.5 6.9		-5.6 2.3	-2.6 0.3	-20.4 5.9	28.6 6.4	_ 14.9
Domestic uses of final								_		
sources (3)	6.4	20.0	66.0	35.0	127.4	6.6	19.2	64.1	35.5	125.4
Percentage composition	5.0	15.7	51.8	27.5	100.0	5.3	15.3	51.1	28.3	100.0
Industry	5.1	8.7	14.2	19.9	47.9	5.4	8.0	12.6	19.4	45.4
Transport (3)	_	0.3	28.3	1.0	29.6		0.3	29.5	1.0	30.8
Other energy uses	1.0	9.3	17.8	14.1	42.2	0.9	9.4	16.3	15.1	41.7
Non-energy uses	0.3	1.7	5.7	_	7.7	0.3	1.5	5.7	_	7.5

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 differences between conventional and actual input (2,186 in 1981 and 2,185 in 1982) are offset under "consumption and losses". The use of the conversion factor of 2,200 Kcal per kWh in the evaluation of final consumption reflects the consumption of primary sources of energy in the generation of electricity; adoption of the conversion factor of 860 Kcal per kWh in line with other statistical sources would reflect the thermal content of electricity from the point of view of the final user. — (2) Plus (+) shows a reduction in stocks; minus (—) an increase in stocks. — (3) Including international maritime bunkers (3.9 million TOE in 1981 and 4.1 million TOE in 1982).

The demand for final sources of energy declined in all sectors except transport. Industrial consumption, including that of the petrochemical sector for non-energy uses, had already begun to fall in 1980, but there was an acceleration in the rate to 4.9 per cent last year, compared with 4.6 per cent in 1981, bringing a further decrease in energy use per unit of value added. The fall in consumption concerned all sources of energy except solid fuels; oil products again showed the largest contraction, 8 per cent, which was similar to that of the previous year.

In the nine years since the first oil shock the ratio of total energy requirements to GDP has declined by 17 per cent and that of oil has fallen by 29 per cent. The policy of diversification, which was intensified in the

latter part of the period, has brought about substantial changes in the composition of energy uses (Table 9); it has encouraged the use of natural gas,, which has seen its share in the total rise by almost 6 percentage points to 16 per cent, and coal, which has increased its contribution to total requirements by 3 points to 10 per cent, with most of the increase occurring in the last three years. The proportion met by oil has declined from 75 to 64 per cent. In view of the inelasticity of domestic demand, there has been no change, however, in the Italian economy's dependence on imported energy, which has remained at 82 per cent.

The composition of final consumption has also changed radically since 1973. Other energy uses (residential, commercial, general government and other services, agriculture) now account for one-third of total consumption and there has been considerable diversification in the types of energy used: the share of oil products (almost exclusively gas-oil for heating) has fallen from 61 to 39 per cent, that of natural gas has more than doubled to stand at 22.5 per cent and that of electricity has gone up from 24.5 to 36.2 per cent.

The proportion of total energy consumption taken by industry as a whole, including the petrochemical industry's use of energy products as a feedstock, has declined by almost 6 percentage points. The share of oil and oil products in the sector's consumption has declined by about 14 points. Part of the diversification into other sources has taken the form of an increase in the use of natural gas and solid fuels, which rose by 3.1 and 2.8 percentage points respectively; more importantly, however, there has been a steady rise in the consumption of electricity, which has gone up by 8.2 points to account for 37 per cent of the total.

The ratio between the trade deficit on energy account and total exports had been increasing steadily since 1973, but in 1982 it declined sharply from 34 to 30 per cent; the size of the deficit is such, however, that it continues to place Italy in 'a position of serious weakness in comparison with other industrial countries, which have made greater progress towards resolving the energy problem. In view of the dangers associated with the continuing strong bias towards oil and the length of time required for decisions in the energy field to be implemented, Italy must persevere with policies for the conservation of energy and the diversification of both the types of energy imported and the countries from which they are drawn, as outlined in the National Energy Plan.

Employment, wages, prices and the distribution of income

Employment

After nine years of uninterrupted increases in employment, the prolonged stagnation of production caused a fall of 75,000 units or 0.4 per cent (Table 10). Most of this was in northern Italy and employee workers alone were affected to roughly the same extent (0.3 per cent). The decline in the demand for labour produced a further rise in the number of the underemployed and especially in that of workers who have lost a job (respectively 2.9 and 30.4 per cent).

Table 10

EMPLOYMENT IN ITALY
(percentage changes on previous year)

Sector		Total em	ployment	. 1	Employees			
Sector	1979	1980	1981	1982	1979	1980	1981	1982
Agriculture	-2.7	-2.8	-3.8	-5.6	-1.6	-1.4	-3.7	-3.7
Industry	0.2	0.7	-0.7	-1.6	0.2	0.4	-1.0	-2.1
of which: energy	0.5	1.6	1.0	-0.5	0.5	1.5	1.0	-0.4
manufacturing	0.3	0.6	-1.5	-1.9	0.5	0.2	-1.9	-2.2
total excluding construction	0.3	0.6	-1.5	-1.9	0.5	0.3	1.8	-2.2
construction	-0.2	1.1	1.8	-0.9	-0.5	0.8	1.6	-1.7
Marketable services	3.1	2.3	2.7	2.5	4.7	2.4	2.7	2.8
of which: distribution, hotels, catering and entertainment	3.4	1.7	2.5	2.6	5.8	0.7	2.2	3.8
transport and communications.	0.6	1.6	1.6	0.1	1.1	1.6	1.3	-0.5
credit and insurance	4.2	5.8	3.1	2.3	4.3	5.9	3.2	2.4
miscellaneous services	4.4	3.8	3.8	3.9	6.4	5.0	4.8	4.3
Marketable goods and services	0.8	0.8	0.1	-0.6	1.5	0.9	_	-0.6
Non-marketable services	1.9	1.1	2.1	0.7	1.9	1.1	2.1	0.7
TOTAL	1.0	0.8	0.5	-0.4	1.6	0.9	0.5	-0.3

Source: Istat.

The decline in employment in agriculture accelerated to 5.6 per cent so that this sector's share of the employed labour force dropped to 12 per cent, compared with 17 per cent ten years ago. The contraction, which was large for both self-employed and employee workers (6.9 and 3.7 per cent respectively), was primarily due to workers withdrawing from the labour market, in part because of the poor prospects for earnings.

Employment in the services sector increased by 197,000 units or 1.9 per cent, and now, after fifteen years of continuous growth, represents more than half of total employment. The growth in 1982 stemmed from the very large rise in the distributive trades and "other" services, on the other hand employment in transport was virtually unchanged while that in the credit sector rose more slowly than in previous years (Table 10). The 0.7 per cent increase in non-marketable services was the smallest recorded for many years and reflected not only a cautious government recruitment policy but also a large number of retirements.

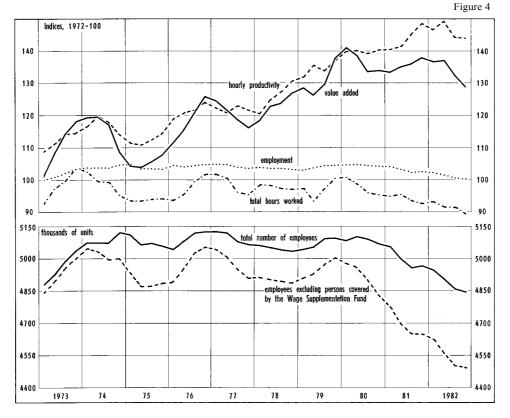
The reduction in productive activity was coupled for the second year running with a fall in industrial employment, which amounted to 123,000 units or 1.6 per cent. The fall affected both construction (0.9 per cent) and to a greater extent industry excluding construction (1.9 per cent; Table 10).

In view of the recessionary conditions, firms continued to use the Wage Supplementation Fund as a means of making labour management more flexible. The total hours paid by the Fund in industry excluding construction rose to 547 million, which was 12 per cent more than the already high number reached in 1981.

The reduction in the work force, the flexibility provided by the Wage Supplementation Fund and the high level of investment in the three preceding years led, notwithstanding the downturn in activity, to a slight improvement in the productivity of industry excluding construction: that per worker rose by 0.4 per cent (1.3 per cent excluding the worker equivalent of the wage supplementation hours paid); that per hour rose by 1.5 per cent. Underlying the positive annual results were considerable variations during the year; with productivity rising slightly in the first half and declining sharply in the second due to the worsening of the recession (Fig. 4).

There was a further increase (0.4 per cent) in the total labour force during 1982, though at a rate that was held down by the decrease in employment. The increase was due to demographic factors: the population aged between 14 and 70 grew by 375,000 (0.9 per cent) while that of all the other age groups shrank by 220,000 (1.4 per cent). As in previous recessions, awareness of the reduced possibility of employment caused the labour force to contract during the year, with the lowest value being recorded in the third quarter.

The number of unemployed went up by 8.1 per cent and averaged over 2 million for the year notwithstanding the withdrawal from the labour force of marginal workers discouraged by the recession. There were large increases in the numbers of both first-time job seekers (167,000 or 16.7 per cent) and unemployed workers (66,000 or 30.4 per cent).



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

As a result of these developments the unemployment rate rose from 8.4 per cent in 1981 to 9.1 per cent. This level, which had already been reached by the end of 1981, remained virtually unchanged during the first three quarters of 1982 and then rose to 9.5 per cent. The rate adjusted to include workers on wage supplementation followed a similar course with the annual average rising from 10.0 to 10.7 per cent.

Wages and salaries

After two years of sharp decline, the number of hours lost through industrial disputes increased substantially (from around 40 million in 1981 to more than 100 million). This can be largely attributed to the negotiations for the renewal of wage agreements (primarily in manufacturing industry). Compared with 1979, when these agreements were last renewed, the reduction in the number of hours lost was nearly 40 per cent.

Confindustria's announcement in June 1982 of its decision to terminate the 1975 wage indexation agreement and the consequent overlapping of the negotiations for the renewal of wage agreements with those for the reform of the indexation mechanism led to an almost complete standstill and the only important agreements reached in 1982 were those for public transport and bank workers.

The deadlock in the negotiations caused the Government to propose a solution of its own, which was accepted by employers and unions on 22 January 1983. The outline agreement imposes a series of constraints on employers, unions and the Government. The first two negotiated a revised wage indexation system and undertook to respect certain general criteria, such as unchanged real wages and a reduction in working hours, in new wage agreements. As regards wages, maximum monthly increases of 25, 35 and 40,000 lire were set for 1983, 1984 and 1985. In the first two years these amounts are to include any increases stemming from company level bargaining.

As a consequence of the agreement, the Government modified the personal income tax system (Irpef) to reduce the effect of fiscal drag, increased family allowances, and extended relief on employers' social security contributions. In addition, it undertook to keep the 1983 average increase in public service charges, administered prices and monitored prices within 13 per cent, revise the regulations governing medical treatment and sickness benefits, and submit a series of changes in labour market legislation for the approval of Parliament.

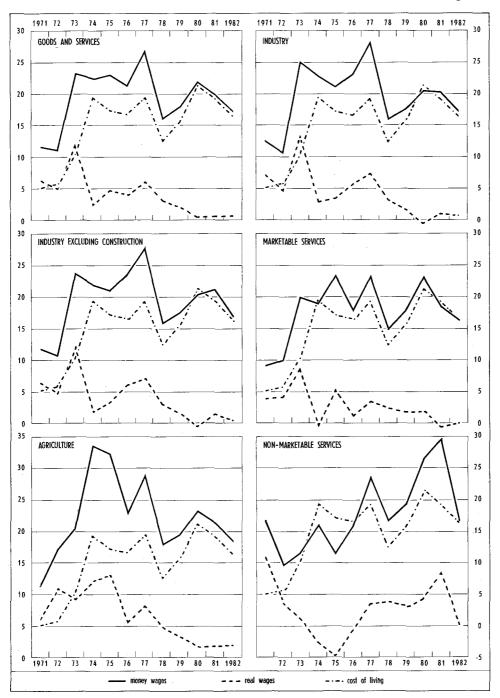
After the employers and unions had accepted the agreement formulated by the Government, they resumed negotiations and wage agreements were signed for workers in the following sectors: agriculture, chemicals, distribution, footwear and public sector engineering.

In 1982 wage rates rose by a minimum of close to 11 per cent in credit and insurance and by a maximum of close to 27 per cent in lodging and catering, where the new wage agreement was implemented. The failure to renew many agreements that had expired and the smaller rise in the index used for cost-of-living increases produced a general reduction in the growth rate of wages compared with 1981.

The 1982 increase of 0.6 per cent in the real wages of the market sector was in line with the much slower growth recorded since 1978 (Fig. 5).

The 17.2 per cent rise in labour costs per employee in the private sector was slightly larger than that in wages owing to an increase in the proportion of social security contributions. Productivity was virtually unchanged, since a sizable reduction in employment in every sector except services (Table 11) almost completely offset the decline in value added. The

Figure 5



Money and real wages and cost of living In six sectors of the national accounts

(percentage changes on previsius year)

Source: Based on Istat data

Table 11 LABOUR COSTS IN THE PRIVATE SECTOR

(percentage changes)

Year	Value added at market prices (1)	Total employment	Output per worker	Per capita employee income	Unit labour costs
		Private sec	tor (excluding	l lettings) (2)	
1979	5.5 4.6 0.2 0.6	0.8 0.8 0.2 -0.5	$\begin{array}{c c} 4.7 \\ 3.7 \\ -0.1 \\ -0.1 \end{array}$	17.0 21.5 18.9 17.2	11.8 17.2 18.9 17.3
,			Agriculture		
1979 1980 1981 1982	$\begin{array}{c} 6.0 \\ 4.0 \\ -0.1 \\ -2.5 \end{array}$	$ \begin{array}{r} -2.7 \\ -2.8 \\ -3.8 \\ -5.6 \end{array} $	8.9 7.0 3.9 3.3	19.4 23.8 21.9 19.2	9.6 15.7 17.4 15.4
		Industry	excluding con	struction	
1979 1980 1981 1982	$\begin{array}{c c} 6.1 \\ 4.7 \\ -0.9 \\ -1.4 \end{array}$	$0.3 \\ 0.6 \\ -1.5 \\ -1.9$	5.8 4.1 0.6 0.4	16.6 19.0 19.3 17.0	10.1 14.3 18.7 16.5
			Construction		
1979	$\begin{bmatrix} 2.6 \\ 4.0 \\ 1.0 \\ -2.2 \end{bmatrix}$	$ \begin{array}{r} -0.2 \\ 1.1 \\ 1.8 \\ -0.9 \end{array} $	$ \begin{array}{c c} 2.9 \\ 2.8 \\ -0.8 \\ -1.3 \end{array} $	17.4 20.6 17.0 18.7	14.1 17.3 17.9 20.2
		Services	(excluding let	tings) (2)	
1979	5.4 4.6 1.1 0.9	3.1 2.4 2.7 2.4	2.2 2.2 -1.5 -1.5	16.5 24.2 18.1 16.3	14.0 21.6 19.9 18.1

Source: Relazione generale sulla situazione economica del paese.

(1) 1970 prices; the data for agriculture, industry and services include imputed bank services. - (2) The data also include "other non-marketable services".

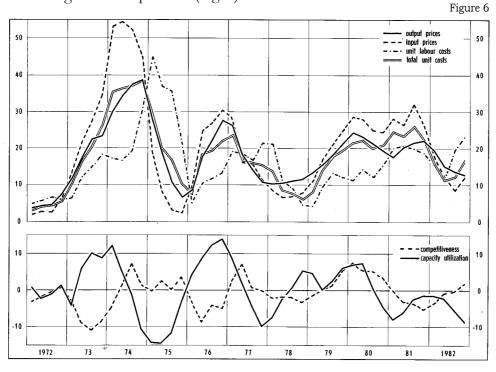
fact that output per employee held up is evidence of the efforts being made to rationalize production and of the weakening of the link between productivity and output compared with a few years ago. To conclude, unit labour costs rose by 17.3 per cent, in line with those per employee.

Prices

Inflation in Italy continued at a high rate in 1982 and the overall gap compared with the other major industrial countries widened. Wholesale and retail prices recorded average increases of respectively 13.9 and 16.5 per cent. During the year the rate of increase of the former slowed down sharply (11.9 per cent in December 1982 compared with 18.2 per cent a year before) while that of the latter was almost unchanged (16.1 as against 18.1 per cent).

Although the slowdown in the rate of increase of the wholesale prices of manufactures (excluding oil products) was greater than in 1981 (3.4 percentage points as against 2.1), there was only a small reduction in the inflation gap: the average gap vis-à-vis the nine major industrial countries declined from 6.6 points in 1981 to 6.1 points in 1982 and vis-à-vis the other EEC countries from 6.4 to 5.1 points. During the year the gap started to widen again, showing that the slowdown of inflation was less pronounced and continuous in Italy, where progress appears to have come to a halt in the last part of the year.

The slower pace of the increase in the prices of industrial products was mostly due to the improved performance of unit production costs, which rose on average by 13.9 per cent, compared with 24.7 per cent in 1981. This result can be attributed primarily to the prices of raw materials and semi-finished products. Despite the large appreciation of the dollar, these rose less than half as much as in 1981 (12.5 as against 28.2 per cent). On the other hand, unit labour costs showed little improvement, rising by 16.5 per cent as against 18.7 per cent (Fig. 6).



Components of the change in output prices in industry excluding construction, capacity utilization and competitiveness

(percentage changes on corresponding period in previous year)

The slowdown of consumer price inflation was less marked than that for producer prices. During the year a gap of more than 4 points developed. This confirms that, apart from the well-known differences in the composition of the two indices, strong inflationary factors are at work in the distributive trades. The strength of these pressures and their persistence can be attributed to unit labour costs having risen faster in the services sector than in industry excluding construction over the last few years. In 1982, furthermore, on top of the normal lag with which the better performance of producer prices was passed on to retail prices (2-3 quarters), there were the effects of the increases in indirect taxes and the policy for public service charges and administered prices (Table 12).

Table 12

THE CONTRIBUTION OF PUBLIC SERVICE

CHARGES AND ADMINISTERED PRICES TO THE INCREASES
IN CONSUMER AND WHOLESALE PRICES

	1980 1979	1981 1980	1982 1981
	per	centage chang	ges
CONSUMER PRICES		40.6	4.5.5
I. Administered prices of goods and services	25.7	18.4	17.7
Foodstuffs and tobacco Oil products Rents Other goods	19.1 44.0 20.3 34.0	17.6 25.6 15.3 12.6	20.1 17.8 16.1 12.6
II. Charges for public services	25.0	25.6	16.5
National	$26.0 \\ 23.1$	25.9 25.1	14.7 19.6
Total (I + II)	25.6	19.9	17.6
Contribution to the increase in consumer prices			
I. Of administered prices (goods and services)	6.2	3.4	3.2
II. Of public service charges	1.3	1.3	0.8
Total (1)	7.5	4.7	4.0
General index of consumer prices	21.2	17.8	16.5
WHOLESALE PRICES		:	
Oil products	45.3	28.5	13.2
Chemical fertilizers	26.0	20.9	22.4
Cement	30.6	23.0	14.7
Sheet glass	19.7	11.0	5.6
Newsprint	16.4	18.2	9.1
Total	42.1	27.3	12.9
Contribution to the increase in wholesale prices (1)	3.7		0.9
General index of wholesale prices	20.0	าช.6	13.9

Source: Based on Istat data

(1) The weights used for 1979 and 1980 were those of the relevant Istat indices with 1976 = 100; after 1981 they were those of the new Istat indices with 1980 = 100.

The general index of wholesale prices rose by 13.9 per cent on average in 1982, nearly three points less than the year before (16.6 per cent). The deceleration during the year was much sharper; in December the twelve-month rate of increase had fallen to 11.9 per cent, compared with 18.2 per cent in December 1981 (Table 13).

Table 13

WHOLESALE PRICES

(percentage changes in indices; 1980= 100)

Indices	1981	1982	Dec. 81	Dec. 82	Mar. 83	June 82	Dec. 82	
In a reed	1980	1981	Dec. 80	Dec. 81	Dec. 82	Dec. 81	June 82	Dec. 82
							l mpound n annual	
General index	16.6	13.9	18.2	11.9	1.2	9.3	14.6	4.9
Classification by sector:								
Agricultural	12.5	12.4	18.5	10.6	1.6	6.9	14.3	6.6
of which: imported products	0.7	9.1	7.2	11.8	0.4	16.4	7.4	1.6
Non-agricultural	17.2	14.0	18.0	12.1	1.2	9.8	14.6	4.9
Classification by product category:								
Food	15.0	14.7	18.5	12.3	1.4	8.6	16.1	5.7
vegetable	11.3	11.2	18.4	11.0	1.0	8.3	13.8	4.1
animal	15.0	15.0	18.7	9.6	2.8	4.2	15.4	11.7
food manufactures	16.9	16.2	18.5	13.4	1.3	9.7	17.3	5.3
Industrial raw materials	19.8	13.6	22.4	10.2	-1.1	7.3	13.1	-4.3
oil	50.1	13.3	35.6	19.0	-7.9	6.7	32.7	-28.0
non-oil	12.7	13.7	18.9	7.5	1.3	7.3	7.6	5.3
Industrial products	16.0	13.4	15.9	12.6	2.2	10.8	14.5	9.1
of which: industrial products	_							
excluding oil products	14.9	12.8	14.9	11.5	2.9	12.2	10.8	12.1
Classification by use:								
Consumer goods	14.9	14.8	17.0	13.6	1.7	9.8	17.5	7.0
Capital goods	19.4	14.8	17.9	13.7	3.9	15.2	12.2	16.5
Ancillary materials	17.5	12.9	18.9	10.3	-4.7	8.1	12.6	-17.5

Source: Based on Istat data.

Despite the gradual appreciation of the dollar, the rise in the lira prices of industrial raw materials eased in the first six months of 1982 - an equivalent annual rate of 7.3 per cent was recorded in June, compared with one of 22.4 per cent at the end of December 1981 (Table 13). In the second half of the year a faster rise in unit labour costs went hand in hand with a new upturn in the prices of industrial raw materials (mainly those under the heading oil), which rose at an equivalent annual rate of 13.1 per cent.

The outcome of the developments in the components of unit production costs just described was an increase in the prices of industrial products of 13.4 per cent on average (12.8 per cent if oil products are excluded). The equivalent annual rates in the first and second halves of the year were respectively 10.8 and 14.5 per cent (excluding oil products, 12.2 and 10.8 per cent) (Table 13). The constraints imposed by greater international competition and weaker aggregate demand thus appear to have acted once more as a brake on the prices of manufactures.

The downward trend of wholesale price increases that developed in 1982 became more pronounced in the first quarter of this year. The twelve-month rate declined from 11.9 per cent in December 1982 to 10.2 per cent in March 1983. In the same month the general index was only 1.2 per cent above the December level. The weakening of industrial raw material prices (1.1 per cent), stemming from the fall in oil prices, was offset by slight upturns in those of foodstuffs and industrial products (respectively 1.4 and 2.2 per cent) (Table 13).

The consumer price index rose by 16.5 per cent on average in 1982 (17.8 per cent in 1981). This kept Italy at the top of the inflation ranking of the major industrial countries.

As normally happens when inflation is slowing down at the production level, consumer prices proved to be more sticky. In fact, though the average rate of increase in 1982 was only half a point above the Government's target of 16 per cent, the twelve-month rate only fell by 2 percentage points (from 18.1 to 16.1 per cent), compared with a fall three times as large for wholesale prices (Tables 13 and 14).

In the first half of the year the twelve-month rate of consumer price inflation dropped from 18.1 to 14.4 per cent on an annual basis under the influence of the slower pace of producer prices, especially those of foodstuffs. The prices of services, by contrast, showed no signs of slackening. In the summer months the upward movement of retail prices was boosted by the increases in indirect taxes and public service charges introduced at the end of July. The acceleration was particularly marked in the sectors of the market that are not constrained by foreign competition. Thus, in the second half of the year consumer prices accelerated again to a rate about 4 points higher than that recorded in the first, with peaks of respectively 17.2 and 19.9 per cent for food and non-food products (Table 14).

The component of consumption that recorded the largest rise in prices was again services (17.5 per cent compared with 20.6 per cent in 1981; Table 14). Public service charges rose by 16.5 per cent, which was much less than in 1982 (25.6 per cent; Table 12). Two items that stand out within this aggregate are the increases recorded by electricity (22.1 per cent) and transport services (18.6 per cent), the latter including rises of respectively 28.4 and 17.8 per cent for urban and railway transport.

CONSUMER PRICES AND THE COST OF LIVING

(percentage changes in indices; 1980=100)

Indices	1981	1982 1981	Dec. 81	Dec. 82	Mar. 83 Dec. 82	June 82	Dec. 82	Mar.
	1900	1301	Dec. 80	Dec. 61	Dec. 82	Dec. 81	June 82	Dec. 8
CONSUMER PRICES						(compound rate on an annual ba		
General index	17.8	16.5	18.1	16.1	3.8	14.4	17.9	16
Food	16.3	16.4	18.2	15.5	1.6	13.9	17.2	6
Non-food products and services	18.6	16.4	18.1	16.5	4.5	14.6	18.4	19
non-food products	17.1	15.8	16.7	16.0	2.7	12.1	19.9	11
services	20.6	17.5	20.1	17.1	6.9	17.9	16.3	30
clothing and footwear	17.1	16.1	16.7	15.3	2.4	12.2	18.5	10
housing, fuel and electricity	20.3	19.0	20.6	21.3	2.5	14.8	28.2	10
housing and water	15.6	16.8	14.6	18.7	3.7	17.2	20.3	15
rent	15.3	16.1	13.6	18.4	3.5	16.2	20.5	14
fuel and electricity	25.9	21.5	27.7	24.0	1.5	12.3	36.9	
liquid fuel	23.3	25.8	32.0	27.2	3.3	8.5	49.2	-12
gas	27.2 28.8	13.9 22.1	23.9 24.6	17.1 25.0	10.0 2.2	16.0 15.1	18.1 35.9	46
furniture, furnishings, equipment and services for domestic use	18.4	15.4	16.9	15.4	3.0	16.1	14.7	12
medical care and health	22.8	16.1	19.3	13.6	3.7	20.3	7.2	1
transport and communications	17.8	16.6	16.4	17.8	4.2	11.1	25.0	17
cars	11.4	16.1	13.7	16.3	4.0	17.3	15.4	12
State Railways	7.5 25.8	17.8 14.8	11.3 17.0	21.2 16.7	0.9	 	46.9 37.6	- 3
recreation, entertainment, education and cultural services	15.8	14.1	17.3	12.1	9.0	10.2	13.9	41
other goods and services	19.8	17.2	19.4	17.3	5.9	18.8	15.8	25
OST OF LIVING								
General index	18.7	16.3	17.9	16.3	3.7	14.0	18.7	15
Food	16.3	16.0	17.5	15.6	2.8	13.3	17.9	11
Clothing	17.2	15.8	18.5	15.4	2.1	12.5	18.3	8
Electricity and fuel	26.6	21.7	28.9	23.7	0.9	13.0	35.5	3
Housing	16.3	16.7	15.8	17.6	4.1	16.7	18.5	17
Miscellaneous expenditure	20.6	16.3	18.1	16.3	4.9	14.4	18.3	21

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Food prices rose on average at virtually the same rate as the general index (16.4 per cent). The differential of close to 2 points compared with the equivalent wholesale rate is attributable to the increase in indirect taxes during the year, even though retailers appear to have raised their prices over and above what would have been strictly justified.

In the first quarter of 1983 consumer prices continued to rise at a fast pace, primarily as a result of the increases in indirect taxes and public service charges. In March the general consumer price index was 3.8 per cent higher than at the end of 1982, while the twelve-month rate remained unchanged for the fourth month running at 16.1 per cent.

The distribution of income

The slowdown in wage increases together with the decline in employment resulted in a stable distribution of income. In the private sector labour incomes accounted for 81.2 per cent of total value added, compared with 81.0 per cent in 1981 (Table 15). The sectoral pattern was very

DISTRIBUTION OF INCOME

Table 15

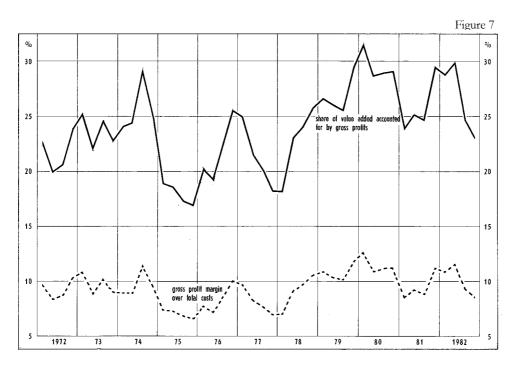
		s share of valu t factor cost (1 (percentages)		Percentage changes 1982/1981			
Sector	1980	1981	1982	Real labour costs per unit of output (2)	Relative prices (3)	Labour's share of income	
Agriculture, forestry and fisheries	88.6	92.6	91.3	-0.3	1.1	-1.4	
Industry	71.1	73.5	73.4	0.1	0.4	-0.1	
excluding construction	70.5	74.0	73.4	-0.4	0.4	-0.8	
construction	73.2	70.8	72.4	2.4	0.1	2.3	
Services (4)	82.7	82.8	83.9	0.6	-0.7	1.3	
Private sector (5)	79.4	81.0	81.2	0.2	_	0.2	

Source: Based on Istat data.

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

irregular, however; the share of labour incomes increased in private services and construction, declined in agriculture but remained practically unchanged in industry excluding construction. The first two sectors recorded increases in real unit labour costs while in the third they declined slightly. On the other hand, the development of relative prices was more uniform.

The stability of income distribution in industry excluding construction can be attributed to firms' success in achieving a more efficient combination of productive factors after the reorganization of the last three years and contrasts with previous cycles, when profit margins fell sharply during recessionary phases (Fig. 7). When the pattern over the year is examined,



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.

however, the share of gross profits in value added dropped considerably as the recession became worse in the second half. In this period the shift in income distribution was accentuated by a large increase in production costs caused by changes in the legislation on social security contributions. In view of the depressed state of the market, firms were only able to pass a part of the additional costs on to their prices. Thus, at the end of 1982 profit margins had fallen close to the very low values recorded in 1975.

THE BALANCE OF PAYMENTS

The overall balance of payments closed with a deficit of 2,521 billion lire, as against a surplus of 1,533 billion in 1981. The deficit on current account declined from 9,225 to 7,393 billion lire. Movements of medium and long-term capital resulted in decreased net inflows of 6,448 as against 9,652 billion lire, while short-term capital movements resulted in a debit balance of 2,761 billion lire after recording a net inflow of 1,734 billion in 1981. The banks' transactions resulted in a sizable outflow, giving an overall financial deficit of 5,582 billion, which compares with substantial equilibrium' in 1981 (Table 16).

Table 16

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

(1)

	Credit		De	bit	Balance	
	1981	1982	1981	1982	1981	1982
CURRENT ACCOUNT (2)	119,314	140,029	128,539	147,422	-9,225	—7,393
Goods (fob)	85,011	97,983	97,043	108,703	-12,032	-10,720
of which: oil and oil products	5,257	6,684	28,382	30,353	-23,125	<i>—23,669</i>
Services	29,229	35,673	27,284	33,514	1,945	2,159
Transfer payments	5,074	6,373	4,212	5,205	862	1,168
CAPITAL MOVEMENTS	58,045	60,201	46,659	56,514	11,386	3,687
short-term	30,678	31,748	28,944	34,509	1,734	-2,761
medium and long-term	27,367	28,453	17,715	22,005	9,652	6,448
ERRORS AND OMISSIONS					—628	1,185
TOTAL					1,533	-2,521
MONETARY MOVEMENTS (3)	4,665	9,067	6,198	6,546	—1,533	2,521
Banca d'Italia-UIC	1,150	7,406	3,354	3,485	-2,204	3,921
Banks	1,319	_		1,505	1,319	-1,505
Exchange rate adjustments	2,196	1,661	2,844	1,556	-648	105
of which: Banca d'Italia-UIC .	2,196	1,661	_	_	2,196	1,661
Banks	-	_	2,844	1,556	-2,844	1,556

⁽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 1981 and 1982 amounts respectively to —14,056 and —13,144 billion lire. — (3) Balance with minus sign indicates increase in assets or decrease in liabilities.

Given the stagnation of the world and national economies and Italy's largely stable competitive position on average in 1982, the balance of trade was influenced primarily by the modest rise in import prices, which also resulted in an improvement in the terms of trade. Increased foreign indebtedness, high interest rates and the depreciation of the lira against the dollar made the burden of interest payments on foreign debt more onerous, although this was more than offset by the favourable performance of tourism. The frequent strains on the exchange market and the numerous changes made to the regulatory framework gave—rise to extensive fluctuations in short-term capital movements.

Medium and long-term capital movements occasioned a net inflow of foreign loans, amounting to about \$ 6.5 billion, as a result of which outstanding indebtedness amounted to \$ 39 billion at the end of 1982.

At the end of the year the banks' debtor position declined to \$ 10.6 billion and outstanding trade credits received from abroad exceeded those

ITALY'S EXTERNAL FINANCIAL POSITION

Table 17

(billions of dollars)

	1977	1978	1979	1980	1981	1982
LIABILITIES						
Banca d'Italia and UIC	-6.9	-3.3			1	-1.3
of which: SDR account	-0.4				-0.8	
Banks: net debtor position	-8.1				1	
Other channels: foreign loans	-14.1	-16.6	-17.6	-23.6	-33.2	-39.0
of which: granted or guaranteed by the government	-3.6	5.5	-7.7	11.2	-15.3	-17.8
Total	—29.1	—27.0	-28.2	—41.7	—48.6	—50.9
ASSETS						
Banca d'Italia and UIC (1)	9.3	12.6	19.9	24.6	21.3	15.0
Other channels: foreign loans	2.6	3.0	3.4	3.6	3.6	3.8
net trade credits	9.9	12.1	16.1	14.8	10.2	11.4
Total	21.8	27.7	39.4	43.0	35.1	30.2
Balance	—7.3	0.7	11.2	1.3	—13.5	-20.7

⁽¹⁾ Net of the gold reserves which equalled 24 billion dollars on 31.12.1982. From 1979 onwards the figures include ECUs created against transfers of gold.

granted by Italian companies by \$ 11.4 billion. If other assets and liabilities are taken into account, Italy's external financial position, net of gold reserves worth \$ 24 billion, deteriorated from a negative value of \$ 13.5

billion to one of \$ 20.7 billion. The change exceeds the deficit on current account, primarily as a result of exchange rate fluctuations (Table 17).

The management of the lira exchange rate within the EMS made use of the wider fluctuation margins available to the lira. The average depreciation of the lira for the year as a whole came to 4.7 per cent against the European Community currencies and to 15.9 per cent against the dollar; the lira's overall depreciation was 8.8 per cent.

Goods

According to the customs data for foreign trade collected by Istat, the development of trade flows in both directions slowed down. Compared with 1981 the rate of export growth fell from 29 to 15 per cent while imports rose by 12 per cent as against 21 per cent. The trade deficit contracted by a modest amount to work out at 16,966 billion lire (17,634 billion lire in 1981). Given that the oil component remained constant (-25,329 billion lire in 1982 as against -25,355 billion in 1981), the improvement is attributable to the increase in the surplus on other goods from 7,721 to 8,363 billion lire.

Average unit values of total imports and exports rose by 15.0 and 10.4 per cent respectively. In volume terms exports were substantially stable while imports increased by 1.5 per cent.

On a seasonally adjusted basis the trade deficit at current prices tended to improve in the course of the year from approximately 5,300 billion lire in the first quarter to 3,600 billion lire in the fourth quarter. The decline was due to the improvement in the terms of trade in the early part of the year and to the rise in volumes recorded in the second half.

The lack of movement in export volume (0.3 per cent up on 1981) was due chiefly to the development of world trade. Indeed, the competitiveness of Italian exports remained on average at more favourable levels than in 1981 while the capacity utilization rate registered a further decline. This was reflected in an increase in Italy's share of world trade which, at constant prices, was virtually the same as in 1979 (7 per cent). On a quarterly basis export volumes declined in the first nine months but showed signs of recovery in the fourth quarter.

The small increase in import volumes can be put down to slackening domestic activity and, as regards manufactures only, to the fact that the competitive position of domestic goods vis-à-vis imports continued at the favourable level achieved at the end of 1981. Despite the improvement in

Italy's competitive position, average import propensity (at constant prices relative to GDP) increased with respect to 1981. This appears to have been partly due to the building of stocks of imports in the early months of the year, which was probably triggered by expectations forming as to a recovery in demand and by the easing of raw material prices at source. Further stimuli possibly ensued from liquidity conditions, which were eased by the abolition of the deposit on foreign payments in February.

In the course of the year seasonally adjusted import volumes showed a tendency to slacken after growing in the early months.

The terms of trade improved by 4.2 per cent overall and by 0.8 for manufactured goods alone. From this it appears that they were mainly influenced by the development of the prices of primary commodities.

Looking at exports according to their economic purpose, above-average increases both by value and by volume were recorded by consumer goods (17.3 per cent at current prices, 3.1 per cent at constant prices) and above all by raw materials (24.7 and 13.3 per cent respectively) (Table 18). According to product group the best performances were those

Table 18
FOREIGN TRADE ACCORDING TO ECONOMIC PURPOSE

	Billions Percentage Variation 1982/			iation 1982/19	1981	
	1982	1981	1982	Value	Price	Volume
	IMPORTS					
Foodstuffs	15,767	12.1	13.6	26.2	11.9	12.8
Raw materials	8,406	7.1	7.2	14.1	13.9	0.2
Energy products	33,231	30.6	28.6	4.8	9.1	-3.9
Semi-manufactures	26,101	21.8	22.5	15.3	11.3	3.6
Consumer goods	18,041	15.3	15.5	13.8	12.4	1.2
Final capital goods	14,666	13.1	12.6	7.8	18.2	-8.8
TOTAL	116,212	100.0	100.0	12.1	10.4	1.5
	EXPORTS					
Foodstuffs	7,408	7.5	7.5	15.1	17.0	-1.6
Raw materials and energy						
products	6,632	6.2	6.7	24.7	10.1	13.3
Semi-manufactures	25,025	25.6	25.2	13.5	17.6	<i>—3.5</i>
Consumer goods	34,970	34.6	35.2	17.3	13.8	3.1
Final capital goods	25,211	26.1	25.4	12.4	13.2	-0.7
TOTAL	99,246	100.0	100.0	15.3	15.0	0.3

Source: Based on Isco data.

of the so-called traditional industries: textiles, clothing, leather and hides, metals. Sales of their products — for which demand is particularly price elastic — were probably stimulated by Italy's competitive edge.

Looking at import volumes, final capital goods and energy products declined by 8.8 and 3.9 per cent respectively. The former were affected by the decline in domestic investment, while the drop in imports of energy sources was attributable to the continuing efforts made to conserve and rationalize the use of petroleum products. Foodstuffs recorded substantially above-average increases (12.8 per cent).

Geographically, as against a very modest increase in exports to the developing countries and, in particular, declining sales in the OPEC area, Italian export penetration of the industrial countries went up. Likewise the geographical make-up of Italy's imports underwent a shift in favour of the EEC (with the sole exception of France), Switzerland and the socialist countries, while there was an appreciable decline in the share accounted for by imports from the developing countries.

Services

The transport deficit improved to a small extent to 1,360 billion lire, as against 1,440 billion lire in 1981. The higher deficit on land transport was more than offset by the improvement on shipping and air transport.

Italy's total payments for the transport of goods by sea worked out at 6,200 billion lire, 660 billion up on 1981. 460 billion of the increase was attributable to dry cargoes and 200 billion to liquid cargoes.

The overall contribution made by the Italian merchant navy and national air transport firms, inclusive of the saving in foreign exchange resulting from the transport of Italian goods and passengers by national carriers and net of outlays abroad, is put at 5,117 billion lire, which compares with 4,288 billion in 1981.

The surplus from tourism increased from 6,693 to 8,930 billion lire. Inflows of foreign exchange came to 11,280 billion lire (up 31.4 per cent on 1981) and outflows to 2,350 billion (up 24.2 per cent).

The performance of tourism in Italy was consistent with the increases recorded in prices of tourist services and in overnight stays by foreign visitors, which were up 18.6 and 11 per cent respectively.

Classified by reason for the journey, an average of around 40 per cent of outlays was accounted for by travel for business, study and health and

the remainder by tourism proper. The latter component was affected, among other things, by the foreign currency allowance for residents travelling abroad, which in real terms has remained virtually constant since 1976.

The deficit on capital income increased sharply, from 3,630 billion lire in 1981 to 5,307 billion in 1982, as a result of outflows rising significantly more than receipts (26 per cent as against 15 per cent).

The higher deficit reflected both the deterioration in Italy's external assets and the fall of the lira against the dollar. These factors were only partially offset by the fall in banks' external liabilities. Since the fall in interest rates on the international markets only occurred in the second half of the year, it did not have a significant impact.

The net yield from labour income and workers' remittances from abroad increased by 17.3 per cent to around 3,500 billion lire.

The deficit on "Other services" excluding labour income rose by a significant amount in 1982 to 1,515 billion lire. This deterioration was principally due to royalties, banking fees and trade commissions.

The deficit in respect of public transfers to international organizations, under the heading "Other items", was, at 781 billion lire, substantially the same as in 1981 (747 billion lire).

Capital movements

Capital movements gave rise to a net influx of 3,687 billion lire, as against 11,386 billion in 1981. The inflow of foreign capital was down from 17,753 to 7,483 billion lire; this was mainly due to the shift in trade credits from a net inflow of 4,072 billion lire to a net outflow of 1,720 billion and a decline in net inflows of loans from 12,144 to 8,765 billion lire. Net outflows of Italian capital declined from 6,367 to 3,796 billion lire, chiefly on account of the deficit on trade credits, which was cut from 3,450 to 1,643 billion lire. If the increased outflow recorded on bank capital movements (3,061 as against 1,525 billion lire) is taken into account, the surplus on balance-of-payments capital account comes to 626 billion lire, less than a tenth of the 1981 surplus (Table 19). This deterioration was above all the outcome of expectations of a decline in the lira, which were particularly strong in some periods of the year, whereas relative interest rate conditions remained largely favourable.

Total foreign loans declined from 12,144 to 8,765 billion lire. New loans amounted to 14,774 billion lire, virtually the same amount as in 1981

CAPITAL MOVEMENTS

 $(billions\ of\ lire)$

	Credit Debit		Balance			
	1981	1982	1981	1982	1981	1982
FOREIGN CAPITAL	35,790	32,803	18,037	25,320	17,753	7,483
Investment:						
direct	1,629	1,464	326	604	1,303	860
portfolio	2,281	1,312	2,103	1,910	178	-598
other	159	141	152	182	7	-41
Loans:						
private	9,184	9,548	2,297	4,638	6,887	4,910
of which: tied	371	<i>635</i>	190	264	181	371
granted or guaranteed by the	5.770	F 00C	-1-	1.071	F 057	0.055
government	5,772	5,226	515	1,371	5,257	3,855
Trade credits:						
medium and long-term	920	650	1,133	889	-213	-239
short-term	15,457	13,976	11,172	15,457	4,285	-1,481
Other capital	388	486	339	269	49	217
ITALIAN CAPITAL	22,255	27,398	28,622	31,194	-6,367	-3,796
Investment:						
direct	918	1,329	2,514	2,623	-1,596	-1,294
portfolio	668	1,194	1,306	1,105	-638	89
of which: unit trusts	244	445	825	525	-581	-80
other	9	14	33	13	-24	1
Loans:			ĺ			
private	587	558	1,034	763	-447	-205
of which: tied	298	460	933	605	<i>—635</i>	-145
granted or guaranteed by the	47	000	0.50	0.50	010	CE 1
government	47	202	259	853	-212	-651
Trade credits:						
medium and long-term	4,805	6,329	5,704	6,692	-899	-363
short-term	15,221	17,772	17,772	19,052	-2,551	-1,280
Other capital	-	-	_	93		-93
BALANCE					11,386	3,687
Bank capital (net of exchange rate adjustments)					—1,525	-3,061

(14,956 billion lire), while repayments climbed from 2,812 to 6,009 billion lire. Net of repayments, loans for imports shifted from a surplus of 181 billion lire to one of 371 billion.

At the end of the year total medium and long-term debt reached \$ 39 billion as against \$ 33 billion in the previous year. The repayments schedules

do not suggest that there will be any bunching of repayments in the next few years. More specifically, it is expected that there will be an outflow of \$4.8 billion in 1983, which is equal to the annual average for 1984-88 (Table 20).

Table 20

REPAYMENT SCHEDULE FOR FOREIGN LOANS AND DEBT OF MONETARY INSTITUTIONS

(billions of lire)

Outstanding of	lebt at end-year		Repayment schedule				
	1981	1982	due in	amount			
Private loans	17.9	21.2	1983	4.8			
Loans guaranteed by			1984	3.6			
Italian government	15.3	17.8	1985	5.1			
			1986	5.4			
Total loans	33.2	39.0	1987	6.6			
			1988	4.4			
Debt of official mone-			beyond	9.9			
tary institutions	1.0	0.8					
Total	34.2	39.8	Total	39.8			

Medium and long-term trade credits gave rise to an outflow of foreign capital of 239 billion lire as against 213 billion in 1981; grants of export credits produced a negative balance of 1,042 billion lire, as compared with one of 1,546 billion in the previous year. The flows recorded in the balance of payments only partly reflect the effective amount of public funds used to support Italian exports. In fact, in recent years intervention techniques have been refined and modified, as a result of which growing amounts of funds have been raised and invested in foreign markets.

Short-term trade credits received from abroad shifted from a positive balance of 4,285 billion lire to a negative one of 1,481 billion. The outflow was concentrated in the first and fourth quarters. Outflows of Italian capital went down from 2,551 to 1,280 billion lire, net outflows of 1,442 billion being recorded in the fourth quarter alone. Despite expectations of a depreciation of the lira, the decline in outflows recorded in the year as a whole was influenced by the interest rate situation and, above all, by the poor performance of exports in value terms, the rate of increase of which was virtually halved.

Net of disinvestment, direct foreign investment in Italy declined from 1,303 to 860 billion lire. The net outflow of Italian investment abroad went down from 1,596 to 1,294 billion lire.

Foreign portfolio investment in Italy — the bulk of it in Treasury securities — resulted in an outflow of 598 billion lire, as against an inflow of 178 billion in 1981. This outcome was determined solely by the decline in new purchases of securities.

In 1982 short-term capital movements through the banking sector gave rise to net outflows amounting to 3,061 billion lire. As a result of the depreciation of the lira the banks' external position improved to a lesser extent from 16,069 to 14,564 billion lire. In 1981 there had been net outflows of bank capital amounting to 1,525 billion lire, while the banks' net external indebtedness had increased by 1,319 billion.

Foreign currency financing to resident customers remained substantially stable at around 17,000 billion lire (Table 21). Despite the approximately 14 per cent growth of trade in value terms and the increased

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

(billions of lire)

Month			ency financing customers		Banks' net external	l prime	Three- month Eurodollar
Month	for exports	for imports	other	total	position		rate (1)
1981 - December	6,590	8,546	1,691	16,827	-16,069	22.2	13.3
1982 - January February March April May June July August September October November December	6,630 6,702 6,640 6,489 7,017 7,808 8,516 8,265 8,402 8,463 8,515 9,103	8,825 9,624 9,188 7,527 7,218 8,014 8,055 8,263 8,092 8,194 7,531 6,572	1,608 1,492 1,516 1,359 1,374 1,373 1,358 1,308 1,245 1,315 1,224 1,069	17,063 17,818 17,344 15,375 15,609 17,195 17,929 17,836 17,739 17,972 17,270 16,744	-16,159 -16,897 -15,895 -14,366 -14,488 -16,305 -16,597 -17,124 -16,822 -14,259 -15,143 -14,564	22.3 22.4 22.1 21.9 21.8 21.8 21.7 21.1 20.9 20.9 20.9	15.9 15.8 14.9 15.2 14.6 15.5 14.4 11.5 11.8 10.4 9.8 9.5

(1) Deposit rate; the current spread should be added in order to arrive at the rate on loans.

differential between domestic and foreign interest rates, the outcome should be linked with the stagnation of overall demand for credit in the commercial sector and with the unused borrowing margins under the ceiling on lira lending.

Table 21

Exchange rate instability during the year on the one hand led business circles to reduce their foreign currency liabilities during periods in which the lira was weakest and, on the other, led them to be more careful to diversify the foreign currency make-up of their borrowing. The upshot was a fall in bank lending in currencies showing a steady appreciation against the lira—such as the Deutsche Mark, the guilder and, to a greater degree, the dollar, whose share in the total fell from 57.9 to 41.5 per cent. In addition, there was an exceptional increase in lending in ECUs, which jumped from almost zero to 9.7 per cent of the total between December 1981 and December 1982. Accordingly the ECU assumed the role appropriate to a currency basket of mediating exchange risks and, to a growing extent, that of a means of payment.

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

At end-1982 net official reserves amounted to 51,642 billion lire, including gold reserves worth 32,449 billion lire. This translates into an overall reduction of 7,128 billion lire compared with 1981. The medium and long-term position improved by 285 billion lire, principally owing to the effect of repayments on the loan granted by the EEC in 1976 to finance the oil deficit. The decline in net official reserves during the year and the slight fall in medium and long-term liabilities determined a deterioration in the overall external position of the Banca d'Italia and the Italian Foreign Exchange Office of 6,843 billion lire (Table 22). Net of the revaluation of gold holdings and exchange rate adjustments, the overall deterioration came to 5,582 billion lire.

The development of the exchange rate

In the course of the year the trade-weighted effective exchange rate of the lira depreciated by 8.8 per cent. The fall was substantial against the dollar (15.9 per cent), less against the EMS member currencies (4.7 per cent). In 1981 the effective exchange rate had fallen by 12.9 per cent, while the depreciation against the dollar had been 24.8 per cent and that against the EMS currencies 5,7 per cent. Between December 1981 and March 1983 the depreciation of the effective exchange rate works out at 6.5 per cent overall, 15.3 per cent against the dollar.

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
	1980	1981	1982	1983 (1)
Banca d'Italia-UIC				
Gold (2)	34,170	34,791	32,449	37,882
Special drawing rights (3)	618	940	1,107	1,148
ECUs (4)	9,982	10,684	8,140	9,737
Foreign currencies	10,152	11,657	9,137	8,711
of which: US dollars	7,102	8,720	6,735	6,647
IMF reserve position	766	881	953	983
Total gross official reserves	55,688	58,953	51,786	58,461
Short-term liabilities	-272	-183	-144	-93
Total net official reserves	55,416	58,770	51,642	58,368
Medium and long-term position				
Assets				
Foreign securities in foreign currencies and in lire	1,260	1,309	1,106	1,157
Italian securities in foreign curren-	20	00	100	105
cies Consolidated accounts	83 18	98 15	102 11	105
Consolidated accounts	10	10		
Liabilities				
SDR account	-683	-981	-1,062	-1,095
EEC account	-1,060	-1,201	-632	-434
	200	700	475	– 258
Total	-382	-760	_475	-236
BALANCE	55,034	58,010	51,167	58,110
Banks				
Assets	29,197	44,809	48,049	
Liabilities	43,947	60,878	62,613	
BALANCE	—14,750	16,069	—14,564	—16,735

⁽¹⁾ Provisional data. — (2) Since December 1979 the gold reserves 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) 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 and have to be renewed every quarter 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.

This performance of the effective exchange rate, which was dominated by the upsurge of the dollar, resulted in a slight improvement in the real exchange rate, despite the inflation differential with respect to the other main countries.

The dollar strengthened on the international exchange markets for the third year running and only recorded a break in its upward path in the latter part of the year. Among the ECU basket currencies the Deutsche Mark showed a tendency to rise, unlike the French franc and, in the third quarter, the pound sterling. As a result, the lira exchange rate for these currencies developed differently.

In June the realignment within the EMS resulted in the central rate of the lira being devalued by 2.75 per cent.

PUBLIC FINANCE

Cyclical developments and structural factors tending to increase expenditure caused the budget deficit to worsen even though the measures taken during last year and the year before produced an estimated 12,000 billion lire of extra income in 1982.

The public sector deficit rose from 49,900 to 61,400 billion lire and as a ratio to GDP from 12.4 to 13.1 per cent — the highest value for thirty years. The borrowing requirement rose even more, from 53,300 to 76,350 billion lire (respectively 13.3 and 16.3 per cent of GDP) in line with the growth in the requirement of the state sector, which went up from 53,000 to 72,600 billion lire (gross of debts paid or funded). This increase reflected the larger contributions made to the endowment funds of public corporations outside the public sector and the drying-up of the inflow of funds from the bank deposits of public bodies under the measures taken in 1981 (Tables 23 and 24).

The borrowing requirement of the enlarged public sector, which includes ENEL (whose deficit was kept down by substantial government grants and higher charges), reached 79,600 billion, compared with 54,300 in 1981. The Government Forecasting and Planning Report, by contrast, had set an objective of 50,000 billion for this aggregate. The difference, which would have been even larger without the measures taken in the summer, is primarily attributable to the overestimate of receipts (especially the revenue from personal income tax and VAT) and the underestimate of outlays (mainly those on interest and transfer payments). The forecasting framework was based on reference indicators which were not always mutually consistent, those for revenue being too high and those for expenditure too low. The overshoot was also the result of the limited effect of the restrictions on government transfers to public bodies and above all of the failure to apply the ceiling on disbursements to the national social security institute (INPS).

The action to curb the deficit, planned concurrently with the presentation of the 1982 budget, was based on the one hand on limiting allocations to decentralized spending bodies so as to induce them either to reduce their outlays or to increase their receipts, and on the other on raising taxes and bringing forward their payment. The squeeze on the transfers to these bodies (local government, social security, health care) only had a small effect, however, since the measures regarding budget appropriations could

PUBLIC SECTOR: CASH OPERATIONS (1)

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

	1980	1981	1982	% increase 1980/1981	% increase 1981/1982
Revenues					
Fiscal revenues	115,928	142,840	178,472	23.2	24.9
of which: direct taxation (2)	38,045 43,755 34,128	51,299 39,025 52,516	66,566 47,909 63,997	34.8 -10.8 53.9	29.8 22.8 21.9
Sales of goods and services	6,452 4,012 3,285	7,980 5,471 3,892	10,033 5,263 4,059	23.7 36.4 18.5	25.7 -3.8 4.3
Total, current account	129,677	160,183	197,827	23.5	23.5
Capital account revenues (4)	553	665	837	20.3	25.9
Total	130,230	160,848	198,664	23.5	23.5
as % of GDP	38.4	40.1	42.3		
Disbursements					
Staff wages and pensions. Purchases of goods and services. Interest payments. Transfers (3). of which: subsidies to industry. social services	47,698 17,797 21,513 55,842 5,019 48,281	63,730 22,797 29,436 72,701 5,353 64,598	75,291 28,066 40,190 88,749 7,331 77,749	33.6 28.1 36.8 30.2 6.7 33.8	18.1 23.1 36.5 22.1 <i>37.0</i> 20.4
Total, current account	142,850	188,664	232,296	32.1	23.1
Capital account expenditure of which: direct investment transfers (5) Total as % of GDP	17,714 13,094 2,973 160,564 47.4	22,092 17,293 3,871 210,756 52.5	27,779 21,914 4,678 260,075 55.4	24.7 32.1 30.2 31.3	25.7 26.7 20.8 23.4
Deficit on current account	13,173	28,481	34,469		
as % of GDP	3.9	7.1	7.3		
Total deficit (5) (6)	30,334 9.0	49,908 12.4	61,411 13.1		

⁽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.

not produce significant results during the year because there was scope both for utilizing unspent allocations and for borrowing from the Treasury and banks. Furthermore, the financing of INPS exceeded the limit by an estimated 6,500 billion lire as a result of the failure to adopt the necessary measures. The late approval of the budget and finance bills, the dropping of

FINANCING OF THE PUBLIC SECTOR BORROWING REQUIREMENT

(on a cash basis; billions of lire)

				1982		
	1981	Year		Quar	ters	
		Tear	I	II	III	IV
			-			
Medium and long-term securities, excluding BI portfolio	5,823	23,678	3,488	-1,300	11,562	9,928
Treasury bills, excluding BI portfolio	28,627	28,837	7,765	14,583	11,787	-5,298
P.O. funds	2,458	3,619	-56	-355	-217	4,247
Lending of credit institutions (1)	131	3,889	-116	508	673	2,824
to: local authorities	1,578	3,101	- 9	534	385	2,191
social security institutions	-1,254	.242	-30	77	57	138
autonomous agencies	-79	-6	68	-27	43	-90
hospitals	-60	-134	-132	<i>—53</i>	14	37
other central government bodies	-87	687	-12	-24	189	534
municipal companies	33	1	-1	1	-15	14
Other borrowings (2)	79	184	25	41	57	61
Total	37,118	60,207	11,106	13,477	23,862	11,762
Borrowing from BI-UIC	13,692	12,593	2,229	971	-326	9,719
Borrowing abroad	2,515	3,554	610	639	775	1,530
TOTAL BORROWING REQUIREMENT	53,325	76,354	13,945	15,087	24,311	23,011
(as % of GDP)	13,3	16,3				
of which: domestic - short-term	44,764	46,073	9,592	15,383	11,155	9,943
medium and long-term	6,046	26,727	3,743	935	12,381	11,538
FINANCING OF ENEL	969	3,273	1,038	1,456	1,322	—543
of which: domestic - short-term (3)	<i>758</i>	2,043	818	1,035	515	-325
medium and long-term (4)	—194	-152	68	<i>—138</i>	252	-334
foreign	1,921	1,382	152	559	555	116
BORROWING REQUIREMENT OF THE ENLARGED PUBLIC SECTOR	54,294	79,627	14,983	16,543	25,633	22,468
(as % of GDP)	13.5	16.9				

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

several measures subsequently resubmitted in a separate bill in August, and the abandonment of others, such as higher health service charges, helped to weaken the effect of the Government's package. To cope with the growth in the public sector's financial requirements, the policy of increasing revenues that had been initiated at the close of 1981 was revived in April and May and intensified during the summer.

As mentioned, built-in stabilizer mechanisms also increased the deficit by causing a larger slowdown in receipts than in outlays.

The rise in expenditures was matched by an equally large one in revenues. The ratio of fiscal revenues (including social security contributions and the quota pertaining to the EEC) to GDP increased from 36.3 to 38.7 per cent — one of the largest rises since the war. This result was due in part to the revenues produced by the tax amnesty decided in the summer, which amounted to around 3,000 billion lire in 1982 alone. Despite the steps taken to reduce fiscal drag, the income elasticity of direct taxes continued greater than one and their yield rose by 30 per cent. Indirect tax revenues were those most affected by the increases made in rates and rose by 23 per cent. The rise in social security contributions (22 per cent) was larger than that in the base, again as a result of increases in the payments of employers, employees and self-employed workers. The sales of goods and services were boosted by the higher charges introduced by the Post Office, the State Railways and the State Monopolies.

Total public sector expenditure increased in relation to GDP from 52.5 to 55.4 per cent — the highest value for the last thirty years. Though substantial, the growth in expenditure (23 per cent) was nonetheless smaller than in 1981 (31 per cent), when the expansionary measures of the previous year made a considerable impact.

There was a particularly sharp upturn in the interest burden (primarily as a result of the swelling of the public debt), in investment expenditure (especially that of municipalities, provinces and the State Railways and for the reconstruction of the earthquake-stricken areas), and in subsidies to firms. Even though they were affected by the renewal of the wage agreement of the State Railways, wages and salaries rose only slightly more than prices.

The structural factors driving up health care and social security expenditure continued to operate, reinforced by the effects of a number of discretionary measures (such as the shortening of the interval between the automatic revaluations of pensions and the renewal of the agreements with doctors).

The public sector's net transfers to households remained virtually unchanged in real terms compared with the previous year. This was due to the increase in fiscal revenues mentioned earlier. Notwithstanding the increase in real interest rates, which sustained households' propensity to invest in financial assets, interest payments continued to serve in large part to restore the real value of the public debt and probably had very small multiplier effects. Nor is the rise in spending on goods and services, and especially in that for investment, necessarily indicative of real impulses being imparted during the year since, owing to administrative delays, it is the result of operations completed in earlier periods. Some stimulus was probably provided in 1982 by the investment of local authorities and the State Railways. In total, therefore, the public sector can be considered as having had only a small effect on the level of economic activity. On the other hand the increases in indirect taxes, social security contributions and public service charges fuelled inflation.

The large borrowing requirement created difficulties for the management of the public debt and monetary policy, especially in the last quarter, when the Treasury current account with the Banca d'Italia was overdrawn at the end of every month well beyond the limit of 14 per cent of total budget appropriations. The fact that the Treasury would not have been in a position to respect the limit at the end of January this year and the need to prevent the Banca d'Italia from being legally obliged to suspend payments on behalf of the government led Parliament to provide, in Law No. 10 of 24 January 1983, a special advance from the central bank to the Treasury of 8,000 billion lire for a maximum of 12 months.

The borrowing requirement in 1982 was mainly covered through net issues of medium and long-term securities (23,680 billion lire as against 5,820 billion in 1981) and Treasury bills (28,840 billion lire as against 28,630 billion). Borrowing from the central bank amounted to 12,590 billion lire, of which more than three quarters came in the final quarter, when the market was under considerable strain.

At the long end of the market the slight recovery in issues recorded in 1981 was strengthened by expectations of a reduction in inflation and hence in interest rates and by the widening of the interest rate differential vis-à-vis short-term assets.

Treasury bill purchases by banks ran at a very high level in the second and third quarters; on the other hand the portfolio of non-bank investors grew less than in 1981 owing to the large volume of disinvestment (10,210 billion lire) in the last quarter. This was due to the differential vis-à-vis medium and long-term rates growing larger while that vis-à-vis bank deposit rates narrowed and, above all, to the spread of fears that a tax would be imposed on the interest on government securities.

Borrowing abroad increased by 3,550 billion lire, compared with 2,520 billion in 1981. This was attributable in large part to the loans raised by the State Railways.

THE MONEY AND FINANCIAL MARKETS

The performance of the money and financial markets was influenced chiefly by the problems deriving from the expansion in the public sector borrowing requirement, which rose to 16.3 per cent of gross domestic product, as described in earlier chapters. In view of the persistence of high rates of inflation and the balance-of-payments constraint, which was reinforced by the absence of a recovery in world trade, monetary policy had to remain restrictive in order to resist the pressures generated by the expansion in the public sector deficit. Monetary policy was also affected by the very existence of a massive volume of short-term public sector debt. The restrictive effect was produced mainly by limiting credit to the corporate sector and encouraging saving by households.

The regulation of monetary base and the administrative controls held the expansion in domestic credit to the private sector within the planned limits; the real cost of borrowing rose above the already high levels recorded in 1981. The proportion of domestic credit absorbed by the productive sector declined further to 32 per cent.

Total domestic credit and the stock of financial assets grew at a faster rate than GDP owing to the burgeoning public sector deficit; the central bank attempted to curb the expansion in the more liquid components of financial assets by fostering the demand for securities. Nominal interest rates on government securities fell, but real yields exceeded the average for the previous year and made it possible to raise households' propensity to save. In 1982 the ratio of the financial assets of households and the corporate sector to income was about 2 points higher than in the preceding year.

The increased public sector borrowing requirement was covered by placing a larger volume of securities in the market (52,500 billion lire, compared with 34,450 billion in 1981). In the course of the year, however, the rapid disintermediation of the banking system came to an end and there was a significant acceleration in the growth of the monetary aggregates; the expansion in the portion of the borrowing requirement financed through the issue of securities, which rose to 69 per cent, was thus the result of the substantial increase in purchases of Treasury bills and Treasury credit certificates by the banks.

At the beginning of 1982 the low level of the Treasury borrowing requirement and the very small size of the expansion in the monetary aggregates had made it possible to initiate a gradual reduction in interest rates in line with the slowdown in inflation. At the end of the first quarter

exchange market tensions, a deterioration in the external accounts associated with the abolition of the non-interest-bearing deposit on payments abroad as well as signs of a strong expansion in the budget deficit compelled the central bank to tighten its control over bank reserves by engineering an increase in interest rates on short-term operations, which was then transmitted to Treasury bills at issue. By mid-year the foreign exchange market had returned to normal and fiscal measures had been taken to reduce the budget deficit, so that the policy of gradually lowering interest rates could be resumed. The yield curve took on a pronounced positive slope as far as medium-term maturities; the one-point cut in the discount rate in August validated the downward trend in Treasury bill rates. In the autumn the higher-than-forecast public sector borrowing requirement and the reappearance of price and exchange rate pressures made it necessary to sacrifice part of the decline in Treasury bill rates; leaving aside short-term fluctuations, they declined by about 2 percentage points during the year.

There was a considerable time-lag before the reduction in Treasury bill rates influenced bank deposit rates, which began to fall only after the cut in the discount rate in August; it was not until February 1983 that they moved below the levels recorded in the final quarter of 1981.

The narrowing of the difference between interest rates on Treasury bills and those on bank deposits reduced the demand for Treasury securities on the part of companies and households; given the large public sector borrowing requirement, the rate of growth in the M₂ money supply rose to 17.2 per cent at the end of 1982 and thus again resembled that in total financial assets after two years of rapid disintermediation of the banking system. The fall in demand for Treasury securities was reinforced in the final quarter of the year by alarmist reports about the compulsory consolidation of public debt. During this phase, when positive real yields were available on Treasury bills and the cost of credit was high, the central bank did not resist the shift in the public's preferences towards bank deposits induced by disturbances in the financial markets in order to avoid aggravating the recession and to encourage the return of orderly market conditions. As a result, there was a substantial increase in the banks' reserves towards the end of the year, accompanied by heavier investment in government securities by the banks. By the end of December, however, bank liquidity had already become extremely tight again: over the year the growth in bank reserves — adjusted for the change in the average compulsory reserves ratio — was held down to 13 per cent, whereas deposits expanded by 18 per cent.

The public sector borrowing requirement and the current account balance-of-payments deficit were sufficiently large to influence the

composition of monetary base creation. Liquidity stemming from repayment of the non-interest-bearing deposit on foreign payments was augmented by the monetary financing of the Treasury, which expanded by 19.6 per cent, a larger increase than had been expected; one-third of the monetary base created via domestic channels was neutralized via the external sector. The larger-than-expected creation of monetary base to finance public sector borrowing did not come about as a result of purchases of government securities by the Banca d'Italia, which were kept broadly consistent with the targets for inflation and the balance of payments; it came about because the Treasury exceeded the legal overdraft limit on its current account with the central bank. The conflict between the need to cover the public sector borrowing requirement and monetary policy objectives arose at the end of 1982 and was finally resolved in early 1983, when Parliament decided to grant an extraordinary advance of 8,000 billion lire. The duration of the operation was limited to one year in order to prevent a permanent increase in the monetary financing of the Treasury.

The change in the composition of financial assets in favour of bank deposits was caused primarily by a reduction in the demand for Treasury bills, so that it was confined within the wider M_3 definition of liquidity, the growth rate of which slowed down slightly.

The disturbances that occurred in the financial markets in the latter part of 1982 highlighted the risks of market instability caused by the existence of a massive volume of short and very short-term securities. The monetary authorities took steps to lengthen the maturity of new issues of Treasury securities: the higher yield offered on Treasury credit certificates than on Treasury bills made them easier to place with the public, which purchased twice as much as in the previous year and thus, partly offset the decline in subscriptions of short-term paper. The share of financial assets invested in medium-term Treasury securities rose from 6 to almost 10 per cent. This heightened preference among investors for Treasury credit certificates helped raise the proportion of the borrowing requirement financed in securities at terms longer than those on Treasury bills from 11 to 31 per cent. The expansion in the proportion of medium-term securities held by the public was even larger if one also includes purchases of bonds and certificates (many of them at floating rates) that were issued by the special credit institutions to take advantage of tax exemption on the interest payments.

Net of the repayment of loans used to finance the non-interest-bearing deposit on foreign payments, the growth in domestic credit to the non-state sector came to 32,500 billion lire or 14.1 per cent, a slightly larger increase than that recorded in 1981. However, the rate of growth in overall domestic and foreign lending to households and the corporate sector

fell from 18.2 to 14.9 per cent (net of shares). The increase in bank lending was similar to that of the preceding year, although there was a slowdown in credit-granting by special credit institutions; corporate issues of bonds increased, mainly as a result of the temporary exemption from taxation.

Credit demand was still strong in the early months of 1982, partly owing to the rebuilding of stocks, but it gradually slackened in the second half of the year as a result of the fall in production; companies' liquidity improved in the course of the year. From June onwards lending in lire expanded considerably, although it remained within the limits. The trend in credit-granting by special credit institutions was the inverse of that in bank lending: its rate of growth slowed down as the lending ceiling became less restrictive. The fall in investment and the central bank's action to curb short-term lending by these intermediaries were also factors in this development.

The decline in bank lending rates was a delayed reaction to conditions in the credit market and to the fall in inflation; the time-lag was due partly to the divergent movement in deposit rates. The real rate of interest on bank credit was considerably higher than the average for the preceding year; it rose by more than 4 percentage points in relation to wholesale prices in the first half of the year and remained at this high level in the second half. The high cost of borrowing contributed to the weakening of demand by compounding the effects of the decline in production caused by the stagnation of world demand, the decline in investment owing to the increase in idle capacity and uncertainty about the prospects for recovery.

In the last two years new trends have emerged in the evolution of the financial markets and in the system of monetary controls. The markets have developed new instruments and have become more efficient; the central bank has refined its methods of market intervention, the non-automatic nature of its financing of the Treasury has been endorsed at the institutional level and it has become clearer that administrative credit controls gradually lose their effectiveness with the passage of time and impede the growth of the markets.

The measures taken at the end of December accord with the longer-term trend towards applying monetary policy chiefly through the control of monetary base creation and its absorption through compulsory reserves. The increase in the marginal reserve ratio is designed to slow down the growth in bank deposits from the rate recorded in the last part of 1982 and to increase market stability at times of rapid expansion in the state borrowing requirement, which can cause wide fluctuations in monetary base in the very short term. The extension of the reserve requirement to repurchase agreements between banks and their customers and to all other forms of fund-raising has reinforced the control of credit via the monetary

base. Furthermore, these changes in the rate and coverage of the reserve requirements form part of a gradual changeover to a stock-based compulsory reserve which will make it possible to eliminate disparities in the incidence of the reserve on the different categories of banks.

The ceiling on bank lending was not in fact a constraint for many banks in the second half of 1982, but it was renewed for a period of six months in view of the delicate situation that still obtained owing to the seasonal deterioration in the balance of payments. At the same time the securities investment requirement was further eased by reducing the rate to 5.5 per cent of the growth in deposits and limiting compulsory reinvestments to 50 per cent of eligible securities reaching maturity.

The yield on the compulsory reserves in respect of negotiable fixed-term certificates of deposit was raised to 9.5 per cent as a first step towards encouraging the banks to obtain funds by issuing instruments of this kind. A stronger differentiation between deposits that serve as means of payment and those that represent more authentic saving might lead to greater transparency and efficiency in fund-raising by the banks and foster a closer link between rates on bank loans and those ruling in the money market.

The easing of the constraints on the banks' assets and the diversification of yields on compulsory reserves are aimed at increasing the operational flexibility of the banks; in particular, the banks have been given an incentive to pay closer heed to conditions in the money and credit markets and to the structure of their balance sheets when setting borrowing and lending rates.

The prospects for 1983

In the first quarter of this year the state borrowing requirement was only slightly higher than it had been in the same period of 1982. The demand for government securities from the corporate and household sectors increased considerably; conditions on the Treasury bill market reverted to normal and the public's preference for medium-term Treasury securities grew stronger, encouraged by yield differentials and expectations of a decline in interest rates. During this period the volume of medium-term paper placed on the market was only slightly less than the state borrowing requirement, but there was a net reduction in outstanding Treasury bills, mainly owing to the shortage of liquidity at the banks.

The strengthening of the demand for securities and the trend in the borrowing requirement enabled the authorities to halt the acceleration in

the monetary aggregates and to bring their rate of growth gradually into line with the objectives of restoring domestic equilibrium and curbing inflation; a gradual decline in interest rates became possible despite the strict control exercised over bank reserves. Liquidity became particularly tight in the weeks before the realignment of the central rates of currencies belonging to the European Monetary System, which took place in the last ten days of March. Expectations of a realignment had caused a temporary outflow of capital, which was checked by a swift adjustment of the spot exchange rate and the temporary hardening of very short-term interest rates. Once this phase had been overcome the banking system's liquidity returned to normal, partly owing to the influx of foreign exchange from abroad, so that the gradual fall in bank interest rates and in those on the money and financial markets could resume. In April it became possible to reduce the discount rate by one point to 17 per cent. In the first five months of the year the rates of interest on three-month and six-month Treasury bills went down by 2 and 1, points respectively; bank interest rates also declined considerably, with prime rate falling in a number of steps from 20.75 to 18.75 per cent.

The guidelines on financial flows for 1983 laid down at the beginning of the year by the Interministerial Committee for Economic Planning placed a limit of 71,000 billion lire on the state borrowing requirement (67,000 billion lire net of funds transferred to financial intermediaries and accruing from borrowing abroad) and indicated that 38,000 billion lire was available in finance for the productive sector; provision was made for holding the growth in the economy's financial assets below 20 per cent. The failure to introduce parts of the planned budgetary package and the implementation of legislation that increases the deficit will tend to push the borrowing requirement beyond the target during the second half of the year. The state borrowing requirement will again exert strong pressure on the financial markets and could induce an increase of 5 percentage points in the ratio between the financial assets of the economy and income this year. The absorption of such a large volume of financial assets will prevent nominal interest rates from anticipating a fall in inflation; the economy's liquid assets should grow less rapidly than total financial assets.

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

The central bank's intervention was designed to regulate the creation of monetary base in line with forecast financial flows and with their development as a result of the growing divergence of the public sector borrowing requirement from target.

The slowdown in inflation meant that short-term interest rates could be gradually brought down in the early months of the year without this resulting in faster growth of the monetary aggregates. After a spell of strong speculative pressure on the lira — which was countered by stepping up control of bank reserves — the fall in rates on the international markets made it possible for interest rate reductions to resume in June. Following the introduction of fiscal measures designed to check the growth of the public sector deficit, the discount rate was cut from 19 to 18 per cent, confirming the trend.

In the subsequent months the fiscal measures proved to be insufficient to bring the borrowing requirement within the new, higher target values. Inflation rose again. Yields on Treasury bills were not raised promptly enough to enable a sufficient amount to be placed on the market. The difficulties were compounded by rumours about consolidation and taxation of short-term public debt; on top of this precarious situation, a fresh bout of exchange rate pressures set in.

A conflict arose between the control of the money supply and financing the growing borrowing requirement. The failure to place sufficient Treasury bills on the market resulted in the legal limit on the Treasury's current account overdraft being exceeded, first in September and then, by substantial amounts, in the following three months. The danger of a crisis on the financial markets was forestalled by allowing the monetary base to accelerate temporarily; this was reflected in the end-year figures and resulted in the growth of the monetary aggregates in 1982 exceeding the targets that had been set in conformity with the Government's economic policy objectives. The growth in bank deposits started to decelerate in the early months of 1983, while the overdraft on the Treasury's current account — amounting to 2,290 billion lire at end-December — was brought back within the legal limit in January 1983, thanks only to an extraordinary advance made by the Bank to the Treasury with the approval of Parliament.

The Bank could have avoided this outcome by buying a sufficient amount of the securities remaining unsold on the market. But this would have been tantamount — also from a formal point of view — to its supporting developments which would have been at odds with the control of the monetary and credit aggregates and with the need to overcome inflation. The increase in the Bank's holding of securities — albeit substantial in the final quarter — was geared to the attainment of these basic objectives.

The monetary base and bank reserves increased by 10,378 and 6,850 billion lire respectively (as against 8,557 and 4,127 billion lire in 1981); corrected for changes in the compulsory reserve ratio, the corresponding growth rates came to 12.6 and 13.1 per cent (as against 11.6 and 7.8 per cent in 1981; Tables 25 and 26). The greatest increase was recorded in the months running up to the end of the year; the rates of increase for the two aggregates for the twelve months ending in November were 16.1 and 17.3 per cent respectively.

Table 25
MONETARY AGGREGATES AND INTEREST RATES (*)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
				PERCEI	NTAGE	INCREA	ASES (1)		
Monetary base (2)	19.0	15.3	18.6	17.3	19.1	24.5	13.8	13.9	13.1	14.1
Monetary base, adjusted (2) (3)	18.4	15.9	21.3	11.5	18.6	23.7	13.7	13.1	11.6	12.6
Bank reserves	18.2	17.9	20.3	20.2	23.5	28.7	13.7	12.1	10.4	15.6
Bank reserves, adjusted (3)	17.3	18.8	24.9	10.1	22.7	27.2	(4)13.6	(4)10.8	7.8	13.1
Bank deposits	20.1	16.8	25.0	22.0	23.2	23.1	20.1	13.2	9.2	18.2
	INTEREST RATES (5)									
Interbank sight deposits (6)	6.93	14.57	10.64	15.68	14.04	11.49	11.86	17.17	19.60	20.18
Treasury bills (7)		14.12	11.01	16.63	15.19	11.99	12.51	15.92	19.70	19.44
Bank loans	8.31	14.22	15.08	17.33	18.58	16.00	15.43	19.41	21.83	21.65
Industrial bonds	7.48	10.20	10.82	13.39	14.56	13.34	13.58	15.39	19.68	20.28

^(*) The definition of monetary base has been amended so as to exclude the social security institutions' deposits with the Treasury.

(1) From end-of-period values. — (2) Excluding Post Office deposits. — (3) Adjusted for changes in the ratio of the compulsory reser-

When comparing the 1982 increase with the previous year's it should be borne in mind that the moderate growth recorded by the monetary aggregates in 1981 was partly due to the return to the Treasury of a considerable amount of the deposits held by the public sector, as a result of legislation.

The constraints to which the Bank's action was subject are clearly shown by the movements in the relative importance of the channels of liquidity creation. Sales of securities on the market — already running at a high level in order to cope with the increased borrowing requirement —

⁽¹⁾ From end-of-period values. — (2) Excluding Post Office deposits. — (3) Adjusted for changes in the ratio of the compulsory reserver requirement and for the non-interest-bearing deposit against lending in excess of the ceiling. — (4) When corrected for the random movements at the end of 1979, the increases become respectively 10% and 15% for 1979 and 1980. — (5) Average values for the period. — (6) Average of the interest rates reported by six large banks. — (7) Weighted average of rates at auction.

MONETARY BASE (*)

(changes in billions of lire)

		(changes in o	illions of life)	·						
					1982					
	704.9 24.8 —5,646.7 —6,257.8 —7,525.0 —3,061.0 —7,525.0 —3,061.0 —7,525.0 —3,061.0 —7,525.0 —3,061.0 —7,525.0 —3,061.0 —7,525.0 —7,525.0 —3,061.0 —7,525.0 —7		Quan	ters						
			Tear	1	II	III	IV			
					ļ					
			S	OURCES						
Foreign sector (1)	704.9	24.8	-5,646.7	-4,630.2	693.1	2,148.8	-3,858.4			
balance of payments net foreign position of banks				$ \begin{array}{c c} -3,508.0 \\ -1,073.0 \end{array} $	688.0 5.0	1,789.0 368.0	-1,490.0 $-2,361.0$			
Treasury (2)	10,086.5	13,637.5	12,713.0	2,221.4	1,010.3	-323.1	9,804.4			
total borrowing requirement	37,010.3	52,953.7	72,611.1	13,957.9	14,865.7	24,100.0	19,687.5			
financing from banks and the public (3)	-26,923.8	-39,316.2	-59,898.1	-11,736.5	-13,855.4	-24,423.1	-9,883.1			
Refinancing	—2,810.2	554.7	641.4	433.4	—406.7	697.1	—82.4			
Other sectors	-24.9	-5,659.8	2,670.2	1,518.6	1,233.8	—781.8	699.6			
of which: tied foreign currency deposits (4)	32.2	_	118.1	6.9	8.3	52.0	50.9			
non-interest-bearing de- posit on payments abroad	_	-3,822.2	3,822.2	2,642.6	1,179.5	0.1	_			
TOTAL	7,956.3	8,557.2	10,377.9	—456.8	2,530.5	1,741.0	6,563.2			
Total, including Post Office deposits	10,064.2	11,096.9	13,979.9	-496.6	2,157.7	1,566.4	10,752.4			
				USES						
The Public	3,670.0	4,429.9	3,527.9	—1,991.9	964.2	553.7	4,001.9			
Banks	4,286.3	4,127.3	6,850.0	1,535.1	1,566.3	1,187.3	2,561.3			
compulsory reserves	3,046.4	2,946.4	8,544.4	4,374.5	-598.3	1,877.1	2,891.1			
non-interest-bearing deposit against excess lending	626.3	821.4	-518.5	-390.6	1,012.9	-818.2	-322.6			
excess reserves	613.6	359.5	-1,175.9	-2,448.8	1,151.7	128.4	-7.2			
		COI	MPONENTS O	F TOTAL MON	ETARY BASE					
Domestic component (5) Foreign component (6)	7,219.2 737.1	8,532.4 24.8	15,906.5 5,528.6	4,166.5 -4,623.3	1,829.1 701,4	-459.8 2,200.8	10,370.7 —3,807.5			
	<u> </u>									
		FAC	CTORS OF CH.	ANGE IN BAN	K HESERVES					
Autonomous (7)	33,183.4 —28,897.1	46,285.6 42,158.3	60,009.8 53,159.8	11,471.7 —9,936.6	14,108.1 —12,541.8	25,961.2 —24,773.9	8,468.8 -5,907.5			
TOTAL BANK RESERVES	4,286.3	4,127.3	6,850.0	1,535.1	1,566.3	1,187.3	2,561.3			

^(*) The definition of monetary base has been amended so as to exclude the social security institutions' deposits with the Treasury.

⁽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-UIC and to the inclusion of the convertible currencies of banks. — (2) Net of P.O. deposits by the public. — (3) P.O. deposits, foreign debt, deposits by the social security institutions and net purchases of Treasury securities by the public and banks, at issue and on the open market. — (4) Connected with compensatory loans. — (5) Treasury, refinancing and other sectors (net of tied deposits connected with compensatory loans. — (7) Balance of payments, net of compensatory loans, banks' net foreign position and the Treasury borrowing requirement, not covered by P.O. deposits or by deposits by social security institutions, 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.

also had to absorb the expansionary impact of the repayment of the deposit on foreign currency purchases, the introduction of which had destroyed 3,822 billion lire of monetary base in the previous year. The external sector, the effect of which had been nil in 1981, destroyed monetary base worth 5,647 billion lire. Only the — albeit modest — share of refinancing in total liquidity creation, which was up by 641 billion lire (555 billion lire in 1981), remained virtually unchanged.

In order to rein in the growth of deposits and in anticipation of a possible greater use of market instruments in the implementation of monetary policy, the Interministerial Committee for Credit and Savings approved substantial changes to the compulsory reserve regime at its meeting on 23 December. The new rules, which set out to increase the measure of control exercised by the authorities, came into force at the end of January 1983. The marginal reserve requirement was increased from 20 to 25 per cent so as to limit the impact on the credit market of unforeseeable fluctuations in monetary base, such as those which occasionally stem from the budget deficit. Funds obtained from customers through repurchase agreements were also made subject to the compulsory reserve system so as to regulate this form of fund-raising, which had come to acquire considerable importance.

In the medium term, transition to a stock-based, rather than a flow-based, system of reserve requirements will enable adjustments of the ratio to have an unequivocal steering effect also in the short term as well as eliminate the disparities still subsisting between the various categories of credit institution.

The underlying reason for this innovation is that in recent years bank deposits have often recorded substantial seasonal declines: to increase the flow-based ratio in such periods would have the effect of liberating a greater amount of reserves and so would have the opposite short-term effect to that which was intended. It was to prevent this effect and to avoid delay in the introduction of the stock-based ratio that the decision was also taken to leave the ratio referred to declines in the total deposit base unchanged at 20 per cent.

Developments over the year.

The fall in the inflation rate and the temporary slowing-down of the rate of growth of the public sector deficit enabled short-term rates to be brought down at the beginning of the year. Both the base rates for three

and six-month Treasury bills and yields on the Banca d Italia's repurchase agreements were cut. Consequently, the yield curve gradually lost the negative slope that it had taken on at the end of 1981.

At the end of March the rates on repurchase agreements were rapidly raised as a result of strong pressures on the lira. In addition, foreign exchange restrictions were brought in and the penalties for exceeding the ceiling on bank lending in lire were stepped up. The delay in adjusting base rates caused the demand for Treasury bills at the tender to drop. At the end of April the Treasury's current account exceeded the limit, albeit only to a minor extent.

The pressure on the exchange rate fell off in May, which enabled the downward movement of short-term rates to resume, and at the end of June the yield curve took on a markedly positive slope. The yield on twelve-month Treasury bills was also reduced, albeit only slightly, and bank liquidity returned to higher average levels. In the first half of the year two-thirds of the total monetary base created via domestic channels was destroyed via the external sector. For the twelve months ending in June the increase in adjusted monetary base worked out at 11.7 per cent, which was in line with the rise recorded in the previous year.

In July and August the fiscal measures, the gradual fall in interest rates abroad, the cuts in the base rates for Treasury bills and the lowering of the discount rate led to growing market expectations of further interest rate reductions, which rapidly boosted demand for Treasury credit certificates.

At the end of August the Banca d'Italia had to step up sales of securities on the market in order to neutralize the influx of foreign currency from abroad and the seasonal fall in the amount of currency in circulation. The shift in market preference towards Treasury credit certificates was initially satisfied by substantial sales from the Bank's portfolio and subsequently by a particularly large issue, which was taken up almost entirely by the market in early September.

The decree concerning the issue of Treasury bills at the end-September tender was rejected by the Court of Auditors and had to be reformulated so as to reduce the volume of three-month bills on offer. The upshot was a significant discrepancy between the make-up of supply and demand, with demand for six-month bills remaining partly unmet. The purchase by the Bank of all the twelve-month bills remaining unplaced on the market did not prevent Treasury borrowing from overshooting the legal limit — if only slightly — on the last day of the month.

In October and November expectations as to a rise in the dollar and of a realignment within the European Monetary System triggered fresh pressures on the lira, and the rate on repurchase agreements was gradually raised. The public sector deficit was not reduced in line with the forecasts made on the enactment of the fiscal measures, and sales of Treasury credit certificates, though substantial, were insufficient to offset the decline in purchases of Treasury bills. The base rates for the shorter maturities were not revised upwards until between the end of October and mid-November; despite this move, the amount of Treasury bills held by firms and the public still diminished by 4,924 billion lire in October and November.

In this period the Bank took up all the Treasury credit certificates and some of the Treasury bills remaining unplaced on the market, and from mid-October until the closure of the tender at the end of November virtually suspended outright sales on the open market. Despite this, the overdraft on the Treasury's current account grew apace to exceed the legal limit by around 6,000 and 5,000 billion lire at end-October and end-November respectively. The latter figure represents three-quarters of the increase in the monetary base recorded in the first eleven months of the year.

At the beginning of December the outflow of foreign exchange reserves came to a halt — thanks in part to higher interest rates. Revenue from the sale of Treasury credit certificates and from self-assessed taxation enabled the Treasury to bring its overdraft back within the limit for a time, although it overshot again at the end of the year. The Bank supported the seasonal increase in demand for monetary base by stepping up its purchases on the new-issues market.

In January 1983 the excessive overdraft on the Treasury's current account began to increase again. An inflow of receipts sufficient to eliminate the excessive overdraft with due speed was not expected, and so Parliament approved the grant to the Treasury of an extraordinary advance amounting to 8,000 billion lire for a maximum term of one year, thus avoiding the suspension of payments.

The deposit of compulsory reserves in January 1983 resulted in the absorption of an extremely large amount of monetary base, causing the central bank to intervene with substantial refinancing operations, which were gradually repaid over the following two months. In the first quarter the borrowing requirement was fairly moderate (13,900 billion lire) and sales of Treasury credit certificates continued to be successful, which helped maintain bank liquidity at fairly low levels. Despite a cut of one point in the base rate for three-month Treasury bills between the end of February and the end of March, the rate of growth of the monetary aggregates began to fall off.

After a fresh exchange rate crisis affecting all the EMS currencies had been overcome by means of a general realignment of central rates, the discount rate was lowered by a further one point on 11 April. In the course of the month the base rates for Treasury bills were lowered by the full one percentage point in the case of three-month bills and by smaller amounts in the case of bills with longer maturities.

The creation of monetary base

External operations, which in 1981 had given rise to a modest inflow of liquidity (25 billion lire), absorbed monetary base worth 5,647 billion lire as a result of the balance-of-payments deficit of 2,521 billion lire and the 3,061 billion lire fall in the banks' net foreign position (which had already dropped by 1,525 billion lire in 1981).

The Treasury's monetary base financing, excluding Post Office deposits, amounted to 12,713 billion lire (925 billion lire down on the previous year) compared with a borrowing requirement of 72,611 billion lire (52,954 billion lire in 1981).

The importance of refinancing as an instrument for regulating liquidity remained modest for most of 1982. There was an increase in the last few months of the year when the operation of the multi-branch banks' centralized accounts was paralyzed by strikes in the banking sector, which hampered banks' liquidity management.

On the other hand, there was an increase in the importance of refinancing as an instrument for supporting individual financial intermediaries faced with exceptional liquidity problems. With a view to endowing this support with more permanent characteristics than those attaching to the grant of fixed-term advances, the credit lines granted for ordinary advances were increased by around 670 billion lire in 1982.

"Other sectors", which had destroyed 5,660 billion lire of liquidity in 1981, created 2,670 billion lire of monetary base in 1982. The abolition of the deposit on purchases of foreign currency at the beginning of February created 2,643 and 1,180 billion lire of liquidity respectively in the first and second quarters of the year.

Uses of monetary base

Currency in circulation increased by 3,563 billion lire in 1982 (against 4,383 billion lire in 1981). On the basis of end-period data the rise was 12 per cent, more than five points less than the corresponding figure for 1981.

However, taking the average of daily data the decline in the growth rate was smaller — 15.8 per cent as against 18.6 per cent in 1981. Yet whichever measure is used the rate of increase was still below the growth of GDP and private consumption, which each rose by 17.1 per cent (as against 18.5 and 19.8 per cent respectively in 1981).

Bank reserves recorded an increase of 6,850 billion lire in 1982 as against 4,127 billion lire in 1981; in percentage terms the increase rose from 10.4 to 15.6 per cent. The change in total reserves was entirely attributable to the increase in compulsory reserves, which worked out at 8,544 billion lire (2,946 billion lire in 1981). Liquidity and the non-interest-bearing deposit required of banks exceeding the ceiling on loans in lire, which had risen by 360 and 821 billion lire respectively in 1981, registered declines of 1,176 and 519 billion lire respectively.

The sharp increase in compulsory reserves (22.9 per cent as against 8.6 per cent in 1981) was mainly due to the higher growth rate recorded by deposits (18.1 per cent for the twelve months ending in November 1982 as against 8 per cent in the same period in 1981). As a result of the change in the marginal reserve ratio from 15.75 to 20 per cent in March 1981, the growth in the total deposit base also caused the average compulsory reserve ratio to rise from 15.6 to 16.4 per cent between December 1981 and December 1982.

Banking

In 1982 the banks recorded an upturn in deposits and a small increase in lending. The huge expansion in the public sector deficit, the lowering of government security yields in the middle of the year and the rise in deposit rates fuelled the growth in bank deposits, which was also influenced by bouts of turbulence in the money markets during the last few months. On the other hand, the weakening of economic activity and the persistence of a strong flow of finance from sources other than banks caused the increase in lending to be smaller than that permitted by the ceiling, though this was not sufficient to persuade banks to accelerate the reduction in their average lending rates, which returned to levels only slightly below those obtaining in 1981, despite the larger cut in the prime rate.

The rise in the average cost of deposits, coupled with the albeit small reduction in unit interest income, led to a 0.27 percentage point fall in the interest margin after two years in which the considerable widening of the differential between borrowing and lending rates had boosted banks' profits. Despite the fall in the interest margin, banks increased their unit profits by making smaller provisions for losses on securities.

Deposits rose at a rate of 18.2 per cent (compared with 9.2 and 13.2 per cent respectively in 1981 and 1980; Tables 27 and 28). The growth was stronger in the second half of the year (22.7 per cent on an annual basis) and was considerably influenced by rumours about the consolidation of Treasury bills and the taxation of interest on government securities. In the first three months of 1983 the effect of these transient factors wore off and the growth rate of deposits dropped to a low level (6.1 per cent on a seasonally adjusted annual basis), partly as a result of the tightening of the compulsory reserve requirement.

Table 27 THE ACTIVITY OF THE BANKS: INDICATORS

							1982		
	1978	1979	1980	1981	Year	Quarters			
					1 Cai	I	II	III	IV
			PEI	RCENT	AGE C	HANGE	S (1)		
Deposits	23.1	20.1	13.2	9.2	18.2	10.6	17.2	22.9	22.6
Lending	18.2	18.6	14.7	8.9	16.8	-10.8	19.0	46.0	20.4
Loans (2)	12.1	21.8	19.5	12.1	8.0	1.6	5.1	14.2	11.4
Treasury bills (3)	31.5	6.3	40.4	5.6	45.4	-53.3	144.6	159.3	50.8
Long-term securities (4)	23.4	18.6	-0.1	5.1	19.7	-7.8	10.3	66.6	21.0
				FIN	ANCIA	L RATIO	os		
Excess reserves Deposits (5)	1.9	1.7	1.4	1.4	1.3	1.3	1.2	1.2	1.5
$\frac{Deposits}{Domestic \ financial \ assets \ (6)} \ \ (5) \ \ .$	68.1	66.4	64.2	60.4	57.5	57.8	57.8	57.3	57.1
Loans to the Economy Total domestic credit to the Economy (7)	64.9	84.2	74.0	53.8	42.5	-30.6	14.4	37.3	83.6
Credit to public sector Borrowing requirement of public sector (7)	33.9	28.7	16.5	5.7	40.0	-56.4	50.3	73.5	52.7

⁽¹⁾ Quarterly data are seasonally adjusted and calculated on an annual basis. — (2) The figures include bankers' acceptances and are adjusted for the effect of the funding of bank loans and changes in the exchange rate. — (3) Net of repurchase agreements with the Banca d'Italia. — (4) Adjusted for the effect of the funding of bank loans and the effect of repurchase agreements with the Banca d'Italia. — (5) Percentage ratio of average values for the period. — (6) Excluding shares. — (7) Ratio of flows in period.

Banks also increased their fund-raising in 1982 through repurchase agreements with the public. These operations, which were exempt from reserve requirements, were widely used to counter the growing competition from Treasury bills and the higher cost of compulsory reserves owing to the

BANKS' ASSETS AND LIABILITIES (*

(amounts and changes in billions of lire)

					Changes	1		
	Amounts at	1980		1981			1982	
	end of 1982	Year	Half	-year	Year	Half	-year	Year
		1000	I	II	T Can	I	II	I Cai
ASSETS								
Bank reserves (1)	49,875.2	4,286.3	1,713.4	2,413.9	4,127.3	3,101.4	3,748.6	6,850.0
Excess reserves	3,882.9	613.6	-1,498.6	1,858.1	359.5	-1,297.1	121.2	-1,175.9
Compulsory reserves and backing for cashiers' cheques	45,172.0	3,046.4	2,389.9	556.5	2,946.4	3,776.2	4,768.2	8,544.4
Non-interest-bearing deposit	820.3		822.1	-0.7	821.4		-1,140.8	-518.5
Lending	307,620.4	33,641.1	-3,900.4	27,937.1	24,036.7	—651.5	47,534.7	46,883.2
Loans (2)	155,313.7	21,043.1	5,533.5	10,201.0	15,734.5		14,527.4	12,858.9
of which: in foreign currency (3) Treasury bills (4)	16,500.0 51,084.5	7,251.6 9,667.0	1,608.1 -10,630.7	<i>408.8</i> 13,837.8	1,199.3 3,207.1		87.5 14,863.8	703.1 14,279.9
Long-term securities (5)	101,222.2	2,931.0	1,196.8	3,898.3	5,095.1		18,143.5	19,744.4
of which: securities to fund debts	7,062.2	-515.4	-261.3	2,029.0	1,767.7	-972.3	-422 .1	<i>−1,394.4</i>
Bad debts and protested bills	9,264.1	1,657.7	572.7	697.8	1,270.5	918.9	1,299.3	2,218.2
Shares	5,152.1	762.1	333.7	93.9	427.6	563.8	1,091.5	1,655.3
Interbank accounts	77,568.0	12,411.6	_12,301.7	23,969.8	11,668.1	_17,466.0	29,083.4	11,617.4
Deposits with special credit institutions (6)	7,484.4	1,064.7	316.8	1,483.9	1,800.7	646.3	378.3	1,025.1
of which: cash certificates and certificates of deposit (6)	3,566.4	222.2	-70.2	456.9	386.7	605.2	1,262.6	1,867.8
TOTAL	456,964.2	53,823.5	_13,265.5	56,596.4	43,330.9	-12,887.1	83,136.3	70,249.2
LIABILITIES								
Deposits	328,449.8	29,696.5	-8,123.4	31,553.7	23,430.3	4,188.9	54,867.8	50,678.9
Savings deposits	148,402.7 180,047.1	11,309.1 18,387.4	-2,583.9 -5,539.5	14,461.8 17,091.9	11,877.9 11,552.4		23,505.7 31,362.1	23,585.2 27,093.7
Other deposits	2,318.4	404.8	395.5	229.4	166.1	255.4	-3.3	252.1
Foreign currency accounts of residents	1,038.3	-31.7	87.8	221.9	309.7	-68.2	313.9	245.7
Third parties' funds held in trust	1,280.1	-373.1	307.7	-451.3	-143.6	323.6	-317.2	6.4
Interbank accounts	68,567.0	11,665.6	_10,378.0	21,270.1	10,892.1	14,255.1	24,515.8	10,260.7
Deposits with special credit institutions (6)	6,653.1	426.5	-941.0	573.7	-367.3	291.5	293.4	584.9
Lending by BI-UIC (1)	3,624.5	-2,810.2	588.5	-33.8	554.7	26.7	614.7	641.4
Net foreign position (3) (7)	13,964.7	7,885.8	1,098.0	221.0	1,319.0	236.0	-1,741.0	1,505.0
Equity capital	21,340.8	2,666.5	3,487.5	808.9	4,296.4	3,991.6	591.0	4,582.6
Other Items	12,045.9	4,697.6	607.4	2,432.2	3,039.6	755.7	3,997.9	4,753.6

^(*) 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 26 and 36). 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. For an explanation of the substantial discrepancy between these two items in 1982, see chapter on the balance of payments. — (4) At face value. — (5) Changes in long-term securities are calculated on the basis of market prices during the year. — (6) Changes are taken from the special credit institutions' accounts. — (7) The net foreign position of the banks, which in this table is taken from the balance-of-payments statistics, does not coincide with the balance between foreign assets and liabilities in banking statistics owing to the different criteria used when recording operations with "non-residents". Also includes the convertible currencies, forming part of the excess reserves.

rise in interest rates. The Interministerial Committee for Credit and Savings extended the compulsory reserve requirement to these repurchase agreements on 23 December 1982, and as a result they declined sharply in the first quarter of 1983 (from 4,186 billion lire to 1,511 billion).

Bank loans, net of those to finance deposits on payments abroad, increased by 9.8 per cent in 1982, compared with 10.2 per cent in 1981. Their growth was limited more by the cost of credit and the decline in economic activity than by the ceiling on credit expansion. Administrative controls nonetheless did prevent many banks, above all among the smaller ones, from meeting demand in full. Controls also helped to halt the outflow of short-term funds at times of pressure on the exchange rate, especially after the April increase in the penalties on lending above the ceiling. In the last quarter, on the other hand, unutilized lending margins made it more difficult to curb the reduction in foreign currency loans triggered by a new worsening of expectations about the exchange rate.

Banks' share of intermediation, measured as the ratio of deposits to the public's financial assets, declined slightly in 1982 after falling sharply in the three previous years (Table 27). It continued to decline in the first quarter of 1983 as a result of the slowdown in deposits and the upturn in the public's purchases of government securities. The disintermediation that the banks have suffered since 1979 has primarily been the result of the soaring public debt and the authorities' policy of limiting monetary financing. More recently, bank deposits have come under competitive pressure not only from the Treasury but also from the special credit institutions, which have reacquired a capacity for raising funds directly in the market through the issue of variable rate securities and certificates of deposit.

The banks' deposit rate policy (Fig. 8) has encouraged the replacement of deposits by other financial assets as a result of the increased depth of the short-term securities market and the public's rapid reaction to changes in interest rate differentials. In 1980 and 1981 banks' slowness in bringing their deposit rates into line with the higher yields on short-term securities encouraged the huge switch into government paper. In 1982, when the average Treasury bill yield fell by 2.4 points over the year, the 0.7 percentage point rise in the average deposit rate helped to produce an upturn in bank deposits.

The greater remuneration of compulsory reserves in respect of certificates of deposit (9.5 per cent as against 5.5 per cent for ordinary deposits) should allow banks to expand their fund-raising with instruments whose yields are more sensitive to market interest rates and thus make bank deposits and profits more stable. The introduction of certificates of deposit should stimulate banks to differentiate their rates more strongly according

to how liquid the different types of deposit really are and thus increase the transparency of the deposit market.

The 0.8 percentage point reduction in rates on lira loans, which is discussed in greater detail below, was smaller than that in the yield on Treasury bills. The adjustment took another step at the beginning of 1983, however, when the Italian Bankers' Association reduced the prime rate by 0.75 points as of 1 February. This was followed by further cuts of 0.50 and 0.75 points in April and May.

The risks inherent in the variability of interest rates and deposits influenced the banks' choice of securities for their portfolios. Apart from Treasury bills, they mainly purchased Treasury credit certificates and indexed bonds issued by firms, public bodies and special credit institutions.

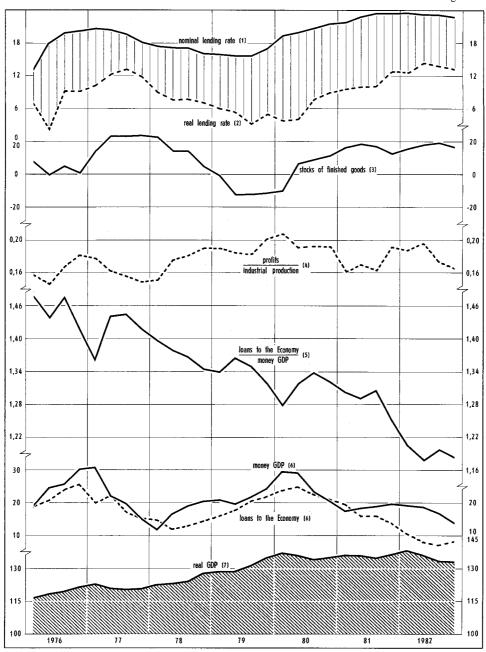
The large proportion of the banks' portfolio now made up of variable rate securities will enable them to limit the fluctuations in the differential between lending and borrowing rates when money market rates vary considerably. Previously, capital losses or gains on fixed rate securities were offset through changes in lending or borrowing rates.

Bank lending

Total lending rose by 9.8 per cent (13,797 billion lire), that in lire by 11.8 per cent (10.2 and 13.0 per cent respectively in 1981). The slowdown in the growth rate in lira lending helped to annul the overshoot of the ceiling, which, at the end of 1981, had amounted to around 1,700 billion lire net of unutilized margins. In December 1982 the lending regulated by the ceiling was 660 billion less than the permitted total. Most of the excess was absorbed in the second half of the year, when the authorities raised the ceiling by 14.4 per cent. This was done primarily to compensate for the absence of the expansionary effect produced by the ending of the foreign payments deposit scheme. Lending to households and the corporate sector expanded by 8.8 per cent (9.9 per cent in 1981) and that to the public sector grew by 30.7 per cent (14.9 per cent). This increase was principally the result of Law No. 767 of 21 October 1982, which made full payment of government transfers to the large municipalities conditional on their first making full use of their bank credit facilities.

The behaviour of individual banks with respect to the ceiling varied considerably: some regularly had large unused margins, while other, mainly smaller, banks consistently allowed their lending to grow faster than permitted.





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.

20 of the 89 banks that submit detailed accounts to the Banca d'Italia exceeded the ceiling in at least ten months. More specifically, 14 (of which only three were commercial banks) overshot every month. On the other hand, 14 banks recorded unutilized margins in at least ten months and 8 (of which half were commercial banks) never overshot. Over the year as a whole the "small" and "minor" commercial and savings banks accounted for around 68 per cent of total excess lending, even though their share of total lending regulated by the ceiling was only around 36 per cent. The larger banks overshot only occasionally and some of them kept the growth in their lending below the permitted rate for long periods. In the second half of the year six of the ten "major" and "large" commercial banks, with 20 per cent of total lending, had unutilized margins that averaged around one third of the total.

On 22 December 1982 the Banca d'Italia renewed the ceiling for the first half of 1983 with a 14 per cent equivalent annual rate of increase in regulated lending, which is made up of loans in lire, bankers' acceptances and bad debts. The exemption of loans disbursed to households and businesses in Campania and Basilicata was kept in force.

The worsening of the recession was reflected in the increase in bad debts and overdue and protested bills, which rose by 2,218 billion lire or 31 per cent. However, the increase was only in part related to cyclical developments: during recessionary phases the granting of new loans slows down, while the probability of outstanding loans becoming irrecoverable goes up. The ratio of bad debts to total lending has nonetheless recorded a sharp upward trend since the end of 1976, with the value rising from less than 2 to over 6 per cent at the end of 1982. The biggest rise in irrecoverable debts last year was recorded by small and medium-sized firms and mainly affected the "small" and "minor" commercial banks (43 per cent as against 27 per cent for other banks), whereas in the previous three years these categories had recorded the smallest increase (116 as against 179 per cent for the banks in the classes from "major" to "medium-sized").

Securities

The growth in deposits at a time when the scope for lending was limited resulted in a substantial increase in the banks' securities portfolio of 32,501 billion lire or 27.5 per cent net of repurchase agreements with the Banca d'Italia (7.5 per cent in 1981). The share of securities in total credit thus rose to 49.2 per cent, a sharp increase compared with the 45.3 per cent recorded in 1981.

The largest expansion in the portfolio was that of Treasury bills (16,110 billion lire as against 1,886 billion in 1981) and came primarily in the second half of the year in parallel with the upturn in deposits; however, the sharp slowdown in the growth of deposits in the first quarter of 1983 led to a large flow of funds out of these securities (15,000 billion lire as against 6,148 billion in the first quarter of 1982). Purchases of Treasury credit certificates also ran at a high level in 1982 (9,351 billion lire, an increase of 68 per cent), so that the share of government securities in the banks' portfolio rose from 53.6 to 59.6 per cent.

Whereas the banks invested heavily in the bonds of firms and public bodies (2,008 billion lire as against 335 billion), they purchased fewer of the special credit institutions' securities (4,087 billion lire as against 4,345 billion), since these institutions raised more funds directly from the public.

The banks increased their portfolio of real estate securities by 1,716 billion lire and their purchases of eligible securities exceeded the securities investment requirement. This constraint has been considerably relaxed for 1983: in a resolution of 23 December 1982 the Interministerial Committee for Credit and Savings reduced the proportion of new deposits to be invested from 6.5 to 5.5 per cent while the Banca d'Italia used the powers conferred upon it by the same resolution to instruct the banks to replace only 50 per cent of the maturing eligible securities of the industrial credit institutions. This measure means that the volume of securities to be purchased in 1983 will be around 1,900 billion lire.

Investment in indexed securities in 1982 amounted to around 84 per cent of the total (as against 38.1 per cent in 1981). The banks' purchases of securities issued by the public and corporate sectors all carried variable coupons, whereas around 38 per cent of the increase in the banks' holdings of special credit institutions' paper consisted of indexed bonds. The proportion of Treasury bills and variable rate medium and long-term securities thus amounted to approximately 50 per cent of their total holdings at the end of 1982 (compared with 40 per cent at the end of 1981).

Deposits

At end-1982 bank deposits totalled 328,450 billion lire. After falling by 5,293 billion in 1981, general government's deposits with the banking system rose by 1,394 billion lire. Nevertheless the ratio to total deposits fell back to below 5 per cent after having reached 10 per cent during 1980. Of the various components going to make up bank deposits by the Economy

(which were up by 49,285 billion lire, or 18.7 per cent as against 12.2 per cent in 1981), deposits by households recorded the biggest rise (19.7 per cent), while the high cost of borrowing had a restraining effect on businesses' bank deposits, which grew at an only slightly faster rate than in 1981 (15.5 as against 12.9 per cent).

The major change in the last few years as regards the various forms of deposit is the decline in tied deposits. 'Whereas in 1972 these accounted for almost one-third of total deposits, their current share is just over 10 per cent. The banks did not raise their rates to resist this tendency, which is attributable to the development of inflation and the burgeoning Treasury bill market, and rates on tied deposits fell below the yield on free savings deposits. Indeed, the rise in free savings offset the decline in tied deposits, with the result that current account deposits remained largely unchanged as a proportion of total deposits.

Interest rates

Since the early seventies bank deposit rates have consistently fluctuated to a smaller extent than interbank or Treasury bill rates and their reaction to cyclical changes has been lagged. In the final months of 1974 and 1975 and again between the last quarter of 1976 and end-1977, the fall in Treasury bill rates was accompanied by a rise and, subsequently, a smaller decline in both bank lending and borrowing rates. In the latest cycle, the changes in the differential between interest rates were similar in magnitude to those observed in previous cycles. However, it appears that the lending rate was quicker to react: indeed, changes in the differential were smaller from 1979 onwards.

One reason for the sluggish response of the average lending rate to changes in market conditions is the increasing average risk attaching to bank loans in periods of falling rates and vice versa. When credit is tight, lending to the more risky customers tends to be rationed, and hence the distribution of lending according to rate category is more concentrated than it is at other times. It follows that the average risk attaching to loans tends to be subject to cyclical fluctuations that check the movement of the average lending rate.

This cyclical movement in the composition of lending has been accompanied by a rise in the average risk attaching to new loans in recent years. This is evidenced by the mounting incidence of bad debt and borne out by the fall in the number of customers to whom the prime rate is

applied. In fact, as a percentage of total current account lending, that at the prime rate went down during 1982 to the lowest level reached since the late sixties (18.5 per cent). It follows that the prime rate would appear to have become a less meaningful guide to the cost of bank credit in the present period.

Profit and loss accounts

It emerges from the banks' profit and loss accounts that the fact that the banks raised interest rates on deposits in a year of falling average yields on lending did not have adverse effects on bank profitability. The decline in the interest margin from 3.40 to 3.13 per cent of total funds intermediated was offset to some extent by higher net profits on services (up from 1.42 to 1.47 per cent) and by the drop from 2.13 to 2.04 per cent in personnel costs (Table 29). As a result, operating profits, which provide an indication of banks' cash flow, only dipped below the peak level reached in 1981.

Following the substantial increase in 1981, provisions for the depreciation of securities were reduced (from 0.55 to 0.17 per cent), reflecting higher market prices. This enabled the banks to offset lower operating profits and increase their gross profits.

The increase in gross profits was almost completely absorbed by higher duty and taxes (up from 0.40 to 0.56 per cent), principally owing to Law No. 626 of 4 November 1981, which tightened the rules relating to offsetting costs and charges against profits for the purposes of corporation tax.

The lower interest margin reflected both the decline in the differential between the average yield on lending and the average cost of deposits and the lower ratio to total intermediated funds of lending in lire, the most remunerative part of assets. These factors were offset by the very large increase in the average yield on securities, which stemmed from the fact that average yields on Treasury bonds went up over the year and from the shift in the composition of holdings of medium and long-term securities towards Treasury credit certificates and indexed bonds. The differential between the yield on securities and the cost of deposits reached one of the highest levels ever.

The structure of intermediation in 1978-82

In the 1978-82 period the percentage of total domestic financial assets accounted for by deposits gradually declined, after growing from 61 to 68

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	1982 (*)
Interest income (2)	9.28	9.47	10.60	11.17	9.90	9.66	11.40	12.64	12.51
Interest expenses	6.10	5.90	7.29	8.09	7.16	7.07	8.08	9.24	9.38
Interest margin	3.18	3.57	3.31	3.08	2.74	2.59	3.32	3.40	3.13
Non-interest income (net)	0.67	0.89	1.03	1.08	1.11	1.09	1.15	1.42	1.47
of which: securities transactions	0.03	0.23	0.22	0.31	0.50	0.44	0.43	0.56	0.66
Gross eamings margin	3.85	4.46	4.34	4.16	3.85	3.68	4.47	4.82	4.60
Operating expenses	2.55	2.77	2.85	2.67	2.48	2.41	2.70	2.69	2.64
of which: staff costs	2.21	2.36	2.41	2.20	2.02	1.95	2.19	2.13	2.04
Operating profit	1.30	1.69	1.49	1.49	1.37	1.27	1.77	2.13	1.96
Depreciation and provisions (3)	0.89	1.20	1.05	0.98	0.86	0.80	1.19	1.45	1.11
in respect of: loans (3)	0.26	0.37	0.24	0.37	0.36	0.32	0.43	0.44	0.46
in respect of: securities	0.49	0.50	0.50	0.22	0.07	0.08	0.20	0.55	0.17
in respect of: buildings and equipment	0.10	0.13	0.14	0.15	0.15	0.14	0.15	0.16	0.18
Profit before tax	0.41	0.49	0.44	0.51	0.51	0.47	0.58	0.68	0.85
Tax	0.30	0.36	0.29	0.34	0.33	0.29	0.36	0.40	0.56
Net profit	0.11	0.13	0.15	0.17	0.18	0.18	0.22	0.28	0.29
							l	l	
	OTHER DATA								
Number of employees (°)	203,205	216,346	227,338	239,901	249,999	261,505	274,889	287,420	292,597
Funds intermediated per employee	593	644	747	873	1,030	1,198	1,364	1,539	1,767
(millions of lire)	13.08	15.23	18.04	19.26	20.85	23.07	29.84	32.83	36.10
Society of Company of	10.00	10.20	10.01	10.20	20.00	20.01	20.01	32.30	00,10

⁽¹⁾ Excluding central credit institutions. — (2) Excluding interest on bad debts. — (3) Excluding provisions for interest on bad debts. — ($^{\bullet}$) The data for 1982 were not based on a full sample of banks and are hence provisional; funds intermediated per employee in 1981 in the banks not included in this sample came to about 1,430 million lire in 1981. — ($^{\circ}$) The figure for 1982 includes an estimate of the number of employees of banks not included in the sample (see preceding note).

per cent in the preceding five-year period. The figure for 1982 was 57.5 per cent, similar to that for 1970.

On average over the last five years bank lending as a proportion of total domestic credit came to around 22 per cent, as against 35 per cent in the previous five-year period.

The ceiling on bank lending in lire has remained in force, but since September 1978 the securities investment requirement has been eased from 30 to 6.5 per cent. Between 1977 and 1982 the ratio of tied securities to deposits went down from 25.7 to 21 per cent. The decrease in this ratio was entirely due to the decline in the ratio of total tied assets to deposits from 40.9 to 36.5 per cent. The ratio between compulsory reserves and deposits remained virtually unchanged for the banking system as a whole, although there were considerable differences between banks and savings banks. These developments were attributable to the reforms made to the compulsory reserve system in 1975. For banks the ratio between the stock of compulsory reserves and deposits declined to 16.1 per cent in 1982 from 17.6 per cent in 1977; for the savings banks it increased from 6.4 to 11.5 per cent. Savings banks also saw an increase in the ratio to deposits of the non-interest-bearing deposit on lending in excess of the ceiling (1.2 per cent in 1982), which had been introduced by the Banca d'Italia in March 1980. In 1983 the decisions taken in 1982 to increase the compulsory reserve ratio and ease the securities investment requirement further will have the opposite effect on tied deposits.

The banks diversified their traditional domestic deposit-taking and lending business. In particular, the supply of banking services, as has already been mentioned, was a significant source of income, reaching more than 30 per cent of the banks' gross earnings margin, as against only a quarter in 1977 and less than a fifth in 1974. Securities dealing recorded the biggest growth: the volume of total securities, acceptances and shares deposited with the banks plus securities to be delivered increased, as a ratio to deposits, from 34.6 per cent in 1977 to 76.8 per cent.

Measured by the volume of their fund-raising abroad, the banks' international business increased in terms of lire over the past five years at an average annual rate of 24.8 per cent; however, about one-third of this growth reflects the depreciation of the lira.

The capital market

Net issues of medium and long-term securities more than doubled with respect to 1981, mainly as a result of heavier public sector demand for

funds. The growth of the capital market was fostered by the spread of variable rate securities, which accounted for more than three-quarters of total issues. This type of security enabled the risk deriving from the interest rate volatility recorded in recent years to be reduced, which stimulated banks and the public to invest beyond the short term. The marked expansion in demand for securities helped to bring about a reduction in nominal interest rates, although they moved down less than inflationary expectations.

Public sector issues consisted almost exclusively of variable rate Treasury credit certificates (Table 30). Firms and public agencies issues — albeit still accounting for only a small share of the market — recorded a considerable increase. This was due in the main to smaller recourse by ENEL to foreign borrowing. During the year the demand for funds was

Table 30

NET HOLDINGS AND ISSUES OF BONDS AND GOVERNMENT SECURITIES

(billions of lire)

]		N	et issu	e s		
		ounts cember			1981			1982	
			1980 Year	Half-	year	Year	Half	-year	Year
	1981	1982		I	II	Tear	I	II	Tear
BONDS AND GOVERNMENT SECURITIES		!					1	İ	
Issuers									
Public sector	86,754	111,307	-1,923	4,152	3,359	7,511	3,189	20,472	23,661
Special credit institutions	69,368	77,792	5,647	2,719	4,789	7,508	3,642	4,505	8,147
Firms and public agencies	15,028	19,462	265	33	669	702	3,387	1,028	4,415
Total	171,150	208,561	3,989	6,904	8,817	15,721	10,218	26,005	36,223
Investors									
Banca d'Italia and UIC (1)	30,118	31,605	3,140	119	-946	-827	715	1,243	1,958
Banks (1)	93,615	111,615	612	2,454	4,960	7,414	1,601	15,912	17,513
Other financial intermediaries	12,084	16,508	1,547	1,109	2,475	3,584	154	4,154	4,308
Firms, households and foreign investors	35,333	48,833	-1,310	3,222	2,328	5,550	7,748	4,696	12,444
CERTIFICATES OF			ļ		İ		İ		
DEPOSIT	9,515	18,060	749	538	1,533	2,071	3,937	4,608	8,545

(1) Net of repurchase agreements.

affected by the expiry in September 1982 of the temporary tax exemption scheme in respect of securities; the special credit institutions, the public agencies and firms concentrated their issues in the third quarter, as a result of which there were net redemptions in the fourth quarter.

The expansion in demand for securities involved all categories of investor. The banks recorded the highest increase in purchases, the bulk of which occurred in the second half of the year. Non-banks, too, considerably increased their holdings of medium-term securities, 70 per cent of their demand being for Treasury credit certificates.

For the first time, certificates of deposit issued by the special credit institutions occupied an important position (8,545 billion lire of net issues, as against 2,071 billion in 1981). Their high yields, especially on variable rate certificates, their short maturities and the existence of a secondary market helped to ensure the spread of this type of security, particularly among non-banks, which accounted for more than three-quarters of total purchases.

The average maturity of public debt stabilized around the values recorded in the last two years. 'Whereas there was a further slight fall in the medium and long-term section (from 27 months at end-1981 to 25 months at end-1982), the average maturity of overall public debt, including Treasury bills, went up from 11 to 12 months. This is attributable to the growing importance of medium-term securities as a proportion of total outstanding public debt and to the longer average maturity of Treasury bills.

In the first quarter of 1983 the shift that had already been observed in the preceding months towards longer maturities strengthened. Whilst there were large issues of medium-term (mostly public sector) securities, there were net redemptions of Treasury bills. Against a backdrop of falling nominal yields, purchases of medium and long-term securities by both banks and non-banks were high and chiefly involved Treasury credit certificates.

The supply of securities

Issues of bonds and government securities on the domestic market totalled 72,933 billion lire gross (as against 33,872 billion in 1981 and 24,830 billion in 1980), or 36,223 billion lire net of discounts and redemptions

(15,721 and 3,989 billion lire respectively in 1981 and 1980). The exceptionally high growth in supply is also apparent from the ratio of net issues to GDP (7.7 per cent, as against 3.9 per cent in 1981 and 1.2 per cent in 1980). It was due to heavier pressure from the state borrowing requirement, which was financed to a greater extent than in the past by the issue of medium-term securities, and to the improved conditions on the bond market.

Net recourse to the market, defined as the difference between net issues and the amount paid on coupons, became positive again for the first time for two years (14,183 billion lire as against net payments of 2,238 and 11,691 billion lire respectively in 1981 and 1980). Comparison of this indicator, which provides a more accurate measure of actual borrowing on the financial market, with Treasury bill issues net of repayments and discounts (8,669 billion lire as against 17,523 and 16,206 billion lire) brings out the size of the shift that has occurred in the maturity composition on the supply side. Issue activity was influenced by the scale of repayments (35,552 billion lire, as compared with 17,472 and 20,036 billion in 1981 and 1980 respectively), which rose to a very high level owing to the fall in the average maturity of securities in circulation. Discounts at issue continued to decline as a percentage of gross issues (1.6 per cent as against 2.0 per cent in 1981 and 3.2 per cent in 1980); this was due to a significant closing of the gap between coupon rates and effective yields as a consequence of increasingly extensive indexation.

The public sector issued medium and long-term securities totalling 52,272 billion lire gross (18,660 billion in 1981) and 23,661 billion lire net (7,511 billion). Two and four-year Treasury credit certificates (totalling 33,250 and 14,000 billion lire respectively) accounted for around 90 per cent of gross issues. They were offered regularly throughout the year, except in February and April. The success of these securities came at the end of a fairly lengthy introductory period in which the necessary learning process on the part of the market was encouraged by refining the indexation mechanism and by the placement procedures introduced in January. The new placement procedures resulted in an extension of the subscription period, greater readiness on the part of the banks to deal in this type of security and greater yield transparency, thanks to the absence of commission payable by investors.

In February and November the Treasury made its first issues of ECU-denominated certificates for a total of ECU 500 and 700 billion respectively, of which, on both occasions, ECU 50 billion was earmarked for the foreign market. The two issues, repayable after seven years and carrying annual coupons of 14 and 13 per cent respectively, were offered for subscription at face value; subscriptions were paid in lire at the conversion rates of 1,302.02 and 1,343.68 lire respectively.

The special credit institutions issued securities for a total amount of 14,471 billion lire gross (as against 12,861 billion) and 8,147 billion net (7,508 billion). In relative terms, the increase in net issues was higher in the case of the public works sections (1,170 billion lire, as against 687 billion) than in the case of the real-estate credit institutions (4,509 billion as against 4,181 billion lire); there was a slight decline (from 2,640 to 2,468 billion lire) in issues by the industrial credit institutions, which raised considerable funds through issues of certificates of deposit. The percentage of securities using indexation mechanisms worked out at 43.7 per cent of the total issue (compared with 37.0 per cent in 1981).

Firms and public agencies issued securities totalling 6,190 billion lire gross (2,351 billion in 1981) and 4,415 billion net (702 billion in 1981). As regards the public agencies, very sizable gross issues were made by ENEL (2,386 as against 300 billion lire), making a return to the domestic market after a comparative let-up in 1981, and IRI (up from 502 to 2,300 billion lire, including 2,000 billion lire for the funding of loans pursuant to Law No. 617 of 4 November 1981 relating to structural reform in the steel industry). Firms also took advantage of the temporary tax exemption scheme to increase their issues slightly, while international institutions placed no securities on the Italian market for the second year running.

The demand for securities

The public (households and firms and the external sector) purchased 12,444 billion lire of bonds and government securities net of discounts and repayments (as against 5,550 billion in 1981) (Table 31). This represents the highest ratio to GDP recorded since the early seventies (2.6 per cent). At the same time, there was a significant decline in demand for Treasury bills, public purchases of which went down from 24,832 billion lire in 1981 to 11,417 billion. Even though as a result of the tax exemption scheme the public stepped up its net investment in the securities of special credit institutions, public agencies and firms by a substantial amount (3,752 billion lire as against 1,009 billion in 1981), the increased purchases recorded in the medium-term sector related primarily to Treasury credit certificates (9,616 billion lire as against 3,072 billion in 1981). These large purchases were fostered by the higher yield differential over short-term securities, by the indexation mechanism, which was more sensitive than formerly to short-term interest rate variations, and by the improved placement conditions (Fig. 10).

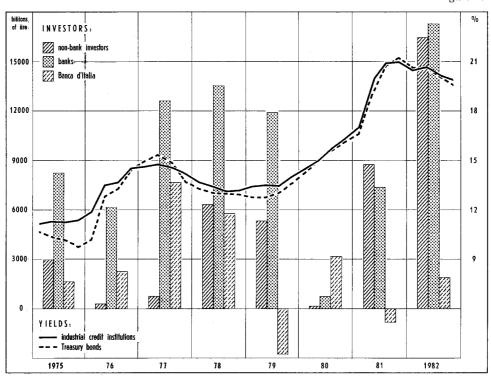
In the first half of the year the investment made in the medium-term sector (7,748 billion lire) was accompanied by very substantial purchases of

Table 31 **NET PURCHASES OF BONDS AND GOVERNMENT SECURITIES**(percentage composition)

Class of investor	1961	Yearly average 1968-77	1978	1979	1980	1981	1982
Banca d'Italia and UIC (1)	3.8	28.2	22.6	-19.1	78.1	-5.3	5.4
Banks (1)	24.5	58.3	52.7	82.5	15.2	47.1	48.3
Other financial intermediaries	9.9	2.1	2.8	13.0	38.5	22.8	11.9
Firms, households and foreign investors	61.8	11.4	21.9	23.6	-31.8	35.4	34.4
vestors	01.6	11.4	21.5	25.0	-31.0	33.4	34.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total in billions of lire	931	7,827	25,634	14,640	3,989	15,721	36,223

⁽¹⁾ Net of repurchase agreements.

Figure 10



Yields on bonds and government securities and net issues by class of investor

Treasury bills (20,992 billion lire). In the second half, as against still significant investment in medium and long-term securities (4,696 billion lire), there was net disinvestment in Treasury bills amounting to 9,505 billion lire. This was due not only to seasonal factors but also to a fall in their relative yields and rumours about the taxation of public debt.

The acceleration of bank deposits was reflected in bank balance sheets by major investments in securities, which, net of repurchase agreements, attained 17,513 billion lire (7,414 billion in 1981); moreover, the banks resumed substantial purchases of Treasury bills. Their total investment in short and medium-term securities amounted to 33,623 billion lire, significantly up on 1981 (9,300 billion lire). The most-purchased medium-term security was the Treasury credit certificate (10,639 billion lire as against 397 billion in 1981) (Table 32).

Although investment in the bonds of the special credit institutions was virtually unchanged with respect to 1981 (5,077 billion lire compared with 5,051 billion), it recorded a further fall in terms of total net issues (62 per cent as against 67 per cent in 1981 and 85 per cent in 1980). This was due to the fact that there was less need to buoy up these institutions' deposits, which developed more autonomously, thanks to certificates of deposit, among other things. The banks also purchased 2,091 billion lire of corporate and government agency bonds (against 435 billion in 1981), of which more than half was accounted for by IRI securities (1,174 billion lire, or 700 billion net of funding operations).

The huge purchases of variable rate securities changed the composition of investors' holdings of medium and long-term securities: at end-1982 it is calculated that around a quarter of the securities held by credit institutions and three-fifths of those held by the public were indexed.

Of the remaining financial intermediaries, the special credit institutions invested 2,429 billion lire on the financial market, almost doubling their portfolio of medium and long-term securities (2,749 billion at end-1981). This outturn, which was further reinforced by purchases of 3,299 billion lire of Treasury bills, is connected with sustained borrowing in the first three quarters of the year, against which there was a slowdown in lending growth, especially in the latter part of the year.

Net of repurchase agreements, the Banca d'Italia purchased 1,958 billion lire of medium and long-term securities, which compares with disinvestment of 827 billion lire in 1981; if Treasury bills are included, purchases of short and medium-term securities came to 4,114 billion lire (5,952 billion in 1981). In the first six months of the year the Bank's transactions were small and concentrated mainly on Treasury bonds. In the third quarter the Bank made net disinvestments of 5,000 billion lire in

Table 32

SHORT, MEDIUM AND LONG-TERM SECURITIES

(billions of lire)

				N e	t issue	s		
	Amounts at			1981			1982	
	December 1982	1980 Year	Half	year	Year	Half	-year	37.
			I	II	rear	I	II	Year
Public sector	251,456	23,577	17,654	23,640	41,294	26,912	29,361	56,27
Treasury bills	140,149	25,500	13,502	20,281	33,783	23,723	8,889	32,61
Treasury credit cer-				,		-,	-,	,
tificates	59,380	2,691	3,450	-634	2,816	5,945	21,433	27,378
Other	51,927	-4,614	702	3,993	4,695	-2,756	- 961	-3,71
Special credit institutions and enterprises	97,254	5,912	2,753	5,457	8,210	7,029	5,533	12,56
TOTAL	348,710	29,489	20,407	29,097	49,504	33,941	34,894	68,83
		i						
Banca d'Italia and UIC (1)	43,182	2,124	6,029	—77	5,952	1,233	2,881	4,114
Treasury bills	11,577	-1,016	5,910	869	6,779	518	1,638	2.156
Treasury credit cer-								
tificates	12,706	4,449	-72	-1,105	-1,177	292	4,436	4,728
Other	18,899	-1,309	191	159	350	423	-3,193	-2,770
Banks (1)	163,209	10,279	8,485	17.785	9,300	2,130	31,493	33,623
Treasury bills	51.594	9,667	_10,939	12,825	1,886	529	15,581	16,110
Treasury credit cer-		.,,		,	,000		,	,
tificates	21,320	-2,768	802	-405	397	41	10,598	10,639
Other	90,295	3,380	1,652	5,365	7,017	1,560	5,314	6,874
The public	142,319	17.086	22,863	11,389	34,252	30,578	520	31.098
Treasury bills	76,978	16,849	18,531	6,587	25,118	22,676	-8,330	14,346
Treasury credit cer-	10,570	10,043	10,001	0,007	20,110	22,010	-0,000	17,040
tificates	25,354	1,010	2,720	876	3,596	5,612	6,399	12,01
Other	39,987	-773	1,612	3,926	5,538	2,290	2,451	4,74
							i	

(1) Net of repurchase agreements.

medium-term securities (Treasury bonds and Treasury credit certificates) and 1,414 billion in Treasury bills in order to mop up liquidity and satisfy high demand for securities. By contrast, in the final quarter, when market turbulence and spreading uncertainty about interest rate developments made it difficult to place securities on the market, the central bank made extensive purchases of medium-term securities (6,244 billion lire) and Treasury bills (3,052 billion lire).

In 1982 yields on medium and long-term securities fell, although fluctuations were recorded within individual quarters. This trend came after the long period of rising interest rates which commenced in the third quarter of 1979 and continued until the second quarter of 1981, with peak levels being reached in November of that year.

There was an increase in average real interest rates on investments going beyond the short-term; this helped to channel substantial flows of savings to the capital markets.

At the end of 1981 interest rates began to decline following the drop in inflationary expectations. After a temporary reversal of the trend, spanning the first and second quarters and caused by strains on the exchange market, rates resumed their downward movement in the third quarter. In the final part of the year the higher-than-expected public sector borrowing requirement, the re-emergence of difficulties on the foreign exchange market and greater uncertainty on the money and financial markets caused interest rates to rise anew. In the first few months of 1983 the easing of these conditions encouraged a change in the interest rate trend. Yields on Treasury bonds, which had moved from 21.34 per cent in December 1981 to 19.62 per cent in December 1982, went down to 18.21 per cent in April 1983. By contrast, the yield on Treasury credit certificates, calculated assuming stable reference rates, dropped by a smaller amount — owing to the effect of the higher spread on the four-year security introduced in January and to the more appropriate issue conditions vis-à-vis the banks and its variability was less marked (Table 33).

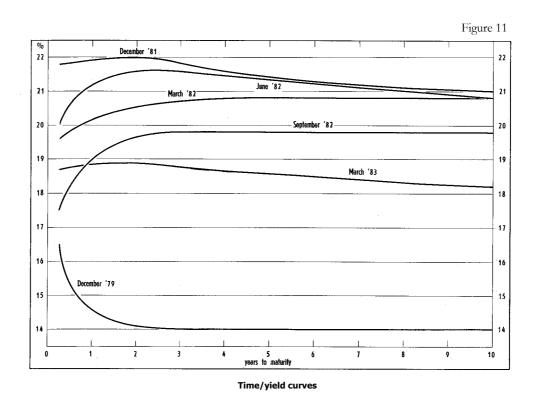
At the end of 1981, when interest rates were still close to their peak, the initial part of the yield curve was virtually flat and displayed a negative slope for the longest maturities (Fig. 11). Following the fall in short and medium-term rates, the yield curve resumed a positive slope, with its peak falling within the densest segment of the market (terms of around two years) and with a slight downward slope in the subsequent part. The rapid fall in rates in mid-year accentuated the positive slope up to maturities approaching two years, beyond which it was virtually flat; in the part relating to the longer-term end there was a considerable decline compared with the previous values. Following the reversal of the slope of the yield curve in connection with the events in the final part of the year, interest rates began to move into line in the first few months of 1983 and there was a gradual downward movement, which also affected long-term rates.

EFFECTIVE AVERAGE YIELD ON BONDS
AND GOVERNMENT SECURITIES

Table 33

								Absolute	changes	between	
	1979 June	1981 Nov.	1982 March	1982 June	1982 Sept.	1983 March	June 79 Apr. 77		March 82 Nov. 81		March 83 Nov. 81
Treasury credit cer-											
tificates	_	22.28	20.84	21.05	20.21	21.31	-		-1.44	0.21	-0.97
Treasury bonds	12.75	21.44	20.08	20.90	19.15	18.76	-2.67	8.69	-1.36	0.82	-2.68
Bonds:											
on behalf of the Treasury	13.74	21.65	20.91	21.20	20.42	18.23	−1.25	7.91	-0.74	0.29	-3.42
industrial credit institutions	13.42	21.01	20.43	20.75	19.80	18.28	_1.50	7.59	-0.58	0.32	-2.73
ENEL-ENI-IRI	13.52	20.49	20.43	20.93	19.45	17.87	-1.40	6.97	-0.06	0.50	-2.62

Overall, between the end of 1981 and March 1983 the curve recorded a marked fall of around three percentage points, following the adjustment of nominal rates to take account of the decline in the expected inflation rate.



Share issues

Total risk capital raised by joint stock companies amounted to 6,892 billion lire gross (as against 8,812 billion in 1981 and 4,133 billion in 1980), or 6,004 billion lire net of double counting (as compared with 7,185 and 3,084 billion lire). If net issues made by credit institutions and state-controlled commercial and industrial corporations are deducted from this figure, share issues by private sector commercial and industrial companies amounted to around 1,500 billion lire. Both state-controlled and private sector companies reduced their recourse to share issues from the peaks recorded in the previous year; the reduction extended to the whole section of listed and smaller unlisted companies (Table 34).

Table 34 GROSS SHARE ISSUES

		Billion	s of lire			Percentage	composition	1
	1979	1980	1981	1982	1979	1980	1981	1982
Listed	1,901	1,442	5,380	2,975	48.8	34.9	61.1	43.2
State-controlled corporations	1,548	737	3,979	1,974	39.7	17.8	45.2	28.7
private firms: main other	334 19	653 52	1.233 168	893 108	8.6 0.5	15.8 1.3	14.0 1.9	13.0 1.5
Unilsted	1,993	2,691	3,432	3,917	51.2	65.1	38.9	56.8
State-controlled corporations	961	920	1,255	1,897	24.7	22.3	14.2	27.5
private firms: main other	356 676	295 1,476	311 1,866	568 1,452	9.1 17.4	7.1 35.7	3.5 21.2	8.2 21.1
TOTAL	3,894	4,133	8,812	6,892	100.0	100.0	100.0	100.0
State-controlled corporations	2,509	1,657	5,234	3,871	64.4	40.1	59.4	56.2
private firms: main other	690 695	948 1,528	1,544 2,034	1,461 1,560	17.7 17.9	22.9 37.0	17.5 23.1	21.2 22.6

The unpropitious conditions on the equity market led listed private sector companies to slow down the process of strengthening their capital base. However, the state-controlled corporations continued to raise huge amounts of capital, even though their shares were way below par; this was the case of Finsider (862 billion lire), STET (720 billion) and SIP (350 billion). Given that it was not attractive economically for minority

shareholders to make use of their pre-emptive rights, the shares concerned were subscribed by the respective holding companies.

In order to foster the growth of the equity market, Law No. 169 of 4 May 1983 made provision for tax concessions for companies that apply for stock-exchange listing or quotation on the over-the-counter market within six months of the closure of public offers of shares.

Demand for shares and unit trusts

The annual survey of shareholdings conducted on the basis of the balance sheets of joint stock companies and public agencies revealed a reduction with respect to the two previous years in the proportion held by "The public", which reflected the increased uncertainty on the equity market (Table 35). As against this reduction, the proportion held by "Public agencies" and the "Banking system" increased, while the share of other types of holders remained substantially stable.

Table 35

SHARE CAPITAL BY CLASS OF INVESTOR

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

	Yearly average 1967-77	1978	1979	1980	1981	1982
The public	27.4	14.0	11.8	14.9	14.2	12.4
Public agencies	19.6	11.6	12.5	9.0	10.6	11.8
Companies	32.0	53.5	58.1	62.1	62.7	62.2
Foreign sector	17.0	15.9	12.8	10.2	8.6	8.2
Banking system	2.1	3.0	3.2	2.3	2.4	3.8
Other financial intermediaries	1.9	2.0	1.6	1.5	1.5	1.6
Total	100.0	100.0	100.0	100.0	100.0	100.0
listed	30.1	26.5	20.4	16.2	16.1	17.4
unlisted	69.9	73.5	79.6	83.8	83.9	82.6
Total share capital at market value .	23,498	52,019	77,591	203,193	214,274	212,660

The net assets of the nine unit trusts that make up the Banca d'Italia sample increased by a fairly small amount, from 1,725 billion at end-1981 to 1,773 billion at end-1982. The composition of these assets changed to a larger extent: there was a net fall in liquid assets (from 162 to 91 billion lire), whereas the amount of shares and "Other securities" increased from 868 to 957 billion lire and that of bonds and government securities from 695 to 725

billion lire. As against the decline in the share of liquid assets from 10 to 5 per cent, there was an increase in the proportion of net assets made up of shares and "Other securities", which went up from 50 to 54 per cent and from 40 to 41 per cent respectively.

Unit trusts constituted under Italian law were set up by virtue of Law No. 77 of 23 March 1983. The management of the funds, which are of the open-ended type, is restricted to joint stock companies with a paid-up capital of not less than 2 billion lire which have been authorized by the Treasury Minister after consultation with the Banca d'Italia. The law embodies a set of provisions designed to protect the saver and concerning, inter alfa, the repurchase of units, porfolio diversification, the valuation of net assets and the publication of quarterly statements relating to the composition and worth of the unit trust fund. The Banca d'Italia is responsible for the supervision of the management companies, determines the methods of capital investment, approves individual unit trusts' rules and, after consulting the Consob, establishes model balance sheets and the methods for calculating issue prices and the repurchase price of units.

Share prices

At the close of a year in which share prices were still highly volatile though less markedly so than in the preceding two years, the share price index (1958 =100) fell to 145.4, 5.9 per cent down on December 1981 (it had risen 1.0 per cent in the previous twelve months). After gaining 7.6 per cent in the first quarter, quotations fell 24.8 per cent between end-March and end July before recovering 16.3 per cent in the last five months of the year.

At the beginning of the year there was a marked preponderance of buyers, who were influenced by favourable reports concerning the results for the financial year that had just ended. The high level of demand, which extended to both outright purchases and options, resulted in widespread and, in many cases, substantial improvements in share prices. Subsequently, drawn-out sales by underwriting syndicates of securities remaining unsold in capital-raising operations, the spread of adverse reports about the accounts of some major companies at the close of the financial year and the reduced propensity to purchase close to the coupon detachment date (because this entails registration in the General Registry of Shares) made for an abrupt change in the trend.

The sharp falls increased anxiety and hence sales on the part of many investors, which put many operators in difficulty as a result of the reduced

value of their collateral. The market situation, which was depressed by the almost complete absence of buyers, deteriorated markedly in June owing to the grave events associated with the Banco Ambrosiano affair. Securities of companies belonging to the Ambrosiano group were sold in large quantities, and this had a knock-on effect on shares in other companies, on the assumption that they, too, were starting to be exposed to increasing financial difficulties.

In August there was a further change of trend, which was fostered by the low level of share prices and by the fall in yields on other investments on the money and capital markets. In the last two months the index made up some lost ground, thanks to purchases concentrated on securities of the IRI group, which have a very large impact on the index owing to their high paid-up value, even though they represent only a small proportion of the total shares in circulation.

The compulsory cash deposit on forward transactions in shares, which was introduced by the Consob in July 1981 after the revocation of the requirement that all trading should be on a cash basis, had the effect of removing numerous speculative elements from the market, and resulted in a drastic fall in the volume of trading; the value of transactions on the Milan stock exchange was 3,770 billion lire as against 12,334 billion in 1981, an exceptionally busy year.

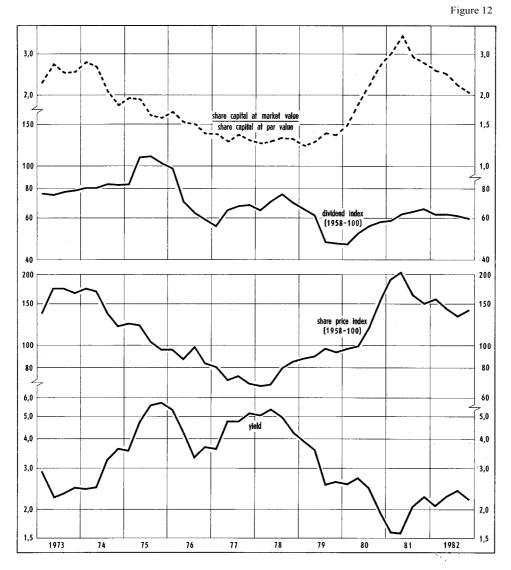
The fall-off in trading, adjusted for price developments, translates into a drop of approximately 65 per cent in the volume of securities traded. This change was largely due to the reduction in the credit element inherent in options trading as a result of the introduction of the cash deposit, and hence reflected the sharp fall in the amount of bargains completed within any one stock-exchange month.

The fall in trading was concentrated principally in the first four months and was strongly correlated with the development of share prices.

Listed companies tended to allocate their trading profits to reserves rather than distribute them; as a result, dividends remained very low at 2.1 per cent of the year-end value of securities (Fig. 12), a figure unparalleled in the other major countries.

After four years of almost uninterrupted growth the prices of securities quoted on the over-the-counter market underwent extensive and marked falls as a result of profit-taking; the share price index (18 May 1978=100) went down to 411.5, 31.6 per cent down on December 1981 (which compares with the 22.3 per cent increase in the preceding twelve months). Developments during the year were fairly similar to those on the principal market, except for the last four months, when quotations fell further.

The first three months of 1983 were influenced by expectations that laws would be approved on the establishment of unit trusts under Italian law and on the revaluation of corporate assets. Considerable buying



Prices, yields and other share market indicators (quarterly averages, semi-logarithmic scale)

gradually pushed up share prices, causing the price index of the principal market to rise by 30.1 per cent and that of the over-the-counter market by 7.4 per cent with respect to their December 1982 levels.

The activity of the special credit institutions

The lending of the special credit institutions again recorded a considerable expansion, in line with the demand for credit. This remained strong until the summer, partly because of the ceilings on the growth of bank lending. Fund-raising was substantial, benefiting from the temporary tax exemption of the interest on the institutions' securities and the diversification of their fund-raising instruments.

Domestic disbursements amounted to 31,200 billion lire, compared with 26,500 billion in 1981. Net of export credit, the ratio of disbursements to spending on fixed investment showed a further rise (Fig. 13). Net of repayments, lending increased by 17.9 per cent, compared with 21.1 per cent in 1981.

In the first part of the year the institutions' lending, and especially the short-term component, rose at a rate that was incompatible with the planned expansion of credit to the non-state sector. The moral suasion the Banca d'Italia applied to the major institutions helped to bring annual growth back within the planned limits. From September onwards the expansion of lending slackened, especially in the market-rate and short-term sectors. The deepening of the recession not only lowered demand for special credit directly but depressed that of the banking-related sector and weakened the incentive to substitute special credit for bank credit in view of the reduced stringency of the ceilings on bank lending and the signs of a narrowing of the differential between bank rates and short-term special credit rates.

The increase in loans at market rates was mainly at variable rates, which were also widely applied outside the industrial credit sector. There was a large upturn in disbursements of subsidized credit for the financing of both exports and investment. The recovery in subsidized credit from the very low levels of the seventies was coupled with the development of a system of incentives that differs from the traditional one in both its aims and its modalities. New objectives, such as reorganization and innovation, are being added to those of overcoming regional disparities and maintaining a network of small and medium-sized firms. Interest rate subsidies are now being supplemented by funds granted or managed directly by the government as well as other interventions to reduce the cost of credit.

Until there is a comprehensive reform of the incentive system that eliminates the intermingling between credit and subsidy, it will remain difficult to raise sufficient funds through the placement of fixed rate bonds at times of high and variable inflation. It is thus becoming more common both for the volume of transfers to the institutions to increase and for the Deposits and Loans Fund to support their fund-raising.

Other public interventions in the special credit sector are the exchange risk guarantees provided on the large volume of lending by Community bodies and the support given to the institutions involved in the solvency crises of motorway companies. This enlargement of the government's role in the activity of the institutions was matched by a considerable increase in lending to the public sector.

The special credit institutions increased their resources well beyond their immediate lending needs, especially in proximity of the expiry, at the end of September, of the temporary exemption from withholding tax on the interest on the institutions' bonds and medium-term certificates of deposit. The latter, which were issued for the first time by some institutions that had previously been barred from using this instrument, recorded a sharp rise, which was especially pronounced for the certificates of the industrial credit institutions carrying a maturity of between 18 and 24 months. Even though the share of the other channels of fund-raising increased, the net issues of bonds were slightly greater than in 1981; among these the proportion of fixed rate issues declined further. There was a large increase in the institutions' borrowing in foreign currency, most of which was used to provide domestic loans (Table 36).

Among the sectors supplying resources there was a particularly large increase in the contribution of the public owing to the greater availability of variable rate securities that tax exemption made competitive with government paper. The institutions thus regained a degree of independence in their fund-raising, with the share of the banks falling to the levels recorded in the years prior to the introduction of administrative controls on their assets. In line with this tendency, the monetary authorities modified the banks' securities investment requirement when this was renewed for the first six months of 1983: not only was the proportion of compulsory investment in the bonds of the real estate institutions reduced but only fifty per cent of the face value of the maturing securities of the industrial institutions in banks' compulsory portfolios will have to be renewed.

The institutions' liquid funds, which were held mainly in government securities, recorded substantial growth until September. Notwithstanding the slight slowdown in the last quarter, they covered the financing requirements in the early months of this year.

ASSETS AND LIABILITIES OF THE SPECIAL CREDIT INSTITUTIONS

(billions of lire)

	,	<i>J</i>						
			-		Change	s		
	Amounts			1981	-		1982	
	December 1982	1980	-	-year	Year		f-year	Year
		<u> </u>	I	II		I	II	
ASSETS								
Loans: domestic (1)	97,157	8,424	5,212	7,898	13,110	6,511	8,178	14,689
foreign	4,360	660	682	139	821	563	160	723
on behalf of the Treasury	9,913	– 656	-307	—525	-832	-349	-309	-658
Securities portfolio	12,079	211	590	1,759	2,349	2,204	3,869	6,073
of which: Government securities	8,148	3	631	24	655	1,988	3,300	5,288
Deposits and Loans Fund securities	1,510	_	_	1,275	1,275	-127	362	235
Cash and liquid assets	5,452	515	_1,130	-138	-1,268	854	-256	598
with: B.I. in foreign currency (2)	437	_35	76	—74	2	-14	-103	-117
B.I. in lire (2)	56	-750	561	-606	45	544	-602	<i>—58</i>
banks	4,600	427	— 941	574	— 367	291	294	585
other	359	873	—826	-31	<i>–857</i>	33	155	188
Other (3)	6,379	-110	605	-558	47	333	-863	-530
Total	135,340	9,044	5,652	8,575	14,227	10,116	10,779	20,895
LIABILITIES								
Bonds (4): ordinary	77,792	5,647	2,719	4,789	7,508	3,642	4,505	8,147
on behalf of the Treasury	10,015	— 565	-458	-352	-810	-553	-337	-890
Deposits and interest-bearing certificates	18,060	749	538	1,533	2,071	3,937	4,608	8,545
Financing by banks	4,230	864	387	1,027	1,414	34	-838	-804
Public funds (5)	4,911	283	237	179	416	45	529	574
Foreign currency loans (6)	9,605	933	984	962	1,946	1,541	2,111	3,652
Equity capital (7)	10,028	1,126	1,210	378	1,588	1,405	263	1,668
Rediscounts	699	7	35	59	94	65	-62	3
	ı II		ŀ		1	i	1	

⁽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.

Fund-raising

The resources of the special credit institutions, net of the operations on behalf of the Treasury and of the repayment of compensatory loans, increased by 22,382 billion lire, which is considerably more than the already large amount recorded in 1981 (15,817 billion; Table 37). Certificates of deposit accounted for 38 per cent of the total (13 per cent in 1981) and for

Table 37
FUND RAISING OF THE SPECIAL CREDIT INSTITUTIONS
(changes in percentage, composition)

Type of liability			1981			1982	
Sector of origin	1980	Hal	f-year	Year	Hal	f-year	Year
		I	II	Year	I	II	Year
TYPE OF LIABILITY							
Bonds (1)	60.5	45.4	53.0	49.9	33.6	40.5	37.1
Deposits and interest-bearing cer-							
tificates	7.2	8.3	16.5	13.1	36.0	40.3	38.2
Short-term financing	8.3	6.0	11.0	9.0	0.3	-7.3	-3.6
Mediocredito centrale funds	1.8	4.6	1.1	2.5	1.3	1.3	1.3
Foreign currency loans (2)	9.3	13.9	11.1	12.3	14.2	19.3	16.8
Equity capital	10.9	18.6	4.0	10.0	12.8	2.3	7.5
Other	2.0	3.2	3.3	3.2	1.8	3.6	2.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
SECTOR OF ORIGIN							
The public and companies	-0.9	11.1	22.7	17.9	45.7	36.5	41.0
Banca d'Italia and UIC	0.3	0.9	0.8	0.8	0.9	-0.5	0.2
Banks	61.0	37.9	53.8	47.3	19.8	35.2	27.6
Other credit institutions (3)	13.5	22.2	7.8	13.8	16.5	4.8	10.5
Public sector	16.7	13.0	3.2	7.2	3.5	4.5	4.1
Foreign sector (2)	9.4	14.9	11.7	13.0	13.6	19.5	16.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total (in billions of lire)	10,381	6,501	9,316	15,817	10,938	11,444	22,382

⁽¹⁾ Excluding bonds issued on behalf of the Treasury and by the Mediocredito centrale, the value of which increased by 103 billion lire in 1982 and by 60 billion in 1981. — (2) Net of compensatory loans held by the Banca d'Italia, which remained unchanged in 1981 and dropped by 118 billion lire in 1982. — (3) Special credit institutions and insurance companies.

52 per cent (as against 22 per cent) of the funds raised by the industrial credit institutions. To benefit from the temporary tax exemption scheme, funds were raised in advance of actual requirements despite the curbing of bond issue authorizations by the Supervisory Department. By themselves

the bonds and certificates of deposit placed in September accounted for 34 per cent of the total for the year, while the fourth quarter contributed only 4 per cent (38 per cent in 1981).

Net bond issues amounted to 8,308 billion lire (7,886 in 1981). The supply of index-linked securities consisted mainly of bonds with variable rates as well as others whose nominal value is linked to prices or the lira-ECU exchange rate. These securities accounted for approximately 44 per cent of the gross issues in the year, compared with 37 per cent in 1981. The share of index-linked bonds in the special credit institutions' total outstanding issues rose from 8 to 15 per cent.

A very large volume of certificates of deposit was placed (8,545 billion lire), nearly doubling their outstanding value. This result was primarily attributable to certificates with maturities of less than 24 months, which accounted for 76 per cent of the total.

The banks' purchases of certificates of deposit (1,687 billion lire as against 715 billion in 1981) partly replaced their short-term loans, which declined by 804 billion (compared with an increase of 1,414 billion in 1981). This switch was related to the limits fixed under recently introduced regulations on the freedom of special credit institutions to receive advances from their shareholders.

Net of compensatory loans, foreign currency borrowing went up by 3,770 billion lire (compared with 1,946 billion in 1981). One-fifth of this increase is to be attributed to exchange rate variations (half of which occurred in 1981). In contrast with previous years, only a part of the foreign currency resources obtained were used to finance operations abroad. A large part of the supply of foreign currency came from the increased lending of international organizations, especially the EIB, with the government guaranteeing the exchange risk. The institutions also raised funds in foreign markets on behalf of the State Railways and to provide domestic loans in foreign currency for imports and exports.

The 1,668 billion lire rise in the institutions' capital and reserves was in line with that recorded in 1981 (1,588 billion) and the slower growth in lending thus produced an increase in the ratio of own funds to the sum of lending, overdue instalments and bad debts (from 9.2 to 9.5 per cent).

Lending

The special credit institutions' domestic lending increased by 14,652 billion lire or 17.8 per cent. Excluding their claims on chemical companies,

which have been taken over by the Deposits and Loans Fund, the increase was nearly the same as in 1981 in absolute terms (14,887 as against 14,508 billion lire), but substantially smaller in percentage terms (17.9 as against 21.1 per cent).

The sum of lending, overdue instalments and bad debts rose by 17.2 per cent. The ratio of the industrial institutions' overdue instalments to their lending dropped from 2.74 to 1.96 per cent, the lowest value for the last five years. The value of the ratio including bad debts declined from 5.65 to 5.08 per cent.

The lending of the industrial institutions up to 18 months again grew faster than their total lending, though there was a pronounced slowdown compared with 1981 (32 as against 58 per cent).

The breakdown of lending by type of borrower highlights the strong upturn in the financing of public sector firms and bodies. Loans to general government expanded by 2,146 billion lire or 20.8 per cent (835 billion or

Table 38

DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS
BY CLASS OF BORROWER

Class of borrower	Subs	idized	Unsul	osidized		Tot	a l		
Class of borrower	1981	1982	1981	1982	1981	1982	1981	1982	
		absolute changes in billions of lire						percentage changes	
General government	44	279	791	1,867	835	2,146	8.8	20.8	
of which: local authorities	21	88	752	1,389	773	1,477	10.0	17.4	
other public agencies (1)	23	191	39	478	62	669	3.5	36.2	
Finance and insurance companies	47	—23	1,075	746	1,122	723	96.6	31.7	
Industrial & commercial companies	2,661	2,932	6,833	7,085	9,494	10,017	19.5	17.2	
public sector	250	908	1,938	2,240	2,188	3,148	17.0	20.9	
nationalized	4	—15		/ '	i .	-,		148.2	
state-controlled	246	923	1,765	481	2,011	1,404	16.9	10.1	
private sector	2,411	2,024	4,895	4,845	7,306	6,869	20.4	15.9	
Households	315	633	1,467	1,133	1,782	1,766	19.1	15.9	
TOTAL	3,067	3,821	10,166	10,831	13,233	14,652	19.3	17.9	
of which: public sector companies & agencies	294	1,188	2,729	4,106	3,023	5,294	13.5	20.8	
households & private sector companies	2,773	2,633	7,437	6,725	10,210	9,358	22.1	15.6	

(1) Including social security institutions.

8.8 per cent in 1981). The largest increase was in lending to local authorities (1,477 billion, of which 90 per cent was to municipalities alone), which stepped up their borrowing from the public works special credit sections. There was an exceptional rise in lending to industrial and commercial companies in the public sector (ENEL and the autonomous agencies) while that to state-controlled companies declined (Table 38).

The weighted average cost of credit at market rates was higher than in 1981 (21.5 compared with 20.2 per cent). More specifically, the cost of the industrial institutions' variable rate credit continued above that of fixed rate loans (Fig. 13).

Domestic disbursements of subsidized credit amounted to 8,963 billion lire, a 30 per cent rise over the previous year. The increase in outstanding credit was 3,821 billion or 15.1 per cent (Table 39).

DOMESTIC LENDING BY THE SPECIAL CREDIT INSTITUTIONS BY SECTOR

(billions of lire)

Table 39

Type of credit	Agricı	ılture	Hous	sing	Indu	istry	distri	sport, oution services	Ехр	orts	То	tal
or credit	1981	1982	1981	1982	1981	1982	1981	1982	1981	1982	1981	1982
											l)	
						Disburs	ements	1				
Subsidized	2,288	2,848	641	851	1,773	2,282	555	766	1,609	2,216	6,866	8,963
Unsubsidized .	1,330	1,673	2,561	2,335	8,112	8,119	7,627	10,111	_	_	19,630	22,238
Total	3,618	4,521	3,202	3,186	9,885	10,401	8,182	10,877	1,609	2,218	26,496	31,201
	Net Increases in lending											
Subsidized	905	706	652	854	171	813	380	288	959	1,160	3,067	3,821
Unsubsidized .	433	207	1,890	1,605	3,458	3,248	4,385	5,771	-	_	10,166	10,831
Total	1,338	913	2,542	2,459	3,629	4,061	4,765	6,059	959	1,160	13,233	14,652
					Percent	age incr	eases in	lending				
Subsidized	21.5	13.8	26.2	27.2	1.7	8.0	15.0	9.9	31.5	29.0	13.8	15.1
${\it Unsubsidized}$.	31.3	11.4	14.0	10.4	<i>25</i> .9	19.3	24.2	25.6	-	-	21.9	19.1
Total	23.9	13.2	15.9	13.2	15.6	15.1	23.0	23.8	31.5	29.0	19.3	17.9

A sizable proportion of the subsidized credit disbursed to the various sectors went to agriculture (one third, mostly short term) and exports (one quarter).

A growing proportion of special credit, though not subsidized in the narrow sense, is granted at below market rates as a result of funds being raised abroad with the government underwriting the exchange risk. The operations that enjoy this advantage are primarily those financed with funds from the European Coal and Steel Community, the Council of Europe's Resettlement Fund and the European Investment Bank. In 1982 the latter granted the institutions loans, primarily for use in industry, amounting to around 1,700 billion lire. Some of these loans had interest subsidies of 3 points paid out of the Community budget.

Credit to industry

Net of export finance, disbursements to industrial companies were slightly up on the previous year (10,401 as against 9,885 billion lire) as a result of the large increase in subsidized operations. The ratio of disbursements to fixed investment nonetheless increased (from 44.0 to 44.6 per cent), since the latter only expanded slowly.

There was a substantial increase in lending to the electricity industry and especially in short-term loans to ENEL to bridge the gap until it received the increases in its endowment fund. As regards the financing of manufacturing companies, credit continued to be granted primarily to the food processing and engineering industries, which accounted for most of the lending at subsidized rates. The flow of credit to the chemical industry was substantial, especially when the claims taken over by the Deposits and Loans Fund are taken into account.

Credit to services

The pronounced upturn in the financing of the services sector that started in 1981 was maintained: disbursements amounted to 10,877 billion lire, compared with 8,182 billion in 1981. The ratio of disbursements to investment (excluding that in housing) rose from 26.3 to 31.2 per cent.

Lending to the transport and communications sector increased again. 'Whereas air transport and shipping received much less additional credit, there was a very large increase in that to land transport (1,585 billion lire as against 126 billion in 1981). This result reflects both the operations with

foreign currency borrowing as their counterpart carried out on behalf of the State Railways and the funding of motorway companies' debts. Lending to the distributive trades and "other services", which include leasing companies, and to finance and insurance companies was at a high level in 1982.

Credit to housing

The total volume of special credit disbursed to the housing sector did not change compared with the previous year (3,186 as against 3,202 billion lire). The fact that most of this lending was for new buildings nearly halted the downward trend of the ratio of financing to investment in housing, which rose only slowly in view of uncertainty about the profitability of property and the expected rise in the real yield of financial assets.

The lending of the real estate credit institutions expanded less than in 1981 (14.5 as against 17.7 per cent), while the temporary tax exemption scheme boosted their fund-raising. They also continued to strengthen their capital base (475 as against 248 billion lire) and to increase their borrowing abroad (259 as against 176 billion lire).

The importance of fixed rate operations declined further. Securities of this type, which accounted for 63 per cent of gross issues as against 77 per cent in 1981, were placed at yields below those of the secondary market for a net total (2,170 billion lire) that was nearly equal to the banks' securities investment requirement and more than twice the increase in subsidized credit recorded during the year. Variable rate bonds and those with capital indexation (which increased by respectively 1,610 and 170 billion lire net of reimbursements) were mostly taken up by private individuals and insurance companies.

Though the cost of fixed rate loans decreased over the year, the average went up compared with 1981 to 22 per cent, only slightly below that of variable rate loans. Even if the current income tax relief on interest payments represents a reduction of about a quarter of the gross rate, the scale of the early repayment instalments has made the burden of mortgage debt increasingly heavy for middle-income households.

The demand for mortgages for the purchase of a first house could be satisfied to a greater extent outside the subsidized credit system if more widespread use were made of capital indexation, which in periods of high and uncertain inflation allows long-term intermediation to be expanded.

The full effects of Law No. 457 of 1978, together with those of other subsidies, led to a substantial increase in disbursements of subsidized credit to housing (851 as against 641 billion lire). For the second year running there was an increase in the estimated proportion of investment covered by incentives, from 4.5 to 5.2 per cent.

Public housebuilding, entirely paid for by the government, also rose both in absolute terms and as a proportion of total investment (from 5 to 6 per cent). There was thus a slight increase in total public investment including subsidies, from 9.5 per cent in 1981 to 11.2 per cent.

Export credit

The special credit institutions disbursed subsidized export credits amounting to 3,500 billion lire, as against 2,714 billion in 1981 (Table 40). With the value of trade rising relatively slowly, the ratio of disbursements to exports of final investment goods increased (from 12.1 to 13.9 per cent), reversing the downward trend of the previous four years.

EXPORT CREDITS (1)(billions of lire)

Table 40

Type of credit	Disburs	ements	Net inc	reases	Loans	Financing	Applications to	
	1981	1982	1981	1982	Donne	commitments	examine	
	Π							
		flo	ws	outstanding at end-198.				
Supplier credits	1,609	2,216	2,216 959 1,160 5,165		4,406	684		
Buyer credits	1,105	1,284	607	720	3,916	5,294	428	
tied	1,004	1,119	553	642	<i>3,57</i> 5	5,073	426	
untied	101	165	54	78	341	221	2	
TOTAL	2,714	3,500	1,566	1,880	9,081	9,700	1,112	

(1) Excluding refinancing by UIC and compensation payments by SACE totalling, at end-1982, 2,109 billion (1,909 at end-1981).

The volume of buyer credits disbursed went up from 1,105 to 1,284 billion lire. Disbursements of supplier credits on the other hand rose from 1,609 to 2,216 billion lire. The expansion of this form of credit was concentrated mainly in the engineering and basic metals sectors, while the flow to the motor industry and construction companies contracted.

The developing countries continued to receive a large proportion of these credits (69 per cent of the increase in lending, compared with 71 per cent in 1981). The sharp fall in credits to the OPEC countries was coupled with growth in those to non-oil countries, with Brazil taking a quarter of the total increase in lending. The share of the centrally planned economies increased slightly, primarily as a consequence of the buyer credits disbursed to Poland and the Soviet Union, whereas that of the industrial countries recorded a small reduction.

The value of the applications for supplier credits approved by the institutions rose slightly compared with 1981, while there was a downturn in that of the applications for buyer credits. The institutions' total outstanding commitments at the end of December 1982 amounted to 9,700 billion lire, of which 2,919 billion was in signed contracts for buyer credits. The uncertain development of the economic cycle and the financial difficulties still gripping many developing countries would appear to darken the outlook for growth in exports of investment goods with deferred payment terms. The special credit institutions' activity in this sector is also linked, however, to other contracts that are not influenced by cyclical factors.

Credit to agriculture

After two years of rapid growth, the lending of the agricultural credit system recorded only a small increase, 1,614 billion lire or 14.5 per cent (1,853 billion or 19.9 per cent in 1981; Table 41).

The slowdown, which was partly attributable to farming conditions during the year, was sharper for working credit. This rose by 12.9 per cent, which was less than the already small increase recorded by gross marketable production. This result was attributable in part to the difficulties of the cooperative sector, which caused the volume of lending to agricultural agencies and cooperatives to be unchanged and led to an increase in overdue instalments and bad debts, traditionally of marginal importance.

The rate of increase in the working credit provided by banks slowed down though it remained above that for total bank lending. The lending of the special credit institutions and the other authorized institutions grew even less fast.

Most of the increase in working credit consisted of lending at subsidized rates, three quarters of which was arranged under regional laws. The weighted average interest rate on the subsidized short-term credit disbursed by the special credit institutions rose from 7.70 per cent in 1981 to 9.60 per cent. This increase is attributable in part to the raising, in May 1982, of the minimum interest rates that regions are required to apply when granting interest subsidies to the agricultural sector.

Table 41 LENDING BY THE AGRICULTURAL CREDIT SYSTEM

(changes in billions of lire)

	Agricultus credit ins	ral special stitutions	Other au institu		тот	ral .
	1981	1982	1981	1982	1981	1982
Working credit	529	301	654	549	1,183	850
Improvement credit	500	589	170	175	670	764
SUB-TOTAL	1,029	890	824	724	1,853	1,614
Financing of stockpiling operations	-30	15	47	39	17	54
compulsory	26 —56	36 —21	41 6	43 —4	67 —50	79 —25
Other loans	6	9	_	_	6	9
GRAND TOTAL	1,005	914	871	763	1,876	1,677

The rate on unsubsidized credit was also above the average of the previous year, even though it declined during the year. Though agricultural working credit costs less than short-term loans to other sectors, it can prove expensive for farms, since the increases in Community prices do not fully cover the rise in costs. The EEC has recently provided interest subsidies on livestock farming loans.

Disbursements of improvement credit amounted to 998 billion lire, compared with 913 billion in 1981. The ratio of disbursements to fixed investment for the sector remained unchanged at 16.7 per cent.

Partly owing to the availability of interest subsidies, disbursements of subsidized improvement credit increased. On the other hand there was a downturn in disbursements at market rates, which rose from 18.20 to 19.80 per cent. In a sector that is almost totally lacking in variable rate instruments such high interest rates on loans with very long maturities increase the risk of borrowing.

Profit and loss accounts

Average lending and borrowing rates were respectively 14.40 and 11.40 per cent of the total funds intermediated by the special credit institutions, as against 12.91 and 9.99 per cent in 1981. The rising trend of

interest rates, which has been under way since the mid-seventies, was accentuated both by the shorter maturities of the institutions' loans and securities and by the higher proportion of variable rate instruments (Table 42).

Table 42

PROFIT AND LOSS ACCOUNTS OF THE SPECIAL CREDIT INSTITUTIONS: FORMATION OF PROFIT

(as a percentage of total funds intermediated)

	1975	1976	1977	1978	1979	1980	1981	1982
Interest income	8.31	8.83	9.51	10.43	10.97	11.76	12.91	14.40
Interest expenses	6.83	7.10	7.62	8.18	8.57	9.03	9.99	11.40
Interest margin	1.48	1.73	1.89	2.25	2.40	2.73	2.92	3.00
Non-interest income	0.07	0.04	0.03	-0.01	-0.02	0.03	0.01	-0.04
Gross earnings margin	1.55	1.77	1.92	2.24	2.38	2.76	2.93	2.96
Operating expenses	0.36 0.29	0.39 <i>0.31</i>	0.42 0.33	0.44 0.34	0.49 <i>0.37</i>	0.61 <i>0.44</i>	0.66 <i>0.44</i>	
Operating profit	1.19	1.38	1.50	1.80	1.89	2.15	2.27	2.23
Depreciation and provisions (1)	0.71	0.89	0.98	1.17	1.37	1.62	1.50	1.03
Profit before tax	0.48	0.49	0.52	0.63	0.52	0.53	0.77	1.20
Tax	0.28	0.26	0.28	0.41	0.24	0.23	0.32	0.42
Net profit	0.20	0.23	0.24	0.22	0.28	0.30	0.45	0.78
								I
	OTHER DATA							
Number of employees	7,968	8,270	8,664	8,926	9,990	10,318	10,654	11,130
Funds intermediated per employee (millions of lire)	7,226	8,012	8,326	8,906	8,486	8,906	9,770	11,161
Cost per employee (millions of lire)	21.08	24.67	27.35	29.91	31.13	39.63	43.12	49.08
- "								

The interest margin rose to 3 per cent, the result of different tendencies in the various sectors: whereas the margins of the real estate

(1) Includes the difference between extraordinary profits and losses. - (*) Provisional data.

credit institutions and public works credit sections widened, that of the industrial credit institutions narrowed slightly, as in the previous year.

Depreciation and provisions declined (1,690 billion lire as against 1,780 billion in 1981) as a consequence of the less pronounced worsening of the quality of the institutions' lending. Net profits doubled from 470 to 960 billion lire.

Total financing and the formation of financial assets

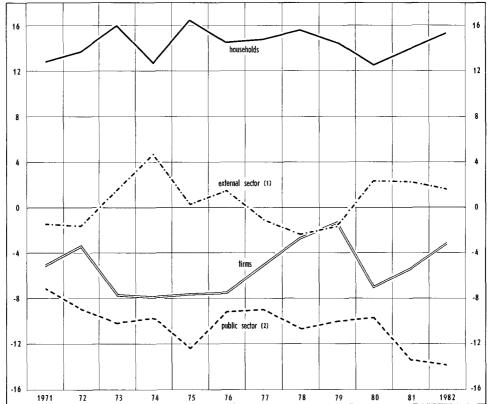
In 1982 net public sector debt increased from 53,680 to 65,260 billion lire to exceed the already very high ratios to GDP recorded in 1981. The public sector absorbed a growing fraction of domestic saving by offering higher real yields on government securities. The higher real cost of borrowing, together with administrative controls, curbed the expansion of lending to the corporate sector. The restrictive impact on production and investment was especially evident in the second half of the year, and a decline in demand for credit ensued. Despite the low level of profits, the financial deficit of the corporate sector went down from 21,440 to 14,450 billion lire, or from 5.4 to 3.1 per cent of GDP.

Households' financial surplus climbed from 56,360 to 71,890 billion lire, or from 14 to 15.3 per cent of GDP, partly as a result of the higher real yields on financial assets; apart from satisfying the borrowing requirement of the public and corporate sectors it also enabled the balance-of-payments deficit on current account to be cut from 9,220 to 7,390 billion lire (Fig. 14).

The state sector's domestic borrowing requirement (net of funded debt and of funds transferred to the financial intermediaries) came to 67,960 billion lire, as against the forecast figure of 43,000 billion lire. However, the expansion of domestic credit to the non-state sector was kept within the limits set by the Interministerial Committee for Economic Planning. The grant of finance to the public worked out at 30,130 billion lire; if account is taken of the repayment of bank loans used to finance the deposit on foreign payments, this figure rises to 32,510 billion lire (27,870 billion in 1981). Its growth rate, at 14 per cent, was somewhat higher than the 13.4 per cent recorded in 1981.

As a result of the stronger growth of the public sector deficit, total domestic credit increased by more than a third with respect to the target figure. The total domestic credit flow came to 100,480 billion lire, as against





Financial balances of domestic sectors that are final users of resources and of the external sector (ratios to GDP)

(1) Balance of payments on current account. — (2) Net indebtedness; differs from that shown in Table 23 chiefly owing to the inclusion of the actuarial reserves of the social security system.

72,770 billion in 1981; the corresponding growth rate went up from 18 to 21 per cent, while the ratio to GDP increased from 18.1 to 21.4 per cent (Tables 43 and 44).

Given the downturn in production and the already low forecast figure, it was thought inappropriate to reduce domestic credit to the non-state sector further, especially since, unexpectedly, a substantial fraction of new credit flows was utilized by public agencies and, in particular, by the local authorities, whose indebtedness to the credit system increased by 4,010 billion lire, more than twice the increase recorded in 1981.

The restrictive impact was heightened by the fact that the contribution made by the other — domestic and external — channels towards financing the productive sector decreased from 16,130 to 11,660 billion lire. Total lending to the Economy (households and firms) came to 42,630 billion lire,

TOTAL DOMESTIC CREDIT AND TOTAL FINANCING

(changes in billions of lire)

	1978	1979	1980	1981	1982
Total domestic credit	49,240	53,252	63,221	72,771 75,152	100,479 98,098
State sector borrowing requirement (1)	31,707	28,503	34,008	44,904	67,964
Lending to the non-state sector (2)	17,533	24,749	29,213	27,867 <i>30,248</i>	32,515 30,134
Total financing (3)	54,436	60,515	73,194	89,086	109,910
Public sector (4)	29,796 24,640	29,551 30,964	31,441 41,753	45,238 43,848	67,275 42,635

⁽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 and 1982, excludes bank loans to finance the non-interest-bearing deposit on payments abroad; accounting data are shown in italics. — (3) Total financing to domestic sectors that are final users of resources is the sum of TDC, bad debt of the credit institutions, funds obtained through the issue of bankers' acceptances, shares and atypical securities, and foreign loans. — (4) Total borrowing requirement of the public sector net of financing to credit institutions, of securities issued to fund debt and of public funds to the Economy. — (5) For 1981 and 1982 the data differ from those given in Table 45 in that bank loans are shown less loans used to finance the non-interest-bearing deposit on payments abroad.

as against 43,850 billion in 1981; net of equities, its growth rate declined from 18.2 to 14.9 per cent, thus slowing less than gross domestic product, whose twelve-month rate of increase went down from 19.7 per cent to 14.4 per cent between 1981 and 1982 (Fig. 15).

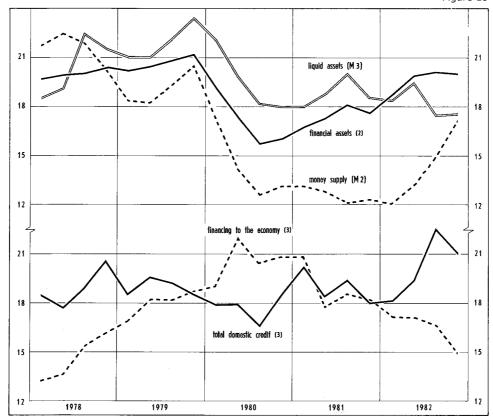
The Economy's share of total finance to the domestic sectors that are final users of resources went down from 49 per cent in 1981 to 39 per cent; in the final quarter this ratio declined by 18 percentage points.

Table 44
FINANCIAL ASSETS, FINANCING TO THE ECONOMY
AND TOTAL DOMESTIC CREDIT

	Percentage rates of increase				Percentage ratio to GDP				
Year	liquid assets (M ₂)	financial assets (1)	total financing (1)	total domestic credit	liquid assets (M ₂) (2)	financial assets (1) (2)	total financing (3)	total domestic credit (3)	
1979	20.5	21.2	18.7	18.5	83.9	117.0	11.3	19.7	
1980	13.2	16.0	20.8	18.5	77.2	110.3	11.7	18.7	
1981	12.3	17.6	18.2	18.0	73.5	109.5	10.4	18.1	
1981 (4)		18.5	19.2	18.6		110.1	11.0	18.7	
1982	17.2	20.0	14.9	21.0	71.6	111.8	8.8	21.4	
1982 (4)		19.0	13.9	20.5		112.1	8.3	20.9	

⁽¹⁾ Excluding shares. — (2) Average annual stocks. — (3) Annual changes. — (4) Calculated using data uncorrected for the non-interest-bearing deposit on payments abroad.





Credit, money supply and financial assets of the Economy (1)

(1) Twelve-month rates of increase. — (2) Net of the non-interest-bearing deposit on payments abroad. — (3) Net of bank financing of the non-interest-bearing deposit on payments abroad; financing to the Economy is shown as an overall figure net of shares.

Corrected for the impact of the deposit on payments abroad, bank lending to the Economy came to 14,050 billion lire, as against 13,010 billion in 1981. The corresponding growth rate, at 10.4 per cent, was virtually the same as in 1981. Loans by the special credit institutions worked out at 12,490 billion lire, as compared with 13,990 billion in 1981. The corresponding rate of increase dropped from 23.8 to 17.6 per cent, which reduced the differential vis-à-vis the rate of growth of bank lending with respect to 1981. The existence of this differential over the last two years is largely attributable to the shift of a proportion of bank financing from the traditional channels to channels not subject to administrative controls, and, in particular, to short-term lending by the special credit institutions and financing by banking-related intermediaries (Table 45).

Net issues of bonds by firms came to 4,430 billion lire (710 billion in 1981), partly as a result of the temporary tax concession. Half was subscribed for by banks. In the short-term sector of the capital market there

THE FINANCIAL ASSETS OF THE ECONOMY AND THEIR COUNTERPARTS

(amounts and flows in billions of lire)

			Flows				
	Amounts at			1982			
	end 1981	1981			Quarters		
	1561		Year	1	II	III	IV
FINANCIAL ASSETS:							
Domestic	645,121	77,835	90,442	8,823	16,800	14,031	50,788
Currency	28,839	4,294	3,472	-1,685	552	748	3,857
Deposits: Post Office & with Treasury	35,413	2,631	3,697	-130	-373	-175	4,375
bank	263,401	29,099	49,297	-8,768	4,518	8,255	45,292
Short-term securities	58,710	24,461	11,552	13,587	7,736	-1,935	-7,836
Other deposits and savings certificates	7,816	1,365	6,847	1,620	1,803	2,287	1,137
Fixed-interest securities	34,005	5,324	12,404	5,438	1,339	3,405	2,222
Shares (1)	183,494	1 '	1,456	327	179	75	875
Other financial assets (2)	29,621	5,032	5,539	1,077	2,225	1,371	866
Deposit on payments abroad	3,822	3,822	-3,822	-2,643	-1,179	_	_
Foreign	30,043	642	4,437	899	971	51	2,516
TOTAL	675,164	78,477	94,879	9,722	17,771	14,082	53,304
AGAINST FINANCING OF:							
ECONOMY	463,518	46,229	40,254	5,961	7,717	8,610	17,966
Borrowing from: banks (3)	136,544	15,396	11,674	-1,998	172	3,328	10,172
special credit institutions (3) (4)	70,982	13,992	12,489	3,508	3,172	3,852	1,957
Public sector loans	2,079	288	411	45	145	92	129
Foreign loans	30,241	8,422	2,033	317	2,503	-192	- 595
Bonds	14,631	715	4,433	2,784	612	1,218	-181
Shares (5)	182,753	2,220	1,534	338	184	61	951
Endowment funds	18,421	3,266	7,481	917	921	223	5,420
Financing by local authorities	4,442	716	207	52	10	30	115
Other financial liabilities (6)	3,425	1,214	-8	-2	-2	-2	-2
FOREIGN SECTOR (7)	24,168	-9,225	-7,393	-5,772	-1,235	603	-989
PUBLIC SECTOR (consolidated)	230,112	53,684	65,260	12,363	13,378	24,124	15,395
UNCLASSIFIED (8)	-42,634	-12,211	-3,242	-2,830	-2,089	_19,255	20,932
TOTAL	675,164	78,477	94,879	9,722	17,771	14,082	53,304
ECONOMY'S FINANCIAL BALANCE	211,646	32,248	54,625	3,761	10,054	5,472	35,338

⁽¹⁾ Does not include shares issued by state-controlled firms purchased by their parent companies. — (2) Includes actuarial reserves and an estimate of atypical securities. — (3) Flows are adjusted to take account of bad debts of credit institutions totalling 1,685 billion lire in 1981 and 2,352 billion in 1982. Also includes funding of debts totalling 1,947 billion lire in 1981 and 362 billion in 1982. — (4) Includes insurance companies. — (5) Net share issues by private companies and third parties' contributions to state-controlled firms. — (6) Acceptances purchased by non-bank investors and atypical securities. — (7) Current account of the balance of payments on a transactions basis. — (8) Includes discrepancies.

was a net disinvestment in bankers' acceptances of 390 billion lire, as against net purchases of 600 billion lire in 1981. Net of double counting and share issues by state-controlled companies which were taken up by the relevant holding companies, share issues dropped from 2,220 to 1,530 billion lire. In contrast, endowment funds granted to public corporations went up from 3,260 to 7,480 billion lire.

Direct corporate borrowing abroad went down from 8,420 to 2,030 billion lire; if account is taken of funds denominated in foreign currencies and intermediated by the credit institutions, the ratio of foreign lending to the total flow of credit to the Economy went down from 21 per cent in 1981 to 8 per cent in 1982.

As a consequence of the expansion of total finance to the Economy, the amount of financial assets held by firms and households increased by 94,880 billion lire, which compares with a rise of 78,480 billion lire in the previous year; the corresponding growth rate — calculated net of shares and corrected for the deposit on foreign payments — rose from 17.6 to 20 per cent, while, as a ratio to GDP, financial assets held by the Economy went up from an average 109.5 per cent to 111.8 per cent. At the end of the year, the ratio of financial assets to earnings reached the highest level for the last three years. To avoid excess supply of financial assets having an adverse effect on domestic demand for goods, the exchange rate and prices in the current year, real yields on financial assets should remain high and

Table 46

MONEY SUPPLY AND ITS COUNTERPARTS

(changes in billions of lire and percentage rates of increase) (1)

	1001	1982						
	1981	Year	I	II	III	IV		
Public sector	19,505 6.7	47,037 14.4	-5,178	6,276	17,455	28,484		
Total domestic borrowing requirement	50,810	72,800	13,335	14,448	23,536	21,481		
(—) State securities (2)	31,305	25,763	18,513	8,172	6,081	-7,003		
Economy	15,396 5.3	11,674 3.6	-1,998	172	3,328	10,172		
Foreign sector (3)	1,538 <i>0.5</i>	-2,521 -0.8	-3,508	688	1,789	-1,490		
Other and discrepancies	-415	276	101	-2,439	-13,744	16,358		
LIQUID ASSETS (M ₂) (4)	36,024 12.3	56,466 <i>17.2</i>	-10,583	4,697	8,828	53,524		

⁽¹⁾ Rates of increase are calculated on the basis of the level of M_2 at the end of the preceding period. — (2) Treasury bills and medium and long-term securities purchased by operators other than the banking system. — (3) Overall balance of payments. — (4) Differs from the data published in the Supplementi al Bollettino in that it does not include bank deposits of general government, of the autonomous agencies or of insurance companies.

public sector borrowing and corporate liquidity should be kept strictly in check.

After falling in the previous two years as a proportion of the flow of newly-issued financial assets, bank deposits rose back close to the average levels for the second half of the seventies. The shift towards deposits, which occurred mainly in the second half of the year, chiefly involved households. The impact on the degree of liquidity of the Economy was small, since the change in the composition of financial portfolios principally reflected the move out of Treasury bills, chiefly as a result of the progressive drop in the yield differential in their favour. The rate of growth of M2 money supply increased from 12.3 per cent in 1981 to 17.2 per cent in 1982, whereas the growth rate of overall liquidity (M₃) decreased from 18.5 to 17.6 per cent. The development of the counterparts of the money supply reveals that there was a strong growth of finance to the public sector, which was responsible for over four-fifths of the growth recorded by M2 (Table 46).

Higher real yields on securities, greater recourse to variable rate securities and the existence for most of the year of a positively-sloped yield curve encouraged savers to move into longer maturities; the proportion of medium-term securities and certificates as a fraction of total newly-issued assets more than doubled from 8.5 to 20.3 per cent. This effect continued to be observed in the first few months of 1983.

THE SUPERVISION OF CREDIT INSTITUTIONS

Structure and operations of the credit system

Size and geographical distribution. — On 31 December 1982 there were 1,085 registered banks in Italy, as against 1,079 at the end of 1981. The possibility of setting up a new bank remains restricted by the Interministerial Committee for Credit and Savings' resolution of 23 June 1966 imposing a general moratorium. The increase in the number of banks was attributable, except as regards foreign banks, exclusively to rural and artisans' banks, whose establishment the Credit Committee had subsequently authorized under special conditions.

The whole matter will have to be re-examined when EEC Directive No. 780 of 12 December 1977 is incorporated into Italian law. The Directive concerns the coordination of the regulations governing access to banking activity and a bill for its implementation has already been approved by the Senate.

In a sentence handed down in March 1983 the Court of Justice of the European Communities nonetheless condemned the Republic of Italy for failing to fulfil its obligations under the Treaty of Rome, since it had not taken the measures needed to conform with the Directive in the time allowed. For its part, the Banca d'Italia examines the applications of EEC banks in a manner consistent with the spirit of the Community directives. It is for this reason that the point at issue is the question of principle regarding the speedy and formal adoption of the Directive, while no Community banks can complain about discrimination in connection with establishment in Italy.

By the end of 1982 the number of authorized branches offering a full range of services had risen by 643 from 12,210 to 12,853 as a result of the implementation of the 1981-82 national branch plan.

Besides the shifts in the geographical distribution of the banking system produced by the authorizations granted under this plan, there were major changes in the structure of ownership.

These revived discussion about the size of the public sector component in the Italian banking system. With the aim of providing objective data, a study was made of the expansion in the last few years of public sector banking (taken to include: savings banks, first class pledge banks, public-law banks and, since they are owned by IRI, the banks of national interest —

the narrow definition — as well as the joint-stock banks they control — the broad definition).

The analysis reveals a downward trend in the importance of the public sector banks in the narrow sense. In relative terms the reduction was more pronounced for lending to customers than for deposits or the number of branches.

A different result is reached when public sector banking in the broad sense is considered, with both the geographical network and the volume of intermediation tending to expand.

The analysis confirms that Italian banks, and especially those of the public sector, are now seeking to increase their market share not only through growth of the original company but also through the creation of groups made up of banks with different legal forms.

While the takeover of smaller banks usually leads to their being merged with the parent company, larger banks are often left as separate entities to promote operational flexibility. This permits a degree of autonomy in management choices that will generally be set, however, within the framework established by group membership.

Shareholdings. —During the year banks complied with the instructions, issued in pursuance of the resolution of the Credit Committee of 28 January 1981, for the preparation and implementation of plans for the reorganization of their shareholdings and the disposal of those not conforming with the principles set out in the new regulations.

As regards banks' interests abroad, the greatest problems arose in connection with the dismantling of the holding companies upon which they had based their foreign networks. The willingness of the banking system to tackle the complicated problems involved in concert with the supervisory authority enabled a satisfactory start to be made on their solution and the conditions to be created for complying with the Banca d'Italia's instructions without serious drawbacks or harm to banks' balance sheets.

In Italy the supervisory authority supported banks' plans for maintaining ownership of their subsidiaries by modifying their objects to make them conform with the new regulations.

As regards acquisitions, most of the investments were in companies performing banking-related activities, above all leasing and factoring companies. This confirms banks' strategy of developing structures that will broaden their range of services while contributing to their profits.

Banks' statutes. — The revision of the regulations governing public sector banks' statutes made substantial progress for public-law and savings banks. Some new statutes have already been approved, while others are in the process of being approved or drafted by the responsible organs.

These revisions, which cover all the operational, organizational and capital aspects of banks enable them to:

- redefine their objects so that their operations can be brought into line with the new forms of intermediation developed by the market in accordance with the entrepreneurial nature of banking;
- achieve a more effective division of functions among their governing organs as regards policy-making, and the related control of results, and execution a distinction designed to stimulate fruitful interaction and effective internal control;
- strengthen their capital base by having recourse to the market without this implying withdrawal from the public sector.

Through their central association the savings and first-class pledge banks made an important contribution in 1982 to the implementation of these aims by preparing, and submitting to the Banca d'Italia for its approval, a set of guidelines for banks seeking to raise capital in ways suited to the markets in which they operate or introduce more entrepreneurial organizational structures.

One of the Banca d'Italia's aims when examining new statutes is to limit the scope of the organs with delegated powers by reserving the choice of operational policies to the board of directors and making the number of persons who can be given autonomous decision-making powers proportional to actual operating requirements.

With regard to monocratic executive organs, without prejudice to the decisions reserved to boards of directors, the authorities supported, and where necessary required, changes in statutes designed to result in the introduction of controls on the activity of the managing director in carrying out his duties.

Lending. — At the end of 1982 the Banca d'Italia implemented the Treasury Ministry decree of 22 November, issued in pursuance of Law No. 23 of 1981, by issuing instructions on the criteria for limiting the risk concentration of the special credit institutions.

These new regulations change the way in which the Banca d'Italia intervenes in this sector. In compliance with the principle of independent bank decision-making, the Bank is no longer required to authorize certain lending operations.

The new rules lay down limits for individual loans (related to own funds) and for total lending (related to own funds and to the total of large loans). These, however, are objectives to be achieved over three years. The limits vary according to the sector of operations and the size of the bank. The limit for individual loans can be exceeded only if a bank's board of directors passes a resolution giving the reasons for the decision. That on total lending, on the other hand, can never be exceeded.

Bank lending beyond the short term. — In this field the supervisory authority prefers banks to use their scope for lending and borrowing with matched maturities rather than permit greater maturity transformation. Banks have been requested to raise more medium-term funds in view of the risk inherent in excessive mismatching in the present state of the international capital market, with numerous borrowing countries carrying out complex rescheduling operations.

Regulation of the securities market

Access. — There was a further increase in the intermediation of the special credit institutions in 1982.

The control of total domestic credit made it necessary to adopt a restrictive stance in granting authorizations. Specifically, when the demand for funds appeared to serve primarily to build up liquid reserves in a period of tax exemption of security interest, the supervisory authority reduced the amounts requested in the light of an assessment of applicants' real financial needs.

Recourse to the share market by joint-stock companies was at a lower level than in 1981. This reflected the sharp decline in issues by listed companies, which was only partly offset by the increase in those of unlisted companies.

In particular, the process of strengthening their capital base in which listed companies have been engaged for several years slowed down considerably, primarily because a series of factors combined to depress the equity market: the need to absorb the large volume of securities taken up in previous years by underwriting syndicates, the decline in prices that lasted the whole year, and the delay in approving measures that would increase savers' propensity to invest in shares.

Atypical securities and unit trusts. — The broadening of the financial structure that has been under way for several years through new intermediaries entering the capital market was reflected at the legislative level by the approval of Law No. 77 of 23 March 1983. This regulates the setting up and working of unit trusts as well as some aspects of the issues of the numerous financial assets that have been developed outside the sphere of the credit intermediaries and have come to be known as atypical securities.

The legislation, which aims at providing a regulatory framework for the new forms of mobilizing saving, is designed to ensure the orderly development of financial intermediation and thus includes among its general objectives control of the money and credit aggregates and market efficiency. As regards unit trusts, the legislation also seeks to increase the propensity of savers to purchase longer-term financial assets.

The characteristic feature of the supervision of unit trusts is its global nature, since it extends to the various organizational and management aspects of the trusts themselves and differs from the role assigned to the Banca d'Italia in connection with atypical securities, for which the Bank can only intervene with regard to the maximum amount of issues, primarily to regulate the volume and composition of financial flows.

The supervisory powers apply to companies that set up and manage unit trusts and are basically designed to protect unit-holders' interests, thus creating the conditions for a greater flow of households' saving towards equity capital via intermediaries of good standing.

The protection of saving is provided for under Law No. 77 both through the control of intermediaries' soundness and by guaranteeing the transparency of the conditions governing the relationships between unit trusts and investors.

To this end the Banca d'Italia not only plays an advisory role in the procedures for the authorization of new unit trusts but also has regulatory powers over their operations. Especially important in this connection are the manner in which the management companies invest funds and the general control of the activity of unit trusts, which is achieved through the approval of their regulations as well as by setting prudential limits on their investments.

Banking supervision

Capital adequacy. — In 1982, continuing a tendency that now dates back several years, banks' own funds increased at a faster rate than intermediation.

The ratio of own funds to lending rose from 11.0 to 12.6 per cent and that of own funds to borrowed funds from 5.9 to 6.1 per cent (Table 47). The smaller increase in the second ratio compared with those of 1980 and 1981 was largely due to the strong recovery in banks' deposits last year.

Table 47 **RATIOS OF CREDIT INSTITUTIONS' OWN FUNDS TO THEIR LENDING**AND BORROWED FUNDS (1)

	1978	1979	1980	1981	1982
BANKS (2)					
Own funds/lending	8.3	8.7	9.1	11.0	12.6
Own funds/borrowed funds	3.9	4.1	4.6	5.9	6.1
SPECIAL CREDIT INSTITUTIONS (3)					
Own funds/lending	7.6	9.1	9.9	9.9	10.0
Own funds/borrowed funds	6.8	8.4	9.3	9.4	9.2
CREDIT SYSTEM					
Own funds/lending	8.1	8.9	9.4	10.6	11.6
Own funds/borrowed funds	4.6	5.1	5.7	6.7	6.9

⁽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) Monthly sample excluding central credit institutions. — (3) Excluding Mediocredito centrale and Artigiancassa.

The growth in the special credit institutions' own funds was in the region of 1,700 billion lire. Consequently, notwithstanding the relatively large increase in their operations, especially on the fund-raising side, they maintained their capital ratios at the levels of the two previous years. At the end of 1982 the ratios of own funds and borrowed funds to lending stood at respectively 10.0 and 9.2 per cent, compared with 9.9 and 9.4 per cent in 1981.

Inspections. — A total of 148 inspections were made in 1982 in accordance with the annual plan and in response to special situations that developed during the year. All the inspections were of the general kind and involved one special credit institution and 147 banks (with deposits of 39,162 billion lire or 13.5 per cent of the banking system total).

Extraordinary interventions

Banking supervision continued with the policy of seeking to provoke changes that will promote the return of normal conditions in the banking system as a whole, and more specifically in those banks with technical or operational anomalies. 'Whenever signs of difficulty appeared, the supervisory authority sought to strengthen banks' self-regulating capacity, if necessary through changes in the organization and membership of their governing bodies. When external intervention was required, preference was given to mergers with other banks, changes in the structure of ownership and the strengthening of the capital base of the problem bank by other banks or by the central credit institutions.

The creation by the central credit institutions of new instruments of intervention in favour of member banks would further reduce the need for extraordinary measures by making it easier, under the control'of the supervisory authority, to overcome the crises of individual banks and avoid repercussions on customer relations while safeguarding the organizational and professional capital of banks in difficulty. The Banca d'Italia always bears these objectives in mind in the measures it requires banks to take with the aim of ensuring the protection of savers' interests.

In cases of compulsory liquidation the supervisory authority tends to encourage other banks to take over problem banks' operations in a way provided for by the existing regulations, when this can be justified in economic terms by the potential the bank still possesses.

On the one hand, interventions are designed to attenuate the negative consequences of failure and also to avoid the transfer of losses to other healthy banks; on the other hand, they make it possible to free the credit system of banks that are no longer able to exist autonomously and, besides, do not preclude legal proceedings being instituted against those responsible for failures.

The outstanding development during the year was the crisis of Banco Ambrosiano, which was first placed under extraordinary administration and then in compulsory liquidation.

Banco Ambrosiano had created a group of considerable size with a substantial proportion of foreign operations. Furthermore, the structure of ownership was marked by the concentration of shareholdings with foreign companies, the real owners of which — in the absence of legislation guaranteeing the transparency of shareholdings — could not be established.

The instruments that the law makes available to the Banca d'Italia for the performance of its supervisory function, including inspections, were not sufficiently powerful to allow the Bank to obtain adequate information about the operations of Banco Ambrosiano's foreign subsidiaries. Nor was it possible to have recourse to the cooperation of local supervisory authorities, who either declared the matter to be outside their jurisdiction or refused to cooperate.

Following the Credit Committee's resolution of January 1981 regarding the new regulations on banks' shareholdings — regulations that the Banca d'Italia had promoted partly with the problems of Banco Ambrosiano in mind — the action of the supervisory authority sought to make the group conform, albeit with the gradualness foreseen in the resolution.

The interventions designed to modify the structure of the group were then flanked by an investigation of the risks attaching to the operations with Banco Ambrosiano's foreign subsidiaries. This involved establishing their roles in the group as well as quantifying their commitments and loans to third parties.

Since the behaviour of Banco Ambrosiano continued to be uncooperative, continuous pressure was brought to bear on the Board of Directors to supply information that it was in any case required to procure in order to make the assessments within its sphere of responsibility. This pressure finally produced the total lending of the foreign group to third parties, a figure to which the Ambrosiano Board's attention was specifically drawn. This had the result of causing, for the first time, a split within the Board, which, in view of the disappearance of the Chairman and the fast deteriorating financial situation of both Banco Ambrosiano and its foreign subsidiaries, asked on 17 June 1982 for the bank to be placed under extraordinary administration.

Throughout the commissioners' administration Banco Ambrosiano came under enormous strain, primarily as a result of an unmanageable run on deposits, loss of creditworthiness on international markets and the non-repayment of large sums owed by the foreign subsidiaries. It also began to emerge that a fraudulent and highly detrimental strategy had been developed and implemented with the connivance of third parties. The subsidiaries' assets were tied up in loans offering little prospect of repayment. Banco Ambrosiano was only able to continue in business because a group of leading banks provided large amounts of liquid funds under special arrangements.

While Banco Ambrosiano's liquidity crisis now appeared to be irreversible, a realistic estimate of its assets and liabilities indicated that its

capital had been completely wiped out and that there was a very large shortfall in the bank's own funds that would leave a sizable part of the claims of third parties unsatisfied and was bound to grow larger as a result of operating losses.

In the meantime very serious irregularities by the previous management came to light, especially as regards the prolonged failure to provide the data and information that were indispensable for the assessment of the bank's underlying situation, notwithstanding the repeated and detailed requests of the supervisory authority.

It was also judged that there was no way in the short term of arriving at a positive solution to the problem of the subsidiaries' claims and that the continuation of operations was technically impossible because of the total lack of liquidity, and in any case would have led only to the accumulation of further large losses and the gradual erosion of goodwill. In other words, Banco Ambrosiano was objectively bankrupt and unable to perform the functions of a bank. In addition, an attempt to arrange its rehabilitation by members of the banking system had made no headway.

In these conditions and with no realistic alternatives the Credit Committee was especially convened on 6 August 1982 and unanimously approved the Banca d'Italia's proposal — drawn up on the basis of a request to this effect by the extraordinary commissioners — that Banco Ambrosiano should be put into compulsory liquidation. At the request of the bankruptcy commissioners the Milan tribunal declared the bank to be insolvent on 25 August 1982.

As in previous cases of bank failure, the liquidation procedure went hand in hand with a multipronged intervention to protect depositors and creditors as well as employment and goodwill. To carry out the intervention, the supervisory authority employed the full range of available instruments and this proved sufficient to cope with the failure, notwithstanding its scale. In view of Banco Ambrosiano's structure, the solution chosen was the creation of a new company by the banks that had provided liquidity during the period of extraordinary administration. This company then took over assets and liabilities from the liquidators. The rapidity of this intervention made it possible for banking operations to continue without interruption and orderly customer relations to be maintained at all the branches. The takeover did not include the positions of Banco Ambrosiano with the Luxembourg holding company or the foreign subsidiaries. The management of these positions was left with the liquidators with the aim of achieving their recovery.

A common feature of failures is that they are not attributable to normal banking risk but to the improper use of the powers entrusted to members of bank managements. This abuse is made easier by shortcomings in the performance of the functions of the Boards of Directors and Auditors and often by the lack of an internal organization able to guarantee the necessary link between the top of the bank and operational reality.

The timely identification of banks affected in this way is entrusted primarily to the instruments prepared by the supervisory authority for the preventive control of the situation of individual banks and is based mainly on the regular analysis of the data that banks are required to provide.

This analysis can permit the early identification of anomalies in banks' financial positions, profitability and capital adequacy as well as forecasts of developments in the short term — provided always that the information provided is true and that banks behave rationally and in conformity with their declared objects. The continuous efforts made to improve the analysis of prudential returns — including the consolidation of accounts — cannot, however, prevent false data from being used to mask anomalous behaviour. The supervisory authorities check the veracity of the information supplied by means of inspections but it is up to company organs, and especially the Board of Auditors, to control that the accounts correspond to operational reality. In fact, while the Banca d'Italia's inspections are necessarily occasional, internal controls are by their very nature continuous and can therefore be more effective and penetrating, and not only at board but also at the executive level if special internal control centres are set up.

The improvement of the organizational aspects of both private and public sector banks has received special attention from the supervisory authority in furtherance of the policy of making suitable changes in banks' statutes to achieve a balanced distribution of powers and curb those assigned to monocratic positions such as that of managing director or general manager.

This action could be reinforced by legislative changes requiring well-defined moral qualities and professional qualifications for the members of banks' governing organs and establishing penalties for behaviour designed to elude internal and external controls as foreseen in the government bill on the penal responsibility of bank directors.

The composition of the controlling interest in a bank may also be an important cause of anomalous behaviour. The identification of shareholders makes it easier to assess the degree of a bank's independence, which is a basic requirement for the correct exercise of banking.

The practice of registering shares in the names of foreign nominees gets round the requirement that shares should be registered in their owner's name, a requirement that existed in the Banking Law even before the principle was adopted generally, and not for fiscal reasons but to prevent the exploitation of banks. The obstacles thus placed in the way of identifying the persons in a position to decide company policy make it impossible to discover the aims of strategies that diverge from the normal canons of behaviour and hence assess the threat to a bank's soundness. A legislative solution to the problem may lie in a government bill that attributes special powers to the Banca d'Italia with the aim of promoting the real transparency of bank ownership.

Banks' international operations

The problems of supervision at the international level. — The increasing internationalization of banking has created problems of control for the supervisory authorities, especially with regard to the operations carried out through companies that are legally distinct from the parent bank.

The separate nature of these companies results in their operations not being included in the information that each parent bank is required to submit at regular intervals to its supervisory authority. Furthermore, knowledge about the operations of foreign subsidiaries is sometimes hindered by local regulations on banking secrecy. An additional obstacle lies in the use of foreign holding companies to run banking companies in third countries.

Taken together, these weaknesses risk undermining the effectiveness of the instruments available to monetary authorities for the prevention of abnormal banking behaviour, especially when banks set out to elude public controls by locating their foreign establishments in countries where such controls are defective or totally lacking.

These problems have been carefully studied at the international level over the last few years. The Basle Committee on Banking Regulations and Supervisory Practices has agreed on the revision of the principles upon which the supervision of banks' foreign establishments should be based (set out in the document known as the 1975 "Concordat").

This document attributes responsibility for the supervision of foreign subsidiaries to the authorities of the host country, though recognizing that the parent bank's own supervisory authority must take account of the operations of such subsidiaries in view of the "moral responsibility" of the parent bank towards its foreign establishments. The concept of parental responsibility referred to in the Concordat does not, of course, have any legal force and in any case cannot be invoked in the case of a parent bank's insolvency.

Furthermore, the 1975 Concordat refers exclusively to preventive supervision and does not cover the issue of central bank support in individual bank crises.

The question of banks in financial difficulties is different and in this case the principle set out by the Governors of the Group of Ten in their September 1974 Basle communiqué remains valid. This declaration, however, only assured the financial community that in principle means were available for interventions in the international markets to cope with temporary liquidity crises.

Effective prevention requires both that no banking establishment should slip through the supervisory net and that the supervision should be carried out adequately. These objectives have been reaffirmed in the recent revision of the Concordat mentioned above.

To achieve the first objective countries with powers of authorization, such as Italy, could use them to allow banks to expand only in centres in which effective control systems are in operation and the authorities willing to cooperate internationally.

As for the adequacy of controls, it is generally agreed that the consolidation of accounts permits risk exposure at the aggregate level to be determined more accurately and the capital adequacy of banks with an international structure to be correctly evaluated.

Conviction about the effectiveness of control carried out by parent banks' supervisory authorities on the basis of worldwide consolidation needs to be tempered by recognition of the method's limits: risk concentration and asset quality can only be adequately assessed by host countries. Thus the adoption of supervision on a consolidated basis in parent banks' countries does not imply any reduction in the performance of the tasks assigned to the authorities of host countries.

The measures introduced by the Supervisory Department.

Notwithstanding considerable institutional and operational difficulties, the supervisory authority has gradually brought its operating criteria in Italy into line with those agreed at the international level, to the formulation of which it also contributed. A series of projects, already implemented for the part within the Banca d'Italia's jurisdiction, are designed to create a system of supervisory controls.

The special regulations on shareholdings in foreign finance and banking companies adopted by the Credit Committee in January 1981 introduced controls on the creation and continued existence of foreign establishments that are distinct from the parent bank. On the basis of the

guidelines laid down by the Committee, the Banca d'Italia's operational instructions stated that the acquisition of foreign shareholdings would be allowed only if the information about the foreign company judged to be necessary for effective supervision were obtainable and the host countries had adequate control structures. Furthermore, shareholdings abroad must normally be acquired directly without the intermediation of non-banking companies. In conformity with this directive, banks started to dismantle their holding companies.

With a view to assessing the advisability of allowing subsidiaries in offshore centres, the supervisory authority recently established bilateral contacts with the authorities of these countries in order to verify the existence and extent of controls.

As regards the *domestic supervision of the operations carried out via foreign establishments*, the Supervisory Department's fact-finding ability was strengthened in 1982 through a series of coordinated measures. The most important were the start of regular prudential returns on the consolidated accounts of foreign finance and banking subsidiaries and country risk. These controls complement those started at the end of 1981 on the financial flows between banks and their foreign affiliates as well as between their subsidiaries and companies associated with them. They are designed to measure the impact on the parent bank's balance sheet of all the funds disbursed to directly and indirectly controlled subsidiaries. At the time this information was analyzed, the supervisory authority reminded the boards of directors of the banks involved of the advisability of carefully assessing the results of the investigation.

The consolidation of accounts that banks have been asked to adopt in the future is designed to quantify the assets and liabilities, own funds and profits of the groups formed by Italian parent banks and the finance companies and banks they control directly or indirectly through ownership of more than half their equity capital. The collection of this data is a suitable instrument for the future implementation of the proposed EEC directive on supervision on a consolidated basis. This is currently being studied by the responsible Community authorities and also foresees mechanisms for cooperation between member countries in the exchange of information.

To achieve a more effective classification and quantification of asset and liability positions with various countries, as well as the related risk, the flow of information regarding the distribution of operations by country has been strengthened. The monitoring of Italian banks' exposure to country risk is designed to provide information both on the distribution of operations according to the country of residence of the counterparts and on the transfer of the final risk to residents in other countries. The data is classified by broad groups of operations and separately for banks in Italy, their branches abroad and their foreign subsidiaries.

International cooperation. — This continues to expand in the field of banking supervision with a series of initiatives being developed in various international organizations.

The EEC continued with the harmonization of laws, regulations and administrative provisions. The Advisory Banking Committee, the driving force behind the integration of rules and regulations within the Community, indicated the priorities for coordination to the EEC Commission. These indications gave new impetus to the proposed directive on "supervision on a consolidated basis", now being examined by a technical group attached to the Council, and to the plan for a directive on the winding-up of banks, which has been expanded to include measures to prevent crises from arising.

On the basis of the proposals put forward by the Contact Group of EEC supervisory authorities, the Advisory Committee made changes to the criteria for calculating the observation ratios for assessing solvency and liquidity as well as introducing a new ratio for profitability. Detailed technical issues were also studied by working groups set up by the Commission.

The questions discussed by the Cooke Committee in Basle in connection with the above-mentioned revision of the Concordat were communicated to the leading offshore centres in accordance with the policy of progressively developing international cooperation in the field of banking supervision.

The rising scale of developing countries' debt rescheduling attracted the Committee's attention to the policies of the exposed banks with regard, in particular, to provisions for bad debts. On the basis of the recommendations contained in a report submitted to the Governors for approval in September, the Committee decided to monitor the situation through regular exchanges of information among its members. The views that emerged at the international level were communicated to the leading Italian banks engaged in international business.

During 1982 the OECD agreement on subsidized export credits known as the Consensus was renewed for a year and subsequently extended to 30 June of this year. The most important aspects of the new agreement are the increase in minimum interest rates, the reclassification of countries on the basis of per capita income, and special arrangements for countries with interest rates below the minimum consensus level. These arrangements are the key issue in the current negotiations to renew the Consensus for a further period.

THE GOVERNOR'S CONCLUDING REMARKS

The Banca d'Italia was founded ninety years ago in August. In the first twenty years of the Bank's existence international political equilibrium permitted an increase in prosperity, security and liberty. This period of progress was followed by three decades in which grievous harm was inflicted on the fundamental values of civilized society. Italy was a party to these violent changes, as it was to the subsequent long phase of renewed stability and growth and to the tensions that have prevailed for the past decade; it not only reflected but helped to shape the course of these events, for good or for ill.

Similarly, in its main activities — management of the currency, the control and direction of credit and economic research — the Banca d'Italia has not simply mirrored the events and the features of Italian society: it has also acted as an instrument of economic progress and civic advancement, especially by identifying itself with the latter and displaying a sense of commitment that the serious problems now facing the country require us to strengthen still further.

We have begun a programme of research into the history of the Bank since its foundation. We considered that a review of the events in the life of the institution, even those in the distant past, was the best way to prepare for the Bank's centenary, to make a documentary and analytical contribution to the annals of our country and to enrich the store of knowledge of present and future members of staff and strengthen their capacity for decision-making. This historical research ties in with the intensification of the analysis of current economic trends now being undertaken, the findings of which will be published, starting in the autumn, in an Economic Bulletin prepared by the Research Department.

At this annual gathering we are called upon to give account of a range of activities that vary widely in purpose and in the manner of their execution but which all have the currency as their point of reference.

It is the duty and *raison d'être* of the central bank to act in such a way that the currency is stable and thus provides a certain and orderly framework for economic activity and for society as a whole. This order and certainty have been under threat for some time; the year 1982, the events of which are portrayed and interpreted in the Report that has been submitted to you, brings to an end a decade in which prices increased at an annual

average rate of 16 per cent, thereby reducing the lira to one-quarter of what it was worth ten years ago. The Bank in all its aspects, its working environment and the manner in which it performs its tasks cannot but be infused with a feeling of bitter disappointment at this state of affairs.

In an economy rendered vulnerable by a high degree of internal complementarity, where the government budget absorbs more than half of national resources, where a high degree of concentration in the organization of production and labour can have a destabilizing influence on the economic aggregates, the objective of monetary stability tends to move out of the central bank's sphere of influence; the danger can be averted only if society itself ceases to be inured to the steady debasement of the currency and resolves to reject the modes of behaviour, decisions and institutional arrangements that perpetuate inflation.

The duties of a central bank entail not merely carrying out the operations required to achieve price stability with all the determination and technical competence at its command: it must also unceasingly warn that the threat inflation poses for society and for the very institutions of the country is no less serious, yet more subtle, than others that Italy has courageously managed to overcome in recent years.

The Bank's organizational decisions, the definition and management of the activities of the branches and departments and the Bank's staff policy are based on the conviction that by laying increasing emphasis on professionalism in internal management the Bank not only increases the effectiveness of its own operations but places itself in a position to clarify the problems, choices and values that are involved in the smooth operation of a money economy. If it is nurtured and enhanced and coupled with an exclusive regard for the interests of the community, professionalism makes it both possible and imperative to voice the unpleasant truths that must be heeded for the sake of a stable currency.

The world economy _ from stagnation to recovery

After two years of stagnation, world demand failed to show the expected signs of recovery in 1982. The stance of economic policy remained restrictive; the recession deepened and spread to all areas of the world. The volume of world trade fell by 2 per cent. Over the last three years the number of people out of work in the OECD area has climbed from 20 to 32 million, or 9 per cent of the work force. Young people are the worst affected group: persons under 25 years of age account for more than 40 per cent of the unemployed. The prolonged recession has had serious repercussions on the developing countries; the contraction in their trade

outlets and the burden of high interest rates on a heavy volume of debt have exacerbated their `external financing problems.

Against these costs has to be set the progress that many industrial countries have made in bringing down inflation, which was impeding recovery in the economies concerned and undermining international monetary relationships.

In the United States, the Federal Republic of Germany and Japan the annual rate of increase in consumer prices fell to 3.6, 3.5 and 2.3 per cent respectively in March 1983. In the three major industrial countries inflation has thus returned to the levels obtaining before the two oil crises. In Japan and Germany the slowdown was achieved despite the weakness of the yen and the Mark vis-à-vis the dollar: their ability to curb the growth in money incomes and to prevent a damaging wage/price spiral as the exchange rate deteriorates has increased the. effectiveness and reduced the cost of their stabilization policies.

The slowdown in inflation permitted a substantial reduction in nominal interest rates in the United States and on international markets during the year, although real interest rates remained high.

The forecasts of a recovery in 1982 were based on the assumption of a revival in the US economy. In the early months of the year fears about the present and prospective growth in the Federal budget deficit placed an additional burden on monetary policy, which, in the fight against inflation, is strongly biased towards control of the monetary aggregates. The initial implementation of supply-side policies did not immediately trigger a virtuous circle of recovery, as their proponents had predicted. Far from stimulating private investment, the new Administration's cuts in direct taxation combined with the subsequent increase in defence expenditure to keep long-term interest rates high, thus discouraging investment.

In June a new fiscal policy was gradually introduced that was designed to reduce the deficit mainly by increasing indirect taxation. The measures already taken and those now before Congress have soothed market concern about the Federal borrowing requirement over the medium term but have not slowed down the growth in budget expenditure: current estimates still put the deficit for the 1983 fiscal year at more than \$ 200 billion, almost double the outturn for 1982 and the forecast made a year earlier for 1983.

Monetary policy also showed signs of a change, with a more pragmatic approach being adopted towards achieving the quantitative targets. In the summer the payments crisis in Mexico accelerated the transition to a less rigid monetary policy stance, coming as it did at a time of economic and financial strains in the United States that caused failures among businesses and financial institutions. The new approach was made possible by the unexpectedly large fall in inflation. The Federal Reserve considerably expanded the creation of monetary base. In the second half of

the year the discount rate was reduced from 12 to 8.5 per cent and the yield on Federal funds came down from 14 to 9 per cent.

Until November the dollar showed a continual tendency to appreciate, even after short-term US interest rates had declined. The strength of the dollar appears to have been due not only to the persistence of a positive interest rate differential in relation to other countries, particularly in long-term rates, but also to the uncertainties that hung over the world economy from the summer of 1982 onwards and which induced inflows of funds to the United States. Between November and the end of the year the exchange rate declined considerably but it rose again in 1983 when the interest rate differential stabilized at a level that was still favourable to the United States and expectations of further reductions in US interest rates receded.

The real exchange rate of the dollar, which is calculated by correcting market exchange rates to take account of the relationship between the level of prices for manufactures in the United States and the average of those in competitor countries, was 5 per cent higher in March than it had been at the beginning of the seventies in spite of the pronounced decline that occurred until the closing months of 1978. The appreciation between the beginning of 1979 and March 1983 came to 28 per cent. Taking forecasts for the current year into account, it is estimated that in the three years from 1981 to 1983 the volume of US exports of manufactured goods fell by 25 per cent, whereas world markets grew by 2 per cent.

The United Kingdom has suffered a similar loss of export market share in the last five years as a result of the real appreciation of 63 per cent in sterling between the end of 1976 and the beginning of 1981; between February 1981 and March 1983 the real sterling exchange rate declined by 19 per cent. In March the real value of the yen was close to the level recorded at the beginning of the seventies; it underwent wide cyclical fluctuations during the period under review, appreciating by 30 per cent between the end of 1975 and mid-1978 and depreciating by a similar amount in the subsequent four years. The variations in the exchange rate of the Deutsche Mark were less pronounced, but substantial nonetheless.

The last ten years have seen a combination of economic shocks and policy changes that was bound to cause substantial shifts in equilibrium exchange rates. It would have been difficult to avoid using the flexibility provided by floating exchange rates as a means of alleviating the resultant pressures.

Nevertheless, the variations that have occurred seem excessive. Short-term volatility, with daily movements in the rates of the principal currencies not infrequently exceeding 1 per cent, introduces an element of uncertainty into international relations. More worrying still are the long-term shifts in real exchange rates and in particular the radical changes

caused by anti-inflationary policies in the United States and the United Kingdom that hinge upon monetary policy. Such large changes impinge upon the allocation of resources through their effects on external trade, direct investment and the burden of international debt. In a highly interdependent world, investment decisions are hampered by the risk of arbitrary exchange rate movements that can distort the conditions for the profitability of plant. Protectionist tendencies are thus rekindled.

The reduction of inflation in the three major economies, and especially in the United States, is an important prerequisite for the restoration of a stable international monetary order. For exchange rate variations to be checked, however, it must be possible to count on consistency between monetary and fiscal policies. Coordinated interventions could then give more effective guidance to exchange markets by reducing exchange rate volatility.

Experience with the EMS supports these conclusions. The currencies linked together by the European exchange rate agreements have displayed relatively small fluctuations in both nominal and real terms. It has been seen, however, that the cohesion of the system can be safeguarded only when exchange rate changes are accompanied by a convergence of economic policies in the various countries. There have been delays in bringing about adjustment and serious tensions have developed, such as were evident at the time of the realignment in March of this year, but the discipline imposed by participation in the exchange rate agreement has strengthened convergence, thus dampening centrifugal forces that might have torn the entire European edifice apart.

The reintroduction of an international monetary standard that could serve as an instrument to reconcile external equilibrium and the recovery of world trade is a fundamental objective which must be pursued with the necessary gradualism. The Special Drawing Right could form the cornerstone of such a scheme. If this reserve asset is to play a central role, it must become the vehicle for IMF financing and lending operations. At the same time the creation of international liquidity through other channels must be curbed and its distribution controlled.

Interaction between the persistence of recession for a third year, the high level of real interest rates, the strength of the dollar and the deterioration in the terms of trade caused a rapid increase in the debt burden of developing countries and high-absorbing OPEC countries. The full gravity of the difficulties in the international payments field became apparent from the summer of 1982 onwards.

With hindsight, it is plain that too little attention was paid too late to the need for adjustment of these countries' economies and that the commercial banks were too ready to grant loans, often for purposes other than the expansion and modernization of industry. However, it was not easy to foresee that so many factors would conspire to exert a negative influence.

Export growth remained relatively high after the first oil crisis; in the five years from 1973 to 1977 the terms of trade of the developing countries improved at an annual average rate of 0.4 per cent, the same as in the preceding decade. In the five years that followed, however, they deteriorated by 3.4 per cent a year.

Between 1973 and 1979 average real interest rates were negative, thus contributing to the delay in adjustment. It should have been foreseen that interest rates would return to positive values, but from 1980 onwards the real cost of the developing countries' borrowing exceeded all reasonable expectations: the increase in nominal interest rates was accompanied by the decline in the dollar prices of their exports of primary products.

Oil imports by non-OPEC developing countries rose from \$ 19 billion in 1978 to \$ 39 billion in 1980, before declining to \$ 30 billion in 1982. Interest payments increased from \$ 20 billion in 1978 to \$ 40 billion in 1980 and \$ 60 billion last year. In the last three years their current account position has therefore shown a large deficit of between \$ 75 and 95 billion.

The international indebtedness of this group of countries, which had totalled \$ 340 billion at the end of 1978, exceeded \$ 600 billion at the end of 1982, with more than half this amount being owed to banks. The three most heavily indebted countries saw the ratio of their total short-term debt and repayments of long-term debt to their exports of goods and services deteriorate by about 50 per cent on average in 1982 alone to stand at 100 per cent in the case of Mexico, 75 per cent in that of Brazil and 140 per cent in that of Argentina.

In these circumstances a slowdown in the flow of credit owing to more cautious lending policies, which were induced partly by the fall in the price of oil, was sufficient to trigger a rash of crises. The emergencies were tackled by means of a coordinated series of actions by international institutions, central banks and commercial banks.

The International ,Monetary Fund played a central role, negotiating loans conditional upon the introduction of adjustment programmes by the countries in difficulties. Substantial bridging facilities were arranged; some were granted by the US monetary authorities themselves and others by the principal central banks under the aegis of the Bank for International Settlements. The commercial banks were asked not to call in outstanding loans; this action, which involves mainly the exchange of information and coordination at international level, should not be taken to the point where it leads to an improper blurring of responsibilities between official institutions and private banks, whose functions are necessarily complementary.

The need to enable the International Monetary Fund to play a greater role in financing balance-of-payments deficits made it advisable to bring forward the eighth review of quotas, which will be raised from SDR 61 to

90 billion, to expand the finance available under the General Arrangements to Borrow from SDR 6.4 to 17 billion and to permit the latter to be used by countries not belonging to the Group of Ten in the event of balance-of-payments crises threatening the stability of the international financial system.

The problems of international indebtedness have been tackled, but their solution requires not only the implementation of adjustment programmes in the debtor countries but also a return to lasting growth in the world economy. In the present circumstances neither the developing countries nor those belonging to OPEC can help set the recovery in motion, which must spread and gain momentum in the industrialized countries. It is on the results achieved in promoting recovery and in the campaign against direct and indirect forms of protectionism that the ability to manage the risks of international financial instability will ultimately depend.

The main indicators suggest that the US economy has begun to recover; the changes that have been made in economic policy will allow this trend to gain strength, but the mix of fiscal and monetary policies is still such that it will have an adverse effect on longer-term prospects. The budget deficit is a factor in the continuing high real interest rates, particularly at medium term; this not only impedes investment but also perpetuates the inflow of capital, which bolsters the external value of the dollar.

Signs of a cyclical turnround are also emerging in Germany: the decline in interest rates and the expansion in the money supply give cause to view the German economy's capacity for recovery with a fair degree of confidence. In the United Kingdom cautious monetary and fiscal stimulus and the recovery in competitiveness should enable the British economy to come out of the prolonged recessionary phase. In Japan private consumption and residential construction are gaining strength. The decline in oil prices provides a significant boost for importing countries by reducing inflation and easing the balance-of-payments constraint.

Signs of impending recovery are therefore discernible in the countries with the best record in the fight against inflation and where it appears that pressures on the labour costs front will remain lower. Any tightening of economic policies that nipped recovery in the bud would have consequences which would be hard to control.

The world economy has drawn back from the brink of a crisis not dissimilar to that of the thirties, which led to the collapse of trade relations and to protectionism. The conditions now exist for a resumption of growth. The battle must be joined and won. Each and every country can and must contribute by taking coordinated decisions and actions appropriate to the state of its economy.

The Italian economy in the grips of inflation and recession

In 1982 Italy went through the bitter experience of recession in common with the rest of the world economy, but did not succeed in curbing inflation. The continued steep rise in prices and the persistent external deficit meant that a restrictive stance had to be maintained with regard to interest rates and lending. An acute conflict developed between the need for monetary stringency and the need to finance the public sector borrowing requirement.

At 79,600 billion lire, the borrowing requirement of the enlarged public sector exceeded the target set in the Forecasting and Planning Report by almost 30,000 billion lire and represented 16.9 per cent of gross domestic product, the highest ratio since the immediate post-war period.

The recessionary phase which began in mid-1980 became more acute in 1982, spreading to fixed investment and proving to be more protracted than the downturns experienced in previous cycles. Employment fell for the first time since 1972, with the services sector failing to make good all the job losses in agriculture and industry. Firms responded to the recession by putting surplus labour on the Wage Supplementation Fund and by virtually stopping recruitment altogether. Excluding workers covered by the Wage Supplementation Fund, unemployment passed the two million mark, or 9 per cent of the labour force. The deterioration continued in the first few months of 1983.

Despite the contraction in world trade, export volumes remained unchanged. Imports went up by 1.5 per cent as a result of the replenishment of stocks of raw materials, stimulated by low prices on international markets and, at the beginning of the year, by expectations of an impending recovery in demand, which in the event did not materialize. The trade deficit was kept down by the improvement in the terms of trade in the first half of the year, when the decline in raw material prices more than outweighed the stronger dollar; this trend came to halt in the second half of the year. The favourable performance of tourism offset the higher burden of interest payments on Italy's external debt. The current account deficit amounted to 7,400 billion lire, or 1.6 per cent of gross domestic product, as against 9,200 billion lire in 1981.

The current account deficit and the outflow of short-term capital occasioned by the reduction in banks' and commercial firms' indebtedness were financed by new foreign loans worth 8,800 billion lire and drawings on official reserves to the extent of 5,600 billion. At current exchange rates and excluding gold reserves, Italy's net financial position moved from a surplus of \$11 billion at the end of 1979 to a deficit of approximately \$21 billion at the end of 1982.

The rate of consumer price increase for the twelve months ending in December fell from 18.1 per cent in 1981 to 16.1 per cent in 1982. 'Wholesale prices turned in better results: whereas in 1981 their growth rate was close to that of consumer prices, in 1982 it fell to under 12 per cent. That the rate of consumer price increase was more reluctant to slow down is attributable to rises in public charges, administered prices and indirect taxation as well as to the fact that retailers' profit margins held up.

In the industrial sector increases in a number of social security contributions and the new arrangements for severance grants combined with the automatic support for wages afforded by the *scala mobile* to cause an average increase in hourly labour costs of 18 per cent in 1982, despite the absence of wage settlements. If productivity gains are taken into account, unit labour costs increased by 16.5 per cent.

The slowdown in the rate of growth of producer prices, from 17.8 per cent in 1981 to 13.5 per cent in 1982, was almost entirely due to external cost components, such as energy and raw material prices, the rate, of increase of which dropped from 33 to 11 per cent. As against this, the growth rate of domestic components, the most important of which is unit labour costs, went down from 18.9 to 16.1 per cent.

The inflation differential between Italy and the main industrial countries widened. Between the peak levels reached in the wake of the second oil crisis and March 1983 the twelve-month rate of consumer price growth fell from 14.6 to 3.6 per cent in the United States, from 8.7 to 2.3 per cent in Japan, from 6.8 to 3.5 per cent in the Federal Republic of Germany, from 14.3 to 9.0 per cent in France and from 22.6 to 4.6 per cent in the United Kingdom: in Italy it went down from 22.0 to 16.1 per cent.

The persistence of inflation in Italy has proximate causes and also deep roots in the past. The first increase in the price of oil hit an economy that was particularly dependent on this source of energy and already inflation-prone as a result of spiralling wages and institutional rigidities. It was followed by a further acceleration of wages and unit labour costs. The profound changes in the productive system required in the light of the changes in relative prices were hampered by insufficient labour mobility, by spreading and mounting indexation and by sectoral and regional disequilibria.

Consequently, the second oil shock came on top of inflationary factors which had not been eradicated in the previous years despite the stabilization measures that had been taken. Success in strengthening the industrial base in 1979-81, energy conservation, improved labour mobility and, recently, new budgetary measures, together with restrictive monetary policy, barely served to bring inflation down from the peak levels recorded in 1980 to the average for the decade from 1973 to 1982. These accomplishments failed to

make serious inroads into the corpus of underlying causes, which took a firmer hold and became more tenacious as the years went by.

The combination of recession and inflation is not sufficient in itself to explain the extent to which the state borrowing requirement and exchange rate movements brought pressure to bear on the management of the money supply in the course of the year.

In the first few months of 1982 the slowing of price inflation and the beginnings of a decline in interest rates abroad enabled short-term rates to be manoeuvred cautiously downwards and the maturities of Treasury securities to be lengthened. This movement was interrupted by exchange rate pressures in March and April; in May normal conditions returned.

We gave an account of these events on this occasion last year. In remarking on the fall in inflation we intimated that further progress would hinge on the adoption of patterns of behaviour capable of correcting the forces that nurture inflation, and identified leapfrogging wages and prices and the public sector borrowing requirement as the chief threats to the domestic and external value of the lira. We also pointed out that the risk that the recovery of the world economy might be slow to appear could make the adoption of a more restrictive stance a matter of greater urgency. This assessment was borne out by subsequent events.

Strains within the European Monetary System culminated in the June realignment. In the talks on parities Italy stood by the line that it had maintained since the inception of the EMS, i.e. that the appreciation of the real exchange rate as a result of the faster momentum of prices and costs in relation to those in the other countries should not erode Italy's competitiveness to the extent that it undermined its industrial base, but that a policy of accommodation at odds with the objective of curbing inflation should be rejected.

The action taken in the summer stemmed from the recognition that the public sector borrowing requirement was diverging from the planned levels. Measures designed to bring in around 6,000 billion lire were taken in the fields of taxation, social security contributions and public charges.

These moves were also consonant with the need for a more fitting allocation of responsibilities as between monetary policy and fiscal policy in a period of falling inflation and declining industrial output. The downward movement in interest rates resumed after the break in the spring, induced by successive cuts in the tender rates of Treasury bills, which pushed yields on three-month bills to a low of 17.5 per cent in September.

In proposing a one-point cut in the discount rate in August — which had been constant at 19 per cent since March 1981 — the Banca d'Italia gave notice that the reduction in the cost of borrowing could be

consolidated and extended to the whole structure of market rates only if the measures taken succeeded in keeping the Treasury borrowing requirement within the new targets.

In early autumn it was already becoming apparent that the effective deficit was exceeding the new estimates: even though the measures were beginning to bite, the monthly requirement was rising instead of falling. Further, the still unbroken link with the wage indexation mechanism caused the price impact of the tax and social security increases to have a ripple effect above and beyond their initial impact. At the same time the favourable shift in the terms of trade was petering out. Inflation rekindled: between July and November the average monthly change in wholesale and consumer prices worked out at 1.3 and 1.5 per cent respectively as against 0.6 and 1.0 per cent in the preceding five months.

The pressures made their appearance on the eve of a seasonally unfavourable period for the balance of payments. They were heightened by the imponderables associated with the negotiations on the wage indexation mechanism and by political difficulties, which delayed parliamentary approval of both the July measures and the finance bill and budget for 1983.

Soon thereafter the money and exchange markets were hit by acute difficulties.

The central bank had to take pressure off the exchange rate by clamping down on bank liquidity, and tackle the difficulties experienced in financing the public sector borrowing requirement. The situation would have called for a prompt increase in Treasury bill base rates at the tenders, allowing the State to tap liquidity direct from the market, which would have made it easier to counter the currency speculation.

Yet again, the pressure on the lira stemmed from leads and lags and the reduction in foreign currency borrowing with the banks. In October and November the official reserves fell by a total of 4,500 billion lire. As in the spring, the pressures were resisted. Control of bank liquidity — principally by means of repurchase agreements — was coupled with exchange measures: the requirement that 70 per cent of export credits of up to one year's maturity had to be financed in foreign currency was introduced in order to stabilize bank lending at the levels reached at the end of the summer

The strains on the money market were more drawn out. The sheer scale of Treasury borrowing on the market, together with inadequate yields, spawned mounting anxiety and uncertainty. Statements about public debt and taxation of income from Treasury bills transformed these fears into a state of alarm. There was a real danger of a movement out of government securities.

Faced with the need to make payments, the Treasury got round the shortfall in market borrowing by overdrawing on its current account with the central bank beyond the permitted limit in September and, to a substantial extent, in all the remaining months of the year. The Banca d'Italia gave immediate notice of this state of affairs to the Treasury Minister as it is required to do by the law, which provides that payments must be suspended in the event that the overdraft is not brought inside the limit within 20 days of notification. At the height of the crisis the Bank made large purchases of securities at issue, raised yields on the secondary market to mop up liquidity and drew the Government's attention to the untenable situation that was developing. Treasury bill base rates were adjusted upwards slightly at the end of October and by a larger amount in mid-November, thus returning to the levels reached in March and close to long-term Treasury bond rates.

As a result of this action the difficulties on the money market were overcome — at the cost of overshooting the end-year objectives. In the event, the creation of monetary base via the Treasury amounted to 12,700 billion lire in 1982 as against the forecast made in June of 9,000 billion lire. The public's movement out of Treasury bills made for faster growth of bank deposits, which had already been expanding rapidly since mid-year.

Economic and financial policy programmes for 1982 had assumed that the public sector's domestic borrowing requirement would run at 43,000 billion lire and that domestic lending to the economy would expand by 30,000 billion lire. Midway through the year the public sector borrowing requirement was lifted to 61,000 billion lire; the final figure for the year was 67,900 billion. Lending to the economy grew by 30,100 billion lire.

Public sector borrowing came to 27.6 per cent of outstanding debt, as against the initial forecast of 17.5 per cent, while lending to the economy, at 14.0 per cent, was on target. Total domestic credit expansion reached 21.0 per cent; as a percentage of gross domestic product it rose from 18.1 to 21.4 per cent between 1981 and 1982.

Restrictive action by the Bank — in the shape of the regulation of monetary base and direct controls — was directed towards limiting borrowing and increasing the propensity to save by allowing real interest rates to rise.

The rate of growth of total lending to the economy fell from 18.2 per cent in 1981 to 14.9 per cent in 1982. The real cost of bank credit — calculated by deflating the average lending rate for wholesale price changes — worked out at 8.1 per cent, 3.4 points up on 1981. Industrial firms paid an average real rate of 6.5 per cent on total credit granted in 1982.

Under the pressure of the public sector borrowing requirement, financial assets held by the economy expanded by 20.0 per cent, two points more than in 1981. Compared with the recent past, the composition of flows shifted away from Treasury bills to bank deposits and securities with maturities of more than one year. Corrected for changes in consumer prices, the yield on financial savings increased by an average of four points in the

course of the year, albeit remaining negative. Net of the inflation-induced loss of purchasing power, households invested 2.8 per cent of their disposable income in financial assets, as against 0.3 per cent in 1981.

The flow of 30,000 billion lire earmarked for lending to the economy when the forecasts for financial flows were made, was viewed by the Bank as restrictive, and it was in fact so low that it was not possible to offset even part of the higher public sector borrowing requirement by further restricting lending to the corporate sector. Had this been done it would have pushed up the cost of borrowing to intolerable levels, which would have had grave effects on production and investment. To have offset this difference in full would have entailed cutting lending to the economy by 83 per cent last year. Ten years ago, when the public sector borrowing requirement amounted to 34 per cent of total domestic credit — as against 68 per cent today — offsetting a percentage difference of the level recorded this year would have necessitated pruning lending to the economy by 30 per cent.

At the beginning of the new year the technical and institutional problems posed by the excessive overdrawing on the Treasury's current account were overcome — but certainly not the economic and monetary ones — by Parliament's approval of an extraordinary advance to the Treasury. Action to curb deposits and bank lending was stepped up as a result of the measures taken by the Interministerial Committee for Credit and Savings and the Banca d'Italia in December. The changes made to the compulsory reserve system sought to slow down the expansion of deposits, to make operations economically tantamount to bank deposit-taking subject to the same rules and to increase the effectiveness of indirect methods of monetary control.

The acceleration recorded by the monetary aggregates at the end of 1982 was gradually corrected in the first few months of 1983. The public increased its preference for longer-term securities, making a significant investment in Treasury credit certificates. There was a break in the process of reintermediation by the banks.

On the exchange market the lira — helped to some extent by the interest rate differential — remained stable in the upper part of the EMS fluctuation band throughout the winter until early March, although from early February onwards approaching elections in France and the Federal Republic of Germany, on top of the divergent performance of the European economies, created expectations of a realignment and concomitant strains within the European Monetary System.

When the lira was caught up in the crisis, the Bank reacted by curbing bank liquidity, raising very short-term interest rates and allowing the exchange rate to find its own level in order to discourage moves prompted by the delay in carrying out the realignment, which was now inevitable.

Following the realignment of central rates on 21 March the lira settled at values slightly above those that it had attained in the two preceding weeks. The reserves used to defend the exchange rate were quickly recouped. Liquidity returned to normal and interest rates were able to resume their downward path, assisted in early April by a one-point cut in the official discount rate.

These tactical successes — accomplished by keeping the exchange rate and liquidity under control — do not resolve the fundamental problems. As a result of the recent realignment and the prevalence of stabilization policies in the other countries, Italy is in danger of remaining the only EMS country out of step, the only one in which the fundamental corrections have still to be taken in hand.

Public finance and monetary policy

In an economy suffering from high unemployment and needful of changes in the industrial fabric, budgetary policy can help to alleviate the existing disequilibria and stimulate capital formation in appropriate directions. In Italy this vital role is hampered by the sheer size of the deficit and by the characteristics which expenditure policy has acquired in the course of time, which influence the economy in ways incompatible with the external constraint and price stability. The events of 1982 underscore the extent to which this has conditioned monetary policy.

The efficiency and controllability of expenditure have been affected by institutional changes that have divorced responsibility for decision-making from responsibility for financing the measures, increased the degree of indexation of expenditure, indiscriminately expanded the social security system and ignored demographic trends. The forms and dimensions that state aid to households and firms has acquired disregard the need for compatibility between resources and the calls upon them. Government expenditure has generated demand without significantly improving supply conditions. The standard of public services has widened the gulf between the trend of labour costs and that of productivity in the economy as a whole.

The strength of these causes of fundamental disequilibrium is borne out by the size of the 1982 borrowing requirement and that forecast for the current year, despite the extensive corrections that have been made, particularly on the receipts side, and which should produce improvements equal to 6 per cent of gross domestic product in 1983.

The rapid growth in many components of expenditure will soon begin to raise even greater problems. In particular, demographic trends, the gathering momentum of the pension schemes and the tendency for the scope and cost of health services to increase will enlarge the deficit and raise the pressure on financial resources.

The population of pensionable age will increase rapidly and will exceed the present level by about 1 million at the end of this decade; the ratio of this group to the population of working age over 20, which will itself grow by almost the same number, will rise to 45 per cent in 1991, after having increased from 40 to 42 per cent between 1971 and 1981.

For a family, a firm or a community, the budget constraint is another way of saying that the satisfaction of needs depends upon the resources that are available or can be generated. Openness to foreign trade and the countercyclical function of public spending make higher levels of prosperity possible, but they do not remove the budget constraint. If economic agents formulate their behaviour on the assumption of a volume of resources that is not and will not be available, the inevitable restoration of real equilibrium will be all the more painful the less it is the result of a conscious choice; if the return to equilibrium occurs by monetary means, economic performance and patterns of economic behaviour will be modified by shifts in the exchange rate, the level of prices and interest rates, each of which reflects the value of the currency from a different angle.

In 1981 and 1982 gross domestic product remained unchanged; the public sector, on the other hand, increased its borrowing by 14 per cent in real terms and the country's external debt went up by \$ 9 billion.

The ratio of taxation to GDP rose by some 2.5 percentage points in 1982 and is expected to increase by a further 3 points in 1983 to 42 per cent. In view of the temporary nature of some of the measures that have been taken, major action will be needed in this area just to keep the ratio at this level. In order to avoid further stimuli to inflation, the planned increase in indirect taxation will have to be coupled with changes in the indexation arrangements in accordance with the procedures, embodied in the agreement on the cost of labour.

The long-term trend of the government deficit cannot be reversed by continually increasing the tax burden, even though more radical steps have to be taken to deal with tax evasion.

The expenditure problem will have to be tackled by making a course correction. We have mentioned certain aspects of the pension and health systems because of their size and the nature of the mechanisms that operate within them, but the choices that must be made apply equally to the entire range of public expenditure. The progress that has been achieved in the social security field as a result of greater prosperity and a stronger feeling of solidarity can be protected and perpetuated only if there is true fairness in the distribution of income, monetary stability and efficiency.

Certain technical and economic criteria should be emphasized. First, a clear distinction should be drawn between public goods and services offered in accordance with the efficient allocation of resources, and welfare payments granted on the basis of social justice and solidarity. Secondly, the types of public goods and services offered and the level of provision should accord with the aim of balancing benefits against costs in terms of the overall utilization of resources. The third criterion is that eligibility for welfare payments should be determined on the basis of actual need in order to ensure greater fairness and to prevent the indiscriminate provision of subsidies which, because of their low unit value and the large number of claimants, are inadequate for recipients and yet burdensome for the community.

Improved efficiency in the provision of public services and revision of the indexation mechanisms, which accentuate the unchecked expansion in outlays, are essential if a more correct stance in terms of the principles involved is to be translated into better control over expenditure.

The problems described above are common to the majority of industrial countries, but in Italy they have taken on larger proportions and there has been delay in taking corrective measures. Over the last five years the general government deficit has averaged more than 10 per cent of gross domestic product, whereas in the other six major industrial countries it has ranged from 1 per cent in the United States to 4.5 per cent in Japan. The gap is smaller, but still substantial, if interest payments are excluded.

If corrective action is not taken, the task of monetary policy will become extremely arduous. The monetary authorities would be failing in their duty if preoccupation with minimizing the cost of public and private borrowing led them to accept the monetization of the debt and to acquiesce in inflation and a flight from money. In order to prevent this, monetary policy should keep interest rates sufficiently high to encourage saving. However, in times of stagnation or slow growth, positive real interest rates can outstrip the rate of growth of the economy and prove unsustainable over the long term because they give entitlement to an income that the economy does not in fact produce.

In the recent past the payment of positive real yields on government securities has averted the danger of financial assets being dissipated in higher inflation as a result of attempts to use them for consumption or the purchase of hedge goods. Monetary policy has thus avoided a vicious circle involving mounting debt, inflation, external deficits and the exchange rate. But these remedies cannot cure the fundamental disequilibria.

An economy has no built-in safeguards against the danger that inflation will rise to ever higher levels, particularly after monetary depreciation has been rooted in expectations and behaviour for more than a decade. The fact that this danger has been averted once does not mean that it has been banished for all time. Daring manoeuvres to bring down interest rates would be steps towards the disintegration of the currency.

The corporate sector, which in past years benefited from the subsidy implicit in negative real interest rates, is smarting under the high cost of money and has expressed its discomfort in no uncertain terms. However, if we are to be consistent in our rejection of inflation, a decrease in interest rates should be strictly conditional on a decrease in inflation. This is the line we have followed in the past and are still following today. The gradual reduction in the cost of money has not been helped by the attacks on the lira, which were launched and repulsed twice in 1982 and which twice caused the downward movement in interest rates to be suspended.

The Government's decision to place the matter of the Treasury's excessive overdrafts on its current account with the central bank before Parliament by requesting an extraordinary advance was the institutionally proper course of action. By this means the representatives of the community at large were made aware of the serious imbalance between the amount of funds to be disbursed and the amount of funds actually available. Had the central bank chosen to conceal this problem by purchasing sufficient securities to bring the overdraft back within the legal limit, it would have violated the spirit of the rules governing its conduct. The limit on the Treasury overdraft is not a mere technicality, it is a necessary condition for a policy of monetary stability and is rooted in the constitutional principle that savings must be protected. The discretionary powers vested in the Banca d'Italia may not be used to betray this principle.

The extraordinary advance enabled Parliament to avoid the trauma of the suspension of payments. The fact that the advance was for a fixed term commits the Legislature itself and the Executive to making the budgetary aggregates consistent with a tight monetary stance.

For stable and predictable monetary conditions to return, society itself must make fundamental choices: no technique or instrument of monetary control can stand in their stead or indeed induce them. However, this does not detract from the importance of seeking and perfecting methods of credit control and market intervention that are valid now but also go beyond the needs of the moment.

Starting with the reforms made to the compulsory reserve system and to the Treasury bill tender in 1975, the measures taken in recent years have resulted in increased operations on the open market in conditions in which the professional skills of the intermediaries are fully utilized and developed, the flow of information to the public is increased and competition strengthened. The Treasury bill market has been made accessible to a greater number of participants and its operational structure reinforced so

that it has become the main forum for the control of monetary base and liquidity, even though the burgeoning public sector borrowing requirement and the persistence of inflation have caused it to expand to such an extent as to complicate this exercise. Monthly issues of Treasury bills climbed from 2,780 billion lire in 1975 to 22,800 billion in 1982 gross and from 870 to 2,800 billion lire net. The fact that bank liquidity — the operationally significant aggregate in the very short term — increased from 2,350 to 3,350 billion lire in the same period brings out the increased delicacy of the mechanics of monetary base control and the extent to which access to adequate techniques and mobility of short-term interest rates is necessary in order for it to operate effectively. The measures taken more recently are consistent with and strengthen this approach.

The need to reduce fluctuations in liquidity led to the introduction of fortnightly tenders on the new issues market and to the development of repurchase agreements on the secondary market. By virtue of their flexibility the latter have proved to be an efficient instrument for the day-to-day regulation of monetary base; they are a useful means of maintaining orderly market conditions in the presence of high and variable Treasury payments flows as well as facilitating the successful outcome of Treasury bill tenders, and enable vigorous restrictive action to be taken when special circumstances so require.

The introduction of competitive tenders for three-month Treasury bills, which are still open only to credit institutions, constitutes a further step in the delicate operation of reconciling the requirements of monetary control with the Treasury's need to procure funds in the market on the best terms.

The increased ability to regulate monetary base afforded by these innovations is complemented by the changes made to the compulsory reserve system last December, which link the monetary base more efficiently to the level of bank intermediation. The reserve ratio was increased, which had the effect of reducing and stabilizing the deposit multiplier. The Interministerial Committee for Credit and Savings further resolved that the ratio could be changed, within specific limits, by the Treasury Minister at the proposal of the Banca d'Italia. Finally, it decided that the system should converge towards a single stock-based ratio, thus speeding up the existing trend towards a reduction in the differential impact of the reserve requirement on the various credit institutions; this will ensure that changes in the reserve requirement will have unequivocal effects on monetary expansion irrespective of whether deposits are increasing or decreasing.

The introduction of forms of negotiable bank deposits with less marked monetary characteristics, such as certificates of deposit, which was encouraged by the payment of a higher rate of interest on the corresponding portion of compulsory reserves, makes for greater transparency and hence for enhanced protection of savers, stimulates the proper exercise of competition and in time should result in a closer link between money-market rates and bank lending rates.

The choice of intervention techniques and instruments calls for a sense of pragmatism and heed for the long-term implications. Methods of indirect control avoid the inefficiencies entailed by applying a uniform yardstick to a system which is simply not uniform. Administrative credit controls can be useful in order to obtain a swift and more precise impact on the expansion of lending; we have repeatedly had recourse to such measures.

The lapsing of the ceiling on bank lending at the end of June 1983 in accordance with, the intention expressed last December stems partly from the conviction that prolonged usage has reduced its effectiveness and is taking its toll of the economy. The degree of credit restraint and the instruments used to achieve it are separate issues. The transitional period will be facilitated by responsible behaviour on the part of banks, large and small; the necessary precautions will be taken.

Guidelines for the financial system

The disparity between the financial balances of the three main domestic sectors that are final users of resources was again extremely large in 1982. In relation to gross domestic product, the net borrowing of the public sector and the corporate sector amounted to 13.9 and 3.1 per cent respectively, while households' net financial saving was 15.3 per cent. The capital market and especially the credit intermediaries had to cope with a correspondingly large flow of funds in difficult conditions.

Criticisms were levelled against the banking system that may have given the impression that firms' difficulties are basically of a financial nature and that industrial growth could be revived merely by eliminating certain inefficiencies in intermediation. Analysis of banking costs presents difficulties both in theory and in practice. The Banca d'Italia has carried out research with a view to supplying objective data and helping bankers improve their performance through a better understanding of the system; the findings of this research are to be published shortly.

The least unsatisfactory indicators of how much the banking industry costs the economy are the difference between total interest received and paid (the interest margin) and the sum of this balance and net income from banking services (the gross earnings margin), related in both cases to a measure of the volume of business.

According to a comparative OECD study for the year 1977, the margins of the Italian banking system were in the middle of the range for the OECD countries. A fresh analysis has subsequently been carried out for

1977-81 using basically the same methodology but differentiating between classes of banks and covering a smaller number of countries.

The most meaningful comparison is that of the interest margins of commercial banks, since their operations are broadly similar in the various countries concerned. The Italian banks were also found to be close to the median during the five-year period, with an interest margin of 2.8 per cent of balance sheet assets. The lowest margin, 2.1 per cent, was recorded by the German commercial banks. If gross earnings margins and the other categories of banks are considered, the values recorded by the Italian banking system tend to rise.

International comparison thus shows that there is scope for reducing banks' margins, but it also reveals the limits to such action. Achievement of this objective, which certainly cannot be brought about by fiat, is the contribution of greater efficiency the banking system is required to make, together with an improvement in the quality of its services. Nonetheless, there is no hiding the fact that the effect on interest rates will necessarily be small in relation to their present level.

If real progress is to be made in bringing down the cost of money, conditions permitting a less restrictive monetary policy will have to be created. The decline in rates started as soon as the imbalances in the economy showed signs of diminishing. From a peak of 25.4 per cent at the beginning of 1982 the average rate on overdrafts declined to 23.7 per cent in April of this year. Over the same period the prime rate decreased by three points to 18.75 per cent.

The interest rate problem, however, must not distract attention from the real as opposed to the financial difficulties of many large firms. Their heavy reliance on loan capital reflects their inadequate self-financing capacity or even losses. The balance sheets of the leading companies show that in 1975-81 not even gross operating profits would have been enough to cover depreciation that took full account of the useful life and replacement cost of capital goods. It follows that the anaemic profit and loss accounts of many sectors are due to the serious imbalance that has developed between prices and non-financial costs.

Progress in getting the economy back on to a sound footing will push interest rates down not only directly but also by reducing the cyclical component of banks' gross earnings. In recent years the commitment to fight inflation, coupled in some cases with the external constraint, has led the major countries to maintain a restrictive monetary policy stance even after economic activity has turned down: because lending rates rise faster than deposit rates, the pro-cyclical nature of banks' margins has been accentuated.

A no less important aspect of banking, especially in an economy engaged in a large-scale reallocation of resources, is the ability to assess creditworthiness.

Experience and banking practice supply general criteria, based on the interaction between production and finance, that make full use of the scope for the responsible exercise of discretion and prevent this from degenerating into arbitrariness. By drawing attention to these criteria in last year's Concluding Remarks and then carrying out a study both in Italy and abroad, we sought to stimulate and strengthen the commitment to apply them in the most appropriate manner.

Prudence and independence in the selection of borrowers safeguards both the soundness and the allocative efficiency of the banking system. The stagnation of the economy was bound to be reflected in bank lending. The credit system did not shirk the task of supporting firms and thus enabled them to make vital investment in reorganization.

The proportion of bad debts increased in every sector. Banks looked for ways of reducing or offsetting the marginal risk attaching to loans. The data collected by the Central Risks Office show that banks tended to prefer customers in sectors, geographical locations and size categories with a better-than-average record of bad debt. In addition, gross profits were used to increase provisions and depreciation. The Italian banks' own funds thus approached the levels obtaining in countries where banks can more readily strengthen their capital base through share issues.

In its role as supervisory authority the Banca d'Italia has analyzed the determinants of competition to discover the means of achieving lasting improvements in the efficiency of the banking system. It has sought to achieve stability by encouraging banks to diversify their risks and strengthen their capital base and by maintaining orderly conditions in the capital markets. Faced with the spread of erroneous views of the role of the credit system as a result of the difficulties in the economy and certain events in the banking sector, the intrinsically entrepreneurial nature of banking was reaffirmed through the organizational changes made in public sector banks, the new regulatory framework for medium and long-term credit institutions, the proposals for new legislation on the control of bank ownership, banks' shareholdings in other companies and the separation of lending from the granting of incentives.

It was made easier for foreign banks to set up in Italy. Authorizations to open or transfer branches and to acquire controlling interests in other banks made inroads into local oligopolies. The stimulus to competition was also heightened by strengthening the money market.

The supervisory authority sought to resolve the potential conflict between economies of scale and competition by avoiding excessive concentration, fostering rationalization rather than expansion of the branch network, encouraging an increase in the average size of the smaller banks engaged in domestic deposit-taking and lending, and entrusting the major banks with the most demanding forms of international banking business.

To have left large parts of the banking system to perform a purely deposit-taking function would have conflicted not only with the requirement for competition but also with that of satisfying credit demand from deserving small and medium-sized firms. The savings banks have been working for some time now to achieve a better balance between deposit-taking and lending. The completion of this process is in the hands of the individual banks; proposals have been made, and in several cases implemented, for changes in company statutes to permit the public to supply minority capital and entrepreneurial ability; the range of savings banks' operations has been extended and encouragement given to the search for ways of achieving more efficient size, including voluntary mergers.

The need to re-establish the distinction between the political and business spheres also applies in the banking field, especially in connection with appointments to governing organs. Since the key aspect of banking is the granting of loans in accordance with economic criteria, the professional ability of the governing organs must be used to the best possible advantage by excluding partiality. Above all, managing directors and general managers must be chosen among bankers with no "labels" who have passed the test of a long career in banking or business management.

Partly as a result of supervisory regulations, bank balance sheets already go beyond the minimum requirements of the Civil Code and are normally more detailed than those of Italian non-banking firms and banks abroad. A study is nonetheless to be conducted of ways of increasing the flow of information from banks, including the publication of interim accounts. The value of the information would be increased if the law were changed to allow more consolidation of accounts. An equally important objective is the transparency of the terms and prices of banking services. Competition and disclosure of information, which should not be confused with the confidential returns submitted to the supervisory authority, do not detract from the stability of the financial system; on the contrary, they reinforce it.

Supervision must continue to be based on discretion both in general and in individual cases. It would be facilitated if authorization procedures were simplified, as in the case of the amendments made, under Law No. 23 of 1981, to the rules governing lending by special credit institutions in excess of their limits. However, the effectiveness of controls also presupposes that other bodies, first and foremost bank boards themselves, accept a full share of responsibility and requires a more structured definition of some international aspects of supervision. The new Basle Concordat, which was recently concluded, is intended to strengthen the coordination needed to

prevent banks or banking establishments slipping through the supervisory net.

The failure of Banco Ambrosiano highlighted the gravity and dangerousness of the disorders that develop when fraudulent behaviour manages to insinuate itself into banking behind a screen of ordinary operations, with the connivance of third parties. The intervention of the supervisory authority brought to light abnormalities that dramatic events have shown to extend well beyond the world of banking. It subsequently took steps to remedy the repercussions on the bank itself using the instruments available under the present regulations; in so doing it had to strike a balance between the need to determine the scale of the failure and where the responsibility lay and the need to limit its impact on the stability of the banking system as a whole.

The Banca d'Italia's adoption of a new stance towards banks' activities abroad dates back several years and was embodied in the regulations laid down in the January 1981 resolution of the Interministerial Committee for Credit and Savings. This confirmed the policy of not allowing indirect shareholdings, set in motion the dismantling of the holding companies upon which many Italian banks had based their networks of foreign subsidiaries and made it possible to introduce regular returns, some of them on a consolidated basis, on the main aggregates of subsidiaries' accounts. The direct ownership of foreign subsidiaries is designed to eliminate the difficulties that intermediate holding companies create for supervision. A parallel policy is that of requiring banks to divest themselves of their holdings, in whatever form, in companies located in countries whose systems of control either do not appear adequate or do not allow sufficient information to be made available to the parent bank's supervisory authority. The banks concerned have taken the decision to dismantle their holding companies or are about to do so. Many banks have already sold off some participations, reduced other shareholdings and revised their subsidiaries' statutes as part of a process that they are required to complete as rapidly as possible.

Legislation and supervision will have a greater impact on the efficiency and soundness of banks if they are complemented by expansion of the share market. This is also a condition for resolving the perennial problem of imbalance in the capital structure of firms.

Looking back at the diagnoses and proposals made in past years, one finds that many of the legal and institutional conditions then considered desirable have now been created, the most recent being the possibility of setting up unit trusts.

The development of merchant banking activities would help medium-sized firms grow bigger and stronger and would pave the way towards stock exchange listing. Looking to the future, these activities could usefully complement the operations of unit trusts and increase their investment opportunities. If new structures were required to achieve this, flexible and effective forms could be promoted jointly by the banks without precluding participation by other parties. The object of these companies should accord with investment in bonds and shares issued by private and public sector companies on the basis of the risk and yield of the portfolio as a whole; they should be formally prohibited from acting as holding companies with *a priori* preferences about the firms to be financed. Shareholdings in the new companies should be related to the own funds of each participant, just as both the shareholdings and the borrowings of these companies should be related to their own funds.

Finally, it is worth re-examining the experience gained with Law No. 787 of 1978 from the points of view of the techniques employed and the underlying principles; this law provided practical means for setting up banking consortia that would meet the capital needs of firms in temporary financial difficulties.

On its own, the institutional framework cannot change propensities or patterns of behaviour. This can be done by markets, however, when they are backed by a banking system that realizes their role not only competes with but also complements its own intermediation and when they allow the basic determinants of share prices to prevail, thus encouraging firms to issue equity capital that savers wish to purchase.

The choices for stable recovery

The world economy is emerging from the longest recession since the second world war. There are doubts about the duration of the recovery and hence about the scale of the effects that it will have on world trade. As far as Italy is concerned, the question to be asked is to what extent and in what conditions exports can benefit from the upturn and stimulate balanced growth.

The impending recovery in the international economy will find Italy with a productive system that is profoundly changed compared with the beginning of the seventies. The 1981 Census shows the change to have been even larger and more extensive than previously realized. It affected the geographical distribution of production, its organization and the relationships between sectors.

The gap between the industrial triangle and the rest of the country was narrowed by the rapid growth of the eastern regions in the north and centre and by the emergence of new economic conditions in large parts of the Mezzogiorno. The importance of agriculture declined. This was due less to workers leaving the land than to old agricultural and craft economies turning to industrial activities, to which they have brought solid traditions and stable social relationships.

The larger role of the services sector came not only from the growth in consumer services but also from the greater complementarity of industry and services and new forms of specialization. Functions that were previously carried out internally, such as accounting, financial management and research, are being separated from the production side.

The industrial fabric has been transformed both by changes in the existing structure and by the setting-up of factories based on new criteria. Partly to escape from the increasing rigidities deriving from the legal and social environment, manufacturing industry moved away from plants geared to the mass production of a small number of goods towards smaller units specializing in individual phases of the production process. In engineering and the motor industry, where 40 per cent of manufacturing employment is concentrated, small and medium-sized factories established themselves in a strong position: more recently, some large factories have also been modernized with the introduction of multi-purpose machines and the automation of parts of the manufacturing process.

The new picture shows a production system which, in certain important respects, is able to adapt and react to market developments. However, dynamism and innovation have been evident mainly in the so-called mature sectors; there has been less initiative in those making advanced-technology products. Alongside the new firms and those with modernized organizations and production techniques there are still firms and groups, especially among those operating in the public sector and in basic industries, that have made little progress in curing their ills.

The cyclical course of the Italian economy in the wake of the second oil crisis has been characterized by sustained high levels of domestic demand compared with other countries. At the end of 1982 demand was 3.3 per cent above the average for 1979: over the same period it rose by 4.7 per cent in France and by 0.5 per cent in the United States and fell by 1.2 per cent in the United Kingdom and by 4.3 per cent in Germany. The deficit on Italy's external accounts over the last three years was the largest recorded by a major industrial country.

Elsewhere the long recession has provided an opportunity and a stimulus to curb domestic costs and reduce the share of saving absorbed by the public sector. According to OECD calculations of the cyclically adjusted ratio of public sector balances to GDP, in the period 1980-82 every major industrial country apart from the United States and Italy (which already had the largest deficit) recorded a smaller deficit or a larger surplus. In the same

period, Italian money wages continued to rise at a rate that was incompatible with bringing inflation close to the levels obtained in the other industrial countries. Moreover, the narrowing of wage differentials has increased wage pressures and caused distortions in the allocation of labour. Real hourly earnings in industry rose by an annual 1.8 per cent in Italy and France, whereas they dropped by 1.4 per cent in the United States and by 1.3 per cent in the United Kingdom and remained stable in Germany.

The latest data portray an economy still in the grips of recession, with public finances in serious imbalance and with costs and prices beset by undiminished tensions.

In the first quarter of 1983 industrial production fell below the levels recorded at the close of 1982 and in January the unemployment rate reached 9.8 per cent. Economic forecasts and business surveys indicate an improvement in production prospects in the coming months fuelled both by exports and by demand for non-durable consumer goods. Wage settlements in the public and private sectors, tax reliefs and other government expenditure will have an expansionary effect on households' disposable income.

As regards public finances, primarily owing to the postponement of some corrective measures and the failure to approve others, the borrowing requirement threatens to overshoot the Government's target for the third year running. In 1984, even if the intention of keeping the tax to GDP ratio unchanged is achieved, expenditure will tend to raise the state sector borrowing requirement as a percentage of GDP above the level planned for 1983. This is a tendency that delays instead of advancing the adjustment of the economy; its correction will require other interventions.

The doubling of the borrowing requirement in the space of two years produced a rapid increase in financial assets. In relation to GDP they rose from 108 per cent at the close of 1980 to 113 per cent at the end of 1982 and the forecast is that the ratio will rise by as much again in 1983 to reach the highest value for the last ten years.

In the first three months of 1983 wholesale prices slowed down considerably to an average monthly rate of increase of 0.4 per cent; consumer prices rose at an average rate of 1.1 per cent in the first five months of the year. As in 1982, the deceleration of producer prices forecast for 1983 as a whole is attributable to the slowdown in the external cost components, such as energy and raw material prices; this could be brought to a halt by world recovery. The domestic components continue to rise rapidly: the wage agreements signed so far, the implementation of the changes in the legislation on severance payments and the effects of the indexation mechanism do not presage a significant reduction in the rate of increase in labour costs per worker in 1983.

Coming at a difficult juncture for industrial relations, the agreement of 22 January averted a deterioration in the labour climate, but if it is to prove a turning point, it must not be allowed to remain an isolated event. In the agreement the two sides of industry reduced the coverage provided by wage indexation and established the principle that their decisions and behaviour would be constrained by predetermined rates of consumer price inflation. This principle must be applied rigorously with a view to achieving a rapid reduction in inflation.

If a premature recovery in consumption generated by the public sector deficit and by the growth in money incomes were to come on top of the expected stimulus from exports, the fight against inflation would become arduous. Imports of finished products and raw materials would surge and nullify the good results of exports and tourism; the current account, which is moving into balance, would swing back into substantial deficit. The additional costs deriving from wage settlements would be coupled with fewer scruples about restoring profit margins through price increases. There would be a risk that the small progress laboriously made on the road to stability since the second oil crisis would be rapidly annulled.

The burden of holding inflation under control would once again fall on monetary policy alone and the incipient recovery would be stifled.

Ladies and Gentlemen,

The capacity to save, the availability of labour and the existence of unmet social and private needs are features of an economy that fulfills the basic conditions for embarking on a growth path which will increase households' prosperity and improve the outlook for the employment of young people. While continuing to exhibit proof of its vitality, the Italian economy nevertheless suffers from rigidities and fragmentation and from a pattern of savings utilization and a cost structure that prevent it from realizing its growth potential.

High inflation, not scarcity of resources, is the real barrier to sustained growth.

The reason why inflation has not been checked in Italy in the way that it has been in the major industrial countries is that Italian society has failed to show real determination in tackling it. The economies successful in curbing inflation, which are now seeing prospects of recovery open up as a result, have had to make bold choices, adopt tenacious policies and accept costs and sacrifices.

In Italy limited time frames have precluded even the definition of a long-term anti-inflationary policy. Even more importantly, the tendency in Italy has been to regard inflation as a minor ill with no bearing on growth or employment or even as being their natural accompaniment; or to consider that inflation will burn itself out on its own, even though it has to be admitted that the fires of inflation have been burning for more than a decade. There has been insufficient understanding of the causes of inflation and of the damage it occasions. It has not been fully realized the extent to which inflation has been implanted and nurtured by external factors ranging from the cost of energy sources to the abandonment of fixed exchange rates and the fading-away of an international monetary standard — and domestic factors, such as indexation and the widespread tendency to look to the State to provide. The idea has even taken root that it is possible to live with inflation, provided something is done from time to time to keep it in check, or, alternatively, that groups and individuals can protect themselves by offloading the damage onto others.

There is no other explanation for the out-and-out defence of mechanisms and patterns of behaviour that can only cause nominal incomes and prices to rise in step, when the same real incomes could have been obtained through consensus policies designed to keep both inflation and money incomes under control.

Nor is there any other explanation for the willingness to introduce public intervention systems involving budgetary outlays that — now and to an even greater extent in the future — are at odds with the most sanguine growth forecasts and promise to distribute income that has not been produced, indeed shows no likelihood of being produced, at least in the short term.

Two years ago on this occasion I analyzed the causes of the spread of inflation within the Italian economy and spoke of the dangers of a breakdown in industrial relations and of the very fabric of society inherent in the continued debasement of the monetary yardstick. My reference to the need for a monetary constitution could have been taken as abstract, as advocating Utopia. It was not a mere cry of alarm: it was intended and is intended today to be a plea for a return to reality, to reaffirm that there can only be growth and orderly life in society if the currency is stable, and to indicate principles and methods consonant herewith. The currency cannot be restored to soundness by technical means or by financial tinkering. Anyone who thinks that the system can remain for long in a state of precarious equilibrium waiting for external events to lift us off the shoals is deluding himself. Events abroad can assist us, provided our own efforts are such that we can take advantage of them. Failing this, the events themselves will distance us from the international community.

Italian society must choose: it must either bring sense to bear upon the restoration of economic equilibrium and thus become the instrument of its own salvation, or continue to carry the growing cost of adjustment brought about through the inequitable redistribution of wealth and the waste of resources. There can be no half measures: acts of will are required.

Restoration of a stable currency necessitates changes in behaviour patterns and in institutional arrangements on two fronts: that of the public sector deficit and that of wages and salaries.

Respect for the budgetary constraint must be re-established at all levels of public finance. Today the constitutional requirement for expenditure decisions to be matched by provisions to raise revenue has become nugatory. This constraint, as we have repeatedly stressed, must be enforced with the objective of balancing current receipts and expenditure within a given time span. The same principles should also apply at local level: the aim of improving the efficiency of public spending by administrative decentralization will be thwarted in the absence of the discipline that can only be imposed by an awareness that financial resources are finite.

Dialogue between the two sides of industry is essential to sustain a healthy democracy. Agreements aimed at breaking the wage/price spiral are by no means incompatible with confrontation between workers and employers; indeed, they demonstrate the validity of that confrontation. The spirit of January's agreement on the cost of labour should not be allowed to die. Re-establishing price stability on the basis of wage stability does not call into question the distribution of income but reaffirms the central place of labour in production and trade.

These are the conditions that would enable monetary policy to sustain a growth path that realizes the economy's potential. These are the requirements that must be met if Italy is to continue to be linked, in conditions of monetary stability, to the countries with kindred economic systems, cultures and civil institutions.

IV. — THE BANK'S CAPITAL AND RESERVES

Capital. — Having remained unchanged during 1982, the distribution of the 300,000 shares of the Bank's capital was as follows at 31 December:

Shareholders with voting rights:

Savings banks and pledge banks	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 security institutions	1	22	15,000	"	"	34	27
Insurance companies	7	"	31,500	"	"	91	",
•	94	with	299 898	charac	and	787	votes

94 with 299,898 shares and 787 votes

Shareholders without voting rights:

Savings banks and pledge banks 12 with 102 shares

Total . . . 106 with 300,000 shares

Reserves. — During 1982 the reserve funds underwent the following changes:

		Ordinary reserve fund		Extraordinary reserve fund
Amount at 31 December 1981	Lit.	174,286,004,753	Lit.	186,583,195,127
increase:				
 due to appropriation of 20 per cent of profits for the year 1981 	"	27,054,405,675	33	27,054,405,675
- due to income received in 1982 from investment of reserves	,,	26,844,722,755	"	28,279,347,330
	Lit.	228,185,133,183	Lit.	241,916,948,132
decrease:				
 due to distribution to share- holders of a part of the income accruing in the course of 1981 				
(Article 56 of the Statutes)	Lit.	78,321,845	Lit.	83,678,155
Amount at 31 December 1982	Lit.	228,106,811,338	Lit.	241,833,269,977

V. - BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

BALANCE SHEET

	ASSET	S		
GOLD				
I on hand		Lit.	2,159,903,203,661	
II on deposit abroad			21,376,652,704,793	23,536,555,908,454
GOLD CREDITS (EMCF)			Lit.	8,112,312,467,928
CASH ON HAND				2,393,335,878,427
DISCOUNTS AND ADVANCES				
I portfolio discounts:				
— ordinary bills	Lit.	199,708,674,997		
— stockpiling bills		1,652,025,859,986	1,851,734,534,983	
II advances:			.,,,,	
— current account	Lit.	1,354,656,252,280		
— fixed term		_		
— under Treasury Decree of 27.9.1974		535,724,112,275	1,890,380,364,555	
III deferred payments in the clearing system			' ' -	3,742,114,899,538
BILLS FOR COLLECTION WITH CORRESPONDENTS			τ:.	
BILLS FOR COLLECTION WITH CORRESPONDENTS	• • • • • • • • • • • • • • • • • • • •		Lit.	_
EXTERNAL ASSETS IN FOREIGN CURRENCIES				
I ECUs		Lit.	8,190,164,463,247	
II other assets:				
banknotes and foreign currency bills	Lit.	420,320,682		
current accounts with correspondents		286,270,548,434		
— time deposits		2,691,942,842,574		
— other		1,868,881,877	2,980,502,593,567	11,170,667,056,814
DOLLAR CREDITS (EMCF)			Lit.	1,450,251,572,464
ITALIAN FOREIGN EXCHANGE OFFICE (UIC)				
I current account				
II special accounts				13,119,220,861,334
TREASURY CURRENT ACCOUNT				31,909,777,025,977
SUNDRY CLAIMS ON THE GOVERNMENT	• • • • • • • • • • • • • • • • • • • •			576,325,033,079
SECURITIES				
I government and government-guaranteed securities:	*·. I	24 270 252 714 507	ı	
— freely available		34,370,252,716,597		
investment of statutory reserves investment of staff severance pay and pension funds	1	365,356,887,232 976,258,749,147	25 711 0/0 252 07/	
II securities of companies and agencies:		7/6,236,/47,14/	35,711,868,352,976	
- investment of statutory reserves	r:.	10.014.004.403		
investment of statutory reserves investment of staff severance pay and pension funds		10,916,884,602 270,183,448,446	201 100 222 040	
III shareholdings and participations:		270,103,440,440	281,100,333,048	
in subsidiary companies and agencies				
investment of statutory reserves Lit.	2,391,795,228			
investment of staff severance pay and pension funds "	70,571,694,213	72,963,489,441		
in associated companies and agencies	70,371,074,213	72,703,467,441		
investment of statutory reserves Lit.	729,576,000			
investment of staff severance pay and pension funds "	4,030,611,550	4,760,187,550		
in other companies and agencies	.,555,6,1,550	.,, 55,,57,550		
investment of statutory reserves Lit.	40,203,010,247			
investment of staff severance pay and pension funds "	72,722,226,454	112,925,236,701	190,648,913,692	36,183,617,599,716
moestiment of staff severance pay and pension failes	, =,, ==,,==U,TJT	1,2,723,230,701		
			carried forward Lit.	132,194,178,303,731

LIABILITIES -									
		·							
NOTES IN CIRCULATION	Lit.	34,241,520,367,000							
BANCA D'ITALIA DRAFTS		412,646,602,644							
OTHER SIGHT LIABILITIES									
I transfer orders Lit.	-								
II other	1,896,994,639	1,896,994,639							
FREE DEPOSITS ON CURRENT ACCOUNT	Lit.	286,452,784,388							
TIED DEPOSITS ON CURRENT ACCOUNT		1,000,000,000							
DEPOSITS FOR CASH DEPARTMENT SERVICES		42,406,756,180							
SPECIAL ACCOUNTS UNDER LAW No. 386 OF 17.8,1974		_							
COMLPULSORY DEPOSITS									
I compulsory bank reserves Lit.	45,531,960,191,737								
II collateral for the issue of bankers' drafts and guaranteed personal cheques	714,611,476								
III tied deposits in relation to investment abroad	43,943,520,701								
IV in respect of companies in the process of incorporation	67,972,822,796								
V in respect of bank lending in excess of the ceiling"	929,173,357,434								
VI other"	29,385,875,671	46,603,150,379,815							
DEPOSITS IN FOREIGN CURRENCY ON BEHALF OF THE UIC	Lit.	430,900,400,814							
EXTERNAL ACCOUNTS IN LIRE ON BEHALF OF THE UIC	,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	1,857,967,115,870							
EXTERNAL LIABILITIES									
I deposits in foreign currencyLit.	1,322,739,822								
II external accounts in lire	122,668,115,216	123,990,855,038							
ECU LIABILITIES (EMCF)	Lit.	9,562,564,040,392							
SUNDRY LIABILITIES TOWARDS THE GOVERNMENT		1,124,284,126,218							
SUNDRY PROVISIONS									
I for gold price fluctuations (under Decree Law No. 867 of 30.12.1976) Lit.	27,887,422,412,314								
II for losses ensuing from exchange rate management (under Decree Law No. 867 of 30.12.76) "	1,200,795,276,401								
III for losses on bill portfolio	234,919,178,078								
IV for losses on foreign exchange"	1,210,000,000,000								
V for losses on securities"	2,031,481,643,707								
VI for contingent losses	2,153,185,000,000								
VII for insurance cover	324,691,685,925								
VIII for building works	555,148,236,982								
IX for renewal of equipment	46,250,000,000								
X for taxation "	1,110,871,554,961								
XI for staff severance pay and pensions	1,816,200,000,000								
XII for grants to BI pensioners and their surviving dependants	418,012,420								
XIII for severance pay to contract staff under Law No. 297 of 29.5.82	320,239,849	38,571,703,240,637							
	carried forward Lit.	133,260,483,663,635							

BALANCE SHEET

	A S S E T S		
		brought forward Lit.	132,194,178,303,731
UIC EN	IDOWMENT FUND	Lit.	500,000,000,000
REAL I	PROPERTY		
Т	Bank premises Lit.	. 1	
	investment of staff severance pay and pension funds	39,710,122,717	39,710,122,718
	R INVESTMENTS OF STAFF SEVERANCE PAY AND PENSION FUNDS	Lit.	20,160,000,000
FURNI	TURE AND EQUIPMENT		
I	furniture and fittings Lit.	28,685,609,115	
II	equipment"	89,691,529,909	
III	coins and collections	307,195,088	118,684,334,112
SUNDI	RY ITEMS		
I	banknotes in production Lit.	5,893,022,593	
II	procedures, studies and designs of the technical departments:		
	- completed Lit. 23,089,998,620		
	- in preparation	33,198,237,893	
	sundry debtors Lit.	101,951,980,961	
IV	other	895,311,944,231	1,036,355,185,678
ACCRU	JED INCOME	Lit.	1,387,803,493,748
PREPA	ID EXPENSES		
		Lit.	135,296,891,439,987
мемо	RANDUM ACCOUNTS		
I	Securities and other valuables:		
	- held as collateral Lit. 5,328,207,691,182	1	
	- other	252,598,298,493,567	
II	Depositaries of securities and valuables:		
	- domestic Lit. -		
	- foreign	587,277,774,321	
III	Unused credit limits on advance accounts Lit.	1,647,081,223,478	
IV	Debtors for securities receivable (BI forward sales)	509,000,000,000	
V	Securities receivable (BI forward purchases)	2,231,000,000,000	
VI	Debtors for foreign currency and lire receivable (BI forward sales) - domestic Lit.		
	- foreign Lit. 3,205,209,914,593	3,205,209,914,593	
VII	Foreign currency and lire receivable (BI forward purchases)	3,205,209,914,593	ĺ
VIII	Exchequer for depreciation allowances	318,556,392,572	264,301,633,713,124
			·
		TOTAL Lit.	399,598,525,153,111

Audited and found correct. — Rome 28 April 1983

THE AUDITORS

THE ACCOUNTANT GENERAL

PIETRO SALONICO

DOMENICO AMODEO
ALBERTO CAMPOLONGO
VITTORIO CODA
GIUSEPPE GUARINO
LUIGI GUATRI

LIADILIIIES		
	brought forward Lit.	133,260,483,663,635
DEPRECIATION FUND FOR FURNITURE AND FITTINGS	Lit.	28,462,307,885
DEPRECIATION FUND FOR EQUIPMENT	"	72,231,617,142
FUND FOR THE DEPRECIATION OF THE PROCEDURES, STUDIES AND DESIGNS OF THE DEPARTMENTS	TECHNICAL "	8,667,942,539
SUNDRY ITEMS I sundry creditors Lit. II other "	19,685,127,052 425,105,173,409	444,790,300,461
ACCRUED EXPENSES	Lit.	76,311,620,102
DEFERRED INCOME	"	751,584,737,960
CAPITAL Lit. ORDINARY RESERVE FUND "	300,000,000	
EXTRAORDINARY RESERVE FUND	241,833,269,977	470,240,081,315
NET PROFIT FOR DISTRIBUTION	Lit.	184,119,168,948
	Lit.	135,296,891,439,987
MEMORANDUM ACCOUNTS		
I Depositors of securities and other valuables Lit.	252,598,298,493,567	
II Securities and valuables on deposit	587,277,774,321	
III Holders of advance accounts for the portion of unused credit limits	1,647,081,223,478	
IV Securities for delivery (BI forward sales)	509,000,000,000	
V Creditors for securities for delivery (BI forward purchases)	2,231,000,000,000	
VI Foreign currency and lire for delivery (BI forward sales)	3,205,209,914,593	
VII Creditors for foreign currency and lire for delivery (BI forward purchases) - domestic	3,205,209,914,593	
VIII Depreciation allowances Lit.	318,556,392,572	264,301,633,713,124
	TOTAL Lit.	399,598,525,153,111

THE GOVERNOR CARLO AZEGLIO CIAMPI

PROFIT AND LOSS ACC(

EXPENDITURE AND LOSSES		
COSTS OF ADMINISTRATION		
central and local boards Lit.	1,017,362,612	
staff:	1,017,502,012	
- wages and salaries and related costs Lit. 343,946,747,681		
- pensions and severance payments	492,744,365,085	
provision of services Lit.	51,582,955,511	
other "	86,504,183,839	631,848,867,047
TAXES AND DUTIES	,	
stamp duty on the circulation of banknotes and demand drafts Lit.	_	
other taxes and duties:		
- current year Lit. 3,185,259,437		
- previous years	382,829,004,839	382,829,004,839
INTEREST PAID		
on compulsory bank reservesLit.	2,348,891,144,502	
other	5,027,608,725	2,353,918,753,227
EXPENDITURE ON SECURITIES TRANSACTIONS.	Lit.	6,305,315,670
EXPENDITURE ON FOREIGN TRANSACTIONS		51,375,534
LOSSES ON SECURITIES DEALINGS		
EXCHANGE RATE LOSSES	»	_
LOSSES ON REALIZATION OF ASSETS		
CONTRIBUTIONS TO CHARITIES AND SOCIAL AND CULTURAL ACTIVITIES		709,970,004
TECHNICAL DEPARTMENTS — INITIAL STOCKS		15,766,185,923
VALUATION LOSSES		
on securities Lit.	35,896,836,063	
on other assets		35,896,836,063
CONTRIBUTIONS TO THE TREASURY	T:-	
CONTRIBUTIONS TO THE TREBUNT	Lit.	_
DEPRECIATION		
of Bank premises	42,380,475,982	
of furniture and fittings"	8,170,224,449	
of equipment"	28,548,497,812	
of the procedures, studies and designs of the technical departments	5,080,818,371	
other	6,059,730	84,186,076,344
APPROPRIATION OF INVESTMENT INCOME TO RESERVES	,	
to ordinary reserve fund	26,844,722,755	
to extraordinary reserve fund	28,279,347,330	55,124,070,085
	_	
	carried forward Lit.	3,566,636,454,736

INCOME AND PROFITS		
INTEREST RECEIVED		
on discounts and advances:		
- ordinary portfolio discounts Lit. 21,068,823,253		
- stockpiling portfolio discounts		
- advances	201,849,571,098	
on lending to the Treasury	318,219,389,171	
on lending to the UIC	886,567,755,661	
on lending abroad	495,125,969,375	
other	60,097,017,319	1,961,859,702,624
INTEREST, PREMIUMS AND DIVIDENDS ON SECURITIES		
freely available		
fixed rate:		
Treasury bills		
variable rate Treasury credit certificates		
other government and government-guaranteed securities	2,534,696,397,821	
investment of reserves and staff severance pay and pension funds		
fixed rate:		
government and government-guaranteed securities Lit. 133,413,383,623		
other securities		
subsidiary companies and bodies Lit. 3,143,724,355		
associated companies and bodies		
other companies and bodies	169,013,787,600	2,703,710,185,421
		2,703,710,103,421
INCOME FROM PARTICIPATION IN THE UIC ENDOWMENT FUND	1	25,000,000,000
PROFITS FROM DEALINGS IN AND REDEMPTION OF SECURITIES		429,110,441,425
EXCHANGE RATE GAINS		261,534,594,775
COMMISSIONS AND OTHER FINANCIAL REVENUE	i i i i i i i i i i i i i i i i i i i	171,545,463,375
INCOME FROM REAL PROPERTY		6,093,390,729
PROFITS FROM THE SALE OF:		
real property Lit.	_	
other property	1,150,478,399	1,150,478,399
TECHNICAL DEPARTMENTS-FINAL STOCKS	Lit.	16,854,950,144
TECHNICAL DEPARTMENTS-PROCEDURES, STUDIES AND DESIGNS COMPLETED DURING THE	YEAR "	10,841,375,816
VALUATION GAINS		
on securities	_	
on other assets	_	_
	carried forward Lit.	5,587,700,582,708
		•

PROFIT AND LOSS ACCOUNT

EXPENDITURE AND LOSSE	S	
	brought forward Lit.	3,566,636,454,736
ALLOCATIONS TO PROVISIONS	ı	
for losses on bill portfolio Lit.	-	
for losses on foreign exchange	-	
for losses on securities	684,000,000,000	
for contingent losses	83,000,000,000	
for insurance cover	_	
for building works"	375,000,000,000	
for renewal of equipment"	_	
for taxation"	800,000,000,000	
for staff severance pay and pensions"	352,600,000,000	
for grants to BI pensioners and their surviving dependants"	51,754,689	
for severance pay of contract staff under Law No. 297 of 29.5.1982"	320,239,849	2,294,971,994,538
NON-OPERATING LOSSES AND EXTRAORDINARY CHARGES	Lit.	21,155,637
	Lit.	5,861,629,604,911
NET PROFITS		184,119,168,948
	TOTAL Lit.	6,045,748,773,859

APPROPRIATIOI		A	P	P	R	О	P	R	I	A	Т	I	О	ľ
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TO ORDINARY RESERVE FUND.

TO EXTRAORDINARY RESERVE FUND.

TO SHAREHOLDERS.

TO THE TREASURY.

Audited and found correct ... Rome 28 April 1983

THE AUDITORS
DOMENICO AMODEO
ALBERTO CAMPOLONGO
VITTORIO CODA
GIUSEPPE GUARINO
LUIGI GUATRI

THE ACCOUNTANT GENERAL PIETRO SALONICO

I N	COME AND	D I KOIII 3		
			brought forward Lit.	5,587,700,582,708
WITHDRAWALS FROM PROVISIONS				
for losses on bill portfolio		Lit.	_	
for losses on foreign exchange			-	
for losses on securities			35,896,836,063	
for contingent losses				
for insurance cover			_	
for building works			42,380,475,982	
for renewal of equipment			-	
for taxation			379,643,745,402	
for staff severance pay and pensions for grants to BI pensioners and their surviv			86,251,925	
for grants to bi pensioners and their surviv	ing dependants		00,231,723	
for severance pay of contract staff under I	aw No. 297 of 29.5.1982		<u> </u>	458,007,309,372
for severance pay of contract staff under I NON-OPERATING PROFITS AND EXTRAOR		⁹	Lit.	
		⁹	TOTAL Lit.	40,881,779
NON-OPERATING PROFITS AND EXTRAOR		⁹		40,881,779
		⁹		40,881,779
NON-OPERATING PROFITS AND EXTRAOR		⁹		40,881,779
NON-OPERATING PROFITS AND EXTRAOR	36,823,833,789	⁹		40,881,779
NON-OPERATING PROFITS AND EXTRAOF	EDINARY EARNINGS .	⁹		40,881,779
PROFITS Lit.	36,823,833,789 36,823,833,789 36,823,830,000,000	⁹		458,007,309,372 40,881,779 6,045,748,773,859
F P R O F I T S Lit.	36,823,833,789 36,823,833,789	⁹		40,881,779

THE GOVERNOR CARLO AZEGLIO CIAMPI

ADMINISTRATION OF THE BANCA D'ITALIA

AS AT 31 DECEMBER 1982

BOARD OF DIRECTORS

Carlo Azeglio CIAMPI — Governor and Chairman of the Board

Lamberto DINI — DIRECTOR GENERAL

Antonio FAZIO — Deputy director general

Carmelo OTERI — Deputy director general and secretary to the board

DIRECTORS

Gaetano CARBONE* Paolo Emilio FERRERI

Giovanni CASTELLANI Callisto GEROLIMICH COSULICH

Carlo d'AMELIO* Giuseppe GIOIA
Francesco CONTI Lucio MORODER

Gaetano DI MARZO Giovanni Battista PARODI*
Luigi FALAGUERRA* Giulio PONZELLINI

Luigi FALAGUERRA*
Luigi FANTOLA

BOARD OF AUDITORS

Domenico AMODEO Giuseppe GUARINO Alberto CAMPOLONGO Luigi GUATRI

Vittorio CODA

ALTERNATE AUDITORS

Natalino IRTI

Arnaldo MAURI

CENTRAL ADMINISTRATION

MANAGERS

Giovanni MAGNIFICO — CENTRAL MANAGER FOR CENTRAL BANK OPERATIONS

Pietro SALONICO — ACCOUNTANT GENERAL

Roberto MONTECCHIARI — SECRETARY GENERAL

Giuseppe UGHI — CENTRAL MANAGER FOR BANKING SUPERVISION

Giorgio SANGIORGIO — CHIEF LEGAL ADVISER
Antonio MONTORO — INSPECTOR GENERAL

Luigi PATRIA — CENTRAL MANAGER FOR TECHNICAL DEPARTMENTS

^{*} Member of the Executive Committee.

LIST OF ABBREVIATIONS

BI Banca d'Italia

BIS Bank for International Settlements
Confindustria Confederation of Italian Industry

Consob Commissione Nazionale per le Società e la Borsa

— Stock Exchange Commission —

Crediop Consorzio di credito per le opere pubbliche

Credit Consortium for Public Works —

ECU European currency unit

EEC European Economic Community

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

INPS Istituto nazionale per la previdenza sociale

— National Social Security Institute —

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

MCA Monetary Compensatory Amounts

NCI New Community Instrument

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

STET Società Finanziaria Telefonica

TDC Total domestic credit
TOE Tons of oil equivalent

Ufficio italiano dei cambi

— Italian Foreign Exchange Office —

VAT Value added tax

UIC