BANCA D'ITALIA

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31 MAY 1999

ABRIDGED REPORT FOR THE YEAR 1998

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THE WORLD ECONOMY

The financial crisis that had swept through several East Asian countries in 1997 spread to other areas last year, causing a marked slowdown in world productive activity. Part of the blame lay with financial and economic weaknesses, some long established and others newly emerging, which interacted with one another, at times magnifying the recessionary tendencies that were already evident. The main causes were the continuing stagnation of the Japanese economy and the failure of Japanese economic policy to stimulate recovery and provide a lasting boost to domestic demand. The collapse in the prices of raw materials reduced the income of numerous producer countries, exacerbating their external imbalances, especially in Latin America. In Russia, where the situation was already extremely precarious because of serious structural problems, the large deterioration in the terms of trade triggered strong speculative pressures and led, in the second half of August, to a devastating currency and debt crisis. Several emerging countries found their access to the international capital markets effectively blocked. Outflows of funds from the crisis-stricken Asian economies were substantial and seriously affected the level of productive activity, which had only begun to show signs of recovery in the preceding few months. In mid-January 1999 the Brazilian authorities were forced to abandon the exchange rate peg with the dollar and to allow the real to float freely. The sudden switching of international portfolios into less risky instruments at a time of abundant liquidity pushed share and bond prices in the leading industrial countries to historical highs, exacerbating fears of an abrupt market correction that would have a disastrous effect on confidence.

The recession and economic and financial instability occurring simultaneously in several countries, which could easily have damaging multiplier effects on the global economy, set a daunting task for international cooperation and national economic policies.

In view of the seriousness and complexity of the situation, the international community accelerated the overhaul of the architecture of the international monetary and financial system that had been begun in 1995 in the wake of the Mexican crisis. The underlying problem is the regulation of a system of ever more closely integrated markets in goods and capital in which, given that economic policies are set independently, the volume of credit and money is uncontrolled. Against this background, the fickleness of expectations can cause serious imbalances in the money and financial markets, resulting in falls in output that go beyond those needed to correct economic disequilibria.

The priority objective of the reform now taking shape is to strengthen the procedures and instruments for crisis prevention and management. With regard to prevention, the quality and transparency of information are particularly important, and this must directly involve national authorities, private businesses - especially intermediaries - and even international organizations as far as the criteria on which the latter base their assessments and recommendations are concerned. The proportion of short-term foreign currency liabilities must also be limited, the financial systems of emerging economies strengthened and the effectiveness of banking supervision and market oversight enhanced, partly through the widespread adoption of the international supervisory standards set by the Basle Committee. When strategies for the liberalization of capital flows are being formulated in countries still at an early stage of liberalization, due account should also be taken of the level of development and soundness of each country's financial system. In order to limit the propensity to take risks and encourage the orderly management of crises, every effort should be made to involve the private sector more closely; one way of achieving this would be to adopt procedures that would guarantee the renewal of loans and to include in loan contracts clauses governing relations between lenders and borrowers in the event of insolvency. The meetings of the IMF and the World Bank in Washington in April this year approved the establishment of a new credit facility for countries that have suffered contagion despite having sound economic policies and healthy fundamentals. The resources available are substantial in order to ensure that this instrument will have effective powers of prevention; in order to limit their use, access to the credit line is subject to very strict conditions and penalty interest rates. The adequacy of exchange rate systems is being seriously questioned, especially in non-industrial countries that have liberalized capital movements. There is wide agreement that optimum exchange rate systems do not exist *a priori*; the choice of system must take account of numerous factors and any system must be backed up by economic policies aimed at stability and by sound financial systems. The experience of the nineties, which have witnessed many currency crises of differing intensity, has brought a widespread conviction that regimes of free-floating or of rigid exchange rates, and in the extreme case currency boards, are preferable to hybrid systems.

Notwithstanding the financial turmoil, the European currencies showed a high level of cohesion and stability, benefiting fully from the improvement in economic fundamentals required by the Maastricht Treaty and the prospects opened up by the introduction of the single currency. The convergence of short-term interest rates was accomplished in orderly conditions. The third stage of Economic and Monetary Union (EMU) began on 1 January 1999 as decreed by the European Council on 3 May 1998. Eleven European Union countries are participating, including Italy; the rates for the conversion of national currencies into euros, which were irrevocably fixed on 31 December 1998, are in line with the bilateral rates announced in May by the authorities of the eleven member states, based on the previous central rates of the Exchange Rate Mechanism.

World output grew by 2.5 per cent last year, compared with 4.2 per cent in 1997. Excluding Japan, which was in severe recession, the industrial countries recorded sustained growth of 3.4 per cent, although the pace slowed down during the year. In the Asian developing countries, excluding China and India, output declined by almost 5 per cent after expanding by nearly 4 per cent in 1997. The serious financial crisis in Russia led to a fall of 5 per cent in economic activity. In Latin America the sharp decline in the terms of trade and the marked slowdown in world trade caused the rate of growth to fall by more than half, from 5.2 to 2.3 per cent. In the industrial countries as a whole consumer price inflation came down further, to 1.4 per cent, reflecting the fall in the world prices of raw materials and the moderate rises in unit labour costs.

The international crisis affected monetary policies in the industrial countries. In the United States, the Federal Reserve kept monetary conditions unchanged until the end of September, despite continuing brisk economic growth and signs of tightness in the labour market. Towards the end of the year strains in the financial markets and fears that economic activity might slow down too suddenly led the authorities to reduce interest rates several times. The monetary stance was also relaxed in Europe. Short-term interest rates fell towards the lower levels prevailing in Germany and France; at the end of the year the central banks of the euro area lowered their reference rates to 3 per cent, in the light of the weakening of activity.

In the United States growth continued for the eighth consecutive year, thereby helping decisively to steady the world economy. Output grew by 3.9 per cent, the same as in 1997, with no clear evidence of pressure on prices; the acceleration in the last quarter fueled market expectations of a change in monetary policy. The sustained growth and low inflation in the United States were due in part to the large increases in productivity connected with the substantial growth in investment, particularly in IT equipment. The exceptional expansion in consumption was fueled mainly by the considerable rise in share prices, leading to a worrying decline in households' propensity to save, which fell to almost zero in the last part of the year.

With the sole exception of Italy, the major economies of continental Europe recorded higher growth last year than in 1997, thanks to the strengthening of domestic demand, which was sustained partly by significant stockbuilding. The average growth in GDP in the countries participating in the euro rose from 2.5 to 2.9 per cent, the highest figure this decade. Labour market conditions improved slightly overall, albeit with differences between countries that partly reflected growth differentials. The average unemployment rate for the area, which declined from 11.2 to 10.6 per cent in the course of the year, was more than twice that of the United States. All the leading countries relaxed their efforts to adjust their public finances after the measures taken in 1997 in order to meet the convergence requirements laid down in the Maastricht Treaty. When adjusted for cyclical factors, budget deficits were broadly the same as in the previous year; in France the deficit widened slightly. Economic activity slowed down in most of the countries in the last quarter of 1998, in parallel with the worsening situation worldwide. In April of this year the Governing Council of the ECB lowered the rate on main refinancing operations from 3 to 2.5 per cent in response to the downward revision of growth prospects for the area.

The situation in Japan worsened further in 1998. Over the year as a whole output fell by an average of almost 3 per cent, the largest decline since the War; deflationary pressures intensified, exacerbated by the yen's appreciation in the second half of the year and the fall in the world prices of raw materials, and spread to wages and salaries. The profitability of the banking system declined further, partly on account of the banks' high exposure to the crisis-stricken Asian economies, resulting in a sharp restriction in the supply of credit. A law to restructure the banking system was passed in October, after a long and difficult passage through Parliament; it envisages allocations of public funds of the order of 12 per cent of GDP.

In the course of last year the Japanese Government introduced a number of budget packages, each more substantial than the last, involving an overall total equal to more than 7 per cent of GDP: a large part of the measures will come into force this year. As budgetary policy has proved unable to trigger the desired recovery in consumption and investment, the Bank of Japan forced very short-term interest rates down towards zero from mid-February 1999 onwards. The limits to the ability of monetary policy to stimulate economic activity and counter the fall in prices are now evident and the substantial amounts of liquidity that have been created are poured into the international markets.

Between 1997 and 1998 the correction of the external imbalances of the crisis-stricken Asian economies amounted to about $90 billion, well above the forecasts of a year ago. The main counterpart to this was an increase of $80 billion in the US current account deficit and a reduction of about $20 billion in the surplus of the euro area. As a result of the fall in domestic demand, Japan's surplus increased further, thereby accentuating the disparity in the net external positions of the two leading industrial countries and creating the risk of upsetting international exchange rates.

The movements in current account balances were accompanied by a radical change in the geographical composition of international flows of private capital. Net financing to the emerging economies declined to about $60 billion last year, less than half the average for the nineties.This proved a benefit for the financial markets of the main industrial countries: share prices rose very strongly everywhere during the year and long-term interest rates, which had already fallen significantly in 1997, came down by an average of one percentage point, falling below 4 per cent in the area as a whole. The good performance of the share and bond markets, which was also helped by the gradual easing of monetary conditions and the abundance of international liquidity, provided substantial support for growth in the industrial economies.

The financial crisis and the associated current account imbalances did not unduly affect the exchange rates between the principal currencies. The yen weakened in the first half of last year as a result of the worsening economic situation and domestic political uncertainty; it picked up markedly after the new government took office in July, thereby helping to alleviate the difficulties of the other Asian economies. The easing of monetary conditions in the United States caused the dollar to depreciate slightly in the final months of the year. The downward trend came to a halt in January of this year when it became evident that the economy was continuing to expand briskly, thus increasing the probability that the Federal Reserve would change the stance of monetary policy. Between the beginning of January and the middle of May 1999 the dollar appreciated by 11 per cent against the euro.

The economic prospects for the current year remain fragile and uncertain. The international organizations are forecasting a further slight slowdown in the growth of world output to little more than 2 per cent. Growth in the euro area is expected to decline markedly, to about 2 per cent, with an even poorer performance in Germany and Italy. The Japanese economy will continue to stagnate; so far it has shown no clear signs of recovery and the fall in prices has accentuated. The Asian economies affected by the crisis should record an increase in output, albeit a very small one. Only the United States is expected to provide significant support for world demand, with a growth rate still above 3 per cent, although this positive outcome depends on there being no abrupt and severe fall in share prices and on the macroeconomic situation in Latin America remaining broadly stable. Conditions are still critical in this area: the changes in competitive positions triggered by the devaluation of the real facilitate the spread of the recession from Brazil to the other leading Latin American countries, making it more difficult for them to defend their currencies. Much will depend on the contribution of private capital to financing the area's enormous current account imbalance, which is estimated to amount to about $60 billion this year.

RECENT DEVELOPMENTS AND ECONOMIC POLICIES

Economic developments in the industrial countries

In the United States, the growth in output that had begun in 1991 continued at a very rapid pace last year, without creating inflationary pressures. GDP increased by 3.9 per cent, the same as in 1997 (Table 1). The stimulus came from domestic demand, which grew by 5.1 per cent, compared with 4.2 per cent in 1997. Net foreign trade curtailed the growth in GDP by 1.4 percentage points owing to a widening of the cyclical disparity with the rest of the world and the appreciation of the dollar in 1997. Household wealth increased, benefiting from the dramatic rise in share prices; this stimulated consumption, which grew at a significantly faster rate than disposable income. The propensity to save fell to zero in the fourth quarter.

Non-farm payroll employment rose by an annual average of 2.6 per cent, with particularly large increases in the construction and service industries. The unemployment rate declined further, from 4.6 per cent in January to 4.3 per cent in December.

Consumer price inflation fell from 2.3 to 1.6 per cent on an annual average basis, aided by the decline in the world prices of raw materials and the moderate rise in unit labour costs. A 4.2 per cent increase in hourly wages was partially offset by significant productivity gains, which amounted to more than 2 per cent in the non-farm private sector.

In 1998 Japan was hit by its most severe recession since the war. Output declined by 2.8 per cent and domestic demand contracted even more sharply, partly as a result of the drastic tightening of fiscal policy in 1997. Private consumption fell by 1.1 per cent, a larger decrease than that recorded during the recession in the wake of the first oil shock; a fall of 0.6 per cent in employment contributed to the contraction. Private investment decreased sharply, by approximately 12 per cent, owing partly to the fall in demand from Asian countries and banks' reluctance to lend to firms. Deflation intensified during the year. In the fourth quarter of 1998 wholesale prices were 3.6 per cent lower than a year earlier, partly owing to the appreciation of the yen from August onwards.

Table 1

GROSS DOMESTIC PRODUCT AND DEMAND
IN THE LEADING INDUSTRIAL COUNTRIES (1)
(at constant prices; annualized percentage changes on the preceding period, except where otherwise indicated)

	1996	1997	1998	1998	
				H1	H2
United States					
GDP	3.4	3.9	3.9	4.0	3.8
Domestic demand	3.6	4.2	5.1	5.8	4.4
Net exports (2)	–0.2	–0.4	–1.4	–2.1	–0.9
Japan					
GDP	5.1	1.4	–2.8	–4.0	–2.1
Domestic demand	5.7	0.1	–3.5	–4.4	–2.8
Net exports (2)	–0.5	1.4	0.6	0.3	0.6
Euro 11					
GDP	1.7	2.5	2.9	3.0	2.1
Domestic demand	1.1	2.0	3.5	4.8	2.0
Net exports (2)	0.6	0.5	–0.5	–1.7	0.1
Germany					
GDP	0.8	1.8	2.3	2.7	0.7
Domestic demand	0.3	1.0	2.6	3.4	1.8
Net exports (2)	0.5	0.8	–0.3	–0.7	–1.2
France					
GDP	1.1	2.0	3.2	3.6	2.2
Domestic demand	0.6	0.8	3.6	4.7	2.1
Net exports (2)	0.4	1.2	–0.4	–0.9	0.1
Italy					
GDP	0.9	1.5	1.3	....	....
Domestic demand	0.2	2.5	2.5	....	....
Net exports (2)	0.7	–0.9	–1.1	....	....
Spain					
GDP	2.4	3.5	3.8	3.8	3.6
Domestic demand	1.6	2.9	4.9	5.0	4.9
Net exports (2)	0.7	0.5	–1.2	–1.3	–1.4
United Kingdom					
GDP	2.6	3.5	2.1	1.9	0.9
Domestic demand	3.0	3.9	3.5	3.6	2.4
Net exports (2)	–0.5	–0.3	–1.8	–2.1	–1.9

Sources: Eurostat and national statistics.
(1) Domestic demand includes changes in stocks. For France, Germany, Italy and the United Kingdom, ESA95 national accounts. – (2) Contribution to the increase in gross domestic product, in percentage points.

The dispersion of growth rates in the four leading economies of continental Europe increased by comparison with 1997. GDP rose by 2.3 per cent in Germany, 3.2 per cent in France and 3.8 per cent in Spain. In all three countries growth was sustained by domestic demand; in Germany, however, stock-building accounted for a much greater share, almost 50 per cent. In Spain investment increased appreciably, by 9 per cent. Net exports had a negative effect on growth in all three countries, but especially in Spain, where they reduced growth by 1.2 percentage points. In the fourth quarter of the year, all four economies were affected to differing degrees by the crises in emerging economies. In Germany GDP on an annual basis was 0.6 per cent lower than in the preceding quarter, with net exports having a negative effect of one percentage point. Despite a 5.3 per cent fall in exports, activity in France was higher than in the previous quarter, reflecting vigorous domestic demand. The disparity in growth rates was partially mirrored in the labour market. On an annual average basis employment increased by only 0.4 per cent in Germany, but by 2.1 per cent in France and by 3.4 per cent in Spain. Inflation, measured by the harmonized consumer price index, was particularly low in Germany and France, 0.6 and 0.7 per cent respectively; in the Netherlands and Spain it was 1.8 per cent, significantly higher than the average for the area.

Output increased by an average of 2.9 per cent in 1998 in the euro area countries. The growth in private consumption and investment was vigorous. Domestic demand increased by 3.5 per cent, 1.5 percentage points more than in 1997. Employment rose by 1.3 per cent and the unemployment rate fell from 11.2 per cent in January to 10.6 per cent in December. Productive activity slowed down sharply in the fourth quarter owing to the fall in foreign demand, but the sustained growth in consumption helped to contain the repercussions of unfavourable external developments. Measured in terms of the harmonized consumer price index, inflation in the euro area fell from 1.6 per cent in 1997 to 1.1 per cent last year.

The growth in output in the United Kingdom slowed down from 3.5 per cent in 1997 to 2.1 per cent last year, mainly owing to a large loss in competitiveness as a result of the appreciation of sterling in 1997 and the adverse disparity in price trends. Even though the slowdown intensified during the year and spread from manufacturing to the entire economy, the unemployment rate fell to 4.6 per cent in August and remained at that level for the rest of the year. The deceleration in productive activity helped to hold down inflation, which fell from an annual rate of 2.8 per cent to one of 2.7 per cent, net of mortgage interest payments.

The cyclical disparity among the leading industrial economies became more pronounced in early 1999. In the United States the growth of 4.5 per cent in GDP in the first quarter was higher than expected; private consumption showed a large increase of 6.7 per cent. In Japan the demand stimuli from fiscal policy proved incapable of triggering a recovery; the unemployment rate rose further, reaching 4.8 per cent in March. Deflationary pressures on prices and wages intensified. In the euro area activity continued to slow and economic indicators do not signal a clear reversal of this trend in the coming months. In Germany industrial orders are falling and business confidence has weakened. The economic situation in France has also deteriorated, but the slowdown appears to be less serious than in Germany and Italy, thanks to the favourable performance of the service sector. In Spain the rise in employment has continued to fuel consumption.

Economic policies in the leading industrial countries

Fiscal policies. - Sustained economic growth led to a large federal budget surplus in the United States. In Japan fiscal policy again became expansionary following the tightening in 1997; however, the stimulus to the economy is proving slow to materialize and its potential effectiveness uncertain. Measures to balance the public finances in the euro area countries were less intense in 1998, following the efforts made in 1997.

In the United States the federal budget for the fiscal year to September 1998 showed a $69 billion surplus, equal to 0.8 per cent of GDP; in 1997 there had been a small deficit. About half of the improvement is estimated to have been due to cyclical effects. The Administration projects a surplus of $79 billion in the current fiscal year; the fiscal stance should remain fundamentally unchanged. A cumulative surplus of about $4 trillion should be achieved over the next fifteen years; it is planned that 60 per cent will be set aside to finance the social security system.

In Japan fiscal measures and the operation of automatic stabilizers pushed the deficit for the fiscal year that ended in March 1999 to 9.8 per cent of GDP, net of the surplus of the social security system, compared with 5.9 per cent the previous year. The 1999 budget, which was approved at the end of March, indicates a general government budget deficit, net of the social security surplus, equal to 9.2 per cent of GDP in the current fiscal year. According to preliminary forecasts, the fiscal stimulus should be stronger than last year, partly owing to delays in the approval of support measures. Uncertainty continues to surround the implementation of the measures entrusted to local authorities.

Among the leading European countries, the general government budget deficit decreased considerably in Spain and Germany, to close to 2 per cent of GDP, while remaining practically unchanged in France and Italy at 2.9 and 2.7 per cent respectively. For the euro area as a whole it declined by only 0.4 percentage points, from 2.5 to 2.1 per cent of GDP; the acceleration of growth and the decline in interest rates were contributory factors.

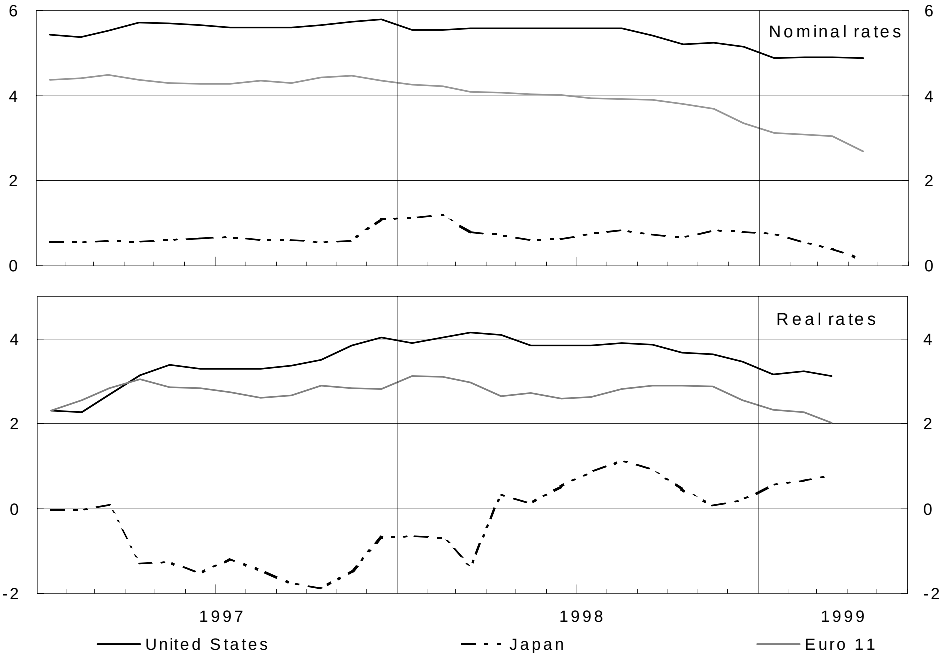
Cyclically adjusted, the deficit remained unchanged, at 2.1 per cent of GDP. The ratio of public debt to GDP fell by about 1.5 percentage points to just above 73 per cent.

Monetary policies. - In the United States the Federal Reserve eased monetary conditions in response to the growing and spreading turbulence in international financial markets. In Japan the expansionary stance of monetary policy was intensified in an attempt to bolster activity and increase liquidity in the banking system. Interest rates in the euro area countries converged to the low levels prevailing in the countries with a longer tradition of stability.

The Federal Reserve reduced the target rate for federal funds three times between September and November, lowering it from 5.5 to 4.75 per cent; the discount rate was reduced in two steps to 4.5 per cent. The changes were motivated by the growing difficulty of firms in obtaining credit, the widespread fear of an abrupt slowdown in the economy and the need to inject liquidity into the international markets. The resulting decline in short-term interest rates continued into the early months of 1999 (Figure 1). The monetary aggregates increased rapidly, accelerating towards the end of the year.

Figure 1

NOMINAL AND REAL SHORT-TERM INTEREST RATES (1)



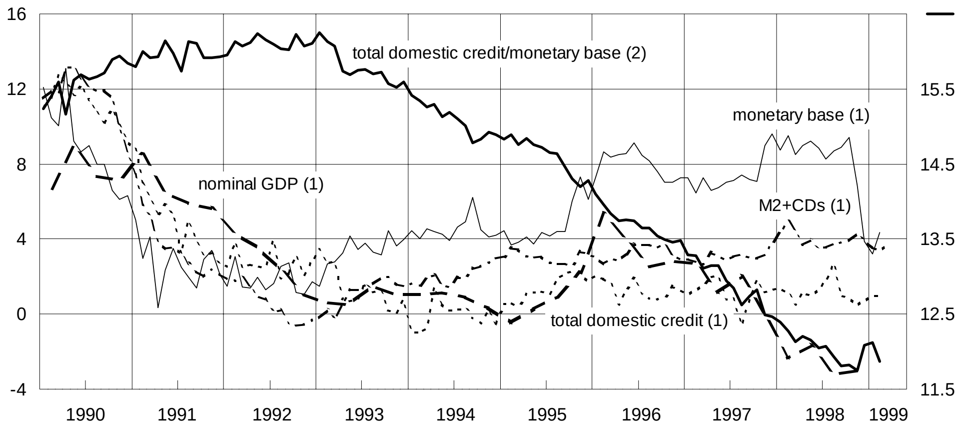
(1) Average monthly data. For the euro area, until December 1998, the average of national short-term rates weighted by the GDP of each country; from January 1999 onwards, 3-month Euribor. Real interest rates are obtained by deflating nominal rates by the rate of increase in consumer prices recorded in the preceding 12-month period.

In September the Bank of Japan encouraged a decline in the overnight rate to 0.25 per cent; since mid-February 1999 it has pushed the rate to almost zero. In 1998 the M2 plus CDs aggregate grew by 4.0 per cent, despite a fall of 3.0 per cent in nominal GDP; monetary base increased by between 8 and 9 per cent (Figure 2). The credit multiplier continued to fall; this trend, which began in 1993 and has intensified since 1995, reflects the problems of capital adequacy and profitability in the banking system, which have caused banks to be extremely cautious in their lending to the private sector. Both short and long-term interest rates on new loans remained unchanged, despite the progressive easing of monetary conditions.

Figure 2

MONETARY AGGREGATES IN JAPAN

(seasonally adjusted data; percentage change on year-earlier period)



Source: National statistics.
(1) Left-hand scale. - (2) Right-hand scale.

Interest rates in the euro area countries gradually declined during the year to the levels prevalent in France and Germany. In the absence of inflationary pressures and in response to signs of a cyclical slowdown, the monetary authorities of all the countries concerned reduced their reference interest rates to 3 per cent in December. In April 1999, with current and expected inflation below the 2 per cent limit and with growth in M3 close to the reference value of 4.5 per cent, the Governing Council of the ECB lowered the rate on main refinancing operations by half a percentage point to 2.5 per cent, the interest rate on deposits at the national central banks by the same amount to 1.5 per cent and the rate on marginal refinancing operations by one percentage point to 3.5 per cent.

In the United Kingdom the Bank of England tightened monetary conditions in June to curb the acceleration in inflation. From October onwards, however, it reduced the base rate several times by a total of 1.25 percentage points to 6.25 per cent in December. Further cuts followed in early 1999, bringing the rate down to 5.25 per cent.

The non-industrial countries

The growth in GDP in the developing countries fell from 5.7 per cent in 1997 to 3.3 per cent last year, its lowest level this decade. International organizations forecast a similar rate for 1999, with faster growth in Asia being offset by a slowdown in Latin America.

The financial crisis in Asia had a serious impact on activity in all the countries directly involved. Except in Indonesia, currency devaluations did not trigger an inflationary spiral, partly owing to the restrictive monetary policies in place. Current accounts everywhere once again showed large surpluses.

The aggregate GDP of the newly industrialized Asian economies fell by 1.5 per cent, with Hong Kong and South Korea recording declines of 5.1 and 5.5 per cent respectively. In South Korea the unemployment rate rose to 6.8 per cent, from 2.7 per cent in 1997; gains in competitiveness and a drastic fall of 20 per cent in the volume of imports generated a current account surplus of 13.1 per cent of GDP. The signs of an economic recovery that appeared at the end of 1998 point to an increase of about 2 per cent in GDP in 1999.

In the Asian developing countries the growth rate fell to 3.8 per cent, from 6.6 per cent in 1997. In Indonesia, Thailand and Malaysia output fell by 13.7, 8.0 and 6.8 per cent respectively. Growth in China came down from 8.8 to 7.8 per cent, mainly on account of an abrupt slowdown in exports, the main engine of the country's growth in the nineties. The financial situation of firms worsened and the ratio of bad loans in the banking system increased. The current account of the balance of payments remained in surplus and the foreign exchange reserves amounted to a substantial $145 billion at the end of 1998. The Asian crisis had only a limited effect on the Indian economy, given the low ratio of foreign trade to GDP; output grew by 5.6 per cent, the same rate as in 1997, and the current account deficit remained small.

In Latin America growth slowed down from 5.2 per cent in 1997 to 2.3 per cent last year; in Brazil it came to a standstill.

In Argentina growth fell to 4.2 per cent, less than half the 1997 rate; the current account deficit nevertheless rose to 4.4 per cent of GDP, reflecting the pronounced slowdown in foreign demand. In Mexico activity increased by 4.9 per cent, thanks to exports to the United States. In Venezuela output declined by 0.4 per cent and the current account balance deteriorated by more than 8 percentage points of GDP. The external accounts of the last two countries were adversely affected by the steep fall in oil prices.

In Russia the profound structural problems of the economy led to a devastating financial crisis in August 1998, which culminated in the declaration of a debt moratorium and a large devaluation of the rouble. Output fell by 4.8 per cent in 1998 and consumer prices rose by 71 per cent between August and December. It is estimated that the budget deficit rose to 8.5 per cent of GDP and that foreign debt at the end of 1998 amounted to $137 billion, or 41.6 per cent of GDP. In April of this year agreement was reached with the IMF on a new loan of about $4.5 billion to replace the programme that had been negotiated in July 1998 but subsequently suspended; it commits the Russian authorities to achieve a primary budget surplus equal to 2 per cent of GDP in 1999, to service the country's foreign debt and to adhere to the reform programme.

In the other countries of Central and Eastern Europe, the average rate of growth fell from 3.1 per cent in 1997 to 2.4 per cent. In most of them output continued to increase steadily, with Bulgaria achieving a significant expansion. In the Czech Republic and especially in Romania, by contrast, productive activity fell.

THE INTERNATIONAL FINANCIAL MARKETS AND EXCHANGE RATES

The currency and financial crisis that erupted in Asia in 1997 spread to the markets of other emerging countries last year. Given the abundance of liquidity, the sudden adjustment of international portfolios which it triggered caused share and bond prices to rise sharply in the leading industrial countries; the impact on the exchange rates between the leading currencies was smaller on an annual average basis. The yen nevertheless fluctuated widely during the year; it appreciated in the second half, partly as a consequence of the repatriation of funds previously invested in emerging countries.

The financial crisis in the emerging countries

The turmoil that had swept through some South-East Asian countries in the second half of 1997 abated in the first few months of last year. Their stock markets and exchange rates made good part of the large losses suffered in 1997. The situation in the Asian financial and foreign exchange markets deteriorated again from the summer onwards, however, partly owing to the deepening of the recession in Japan.

Pressure on the rouble intensified in mid-August after difficulties had arisen in obtaining parliamentary approval for important deficit-reduction measures that had been agreed between Russia and the IMF. In order to curb the exchange rate pressures, the Russian authorities first announced a widening of the rouble’s fluctuation band against the dollar, with the upper limit being raised by about a quarter, and imposed restrictions on capital movements. The measures were interpreted as a further sign of the country’s fragility. The consequences were devastating: in a matter of a few days the rouble lost about two thirds of its value against the dollar, forcing the authorities to abandon the target exchange rate band, and the stock market index fell by 40 per cent.

At the end of September the Federal Reserve coordinated the actions of a consortium of private banks to rescue a large non-bank intermediary that had incurred huge losses as a result of the turmoil in the financial markets.

Underlying the intervention by the US monetary authorities was concern that if the highly leveraged intermediary collapsed it could have repercussions on banks with large exposures towards other hedge funds, thus leading to potential systemic damage.

In September turbulence spread to the markets in Latin America. The authorities in Brazil, which was at risk of contagion owing to its large budget deficit financed largely by funds from abroad and using short-term instruments denominated in foreign currency, responded to the massive capital outflows by raising short-term interest rates drastically and intervening heavily in the foreign exchange market. Tensions abated from October onwards, especially after the Federal Reserve had eased monetary conditions.

The situation in Brazil deteriorated again at the beginning of 1999. The obstacles to implementation of the adjustment measures and the announcement by one of the states in the Federation that it was suspending the servicing of its debt caused massive capital outflows. The authorities raised the upper limit of the real's fluctuation band by 8.2 per cent and then allowed the currency to float freely; this led to a further sharp depreciation of the real. The yield differential on dollar bonds issued by emerging countries in Latin America and Eastern Europe increased.

The exchange rate changes in Latin America nevertheless caused profound shifts in competitive positions within the region, which will have repercussions on economic performance and the external accounts. The substantial gain in competitiveness recorded by Brazil, equal to 26 per cent between the end of 1998 and March 1999, contrasts with losses of between 6 and 8 per cent in Argentina, Mexico and Venezuela.

Financial markets in the industrial countries

The crisis in the emerging countries had a significant impact on the capital markets of the industrial economies. Portfolio adjustment by international investors caused share prices to rise substantially; bond yields fell, most markedly in countries with a longer tradition of stability and, within those countries, for the paper of issuers with a high credit rating.

Nominal long-term interest rates in the leading industrial countries fell to their lowest levels for thirty years. In the United States they stood at 4.5 per cent in October, more than one percentage point lower than at the end of 1997. Between October and the middle of May 1999 the exceptional growth in economic activity favoured a rise in 10-year bond yields by an average of one percentage point to 5.5 per cent. In January of this year bond yields in the euro area were 3.8 per cent, 1.6 percentage points less than at the end of 1997; in subsequent months they fluctuated around a level only slightly higher than this. In Japan 10-year bond yields declined to a low of 0.7 per cent at the beginning of October before recovering to 2 per cent in December. They were affected by the deterioration in the country's credit rating due to the rising budget deficit and by the announcement that postal deposits would no longer be used to subscribe government securities. The yield differential between 10-year Japanese Treasury bonds and equivalent World Bank securities, which had been zero in 1998, became marginally positive from January of this year onwards. Japanese long-term rates behaved erratically in the first few months of this year; in mid-May they stood at 1.3 per cent.

In the second half of 1998 long-term interest rates adjusted for the medium and long-term inflation expectations ascertained by Consensus Forecasts declined to their lowest level for twenty years. In October they were 2.3 per cent in the euro area and 1.8 per cent in the United States; in Japan they were negative (-1.0 per cent). On the basis of the latest survey conducted in April of this year, rates have remained unchanged in the euro area but have risen in the United States and especially sharply in Japan, to 2.5 and 1.1 per cent respectively.

Share prices in the industrialized countries rose substantially between the beginning of 1998 and the middle of May of this year. The increase, which was interrupted only temporarily in the summer of last year, was particularly rapid in Italy (42 per cent), the United States and France (40 per cent), where price/earnings ratios rose respectively from 22 to 24, from 23 to 32 and from 18 to 20. In Japan the pattern was different; a fall of 7 per cent during 1998 was followed by a rise of 27 per cent between the beginning of January and the middle of May of this year.

Exchange rates

The dollar remained broadly stable in the first eight months of 1998 and then depreciated by about 7 per cent against the ecu between August and October, partly owing to fears that the financial crisis would spread and to the switch to a more expansionary monetary stance in the United States. From November onwards the slowdown in economic activity and the easing of monetary conditions in the euro area, which contrasted with the continuance of strong growth in the United States, led to a reversal of market expectations and a gradual recovery on the part of the dollar.

The economic recession in Japan and the country's expansionary monetary stance caused the yen to depreciate by 12 per cent against the dollar between January and August, to stand at ¥147; between then and the end of the year, however, the currency appreciated by 28 per cent. The reversal of the trend was ascribable partly to the stabilization of the domestic political situation, but also partly to the decision of many foreign investors to liquidate their assets in emerging markets, which had been financed in yen, and to the repatriation of funds by Japanese banks, fearful that a further depreciation of the yen would increase the book value of foreign currency lending and thus make capital adequacy ratios more stringent.

In the first few months of 1999 the dollar steadily strengthened against the euro to an exchange rate of $1.06, an appreciation of 11 per cent since the beginning of January. The downward revision of growth forecasts for the euro area and a change in market expectations about the monetary stance of the Eurosystem contributed to the weakness of the euro. The dollar appreciated by 5 per cent against the yen, which was affected by continuing uncertainty about the outlook for the Japanese economy.

INTERNATIONAL TRADE AND THE BALANCE OF PAYMENTS

International trade and the prices of raw materials

The rate of growth of world trade in goods and services fell sharply last year, reflecting the recession in Japan and the marked slowdown in economic activity in the developing countries. The rise of 3.3 per cent in the volume of trade was the lowest since 1985 and contrasted with one of 10 per cent in 1997. The growth in merchandise trade slowed down even more markedly, from 10.6 to 3 per cent. World trade will continue to be affected this year by the weakness of economic activity in many of the industrialized and developing countries; the IMF forecasts an increase of 3.8 per cent in trade in goods and services, compared with an average of 6.4 per cent during the nineties.

The industrialized countries' merchandise exports grew by 3.6 per cent in volume, while their imports increased by 4.6 per cent. In Japan imports declined by 5.3 per cent and exports also fell slightly, by 1.2 per cent; the collapse of 30 per cent in exports to the Asian countries afflicted by the crisis was largely offset by increases in shipments to the industrialized countries. In the United States the strength of domestic demand sustained imports, which grew by 11.2 per cent, while exports increased by only 2.3 per cent owing to the slowdown in world trade and the deterioration in competitiveness by about 9 per cent in the last two years. The increase in domestic demand also caused imports to the EU to rise significantly, by 7.1 per cent, while exports grew by 5.2 per cent. The rate of export growth was 6.8 and 5.9 per cent respectively in France and Germany, compared with 2 per cent in Italy and virtually nil in the United Kingdom.

In the developing countries the growth in the volume of merchandise exports slowed down from 11.1 per cent in 1997 to 1.5 per cent. Imports contracted by 3 per cent; the decrease was particularly large in Asia: 11.6 per cent for the area as a whole and more than 20 per cent if China and India are excluded.

Last year the terms of trade of the industrialized countries improved by 1.4 per cent, with Japan and the United States recording particularly large increases of 6.7 and 2.5 per cent respectively. The terms of trade of developing countries showed a sharp fall of more than 6 per cent; the reduction was about 18 per cent in the case of fuel-exporting countries as a whole. The average price of the three main grades of crude oil fell to $13.10 a barrel last year, 32 per cent less than in 1997; in relation to the prices of manufactured exports from industrialized countries, oil prices thus returned to the levels obtaining before the 1973 oil shock. The collapse is attributable to both an increase in supply from OPEC countries and much slower than expected growth in demand.

The prices of non-fuel raw materials fell by about 15 per cent in 1998 and continued to decline in the first quarter of this year. The IMF forecasts a modest recovery in the remainder of the year.

The balance of payments

The continuing expansion in the United States and the recession in many Asian economies led to substantial changes in the current account balances of the main economic areas last year. Japan's surplus increased by $27 billion (Table 2). The five Asian countries hardest hit by the crisis (Indonesia, Malaysia, the Philippines, South Korea and Thailand) turned a combined deficit of almost $30 billion in 1997 into a surplus of $67 billion, with South Korea alone accounting for $41 billion of the total. The correction was considerably larger than the IMF had forecast a year ago, when it had predicted an improvement of about $50 billion. The main counterpart was a significant worsening of about $80 billion in the current account deficit of the United States. The deficit of the Latin American countries increased by $25 billion to almost $90 billion, with Brazil alone accounting for $35 billion, equal to 4.5 per cent of GDP. The errors and omissions item at world level, which should be nil, recorded an outflow of $100 billion last year, almost 1 per cent of global current transactions.

The current account deficit of the United States rose last year to $233 billion, or 2.7 per cent of GDP. The deterioration in relation to 1997 stems from the trade deficit and the deficit on investment income. The deficit on merchandise trade with Asian developing countries and Japan increased further. The current account deficit was easily financed by net inflows of almost $200 billion in portfolio investment and $64 billion in direct investment.

Japan's current account surplus increased to $121 billion, equal to 3.2 per cent of GDP, compared with 2.3 per cent in 1997, reflecting the growth in the trade surplus. The latter, which benefited partly from the fall in energy prices, rose primarily vis-à-vis industrialized countries and contracted sharply vis-à-vis Asian economies. There was a net capital outflow of more than $100 billion. During the year Japanese banks made net sales of foreign assets, so that their net creditor position contracted from $281 to 250 billion.

Table 2

CURRENT ACCOUNT BALANCES OF MAJOR COUNTRIES OR COUNTRY GROUPS

	Billions of dollars				As a percentage of GDP			
	1996	1997	1998	1999 forecasts	1996	1997	1998	1999 forecasts
Industrial countries	**36.7**	**64.1**	**–45.6**	**–86.0**	**0.2**	**0.3**	**–0.2**	**–0.4**
United States	*–134.9*	*–155.2*	*–233.4*	*–309.9*	*–1.8*	*–1.9*	*–2.7*	*–3.5*
Japan	*65.8*	*94.1*	*121.0*	*148.2*	*1.4*	*2.3*	*3.2*	*3.6*
Euro 11	....	....	*75.4*	....	....	....	*1.2*	....
of which: Germany	*–5.7*	*–1.7*	*–3.5*	*–2.0*	*–0.2*	*–0.1*	*–0.2*	*–0.1*
South Korea	**–23.0**	**–8.2**	**40.5**	**26.1**	**–4.7**	**–1.8**	**13.1**	**7.1**
Asian developing countries	**–38.9**	**–4.0**	**35.5**	**26.4**	**–1.8**	**–0.2**	**1.6**	**1.1**
of which: *Asean-4* (1)	*–30.4*	*–18.8*	*26.0*	*24.7*	*–5.2*	*–3.4*	*7.5*	*5.8*
Latin America	**–38.9**	**–65.1**	**–89.9**	**–60.7**	**–2.1**	**–3.2**	**–4.4**	**–3.3**
of which: *Argentina*	*–6.4*	*–11.9*	*–15.0*	*–14.3*	*–2.2*	*–3.7*	*–4.3*	*–4.2*
Brazil	*–23.1*	*–33.3*	*–35.0*	*–16.5*	*–3.0*	*–4.1*	*–4.5*	*–3.0*
Mexico	*–2.3*	*–7.5*	*–15.7*	*–8.7*	*–0.7*	*–1.9*	*–3.7*	*–2.0*
Countries of Central and Eastern Europe and the former USSR (2)	**–16.2**	**–29.3**	**–25.8**	**–13.4**	**–1.8**	**–3.1**	**–3.2**	**–1.9**

Sources: IMF and national statistics.
(1) Indonesia, Malaysia, the Philippines and Thailand. – (2) Includes Mongolia.

On the basis of initial estimates using the new method of calculation the current account surplus of the euro area amounted to about $75 billion, or 1.2 per cent of GDP. There were substantial net outflows of direct and portfolio investment of $114 and 103 billion respectively. France's current account surplus remained very high ($39 billion) and Germany continued to record a small deficit (about $4 billion).

A significant correction in the current account deficit of Latin America appears to be taking place. According to IMF estimates (Table 2) it should decrease by at least $30 billion in 1999, though still remain very high. The correction could be larger if the hoped-for resumption in capital inflows to the area fails to materialize during the rest of the year. The United States is expected to bear the brunt of the adjustment - its current account deficit is forecast to rise to $310 billion, or 3.5 per cent of GDP, thanks mainly to continued economic growth. In Japan the persistent weakness of domestic demand is expected to cause the surplus to increase further to about $150 billion, equal to 3.6 per cent of GDP.

Financial flows to the non-industrialized countries

As a reflection of the crises in several emerging countries, net external financing to non-industrialized countries (excluding the newly industrialized Asian economies), declined by about 22 per cent in 1998, from $282 to 219 billion, following three years of continual growth (Table 3).

Table 3

EXTERNAL FINANCING TO DEVELOPING COUNTRIES, CENTRAL AND EASTERN EUROPE AND COUNTRIES OF THE FORMER USSR

(net flows in billions of dollars)

	1994	1995	1996	1997	1998
Total net financing (1)	**161.7**	**219.0**	**249.2**	**281.7**	**219.4**
Africa	21.5	20.3	16.1	12.1	13.8
Latin America	62.3	66.3	82.1	98.5	89.6
Asia	75.4	106.2	117.0	106.7	51.4
Middle East (2)	–2.0	4.6	11.4	16.1	20.2
Central and Eastern Europe and countries of the former USSR (3)	4.5	21.6	22.6	48.3	44.4
External borrowing (1)	**52.5**	**103.6**	**100.7**	**105.0**	**72.4**
From official creditors	4.0	44.2	0.2	8.7	42.1
From banks	–25.4	10.4	16.3	7.0	15.7
From other lenders	73.9	49.0	84.2	89.3	14.6
Other flows (1)	**109.3**	**115.4**	**148.4**	**176.7**	**146.9**
Direct and portfolio investment equity flows	104.1	113.1	138.4	168.0	140.1
Capital transfers (4)	5.2	2.3	10.0	8.7	6.8

Source: IMF.

(1) Rounding may cause discrepancies in totals. – (2) Includes Cyprus, Malta and Turkey. – (3) Includes Mongolia. – (4) Includes debt cancellation and other capital account transactions, as defined in the fifth edition of the IMF Balance of Payments Manual.

Financing to the developing economies of Asia declined by more than half, to $51 billion; in Latin America it fell from $99 to 90 billion and in Central and Eastern Europe and the former USSR from $48 to 44 billion, with Russia recording a contraction of about $7 billion. Flows to other areas, which are not highly integrated into the international financial system and were thus less affected by the massive switching of private capital towards financial markets in industrialized countries, increased from $28 to 34 billion.

Flows of private capital decreased overall from $273 to 177 billion, a contraction of 35 per cent; non-bank borrowing declined from $89 to 15 billion and the equity component of direct and portfolio investment fell from $168 to 140 billion. According to recent estimates by the World Bank, there was a fairly moderate decline, from $163 to 155 billion, in foreign direct investment, including the non-equity component; investment in the main crisis-stricken countries is thought to have been virtually the same as in 1997, with disinvestment occurring only in Indonesia, partly because of political and social problems. Notwithstanding the poorer prospects for short-term growth in Asia, the fact that direct investment in these countries is holding up is attributable to their improved competitiveness and also in part to the fall in the prices paid by foreign investors for local businesses.

The decline in flows of private capital was offset by a large increase in official financing from $9 to 42 billion; this reflects the substantial financial assistance measures put together by the international community. The IMF has continued to support the Asian economies and has coordinated the granting of new loans to Russia and Brazil.

THE ITALIAN ECONOMY

Last year output in the euro area grew by almost 3 per cent, as against 2.5 per cent in 1997. Industrial production increased significantly. Growth was strongest in Spain and France. However, clear signs of a slowdown appeared in the second half of the year, especially in Germany. Domestic demand accelerated everywhere, but net foreign demand curtailed growth.

At the beginning of 1998 the high level of plant utilization in Italy, the expected decline in interest rates, the continued growth of international trade, albeit at a slower pace, and manufacturing firms' capital expenditure plans all pointed to an acceleration in economic activity. Instead, the cyclical upswing that had started in 1997 began to lose momentum earlier than in the other euro area countries; the main factors were the slowdown in world trade and Italian goods' loss of price competitiveness, especially with respect to Asian competitors.

Italy's GDP grew by 1.3 per cent in 1998, slightly less than in the previous year. Consumer price inflation remained unchanged at 2 per cent.

The expansion of gross fixed investment amounted to 3.5 per cent, up from 0.9 per cent in 1997, and was in line with that of the other euro area countries; investment in machinery and transport equipment nevertheless grew much less rapidly than in the other leading European countries. The growth in household consumption slowed, from 2.6 to 1.7 per cent, partly owing to the end of the incentives for scrapping motor vehicles. Stockbuilding accounted for almost half the growth in the economy. The numbers of employed persons increased by 111,000 or 0.6 per cent. The surplus on the external current account fell by one third to 39.1 trillion lire, despite the improvement in the terms of trade.

Weak growth

The expansionary phases recorded by the Italian economy in the nineties were shorter than in the past. The difficulty the economy had in growing can be attributed to the combined effect of budgetary consolidation and long-term factors. From 1990 to 1998, the annual increase in output was about one point less than in the other euro area countries on average. In the last three years, when the effects of deficit reduction measures were most pronounced, average annual GDP growth in Italy was less than half that in the other euro area countries (1.2 per cent versus 2.6 per cent). Investment spending appears insufficient in the light of the competitiveness required by the new single currency framework.

Fiscal tightening and reform of the social security and welfare system curbed consumption. The reduction in public investment contributed to stagnation in the construction industry. The temporary suspension of extraordinary measures in Southern Italy was a factor in the productive standstill in the area and indirectly in the slowdown in the rest of the country, for which the South is an important outlet market. The fall in the growth rate aggravated the employment situation, thereby making consumers' decisions even more prudent.

Structural shortcomings and rigidities hindered the utilization of resources made available by the adjustment of the public accounts. The country's productive specialization has shown a worrying involution over the last twenty-five years, since Italy is the only large industrial nation to export a growing share of goods with a low value added and a high price elasticity, and thus more exposed to competition from emerging countries. Last year's results support the validity of this diagnosis.

Most output is produced by small firms, which have difficulty in grasping opportunities for growth and achieving the economies of scale inherent in larger size, even though innovative solutions such as industrial districts help to offset this weakness. The structure of employment reflects sub-optimal organizational choices and the under-utilization of resources: Italy's participation rates are the lowest in the western world; self-employment, which potentially has positive aspects, is on an abnormal scale, about twice that of the other European countries; in many cases it amounts to a form of camouflaged payroll employment; there are serious disparities between the employment opportunities open to younger and older people, men and women, residents in the South and the rest of Italy, and workers in regular and irregular jobs. Although it has increased, investment in education remains modest; in 1995 only 35 per cent of the adult population between the ages of 25 and 64 had a high school diploma or university degree, less than half the figure in almost all the other industrial countries. Combined with widespread avoidance of tax and labour laws, the segmentation of the labour market, the prevalence of small firms, and workers' low educational attainments result in an economy that has difficulty in drawing on the sources of competitiveness available to other advanced nations: the ability to innovate, solidly organized markets and efficient public services and utilities.

One cause of the under-performance of the Italian economy is the persistence of a vast relatively backward area with more than one third of the population. Even though conditions in the South are now widely differentiated, the overall macroeconomic results remain unsatisfactory; the share of the labour force that is unemployed continues to increase.

Slower population growth also constitutes a curb on growth. The insufficient flexibility of the labour market and the possibility for many young people to rely on family resources delay entry into the labour market, reduce the willingness to move, and cause the formation of new families to be postponed.

With suitable policies, several weaknesses could easily become resources fostering growth. The contribution to the labour force of women and young people has started to grow again; this reflects the development of contractual arrangements that increase the flexibility of using labour, thereby improving the match with firms' needs and rendering generation turnover easier. In parallel with the structural changes in the labour market that have occurred in recent years, the social security system is also slowly moving in the direction of greater equity between protected and unprotected groups. The large margins for improvement in administrative action are beginning to be exploited. The efficiency of the markets for goods, services, labour and capital is benefiting from liberalization, privatization and the modernization of the regulatory system. Export-oriented industrial nuclei continue to become more widespread, in the South as well as in the North.

The new single currency framework appears to permit a lengthening of the time horizons of production and consumption decisions and offers an opportunity to raise the level of firms' international competitiveness, in part through a strong recovery in investment.

The economic slowdown

Domestic demand contributed 2.5 percentage points to the growth in GDP in 1998; net exports made a negative contribution of 1.1 points (Table 4). The deterioration in cyclical conditions emerged in full in the final part of the year.

The growth in households' consumption as defined in the new national accounts based on ESA95 decelerated from 2.6 to 1.7 per cent; the acceleration in spending on services was matched by a slowdown in purchases of durable goods, which was partly due to the stabilization of motor vehicle sales at the high level they had reached in 1997 thanks to government incentives. Durable goods as a whole nonetheless continued to be the fastest-growing component, increasing by 3.4 per cent. Households' consumption was sustained by the growth in gross disposable income, which rose by 2.9 per cent after adjusting for the erosion of the purchasing power of net financial assets. Households' propensity to spend diminished.

Table 4

RESOURCES AND USES OF INCOME

	1997			1998		
	Percentage changes		Contribution to GDP growth at constant prices	Percentage changes		Contribution to GDP growth at constant prices
	Values at constant prices	Deflators		Values at constant prices	Deflators	
Resources						
GDP	1.5	2.6	1.5	1.3	2.8	1.3
Imports of goods and services	10.0	1.9	−2.2	6.1	−1.7	−1.4
of which: goods	*9.7*	*1.6*	*−1.8*	*6.8*	*−2.3*	*−1.4*
Uses						
Domestic demand	2.5	2.6	2.4	2.5	2.2	2.5
Consumption by households	2.6	2.5	1.5	1.7	2.3	1.0
Consumption by government and non-profit institutions	−0.5	4.8	−0.1	1.3	2.6	0.2
Gross capital formation	0.9	2.1	0.2	3.5	1.6	0.6
of which: machinery, equipment and transport equipment	*2.9*	*1.7*	*0.3*	*5.7*	*1.4*	*0.5*
buildings	*−1.8*	*2.6*	*−0.2*	*0.1*	*1.7*	*. .*
intangible goods	*5.5*	*2.3*	*. .*	*10.8*	*2.7*	*0.1*
Change in stocks and valuables (1)	–	–	0.8	–	–	0.6
Exports of goods and services	5.0	1.6	1.2	1.2	1.0	0.3
of which: *goods*	*3.1*	*2.0*	*0.7*	*1.7*	*0.9*	*0.4*

Source: Istat, national accounts according to the new European system of accounts ESA95.
(1) Includes statistical discrepancies.

Investment increased, albeit at widely differing rates. Total gross capital formation increased by 3.5 per cent: investment in buildings stagnated, while other investment gained pace and grew by more than 6 per cent.

The growth in capital spending on machinery and equipment rose from 3.2 to 4.5 per cent. This result fell short of expectations. The spread of uncertainty among businessmen about the Italian economy's capacity for sustained growth may have been a factor. Investment in non-residential buildings slowed down, partly because only a small share of firms' capital spending was earmarked for plant expansion. Expenditure on public works continued to grow at a lively pace. Investment in residential buildings benefited mildly from the tax incentives for renovation projects.

Imports rose at a rapid pace of 6.1 per cent, although they slowed considerably compared with 1997. One contributory factor was the build-up of stocks in the early months of the year, when commodity prices recorded significant falls, but the competition of Asian exporters in the domestic market also increased following the devaluation of their currencies.

Exports lost momentum, growing in volume by only 1.2 per cent. The principal causes of the slowdown were the fall in world demand and Italy's product specialization, which magnified the effects of the loss of international competitiveness vis-à-vis the Asian countries. As in 1997, Italian firms' share of the world market contracted.

Despite an improvement in the terms of trade, the aggregate of the current account and the capital account, which is comparable to the current account in the old version of the balance of payments, declined from 60.9 to 39.1 trillion lire, or 1.9 per cent of GDP. The deterioration affected all the main components, including transfers to the European Union, which returned to a level close to their medium-term average. Capital movements intensified, reflecting major progress in European and global financial integration. Portfolio investment, which accounts for a large share of these movements, shows net inflows in decline. Outflows continued to grow at a rapid pace, reflecting further portfolio diversification by residents; inflows tended to slow down with the gradual disappearance of the differentials between the yields on Italian and foreign financial assets. Direct investment recorded a further increase in outflows, which amounted to 21.7 trillion lire, and a decrease in inflows, which fell to 4.5 trillion. The widening gap primarily reflects the economy's limited ability to attract investment in production facilities. The item "errors and omissions", which presumably includes balances accumulated abroad by Italian exporters, grew from 25.8 to 45 trillion lire. The net external position worsened in spite of the current account surplus, mainly as a result of exchange rate variations.

The slowdown in activity was unevenly distributed across the economy. The value added of industry received impetus from the energy and construction sectors, while the growth of that of manufacturing slowed down. The services sector, whose value added rose by only 0.9 per cent, was marked by the stagnation of wholesale and retail trade.

Per capita GDP grew at the same rate in the North and the South. The difference in the rate of increase in GDP, which was 0.4 percentage points lower in the South, was offset by migration. In the North, and especially in the North-West, the growth in output was dampened primarily by the performance of exports; in the South, the growth in exports, which account for only a limited part of output, remained strong (8.2 per cent at current prices on average for the year).

The increase in unemployment was concentrated in the South, where the rise in the participation rate may indicate that groups of previously discouraged job seekers are re-entering the labour market. Many of the development measures planned for the coming years focus on turning the labour potential to account, assisting local productive systems, especially those that have lately given proof of their competitiveness, and developing the tourist industry in the South by capitalizing on the region's natural resources.

Although unemployment edged upwards to 12.3 per cent, conditions in the labour market showed signs of improving. Albeit in a period of weak growth, the rise in the number of employed workers recorded by labour force surveys gathered pace in the second half of the year. In 1998 as a whole, the increase was equal to 0.6 per cent, or 111,000 persons. As in the preceding years, a contributory factor was the further spread of part-time and fixed-term contracts, which now cover nearly two and a half million workers, or more than 15 per cent of all employees. These contracts are still much less widely used in Italy than in the other European countries: the slight acceleration in their growth last year was due in part to the provisions governing temporary work coming fully into effect.

Employment increased in many branches, above all in manufacturing and services, especially personal care. By contrast, it contracted in agriculture, construction and general government, in line with well-established trends.

National contract renewals were less numerous than in 1997, leaving room for supplementary bargaining. Settlements reflected the stabilization of inflation expectations. As a result of the sharp slowdown in productivity growth, the increase in unit labour costs in manufacturing, adjusted for the effect of the introduction of the regional tax on productive activities, was larger than in 1997 (1.5 against 1.1 per cent).

After accelerating briefly at the beginning of the year, inflation was curbed by the containment of wage pressures, the slowing of domestic activity and the contraction in world demand, which was reflected in a pronounced fall in commodity prices; it reached historically low levels towards the end of the year. The average annual increase in both the harmonized consumer price index and the index of consumer prices for the population as a whole remained virtually unchanged at 2 per cent.

Recent developments and the outlook for 1999

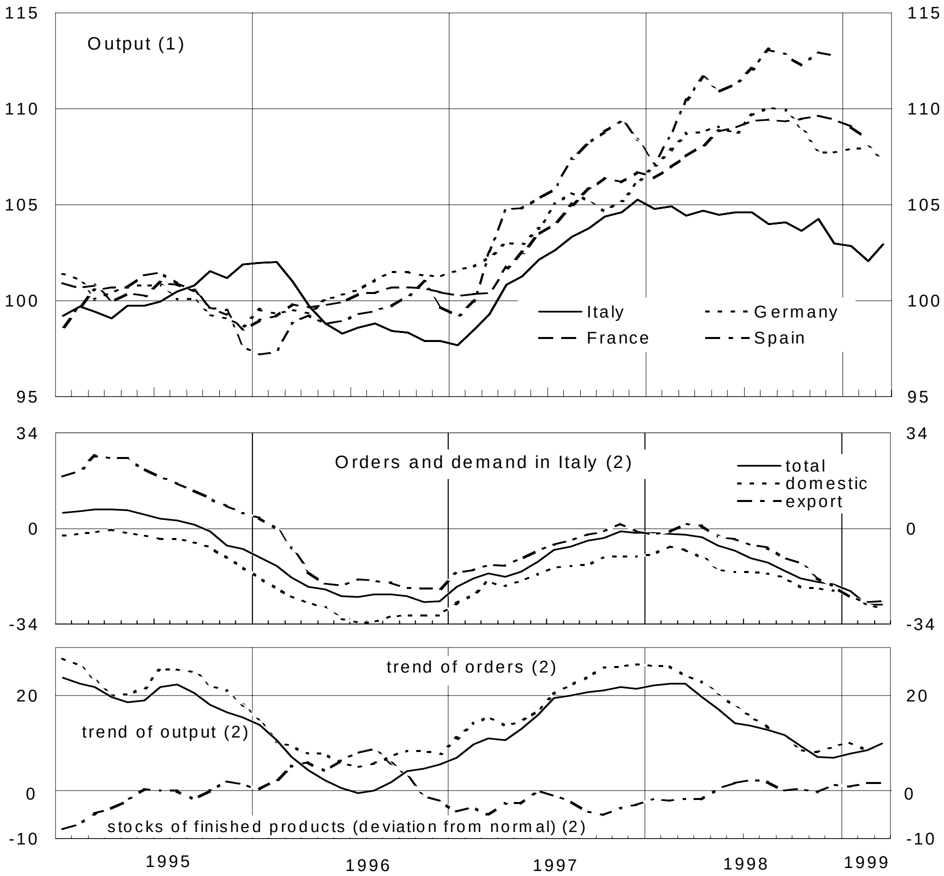
Seasonally adjusted industrial production appears to have fallen slightly again between the fourth quarter of 1998 and the first quarter of 1999. A significant recovery in output could take place in the second half.

Since the end of last year some positive signs have appeared, such as the modest pickup in the trend of orders and production (Figure 3). The leading indicator prepared by the Bank's Research Department and the Institute for Economic Research and Analysis (Isae) also shows a movement that, if confirmed, would point to an upturn in activity in the second half of the year (Figure 4).

Figure 3

INDUSTRIAL OUTPUT, DEMAND AND STOCKS

(three-month moving averages ending in the reference month)



Sources: Based on data published by Istat, BIS and Isae (Isco up to 1998).

(1) Indices, 1995=100. Data seasonally adjusted for all countries and adjusted for the different number of working days for Italy and Germany. - (2) Differences between the percentage of positive replies ("high", "increasing") and negative replies ("low", "decreasing") to Isae surveys of businessmen. Seasonally adjusted except for stocks of finished products.

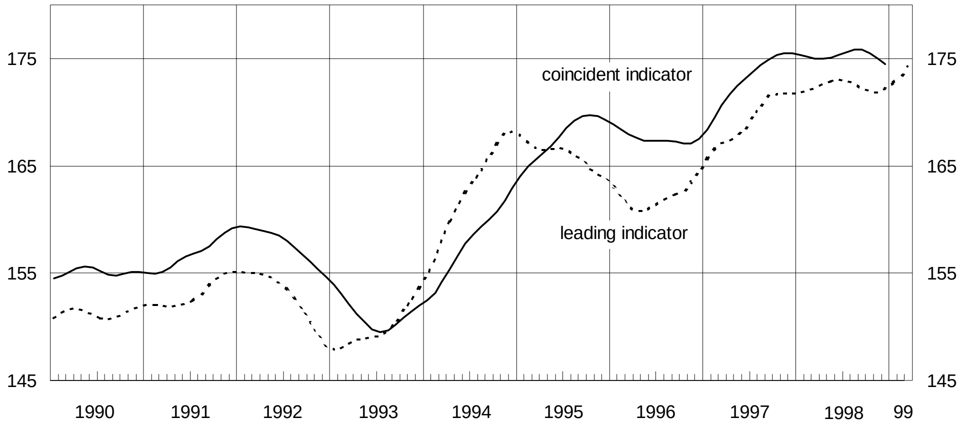
For now, the forecasts for 1999 assume that there will be a modest recovery in world trade during the year, that the exchange rates of the euro and short-term interest rates will remain at their current levels, and that the oil price will be higher than last year and in line with current spot and forward quotations.

Although exports have not yet recovered from their sharp decline in the closing months of 1998, the gain in competitiveness stemming from the depreciation of the euro and the expected acceleration in the world economy during the year are likely to buoy up foreign demand.

Figure 4

BUSINESS CYCLE INDICATORS FOR ITALY

(indices, 1978=100)



Sources: Based on Istat, Isae, Bank of Italy, INPS and State Railways data.

Fixed capital formation, sustained by low interest rates and the recent tax incentives for purchases of capital goods financed with corporate profits, is expected to grow at a similar rate to that recorded last year, despite the slackening of investment in machinery, equipment and transport equipment.

Households' consumption is forecast to contribute to GDP growth, as it has in recent years, thanks to a further rise in real disposable income, a slight improvement in employment prospects and favourable interest rates. However, consumer spending could be affected by a worsening of the Balkan crisis.

The final figures for 1999 could show an increase in GDP similar to that achieved in 1998.

Slight improvements in employment could come from the expected growth in recourse to part-time work and a further shift in supply towards household services. The unemployment rate is likely to remain almost unchanged.

In the first few months of this year there have been signs in Italy and the rest of the euro area of a moderate acceleration in consumer prices due to external pressures: an increase of around 50 per cent in the price of crude oil and a sizable fall of the euro against the dollar. Intended changes in producer prices have also begun to move upwards, in line with the short-term forecasts for output. However, expected consumer price inflation for 1999 remains below 1.5 per cent for Italy. According to market expectations, the inflation differential between Italy and the euro area as a whole will disappear during the year.

An improvement in the outlook for a recovery in growth depends on the consistency and determination with which economic policies continue to encourage capital formation, reduce current budget expenditure and the tax burden on consumers and firms, make labour contracts more flexible, liberalize public services, reform administrative action and renew governmental support for programmes to redress regional disparities.

DEMAND

As in the other leading European countries, economic growth in Italy was constrained in 1998 by adverse trends in foreign trade. Despite a pronounced and intensifying deceleration in the course of the year, the growth in imports was considerable, buoyed by declining world prices for raw materials and fuel and by the loss of competitiveness vis-à-vis producers in South-East Asia. The decline in competitiveness also affected exports, which slowed abruptly and actually contracted in the closing months of the year. Domestic demand increased less than in the other European economies, as the reduction in the growth of private consumption was only partially offset by an acceleration in gross fixed capital formation and substantial stock-building. GDP grew by 1.3 per cent, 1.5 points less than the average for the euro area countries.

Households' consumption

Households' final domestic consumption at constant prices increased by 1.7 per cent in 1998, nearly one percentage point less than in 1997 (Table 5). The reduction was due largely to the expiry of government incentives for the scrapping of old motor vehicles. The modest growth of households' spending in Italy contrasts with a larger increase of 2.8 per cent in the euro area as a whole. The disparity was especially wide vis-à-vis France and Spain (where the increase was 3.8 per cent) and practically nil vis-à-vis Germany (1.8 per cent). The growth in national consumption, in other words residents' expenditure in Italy and abroad, slowed less markedly, from 2.5 to 1.8 per cent.

The growth in private consumption was restrained by the smallness of the increase in spending capacity. On the basis of the new system of national accounts, it is estimated that households' gross disposable income rose by 3.0 per cent at current prices and 0.6 per cent at constant prices (Table 6).

Allowing for the loss of purchasing power of net financial assets (estimated on the basis of inflation expectations), the gross disposable income of consumer households increased by 5.3 per cent at current prices and 2.9 per cent at constant prices. The propensity to save thus rose by about one percentage point.

Table 5

HOUSEHOLDS' CONSUMPTION

(at 1995 prices; percentage changes)

	% share in 1998	1995	1996	1997	1998
Non-durable goods	44.7	1.2	–0.5	1.1	1.1
of which: food	*16.8*	*–1.9*	*–1.0*	*0.4*	*0.8*
Durable goods	11.7	1.6	2.0	17.3	3.4
of which: furniture and repairs	*3.9*	*2.9*	*1.4*	*1.0*	*–1.9*
electrical household appliances and repairs	*1.2*	*0.1*	*–4.2*	*2.8*	*1.2*
television receiving sets, photographic, computer and hi-fi equipment	*1.0*	*11.7*	*–3.9*	*15.0*	*6.1*
transport equipment	*4.3*	*–0.9*	*1.2*	*42.6*	*0.3*
Services	43.5	3.3	1.4	0.8	1.9
of which: hotels and restaurants	*8.7*	*2.6*	*1.3*	*1.0*	*1.8*
communications	*2.9*	*10.7*	*12.2*	*12.2*	*16.2*
recreational and cultural	*2.6*	*7.8*	*9.4*	*5.3*	*3.8*
Total domestic consumption	**100.0**	**2.2**	**0.5**	**2.6**	**1.7**
Residents' consumption abroad	–	–0.5	5.6	11.8	2.1
Non-residents' consumption in Italy	–	12.2	–5.0	8.6	–0.6
Total national consumption	**–**	**1.7**	**0.9**	**2.5**	**1.8**
Memorandum item:					
Implicit price deflator of national consumption	–	6.0	4.4	2.6	2.3

Source: Istat, national accounts according to the new European system of accounts ESA95.

Consumers continued to be cautious in their spending plans in view of uncertainty about the economic outlook, as signaled by the pronounced variability of households' confidence (Figure 5). This indicator was at historically high levels, as in other European countries, but with the difference that in Italy the swings were much wider. In the first quarter of this year confidence declined to near the level prevailing at the beginning of 1998.

Using data based on the ESA79 classifications, it is possible to compare the composition of households' consumption according to economic purpose in several EU countries over the period from the early eighties to the mid-nineties. The proportion of expenditure on services, which was already very high in the Netherlands and Austria in the first three years of the eighties, rose substantially in Finland, France and the United Kingdom over

Table 6

GROSS DISPOSABLE INCOME AND AVERAGE PROPENSITY TO SAVE

(at current prices unless specified) (1)

	1995	1996	1997	1998
	Percentage changes			
Wages and salaries net of employees' social security contibutions	1.1	5.4	3.8	3.0
per capita compensation of employees	*4.2*	*6.3*	*4.2*	*–1.5*
total social security contributions (2)	*–2.8*	*–0.9*	*–0.9*	*3.7*
employee labour units	*–0.3*	*0.1*	*0.5*	*0.8*
Self-employment income net of social security contributions	4.5	4.7	3.1	5.8
per capita self-employment income	*4.6*	*4.2*	*3.9*	*3.4*
total social security contributions (2)	*–0.7*	*0.4*	*0.3*	*1.9*
self-employed labour units	*0.6*	*0.1*	*–1.1*	*0.4*
Net property income (3)	12.0	3.9	–3.6	–1.9
Social security benefits and other net transfers	5.3	7.1	6.9	3.1
of which: *net social security benefits*	*5.6*	*7.0*	*6.3*	*3.1*
Current taxes on income and wealth (–)	5.9	8.0	6.2	2.5
Gross disposable income of households (4)	**4.7**	**4.9**	**2.4**	**3.0**
at 1995 prices (5)	–1.3	0.5	–0.2	0.6
at 1995 prices, adjusted for expected inflation (6)	–1.0	1.4	1.6	2.9
at 1995 prices, adjusted for past inflation (7)	–3.4	4.8	0.9	1.8
Gross disposable income of the private sector	**8.3**	**4.8**	**1.0**	**2.9**
at 1995 prices (5)	2.2	0.5	–1.6	0.6
at 1995 prices, adjusted for expected inflation (6)	2.6	1.1	–0.3	2.5
at 1995 prices, adjusted for past inflation (7)	0.6	3.8	–0.8	1.5
	Percentages			
Households' average propensity to save (4) (8)	**18.2**	**17.9**	**15.7**	**14.7**
calculated on income adjusted for expected inflation	13.2	13.6	12.8	13.7
calculated on income adjusted for past inflation	10.9	14.2	12.8	12.8
Average propensity to save of the private sector (8)	**30.2**	**29.9**	**27.0**	**26.1**
calculated on income adjusted for expected inflation	26.8	27.0	24.9	25.3
calculated on income adjusted for past inflation	25.3	27.4	24.9	24.6

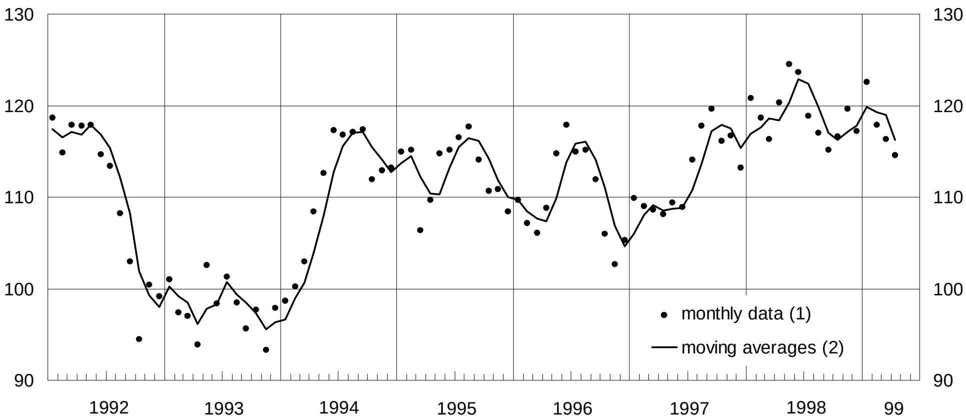
Sources: Based on Istat and Bank of Italy data.

(1) Estimates based on the new European system of accounts ESA95. – (2) Change in net wages and salaries and net self-employment incomes attributable to social security contributions, in percentage points; a minus sign indicates an increase in contributions. – (3) Comprises gross operating surplus (primarily actual and imputed rents), net income from land and intangible assets, net interest, dividends and other profits distributed by companies. – (4) Consumer households, including private non-profit institutions. – (5) Deflated using the implicit price deflator of national consumption. – (6) Gross disposable income net of expected losses on net financial assets due to inflation (estimated from the results of the Forum-Mondo Economico survey); deflated using the implicit price deflator of national consumption. – (7) Gross disposable income net of actual losses on net financial assets due to inflation; deflated using the implicit price deflator of national consumption. – (8) Ratio between saving, before deduction of depreciation and net of the change in severance pay and pension funds, and the gross disposable income of the sector.

Figure 5

CLIMATE OF CONFIDENCE AMONG CONSUMER HOUSEHOLDS

(indices, 1980=100)



Source: Based on Isae data.

(1) Until 1994 no survey was conducted in August; the data for that month were calculated as simple averages of data for July and September. Since January 1995 interviews have been conducted by telephone, not in person, and the interviewee is no longer necessarily the head of household but any adult member who contributes to the income of the household. - (2) Three-month moving average ending in the reference month.

the 15-year period (Table 7). In Italy and the other Mediterranean countries it began at a much lower level and showed an increase only in Italy, and a modest one at that. In these countries non-durable and semi-durable goods together account for a larger share. The differences in the composition of households' consumption are due not only to differences in the level of economic development but also to demographic factors, such as the age of the head of household and the characteristics of the family.

Table 7

COMPOSITION OF HOUSEHOLDS' CONSUMPTION ACCORDING TO ECONOMIC PURPOSE

(percentage shares. at constant prices; averages for periods indicated)

	Durable goods		Non-durable goods		Semi-durable goods		Services	
	1980-82	1995-97 (1)	1980-82	1995-97 (1)	1980-82	1995-97 (1)	1980-82	1995-97 (1)
Austria	10.5	13.1	34.6	31.9	12.6	10.0	42.3	45.0
Denmark	8.1	12.8	40.0	35.9	14.1	14.1	36.4	37.2
Finland	9.3	8.1	41.4	38.7	10.1	9.0	38.2	44.2
France	7.7	8.8	37.0	35.9	16.6	13.3	37.2	42.0
Greece	10.3	8.6	47.2	48.1	13.4	10.7	32.1	32.6
Italy	10.4	11.2	36.4	31.9	18.9	19.2	35.5	37.6
Netherlands	9.5	10.0	27.6	26.0	14.9	15.6	47.1	48.3
Portugal	8.4	9.8	43.0	40.6	17.8	17.8	31.5	31.8
Sweden	9.2	8.2	38.0	35.9	15.0	15.3	38.8	40.3
United Kingdom	7.3	10.0	38.7	30.3	14.3	16.7	39.2	43.0

Source: Based on Eurostat data according to the European system of accounts ESA79.
(1) For Austria and Sweden, 1994-96; for Ireland and Portugal, 1993-95.

In the private sector as a whole gross disposable income increased by 2.9 per cent at current prices, slightly less than that of households alone, and the propensity to save declined from 27 to 26.1 per cent. Adjusted for the erosion of the purchasing power of net financial assets, however, the propensity to save rose by nearly half a point.

In proportion to national income, the saving rate of the private sector as a whole declined from 22.1 to 21.1 per cent. For the entire economy it remained more or less unchanged at 21.7 per cent, thanks to a reduction in the general government deficit (Table 8).

Table 8

GROSS SAVING AND INVESTMENT

(as a percentage of gross national disposable income)

	1988	Average 1990-94	1995	1996	1997	1998
General government saving (1)	−5.8	−6.1	−4.0	−3.2	−0.1	0.5
Private sector saving	27.5	25.3	25.9	25.4	22.1	21.1
of which: consumer households	*16.0*	*14.4*	*13.4*	*13.0*	*11.1*	*10.3*
Gross national saving	21.7	19.3	22.0	22.1	21.9	21.7
Gross investment	22.8	20.9	19.7	18.8	19.1	19.8
Memorandum item:						
Balance of current account transactions with the rest of the world	−0.8	−0.9	2.3	3.3	2.9	1.9

Source: Based on Istat data.
(1) Estimates based on European system of accounts ESA79.

Investment

Gross fixed investment increased by 3.5 per cent in real terms, compared with 0.9 per cent in 1997 (Table 9). In recent years it has amounted to between 18 and 19 per cent of GDP, about 2 percentage points less than in the early nineties.

The increase was appreciable, in line with that in the main European economies. However, in the other euro countries investment in equipment, machinery, transport equipment and intangible goods rose much more rapidly than overall investment and at a higher rate than in Italy (10 per cent in Germany, 9 per cent in France and 13 per cent in Spain, as against 6 per cent in Italy).

Machinery and equipment, transport equipment and intangible goods. - While investment in machinery and equipment, transport equipment and intangible goods rose by 6.1 per cent, that in machinery and equipment alone grew by 4.5 per cent; expenditure on transport equipment increased by 10.8 per cent, sustained until the end of July by incentives for the scrapping of old motor vehicles. Investment in intangible assets, which accounted for 7.4 per cent of total gross fixed investment, also rose by 10.8 per cent.

Table 9

FIXED INVESTMENT

(at 1995 prices; percentage changes and percentages)

	Percentage change			As a percentage of GDP		
	1996	1997	1998	1996	1997	1998
Construction	1.7	–1.8	0.1	8.4	8.1	8.0
of which: residential buildings	*–2.4*	*–2.9*	*0.7*	*4.8*	*4.6*	*4.5*
other	*7.7*	*–0.3*	*–0.6*	*3.6*	*3.6*	*3.5*
Machinery and equipment	2.1	3.2	4.5	7.6	7.8	8.0
Transport equipment	2.0	1.7	10.8	1.8	1.8	2.0
Intangible goods	11.6	5.5	10.8	0.7	0.8	0.8
Total gross fixed investment	**2.3**	**0.9**	**3.5**	**18.6**	**18.5**	**18.9**
Total excluding residential buildings	4.0	2.2	4.4	13.8	13.9	14.3
Total excluding construction	2.7	3.1	6.1	10.2	10.3	10.8
Total net fixed investment (1)	**1.5**	**–4.7**	**6.3**	**4.1**	**3.9**	**4.1**

Source: Based on Istat data, national accounts according to the new European system of accounts ESA95.
(1) Excluding depreciation.

Investment was fueled by the high capacity utilization rate reached at the end of 1997, good corporate liquidity and the reduction in interest rates. It would have increased more strongly but for the slowdown in domestic and international demand in the course of 1998. In the last two years investment in capital goods has risen less rapidly than could have been expected on the basis of the growth of demand and the trends in relative factor prices. Given the low level of confidence in the economy's potential for growth, firms have been very cautious about increasing investment.

Construction. - Building investment stagnated. The structural decline in residential building due to demographic factors was offset by an increase in restructuring and renovation work, encouraged by tax relief introduced in the 1998 budget.

The construction of non-residential buildings and civil engineering projects declined by 0.6 per cent. Following the exceptional increase in 1995 and 1996 as a consequence of the incentives available under the Tremonti Law, non-residential building has presumably been dampened by the fall in the proportion of investment directed towards expanding capacity. Public works increased for the second consecutive year, though by less than in 1997, reflecting the improved spending capacity of general government.

Stocks. - Stockbuilding remained brisk in 1998. As in 1997, the item "changes in inventories and valuables" accounted for nearly half of the entire increase in GDP. Isae surveys of industrial firms found that most of the change in inventories, whether of raw materials and semi-finished goods or of finished goods, occurred in the first part of the year, reflecting the decline in world prices and the slowdown in current and expected demand.

Exports and imports

As in 1997, the contribution of net exports of goods and services to GDP growth was negative, by more than one percentage point. Whereas in 1997 exports had risen by 5 per cent and imports by 10 per cent at constant prices, in 1998 exports increased only marginally (by 1.2 per cent), and import growth slowed to 6.1 per cent (Table 10). The pronounced improvement in the terms of trade limited the adverse effects on the trade surplus. In the euro area as a whole the slowdown in the growth of foreign trade was less abrupt, with imports growing by 7.5 per cent and exports by 5.4 per cent. Export growth was highest in Spain (7.8 per cent) and substantial in Germany (6.5 per cent) and France (6.3 per cent).

Italy's merchandise exports rose by 1.7 per cent at constant prices, compared with 3.1 per cent in 1997. The main factors were the sharp slowdown in the growth of world merchandise trade, which according to IMF estimates came down from 10.6 to 3.0 per cent, and Italy's specialization in medium-technology industries that are highly exposed to competition from Asian producers, who benefited by the depreciation of their currencies. Exports of services, which had increased by 17 per cent in 1997, contracted by 2.0 per cent; most of the decline was in financial intermediation and insurance services. Exports of transport services, which account for nearly one fifth of total service exports, remained basically unchanged.

Total merchandise imports rose by 6.8 per cent at constant prices, with a progressive slowdown in growth over the course of the year. Imports of manufactured goods increased by 9.5 per cent, almost a third of which was

Table 10

EXPORTS AND IMPORTS OF GOODS AND SERVICES IN THE NATIONAL ACCOUNTS

(percentage changes on previous year)

	1996			1997			1998		
	Goods	Services	Total	Goods	Services	Total	Goods	Services	Total
Exports									
At current prices	2.0	1.8	2.0	5.2	16.5	6.7	2.7	–0.9	2.2
At constant prices	1.9	–0.9	1.5	3.1	17.3	5.0	1.7	–2.0	1.2
Deflators	0.2	2.7	0.5	2.0	–0.7	1.6	0.9	1.0	1.0
Contribution to growth of GDP at constant prices (1)	*0.4*	. .	*0.4*	*0.7*	*0.6*	*1.2*	*0.4*	*–0.1*	*0.3*
Imports									
At current prices	–4.2	–1.3	–3.8	11.5	16.2	12.1	4.3	4.4	4.4
At constant prices	–2.2	4.5	–1.3	9.7	11.7	10.0	6.8	2.0	6.1
Deflators	–2.1	–5.6	–2.6	1.6	4.1	1.9	–2.3	2.4	–1.7
Contribution to growth of GDP at constant prices (1)	*0.4*	*–0.1*	*0.3*	*–1.8*	*–0.4*	*–2.2*	*–1.4*	*–0.1*	*–1.4*
Exports/imports									
At current prices	6.5	3.2	6.1	–5.6	0.2	–4.8	–1.6	–5.1	–2.1
At constant prices	4.1	–5.2	2.8	–6.1	5.0	–4.8	–4.7	–3.9	–4.6
Deflators	2.3	8.8	3.2	0.4	–4.5	–0.2	3.3	–1.3	2.7
Contribution to growth of GDP at constant prices (1) (2)	*0.8*	*–0.1*	*0.7*	*–1.1*	*0.2*	*–1.0*	*–1.0*	*–0.2*	*–1.1*

	1996	1997	1998
Memorandum items:			
World trade (3)	6.9	9.9	3.3
Indicator of Italian competitiveness (4)			
Overall (5)	11.5	. .	1.9
Exports (6)	12.4	–1.7	1.1
Imports (7)	12.2	1.3	. .

Sources: Based on data from Istat, national accounts according to the new European system of accounts ESA95, OECD and IMF.
(1) Percentage points. – (2) Sum of the contribution of exports and imports. – (3) Average annual growth in world imports and exports of goods and services at constant prices (IMF data). – (4) Positive values indicate an approciation of the lira. – (5) Based on producer prices of manufactures alone. – (6) Based on average unit values of manufactures alone.

attributable to a surge in imports of transport equipment and office machinery. The growth in imports of services slowed down sharply, from 11.7 to 2.0 per cent, owing mainly to a decrease in the growth of transport services to just over 1 per cent and a contraction of 3.0 per cent in intermediation services.

DOMESTIC SUPPLY

Gross domestic product expanded by 1.3 per cent in 1998. Compared with the previous year's growth this was a slight slowdown, concentrated in manufacturing and in some branches of the service sector.

The growth gap with the other countries of Europe, which emerged in the early nineties and has widened in the last three years, is explained in significant measure by the persistence of medium and long-term negative factors: unfavourable structure and product specialization, inadequate infrastructure, the incomplete liberalization and insufficient flexibility of national markets. The effects of these factors are aggravated by the increasing mobility of capital, the reduction of barriers to international competition, the diminished scope for public subsidies for national industries, and the advent of the single currency.

The size and specialization of Italian companies

A system of small enterprises. - The 1996 mid-term census of industry and services, whose data were released in December 1998, confirms the heavy incidence of small enterprises within the Italian economy and the modest role of larger firms.

Ninety-five per cent of all Italian firms have fewer than 10 employees. This size class accounts for 47 per cent of total employment, compared with 21 per cent in Germany (in 1992), 22 per cent in France (in 1990) and 27 per cent in the United Kingdom (in 1991).

Between the regular census in 1991 and the mid-term survey of 1996, employment contracted while the number of firms held broadly stable. Continuing the long-run trend, the relative importance of services increased: they accounted for 53.3 per cent of total non-farm employment in the private sector, compared with 51.6 per cent in 1991. There was a reduction in the contribution of industry (from 48.4 to 46.7 per cent), the traditional services and financial intermediation, while that of more advanced services such as information or research increased (Table 11).

Table 11

FIRMS AND EMPLOYEES BY SECTOR OF ECONOMIC ACTIVITY, 1991 AND 1996 CENSUSES

	Firms				Employees			
	1991		1996		1991		1996	
	Number	% share	Number	% share	Number	% share	Number	% share
Extractive industries . .	3,617	0.12	4,242	0.12	46,360	0.33	38,546	0.28
Manufacturing	552,334	17.69	551,274	15.65	5,262,555	37.35	4,889,674	35.42
Production and distribution of electricity, gas, water	1,273	0.04	1,990	0.06	172,339	1.22	163,156	1.18
Construction	332,995	10.66	440,842	12.52	1,337,725	9.50	1,350,959	9.79
Total industry	**890,219**	**28.51**	**998,348**	**28.35**	**6,818,979**	**48.40**	**6,442,335**	**46.67**
Wholesale and retail trade	1,280,044	40.99	1,227,711	34.86	3,250,564	23.07	2,981,167	21.60
Hotels and restaurants	217,628	6.97	211,608	6.01	725,481	5.15	725,747	5.26
Transport, storage and communications	124,768	4.00	156,329	4.44	1,131,915	8.03	1,090,998	7.90
Financial intermediation	49,897	1.60	62,997	1.79	573,270	4.07	559,786	4.06
Real estate, leasing, information services, research	375,729	12.03	668,002	18.97	1,157,454	8.22	1,559,966	11.30
Other public, social and personal services . . .	184,595	5.91	196,759	5.59	430,348	3.05	443.210	3.21
Total services	**2,232,661**	**71.49**	**2,523,406**	**71.65**	**7,269,032**	**51.60**	**7,360.874**	**53.33**
OVERALL TOTAL	**3,122,880**	**100.00**	**3,521,754**	**100.00**	**14,088,011**	**100.00**	**13,803,209**	**100.00**

Sources: Istat, *7º Censimento generale dell'industria e dei servizi,* 1991; *Censimento intermedio dell'industria e dei servizi, 1996*, *Note Rapide*, December 1998.

In 1996, firms with fewer than 10 employees numbered 3,340,000, compared with 3,100,000 in 1991, reflecting widespread entrepreneurship but also an incidence of self-employment unequalled in the other large European countries.

After the powerful growth of self-employment in the later seventies and the first half of the eighties, its share of the total has stabilized at comparatively high levels. In the nineties the decline in the number of self-employed workers in the traditional sectors (commerce and agriculture) has been offset by the rise of new occupations and a tendency of larger firms to outsource some activities previously performed internally.

In the services sector tiny firms continue to be the norm; the average is 2.9 employees. Wholesale and retail trade in particular is highly fragmented, with an average of just 2.4. Manufacturing includes 90 per cent of all industrial firms with 250 or more employees, although the average manufacturing company has a modest 8.9 employees.

The size composition of Italian industry has remained stable over time. The small number of medium-sized enterprises and the halting growth of the small ones suggest the presence of barriers to growth. This is accompanied by scanty sectoral mobility. Specialization in mature products of limited technological content means a risk of mounting competition from producers in countries with low labour costs and less stringent social and environmental protection. This has been confirmed in the last two years by Italy’s mediocre export performance.

An industrial system based on small firms will generally have less potential for radical process and product innovation, which requires substantial resources and major research capacity and facilities.

Industrial districts. - One strategic response to the competitive disadvantages of undersized firms is the formation of industrial districts, systematic clusters of small companies within a limited territory. Production is not concentrated vertically in large plants but divided among many small processing units. The advantage of the districts lies in the greater specialization of each firm in individual stages of production, greater flexibility in the use of productive factors and specific external economies.

Istat has identified 199 industrial districts in Italy: 59 in the North-West, 65 in the North-East, 60 in the Centre and 15 in the South. In 1994 specialized industrial districts accounted for 13 per cent of total manufacturing employment. Using a broader definition, not restricted only to the prevalent specialized activity of each district, the ratio rises to 40 per cent nationwide and 60 per cent in the North-East, but falls to 10 per cent in the South. The districts’ share of employment is greatest in shoes, textiles and clothing, and wooden furniture.

The districts draw on the wealth of social capital available locally. Strong fiduciary relations facilitate information exchange and positive externalities connected with location. This attenuates the handicap of smallness in a size-dependent activity such as R&D. In direct contact with so many small businesses in their own industry, entrepreneurs base their strategic decisions not only on their own experience but also on that of their competitors.

Empirical studies suggest that economic branch and firm size being equal, the external economies associated with being in a district generate additional returns on equity of between 2 and 4 percentage points.

Specialization and location. - The imminence of the single currency produced closer coordination of macroeconomic policies and policies for further economic integration of the countries of the EU.

The European economies differ widely in product specialization. Census data for the main countries show profound differences in the sectoral composition of output. Increasing integration could lead to more pronounced sectoral specialization of the different areas, with competitive disadvantages for those specializing in products with low technological content and low value added.

Between 1970 and 1994 Italy, Spain and Portugal intensified their specialization in a few products while undergoing drastic despecialization in many others. This contrasts with Germany, France and the United Kingdom, which over the same decades stepped up specialization in a large number of sectors, almost all medium- or high-value-added. Italy recorded an increase in the relative importance of sectors in which it was already most heavily present (leather goods, textiles, furniture, metal and non-metallic mineral products) and a weakening of its position in almost all the others. An already substantial gap in the high-technology sectors widened further.

The free circulation of goods and productive factors could lead to relocation of productive activities towards the economically "central" regions, with their economies of agglomeration, to the detriment of the "peripheral" regions. Income disparities within the single market could thus be exacerbated.

The risks of increased sectoral disparity and income inequality are connected with the initial economic and technological structure of the various regions. The more flexible systems, capable of swift and efficient response, will sustain lower costs in the process of structural adjustment.

Industry and services

Industry. - According to the new national system of accounts, industry excluding construction recorded a 3.4 per cent increase in value added at factor costs and constant prices. Construction registered a gain of 1.6 per cent (Table 12).

Energy. - Italy’s primary energy requirement increased by 2.6 per cent, domestic production diminished by 1.3 per cent, and import dependency rose from 80.4 to 81.1 per cent. Despite the increase in energy use, the energy bill decreased by 6.4 trillion lire, thanks to a 36.3 per cent decline in the average dollar price, *fob*, of Italy’s crude oil imports. Net imports of energy products, totaling 24.1 trillion lire, fell in proportion to GDP from 1.7 to 1.3 per cent.

Table 12

VALUE ADDED AT FACTOR COSTS

Branch	1997		1998		Percentage changes			
					Volume		Deflators	
	Billions of lire	Percentage of value added	Billions of lire	Percentage of value added	1997	1998	1997	1998
Industry	**540,005**	**29.4**	**537,064**	**29.1**	**2.2**	**3.1**	**0.7**	**–3.6**
Industry excluding construction	**447,836**	**24.4**	**445,554**	**24.2**	**2.8**	**3.4**	**0.5**	**–3.8**
Extractive industries	8,967	0.5	8,170	0.4	2.7	3.7	4.8	–12.2
Manufacturing	399,905	21.8	396,215	21.5	3.4	2.6	0.3	–3.5
Production and distribution of electricity, gas, steam and water	38,964	2.1	41,169	2.2	–3.0	11.7	1.6	–5.4
Construction	**92,169**	**5.0**	**91,510**	**5.0**	**–0.4**	**1.6**	**1.7**	**–2.2**
Services	**1,233,792**	**67.3**	**1,247,139**	**67.7**	**1.1**	**0.9**	**2.5**	**0.2**
Wholesale and retail trade and repairs	244,601	13.3	244,411	13.3	1.3	–	1.5	–
Hotels and restaurants	61,367	3.3	63,417	3.4	0.3	2.0	2.9	1.3
Transport and communications	131,223	7.2	135,779	7.4	3.4	3.2	–1.5	0.2
Financial intermediation	106,552	5.8	109,027	5.9	0.1	2.0	–1.1	0.3
Real estate, leasing, information services, research (1)	329,513	18.0	340,407	18.5	1.8	0.9	3.2	2.4
General government and defence; compulsory social insurance	105,656	5.8	103,108	5.6	–1.6	0.8	5.9	–3.2
Education	93,808	5.1	91,875	5.0	–1.5	–3.8	4.9	1.8
Health and other social services	85,279	4.7	82,980	4.5	2.3	0.9	7.8	–3.6
Other public, social and personal services	60,714	3.3	60,556	3.3	2.0	3.2	1.1	–3.3
Domestic services	15,079	0.8	15,579	0.8	2.6	0.9	4.9	2.4
Agriculture	**60,028**	**3.3**	**58,514**	**3.2**	**0.8**	**1.2**	**–0.6**	**–3.7**
Value added at factor costs (2)	**1,833,825**	**100.0**	**1,842,717**	**100.0**	**1.5**	**1.6**	**1.8**	**–1.1**

Source: Istat, National account (ESA95).
(1) Including the old branch “rentals of buildings”, no longer available in the national accounts based on ESA95. – (2) Gross of indirectly measured financial intermediation services.

Legislative Decree 79 of 16 March 1999 transposes into Italian law EEC Directive 92 of 19 December 1996 on the single market in electrical energy. The measure is part of the ongoing reorganization of the electricity industry preparatory to the privatization of ENEL, the calendar for which has not yet been set. The decree partly liberalizes electricity generation, imports, exports, purchase and sale. Beginning 1 April 1999, major customers can purchase electricity from any European producer, paying for its transmission over high-voltage lines. From 2003 on, no company may control more than 50 per cent of the electrical energy generated or imported in Italy. ENEL can retain its dominant position but will have to dispose of no less than 15,000 megawatts of capacity. As a corporation, ENEL will become a holding company, controlling a variety of companies engaged in production, distribution, sales, exercise of network property rights, and decommissioning of nuclear power plants. A single agency will be formed to act as exclusive manager of the national power grid and the transmission of electricity.

Services. - The real value added of the services sector at factor costs grew by 0.9 per cent, less than the average for the entire economy. Nevertheless, faster price increases resulted in a slight rise in the services' share of nominal value added, from 67.3 to 67.7 per cent. The largest gains were registered by transport and communications (3.2 per cent), "other" public, social and personal services (3.2 per cent), hotel and restaurant services (2 per cent) and financial intermediation (2 per cent). Value added in retail and wholesale trade and repairs remained unchanged (Table 12).

Retail sales increased by 2.7 per cent in nominal terms (2.5 per cent for food products and 2.9 per cent for non-food products). As in 1997, the sales of large stores grew more than twice as fast as those of small shops (5.1 as against 2.3 per cent). The restructuring of the retail sector continued. The number of retailers registered with the Chambers of Commerce diminished by 12,577 (1.5 per cent). The new regulations governing the commercial sector went into effect on 24 April 1999.

The transport sector. - The peculiar characteristics of demand and supply in Italian transport make this sector fundamental to the overall efficiency of the productive system. The organization of productive activity in Italy, based largely on small firms and a very high volume of inter-company shipments of semi-finished goods, amplifies the demand for road transport services. Rail carries a smaller share of freight than in the rest of Europe.

In 1995 the northern regions, which generate two thirds of overall transport demand, produced 55 per cent of GDP, but they had only 44.7 per cent of the national road network and 40.7 per cent of the rail network.

Italy's railway network is small in relation to both population and land area. Above all, it is marked by underutilization of large parts of the system and congestion of the trunk lines (20 per cent of the network carries 80 per cent of the traffic).

The number of automobiles per capita is the highest in Europe (0.53) and second only to the United States. The share of goods carried by road is among the highest in the OECD. In line with the general European trend, it rose from 52 per cent in 1970 to 73 per cent in 1995.

The imbalance between public and private transport does not appear to be due to the sparing of resources by the State. As a percentage of GDP, Italian public spending on collective transport has been above the European average in recent years. Public transport services are still distinguished by high costs, poor technical efficiency and a low cost-revenue coverage ratio. The resources allocated go mainly for current expenditure rather than investment in infrastructure.

Labour productivity in the State Railways has risen appreciably during the nineties, but the number of employees per kilometre of track and the per capita labour cost are still higher than in the main European railway corporations (Table 13). The proportion of operating costs covered by revenues remains far smaller than those of other railway corporations, and government transfers have a significantly greater incidence than in France or Germany. The corporation's losses rose from 1.6 trillion lire in 1995 to 7.3 trillion in 1997.

In March 1999 the Government, implementing EEC Directive 440 of 29 July 1991 and following a similar Government provision of 1 January 1997, issued a directive for the reorganization of the State Railways. It provides for completion of the accounting separation between management of infrastructure and transportation activities (separation of corporate entities should follow by 1 January 2000), preparing the way for other carriers to enter the industry. By 31 May 1999 transport activity is to be distributed among three divisions of the State Railways, one for local and commuter traffic, one for trunk lines and one for freight, with three distinct business areas and three separate cost centres.

The management of port terminals was liberalized by a 1994 reform, following which the main Italian ports recouped efficiency, fostering a surge in traffic. Many international carriers have taken over direct management of goods shipments in Italian ports.

The opening of domestic air routes to foreign competitors and the liberalization of prices have not fully given rise to effective competition between carriers. Takeoff and landing slots are still assigned according to past practices (under a sort of "grandfather clause"), which assures that flag carriers will retain dominant positions within national markets. And competition at European hubs is impeded by the ban on direct flights to non-EU countries from any European airport other than those of the airline's home country.

Table 13

THE RAILWAY CORPORATIONS IN THE PRINCIPAL EUROPEAN COUNTRIES

	Italy		France		Germany		United Kingdom (1)	
	1990	1996	1990	1996	1994	1996	1990	1995
Size of system								
Km. of track	16,086	16,014	34,070	31,851	41,401	40,826	16,588	16,564
Employees (thousands)	200.4	125.0	202.1	177.9	327.1	256.7	135.3	90.2
Traffic units (millions) (2)	64,931	71,391	114,428	103,456	131,887	130,004	49,177	41,753
Indices of density								
Km. of track/1,000 km^2	53.4	53.2	62.3	58.23	116.0	114.36	68.0	67.9
Km. of track/million pop.	279.0	279.48	600.5	548.97	619.7	501.92	288.9	283.68
Indices of productivity								
Traffic units/employee (thousands)	324.0	570.7	566.2	612.9	403.2	495.6	363.5	411.4
Employee/km. of track	12.5	7.8	5.9	5.6	7.9	6.3	8.2	5.4
Costs								
Operating costs/traffic unit (in lire) (3)	294.7	272.0	133.9	192.0	162.3	191.6	204.1	206.2
Labour costs/traffic unit (in lire) (3)	153	153	77	100	99	111	110	130
Staff costs/operating costs (per cent)	51.9	56.3	57.4	51.9	60.9	58.0	53.8	63.3
Labour cost per employee (millions of lire) (3)	49.5	87.4	43.5	61.0	39.9	55.0	39.9	53.7
Indices of self-sufficiency								
Revenues from traffic/total revenues (per cent)	19.6	33.1	56.2	50.7	55.9	51.8	74.8	61.8
Revenues from traffic/operating expenses (per cent)	18.0	25.3	57.2	48.7	56.2	53.0	67.6	77.3
State subsidy per traffic unit (lire) (3)	148.4	119.4	40.9	60.8	42.2	46.1	–	–

Sources: Ferrovie dello Stato, *Analisi di benchmarking delle principali reti ferroviarie europee* (various years); Union Internationale des Chemins de fer, *Chronological Railway Statistics*, 1997; Ministero dei Trasporti e della navigazione, *30 anni di trasporti in Italia*, 1996.
(1) Data for British Rail before restructuring of the British railway system. – (2) Second reference year, 1995. – (3) At purchasing power parities.

Agriculture

Value added at factor costs in agriculture, forestry and fisheries increased by 1.2 per cent in 1998 at constant prices and decreased by 2.5 per cent at current prices (Table 12). Employment in the sector continued its long-term decline, contracting by 1.9 per cent.

After lengthy negotiations, the reform of the European Union's Common Agricultural Policy was concluded as part of the revision of the Community budget under Agenda 2000 with a view to the enlargement of the EU to the countries of Central and Eastern Europe. The European Council meeting of 24-25 March 1999 in Berlin sealed the definitive agreement for CAP reform. The Agenda 2000 document of July 1997 set out the intent to enact a reform that would reduce distortions, promote "decoupling" (separation of farm aid from product volumes, accompanied by a progressive cut in support prices). The reform responds to the necessity of reducing the portion of the EU budget allocated to farming, which was all the more pressing in view of the unsustainability of extending CAP to the prospective new members in Central and Eastern Europe. An additional constraint was imposed by the GATT agreements and the upcoming round of talks within the World Trade Organization.

In part, the compromise reached in Berlin amounts to a confirmation of the status quo and a further postponement of CAP reform. The rules for the dairy sector have not been substantially modified but extended in their present form until 2006. Beef too, despite a 20 per cent cut in guaranteed prices, continues to enjoy subsidies based on output volume, in contrast with the principle of decoupling.

The reform does not fundamentally alter the distortions inherent in Community farm policy, but the agreement does bring better protection of Italian interests. The most important gain is an increase of 600,000 tonnes in Italy's milk quota, to be granted in two tranches (384,000 tonnes in 2000-01 and 216,000 in 2001-02).

Public enterprises and privatization

Disposals of state-controlled enterprises continued last year, though more slowly than in 1997. Overall, the privatization programme generated proceeds of nearly 21 trillion lire in 1998 (Table 14). In the last four years the state has sold shares worth about 87 trillion lire on the market.

In March 1998 the ENI group sold 20 per cent of the equity capital of Saipem by means of a public offering, taking in more than 1.1 trillion lire. Following the sale, ENI's residual holding is about 46 per cent. In June, the fourth tranche of ENI's own shares, equal to 14.2 per cent of equity capital, was offered to the market and brought gross proceeds of 12.5 trillion lire. The Treasury's interest in ENI was thus reduced from 51 to 36.8 per cent. The lowering of the Treasury's holding to under 50 per cent has not entailed loss of control, however, since ENI's corporate bylaws have a golden share clause preventing anyone except the Treasury from holding more than a 3 per cent stake or making shareholder agreements involving more than 3 per cent of the voting rights.

Table 14

MAIN PRIVATIZATIONS IN ITALY
BETWEEN 1 JULY 1997 AND 1 DECEMBER 1998

	Group (sector)	Number of employees (1)	Method of sale	Percentage sold (%) (2)	Remaining public holding (%) (2)	Completion date of sale	Gross proceeds (billions of lire)
Aeroporti di Roma	IRI (Transport)	6,215 (1995)	Public offering	45.00	54.00	17.7.97	541
Telecom Italia . . .	(Telecommu-nications)	126,400 (1996)	Core investors + public offering	39.50	5.17	25.10.97	(3) 22,883
SEAT	(Publishing)	2,000 (1996)	Core investors + public offering	44.74	. .	25.11.97	1,643
SAIPEM	ENI (Energy)	5,154 (1996)	Public offering	20.00	46.00	23.3.98	1,140
ENI (4th *tranche*) (4)	(Energy)	86,330 (1996)	Public offering	14.20	38.70	26.6.98	12,500
BNL	(Banking)	19,885 (1997)	Public offering	80.80	. .	20.11.98	7,732

Sources: R&S (various years); company annual accounts (various years); Ministry of the Treasury, Budget and Economic Planning, *Relazione sulle privatizzazioni*, June 1998; *Documento di programmazione economico-finanziaria per gli anni 1999-2001*; the financial press.
(1) Average number in the year indicated. – (2) For all the companies the percentages sold and the remaining public holding are in relation to the ordinary capital. – (3) Proceeds do not include the amount from the sale to AT&T and Unisource of an interest equal to 1.2 per cent each, conditional on the conclusion of strategic alliances with Telecom Italia. The amount also includes green shoe proceeds of 2,520 billion lire received in January 1998. – (4) Percentages and gross proceeds are calculated assuming the full exercise of the green shoe, equal to 1.2 per cent of the capital.

In November all the shares held by the Treasury and other public bodies in Banca Nazionale del Lavoro (more than 80 per cent) were sold through a public offering. Gross proceeds were 7.7 trillion lire, 6.7 trillion of which went to the Treasury.

The sweeping reorganization of public enterprises has also involved the postal service. On 18 December 1997 the Interministerial Committee for Economic Policy, pursuant to Law 71 of 29 January 1994, resolved that the Italian Postal Agency should be converted into a company limited by shares with effect from the date of the company's first general meeting, which was held on 28 February 1998. The shares of "Poste Italiane S.p.A." are assigned to the Minister of the Treasury, Budget and Economic Planning, who exercises shareholder rights in agreement with the Minister for Communications.

Italy's public postal service suffers from severe inefficiency and financial imbalance. In 1998 Poste Italiane S.p.A. made a loss of some 2.1

trillion lire (compared with 800 billion in 1997) on turnover of less than 12 trillion. Measures to reduce staff, primarily hiring freezes, have been taken in the past decade to increase productivity and curb losses. The number of employees dropped from 237,000 in 1990 to 185,000 in 1997. Nevertheless, staff costs came to 81 per cent of postal agency sales in 1997, compared with 39 per cent in the Netherlands, 62 per cent in the United Kingdom, 71 per cent in France and 69 per cent in Germany. There are also large differences in service quality between Italy and its European partners.

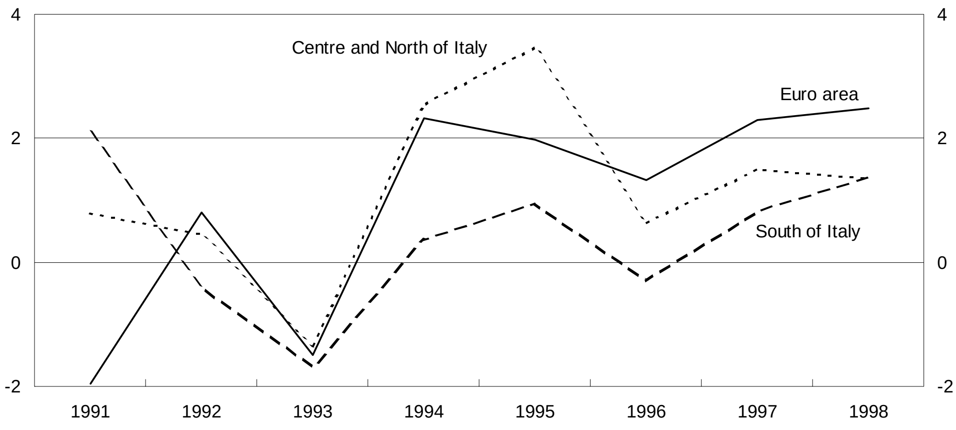
Regional policy and the South

The regional disparity in economic development was reconfirmed last year. The Association for Industrial Development in Southern Italy estimates that output grew by 1.5 per cent in the Centre and North, compared with 1.1 per cent in the South. Even so, in per capita terms the growth differential, which had been narrowing for two years, was actually closed (Figure 6). This was due mainly to migration from South to North, with a net outflow of 88,000 persons.

Figure 6

PER CAPITA GDP IN ITALY AND THE EURO AREA

(at 1991 purchasing power parities; annual percentage changes)



Sources: Based on OECD, Istat and Svimez data.

The rate of increase in household consumption diminished in both major regions, from 2.5 to 2 per cent in the South and from 2.3 to 1.8 per cent in the rest of the country. Gross fixed investment in the South, which had stagnated in 1997, increased by 3.2 per cent in 1998 but was outpaced by the 3.6 per cent growth recorded in the Centre and North. In manufacturing industry alone, however, investment by firms with at least 50 employees grew faster in the South than in the rest of the country.

Part of the capital spending in southern industry was triggered by the resumption of investment subsidies. Investment projects subsidized under Law 488/1992 or Law 341/1995 accounted for 3.5 per cent of investment effected in the Centre and North in 1998 and for 20.7 per cent of that in the South.

The construction industry association reports that the value of public works contracts put up for bids continued to increase, although at a slower rate than in 1997.

As in 1997, southern exports grew faster (8.2 per cent at current prices) than those of the North (0.5 per cent in the North-West, 5.2 per cent in the North-East) or the Centre (1.1 per cent). The impact of the sharp slowdown in total export growth varied from region to region, depending on economic specialization.

A strengthening of the productive fabric in the South, albeit not uniform across the entire area, is indicated by the data on business creation and destruction. In 1998 new registrations of non-agricultural firms outnumbered cancellations by 29,000 in the South, accounting for about 45 per cent of the country's net business creation.

Concertation was begun to determine the contents of Agenda 2000 and define, within the Community Support Frameworks for 2000-2006, the guidelines for co-financed public investment projects. A good many legal, regulatory and administrative measures were taken to simplify the procedures for funding local development projects and to enhance local administrations' capacity to utilize national and Community funds.

The resources available for territorial pacts for 1998-2002 amount to 5.1 trillion lire: 4.8 trillion in national funds and 272 billion in Community resources. Funds available for area contracts over the same five years amount to 3 trillion lire; by mid-April 1999, 2.6 trillion had been awarded for approved contracts and additional protocols. The number of territorial pacts funded, to April, was 46: 12 under the original procedure, 24 under streamlined procedures, 9 Community pacts evaluated by the criteria set by the European Commission, and 1 inter-regional pact for the "central Apennines". The 24 pacts approved by the Interministerial Committee for Economic Planning in February, with public funding of 1.5 trillion lire, should create 14,300 jobs. Seven area contracts funded under national laws, Community grants and regional laws were concluded by 9 July 1998. A further 11 contracts were approved by the Treasury under additional protocols, drawing on Interministerial Committee funds. However, there have been delays in the effective disbursement of the grants.

THE LABOUR MARKET

Employment

After the very modest increase recorded in the three years from 1995 to 1997, employment began to pick up significantly in the second half of 1998 notwithstanding the slow pace of output growth. According to the new national accounts, on average for the year employment rose by 160,000 standard labour units (0.7 per cent) for the entire economy (Table 15) and by 188,000, or 0.9 per cent, excluding agricultural employment, which has declined virtually without interruption for more than three decades now. Net of this sector, average employment in 1998 was still 350,000 units below the peak registered in 1991.

Table 15

EMPLOYMENT

(standard labour units: percentage shares of total and percentage changes on previous year)

	Total employment					Salaried employment				
	% share 1998	1995	1996	1997	1998	% share 1998	1995	1996	1997	1998
Agriculture, forestry and fisheries	**6.4**	**–3.5**	**–5.8**	**–3.2**	**–1.9**	**3.4**	**–2.8**	**–6.6**	**–1.7**	**–0.3**
Industry excluding construction	**23.2**	**0.9**	**–0.7**	**–0.1**	**1.5**	**27.4**	**1.0**	**–0.6**	**0.2**	**1.8**
of which: manufacturing	*22.3*	*1.1*	*–0.7*	*–0.1*	*1.6*	*26.2*	*1.2*	*–0.6*	*0.3*	*1.9*
Construction	**6.4**	**–1.9**	**–2.0**	**. .**	**–2.1**	**5.2**	**–4.6**	**–4.4**	**0.6**	**–4.0**
Services	**64.0**	**0.3**	**1.3**	**0.5**	**1.0**	**64.0**	**–0.2**	**1.2**	**0.8**	**0.9**
Wholesale and retail trade	15.0	–0.9	. .	–1.8	0.6	10.2	0.7	–0.2	0.6	1.7
Hotels and restaurants	5.1	1.0	–0.2	1.0	0.7	4.2	0.9	–0.1	0.3	3.4
Transport and communications	6.1	–3.7	2.5	1.7	–0.1	6.7	–3.9	3.0	2.0	. .
Financial intermediations	2.7	0.1	–1.6	0.3	0.4	3.4	0.7	–1.3	–0.2	–0.4
Services to businesses and households (1)	9.1	4.6	6.8	5.0	4.2	7.0	2.2	6.1	4.6	4.4
Public administration (2)	6.1	–1.1	–1.0	–1.2	–1.2	8.7	–1.1	–1.0	–1.2	–1.2
Education	6.9	0.3	–1.2	–0.3	–0.1	9.0	–0.6	–0.7	–1.0	–0.9
Health and other social services	5.7	1.8	0.3	1.3	1.0	6.5	1.1	1.0	1.8	0.1
Other community, social and personal services	4.0	1.5	2.5	–1.3	1.2	3.5	0.5	2.5	–0.2	1.0
Private households with employed persons	3.4	1.5	6.3	2.7	2.8	4.8	1.5	6.3	2.7	2.8
Total	**100.0**	**. .**	**0.1**	**0.1**	**0.7**	**100.0**	**–0.3**	**0.1**	**0.5**	**0.8**
Total net of agriculture, forestry and fisheries	**93.6**	**0.3**	**0.5**	**0.3**	**0.9**	**96.5**	**–0.2**	**0.4**	**0.6**	**0.9**

Source: Istat, new national accounts based on ESA95.
(1) Including real estate services, leasing, information services, research and other professional and entrepreneurial activities. – (2) Including defence services and compulsory social security services.

The national accounts estimates of employment have been revised owing both to the introduction of the new European System of Accounts (ESA 95) and to improvements in computation methods and, above all, in the use of statistics. For the period 1988-97, the average number of labour units employed was revised up by 185,000 or 0.8 per cent. For wage and salary earners alone, the correction was more substantial (217,000 units, or 1.4 per cent). The size of the adjustment increases over time in both series. The fall in employment from 1991 onwards is less steep in the new series than in the old national accounts.

The growth of employment last year involved all parts of the country. According to Istat's labour force survey, the number of persons in employment averaged 20,197,000, a nationwide increase of 111,000, or 0.6 per cent: 75,000 (0.5 per cent) in the Centre and North and 36,000 (0.6 per cent) in the South. Italy took part, albeit to a lesser degree, in the rise in employment throughout the euro area, which came to more than 1 per cent. The gains were most substantial in Spain and France (Figure 7).

In Italy, job creation derived mainly from the spread of fixed-term and part-time contracts. The tendency of firms to prefer flexible forms of employment has been gradually accommodated in the nineties by reforms adopted both through legislation, with the introduction of temporary employment agencies, and in collective bargaining, with greater acceptance of fixed-term hiring. Last year about half the total flow of new employment consisted of fixed-term jobs; the share of such employees thus rose to 8.9 per cent of total payroll employment. The incidence of part-time workers rose to 7.3 per cent. Although fixed-term employment and part-time work have increased steadily since the early nineties, their incidence remains substantially less in Italy than in Europe as a whole (Table 16).

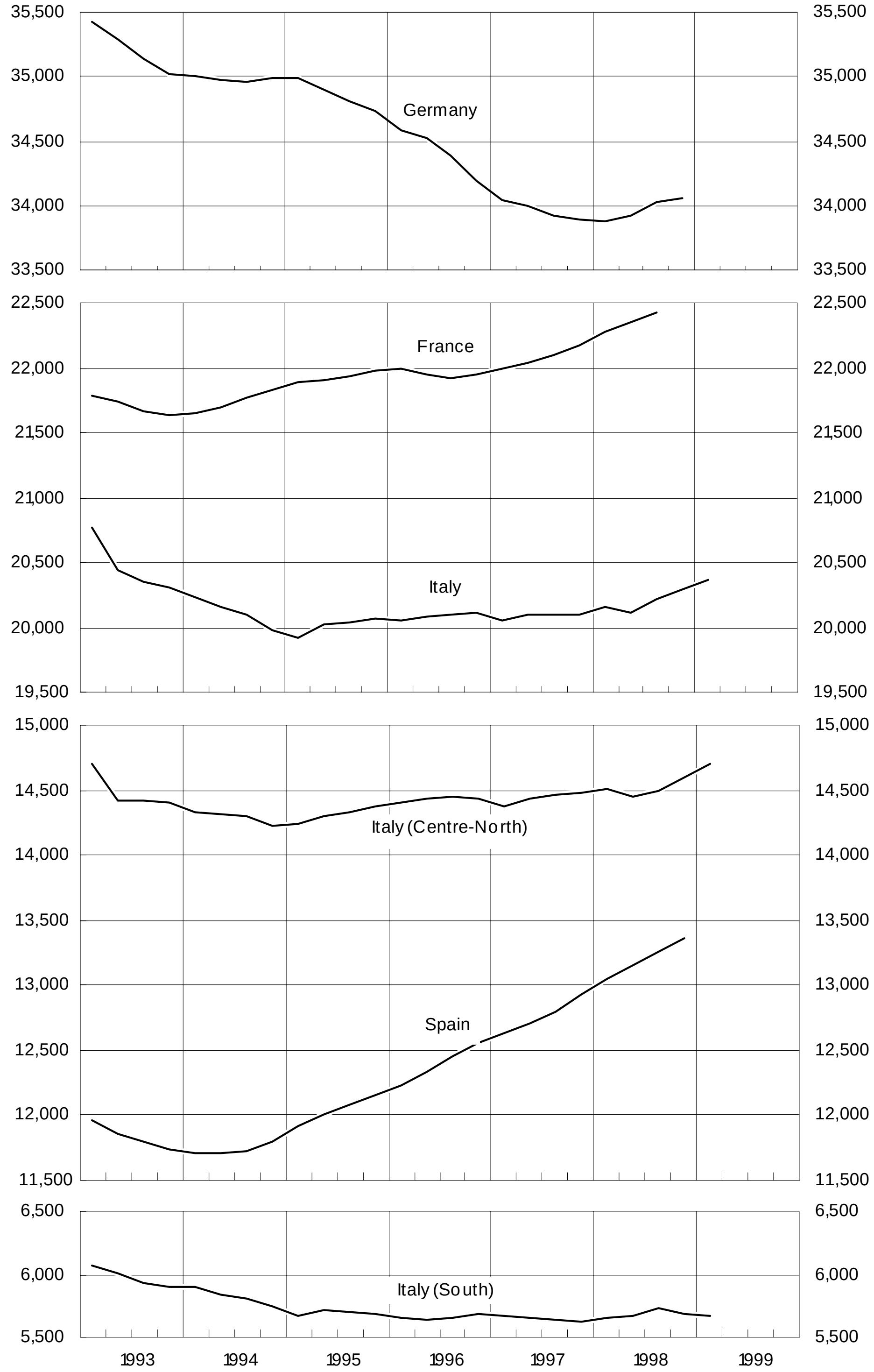
Labour and employment policies. - In April 1998, at the time the Economic and Financial Planning Document was published, the Government presented its Action Plan for Employment. It outlined measures to improve the working of the labour market. Some, including those already provided for by Law 196 of 24 June 1997, were implemented in the course of the year.

The demand for labour in industry. - Average employment in industry excluding construction increased by 79,000 standard labour units, or 1.5 per cent, in 1998. The fact that jobs were created despite the sluggish increase in output confirms the change, observed in 1997, in the pattern of adjustment of labour demand compared with that prevailing until the early nineties. With the recession of 1992-93, industrial firms initiated a process of

Figure 7

EMPLOYMENT IN THE LARGEST EURO AREA COUNTRIES

(seasonally adjusted; in thousands of persons)



Sources: Istat, labour force survey and other national surveys.

Table 16

COMPOSITION OF EMPLOYMENT IN THE EUROPEAN UNION

	Total employment (thousands of persons)	Self-employment (1)	Part-time (2)	Fixed-term employees (3)	Sectoral composition (1)		
					Agriculture	Industry	Services
				1993			
EUROPEAN UNION	147,704	17.1	....	....	5.6	31.3	63.1
Euro area	112,127	17.3	....	....	6.1	32.5	61.4
Austria (4)	3,575	10.0	....	....	7.0	35.1	57.9
Belgium	3,744	17.9	12.8	5.1	2.6	29.5	67.9
Finland (4)	2,030	14.5	....	....	8.6	27.0	64.4
France	21,908	14.1	13.9	11.8	5.5	27.5	67.1
Germany	36,111	10.3	15.1	11.6	3.5	37.9	58.5
western regions	*29,525*	*11.1*	*16.6*	*10.5*	*3.4*	*38.3*	*58.3*
eastern regions	*6,586*	*6.7*	*8.1*	*16.4*	*4.0*	*36.3*	*59.7*
Ireland	1,155	23.4	10.8	9.5	13.1	27.1	59.8
Italy	20,467	28.5	5.4	6.2	8.2	32.9	59.0
Centre and North	*14,488*	*28.1*	*5.7*	*4.7*	*5.7*	*36.2*	*58.1*
South	*5,979*	*29.5*	*4.9*	*10.0*	*14.1*	*24.7*	*61.2*
Luxembourg	165	11.5	7.3	2.7	3.0	26.1	70.9
Netherlands	6,640	11.8	35.0	10.0	4.0	23.6	72.4
Portugal	4.464	25.9	7.4	11.4	11.6	32.9	55.6
Spain	11,868	26.7	6.6	32.2	10.2	30.8	59.0
Denmark	2,567	10.8	23.4	10.7	5.1	26.0	68.9
Greece	3,715	46.7	4.3	10.5	21.3	24.2	54.5
United Kingdom	25,478	13.6	23.5	8.0	2.0	29.2	68.8
Sweden (4)	3,964	10.3	....	....	3.4	25.4	71.2
				1998			
EUROPEAN UNION	152,150	16.7	17.5	13.2	4.8	29.5	65.7
Euro area	114,734	17.1	15.7	14.5	5.1	30.6	64.3
Austria (4)	3,626	13.8	15.7	7.8	6.5	29.6	64.0
Belgium	3,857	17.4	16.0	7.8	2.2	27.2	70.5
Finland (4)	2,179	14.6	11.7	17.7	7.1	28.2	64.7
France	22,468	12.5	17.3	14.5	4.4	26.4	69.2
Germany	35,537	11.0	18.3	13.0	2.8	34.4	62.8
western regions	*29,077*	*11.5*	*19.9*	*11.8*	*2.6*	*34.7*	*62.7*
eastern regions	*6,460*	*8.5*	*11.5*	*18.3*	*3.6*	*33.0*	*63.4*
Ireland	1,373	20.8	12.4	9.6	10.9	28.5	60.7
Italy	20,197	28.4	7.3	8.9	6.6	32.0	61.4
Centre and North	*14,512*	*28.0*	*7.6*	*7.2*	*4.6*	*35.5*	*59.9*
South	*5,685*	*29.5*	*6.5*	*13.4*	*11.7*	*23.3*	*65.0*
Luxembourg	171	9.9	9.9	2.6	2.9	21.6	75.4
Netherlands	7,402	11.7	39.0	12.8	3.3	21.7	75.0
Portugal	4,763	29.0	11.1	17.3	13.7	36.0	50.2
Spain	13,161	23.1	8.2	33.0	7.9	30.4	61.7
Denmark	2,668	9.7	22.5	10.1	3.7	26.3	69.9
Greece	3,919	44.0	6.0	11.8	18.2	22.9	58.9
United Kingdom	26,883	12.7	25.0	8.2	1.7	26.6	71.7
Sweden (4)	3,946	11.4	26.1	13.9	3.1	25.9	71.1

Sources: Based on Eurostat, labour force survey and OECD *Quarterly Labour Force.* For Italy, Istat, labour force survey .
(1) Percentage of total employment. – (2) Salaried and self-employed, as percentage of total employment. – (3) Percentage of total salaried employed. – (4) Data from OECD. – (5) 1997 data.

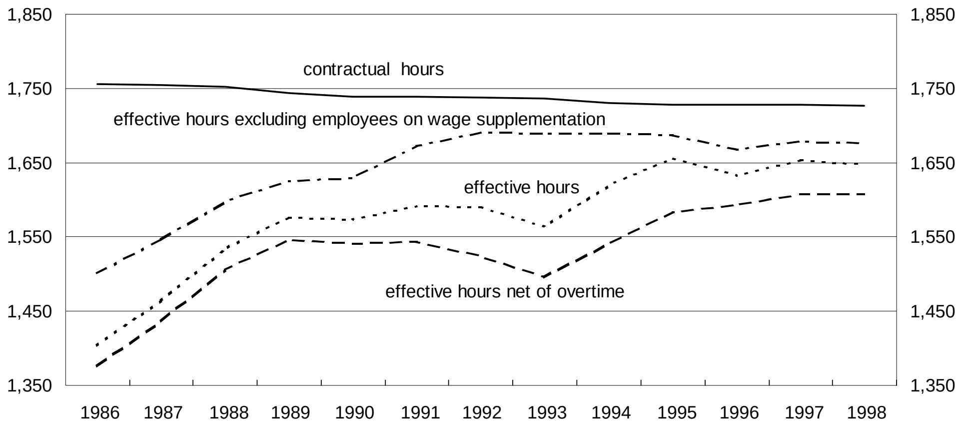
reorganization that resulted in a drastic reduction in employment (409,000 units in two years). Firms responded to the recovery in activity over the next three years by more intensive utilization of manpower. The margins for expanding output without hiring additional staff thus progressively diminished.

This is demonstrated by the recent rise in actual hours worked per capita, now at levels that under the terms of current labour contracts can be considered an upper limit. The Bank of Italy's annual survey of manufacturing firms with 50 employees or more has found that between 1986 and 1998 effective annual hours per worker rose by 18 per cent, or from 1,400 to 1,650 (Figure 8). In the last two years they came to just 2 per cent less than the theoretical ceiling represented by contractual hours, adjusted for normal absenteeism, employees drawing short-time wage supplementation, and overtime. Over the entire period, the most intensive use of manpower was made by the smaller firms (50 to 250 employees). Until 1992 their per capita hours were 7 to 8 per cent higher than those of larger firms; in the last five years the latter have steadily closed the gap with use of additional production shifts. In the last four years firms in the South, which until 1993 operated with consistently fewer per capita hours, have also closed the gap with those in the rest of the country.

Figure 8

ANNUAL WORKING HOURS PER EMPLOYEE IN MANUFACTURING FIRMS WITH AT LEAST 50 EMPLOYEES

(contractual hours)



Sources: Istat; Banca d'Italia, *Indagine sugli investimenti delle imprese manifatturiere.*

The achievement of more efficient utilization of the work force has been accompanied by the growing flexibility in staff size made possible by the new types of employment contract. The Bank of Italy's manufacturing survey found that hirings in 1998 amounted to 14 per cent of payroll staff at the end of 1997 and terminations to 16 per cent (Table 17). Two thirds of all hiring in 1997 and 1998 consisted in fixed-term positions, bringing their share of total staff to 11.2 per cent in 1998.

Table 17

WORKFORCE OF MANUFACTURING FIRMS WITH AT LEAST 50 EMPLOYEES IN 1998

(percentages)

	Total	Size of firm (number of employees)			Geographical area			
		50-199	200-499	500+	North-West	North-East	Centre	South and Islands
	Total workforce (1)							
Annual average	−0.5	−0.2	−0.1	−0.9	−1.1	0.5	−0.4	0.5
Annual average net of wage supplementation	−1.1	−0.5	−0.5	−2.1	−2.1	0.2	−0.5	−0.3
End of year	−1.4	−0.5	−0.9	−2.5	−2.2	0.5	−2.2	−0.1
	Turnover (2)							
Total turnover	29.8	39.3	24.1	23.2	21.4	51.8	27.0	30.3
Permanent hirings	4.2	5.2	4.3	3.1	3.7	5.5	4.5	3.3
Fixed-term hirings	10.0	14.2	7.3	7.2	5.9	20.7	7.9	11.8
Dismissals	3.8	6.0	1.4	2.8	1.7	10.2	2.1	3.7
Voluntary departures	11.8	13.9	11.1	10.1	10.1	15.4	12.5	11.5
	Fixed-term employees (3)							
Total number of workers	11.2	15.8	7.9	8.1	6.7	20.9	8.7	16.1
of which: *up to age 35*	*7.6*	*10.0*	*5.9*	*6.1*	*5.1*	*13.2*	*6.7*	*9.6*
Workers employed for 6 months or less	6.9	11.2	3.9	3.9	3.1	14.9	5.3	10.4
Fixed-term contracts	5.6	9.4	2.9	3.1	2.4	13.6	4.1	7.1
Apprentices, trainees	0.9	1.3	0.7	0.5	0.4	0.7	1.0	3.1
Temporary agencies	0.4	0.5	0.3	0.3	0.3	0.6	0.2	0.2
Workers employed for more than 6 months	4.3	4.6	4.0	4.2	3.6	6.0	3.4	5.7
Fixed-term contracts	1.7	1.8	1.5	1.5	1.0	3.4	1.3	1.5
Apprentices, trainees	2.5	2.6	2.3	2.6	2.4	2.5	2.0	4.1
Temporary agencies	0.1	0.2	0.2	0.1	0.2	0.1	0.1	0.1
Percentage of firms using fixed-term employees	72.0	70.4	80.4	78.0	72.1	74.8	73.4	66.0

Source: Banca d'Italia, *Indagine sugli investimenti delle imprese manifatturiere.*

(1) Percentage changes over same period of 1997. – (2) 1998 flow as percentage of workforce at end of 1997. – (3) Percentage share in average total workforce (except the item "Percentage of firms using fixed-term employees").

The demand for labour in construction. - Reflecting the sector's protracted stagnation, the number of standard labour units employed in construction resumed its decline (-2.1 per cent), after remaining broadly unchanged in 1997 (Table 15). All of the decline since 1992 (193,000, or 11.8 per cent) has concerned payroll employment.

The demand for labour in the services sector. - The largest contribution to employment growth again came from the services sector (Table 15). Service employment increased by 141,000 labour units, or 1 per cent, to 14,549,000, surpassing its 1992 peak. As in years past, the majority of jobs were created in business and household services, but the number of persons employed increased in virtually all service segments, with the notable exception of “public administration and defence”.

According to the labour force survey, the share of employees on fixed-term contracts rose to 8.3 per cent; part-time employment reached 8.3 per cent of the total.

Reversing a decline that had persisted since 1991, employment in wholesale and retail trade increased, thanks to a rise in the number of employee labour units in connection with the continuing expansion of large retail stores (Table 15). The share of employee units also increased in hotel and restaurant services and in transport and communications, which are undergoing restructuring. In the hotel and restaurant segment, there was a net gain in employment; in transport and communications there was a marginal net loss, due in part to further staff reduction of 3,300 by the State Railways. Self-employment units increased strongly in financial intermediation, education and health services, with gains of 6.7, 9.6 and 4.8 per cent respectively.

The share of self-employment in total employment remained broadly unchanged between 1993 and 1998. Last year, self-employed workers continued to make up 28.4 per cent of all persons in employment, one of the highest figures in Europe beside those for Spain, Portugal and Greece (Table 16).

The supply of labour and unemployment

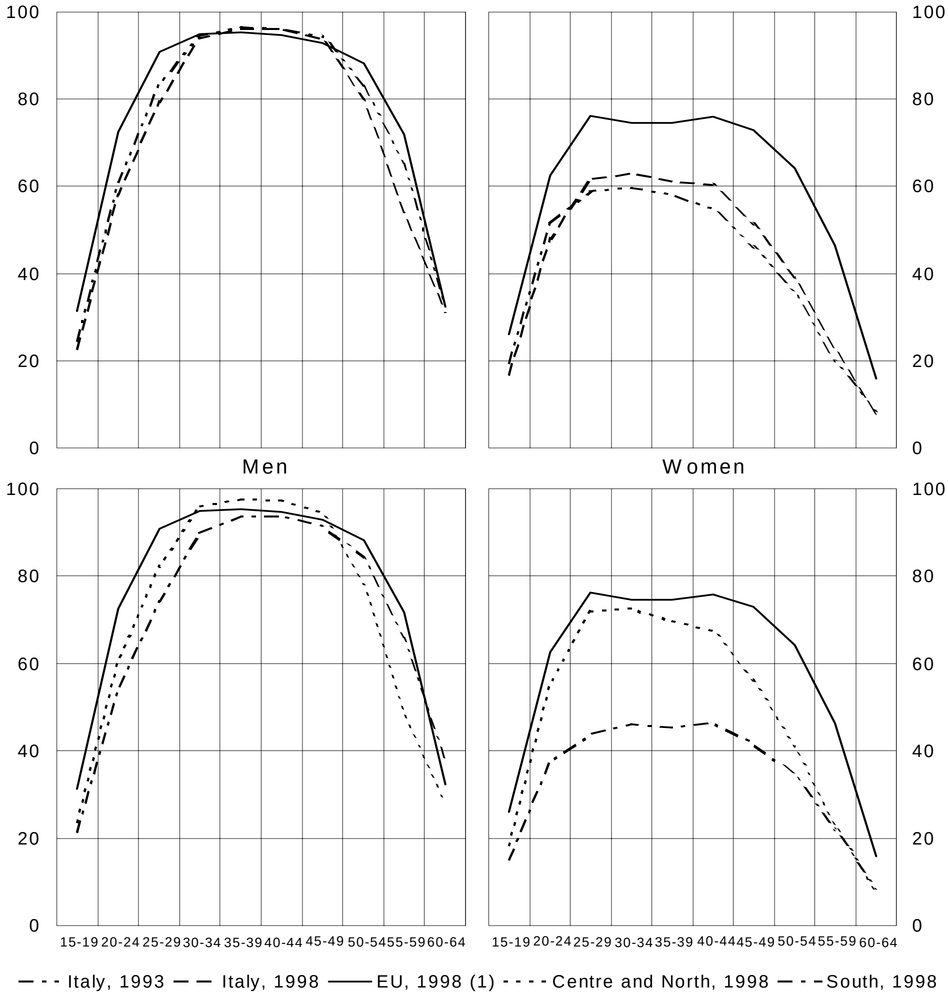
According to Istat’s labour force survey, the labour force grew by 143,000 on an average annual basis, an increase of 0.6 per cent, continuing the expansion that began in 1995. Nevertheless, it remains smaller than in the early nineties. Two thirds of last year’s increase came from the 0.4 per cent growth of the resident population older than 15; one third was due to a rise in the participation rate for this population segment from 47.5 to 47.6 per cent.

As in years past, all of the growth in the labour force was accounted for by the female component. The increase of 170,000, or 2 per cent, in the number of women in the labour market more than offset a decline of 27,000, or 0.2 per cent, in the male component. These contrasting trends have been proceeding, with occasional pauses, for nearly a decade, as the participation rates of the two sexes have converged. The process has accelerated in the last few years. The proportion of women aged 15 and older who are economically active rose from 33.9 per cent in 1993 to 35.3 per cent in 1998, while that of men declined from 63.1 to 61 per cent (both are lower than the averages of 44.1 and 66.6 per cent for the other EU countries). Women's participation rose from 27.7 to 28.7 per cent in the South of Italy and from 37.1 to 38.8 per cent in the Centre and North, while the corresponding male rates fell from 61.9 to 60.2 per cent and from 63.7 to 61.4 per cent.

Figure 9

PARTICIPATION RATES BY AGE

(percentages)



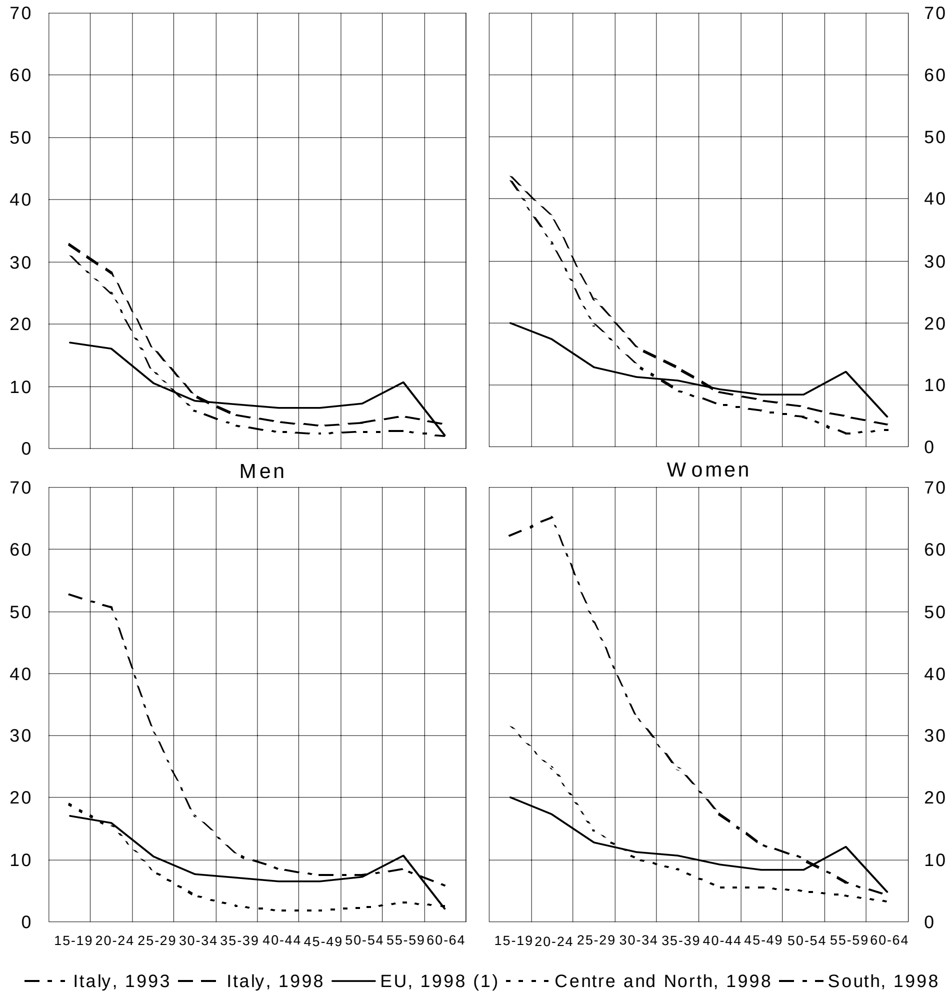
Sources: Istat and Eurostat, labour force survey.
(1) Excluding Italy; for Ireland, 1997 data.

These trends have widened the gap in participation rates between Italy and the European average for men and narrowed it for women. In the male component, Italy's participation rates were lower mainly among men younger than 30 (55 per cent as against 66 per cent in the rest of the EU) and those in their 50s (67 as against 80 per cent), while participation in the central age-groups was in line with the European average, even in the South (Figure 9). For women up to age 35, the participation rate in the Centre and North was near the European level (57 as against 61 per cent), but for those over 40 it was much lower (39 as against 57 per cent). In the South women's participation was considerably lower (35 as against 61 per cent), owing to socio-cultural factors and the discouragement effect of high unemployment.

Figure 10

UNEMPLOYMENT RATES BY AGE

(percentages)



Sources: Istat and Eurostat, labour force survey.
(1) Excluding Italy; for Ireland, 1997 data.

More than three quarters of the average growth in the labour supply in 1998 was absorbed by the increase in demand (111,000 additional persons employed); the rest (32,000) consisted of additional job-seekers. The average unemployment rate remained at 12.3 per cent, as in 1997. The number of unemployed increased only in the South, most steeply among women in the central age-group, and the regional unemployment rate rose from 22.2 to 22.8 per cent. In the Centre and North the unemployment rate came down from 7.6 to 7.4 per cent, its lowest level since 1994; the sharpest reduction was among young women.

The unemployment rate for southern men up to age 24 was above 50 per cent, compared with 16 per cent for the same age-group in the rest of Italy and Europe (Figure 10). This disparity narrows rapidly with age, disappearing altogether at 40. For women, the gap is wider and persists to age 50. In the Centre and North, the unemployment rates among men and women over 35 were lower than the average for the other countries of the Union.

Industrial relations and wage bargaining

About 20 per cent of industrywide contracts in the private sector expired and were renewed last year, compared with 70 per cent in 1997. Years in which industrywide bargaining is reduced tend to feature increased local and company-level bargaining and low levels of labour conflict. The hours lost to strikes in 1998 were the fewest in 25 years.

In the first quarter of the year, uncertainty over the possible statutory shortening of the work week blocked the renewal of the expiring contracts. At the end of March the Government presented a bill setting 35 hours as the normal work week for firms with more than 15 employees starting in January 2001. However, the actual determination of hours was left to collective bargaining, and the introduction of tax relief by the Government in the future was envisaged as an incentive to shorten hours. A possibility appears to be emerging of reduced hours in exchange for greater flexibility on an annual basis in keeping with production needs. This would tend to increase labour productivity, along the lines of what is now happening in France.

A new law on overtime work (Law 409 of 27 November 1998) essentially ratified the provisions of the November 1997 agreement between the major trade union and employer confederations. The proposal by some legislators to place limits on overtime stricter than those established by the two sides of industry highlighted the general danger of conflict between regulation by law and the outcome of concertation. The Social Pact for Growth and Employment, signed in December by the Government, local authorities, unions and employer associations, formally instituted a concertation procedure designed to head off such tensions in the setting of labour policy (see the box "The Social Pact for Growth and Employment", *Economic Bulletin* No. 28, February 1999).

Despite the fact that the Social Pact retained the two levels of collective bargaining, the renewal of the main industrywide contracts continued to be difficult. By May, contracts covering about half of all workers both in industry and in market services were still pending renewal. For the metalworkers, the main point at issue concerned the reduction of hours for shift workers. In any event, the unions' wage claims are such as to rule out the possibility that raises in 1999 and 2000 could exceed the target inflation rate. There thus does not appear to be any emulation of the increases of more than 3 per cent for 1999 alone won by metalworkers and numerous other categories in Germany.

Wages and labour costs

Gross earnings per standard labour unit rose by an annual average of 2.3 per cent in 1998, compared with 3.6 per cent in 1997. At constant prices, the increase came to 0.5 per cent. The sharpest wage deceleration was in manufacturing and public sector employment; there was a slight pickup in construction, wholesale and retail trade, and business and household services (Table 18).

Real gross earnings per standard labour unit in manufacturing rose by 2.4 per cent. A contribution of 2 percentage points came from the rise in contractual wage rates and of 1 point from increments supplementary to industrywide agreements, while a decrease in overtime lowered earnings by about half a point.

To calculate the year-on-year variation in labour costs one must take account of the introduction of the regional tax on productive activities, which is based on value added, and the simultaneous elimination of several social security levies, including employers' health contributions. These innovations create a break in the national accounts series.

Value added per standard labour unit increased by 0.9 per cent for the economy as a whole. This represented a slowdown of about half a point compared with 1997, but it did not entirely offset the effects of wage moderation on unit labour costs, which after adjustment for the new regional tax rose by just 1.4 per cent, compared with 2.8 per cent in 1997. Unit labour

Table 18

LABOUR COSTS AND PRODUCTIVITY

(percentage changes)

	Value added at factor cost at constant prices	Total standard labour units	Output per standard labour unit	Earnings per standard labour unit (salaried employment)	Labour costs per standard labour unit (salaried employment) (1)	Unit labour costs (1)
			Manufacturing industry			
Average 1989-91	1.5	. .	1.5	8.0	9.3	7.6
Average 1992-96	1.4	−1.4	2.9	5.0	5.2	2.3
1997	3.4	−0.1	3.4	3.8	4.6	1.1
1998	2.6	1.6	1.0	2.4	−1.1 (2.4)	−2.1 (1.5)
			Construction			
Average 1989-91	3.5	1.3	2.2	10.0	10.8	8.4
Average 1992-96	−1.2	−1.6	0.5	3.7	3.7	3.4
1997	−0.4	. .	−0.4	2.7	3.2	3.6
1998	1.6	−2.1	3.8	3.3	0.2 (3.3)	−3.5 (−0.4)
			Market services (2) (3)			
Average 1989-91	2.4	1.2	1.2	8.3	8.4	7.1
Average 1992-96	1.7	−0.2	2.0	4.6	4.7	2.8
1997	1.5	0.8	0.7	2.8	2.9	2.2
1998	1.2	1.3	−0.1	2.8	−1.1 (2.8)	−1.0 (3.0)
			Public services (4)			
Average 1989-91	1.2	1.9	−0.7	9.8	9.9	10.7
Average 1992-96	0.7	0.1	0.6	3.3	4.3	3.7
1997	0.2	0.1	0.1	4.4	5.6	5.5
1998	0.1	0.4	−0.3	1.3	−2.6 (1.3)	−2.3 (1.6)
			Total economy (3)			
Average 1989-91	1.9	0.7	1.3	8.8	9.2	7.9
Average 1992-96	1.2	−0.9	2.2	4.3	4.8	2.6
1997	1.5	0.1	1.4	3.6	4.2	2.8
1998	1.6	0.7	0.9	2.3	−1.5 (2.3)	−2.3 (1.4)

Source: Istat, national accounts based on the new European System of Accounts ESA95.

(1) The introduction of the regional tax on productive activities and the simultaneous elimination of some employers' contributions in 1998 produced a discontinuity in the data series. In brackets, figures obtained assuming a rise in labour costs per standard labour unit equal to that in earnings. – (2) Including wholesale and retail trade, hotel and restaurant services, transport and communications, financial intermediation and services to businesses and households. – (3) Value added includes the former item "rentals of building", no longer available in the national accounts based on ESA 95. – (4) Includes public administration, education, health services, other public services, and domestic services.

costs in manufacturing increased by 1.5 per cent, a slight acceleration due above all to developments in the second half of the year. In the main market services unit labour costs rose by 3 per cent, but a tendency towards wage moderation is expected to emerge in 1999.

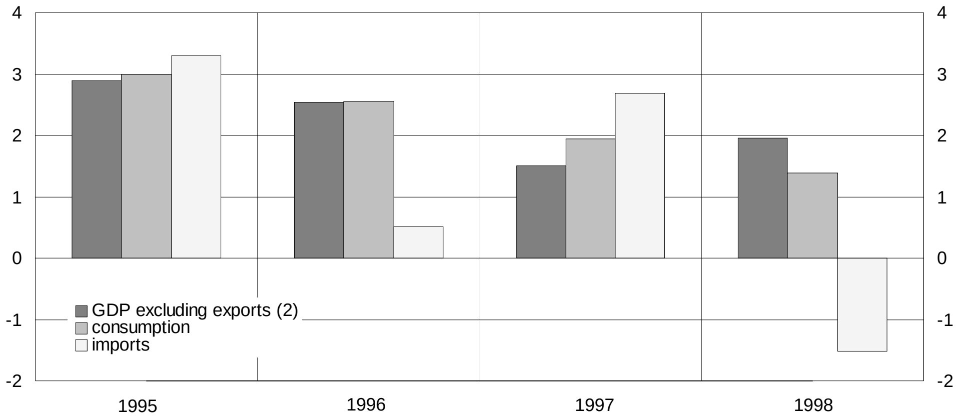
PRICES, COSTS AND COMPETITIVENESS

In 1998 inflation fell to historically low levels in the countries that have been participating in monetary union since 1 January 1999, reaching 1.1 per cent calculated on the basis of the harmonized index of consumer prices and 1.4 per cent in terms of the household consumption deflator. The slowdown primarily reflected the sharp drop in the prices of imports caused by the decline in the dollar prices of raw materials and the appreciation of the euro area currencies. By contrast, domestic factors exerted upwards pressure, reducing the risk of a deflationary spiral: estimated on the basis of changes in the GDP deflator excluding exports, inflation generated within the area remained at just under 2 per cent (Figure 11).

Figure 11

DEFLATORS IN THE EURO AREA (1)

(percentage changes on year-earlier period)



Sources: Based on BIS and Istat data and national statistics; for Germany, France, Italy, the Netherlands and Finland, new national accounts based on the ESA95 system of accounts.

(1) Weighted average of deflators for Germany, France, Italy, Spain, the Netherlands, Belgium and Finland. - (2) Exports are estimated excluding their content of imported goods and services.

Underlying inflation remained virtually unchanged. The twelve-month rate of growth in the harmonized indices excluding food and energy products fluctuated around values just under 1.5 per cent.

In Italy, the increase in the consumer price indices remained unchanged at 2.0 per cent. The convergence of inflation towards the euro area average, which came to a halt at the beginning of 1998, resumed in the second half of the year, benefiting from the prudence with which the Bank of Italy eased monetary conditions. The primary factor in these developments was the poorer performance of profit margins relative to the other euro area countries, while unit labour costs continued to rise more rapidly than the area average owing to the particularly small increase in productivity.

The downward trend in consumer price inflation in the area reversed course in March of this year owing to the rapid rise in oil prices and the depreciation of the euro. Inflation expectations also deteriorated, although they remained consistent with the ECB definition of price stability as a medium-term rate of increase in consumer prices of less than 2 per cent.

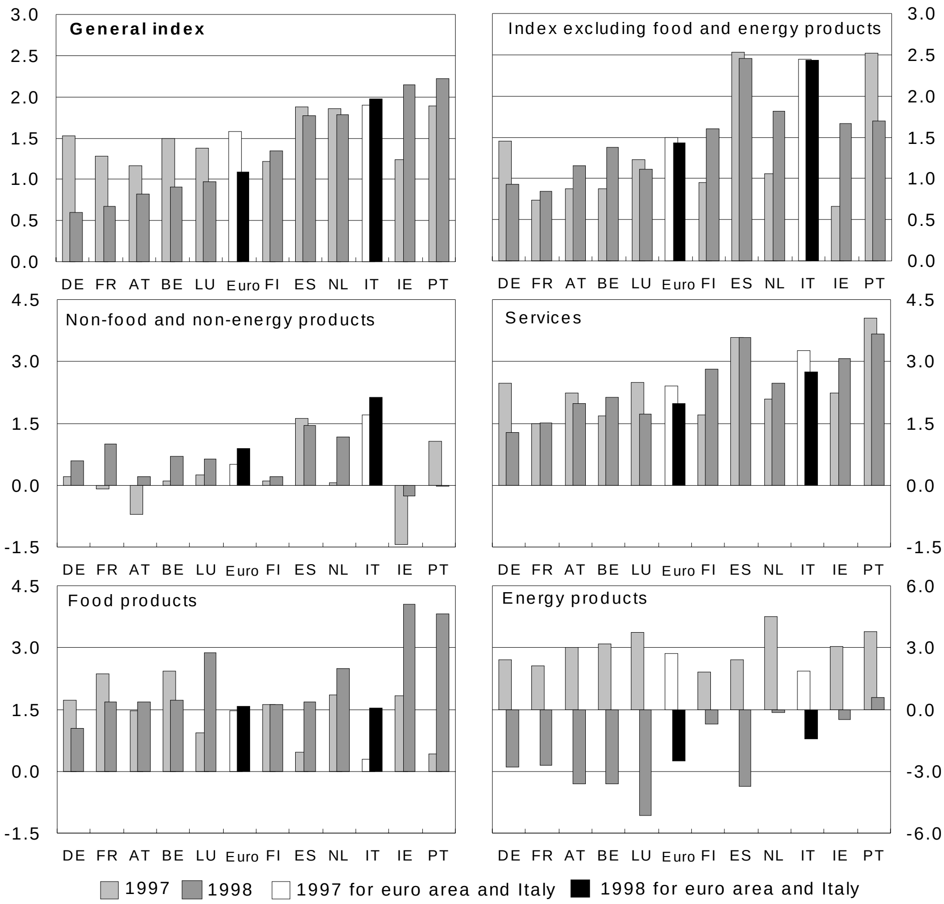
Consumer prices

In 1998 the average annual rate of inflation calculated on the basis of the harmonized index of consumer prices for the euro area fell from 1.6 to 1.1 per cent (Figure 12 and Table a7). The decline is entirely attributable to

Figure 12

HARMONIZED INDICES OF CONSUMER PRICES

(percentage changes on year-earlier period)(1)



Source: Based on Eurostat data.
(1) The figure for the euro area is the weighted average of the harmonized indices of the area countries.

the pronounced fall in the prices of energy products (2.5 per cent, compared with an increase of 2.7 per cent in 1997). Underlying inflation - measured by the increase in the index excluding food and energy products - was 1.4 per cent, close to the level recorded the previous year (1.5 per cent).

Except for Italy, the countries where inflation was higher than the area average grew most rapidly. In Italy, inflation was 2.0 per cent in terms of the harmonized index and the consumer price index (Tables a5 and a6).

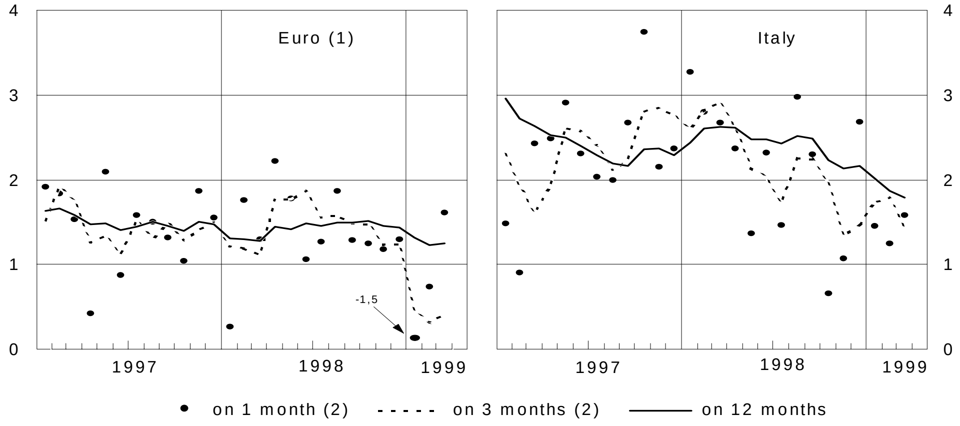
After closing in mid-1997, the differential in the twelve-month rate of increase in the harmonized index in Italy and the euro area average subsequently widened. With a stable differential of about 1 percentage point in the underlying rates of inflation, mainly associated with the faster rise in Italian unit labour costs, the increase reflected the upturn in the prices of unprocessed food products (especially Mediterranean crops) following the decline in 1997 and greater downward rigidity in the prices of energy products.

The differentials in the twelve-month rates and underlying inflation began to narrow again in the final months of 1998 owing to the slowdown in the consumer prices of non-energy industrial products, which was attributable to the similar behaviour of producer prices and, more generally, the weakening of demand. The annualized and seasonally adjusted three-month changes in the index excluding food and energy products declined from an average of 2.2 per cent in the first nine months of the year to 1.5 per cent, compared with an average of just over 1 per cent for the euro area (Figure 13).

Figure 13

HARMONIZED INDICES OF CONSUMER PRICES EXCLUDING FOOD AND ENERGY PRODUCTS

(percentage changes)



Source: Based on Eurostat data.

(1) Weighted average of the indices of the euro area countries, excluding Ireland and Luxembourg. - (2) Seasonally adjusted and annualized.

Seasonally adjusted price indices play an important role in the short-term analysis of inflation. Eurostat's publication of estimates for pre-1995 data has made it possible to analyze the harmonized indices of consumer prices in the euro area countries and the average for the area as a whole. The historical data, which are still provisional, cover the general indices, the expenditure chapters and the main sub-indices (unprocessed and processed food products, energy products, non-energy industrial goods and services) and their relative weights but do not include individual items. Empirical analysis using the TRAMO-SEATS procedure shows that for individual countries and the area average the seasonal component is most significant in monthly changes in the sub-indices for non energy industrial goods, services and unprocessed food products. The most reliable signals of the short-term trend in inflation are therefore provided by the increase in the seasonally adjusted index excluding food and energy products. Conversely, similar increases in the general index, which also contains components that, while not seasonal, are subject to large fluctuations, are often difficult to interpret and potentially misleading. The unsatisfactory level of disaggregation of the harmonized index (which contains about 70 elementary items, compared with 209 for the general index) makes it impossible to construct an index that excludes items subject to price controls in addition to food and energy products.

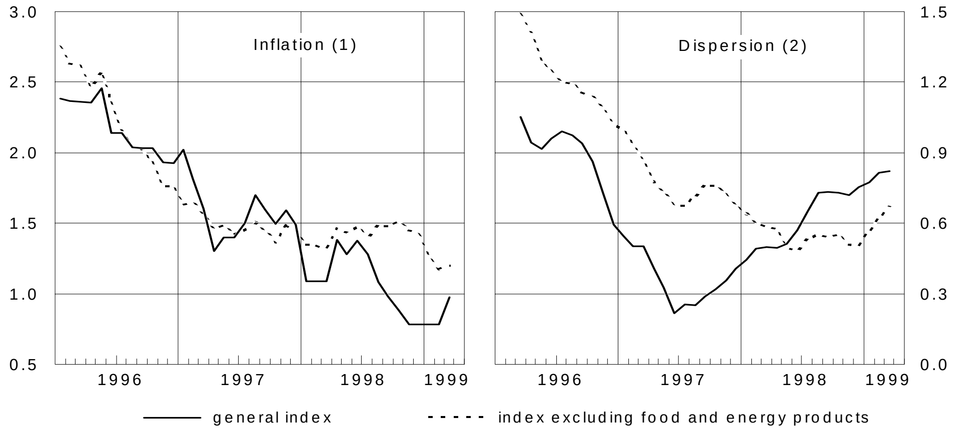
In March of this year the sharp increase in the prices of petroleum products, the gradual depreciation of the euro and the recovery in the prices of unprocessed food products caused the trend of the harmonized price index for the area to reverse course, with the twelve-month rate of increase rising to 1.0 per cent from 0.8 per cent in the previous four months (Figure 14). The twelve-month rate of change in the index excluding food and energy products remained at 1.2 per cent, while the annualized and seasonally adjusted monthly rate of increase rose above 1 per cent after recording a low in January in conjunction with the large reduction in telephone charges in Germany.

In Italy, the twelve-month rate of increase in the harmonized index stood at 1.4 per cent in the first few months of the year. The upwards pressure exerted by fuel prices was offset by the behaviour of other volatile items, such as tobacco products, and that of products more closely linked to underlying inflation: the twelve-month rate of change in the index excluding food and energy products continued to fall, to 1.8 per cent; the annualized and seasonally adjusted monthly rate of change was about 1.5 per cent. In April, the differential in the twelve-month rate of increase in the general index vis-à-vis Germany and France narrowed from about 1.5 percentage points at the end of 1998 to 0.5 and 0.7 points respectively.

The downward trend in the dispersion of inflation rates in the euro area reversed course in June 1997: average inflation differentials (in absolute value) rose from 0.2 points in that month to 0.8 points in March 1999 (Figure 14). The increase was due to the divergent behaviour of the most volatile items and the prices of services, which accelerated in the most rapidly-growing economies (Spain, the Netherlands, Finland, Ireland and Portugal). This was only partly offset by the convergence in the prices of industrial goods. Overall, differences in the underlying rate of inflation continued to decline until mid-1998 before increasing in the first few months of this year; they have been smaller than those in general inflation since the second half of 1998.

Figure 14

THE LEVEL AND DISPERSION OF CONSUMER PRICE INFLATION IN THE EURO AREA



Source: Based on Eurostat data.

(1) Percentage changes on 12 months earlier in indices calculated as a weighted average of the harmonized indices of consumer prices of the individual area countries. - (2) Percentage points. Mean deviation from the average of national inflation rates. Moving averages of the three months ending in the month indicated, excluding Luxembourg.

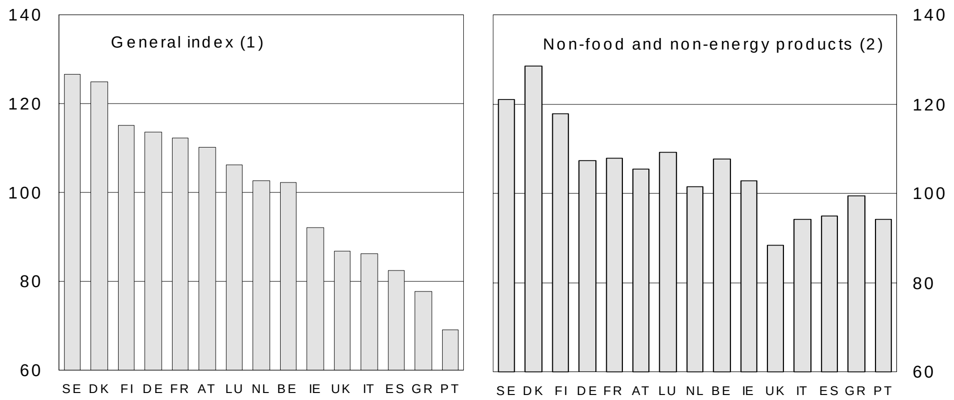
The Eurostat survey on purchasing power parities provides an indication of the degree of consumer price convergence in the EU. In 1996, the most recent year for which data are available, the levels of national price indices expressed in the same currency differed markedly in some cases (Figure 15): for instance, the index for Sweden was 83 per cent higher than that for Portugal, while the index for Germany was 32 per cent higher than that for Italy. Differences in the prices of non-food and non-energy products, which are extensively traded on international markets, were significantly smaller than those in the prices of services. Preliminary econometric analyses performed by the Bank's Research Department show that between 1985 and 1996 differentials in price levels between the countries primarily reflected different levels of development and productivity, as approximated by the level of real per capita income. In fact, in countries with similar levels of development, such as Germany, France, the Netherlands, Belgium, Austria and Luxembourg, price differences were smaller.

Differentials in consumer price inflation in the euro area countries over the last two years do not appear large enough to have significantly modified the dispersion of price levels observed in 1996.

Figure 15

LEVEL OF CONSUMER PRICES IN THE EU IN 1996

(indices, EU average =100)



Source: Based on Eurostat data.

(1) Index of the level of prices expressed in the same currency of households' final consumption. - (2) Average of price indices expressed in the same currency for this category.

Producer prices and the import and export prices of manufactures

In 1998 the producer prices of manufactures for the domestic market declined by an average of 0.8 per cent in the countries of the euro area; in Italy they remained virtually unchanged, rising by only 0.1 per cent (Table a8). In 1997 prices had risen by 1.0 and 1.3 per cent respectively.

Unlike data on consumer prices, where considerable progress on harmonization has been made in recent years, sufficiently homogeneous statistics for producer prices are still not available. The indices published by national statistics institutes, which are used to analyze inflation in each country, are based on different breakdowns of the data, while Eurostat's reclassification of elementary items has still not been perfected.

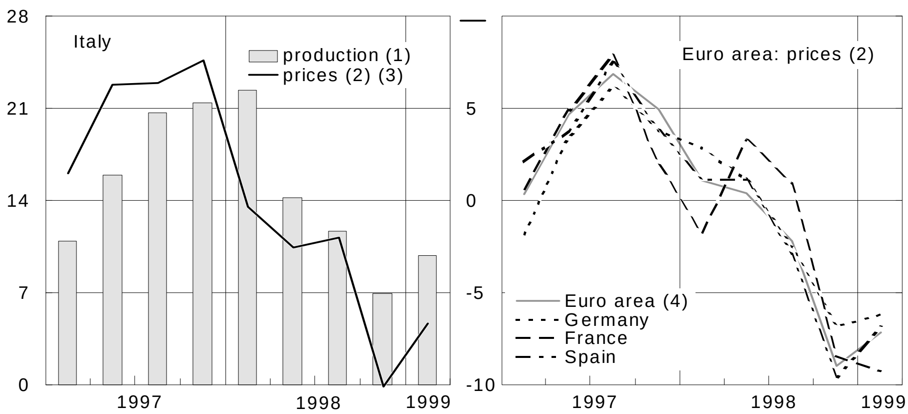
The slowdown in producer prices in Italy was due to the sharp fall in the prices of energy products; excluding the latter, prices rose slightly more rapidly than in 1997 (1.0 per cent, compared with 0.8 per cent). Over the course of the year, however, the prices of non-energy products also began to decelerate, with intermediate goods slowing down most markedly owing to the fall in the prices of raw materials, the weakening of economic activity and the increasing competitiveness of the emerging economies. The rate of increase in the prices of consumer goods, which are more closely linked to the cost of domestic inputs, fell more gradually, with the twelve-month rate of increase remaining above 1 per cent.

Except in Italy, the downward trend in the twelve-month rate of increase in industrial prices in the main euro area countries reversed course in the first quarter of 1999. Recent surveys of area manufacturers show a slight increase in the proportion of firms that are planning to raise prices (Figure 16). This tendency is slightly more pronounced in Italy (especially for consumer goods), where it appears to be in line with expectations for a recovery in production.

Figure 16

INTENDED CHANGES IN PRODUCER PRICES AND EXPECTATIONS FOR PRODUCTION

(quarterly data; percentages)



Sources: Based on ISAE and European Commission data.

(1) Balance between the percentage of firms that expect production to increase in the following 3-4 months and that of those expecting it to decrease. Left-hand scale. - (2) Balance between the percentage of firms that intend to increase prices in the following 3-4 months and that of those that intend to reduce them; deviations from the average for the period between January 1997 and March 1999. Quarterly averages and seasonally adjusted data. - (3) Right-hand scale - (4) Weighted average of balances for the euro area countries.

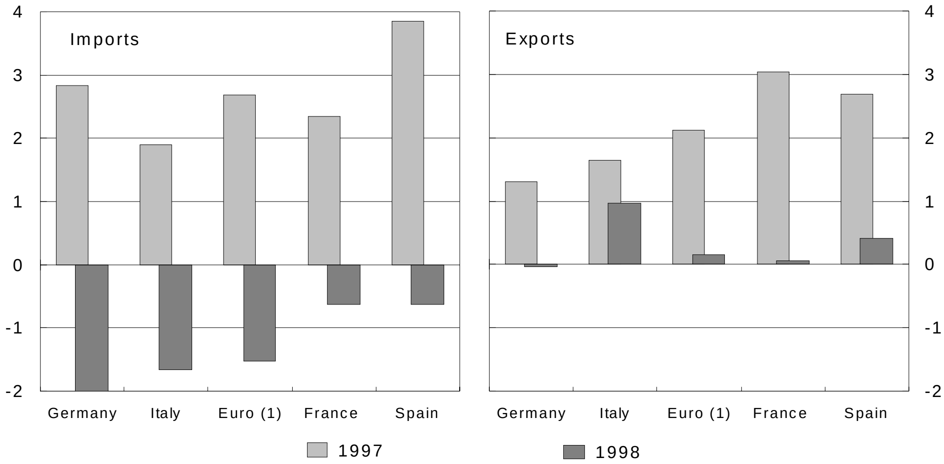
Euro area firms responded to competition from the crisis-stricken economies in export markets by limiting their price increases in order to protect their market share. The rate of increase in the export deflators of the euro area countries declined from 2.1 per cent to an average of 0.2 per cent in 1998 (Figure 17); the decrease was smaller in Italy, where the deflator fell from 1.6 to 1.0 per cent. The rate of increase in the average unit values of Italy’s exports of manufactures gradually fell during 1998, turning negative in the final months of the year: in December unit values were 3.0 per cent lower than a year earlier.

Despite their policy of price constraint in both domestic and foreign markets, the competitiveness of euro area firms progressively deteriorated, especially in the second half of the year (Figure 18).

Figure 17

DEFLATORS OF IMPORTS AND EXPORTS OF GOODS AND SERVICES

(percentage changes on year-earlier period)



Sources: Based on BIS and Istat data and national statistics; for Germany, France, Italy, the Netherlands and Finland, new national accounts based on the ESA95 system of accounts.

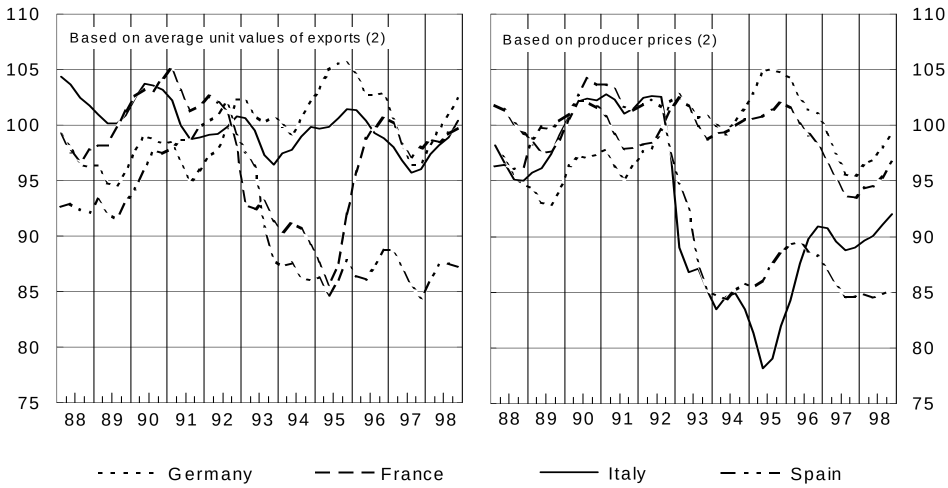
(1) Weighted average of deflators for Germany, France, Italy, Spain, the Netherlands, Finland and Belgium.

The fall in the prices of raw materials and the depreciation of the currencies of the crisis-stricken countries produced a considerable decrease in the prices of imports into the euro area in 1998. The import deflators of the area countries declined by an average of 1.5 per cent, compared with an increase of 2.7 per cent in 1997 (Figure 17); in Italy the fall was slightly larger, at 1.7 per cent, compared with a rise of 1.9 per cent the previous year.

Figure 18

INDICATORS OF COMPETITIVENESS (1)

(indices, 1992=100)



Sources: Based on Istat, OECD and IMF data and national statistics.

(1) Effective exchange rates with 24 countries deflated on the basis of the indicated price indices. Moving averages of the reference quarter and the preceding quarter. An increase in the index indicates a loss of competitiveness. - (2) Manufacturing industry.

Mainly owing to the contraction of demand in the Asian countries, the IMF index of the dollar prices of raw materials dropped by 21.0 per cent on average in 1998, compared with a fall of 4.2 per cent in 1997. In particular, the prices of energy products plummeted by 32.2 per cent (-5.7 per cent in 1997). In March 1999 OPEC and other oil-exporting countries acted to curb significant overproduction by agreeing to cut output. Oil prices reacted immediately, with the price of Brent-grade crude rising by about 50 per cent to around $15 a barrel, close to its level at the start of 1998.

Among imported manufactures in Italy, average unit values in lire fell most sharply for intermediate products; the slowdown in those of consumer goods was much less marked.

Firms' costs and profit margins

Corrected to take account of the effects of the introduction of Irap in Italy (see *Economic Bulletin*, No. 28, February 1999), unit labour costs in manufacturing in the euro area continued to fall in 1998, although less rapidly than in 1997 (-0.9 per cent, compared with -2.2 per cent in 1997; Table 19). This was due to the slower rate of increase in productivity, which was only partly compensated by the slightly smaller increase in earnings. With a moderate acceleration in the growth of value added, the slowdown in productivity reflected the marked recovery in employment in the sector.

Table 19

UNIT LABOUR COSTS, PER CAPITA COMPENSATION AND PRODUCTIVITY IN MANUFACTURING IN THE EURO AREA

(percentage changes on year-earlier period)

	Unit labour costs		Labour costs per employee (1)		Productivity		Components			
							Value added		Labour units	
	1997	1998	1997	1998	1997	1998	1997	1998	1997	1998
Euro area (2)	**–2.2**	**–0.9**	**3.2**	**2.5**	**5.6**	**3.5**	**4.5**	**5.1**	**–1.0**	**1.7**
Italy	**1.1**	**1.5**	**4.6**	**2.4**	**3.4**	**1.0**	**3.3**	**2.6**	**–0.1**	**1.6**
Excluding Italy	**–3.2**	**–1.6**	**2.7**	**2.6**	**6.3**	**4.2**	**4.9**	**6.0**	**–1.3**	**1.7**
of which: Germany	*–5.1*	*–3.4*	*1.7*	*2.1*	*7.4*	*5.6*	*4.4*	*7.3*	*–3.0*	*1.7*
France	*–3.0*	*–1.2*	*3.3*	*2.7*	*6.3*	*3.9*	*5.0*	*4.0*	*–1.3*	*0.1*
Spain	*2.0*	*2.4*	*4.6*	*3.1*	*2.6*	*0.7*	*5.8*	*5.7*	*3.2*	*4.9*

Sources: Based on Istat and BIS data and national statistics; for Italy, new national accounts based on the ESA95 system of accounts.
(1) For Germany, gross wages and salaries. – (2) Weighted average of the indices for Germany, France, Italy, Spain and Finland.

In Italy, the rate of increase in unit labour costs rose from 1.1 per cent in 1997 to 1.5 per cent in 1998 on the basis of the new national accounts incorporating the ESA95 standards. Although the differential with the other leading countries of the area decreased by about 1 percentage point, it remained wide at about 3 points. Since rates of increase in compensation per employee have converged, the explanation for the gap lies in the slower increase in productivity, which in turn reflected the appreciably slower growth of economic activity in Italy.

Overall, unit variable costs in Italian manufacturing industry increased by 0.6 per cent in 1998, marginally greater than in 1997, when the increase was 0.4 per cent (Table 20). This was the outcome of a rise in the rate of increase in domestic cost components from 1.0 to 1.5 per cent, which was only partly offset by a further decrease of 2.2 per cent in foreign input prices. Unit profit margins remained unchanged on average for the year; however, they appear to have declined in the second half in conjunction with the pronounced slowdown in productive activity.

Table 20

UNIT VARIABLE COSTS AND FINAL PRICES IN MANUFACTURING (1)

(percentage changes on year-earlier period)

	Percentage weights (2)	1997	1998
Unit variable costs	**100.0**	**0.4**	**0.6**
Domestic input costs	**74.5**	**1.0**	**1.5**
Unit labour costs	49.6	1.1	1.5
labour costs per employee (3)	...	4.6	2.4
productivity	...	3.4	1.0
Other costs	24.9	0.7	1.5
Foreign input costs (4)	**25.5**	**–1.4**	**–2.2**
Output prices	**100.0**	**0.4**	**0.9**
Domestic	72.0	0.8	1.1
Foreign	28.0	–0.7	0.5

Sources: Based on ENI and Istat data; new national accounts based on the ESA95 system of accounts.

(1) Net of intrasectoral transactions; transport equipment other than cars is excluded. – (2) Calculated on the basis of the input-output table for 1988 at 1980 prices. – (3) The figure for 1998 is estimated by attributing the change in unit wages and salaries to the cost of labour per employee in order to take account of the effect of the introduction of Irap. – (4) The energy products component includes domestic production.

Unit variable costs in private services also increased more rapidly than in 1997. A number of factors contributed to the increase, which was markedly larger than that in industry: the low incidence of foreign cost components, more rapid growth in nominal earnings and stagnant productivity.

Inflation expectations

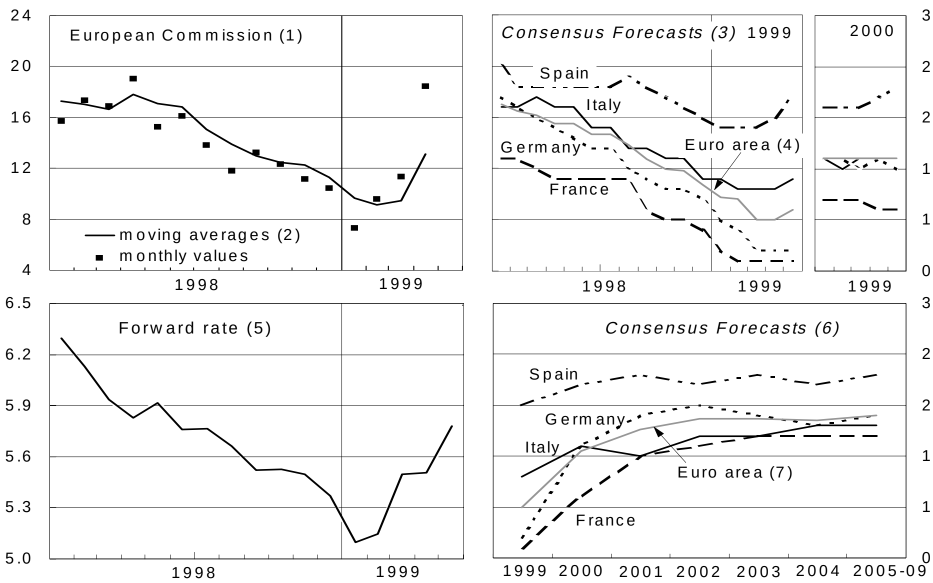
After subsiding continuously in the second half of 1998 and the first few months of this year, inflation expectations in the euro area subsequently turned upwards.

Until last January, the survey of short-term inflation expectations among consumers coordinated by the European Commission showed a decline in the excess of those expecting an increase in prices in the coming twelve months over those expecting a decline; the trend subsequently reversed course (Figure 19). The *Consensus Forecasts* survey showed professional forecasters' expectations for consumer price inflation in 1999 continuing to fall until March of this year; in May they rose slightly to 1.1 per cent for the euro area and 1.4 per cent for Italy. The survey signaled a moderate rise in inflation expectations for the year 2000, to 1.6 per cent for the euro area, and the elimination of the differential in consumer price inflation in Italy and Germany, which is expected to be 1.5 per cent in both countries.

Figure 19

INDICATORS OF EXPECTATIONS CONCERNING PRICES IN THE EURO AREA

(percentage points and percentage changes on year-earlier period)



Sources: *Consensus Forecasts* and European Commission.

(1) Percentage points. Balance between the percentage of consumers who expect prices to increase in the following 12 months and that of those who expect them to fall; weighted average of the balances for the euro area countries, excluding Luxembourg. - (2) 3-month moving average ending in the month indicated. - (3) Survey of inflation expectations for 1999 and 2000. - (4) Weighted average of the forecasts for the countries of the euro area, excluding Luxembourg. - (5) Average of 1-year forward rates between 6 and 9 years ahead, calculated on the basis of Euromarket rates on euro interest rate swaps (weighted average of rates in Germany, France, Italy and Spain until December 1998); the figure for 1999 refers to the average for the first three weeks of the month. - (6) April 1999 survey of expectations for average annual inflation in the period 1999-2009. - (7) Weighted average of forecasts for Germany, France, Italy, Spain and the Netherlands.

The recent evolution of available indicators for more distant time horizons is also consistent with a rise in inflation expectations, which reached a low point between the end of last year and the beginning of 1999. The average of 1-year forward rates between 6 and 9 years ahead on euro interest rate swaps rose from 5.1 per cent in the first two months of 1999 to 5.8 per cent in May. The *Consensus Forecasts* survey conducted in April shows that professionals expect average inflation in the euro area to rise gradually to just under 2 per cent in 2002; expectations for the leading countries converge towards this level, with the exception of Spain, where they are about 0.5 points higher.

THE BALANCE OF PAYMENTS AND ITALY'S NET EXTERNAL POSITION

The external current account was in surplus for the sixth consecutive year in 1998, albeit with a further decline from the peak recorded in 1996. Both the surplus on merchandise trade, which remained at a historically high level in relation to GDP, and that on services were smaller than in the preceding years.

The contraction in the current account surplus stemmed from the repercussions of the financial crisis in several Asian countries and Russia and from the sharp depreciation of the currencies of those countries, some of which compete with Italy in export markets. The shocks, which will presumably prove temporary, have shown Italy's net exports to have greater short-term elasticity than those of other European countries to business cycle position and price competitiveness.

There was a very substantial increase in capital inflows and outflows due to portfolio investment. Outward direct investment also grew, whereas inward direct investment diminished. There was a further increase in the deficit recorded under the residual item "errors and omissions", which has been very large for many years.

From 1999 onwards the model of Italy's balance of payments conforms with the methods established by the European Central Bank and Eurostat, which apply the internationally agreed standards of the fifth edition of the IMF Balance of Payments Manual. In addition to this change, a revision in the collection and treatment of the data on international transport has had a significant impact on the statistics on trade in goods and services.

The balances on current account and capital account

The current account surplus amounted to 34.9 trillion lire, 20.4 trillion less than in 1997, with deterioration in all the main components. The decrease in the surplus on goods and services accounts for nearly two thirds of the change; a contributory factor was the increase in the deficit on net current transfers vis-à-vis the EU, which after declining in 1997 returned to past levels.

There was also a reduction of 1.5 trillion lire in the surplus on capital account, due primarily to the decrease in transfers from the EU and representing a partial reversion to earlier levels. The surplus on the current account plus the capital account, an aggregate corresponding to the current account under the old balance of payments, declined from 60.9 to 39.1 trillion lire and from 3.1 to 1.9 per cent of GDP. Around 85 per cent of the surplus was generated by trade with countries outside the euro area.

Table 21

Balance of payments

(balances in billions of lire)

	1995	1996	1997	1998
Current account	**40,879**	**61,465**	**55,284**	**34,905**
Goods	63,059	83,300	68,107	61,912
Exports	*381,175*	*388,885*	*409,128*	*420,764*
Imports	*318,116*	*305,585*	*341,021*	*358,852*
Services	10,734	12,379	13,266	7,330
Income	–25,524	–23,123	–19,006	–21,381
Transfers	–7,390	–11,091	–7,083	–12,956
EU institutions	*–5,662*	*–8,829*	*–5,088*	*–11,476*
Capital account	**2,711**	**111**	**5,641**	**4,165**
Intangible assets	–42	–645	165	–300
Transfers	2,753	756	5,476	4,465
EU institutions	*3,718*	*1,631*	*6,320*	*5,320*
Financial account	**–9,222**	**–30,515**	**–35,078**	**5,961**
Direct investment	–3,567	–7,950	–11,690	–17,198
Abroad	*–11,413*	*–13,404*	*–17,986*	*–21,731*
In Italy	*7,846*	*5,454*	*6,296*	*4,533*
Portfolio investment	65,573	75,299	19,806	4,350
Assets	*–7,888*	*–39,373*	*–105,853*	*–192,079*
Liabilities	*73,461*	*114,672*	*125,659*	*196,429*
Financial derivatives	369	401	270	348
Other investment	–67,025	–79,623	–20,694	–18,516
Change in official reserves	–4,572	–18,642	–22,770	36,977
Errors and omissions	**–34,368**	**–31,061**	**–25,847**	**–45,031**

(1) The items are calculated using the new method adopted by Eurostat and the European Central Bank, which conforms with the Fifth edition of the IMF Balance of Payments Manual. The time series have been reconstructed and may be subject to revision.

The current account: goods

Merchandise imports and exports grew more slowly than in 1997. The decline in the trade surplus on an *fob-fob* basis from 68.1 to 61.9 trillion lire (3 per cent of GDP) reflects the faster growth of imports than exports (5.2 and 2.8 per cent respectively).

For a breakdown by geographic area it is necessary to use international trade data, which are available on a *cif-fob* basis. These show that the trade surplus diminished by around 5 trillion lire. While the surplus with EU countries remained basically unchanged, that with non-EU countries decreased by 5.2 trillion.

Exports. - Taking account of a modest increase in average unit values, the rise in the value of exports (2.8 per cent) reflected sluggish growth in volume (2 per cent). For the second consecutive year Italy's export volume expanded more slowly than world trade (which grew by 3 per cent, according to IMF estimates), causing a slight contraction in world market share. The main factors curbing export growth were the direct and indirect effects of the Asian crisis and, to a lesser extent, the difficulties besetting Russia and several Latin American countries.

The exceptionally sharp contraction in exports to the five Asian countries most heavily affected by the crisis (Indonesia, Malaysia, the Philippines, South Korea and Thailand) and to Japan, equal to 36.5 per cent at current prices, diminished the growth in Italian exports in terms of value by 1.6 percentage points.

The precipitous fall in domestic demand and the gains in competitiveness in the Asian economies reduced their imports from all of the main industrial countries, but Italy's market share in the six crisis-stricken countries fell more steeply than those of its principal European competitors and the United States. The repercussions on exports were stronger for Italy than for Germany and France, despite the fact that the area accounted for a smaller proportion of Italy's total exports (4.3 per cent just before the crisis).

The indirect effects of the Asian crisis, stemming from the drastic currency depreciation, emerged in Italy's two leading export markets: the European Union and the United States. Italy recorded smaller growth in both export values (5.5 and 12 per cent respectively) and market shares than France, Germany and, in the United States, the EU as a whole. Sharing some sectors of specialization with the Asian economies, Italy was more vulnerable to the latter's gains in price competitiveness in third-country markets than were the other industrial economies.

Exports to Russia also began to decline in the second half of 1998, after the outbreak of the crisis there, and fell by 20 per cent over the year as a whole. Russia's small share in Italian exports limited the impact of this on overall export growth to 0.3 percentage points. Exports to Latin America also slowed down sharply: those to the Mercosur countries declined by 3 per cent, but given the share of total Italian exports involved (2.2 per cent), the overall impact was again very small.

Imports. - The volume of imports grew by a substantial 7.7 per cent, but in value terms the increase was held to 5.2 per cent by a decline of 2.6 per cent in average unit values, resulting from the fall in the prices of oil and other raw materials and, to a much lesser extent, of Asian manufactures.

Price and volume trends in imports from EU countries differed from those in imports from outside the Union. The growth in imports at current prices from the former reflected that in volume (5.6 and 5.8 per cent respectively), whereas the growth in imports by value from the latter (3.2 per cent) was the result of a much larger expansion in volume (11 per cent) coupled with a sharp reduction in average unit values owing primarily to the fall of 32 per cent in the price of oil.

The current account: services, income and transfers

The deficit on invisibles came to 27 trillion lire, 14 trillion more than in 1997.

The deficit on transportation services increased slightly, from 5 to 5.2 trillion lire, according to data based on the new method. Among the sectoral balances, the largest deficit was that on air passenger transport (up sharply to 2.4 trillion), followed by that on sea freight (1.6 trillion), reflecting the increase in foreign carriers' market share of both imports and exports.

An extended sample survey conducted by the Italian Foreign Exchange Office in 1997 and 1998 led to a significant revision of the data on the transport sector for those and the preceding years. Because up-to-date, direct observations were not available, these data had been estimated by means of imputed values, which steadily lost precision over time. The value of freight transport services (charter and auxiliary services) proved to be significantly lower than had been estimated, giving rise to a reduction in both the credit and the debit entries and consequently an improvement in the balance, which has always been in deficit for Italy. Since the value of transport determines the difference between the *cif* valuation used in trade statistics and the *fob* valuation used in the balance of payments, the adjustment reduced the *fob-fob* trade surplus and, marginally, the current account surplus as well.

The surplus on foreign travel decreased by 1.1 trillion lire to 21.3 trillion, or 1 per cent of GDP. The large increase in spending by Italian tourists abroad (6.4 per cent) contrasted with a small increase in spending by foreign visitors to Italy (1.8 per cent, compared with 9.9 per cent in 1997). The latter was attributable to the effects of the crisis in Asia, which reduced the number of visitors from that area by 22 per cent and, given their high per capita spending, lowered the related receipts by 25 per cent or nearly 1.4 trillion (900 trillion of which from Japan alone).

The deficit on services other than foreign travel and transport amounted to 8.7 trillion lire, reverting to trend following the improvement recorded in 1996 and 1997. With the exception of construction services and government services, which were in surplus by 5.3 and 0.7 trillion lire respectively, all the components showed a deficit. The results for communications, computer and information services and other business services confirmed the deterioration in the balances, which have been in deficit since the beginning of the nineties.

The gradual reduction in the deficit on income flows since 1993 came to a halt last year. The deficit on investment income, which accounts for 97 per cent of these flows, increased from 19.3 to 21.3 trillion lire, equal to 1 per cent of GDP. The deficit is only fractionally due to the existence of a net debtor position; fundamentally, it stems from the yield differential between the stocks of liabilities and assets, reflecting the rate spread between the bonds issued by residents and those issued by non-residents and the different composition of assets and liabilities. The latter include a high proportion of government securities, the yield on which was higher than that on foreign bonds and shares, which account for a larger percentage of assets.

The sharp contraction in the deficit on net transfers vis-à-vis the EU budget in 1997 explains part of the increase recorded in 1998. The main items in the deterioration were, among inflows, the decline of 1.9 trillion in transfers from the Guarantee Section of the EAGGF and, among outflows, current transfers from the government to the EU (2.8 trillion) and those on VAT account (1.3 trillion).

The capital account

The surplus on capital account amounted to 4.2 trillion lire, declining slightly from the previous year as a result of a larger decrease in inflows than outflows. Capital transfers from the European Union decreased by 1 trillion lire; transfers from the European Regional Development Fund declined by 0.7 trillion but remained at a high level; the fall of 0.3 trillion in transfers from the Guidance Section of the EAGGF represents a return to pre-1997 values. The substantial decline of 0.7 trillion in inflows from the disposal of intangible assets is attributable to a large transaction carried out in 1997; the balance on intangible assets showed a deficit of 0.3 trillion lire, moving back into line with the average levels of the immediately preceding years.

The financial account and the net external position

Set against a surplus on current and capital account of 39.1 trillion lire, the financial account recorded a net inflow of 6 trillion under the new definition, which includes the change in the official reserves. A negative entry of 45 trillion lire was therefore made under errors and omissions. At the end of the year, Italy's net external liabilities exceeded its net external assets by 34.5 trillion lire (1.7 per cent of GDP).

There was a net direct investment outflow of 17.2 trillion, reflecting an appreciable increase in outward investment together with a decline in new inward investment. The former grew by 20.8 per cent to 21.7 trillion lire, whereas the latter contracted by 28 per cent to a total of only 4.5 trillion.

Portfolio investment flows showed a surplus of 4.35 trillion lire. Inflows rose by 56.3 per cent to 196.4 trillion lire, reflecting growth from 102.9 to 151.9 trillion lire in Treasury liabilities placed abroad.

Accompanying the surge in the stock market (49.2 per cent in the course of the year), foreign investors made purchases of Italian shares totaling 24.9 trillion lire, an increase of 8.9 trillion, or 56.2 per cent, compared with 1997.

Portfolio investment abroad by residents amounted to 192.1 trillion lire, a figure many times higher than those recorded in the years immediately following exchange liberalization and an increase of more than 80 per cent on 1997.

The net outflow of other investment, which includes bank loans and deposits, decreased from 20.7 to 18.5 trillion lire. Excluding the bank component, lending generated a net outflow of 15.9 trillion, less than in the preceding years. The expectation of Italy's entering the euro area at unaltered exchange rates accounts for the decline from 26 to 15.2 trillion lire in Italian loans, which consisted mainly in repurchase agreements negotiated by foreign investors with resident intermediaries in order to hedge exchange rate risk.

Financial flows in 1998 reflected marked differences in sectoral behaviour. Contrasting with net inflows of 6.6 trillion lire for the banking sector and 36.8 trillion for the Bank of Italy (including 14 trillion from the unwinding of temporary operations with resident banks), resident non-bank investors made further net purchases of external assets amounting to 37.4 trillion lire, nearly half of which was recorded under direct investment (21 trillion outward and 4.5 trillion inward). The balance on non-bank portfolio investment, which had been contracting steadily from the high levels of 1993, turned negative: a net outflow of 2.2 trillion was recorded in conjunction with considerably larger gross flows. Purchases of portfolio assets grew appreciably, from 112.5 to 189.9 trillion lire; liabilities worth 187.7 trillion were placed abroad.

Despite the current account surplus, Italy's net external position was negative by 34.5 trillion at the end of the year, compared with a position basically in balance at the end of 1997 (Table 22). The transactions recorded on the financial account were responsible for only 6 trillion lire of the deterioration; the rest was due to valuation adjustments to the stock of residents' financial assets and liabilities as a result of changes in exchange rates and share and bond prices. Valuation adjustments totaled 30.7 trillion lire. Those in respect of exchange rate variations (25.8 trillion) basically reflected the loss in value of assets as a result of the 6 per cent appreciation of the lira against the dollar, in which a large part of external assets are denominated. The balance on the other adjustments (primarily for price changes) was positive by 1.1 trillion for non-banks and negative by 6 trillion for the Bank of Italy.

The banks' net external liabilities rose by 6.6 trillion lire, including 5.9 trillion in foreign currency, set against a significant increase in the corresponding loans to residents. Taking account of exchange rate adjustments of similar size and opposite sign (5.6 trillion lire), the banks' net external position remained comparable to that of the previous year, with a debtor position in foreign currency of 103.5 trillion and a creditor lira component of 31 trillion. The overall spot and forward position in foreign currency, including domestic currency swaps, was negative at the end of the year by 22.1 trillion lire, a deterioration of 8.2 trillion from the end of 1997. Repos on Italian lira securities with non-residents amounted to 9.1 trillion, broadly unchanged.

The official reserves decreased by 45 trillion lire, with a reduction of 38 trillion in holdings of convertible currencies. In January 1999 the Bank of Italy contributed 14.4 trillion of reserves to the European Central Bank, with an offsetting credit entry under "other assets" of the Bank.

Continuing a trend that emerged at the beginning of the nineties, the residual item "errors and omissions" was negative and quite large. A deficit of 45 trillion lire was attributed to this balancing item, 19.2 trillion more than in 1997.

Table 22

ITALY'S NET EXTERNAL POSITION
(billions of lire)

	Stocks at end of 1997 (1)	January-December 1998					Stocks at end of 1998 (1)
		Flows (2)	Adjustments			Change in stocks	
				in exchange rates	other		
	(a)	(b)	(c)	(3)	(4)	(d)=(b)+(c)	(a)+(d)
	Resident non-banks						
Assets	**938,380**	**224,704**	**31,328**	**–27,769**	**59,097**	**256,032**	**1,195,412**
Direct investment	236,723	20,967	24,570	–9,678	34,248	45,537	282,260
Portfolio investment	515,350	189,851	8,853	–15,791	24,644	198,704	714,054
Loans	102,423	15,154	–2,095	–2,300	205	13,059	115,482
Trade credit	84,884	–1,268	–	–	–	–1,268	83,616
Liabilities	**999,379**	**187,336**	**59,359**	**1,346**	**58,013**	**246,695**	**1,246,074**
Direct investment	146,290	4,533	23,408	–	23,408	27,941	174,231
Portfolio investment	677,971	187,690	34,621	16	34,605	222,311	900,282
Government securities	*515,913*	*151,855*	*7,951*	*16*	*7,935*	*159,806*	*675,719*
Loans	127,167	–730	1,330	1,330	–	600	127,767
Trade credit	47,951	–4,157	–	–	–	–4,157	43,794
Net position	**–59,999**	**37,368**	**–28,031**	**–29,115**	**1,084**	**9,337**	**–50,662**
	Resident banks						
Assets	349,235	26,479	–3,619	–3,619	–	22,860	372,095
Liabilities	420,748	33,044	–9,216	–9,216	–	23,828	444,576
Net position	**–71,513**	**–6,565**	**5,597**	**5,597**	–	**–968**	**–72,481**
	Central bank						
Assets	135,619	–36,977	–8,313	–2,267	–6,046	–45,290	90,329
Liabilities	1,975	–213	–34	–34	–	–247	1,728
Net position	**133,644**	**–36,764**	**–8,279**	**–2,233**	**–6,046**	**–45,043**	**88,601**
NET OVERALL POSITION	**2,132**	**–5,961**	**–30,713**	**–25,751**	**–4,962**	**–36,674**	**–34,542**

(1) At end-of-period prices and exchange rates. – (2) Capital movements at the securities prices and exchange rates prevailing on the date of the transaction. A minus sign indicates a decrease in the relevant assets or liabilities. – (3) Calculated on the basis of the composition according to currency. – (4) Calculated on the basis of the composition according to financial instrument.

The view that "errors and omissions" is primarily the result of exporters' not reporting payments by non-residents to accounts abroad is not disproved by the data. On this hypothesis, Italy's net external position would be significantly better than portrayed in the accounts. It should be recalled that in 1998 the outward portfolio investment flow of around 190 trillion lire was the balance of purchases and sales of assets worth almost thirty times that amount. The phenomenon is common to all the leading countries, albeit with lower ratios to capital flows. The euro area's balance of payments for 1998, for example, shows almost four times the amount recorded by Italy under "errors and omissions".

THE PUBLIC FINANCES

Budgetary policy in 1998 sought to consolidate the results obtained in the previous year, when the ratio of the deficit to GDP was reduced by around 4 percentage points in order to meet the objective set in the Maastricht Treaty. The small reduction of 0.2 points in net borrowing indicated in the Economic and Financial Planning Document published in May 1997 was to come from the expected fall of 1.1 points in interest payments, almost entirely offset by the planned reduction of 0.9 points in the primary surplus. This, in turn, reflected the intention of making good only a part of the expected decline in revenue. In order to achieve the objectives for the year, adjustment measures totaling 25 trillion lire were considered necessary.

The broad lines of this policy remained basically unchanged in the subsequent official documents, which updated the planning framework to take account of the downward revision of forecast interest payments, the availability of definitive data for 1997 and the changes in macroeconomic conditions. The Quarterly Report on the Borrowing Requirement published in March 1998 set an objective for net borrowing of 2.6 per cent of GDP, a reduction of 0.1 percentage points on 1997. The objective of 5.5 per cent for the ratio of the primary surplus to GDP was 1.3 points lower than in 1997. The revenue ratio was expected to fall by 1.1 points.

In the event net borrowing remained unchanged at 2.7 per cent of GDP. The primary surplus and interest payments amounted to 4.9 and 7.5 per cent of GDP respectively, or about half a percentage point less than projected in the Quarterly Report on the Borrowing Requirement. The shortfall in the primary surplus was mainly due to the loss in revenue stemming from the introduction of the regional tax on productive activities (Irap) and the deterioration in economic conditions. The result benefited by around 0.3 percentage points from the switch from two-monthly to monthly payments of INPS pensions, which had not been considered among the effects of the budget adjustment measures. As regards the outcome for interest payments, the fall in interest rates was larger than the prudent estimate included in the official forecasts.

The introduction of the dual income tax and Irap in 1998 considerably altered the taxation of firms. The new system rationalizes the structure of corporate taxes, reduces the total tax burden and is more neutral with respect to firms financing decisions. By partly shifting the tax base from net worth and profits to interest payments, it reduces the advantages of debt financing and makes equity capital more attractive. The sign and size of the effects on labour costs vary according to the health service contribution relief firms previously enjoyed. The redistribution of the tax burden has been on a significant scale and influenced by the amount and composition of firms' liabilities and value added. Companies with substantial equity capital, small borrowings, a high ratio of profits to value added and no relief from health service contributions stand to gain. The new regime is likely to result in major changes in firms' economic and financial choices, with an aggregate effect on the allocation of resources that is difficult to assess.

General government debt fell from 122.4 to 118.7 per cent of GDP. The improvement was larger than in 1997, primarily owing to the reduction in the average cost of the debt and the smaller volume of new issues that was made possible by running down the Treasury's assets with the Bank of Italy. The lengthening of the average maturity of the debt, the decline in the variable-rate portion and the introduction of the single currency made the debt less sensitive to variations in short-term interest rates and the exchange rate.

The Quarterly Report on the Borrowing Requirement published in March forecasts a reduction in net borrowing in 1999 from 2.7 to 2.4 per cent of GDP, a smaller fall than that projected for interest payments. The primary surplus is expected to decline from 4.9 to 4.5 per cent of GDP. This setback, which can be attributed in part to the continued weakness of the economy, implies a divergence from the path laid down in the Economic and Financial Planning Document for 1999-2001, which envisaged no change in the primary surplus over the whole period from the level estimated for 1998 (5.5 per cent of GDP). The revenue and primary expenditure ratios are expected to rise by 0.1 and 0.4 percentage points respectively.

With economic conditions still unfavourable, the budget for 1999 set out to reconcile a reduction in net borrowing compared with that projected on a current programmes basis with a strengthening of social and growth policies. The adjustment measures are officially estimated to amount to 18.6 trillion lire, of which 8 trillion represent a reduction in net borrowing. The remaining 10.6 trillion is to be used to refund part of the special Europe tax, grant tax incentives and cover increased spending on social security benefits and support for investment. The contribution of one-off measures is substantial; in particular, the sale of INPS social security contribution claims to banks and other financial intermediaries is expected to generate 5.3 trillion of additional revenue.

According to forecasts made by INPS and the State Accounting Office, pension dynamics in the coming decades will require an increase in social security contributions or taxes unless corrective action is taken. Both these solutions conflict with the need to reduce the ratio of revenue to GDP. In order to curb spending on pensions without lowering the standard of living of future pensioners, it will be necessary to achieve a significant increase in the average retirement age and develop supplementary schemes along the lines laid down in the reforms already enacted.

The Economic and Financial Planning Document for 2000-02 is being prepared. In accordance with Italy's European commitments, the priority objective is to achieve a budget position close to balance in the medium term. The strategy formulated in last year's Document was to maintain the primary surplus at a relatively high level and use the savings expected from the fall in interest payments to reduce net borrowing. In order to reduce the fiscal burden and the resulting distortions in the allocation of resources, it will be necessary for this process to be accompanied by resolute action to curb primary expenditure in relation to GDP.

In 1998 net borrowing in the euro area fell to its lowest level since the beginning of the nineties (2.1 per cent of GDP). The improvement of 0.4 percentage points compared with 1997 was exclusively due to the fall in the ratio of interest payments to GDP. The primary surplus ratio declined slightly. These results appear modest considering the favourable economic conditions prevailing. According to estimates prepared by the EU Commission, the ratio of the cyclically adjusted primary surplus to GDP fell by 0.5 percentage points.

Between June 1998 and February 1999 the EU countries submitted their stability and convergence programmes. For the euro area as a whole they imply a decline in net borrowing between 1998 and 2001 of around 1 percentage point, to 1.2 per cent of GDP. The European Council agreed with the guidelines laid down in most countries' programmes but stressed the need to pursue more ambitious budget objectives in order to limit the risk of incurring excessive deficits in cyclical downturns, reduce debt levels and face the period of more pronounced population ageing with stronger budget positions.

BUDGETARY POLICY IN 1998

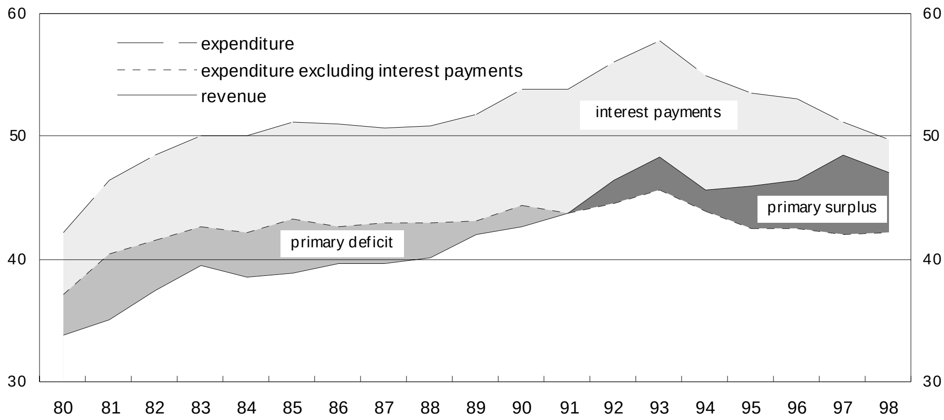
In order to ensure consistency with the data contained in the Government programmes and the notifications prepared for the purposes of the Excessive Deficit Procedure, the section on the public finances refers to the 1979 edition of the ESA rather than the 1995 edition as regards the general government consolidated accounts and GDP.

Italy

General government net borrowing increased from 52.3 trillion lire in 1997 to 54.3 trillion in 1998; in relation to GDP it remained unchanged at 2.7 per cent (Figure 20, Tables 23 and a12). The primary surplus, which had increased almost continuously during the nineties, declined from 127.1 to 98.3 trillion lire and from 6.6 to 4.9 per cent of GDP. The effect of the decrease on the overall balance was offset by a fall in interest payments from 9.2 to 7.5 per cent of GDP. The results in terms of the structural balances were similar: the overall deficit remained broadly stable at 2.3 per cent of GDP while the primary surplus declined from 6.9 to 5.2 per cent.

Figure 20

GENERAL GOVERNMENT REVENUE AND EXPENDITURE (1)
(as a percentage of GDP)



Source: Based on the *Relazione generale sulla situazione economica del Paese.*
(1) Following the revision carried out by Istat in 1999, there is a break in the series between 1994 and 1995.

The decline in the primary surplus mainly reflects a decrease in revenue from 48.5 to 47 per cent of GDP: 1.2 points stemmed from a fall in the fiscal ratio (the ratio of direct and indirect taxes, capital taxes and social security contributions to GDP) from 44.8 to 43.6 per cent.

Table 23

MAIN INDICATORS OF THE GENERAL GOVERNMENT CONSOLIDATED ACCOUNTS (1)

(as a percentage of GDP)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Revenue	42.0	42.7	43.8	46.5	48.3	45.7	45.9	46.5	48.5	47.0
Expenditure	51.8	53.8	53.9	56.1	57.8	54.9	53.6	53.1	51.2	49.7
of which: interest payments	*8.8*	*9.5*	*10.2*	*11.5*	*12.1*	*11.0*	*11.2*	*10.6*	*9.2*	*7.5*
Primary balance (surplus:−)	1.1	1.7	−0.1	−1.9	−2.6	−1.8	−3.5	−4.0	−6.6	−4.9
Net borrowing	9.8	11.1	10.1	9.6	9.5	9.2	7.7	6.6	2.7	2.7

Source: Based on the *Relazione generale sulla situazione economica del Paese.*
(1) There is a break in the series between 1994 and 1995 owing to the revision carried out by Istat in 1999. Rounding may cause discrepancies.

The decrease in the fiscal ratio can be attributed mainly to the following factors: a reduction in collections of withholding tax on financial income due to the fall in interest rates and the postponement of payments as a result of the tax reform that came into force on 1 July 1998; the replacement of a series of taxes and contributions by Irap, which did not generate the same volume of revenue, contrary to the Government's plans; and the non-recurrence of around two thirds of the revenue generated the previous year by the special Europe surtax (the entire yield of the surtax on personal income tax and part of the levy on the funds set aside by companies for workers' severance pay).

The ratio of primary expenditure to GDP rose from 42 to 42.2 per cent. Primary current expenditure remained more or less unchanged in relation to GDP, while capital spending rose as a result of the large increase in investment (10.7 per cent) and the resumption of the settlement of tax credits in securities, which had not been effected in 1997.

Net borrowing was contained by measures that generated temporary effects equal to about 0.6 per cent of GDP, compared with about 1 per cent in 1997. Half of these effects represented savings associated with the switch from two-monthly to monthly payments of INPS pensions; the remainder stemmed mainly from the levy on funds set aside for workers' severance pay, which had been introduced in the 1997 budget (4.5 trillion lire in 1998, compared with 6.6 trillion the preceding year).

Budgetary policy. - The budget measures were aimed mainly at consolidating the achievements of 1997. In the Economic and Financial Planning Document for the three years from 1998 to 2000 presented in May 1997 the objective for net borrowing in 1998 had been set at 2.8 per cent of

GDP, compared with an estimate of 3 per cent for 1997. The expected fall in interest payments from 9.7 to 8.6 per cent of GDP made it possible to envisage a reduction in the primary surplus from 6.7 to 5.8 per cent, mainly as a result of the expected fall in revenue. Corrective measures amounting to 25 trillion lire were foreseen in order to achieve these objectives. Both the objectives and the measures to be adopted were confirmed in the Convergence Programme subsequently drawn up for the EU.

In the Forecasting and Planning Report published in September the objective for net borrowing remained the same but the composition of the position was modified. A reduction of 0.2 percentage points in the ratio of forecast interest payments to GDP was offset by an expected deterioration of the same order of magnitude in the projected primary surplus. It was decided to leave the scale of the budgetary measures unchanged and to set a less ambitious target of 5.6 per cent for the primary surplus.

The measures submitted to Parliament provided for additional revenue of 11 trillion lire and expenditure cuts of 14 trillion; Parliament amended these figures to 13 and 12 trillion respectively. In particular, part of the planned reductions in social security expenditure was replaced by increases in contributions. Around half of the increase in revenue stemmed from the change in VAT rates, which had come into effect in October 1997; in addition, some contribution rates were increased and the withholding tax on incomes from self-employment was raised. The expenditure measures related to transfers to local authorities and public enterprises and expenditure on pensions, health care and public employees' wages and salaries.

In the Quarterly Report on the Borrowing Requirement published in March 1998 the objectives were revised again. Account was taken of the results for 1997, which were better than had been expected, and the forecast for economic growth was raised from 2 to 2.5 per cent; the objective for the primary surplus was nonetheless reduced again, to 5.5 per cent of GDP. The further decrease in interest payments from 8.4 to 8 per cent of GDP brought the objective for net borrowing down from 2.8 to 2.6 per cent. These objectives were confirmed in the Economic and Financial Planning Document for the three years from 1999 to 2001, which was published in May 1998. They remained unchanged in the Forecasting and Planning Report of last September, despite a downgrading of the estimate of GDP growth from 2.5 to 1.8 per cent.

In the event, the ratio of net borrowing to GDP exceeded the objective by 0.1 percentage points. The primary surplus and interest payments were about half a point less than planned, owing partly to the revision of the national accounts by Istat at the beginning of 1999.

The new series of national accounts data have been published for the period from 1995 to 1998. As far as the general government consolidated accounts for 1998 is concerned, the revision reduced both the primary surplus and interest payments by more than 0.2 per cent of GDP, leaving the overall position virtually unchanged. It produced substantial changes in some items of revenue and primary expenditure (see *Economic Bulletin*, No. 26, February 1999, pp. 34-35).

The difference in relation to the planned primary surplus can be attributed primarily to the loss of revenue resulting from the introduction of the regional tax on productive activities (Irap) and the deterioration in the economic situation. In 1998 the real growth in GDP, on the basis of ESA79, was 1.4 per cent, 1.1 percentage points less than forecast in the Quarterly Report on the Borrowing Requirement of March 1998; the effect on the public finances was small, however, because the reduction in growth was largely due to components of GDP in relation to which the budget is least elastic. The shortfall in the primary surplus was limited by the change in the frequency of pension payments.

The Government's forecasts for interest payments were prudently based on an assumption that the gross yield on 1-year Treasury bills would decline by about 0.4 percentage points during 1998 to 4.5 per cent at the end of the year. In fact, they declined by more than 1.7 points.

The introduction of DIT and Irap. - The reform of corporate taxation rationalizes the composition of the levy, reduces the overall tax burden and increases the neutrality of taxation as regards companies' decisions about finance and the use of factors of production. The new system was intended to generate the same volume of revenue as the taxes it replaced, but in fact its introduction led to a decrease of about 9 trillion lire. At the aggregate level the tax burden on firms declined by broadly the equivalent of the yield of the tax on companies' net worth, which was due to expire in 1998 in any case. By shifting the tax burden from net worth and profits to interest expenses, the reform has reduced but not eliminated the preferential tax treatment the latter previously enjoyed, thereby encouraging companies to strengthen their capital base. It has also affected labour costs, though the sign of the change depends on the opportunities that different categories of firm had under the previous system to claim relief from health contributions.

The introduction of Dual Income Tax (DIT) reduces the ordinary rate of corporate income tax for firms which increase their net worth. The regional tax on productive activities (Irap), which is levied on value added net of depreciation, replaced health contributions, the tax on companies' net worth, local income tax and certain local business taxes. Irap has a broader tax base than the taxes it replaces; it affects firms equally, irrespective of the mix of production factors and the structure of their liabilities, as both return on equity and interest expenses are taxable. The neutrality of the tax with regard to decisions on factor use would be greater if depreciation were also taxable.

The changeover to the new regime led to an extensive redistribution of the tax burden. In general, it benefits firms with relatively higher capitalization (thanks to the abolition of the tax on net worth), low debt (because Irap is levied on interest expenses), a high ratio of profit to value added (in view of the benefits deriving from the replacement of local income tax by Irap) and those that did not qualify for relief from health contributions (on account of the savings as a result of the abolition of the latter).

Overall, the redistribution of the tax burden depends on the level and composition of companies' liabilities and value added. Within the latter, the new regime undoubtedly increases the tax on interest expenses and reduces it on profits; the scale and sign of the effects on labour costs differ according to the level of social security costs previously payable in different branches of activity and areas of the country.

In assessing the effects of the replacement of health contributions by Irap on per capita labour costs, it is not enough merely to compare the new tax rate of 4.25 per cent with the old standard contribution rate of 11.46 per cent; account must also be taken of other factors, which together tend to reduce the difference between the effective rates: a) health contribution rates depended on the level of contribution relief for which the firm was eligible; b) under transitional arrangements, a reduced rate of Irap will apply to agriculture between 1998 and 2001 and firms in the South will be able to take a tax deduction equal to 2 per cent of their wage bill in 1998 and 1999; c) the tax base for Irap is wider than that for the old health contributions, as the tax is also levied on firms' allocations for staff pensions; d) unlike health contributions, Irap is not deductible for purposes of corporate income tax. If these factors are taken into account, the reform reduces the taxation of labour only for firms that did not claim relief from health contributions or were eligible for only limited relief. Moreover, on the basis of agreements reached at Community level, contribution relief would have been phased out in 2000.

The borrowing requirement and the public debt. - The overall general government borrowing requirement amounted to almost 52.1 trillion lire in 1998, equal to 2.6 per cent of GDP, and was more than 15 trillion higher than in the preceding year (Tables 24 and a13). In 1997 there had been a substantial disparity between net borrowing and the borrowing requirement, as privatization proceeds had been particularly high and the borrowing requirement had been reduced by temporary factors that did not affect net borrowing, but the gap almost closed last year. The difference between the two aggregates is due to differences in the criteria for recording certain items and the fact that privatization proceeds and the net amount of other financial items (primarily purchases and sales of shareholdings and the granting and redemption of loans) are included when calculating the borrowing requirement. Net privatization proceeds fell from about 21.2 trillion lire in 1997 to around 14.3 trillion in 1998.

Table 24

GENERAL GOVERNMENT BALANCES AND DEBT

(billions of lire)

	1995	1996	1997	1998
Net borrowing	135,059	123,090	52,266	54,330
as a percentage of GDP	*7.7*	*6.6*	*2.7*	*2.7*
Total borrowing requirement	127,109	142,697	36,924	52,132
as a percentage of GDP	*7.2*	*7.7*	*1.9*	*2.6*
Debt (EU definition)	2,201,875	2,322,322	2,374,382	2,403,075
as a percentage of GDP	*125.3*	*124.6*	*122.4*	*118.7*

Source: For net borrowing, *Relazione generale sulla situazione economica del Paese.*

General government debt fell from 122.4 to 118.7 per cent of GDP (Table 24). The nominal growth of 4.3 per cent in output more than offset the increase of 1.2 per cent in liabilities, which was over 23 trillion lire less than the borrowing requirement. Almost 16 trillion of the difference was due to a decrease in Treasury claims on the Bank of Italy, which fell from 59 trillion lire at the end of 1997 to 43.2 trillion a year later, and the remainder to differences in the criteria used for recording securities when calculating the public debt and the borrowing requirement. The ratio of debt to GDP was 0.5 percentage points higher than indicated in the Economic and Financial Planning Document of May 1998. The overshoot was due entirely to the fact that GDP was lower than estimated, owing partly to the revision of the national accounts by Istat (which entailed a reduction of 0.6 percentage points in GDP in 1997) and partly to slower growth in 1998 (4.3 per cent, compared with a forecast of 4.6 per cent in the Document). In absolute terms, however, debt was lower than forecast, mainly because the decrease in Treasury claims on the Bank of Italy was substantially larger than the figure of 5.5 trillion lire predicted in the Document.

In 1998 the authorities continued to lengthen the maturity of the public debt; the average term to maturity rose from 4.5 to 4.9 years. The budgetary cost of this policy was held down by the fall in long-term interest rates. Net redemptions of Treasury bills and credit certificates amounting to 35.5 and 42.1 trillion lire respectively also reduced the responsiveness of interest payments to changes in short-term interest rates; the proportion of the public debt with a residual term of more than one year (excluding Treasury credit certificates) rose from 49.9 to 52.9 per cent.

At the end of 1997 6.9 per cent of the public debt was denominated in foreign currencies and ecus. Since more than half of this share was in the currencies of countries that joined the euro area, the changeover to the single currency led to a significant reduction in the responsiveness of the debt to exchange rate changes. At the end of 1998 3.3 per cent of the debt was denominated in currencies outside the euro area. The proportion of the debt held by non-residents rose from 21 to 26.3 per cent.

The ESA95. - As from the notifications for March 2000 onwards, the data on general government net borrowing used in the procedure for monitoring excessive deficits will be based on the new version of the European System of Accounts, referred to as ESA95. Applying the new methodology to the general government consolidated accounts for 1998 raises expenditure by about 7 trillion lire and revenue by about 5 trillion. Net borrowing rises by 2 trillion, while the primary surplus improves by 9.5 trillion lire (Table 25).

Table 25

GENERAL GOVERNMENT CONSOLIDATED ACCOUNTS FOR 1998: COMPARISON BETWEEN ESA79 AND ESA95 (1)

	Billions of lire			As a percentage of GDP		
	ESA79	ESA95	Difference	ESA79	ESA95	Difference
Total expenditure	**1,006,204**	**1,013,271**	**7,067**	**49.7**	**49.2**	**–0.5**
of which: compensation of employees	*226,005*	*221,953*	*–4,052*	*11.2*	*10.8*	*–0.4*
intermediate consumption	*99,375*	*141,744*	*42,369*	*4.9*	*6.9*	*2.0*
social security benefits	*395,849*	*350,187*	*–45,662*	*19.6*	*17.0*	*–2.6*
interests payments	*152,609*	*164,058*	*11,449*	*7.5*	*8.0*	*0.5*
capital expenditure	*77,685*	*75,131*	*–2,554*	*3.8*	*3.7*	*–0.1*
Total revenue	**951,874**	**957,033**	**5,159**	**47.0**	**46.5**	**–0.5**
of which: direct taxes	*292,611*	*297,256*	*4,645*	*14.5*	*14.4*	*–0.1*
indirect taxes	*311,787*	*317,094*	*5,307*	*15.4*	*15.4*	*0.0*
social security contributions	*270,922*	*267,164*	*–3,758*	*13.4*	*13.0*	*–0.4*
capital taxes	*12,865*	*12,628*	*–237*	*0.6*	*0.6*	*0.0*
Net borrowing	**54,330**	**56,238**	**1,908**	**2.7**	**2.7**	**0.0**
Primary balance (surplus: –)	**–98,279**	**–107,820**	**–9,541**	**–4.9**	**–5.2**	**–0.3**

Source: Based on Istat data.
(1) Rounding may cause discrepancies.

As regards the designation and contents of operations, the most significant change in the general government consolidated accounts is the inclusion of social security benefits in kind among intermediate consumption; such benefits no longer appear in the secondary distribution of income account but are a cost element in the value of production. Operations are recorded more strictly on an accruals basis under ESA95 than was the case for ESA79. Istat has also redefined the general government sector, removing certain agencies (including port authorities, housing agencies, the Italian Automobile Club (ACI), Consob and ISVAP) and adding certain minor bodies.

On the expenditure side the revisions relate to intermediate consumption and social security benefits (on account of the reclassification of benefits in kind, which amounted to more than 43 trillion lire in 1998), compensation of employees (owing to the application of the accruals principle, which in 1998 led to the deletion of disbursements for health contributions for previous years) and interest expenses (owing to the application of the accruals principle to interest on post office savings certificates, which had previously been recorded at the time of redemption). On the revenue side the changes are smaller and stem mainly from the application of the accruals principle.

The euro area

In the majority of the euro area countries the ratio of net borrowing to GDP fell to the lowest levels recorded since the beginning of the nineties. The average for the area as a whole, weighted by national GDP, was 2.1 per cent, compared with 2.5 per cent in 1997. The improvement reflects the decline in interest payments from 5 to 4.5 per cent of GDP. The primary surplus decreased from 2.6 to 2.5 per cent. The achievements are modest when set against the acceleration in real GDP growth from 2.5 to 3 per cent. According to estimates from the European Commission, the structural primary balance deteriorated by about 0.5 per cent of GDP.

The improvement in the public finances was on average more pronounced in the EU countries not participating in monetary union (Denmark, Greece, Sweden and the United Kingdom). An average deficit equal to 1.7 per cent of GDP in 1997 gave way to a surplus of 0.6 per cent in 1998. In contrast to developments in the euro area, the improvement was due largely to an increase in the primary surplus, which rose from 2.8 to 4.8 per cent of GDP; only in Denmark did it remain broadly unchanged.

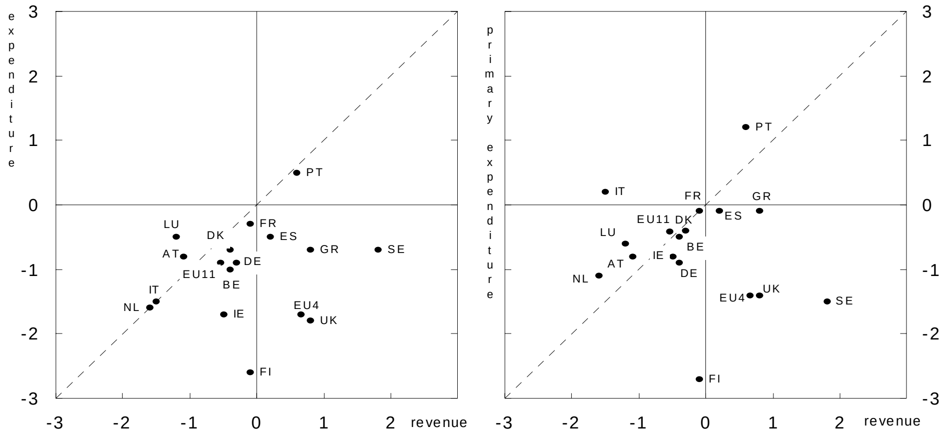
As regards the commitment contained in the Stability and Growth Pact to aim for a medium-term budgetary position close to balance or in surplus, only Finland, Ireland and Luxembourg among the euro area countries recorded a surplus and only the Netherlands had a deficit equal to less than 1 per cent of GDP.

The ratio of expenditure to GDP declined from 50.4 to 49.5 per cent (Figure 21), continuing a trend that has been under way since 1994. Around half of the decrease was in interest payments, which fell particularly sharply in Italy. The ratio of primary expenditure to GDP declined in almost all the countries; it rose moderately in Italy and more markedly in Portugal.

Figure 21

CHANGES IN GENERAL GOVERNMENT REVENUE AND TOTAL AND PRIMARY EXPENDITURE IN EU COUNTRIES BETWEEN 1997 AND 1998 (1)

(as a percentage of GDP)



Sources: Based on Istat and European Commission data.

(1) The changes are calculated as the difference between the ratios to GDP in 1998 and 1997. The values on the vertical axis refer to total expenditure in the chart on the left and to primary expenditure in the chart on the right; those on the horizontal axis refer to revenue. The dotted diagonal lines indicate the points at which changes in revenue and expenditure leave the overall balance unchanged in the chart on the left and the primary balance unchanged in the chart on the right. Points below the line correspond to an improvement in the balance, those above it to a deterioration. The size of the improvement (deterioration) is given by the distance of each point from the diagonal. EU11 and EU4 refer respectively to the GDP-weighted average for the euro area and Denmark, Greece, the United Kingdom and Sweden.

Current transfers to households declined from 20.5 to 20.2 per cent of GDP. The fall, which involved almost all the countries, was due to cyclical factors and reform measures. In Italy the ratio remained more or less unchanged between 1993 and 1998, whereas in the other countries it fell by an average of 0.6 percentage points, mostly in the last two years. In the four EU countries outside the euro area the decrease over the same period was much larger, averaging 3.1 points.

For the first time since 1994 the improvement in net borrowing in the euro area was accompanied by a reduction in the ratio of revenue to GDP, which fell from 47.9 to 47.3 per cent. The fall was evident in a large number of the euro area countries and related exclusively to social security contributions, which as a proportion of GDP fell by 1.1 percentage points to 17.2 per cent. The reduction in the contributions ratio was particularly large in Italy and France; in Italy, where it amounted to 2.1 points, it was due to the abolition of health contributions, while the 1.9 point contraction in France stemmed from a reform of the system for financing social security. By contrast, the ratio of tax revenues to GDP, with capital taxes included in the numerator, rose by 0.6 points to 26.6 per cent.

The ratio of public debt to GDP, which had declined from 75.3 to 75.1 per cent between 1996 and 1997, showed a more pronounced fall to 73.5 per cent last year. It decreased in all the countries except France and Luxembourg, where it rose from 58.1 to 58.5 per cent and from 6.4 to 6.7 per cent respectively; in Ireland and Portugal it came down to less than 60 per cent. The reduction in 1998 was due mainly to an acceleration in the nominal growth in output from 2.2 to 4.2 per cent. Moreover, the average cost of the debt declined, and this effect outweighed the fall in the primary surplus.

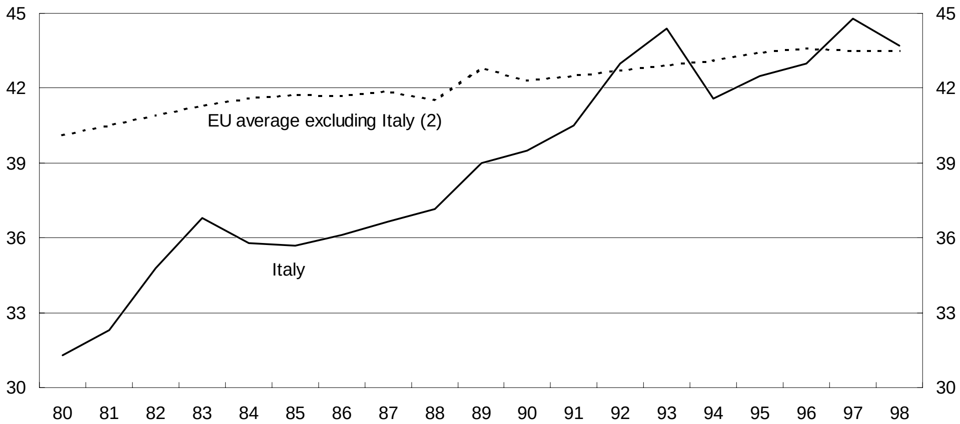
REVENUE AND EXPENDITURE

Revenue

In 1998 general government revenue increased by 1.2 per cent to nearly 951.9 trillion lire. As a ratio to GDP it declined by 1.5 percentage points, from 48.5 to 47 per cent, mainly as the result of the decline of 1.1 points in the ratio of current revenue. The ratio of total direct and indirect taxes (excluding those accruing to the EU), actual and imputed social security contributions and capital taxes fell by 1.2 points, from 44.8 to 43.6 per cent (Figure 22).

Figure 22

TAX REVENUE AND SOCIAL SECURITY CONTRIBUTIONS (1)
(as a percentage of GDP)



Sources: Based on Istat and European Commission data.
(1) Includes imputed social security contributions and capital taxes. Following the revision carried out by Istat in 1999, there is a break in the series between 1994 and 1995. - (2) GDP-weighted average.

Direct taxes. - Total direct tax receipts declined by 5.7 per cent as a result of the abolition of several taxes following the introduction of the regional tax on productive activities (Irap). Net of this effect, receipts remained broadly unchanged. The ratio to GDP fell from 16 to 14.5 per cent (Table 26; for individual items, Table a15).

Personal income tax was the only direct tax to produce higher receipts (up by 9.7 per cent). The portion relative to self-employment income benefited from the increase in the rate of withholding tax introduced in the budget for 1998, while the employee portion was affected by the restructuring of the tax and the enlargement of the tax base as a consequence of the abolition of health contributions.

Table 26

GENERAL GOVERNMENT FISCAL REVENUE (1)

(as a percentage of GDP)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Direct taxes	14.3	14.4	14.5	14.7	16.2	14.9	14.8	15.3	16.0	14.5
Indirect taxes	10.4	10.6	11.1	11.2	12.0	11.7	12.2	12.2	12.6	15.4
Current tax revenue	**24.7**	**25.1**	**25.6**	**25.9**	**28.2**	**26.7**	**27.0**	**27.5**	**28.6**	**29.9**
Actual social security contributions	12.6	12.9	13.1	13.3	13.7	13.0	13.2	14.9	15.1	13.0
Imputed social security contributions	1.5	1.6	1.6	1.7	1.8	1.9	1.7	0.3	0.4	0.4
Current fiscal revenue	**38.8**	**39.5**	**40.4**	**41.0**	**43.7**	**41.6**	**41.9**	**42.6**	**44.1**	**43.2**
Capital taxes	0.2	0.1	0.2	2.0	0.7	0.1	0.6	0.3	0.7	0.4
Fiscal revenue	**39.0**	**39.6**	**40.6**	**43.0**	**44.4**	**41.7**	**42.5**	**42.9**	**44.8**	**43.6**

Source: Based on the *Relazione generale sulla situazione economica del Paese.*
(1) There is a break in the series between 1994 and 1995 owing to the revision carried out by Istat in 1999. Rounding may cause discrepancies.

The yield of the tax on interest income fell from 36.4 to 17.8 trillion lire. The receipts in respect of interest on bank deposits were reduced by the decline in interest rates and the substantial tax credits accrued in the course of 1997, which were used to offset 1998 liabilities. The tax on bond income was affected by a reform that came into effect on 1 July: the withholding tax on the income from bonds held for asset management purposes was replaced by a tax on the results for the year, to be paid before March of the subsequent year. Moreover, in 1998 there was again a shift in receipts to self-assessed taxes owing to the abolition in 1997 of the withholding tax on income from bonds held by legal persons.

The reform of the taxation of financial assets has rationalized the system and enhanced its neutrality by broadening the tax base and leveling the applicable rates. On the other hand, it has increased the variability of receipts, thereby rendering revenue forecasts more difficult. The increased variability is due to the introduction of taxation of all capital gains, which makes part of overall receipts depend on securities prices. Capital gains and losses are assessed on an accruals basis.

Indirect taxes. - Including Irap, which raised 52.3 trillion lire, indirect tax receipts increased by 27.8 per cent, from 12.6 to 15.4 per cent of GDP; excluding the new tax, the increase was 7 per cent.

VAT receipts rose by 9.4 per cent, owing both to the increase in rates in October 1997 and to the broadening of the tax base. The latter stemmed from a revision of the rules on deductions and the introduction of tax relief for home renovation, which apparently brought some formerly underground activities into the open.

Social security contributions and capital taxes. - Social security contributions contracted by 10 per cent, falling from 15.5 to 13.4 per cent of GDP, as a result of the abolition of health contributions in concomitance with the introduction of Irap. Pension contributions rose by 5.8 per cent, while health contributions fell from 55 trillion to 11 trillion lire, which mainly comprised contributions for December 1997 received in January 1998.

Capital taxes decreased by about 5.7 trillion lire, or 30.7 per cent, with the end of the special “Europe” tax and the reduction in the yield of the levy on companies’ staff severance pay provisions from 6.6 to 4.5 trillion lire.

The tax wedge: an international comparison. - The “tax wedge” is an indicator of the tax burden on labour, defined as the percentage of total labour costs accounted for by personal income tax plus employer’s and employee’s social security contributions. A comparatively large tax wedge can have distorting effects, by reducing both the supply of and the demand for labour and encouraging forms of irregular and unregistered employment. Where labour and goods markets are not perfectly competitive, an increase in the wedge tends to increase the cost of labour and thus adversely affects the level of employment and firms’ competitiveness.

Italy is among the countries with the largest tax wedges (Figure 23). The indicator remained stable at around 50 per cent from the beginning of the eighties to 1996, when it rose to 50.8 per cent and employer’s social security contributions accounted for 62 per cent of the total. In 1998 the level and composition of the wedge were modified with the introduction of Irap and the abolition of health contributions.

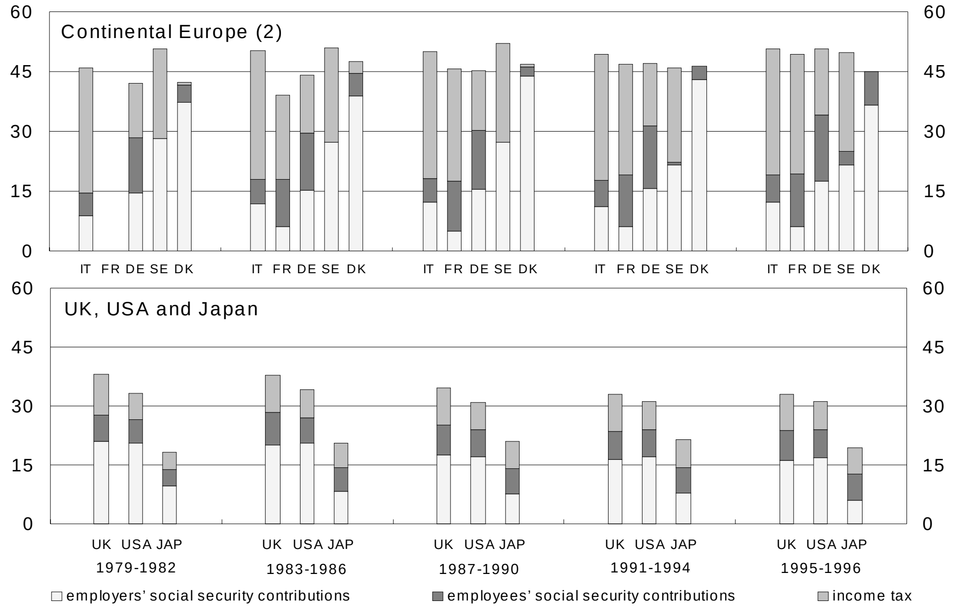
In 1996, the tax wedge in the principal countries of continental Europe and in Scandinavia was close to 50 per cent, well above the levels found in the United Kingdom, the United States and Japan (33, 31 and 19 per cent respectively). Differences in the indicator’s evolution are also observable: since the early eighties the wedge has gradually narrowed in the UK and the US but progressively widened in continental Europe.

In most of continental Europe, more than 60 per cent of the tax wedge is accounted for by social security contributions charged to the employer.

Figure 23

TAX WEDGE ON LABOUR IN THE LEADING INDUSTRIAL COUNTRIES (1)

(percentages)



Source: Based on OECD, *The Tax/Benefit Position of Employees.*

(1) With reference to the average earnings of an unmarried worker in manufacturing. - (2) For France, the data on employer social security contributions are not available for the years from 1979 to 1982.

An exception is Germany, where the three components of the wedge are of roughly equal importance. In Scandinavia the largest components are income tax and, except in Denmark, employer's contributions. In the US and the UK personal income tax is the largest item.

Table 27

GENERAL GOVERNMENT EXPENDITURE (1)

(as a percentage of GDP)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Compensation of employees . .	11.9	12.7	12.7	12.7	12.5	12.0	11.5	11.7	11.8	11.2
Intermediate consumption	4.9	4.8	4.9	5.0	5.2	5.0	5.0	5.0	4.8	4.9
Social security benefits	17.6	18.2	18.3	19.3	19.5	19.5	19.2	19.4	19.9	19.6
Interest payments	8.8	9.5	10.2	11.5	12.1	11.0	11.2	10.6	9.2	7.5
Other current expenditure	3.5	3.0	3.1	2.9	3.6	3.2	2.1	2.4	1.9	2.7
Investment	3.3	3.3	3.3	3.0	2.7	2.3	2.2	2.2	2.4	2.5
Other capital expenditure	1.8	2.3	1.5	1.6	2.3	1.8	2.5	1.7	1.1	1.3
Total . . .	**51.8**	**53.8**	**53.9**	**56.1**	**57.8**	**54.9**	**53.6**	**53.1**	**51.2**	**49.7**
of which: expenditure excluding interest payments . . .	*43.1*	*44.3*	*43.7*	*44.6*	*45.7*	*43.9*	*42.4*	*42.4*	*42.0*	*42.2*

Source: Based on the *Relazione generale sulla situazione economica del Paese.*

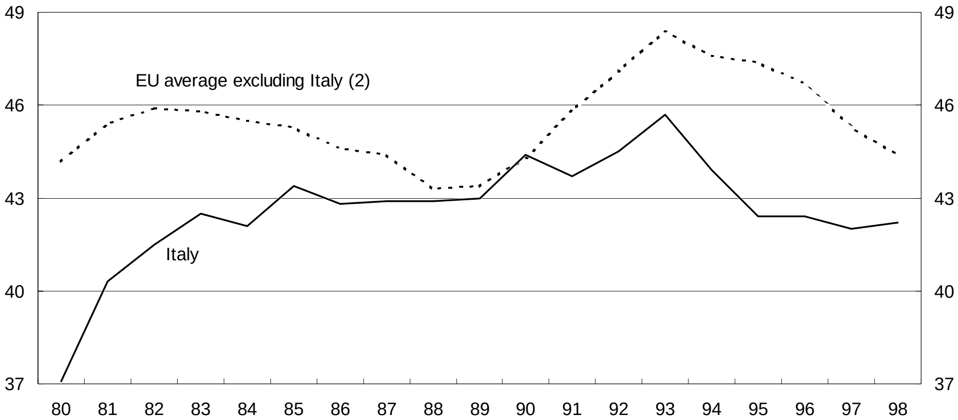
(1) There is a break in the series between 1994 and 1995 owing to the revision carried out by Istat in 1999. Rounding may cause discrepancies.

Expenditure

General government expenditure increased by 1.3 per cent to 1,006.2 trillion lire (Table a12), but declined from 51.2 to 49.7 per cent of GDP (Table 27). Whereas interest expenditure fell by 14.9 per cent, primary expenditure rose by 4.9 per cent, from 42 to 42.2 per cent of GDP (Figure 24). The increase reflects the increase in capital expenditure from 3.5 to 3.8 per cent of GDP.

Figure 24

EXPENDITURE EXCLUDING INTEREST PAYMENTS (1)
(as a percentage of GDP)



Sources: Based on Istat and European Commission data.
(1) Following the revision carried out by Istat in 1999, there is a break in the series for Italy between 1994 and 1995. - (2) GDP-weighted average.

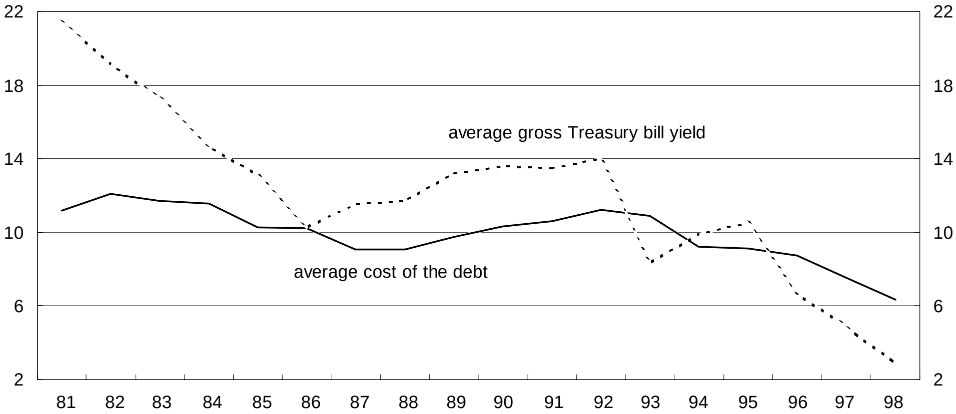
Interest payments. - The very considerable reduction of 26.7 trillion lire in this item was larger than that in 1997 and reflected the decline in interest rates that began in 1996. Between December 1995 and December 1998, the average gross rate on the three maturities of Treasury bills fell from 10.5 to 2.9 per cent (Figure 25). Over the same period, the gross yield on 10-year bonds fell from 10.9 to 4 per cent. The decrease in the average cost of the public debt (the ratio of interest expenditure to the average stock of liabilities) declined less sharply, from 9.1 per cent in 1995 to 6.3 per cent in 1998. The decrease should continue as higher-yielding issues mature.

The ratio of government interest expenditure to GDP in the euro area countries rose from an average of 4.9 per cent in 1990 to 5.6 per cent in 1993. It subsequently declined to 4.6 per cent in 1998. Between 1993 and 1998 the ratio declined in all the euro area countries except Finland, France and Germany. The countries with the largest volume of public debt generally achieved the largest reductions: Belgium's interest expenditure fell from 10.7 to 7.5 per cent of GDP and Italy's from 12.1 to 7.5 per cent.

Figure 25

AVERAGE COST OF THE DEBT AND AVERAGE GROSS TREASURY BILL YIELD

(percentage)

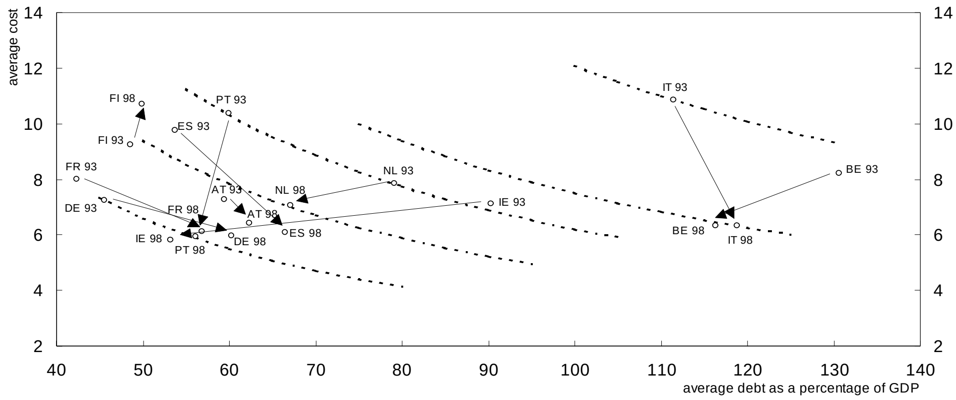


The contributions to the variation in interest payments of the average cost of the debt and its size in relation to GDP varied from country to country (Figure 26). In Italy and Spain, the entire reduction in the ratio of interest payments was due to the decline in the average cost of the debt, since this grew in relation to GDP. In Portugal too the contribution of average interest rates was substantial. The reduction in the ratio of debt to GDP had significant effects in Belgium, the Netherlands and especially Ireland.

Figure 26

BREAKDOWN OF THE RATIO OF INTEREST PAYMENTS TO GDP IN THE EURO AREA COUNTRIES IN 1993 AND 1998 (1) (2)

(percentages)



Sources: Based on Istat and European Commission data.

(1) Excluding Luxembourg. Following the revision carried out by Istat in 1999, there is a break in the series for Italy between 1994 and 1995. - (2) The ratio of interest payments to GDP (I/*GDP*) can be broken down into the product of the average cost of the debt (*I/D*) and the ratio of the average debt to GDP (*D/GDP*). The isoquants are the combination of *I/D* and *D/GDP* giving the same value of I/*GDP.*

Social benefits. - This item declined slightly from 19.9 to 19.6 per cent of GDP. The particularly modest increase in outlays (2.6 per cent, compared with 6.6 per cent in 1997) reflected the growth of 2.4 per cent in pension expenditure. The latter was curbed by the switch from two-monthly to monthly pension payments by INPS, which resulted in a one-off saving of 8 trillion lire that was partly offset by a decrease in withholding tax revenue. Health care spending rose by 7.3 per cent, while welfare benefits decreased by 1.6 per cent.

Pension and annuity expenditure grew much less than in 1997 (rising by 1.4 per cent, as against 6.8 per cent) and declined from 16 to 15.6 per cent of GDP. In the absence of the change in INPS disbursement procedures, the growth would have been 4 per cent and the GDP ratio would have remained broadly unchanged.

The slowdown in pension outlays also depended on other factors: the decrease in the annual adjustment of pensions to prices as a consequence of the decline in inflation (from 3.8 to 1.7 per cent); smaller ex-post adjustments to compensate for the difference between the target and actual inflation rates, which fell from 0.2 to 0.1 percentage points; and restrictions on long-service pension eligibility enacted in the 1998 budget. The welfare component of pension benefits contracted by 1.2 per cent, the second fall in two years.

Compensation of employees. - The 1.5 per cent reduction in expenditure under this heading stemmed essentially from the abolition of health contributions, which cut total social security contributions by 11.5 trillion lire. Compensation of public employees diminished from 11.8 to 11.2 per cent of GDP. Total gross earnings rose by 1.1 per cent; since employment fell by nearly 1 per cent, per capita earnings rose by just under 2 per cent, owing mainly to the carryover effects, estimated at about 1.5 percentage points, of the increases in 1996 and 1997.

Negotiations for the renewal of contracts covering 1998 and 1999 began last year, but the only contracts concluded were those for ministerial employees and those of non-economic public agencies. In the first few months of the new year agreements were reached for most of the remaining areas of public employment. For school employees additional allocations were agreed to, over and above those provided in the budget for 1999. The agreement provides for per capita increases of about 3.5 per cent in 1999. Even allowing for the back pay for 1998, which accounts for about 0.7 percentage points, the increase is still larger than that indicated in the Economic and Financial Planning Document for 1999-2001, according to which per capita increases were to be in line with the target inflation rate (1.5 per cent).

Other current expenditure. - This rose from 6.7 to 7.6 per cent of GDP. About two thirds of the increase was due to indirect tax payments, including Irap payments of around 11.5 trillion lire. This amount was determined by applying the rate of the abolished health contribution to the total earnings of public employees. Transfers to the EU under the heading of supplementary resources also increased significantly. There was relatively rapid growth in both intermediate consumption, which rose by 5.8 per cent, and production subsidies, which increased by 29.1 per cent following the sharp decline in 1997.

Capital expenditure. - Capital expenditure rose by 14.2 per cent, reflecting the large increases in investment (10.7 per cent) and other capital expenditure. The latter rose from 2.2 to 6 trillion lire, mainly as a consequence of the increase from 0.07 to 3.4 trillion lire in payments of tax credits in securities and the partial refund of the special "Europe" tax. Public investment expenditure rose slightly in relation to GDP, from 2.4 to 2.5 per cent. Investment grants increased by 4.7 per cent, after falling by 12.9 per cent in 1997.

Local authorities

The growth in local authorities' revenue and expenditure in 1998 outstripped that recorded by the rest of general government: revenue rose by 6.6 per cent and expenditure by 3.7 per cent, compared with 1.2 and 1.3 per cent, respectively, for general government as a whole.

The faster growth in revenue improved the budgetary position of the local authorities but did not reduce general government net borrowing since it was mainly due to transfers from the state. In fact, the decrease in the latter was smaller than the increase in local authorities' own revenue produced by the introduction of Irap.

Transfers from the state were again subject to local authorities reducing the balances on their centralized Treasury accounts. The restrictions had a smaller effect than in 1997, however, owing to the progressive reduction in the balances and because the system was made more flexible last year for larger authorities by basing the restriction on allocations on an accruals basis instead of the balance at the beginning of the year. The rules introduced for smaller authorities in 1997 were retained last year. According to the General Report on the Economic Situation of the Country, the consolidated cash flow of municipalities and provinces expanded by 9.6 per cent, after contracting by 11.7 per cent in 1997.

The increase in revenue involved both current and capital receipts, which rose by nearly 15 trillion lire and 2.6 trillion respectively. The introduction of Irap and the personal income surtax altered the composition of current revenue, shifting resources from state transfers to own revenue. Irap receipts are assigned to the regions, net of a portion transferred to the state to compensate for the cost of collecting the levy and for the loss of revenue caused by the abolition of the tax on firms' net worth.

The introduction of Irap significantly increases the tax-levying powers of the regions, on which the process of fiscal decentralization largely hinges. Initially, however, the rate will be set, liabilities determined and the tax collected by the state, with regional governments playing no role; moreover, 90 per cent of the receipts are compulsorily earmarked for the National Health Service. Once Irap is fully phased in, the regions will have some freedom to vary the standard rate set by the central government and differentiate between categories of taxpayer and sectors of activity. They will also play an active role in assessing and collecting the tax. The ratio of the regions' own revenue to current expenditure rose from 29.8 per cent in 1997 to 63.3 per cent in 1998.

On the expenditure side, current outlays increased by 2.5 per cent to 5.5 trillion lire, and capital spending by 9.2 per cent to almost 10 trillion. The pattern of the main items was similar to that found in general government as a whole. There was a sharp increase of 10.4 per cent in gross fixed investment, continuing the upswing that began in 1995 after the decline of the early nineties. Local authorities' investment expenditure accounts for about three quarters of the general government total.

The monitoring of regional, provincial and municipal accounts in 1999 is being conducted with reference to the rules laid down in the "domestic stability pact". Introduced as part of the budget, the pact establishes the principle that these government units must contribute to Italy's fiscal consolidation, in conformity with the country's European commitments.

The pact, which is essentially a planning guideline, involves local authorities in the reduction of the budget deficit and the public debt. The balance referred to in the pact is the difference between own revenue and current expenditure net of interest payments. The choice of this aggregate reflects the concern not to penalize public investment. In 1999, the pact calls on local authorities to reduce the balance in question by 2.2 trillion lire compared with the projection on a current programmes basis. The reduction is distributed among the various levels of government in proportion to their total expenditure. All the levels of local government are asked to play their part, regardless of their powers of intervention on their own revenue and expenditure. The target is to keep the annual deficit constant in relation to GDP in 1999 and 2000.

THE OUTLOOK

Budgetary policy for 1999

The two principal objectives of the 1999 budget are to achieve a further reduction in the deficit and strengthen social policies and measures to support growth.

The Economic and Financial Planning Document for 1999-2001, which the Government presented in April 1998, called for the primary surplus to be kept at the 1998 forecast level of 5.5 per cent of GDP. Stabilizing the primary surplus was intended to ensure that the overall deficit would fall from the 2.6 per cent of GDP forecast for 1998 to 2 per cent in 1999. Interest payments were expected to decline from 8 to 7.5 per cent.

The Forecasting and Planning Report for 1999 published in September and the Stability Programme presented to the European Union in December confirmed these objectives, despite the deterioration in the outlook for GDP growth in 1998 and 1999 and the sharper-than-expected fall in interest rates.

The budget the Government prepared in September, which broadly reflected the guidelines indicated in the Economic and Financial Planning Document, aimed to reduce net borrowing by 8 trillion lire vis-à-vis the baseline scenario. Parliament slightly altered the composition of the budget, but without changing its expected impact on the deficit.

The budget passed by Parliament contains measures to reduce expenditure by 10.6 trillion lire and increase revenue by 8 trillion. The former include savings of 2.2 trillion on transfers to local authorities under the domestic stability pact. The additional revenue includes 5.3 trillion to come from the sale to banks and financial intermediaries of social security contributions due to INPS. Part of the resources made available will be used to finance a set of social policy and growth support measures that is expected to involve additional spending of 5.6 trillion lire, above all for social security and support for investment, and lost revenue of 5 trillion, owing to the partial refund of the special Europe tax and the granting of tax reliefs.

The Quarterly Report on the Borrowing Requirement, published in March of this year, revised the public finance forecasts for 1999. Net borrowing is now expected to be 2.4 rather than 2 per cent of GDP and the primary surplus to amount to 4.5 rather than 5.5 per cent. The new forecasts take account of the borrowing overshoot in 1998, which the change in the procedure for paying INPS pensions curbed to some extent, and Istat's revision of the national accounts at the start of 1999. They also reflect the deterioration in the outlook for GDP growth, which has been revised down to 1.5 per cent, compared with the forecast of 2.5 per cent contained in the Economic and Financial Planning Document and the Forecasting and Planning Report. The impact of these factors on the deficit is cushioned by the sharp fall in yields on government securities, which has led to the forecast for interest payments being lowered from 7.5 to 7 per cent of GDP.

Compared with the planning framework included in the Planning Document and substantially confirmed in the Forecasting and Planning Report, the changes introduced by the Quarterly Report on the Borrowing Requirement push the increase in 1999 general government primary expenditure up from 3.7 to 4.8 per cent and that in revenue from 3.8 to 4 per cent. As a result of these revisions and the slower growth forecast in GDP in the Quarterly Report on the Borrowing Requirement, the primary expenditure and revenue ratios are expected to rise by respectively 0.4 and 0.1 percentage points (to 42.6 and 47.1 per cent of GDP), whereas the Planning Document predicted that both ratios would decline by 0.3 points.

The outlook for 1999 is thus for an improvement in the public finances that is smaller than planned and relatively modest in relation to the commitment to bring the budget into balance in the medium term. The delayed arrival of the cyclical upturn continues to weigh on the situation. The decline in the primary surplus and the increase in the size of the budget in relation to output are attributable not only to the sluggishness of the economy but also to the persistent difficulties encountered in controlling primary current spending. According to the forecasts in the Quarterly Report on the Borrowing Requirement, the ratio of such expenditure to GDP will remain broadly unchanged for the third consecutive year, after rising by 0.8 percentage points in 1996. Measures with transitory effects are likely to reduce net borrowing by around 0.1 percentage points of GDP, compared with 0.6 points in 1998.

Net of settlements of past debts and privatization receipts, the state sector borrowing requirement amounted to 45.5 trillion lire in the first four months of 1999, 4.1 trillion less than in the same period of 1998 and in line with the forecast for the entire year given in the Quarterly Report on the Borrowing Requirement.

The pension system. - Despite the reforms enacted in the nineties, pension expenditure rose from 13.8 per cent of GDP in 1990 to 16 per cent in 1997. Last year's decrease in the ratio to 15.6 per cent was due to the temporary effect of the change in the procedure for paying INPS pensions. Although the future growth of expenditure has been greatly attenuated by the reforms, it is still a cause for concern. According to INPS projections, the equilibrium contribution rate - the ratio of pension expenditure to total pensionable earnings - of the private sector employees' pension fund will rise from 45 per cent in 2000 to 47.8 per cent in 2010 and 48.5 per cent in 2025. The corresponding rate of the artisans' pension fund is projected to increase from 21.3 to 28.2 per cent and then to 30 per cent, that of the shopkeepers' pension fund from 18.5 to 25.4 per cent and then to 33.9 per cent. Forecasts made by the General Accounting Office of the Treasury for the pension system as a whole provide similar indications.

In the absence of corrective measures, these trends imply an increase in effective contribution rates or greater use of general tax revenue. Both of these solutions run counter to the need to reduce revenue in relation to GDP and appear all the more problematic in a context of growing international economic integration and mobility of tax bases, which accentuates the distortionary effects produced by high taxation in the markets for goods and factors of production. Reducing the burden of tax and social security contributions requires measures that will curb benefits and not have adverse effects on the budget deficit.

The reforms introduced in the nineties have tightened the link between contributions and benefits, especially for younger workers, and have fostered the lengthening of working careers. They have laid the foundation for developing a pension system made up of two components: a basic, pay-as-you-go public system and supplementary, funded private schemes. This structure, adopted in other western countries, makes it possible to play off the different advantages and risks of pay-as-you-go and funded systems.

Under the rules established by the recent reforms, the two components will give workers with long careers relatively high pensions, with an overall contribution rate on the order of 40 per cent. Assuming that contributions to supplementary pension funds are equal to those currently established for severance pay (possibly topped up with additional tax-exempt contributions) and that funds earn a real net rate of return of 3 per cent, for average working careers and a retirement age of 65 the ratio of total pension benefit to final earnings would be on the order of 100 per cent, a high figure by international standards. This shows there is considerable scope for reducing benefits.

In order to curb the equilibrium contribution rates of the pay-as-you-go schemes in the medium and long term while still ensuring future retirees an adequate standard of living, it will be necessary to develop supplementary pension provision along the lines laid down by the recent reforms and simultaneously raise the age at which workers actually retire. This is estimated to have been around 60 for men and 57 for women in 1995. The 1995 reform will allow workers to retire between ages 57 and 65, with substantial differences in benefits according to the age chosen. It would be appropriate to raise the range of ages at which individuals can choose to retire to a level that takes into account the future age structure of the population; the incentive to delay retirement within that age range could also be increased. According to recent Istat projections, in 2010, when the population aged 65 or over will be equal to 34 per cent of that aged between 20 and 64, the population aged 57 or over will be equal to 61 per cent of that aged between 20 and 56. Raising the retirement age would require substantial changes in the labour market, particularly as regards vocational retraining, flexibility in working hours and labour costs. Broadening the employment base would attenuate the impact of population ageing on the budget as a whole.

Budgetary policy in the medium term

The Economic and Financial Planning Document for 1999-2001 set a path for the gradual reduction of general government net borrowing consistent with the undertaking to achieve a budgetary position close to balance or in surplus entered into with the Stability and Growth Pact. Net borrowing was to fall to 2 per cent of GDP in 1999, 1.5 per cent in 2000 and 1 per cent in 2001. The primary surplus was to remain at the level forecast for 1998 (5.5 per cent of GDP). The public debt was planned to fall from 118.2 per cent of GDP in 1998 to 107 per cent in 2001.

It is to be hoped that the Planning Document for 2000-2002, now being prepared, will follow the same guidelines, notwithstanding the intervening changes in the macroeconomic framework. In particular, the stability of the primary surplus should be pursued, with the savings on interest payments going entirely to reduce the deficit.

Achieving a budgetary position close to balance or in surplus in the medium term will give the Italian public finances fresh scope for counter-cyclical action, especially through the working of automatic stabilizers, without running excessive deficits. It will also lessen the risk of increases in interest rates or other adverse shocks making it necessary to adopt policies that would aggravate these shocks' effects on economic activity.

Deficit reduction should be accompanied by resolute curbs on primary current expenditure so that the fiscal burden can be gradually eased and the recovery in public investment strengthened. The current high ratio of tax and social security contributions to GDP is the source of significant distortions in the allocation of resources that threaten to compromise the Italian economy's growth and competitiveness.

Stability and convergence programmes. - Between June 1998 and February 1999 the euro area countries presented their stability programmes and the other EU countries their convergence programmes. These programmes, many of which extend to 2002, represent the starting-point for the multilateral surveillance mechanism provided for in the EU Treaty and defined in the Stability and Growth Pact. They include the main objectives for the public finances and the underlying macroeconomic assumptions.

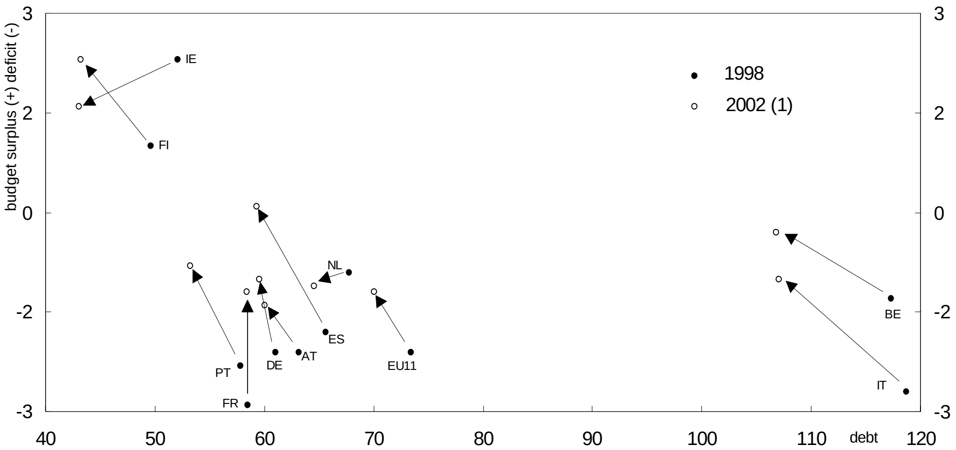
The programmes confirm governments' commitment to deficit reduction in the coming years. If their objectives are achieved, net borrowing for the euro area as a whole will decline from 2.3 per cent of GDP in 1998 (2.1 per cent was the actual outturn, announced after the programmes had been presented) to 1.8 per cent in 1999 and 1.2 per cent in 2001 (Figure 27). For the other EU countries, which, with the exception of Greece, now have budget surpluses, the average surplus will contract from 0.7 per cent of GDP in 1998 (the actual outturn was 0.6 per cent) to 0.4 per cent in 2001. The ratio of general government debt to GDP will fall by more than 3 percentage points over the three years in the euro area and by more than 6 points in the other countries. Carrying out the programmes would bring further convergence of national fiscal conditions: the standard deviation of the budget balances for the countries of the euro area would decline from 1.8 to 1.3 per cent of GDP, while the area's weighted average budget deficit would decline from 1 to 0.4 per cent of GDP.

The reduction in deficits is expected to come largely from the decline in interest payments, reflecting lower average debt-servicing costs and, to a lesser extent, the contraction in debt. The non-interest component of deficit reduction is modest and concentrated in the final years of the planning horizon.

Figure 27

DEBT AND NET BORROWING IN THE EURO AREA: RESULTS FOR 1998 AND STABILITY PROGRAMME OBJECTIVES FOR 2002 (1)

(as a percentage of GDP)



(1) For the euro area, Ireland and Italy, the period ends in 2001. In order to calculate the GDP-weighted average for the euro area, the figures for France and the Netherlands in 2001 were obtained by interpolating and the debt figure for Luxembourg was put equal to the value recorded in 1998 (6.7 per cent of GDP). The forecast figures for France refer to the "prudential" scenario. Luxembourg, which is not shown in the figure, recorded a budget surplus equal to 2.1 per cent of GDP in 1998; the objective for 2002 is 1.7 per cent.

The Council has assessed the adequacy of each national programme, with special reference to the indications of the Stability and Growth Pact, and found that only Denmark, Ireland, Luxembourg and Sweden have objectives that are fully consistent with the Pact. For most of the programmes, the Council expressed a favourable view of the guidelines but stressed the need to set more ambitious goals both in the time span considered and subsequently. In some cases it considered the safety margin for coping with unfavourable shocks to be insufficient. In others, it suggested that the objectives needed to be formulated taking account of adverse factors that already exist, such as the high public debt, or are destined to emerge, such as the ageing of the population.

MONETARY POLICY AND THE MONEY AND FINANCIAL MARKETS

On 1 January 1999 the euro was introduced in eleven member states of the European Union. The Governing Council of the European Central Bank, composed of the governors of the national central banks and the six members of the Executive Board, took over responsibility for the single monetary policy. The primary objective, laid down in the Maastricht Treaty, is to ensure price stability in the area as a whole.

Monetary conditions continued to be eased in Italy in 1998. Against a background of sometimes very rapid growth in the money stock, higher actual and expected inflation than in the other leading countries of the euro area, and domestic and external tensions, the Bank of Italy lowered short-term rates gradually, in order to avoid repercussions on the lira and long-term interest rates during the delicate transition to the euro.

Monetary policy, which constantly strove to modify the behaviour and expectations that tended to perpetuate inflation, made a decisive contribution to ensuring Italy's switch to the single currency.

Despite the major changes in monetary control that accompanied the introduction of the euro, the single money market has rapidly attained a satisfactory degree of efficiency. Italian participants have adjusted to the new environment very smoothly and rapidly.

Developments in 1998

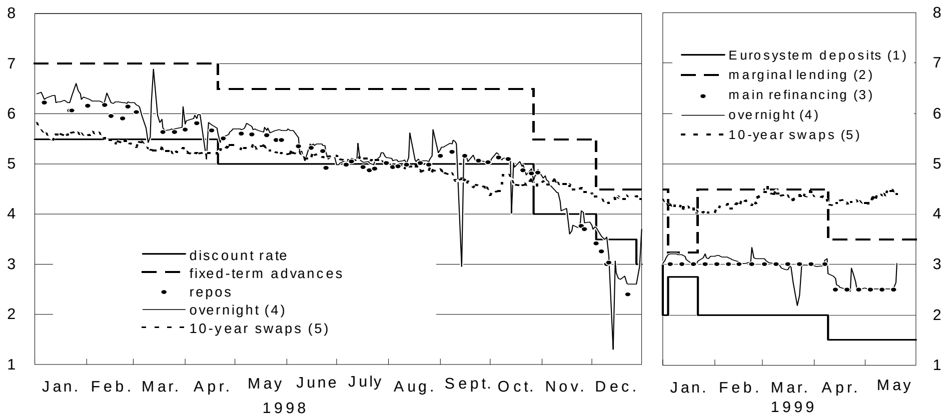
In 1998 the Bank of Italy completed the convergence of short-term lira interest rates towards the level prevailing in the other leading countries of the euro area. The official discount rate was lowered by a total of 2.5 percentage points in four stages (Figure 28). The first reduction of 0.5 points on 21 April brought the rate to 5 per cent, where it was held for the next six months.

The gradualness with which monetary conditions were eased during the year was intended to consolidate market expectations and behaviour consistent with price stability. During the critical period leading up to the introduction of the euro, monetary policy sought to maintain the stability of the lira amidst numerous factors of uncertainty. Expected and actual inflation remained above the average for the euro area. The M2 money supply expanded very rapidly until June, reflecting an acceleration in the reallocation of households' portfolios. The instability that had affected the international financial markets since the end of 1997 worsened with the outbreak of the crisis in Russia, leading to a widening of the differential between long-term rates in lire and marks. In August, the spot and forward exchange rate of the lira came under downward pressure, which was promptly countered. October saw the rise of political tension culminating in the resignation of the Government. As the launch of the single currency approached, the careful timing of the move towards easier monetary conditions sheltered the lira from domestic and external turbulence and prevented a divergence of 1999 expected interest rates from those in the other currencies due to be replaced by the euro, thus avoiding repercussions on economic activity.

Figure 28

OFFICIAL INTEREST RATES AND MONEY AND FINANCIAL MARKET RATES

(daily data and percentages)



(1) Rate on overnight deposits with the Eurosystem. - (2) Rate on the Eurosystem's marginal lending. - (3) Rate on the Eurosystem's main refinancing operations. - (4) Until 31 December 1998, the effective rate on MID transactions; subsequently, the EONIA rate. - (5) Until 31 December, 10-year eurolira interest rate swaps; subsequently, euro swaps.

The discount rate was lowered again on 26 October, to 4 per cent. The subsequent reduction of 0.5 points on 3 December was the first to be coordinated with the other members of the Eurosystem. The final reduction, again by 0.5 points, on 23 December brought the discount rate to 3 per cent, the level at which the first refinancing operations in euros were carried out in January.

In 1998 the 3-month lira interbank rate came down by 2.7 percentage points to 3.2 per cent. The differential with the corresponding German rate narrowed from 2.6 points at the end of January to 1.6 points in August to nil at the end of November, when 3-month rates converged in all the countries of the area. Expected 3-month mark rates in 1999 decreased by about 1.5 percentage points over the year.

The decline in nominal short-term lira rates was accompanied by that in real rates. The moving average of the 3-month interbank rate adjusted for actual inflation over the previous twelve months decreased from 4.5 to 2 per cent; in February 1999 it was about 0.7 percentage points lower than the corresponding average for the four main countries of the euro area, reflecting higher consumer price inflation in Italy.

The fall in money market rates spread to long-term rates, partly owing to the deterioration in the outlook for growth, the massive outflows of capital from the countries gripped by the financial crisis and, more generally, the reallocation of portfolios towards less risky investments. Lira yields also benefited from the decline in inflation, the improvement in the public finances and Italy's participation in monetary union. During the year, the yield on 10-year Treasury bonds fell by 1.6 percentage points to 4 per cent. The differential with the corresponding German securities narrowed from 0.4 points in December 1997 to 0.1 points in December 1998. As in the other countries of the area, the turbulence that buffeted international financial markets in the summer caused a slight, temporary widening. Since the beginning of this year, the differential has held steady at about 0.25 points.

In 1998 monetary base expanded by 8.4 per cent, excluding compulsory reserves released by the gradual reduction of the Italian reserve ratio to the level that would take effect in the third stage of monetary union. The Bank of Italy lowered the ratio to 9 per cent in June, 6 per cent in August and 2.5 per cent in the last maintenance period of the year, which ended on 31 December.

Currency in circulation increased by 7.5 per cent and bank reserves by 9.3 per cent, taking account of the extraordinary factors mentioned above. Monetary base, calculated without adjusting for those factors, contracted by 56.4 trillion lire, reflecting the sharp fall in compulsory reserves (63.9 trillion), which was only partially compensated by the increase of 7.8 trillion in currency in circulation. These changes corresponded to a reduction of 37 trillion lire in the Bank of Italy's net foreign assets, partly the result of not renewing foreign currency repos, and net liquidity absorption of 26.9 trillion by the Treasury, reflecting the redemption of government securities owned by the Bank of Italy.

Until June the M2 money supply grew very rapidly (at a seasonally adjusted annual rate of 13.3 per cent), owing to the rapid increase in its more liquid components: M1 grew by 18.6 per cent over the same period.

The behaviour of the monetary aggregates was affected by the changes in the composition of households' portfolios and the fall in short-term interest rates, which lowered the opportunity cost of holding money. The differential between the average Treasury bill rate and the return on the components of M2, equal to 4.2 percentage points in 1996, narrowed to 3 points in 1997 and to 2.6 in the first half of 1998. The marked slowdown in the aggregates in the second half of the year was a reflection of the gradualness with which monetary conditions were eased and the waning of portfolio reallocation. For the year as a whole M2 grew by 5.8 per cent on the basis of 3-month averages (9.7 per cent in 1997), not far above the target of 5 per cent.

Liquid assets held by the non-state sector contracted by a further 9.5 per cent in 1998 after decreasing by 7.2 per cent the previous year. The decline of 143.7 trillion lire primarily reflected a reduction of 103.7 trillion in Treasury bills, which were purchased mainly by foreign investors.

HOUSEHOLDS AND ENTERPRISES

Against the background of limited growth in disposable income, households' propensity to save declined in 1998 despite the moderate pace of consumption spending; the sector's financial surplus fell from 6.5 to 4 per cent of GDP. There was a sharp acceleration in the reallocation of households' financial portfolios, with increasing use of intermediaries specialized in asset management. At the end of 1998 the sector's financial assets were worth 2.2 times GDP, compared with 2 times GDP a year earlier.

The fall in interest expense as a result of the decline in rates enabled firms to achieve further growth in self-financing, despite the slight decrease in operating profits Although modest, the recovery in capital spending nevertheless could not be financed from internal sources alone; the sector's financial deficit increased from 0.9 to 2.2 per cent of GDP. The expansion in borrowing was concentrated at short term. Italian firms' capitalization, measured as the ratio of equity capital to total liabilities, continued to increase.

The methodology used to construct the financial accounts has been thoroughly revised according to internationally-agreed standards in order to increase the comparability of data from the EU countries. The figures for 1997 and 1998 have been reclassified on the basis of the new definitions of institutional sectors: non-financial corporate and quasi-corporate enterprises now include limited and general partnerships, which were previously classified under the household sector, and sole proprietorships with more than five employees.

The financial balance and debt of households

The decline in households' propensity to save was reflected in a contraction in the sector's financial surplus from 129.2 to 82.3 trillion lire (Table 28). This was accompanied by a massive reallocation of households' financial portfolios, with a continued shift into longer-term assets, achieved mainly by replacing direct investments in securities with managed savings products. The share of foreign assets increased further.

Table 28

FINANCIAL ASSETS AND LIABILITIES OF HOUSEHOLDS (1)

	Stocks				Flows	
	Billions of lire		Percentage composition		Billions of lire	
	Dec. 1997	Dec. 1998	Dec. 1997	Dec. 1998	1997	1998
ASSETS						
Cash and sight deposits	583,443	622,250	14.6	13.7	32,202	38,555
Other deposits	504,661	408,962	12.6	9.0	−91,950	−95,628
bank	*333,864*	*225,697*	*8.4*	*5.0*	*−104,653*	*−108,096*
postal	*170,797*	*183,266*	*4.3*	*4.0*	*12,702*	*12,468*
Short-term securities	203,022	100,340	5.1	2.2	−63,966	−102,574
Medium and long-term securities ..	798,234	689,835	20.0	15.2	44,194	−109,515
government	*515,411*	*374,538*	*12.9*	*8.3*	*−49,923*	*−140,998*
Investment fund units	363,032	712,868	9.1	15.7	143,175	312,761
Shares and other equities	901,019	1,261,767	22.6	27.8	3,081	−9,211
External assets	217,019	263,748	5.4	5.8	33,002	31,439
short-term securities	*3,227*	*3,071*	*0.1*	*0.1*	*−125*	*93*
medium and long-term securities	*100,056*	*110,229*	*2.5*	*2.4*	*21,477*	*16,880*
shares and other equities	*86,118*	*117,314*	*2.2*	*2.6*	*4,019*	*7,154*
invstment fund units	*27,618*	*33,134*	*0.7*	*0.7*	*7,630*	*3,312*
Insurance company provisions for policy claims (2)	422,483	475,337	10.6	10.5	51,951	52,854
Total assets	**3,992,914**	**4,535,107**	**100.0**	**100.0**	**151,689**	**118,681**
as a ratio to GDP	*2.02*	*2.20*				
LIABILITIES						
Short-term loans (3)	78,113	80,508	21.5	20.1	1,889	2,430
bank	*76,376*	*79,398*	*21.0*	*19.8*	*1,042*	*3,057*
Medium and long-term loans (4) ...	251,251	282,555	69.0	70.6	17,919	31,374
bank	*221,660*	*248,412*	*60.9*	*62.1*	*14,360*	*26,789*
Other (5)	34,520	37,118	9.5	9.3	2,691	2,598
Total liabilities	**363,883**	**400,180**	**100.0**	**100.0**	**22,499**	**36,402**
as a ratio to GDP	*0.18*	*0.19*				
Net balance	**3,629,031**	**4,134,927**			**129,189**	**82,279**

Source: Flow-of-funds accounts. See statistical tables a28 and a29.
(1) Includes both consumer households and sole proprietorships. Rounding may cause discrepancies in totals. – (2) Short-term securities, bonds, shares issued by non-residents and units of foreign investment funds. – (3) Includes finance provided by factoring companies. – (4) Includes finance provided by leasing companies, consumer credit from financial companies and sundry minor items. – (5) Insurance companies' technical provisions.

Households reduced their holdings of medium and long-term securities by 109.5 trillion lire, compared with net purchases of 44.2 trillion in 1997. Investment in bank bonds remained considerable, partly reflecting banks' supply policies. Net disposals of short-term securities increased from 64 to 102.6 trillion lire, and the share of these instruments in households' total financial assets consequently fell by more than half, to 2.2 per cent. Savers' altered preferences and the persistence of the effects of the tax changes introduced in 1997 led to a further fall of 108.1 trillion lire in non-sight bank deposits, which include CDs. This was considerably larger than net investment in other instruments issued by banks (sight deposits and bonds).

Including assets held indirectly through investment funds, the overall composition by maturity of households' portfolios shifted markedly towards medium and long-term assets in response to the fall in inflation. The share of short-term instruments fell from 34.4 per cent at the end of 1997 to 28.3 per cent at the end of 1998.

Households also reduced their direct holdings of Italian and foreign shares out of concern over the repercussions of the Russian crisis as well as in connection with the massive shift of funds towards intermediaries specialized in asset management. Net disposals amounted to 2.1 trillion lire, compared with net purchases of 7.1 trillion in 1997; those of Italian shares were especially large, amounting to 9.2 trillion lire.

Italian households concentrated their financial investment in investment fund units. Net purchases came to 312.8 trillion lire, more than double the already substantial figure for 1997 and more than five times that for 1996; the amount is equal to nearly four times the sector's entire financial surplus. The rate of growth eased in the second half of the year with the intensification of the international financial crisis. Households' holdings of investment fund units nearly doubled in value, rising from 9.8 to 16.6 per cent of their financial assets.

There was further large investment in retirement savings products: pension funds and insurance companies' technical provisions, which are largely set aside to meet life policy obligations, recorded a surplus of 52.9 trillion lire in 1998, compared with 52 trillion in 1997.

Direct investment in foreign financial assets remained considerable, at 31.4 trillion lire (33 trillion in 1997). Holdings of foreign assets, consisting mainly of shares and medium and long-term bonds, increased as a proportion of households' portfolios from 5.4 to 5.8 per cent. If shares held via investment funds are included, the proportion of foreign assets rose from 7.9 to 10.9 per cent.

The increase in households' liabilities was appreciably larger than in 1997, rising from 22.5 to 36.4 trillion lire. Bank borrowings recorded especially rapid growth, nearly doubling to 29.8 trillion. An increase in purchases of consumer durables and the recovery in residential investment, which was stimulated by the fall in interest rates and the introduction of tax incentives for building renovations, led to a marked increase in medium and long-term bank borrowings, from 14.4 to 26.8 trillion lire.

Nevertheless, the level of Italian households' bank debt is still low by comparison with that in the other leading industrial countries.

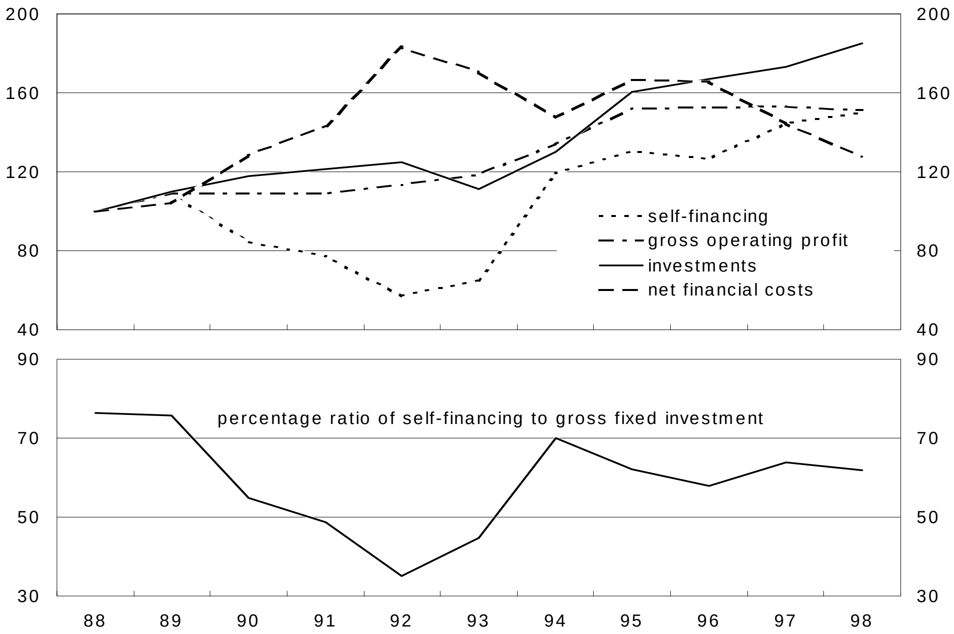
The financing of enterprises and their liquidity

In 1998 the operating margin of non-financial corporate and quasi-corporate enterprises, measured as the ratio of gross operating profit to value added, contracted by half a percentage point to 34.6 per cent. The fall in financial costs associated with lower interest rates led to an increase in self-financing; however, owing to the increase in capital spending, the proportion of investment financed from internal sources declined (Figure 29).

Figure 29

THE BORROWING REQUIREMENT OF FIRMS (1)

(indices, 1988=100)



Sources: Estimates based on Istat and Bank of Italy data. The figures for 1998 are provisional.
(1) Non-financial corporate enterprises.

Firms increased their flow of financial liabilities from 47.9 to 65.7 trillion lire, partly owing to the fall in the cost of borrowing, and reduced their purchases of financial assets from 29.4 to 21.1 trillion; the sector's financial deficit increased from 18.4 to 44.7 trillion lire (Table 29).

Despite the favourable trend of share prices, equity issues by Italian firms decreased from 23.2 to 19.8 trillion lire. Domestic placements fell sharply, from 14.1 to 2.6 trillion, while issues abroad nearly doubled, from 9.1 to 17.2 trillion.

Table 29

FINANCIAL ASSETS AND LIABILITIES OF ENTERPRISES (1)

	Stocks				Flows	
	Billions of lire		Percentage composition		Billions of lire	
	Dec. 1997	Dec. 1998	Dec. 1997	Dec. 1998	1997	1998
ASSETS						
Cash and sight deposits	132,606	138,300	17.3	16.3	6,205	5,003
bank	*126,597*	*138,300*	*16.5*	*16.3*	*7,026*	*11,761*
Other deposits	26,552	19,373	3.5	2.3	6,870	–7,172
bank	*24,887*	*17,668*	*3.3*	*2.1*	*6,814*	*–7,213*
Short-term securities	2,042	1,237	0.3	0.1	–1,325	*–698*
Medium and long-term securities	41,375	40,852	5.4	4.8	–9,202	–1,638
government	*31,175*	*27,172*	*4.1*	*3.2*	*–10,507*	*–4,128*
Shares and other equities	263,427	286,686	34.4	33.9	827	–3,214
Other (2)	44,970	55,550	5.9	6.6	7,926	11,876
External assets	254,040	304,934	33.2	36.0	*18,139*	*16,919*
trade credit receivable	*84,884*	*83,616*	*11.1*	*9.9*	*4,385*	*–1,268*
bonds	*24,010*	*25,894*	*3.1*	*3.1*	*577*	*3,258*
shares and other equities	*130,939*	*174,239*	*17.1*	*20.6*	*10,135*	*6,836*
Total assets	**765,012**	**846,932**	**100.0**	**100.0**	**29,441**	**21,076**
as a percentage of value added	*1.25*	*1.38*				
LIABILITIES						
Domestic liabilities	**1,977,802**	**2,157,759**	**86.8**	**85.1**	**29,971**	**50,326**
Short-term loans (3)	429,823	454,759	18.9	17.9	19,308	25,493
bank	*402,007*	*419,762*	*17.6*	*16.6*	*16,513*	*18,312*
Medium and long-term loans (4)	401,148	413,146	17.6	16.3	–10,652	12,107
bank	*307,599*	*316,770*	*13.5*	*12.5*	*–16,425*	*9,280*
Bonds	30,699	32,780	1.3	1.3	–896	2,081
Shares and other equities	997,417	1,130,306	43.8	44.6	14,100	2,593
Other (5)	118,716	126,768	5.2	5.0	8,111	8,052
External liabilities	**300,396**	**377,634**	**13.2**	**14.9**	**17,906**	**15,423**
trade credit payable	*47,951*	*43,794*	*2.1*	*1.7*	*5,301*	*–4,157*
debt foreign loans	*81,741*	*83,032*	*3.6*	*3.3*	*3,528*	*2,356*
shares and other equities	*170,704*	*250,808*	*7.5*	*9.9*	*9,077*	*17,224*
Total liabilities	**2,278,198**	**2,535,393**	**100.0**	**100.0**	**47,877**	**65,749**
as a percentage of value added	*3.73*	*4.13*				
Net balance	**–1,513,186**	**–1,688,461**			**–18,436**	**–44,673**

Source: Flow-of-funds accounts. See statistical tables a28 and a29.

(1) Non-financial corporate and quasi-corporate enterprises. Rounding may cause discrepancies in totals. – (2) Includes insurance companies' technical provisions and sundry minor items. – (3) Includes finance provided by factoring companies and repo transactions. – (4) Includes finance provided by leasing companies. – (5) Insurance companies' technical provisions including severance pay and pension funds.

The small volume of share issues was accompanied by further change in the ownership structure of Italian firms, a process that began with privatizations and has been sustained by revisions in the rules governing companies listed on regulated markets. The concentration of ownership of listed companies continued to decline in 1998.

Firms' domestic and foreign debt rose by 42 trillion lire in 1998, compared with 11.3 trillion the previous year. Medium and long-term borrowing, which had decreased by 12.5 trillion lire in 1997, increased by 13.1 trillion. Short-term borrowing continued to expand, rising by 28.9 trillion lire, compared with 23.8 trillion in 1997. By comparison, net bond issues totaled only 2.1 trillion lire, confirming the reluctance of Italian firms to make use of debt securities.

Bank credit continues to be the dominant source of debt financing, especially at short term: the share of short-term loans was equal to 56.6 per cent of the total, compared with 56.4 per cent in 1997.

Borrowing from non-residents decreased by 1.8 trillion lire in 1998, compared with an increase of 8.8 trillion in 1997. New short-term borrowing was accompanied by net repayments of longer-term debt, reflecting the limited capacity of Italian companies to place financial instruments in regulated markets abroad.

Corporate leverage, measured as the ratio of financial debt to equity capital, declined from 80.8 to 71.2 per cent. The size of the decrease is primarily attributable to the rise in share prices as well as new share issues.

The contraction in firms' investment in financial assets stemmed mainly from the decline in other bank deposits, which include CDs (net disposals of 7.2 trillion lire, compared with net purchases of 6.8 trillion in 1997). Like households, firms also made substantial net disposals of Italian shares (3.2 trillion lire, compared with net purchases of 800 billion in 1997). By contrast, their investment in shares issued by non-residents remained strong and their overall net purchases of foreign assets were again large, totaling 16.9 trillion lire, compared with 18.1 trillion in 1997.

BANKS AND OTHER CREDIT INTERMEDIARIES

The completion of the Italian economy's convergence created a favourable environment for the growth of credit. The decline in interest rates, larger than the average for the euro area, fueled an expansion in lending and a large increase in income from professional asset management services and securities trading. Thanks to the growth in revenues and the improvement in loan quality, Italian banks were more profitable than in the previous five years.

Table 30

MAIN ITEMS IN BANKS' BALANCE SHEETS (1)

(percentage changes on year-earlier period; billions of lire; end-of-period data)

	1996	1997	1998				March 1999	Balances December 1999
			March	June	Sept.	Dec.		
Assets								
Securities	8.9	−10.5	−10.3	−2.5	0.9	1.1	−0.4	347,123
government securities (2)	*10.8*	*−11.3*	*−13.0*	*−6.3*	*−2.9*	*−2.8*	*−2.5*	*288,088*
Loans (2) (3)	2.4	5.4	6.3	5.1	5.7	6.0	6.2	1,230,406
short-term (4)	*0.9*	*5.5*	*5.9*	*4.9*	*6.0*	*5.7*	*5.4*	*623,879*
medium and long-term (3)	*4.0*	*5.3*	*6.6*	*5.3*	*5.3*	*6.4*	*7.0*	*606,527*
Repos	64.7	−27.8	10.3	6.8	24.3	41.7	16.9	14,788
Bad debts	11.7	−2.5	3.8	5.5	7.2	2.2	1.1	122,629
Estimated realizable value of bad debts	*2.6*	*−4.5*	*−5.5*	*−4.8*	*−0.1*	*−1.0*	*0.5*	*70,192*
External assets (2) (4)	31.0	2.6	11.0	8.4	8.4	7.6	....	372,095
Liabilities								
Domestic funding (5)	6.9	3.0	1.7	2.2	1.1	1.8	1.9	1,373,892
deposits (average data) (6)	*2.9*	*−7.7*	*−6.5*	*−4.0*	*−5.1*	*−1.2*	*0.4*	*829,231*
current accounts	*6.0*	*9.2*	*12.3*	*17.0*	*11.5*	*13.1*	*13.0*	*567,182*
short-term CDs	*12.2*	*27.4*	*12.9*	*1.1*	*−7.9*	*−13.4*	*−18.0*	*74,980*
medium and long-term CDs	*−1.6*	*−49.0*	*−52.3*	*−55.2*	*−52.2*	*−45.3*	*−42.2*	*75,754*
bonds	*30.2*	*34.8*	*29.9*	*26.6*	*20.0*	*15.4*	*11.4*	*436,072*
repos	*−5.5*	*10.6*	*−6.4*	*−15.8*	*−8.2*	*−18.0*	*−17.0*	*108,589*
External liabilities (2) (4)	8.9	5.3	14.2	14.1	12.1	7.9	....	444,576

(1) The figures for March 1999 are provisional. The adjustments described in notes 2 and 3 relate only to the percentage changes. – (2) The foreign currency component is net of exchange rate adjustments.– (3) Net of the effects of the operations concluded in January 1997 between Banco di Napoli and the non-bank collection company SGA. – (4) Source: UIC. – (5) For deposits, monthly averages of daily data; for bonds and repos, end-of-period data. – (6) In lire and the other currencies replaced by the euro; the data are partly estimated.

Bank lending grew by 6 per cent (Table 30), which was higher than the rate of increase in nominal GDP and in line with the result for the euro area. Loans helped to finance the recovery of corporate investment and a substantial volume went to households for purchases of homes and durable consumer goods. Lending grew much more rapidly in the North, but it also picked up in the South, especially to the industrial and services sectors. The difference between the cost of short-term bank credit in the two areas was unchanged at around two percentage points; for medium and long-term loans it is now less than one point.

Banks maintained easy lending policies during the summer, when the strains in the international financial markets kindled fears of a contraction in the availability of credit even in the industrial countries. Overdraft facilities grew faster than the amounts drawn and the spreads between lending rates and market interest rates steadily narrowed. Loans increased as a proportion of total earning assets (Figure 30).

The risk on loan portfolios diminished for all the main customer segments. Loans newly marked down as bad debts decreased from the previous year and the ratio of bad debts to total loans fell from 9.4 to 9.1 per cent.

Domestic fund-raising increased by 1.8 per cent and the bulk was divided between the most liquid instruments and those with the longest maturities. The rapid increase in current account deposits reflected both the fall in their opportunity cost and the desire of households to compensate for the reduction in liquidity connected with the growth in their holdings of asset management products. The increase in net bond issues benefited from a smaller fall in medium and long-term interest rates than in yields on short-term bank liabilities.

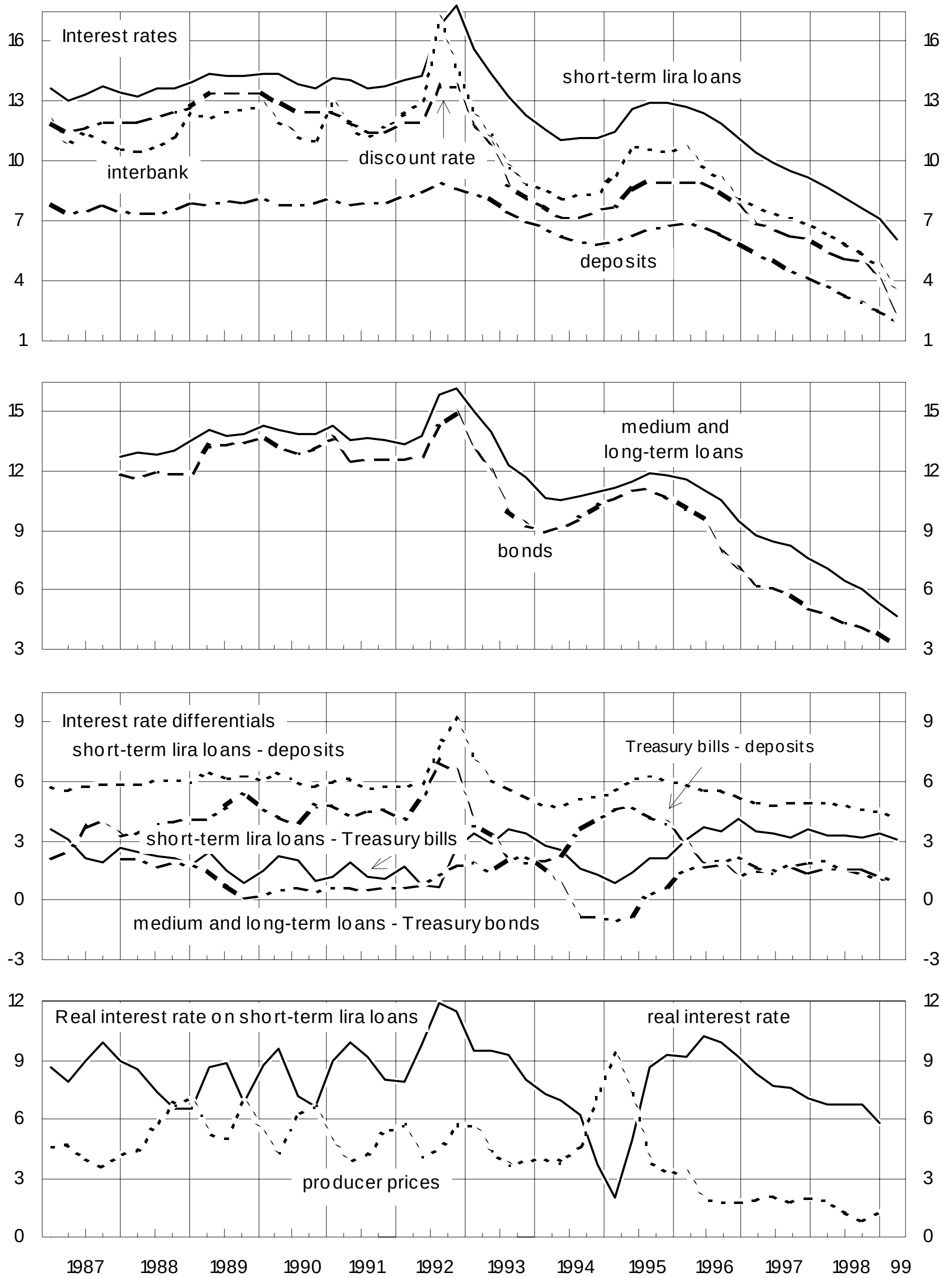
Banks' portfolio management accounts expanded by 24 per cent in value; at the same time, there was an increase of 82.1 per cent in the value of securities deposited for custody with banks by investment funds, whose units continued to be sold largely through bank branches. With the average commissions charged by banks for asset management services remaining stable, the growth in assets under management by investment funds and in individual portfolio management accounts produced a considerable rise in banks' income from services.

Gross income grew by 11.1 per cent despite the further contraction in net interest income. The substantial gains banks realized on securities trading reflected temporary conditions tied to the rapid fall in market interest rates. Operating costs rose by 1.3 per cent. Although the number of staff diminished by 1.7 per cent, staff costs rose by 1.5 per cent as a result of the increase of 2.2 per cent in costs per employee and the additional charges for early severance incentives. Value adjustments to assets decreased by 27.4 per cent; the return on equity rose from 1 per cent in 1997 to 7.4 per cent.

Figure 30

INTEREST RATES AND INTEREST RATE DIFFERENTIALS (1)

(quarterly data; percentages and percentage points)



(1) From January 1999 the discount rate has been replaced by the average rate of return on overnight deposits with the Eurosystem. The rate of return on Treasury bonds refers to bonds with a residual maturity of at least one year traded on the stock exchange.

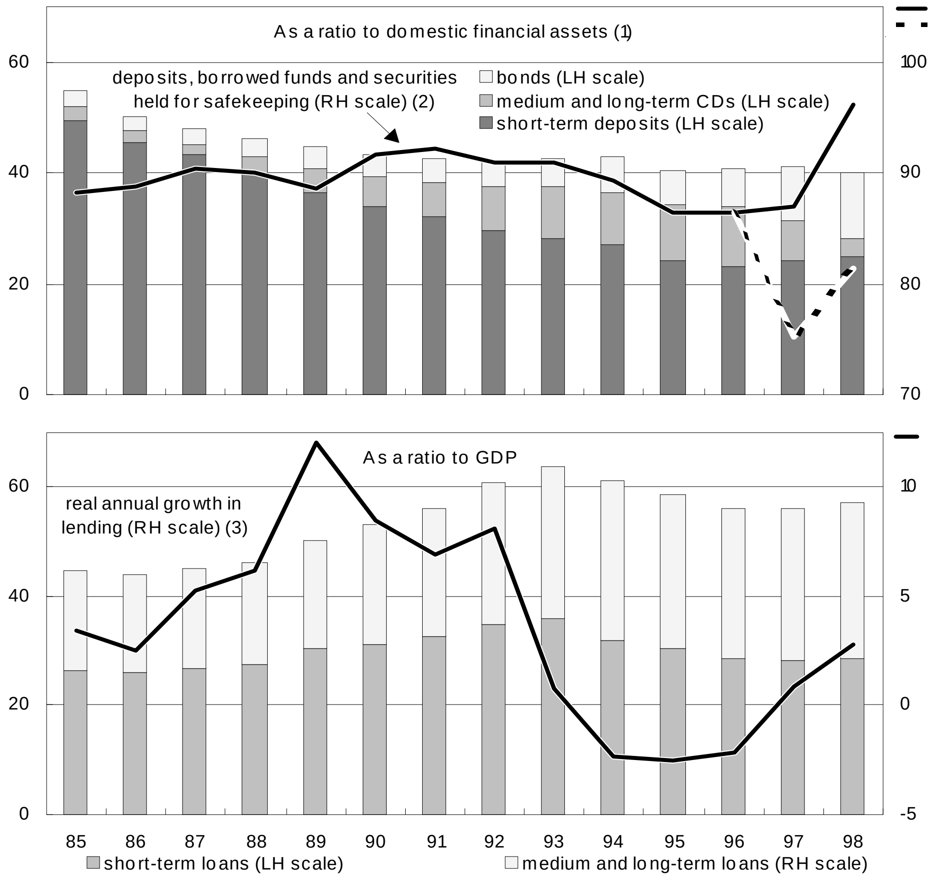
Lending

Net of exchange rate adjustments, bank lending to resident customers increased by 6 per cent last year, compared with 5.4 per cent in 1997, and rose from 56.2 to 57 per cent of GDP (Figure 31). At the end of 1998, 96.5 per cent of all loans were denominated in lire or other euro area currencies (euro loans).

Figure 31

BANKING INDICATORS

(percentages based on average annual data)



(1) Current and savings account deposits, CDs, bonds issued by banks and securities owned by the non-state sector held for safekeeping as a ratio to the domestic financial assets of the non-state sector excluding shares. The securities held for safekeeping are those owned by non-bank customers; they do not include shares, bonds issued by banks, foreign bonds or CDs. - (2) From 1996 onwards, broken line, net of managed savings. - (3) Obtained by applying the GDP deflator to average twelve-month outstanding balances.

Medium and long-term lending expanded steadily and grew by 6.4 per cent (5.3 per cent in 1997); on the other hand, short-term lending increased by 5.7 per cent (5.5 per cent in 1997) but showed wide fluctuations over the year, owing in part to prime customers' cash management transactions.

In the first quarter of 1999 the expansion in bank lending continued at much the same pace: 6.2 per cent on a twelve-month basis for total lending and 5.4 per cent for the short-term component.

Total lending to firms increased by 5.6 per cent in 1998. The growth in lending to the industrial sector fell from 7.3 to 6.2 per cent, mainly owing to the slowdown that occurred in the fourth quarter in conjunction with the sharp downturn in production. Lending to the services sector accelerated, while that to the construction industry remained unchanged after declining sharply in the three previous years.

There was a pronounced rise in lending to consumer households, especially for longer maturities; the total grew by 12.6 per cent and the medium and long-term component by 14.3 per cent. Boosted by the decline in long-term interest rates, disbursements of loans to finance house purchases amounted to 30.1 trillion lire, an increase of 49.2 per cent on 1997.

The fall in bank lending rates was sharper than in the other euro area countries and larger than that in money market yields. The average rate on short-term lira loans and the average minimum rate on loans to firms fell by 2.3 percentage points to 6.7 and 3.8 per cent respectively; the average yield on Treasury bills fell by 2 percentage points. The rates on medium and long-term loans fell even more: by 3.2 percentage points to 6.2 per cent for disbursements of mortgage loans to consumer households and by 2.4 percentage points to 4.5 per cent for new corporate loans. The average real rate on short-term loans, obtained using the index for producer prices, fell to 5.8 per cent in the last quarter of 1998, a decline of 1.3 percentage points on the year-earlier period.

Bank lending rates continued to come down in the first quarter of 1999: the average short-term rate fell by 0.9 percentage points to 5.9 per cent and the minimum rate by 0.6 points to 3.2 per cent. Medium and long-term rates also eased a little, despite the small rise in market yields for longer maturities.

The growth in bad debts slowed from 7.1 per cent in 1997 to 2.2 per cent. At the end of the year they amounted to 122.6 trillion lire and were equal to 9.1 per cent of total loans, down from 9.4 per cent in 1997. The ratio of bad debts to total loans decreased in every branch of economic activity except for the construction industry and sole proprietorships.

The proportion of bad debts covered by specific loan loss provisions rose from 40.9 to 42.8 per cent. The ratio of the estimated realizable value of bad debts to total loans dropped from 6.1 to 5.7 per cent.

The funds provided by consumer credit, factoring and leasing companies increased by 13.7 per cent, as against 17.4 per cent in 1997.

Consumer credit continued to benefit from the demand generated by purchases of motor vehicles and grew by 12.5 per cent, as against 20 per cent in 1997 (Table 31). Finance companies' consumer credit business grew by 21.9 per cent overall and by 27.9 per cent in the South; banks lagged far behind and recorded growth of 4.3 per cent.

Table 31

CONSUMER CREDIT, FACTORING AND LEASING (1)

(end-of-period data; billions of lire and changes on previous year)

	Outstanding 1998 (2)	Percentage changes		
		1996	1997	1998
	Consumer credit			
Total credit	52,670	11.9	20.0	12.5
of which: credit cards	*4,212*	....	*27.8*	*18.7*
Finance companies	26,218	17.0	35.6	21.9
of which: credit cards	*3,412*	....	*30.4*	*18.1*
Banks	26,452	8.0	8.6	4.3
of which: credit cards	*800*	....	*16.1*	*21.6*
	Factoring			
Total credit	46,474	....	....	7.9
Finance companies	43,209	−3.0	21.1	7.7
of which: pro soluto	*15,668*	*−1.5*	*13.2*	*8.0*
Banks	3,265	....	....	10.9
	Leasing			
Total credit	59,578	9.5	6.3	17.1
Finance companies	50,991	11.2	6.6	15.3
Banks	8,587	−1.7	4.3	29.0

(1) Based on supervisory returns – (2) Provisional.

The growth in factoring activity slowed down in 1998. Claims acquired by finance companies rose by 7.7 per cent, as against 21.1 per cent in 1997; those without recourse increased by 8 per cent. The growth in advances was faster and amounted to 10.4 per cent.

The growth in leasing finance, about three quarters of which involves capital goods and buildings, picked up from 6.3 to 17.1 per cent.

The decline in interest rates for consumer credit, factoring and leasing transactions was similar to that in bank lending rates.

Domestic deposits and borrowed funds

Banks' domestic funds grew by 1.8 per cent, after rising by 3 per cent in 1997. For the second successive year the rate of increase was much lower than that in lending.

The growth in current account deposits accelerated again in 1998, from 9.2 to 13.1 per cent, and their share of total resources rose from 37.2 to 41.3 per cent, after reaching a low of 33.1 per cent in August 1996. The acceleration was fueled by the decline in the opportunity costs of such deposits and investors' desire to limit the loss of liquidity resulting from the increase in the proportion of their portfolios consisting of managed savings products, especially shares of mutual funds.

Bank bonds in issue increased by 15.4 per cent, as against 34.8 per cent in 1997; medium and long-term CDs declined by 45.3 per cent. With interest rates falling, customers preferred instruments with longer maturities in order to limit the decline in yields on their portfolios; this enabled banks to offset the effect of the large increase in current accounts and reduce the gap between the durations of their assets and liabilities.

The after-tax differential between the average yield on Treasury bills and the interest rate on current account deposits narrowed from 2 to 1.4 percentage points (Figure 30). The real interest rate on current account deposits, which had been positive since mid-1996, turned negative in August. The average yield at issue for fixed-rate bonds was in line with that for three-year BTPs.

Banks' securities portfolios and net external position

The securities portfolios of banks grew by 3.7 trillion lire in 1998, but declined from 22.8 to 22 per cent of the aggregate including loans. Their holdings of government securities fell by 8.4 trillion lire and from 86.3 to 83 per cent of their investments in securities; their equity investments grew by 18.9 trillion lire, as against 5 trillion in 1997.

In 1998 banks external liabilities rose by 23.8 trillion lire to reach 444.6 trillion; their net indebtedness increased from 71.5 to 72.5 trillion. The balance was virtually unchanged because the deterioration in the net external position in lire and other euro area currencies, from 6.1 trillion of net assets to 0.2 trillion of net liabilities, was largely offset by the fall in net indebtedness in other currencies from 77.6 to 72.3 trillion.

Asset management services

The face value of the securities deposited with banks for safekeeping rose by 19.3 per cent to 2,554.6 trillion lire. Households and firms made greater recourse to institutional investors, especially when acquiring government securities; the resulting contraction of 25.3 per cent in their deposits of such securities was entirely responsible for the decrease of 11.9 per cent in their total deposits.

The securities deposited for custody by Italian securities investment firms and mutual fund management companies increased by 82.1 per cent, while those deriving from portfolios managed directly by banks grew by 24 per cent. Adjusting for the shares of mutual funds in these portfolios, the total value of securities deposited for custody grew by 44.1 per cent.

Profit and loss accounts

Banks reported improved results for 1998, after almost five years of negligible profits (Table 32).

Net interest income fell by 1 trillion lire, or 1.6 per cent, to 2.12 per cent of total assets. The decrease was primarily due to the narrowing of the spread between lending and deposit rates, which was only partially offset by the increase in lending. (Table a20).

The rise in securities prices resulted in trading profits expanding to 9.1 trillion lire, an increase of 1.3 trillion on the already high level recorded in 1997. The growth in asset management business led to income from services expanding by 6.5 trillion to 17.6 trillion. Total non-interest income rose by 10.9 trillion, or 37.5 per cent.

Gross income increased by 11.1 per cent to 99.1 trillion lire, or 3.56 per cent of total assets.

Staff costs rose by 1.5 per cent, total operating costs by 1.3 per cent.

Cost-cutting measures were aimed primarily at reducing staff numbers. At the end of 1998 banks had 312,950 employees, down by 1.8 per cent on 1997 and by 6.7 per cent on the peak recorded in 1993. The contraction was achieved largely by banks offering substantial incentives for workers close to retirement age to depart early. The related cost was 730 billion lire in 1998, up from 610 billion in the previous year. Excluding these extraordinary expenses and adjusting for the changes in the tax regime, the average cost per employee rose by 2.2 per cent.

Table 32

PROFIT AND LOSS ACCOUNTS OF BANKS (1)

	1995	1996	1997	1998	1995	1996	1997	1998
	As a percentage of total assets				**Percentage changes**			
Net interest income (a)	**2.69**	**2.54**	**2.26**	**2.12**	**7.9**	**–1.2**	**–5.4**	**–1.6**
Non-interest income (b)	**0.86**	**1.04**	**1.09**	**1.43**	**–1.2**	**26.9**	**11.5**	**37.5**
of which: securities and foreign exchange trading	*0.25*	*0.38*	*0.29*	*0.33*	*–0.7*	*56.2*	*–17.9*	*16.3*
services	*0.27*	*0.30*	*0.42*	*0.63*	*–6.5*	*16.2*	*46.3*	*58.6*
other financial operations	*0.13*	*0.14*	*0.16*	*0.24*	*8.1*	*8.3*	*21.6*	*58.1*
Gross income (c=a+b)	**3.56**	**3.58**	**3.36**	**3.56**	**5.5**	**5.6**	**–0.5**	**11.1**
Operating expenses (d) (2)	**2.42**	**2.39**	**2.31**	**2.16**	**4.8**	**4.5**	**2.4**	**1.3**
of which: staff costs (2) (3)	*1.54*	*1.54*	*1.44*	*1.32*	*3.0*	*5.9*	*–0.5*	*1.5*
Net income (e=c–d) (2)	**1.14**	**1.19**	**1.05**	**1.40**	**7.1**	**7.8**	**–6.3**	**30.7**
Value adjustments, readjustments and allocations to provisions (f)	**0.78**	**0.69**	**0.72**	**0.50**	**–1.1**	**0.5**	**10.9**	**–27.4**
of which: loan losses	*0.68*	*0.49*	*0.59*	*0.47*	*37.2*	*–18.1*	*29.2*	*–17.0*
Profit before tax (g=e–f) (2)	**0.36**	**0.50**	**0.33**	**0.90**	**30.9**	**19.8**	**–30.1**	**133.2**
Tax (h)	**0.33**	**0.32**	**0.29**	**0.44**	**48.0**	**–0.4**	**–4.7**	**61.7**
Net profit (g–h)	**0.03**	**0.18**	**0.04**	**0.47**	**–47.1**	**86.0**	**–74.7**	**1.042.5**
Dividends	0.14	0.16	0.16	0.27	22.0	19.5	9.9	72.5
	Other data							
	Profit before tax				**Net profit**			
Profit as a percentage of capital and reserves (ROE) (4)	5.4	7.8	5.4	14.1	0.8	3.2	1.0	7.4
	Amounts				**Percentage changes**			
Total assets *(billions of lire)*	2,410,102	2,538,141	2,685,298	2,819,345	1.9	5.3	5.8	5.0
Total number of employees	337.893	331.136	322.583	317.280	–0.3	–2.0	–2.6	–1.6
of which: bank staff	*333,403*	*326,802*	*318,802*	*312,950*	*–0.1*	*–2.0*	*–2.4*	*–1.8*
annual averages (5)	*333,918*	*330,850*	*322,293*	*316,753*	*0.1*	*–0.9*	*–2.6*	*–1.7*
Total assets per employee *(millions of lire)*								
at current prices	7,133	7,665	8,324	8,886	2.2	7.5	8.6	6.7
at constant prices (6)	7,133	7,370	7,846	8,213	–2.8	3.3	6.5	4.7
Bank staff costs per employee (2) *(millions of lire)*								
at current prices (7)	111.4	118.3	118.4	114.2	2.9	6.2	0.0	2.2
at constant prices (6) (7)	111.4	113.8	111.6	105.6	–2.2	2.2	–2.0	0.2

(1) Rounding may cause discrepancies in totals. The data for 1998 are provisional. – (2) The figures for 1998 are only partially comparable with those for 1997 following the suppression of direct contributions to the National Health Service. The percentage changes for 1998 have been adjusted by deducting 6.6 million per employee from the staff costs for 1997. – (3) Comprises wages and salaries, costs in respect of severance pay, social security contributions and sundry bonuses paid to bank staff; the figures for 1997 and 1998 also include the extraordinary costs incurred in connection with early retirement incentive schemes. The number of bank staff is obtained by deducting tax collection staff and staff seconded to other bodies from the total number of employees and adding employees of other bodies on secondment to the banks in the monthly sample. – (4) Profit includes the net income of foreign branches and the change in the provision for general banking risks. – (5) Centred averages of 3-month data. – (6) Deflated using the consumer price index (1995=100). – (7) Excludes the extraordinary costs incurred in connection with early retirement incentive schemes.

Net income increased by 30.7 per cent to 39 trillion lire. The income allocated to make good actual losses or set aside to cover those expected fell from 19.1 to 13.8 trillion, the amount in respect of loan losses decreased by 2.7 trillion.

Net profit rose to 13 trillion lire; when that earned by banks' foreign branches is included, the return on equity was 7.4 per cent.

Italian banks' international activity

In terms of total assets, Italian banks accounted for 10.8 per cent of the banking system of the euro area in 1998; German banks accounted for 37.2 per cent, French banks for 23 per cent and Spanish banks for 6.6 per cent. The ratio of bank assets to GDP was 145 per cent in Italy, as against 189 per cent in Spain, 252 per cent in France, 274 per cent in Germany and 245 per cent in the euro area as a whole.

Three factors of roughly equal importance largely explain Italy's low GDP ratio: compared with the euro area average, in relation to GDP loans to clients are 30 percentage points lower, loans to monetary financial institutions 35 points lower and securities and claims on non-residents 33 per cent lower.

At the end of 1998 Italian banks had 100 branches abroad, 8 fewer than in 1993. In the last five years, 7 branches were closed in the United States and a total of 6 in France, Germany and Spain.

In 1998 there were 59 branches of foreign banks operating in Italy and their share of total assets was about 5 per cent, in line with the equivalent figure for France (5.2 per cent in 1996) and higher than that for Germany (2.8 per cent in 1997). Foreign branches' market shares were larger in Spain and especially the United Kingdom (6.4 and 45.5 per cent respectively in 1997).

Foreign financial institutions have recently acquired significant equity interests in Italian banks. At the end of 1998 they owned more than 10 per cent of the share capital in each of the top five banking groups, which together account for 45 per cent of the total assets of the banking system in Italy.

The banks in the leading euro area countries are much less profitable than their Anglo-Saxon counterparts. In 1997 net profits were 5.3 per cent of capital in Germany and France, 8.5 per cent in Spain, 14.3 per cent in the United States and 18.3 per cent in the United Kingdom.

INSTITUTIONAL INVESTORS

In 1998 net fund-raising by institutional investors as a group - investment funds, portfolio management services, insurance companies and pension funds - totaled 378.6 trillion lire, up 88.6 per cent on the previous year's outstanding result of 200.7 trillion (Table 33). Institutional investors' net assets grew by 45.2 per cent, from 981 to 1,424.7 trillion lire; as a proportion of households' gross financial assets they rose from 24.5 to 31.3 per cent (Table 34).

Table 33

INSTITUTIONAL INVESTORS: NET FUND-RAISING

(billions of lire)

	Net flows				End-of-period stocks			
	1997	1998	Percentage composition		1997	1998	Percentage composition	
			1997	1998			1997	1998
Investment funds (1)	140,417	308,571	51.8	60.6	368,432	720,832	33.8	43.4
Portfolio management services	85,439	145,545	31.5	28.6	375,465	542,205	34.5	32.6
Insurance companies (2) (3)	40,285	44,310	14.8	8.7	240,284	284,594	22.1	17.1
Pension funds (2) (3)	5,181	10,763	1.9	2.1	104,089	114,851	9.6	6.9
Total	**271,322**	**509,189**	**100.0**	**100.0**	**1,088,270**	**1,662,482**	**100.0**	**100.0**
Consolidated Total (4)	**200,726**	**378,602**			**981,032**	**1,424,658**		

(1) Net fund-raising. The figures differ from those in Table 36 because here the dividends distributed each year are subtracted. – (2) Change in technical reserves. – (3) The figure for 1998 is estimated. – (4) Net of flows within the sector.

Growth was sharpest for investment funds, whose share in households' financial assets rose from 9.2 to 15.9 per cent; the insurance sector accounted for a smaller contribution, its share rising from 5 to 5.2 per cent. The share of portfolio management services remained unchanged at 7.7 per cent, net of holdings of investment fund units, and that of pension funds declined slightly, to 2.5 per cent.

By euro area standards, the asset management industry in Italy is of intermediate size in relation to GDP (70 per cent) compared with its counterparts in Germany and Spain (around 60 per cent) and France (more than 90 per cent; Table 35). It still has far to go to catch up with those of the United Kingdom and the United States, where institutional investors play a major role in the financial system.

Table 34

INSTITUTIONAL INVESTORS: NET ASSETS AS A PERCENTAGE OF HOUSEHOLDS' FINANCIAL ASSETS (1)

(end-of-period data)

	1990	1995	1996	1997	1998
Investment funds	2.3	3.8	5.5	9.2	15.9
Portfolio management services (2)	3.2	5.6	7.0	7.7	7.7
Insurance companies (3) (4)	3.7	4.4	4.8	5.0	5.2
Pension funds (4)	0.6	3.0	2.7	2.6	2.5
Total	**9.8**	**16.8**	**20.0**	**24.5**	**31.3**
Memorandum items:					
Households' financial assets (billions of lire)	2,295,583	3,347,503	3,603,156	3,992,914	4,535,107

(1) The data are net of holdings within the sector. – (2) Net of investment fund units. – (3) Technical reserves, excluding securities entrusted to portfolio management services. – (4) The figure for 1998 is estimated.

Despite the pronounced volatility of securities prices, institutional investors lengthened the duration of their portfolios somewhat, mainly by shifting from short-term paper into medium and long-term bonds and only to a limited extent by increasing their exposure to equities. The proportion of longer-dated bonds was increased with a diversification across international markets, particularly those in the euro area. As the launch date for the single currency approached, however, there was an attenuation of the general trend towards international diversification of portfolios, which had been very intense in the first half of the year.

The range of investment fund products supplied to customers continued to expand, notably funds specializing in foreign shares and euro-area bonds, as did that of portfolio management services investing in investment fund units. The pre-eminence of bank-controlled institutional investors was confirmed.

Investment funds and portfolio management services again achieved broadly similar rates of return, after adjustment for the larger proportion of short-term bonds and the smaller proportion of shares in the latter's portfolios.

Investment funds' net subscriptions in the first few months of 1999 remained at the high levels of the previous year. Fund managers showed a renewed propensity to spread portfolios geographically, especially outside the euro area.

Table 35

PERCENTAGE COMPOSITION OF INSTITUTIONAL INVESTORS' PORTFOLIOS IN THE MAIN EUROPEAN COUNTRIES AND THE UNITED STATES (1)

(1997 data unless otherwise indicated)

	Italy (2)	Germany	France (3)	Spain (4)	Nether-lands	UK (5)	US
Bonds	**78**	**64**	**66**	**52**	**46**	**17**	**40**
of which: held by investment funds (6)	*70*	*57*	*68*	*49*	*29*	*6*	*53*
of which: foreign bonds (7)	*26*	*25*	*15*	*11*	*31*	*11*	....
Shares	**15**	**29**	**32**	**9**	**48**	**77**	**57**
of which: held by investment funds (6)	*22*	*36*	*31*	*7*	*52*	*90*	*43*
of which: foreign shares (8)	*52*	*37*	*32*	*24*	*81*	*41*	....
Deposits and cash	**7**	**7**	**2**	**39**	**6**	**6**	**3**
of which: held by investment funds (6)	*8*	*7*	*1*	*44*	*19*	*4*	*4*
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**
of which: invested in external assets (6)	*30*	*28*	*20*	*7*	*51*	*38*	....
Memorandum item: Net assets as a percentage of GDP	70	59	93	58	197	174	197
	Percentage shares of institutional investors' total net assets						
Securities investment funds	51	40	42	60	10	14	26
Insurance companies	17	55	58	37	35	46	21
Pension funds	8	5	..	3	54	40	36
Other	24	..	..	..	1	..	17
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Sources: OECD and Bank of Italy.
(1) Aggregate portfolios of the leading institutional investors of each country. – (2) 1998 data; net assets are calculated on a consolidated basis for the sector. – (3) For investment funds, partly estimated; for casualty insurance companies, 1996 data. – (4) The figure for insurance companies includes the assets of autonomous pension funds. – (5) 1996 data. – (6) As a proportion of investment funds' total assets. – (7) Foreign bonds as a proportion of total bonds held by investment funds. – (8) Foreign shares as a proportion of total shares held by investment funds.

Securities investment funds

Securities investment funds recorded unprecedented growth in net subscriptions, which rose from 143.4 to 313.1 trillion lire (Table 36). The net inflow of resources was equal to 85 per cent of the assets under management at the start of the year. In contrast with 1997, equity funds' share in net subscriptions contracted (by 6 percentage points, to 15 per cent). Bond funds and balanced funds benefited equally from this shift, which increased their shares in net subscriptions to 78 and 7 per cent respectively. Around two thirds of all net subscriptions went to funds specializing in government securities and Italian bonds. The proportion going to funds specializing in foreign securities diminished slightly, to 30 per cent. There are marked differences in the latter's shares according to segment: it is 82 per cent among equity funds (77 per cent in 1997), but far smaller among balanced and bond funds, amounting to 27 and 20 per cent respectively (34 and 18 per cent in 1997).

Table 36

ITALIAN INVESTMENT FUNDS: SECURITIES PORTFOLIO

(billions of lire and percentages; in brackets, millions of euros)

	1997	1998	January-March 1999 (1)	1997	1998	March 1999 (1)
	Net flows			End-of-period stocks *(percentage composition)*		
Italian government securities and bonds	**69,630**	**174,063**	**–9,212** ***(–4,758)***	**60.4**	**56.4**	**50.2**
Short-term and floating rate	–3,365	48,446	–5,233 *(–2,703)*	17.4	16.0	13.8
Treasury bills	–10,929	13,559	–5,370 *(–2,773)*	4.7	4.5	3.3
Treasury credit certificates	7,564	34,887	137 *(71)*	12.7	11.5	10.5
Medium and long-term	72,995	125,617	–3,979 *(–2,055)*	43.0	40.5	36.3
Zero-coupon Treasury credit certificates	41,071	2,101	–3,561 *(–1,839)*	19.0	10.2	7.9
Treasury bonds	29,429	122,414	5,932 *(3,064)*	21.9	29.0	27.3
Other	2,495	1,102	–6,350 *(–3,280)*	2.1	1.2	1.2
Italian shares	**6,362**	**17,648**	**–3,256** ***(–1,682)***	**11.9**	**11.5**	**10.0**
Foreign securities	**55,326**	**122,100**	**76,942** ***(39,737)***	**27.7**	**32.1**	**39.8**
Bonds	35,331	80,366	35,208 *(18,183)*	15.9	19.5	26.1
Shares	19,995	41,734	16,015 *(8,271)*	11.8	12.6	13.7
Other financial assets	**–805**	**8**	**256** ***(132)***	**. .**	**. .**	**0.1**
Total	**130,513**	**313,819**	**64,730** ***(33,430)***	**100.0**	**100.0**	**100.0**
Memorandum items:						
Net fund-raising	**143,377**	**313,085**	**81,543** ***(42,113)***			
Bond funds	106,778	244,059	73,909 *(38,171)*			
Balances funds	6,331	21,304	5,616 *(2,901)*			
Equity funds	30,268	47,722	2,017 *(1,042)*			
Securities portfolio				**330,683**	**666,864**	**731,594** ***(377,837)***

(1) Provisional.

The trend of fund-raising during the year was influenced by the turbulence in the international markets and negatively affected by the sudden increase in the volatility of securities prices and exchange rates. Net subscriptions fell significantly in the fourth quarter, to 38.6 trillion lire, compared with an average of 91.5 trillion in the first three quarters.

In the first quarter of 1999, with share prices rising again and showing diminished volatility in the main markets, investment funds' net subscriptions rose back to near the high levels of the previous year, amounting to 81.5 trillion lire, compared with 103.7 trillion in the first quarter of 1998.

Funds' net assets nearly doubled, rising to 720.8 trillion lire, comprising 666.9 trillion in securities and 54 trillion in liquidity. New subscriptions accounted for nearly 90 per cent of the increase. The contribution of the rise in securities prices was modest except among equity funds, where it approached 30 per cent. Measured by net assets, the market share of funds specializing in Italian securities declined by more than 4 percentage points, to 75 per cent; the fall was concentrated in the bond segment.

Investment funds' average rate of return fell by 2.4 percentage points, to 9.4 per cent (Table 37). The decline was significantly smaller than that in the weighted average of the returns on direct investment in the securities included in the benchmark indices. The average shortfall of funds' rates of return with respect to those of the benchmarks narrowed by 2.6 percentage points, to 3.3 points. The contraction was considerably larger than this for equity funds, exceeding 11 percentage points, while for bond funds it came to just 1 point.

There were again marked differences in funds' rates of return even in the same segment. A contributory factor in the case of equity funds was the very strong performance of the Italian stock market; in that of bond funds, the fall in the securities of some developing countries. Thanks to the rise in the main stock exchanges, equity and balanced funds recorded average rates of return of 22.2 and 18.1 per cent respectively, compared with 30.3 and 24.8 per cent in 1997; bond funds returned 5.2 per cent, compared with 6.6 per cent the previous year (Table 37). In the equity segment, funds investing prevalently in Italian shares returned an average of 34 per cent, compared with 11 per cent for those investing prevalently in foreign shares. In the bond segment, the gap was modest (1.5 percentage points).

The total direct and indirect charges borne by investors in funds, consisting largely of entry, exit and management fees, amounted to 9.2 trillion lire, double the total for 1997. The increase occurred both in management fees and in front and back-end sales charges. The former were boosted by the growth in net assets and by incentive fees tied to fund performance, the latter by the surge in gross subscriptions, which rose by 343.75 trillion lire to a total of 630.1 trillion.

Table 37

RATES OF RETURN OF INVESTMENT FUNDS AND ALTERNATIVE INVESTMENTS (1)

(percentages)

	Investment funds (1)				Alternative investments					
	Share-based	Balanced	Bond-based	Total	Italian shares (2)	Foreign shares (3)	Treasury bonds (4)	Treasury credit certificates (4)	Treasury bills (5)	Foreign bonds (6)
1990	−13.3	−8.0	10.5	−3.5	−23.2	−26.1	12.1	14.2	11.2	−0.8
1991	7.5	7.3	11.6	9.9	0.8	19.3	13.6	13.2	11.2	17.6
1992	5.2	3.9	11.3	8.3	−7.8	22.8	9.8	10.4	11.1	35.9
1993 . . .	37.1	32.8	19.9	25.4	46.4	42.6	25.0	17.3	12.1	29.8
1994	−3.6	−1.2	−1.3	−2.4	2.2	−0.9	−0.8	7.4	7.4	−4.0
1995	1.3	3.9	10.4	6.8	−2.1	18.2	15.6	11.3	9.0	16.5
1996	8.4	9.5	9.4	9.3	16.9	8.5	19.2	9.9	8.9	−0.9
1997	30.3	24.8	6.6	11.8	59.5	34.2	11.4	6.1	5.7	18.1
1998	22.2	18.1	5.2	9.4	41.6	16.8	10.4	5.3	4.3	7.0

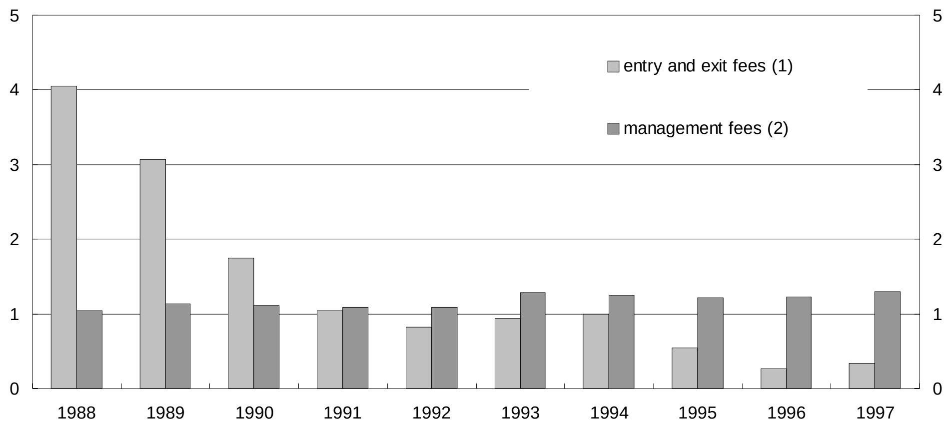
(1) Includes open-end investment companies (SICAVs). – (2) Index of total returns of shares listed on the Italian stock exchange; includes dividends. – (3) Percentage changes in Morgan Stanley index of world stock markets; includes dividends, net of withholding tax; adjusted for exchange rate changes. – (4) Percentage change in index of total return, net of the 12.5 per cent withholding tax, based on prices on the Italian stock exchange. – (5) Issue yield on 1-year bills, net of the 12.5 per cent withholding tax, on 1 January. – (6) Changes in J.P. Morgan index of world bond markets, excluding Italy; adjusted for exchange rate changes.

In the period 1988-1997 management and incentive fees rose from 1.04 to 1.3 per cent of net assets, while sales charges fell from 4.05 to 0.34 per cent of gross subscriptions, primarily as a consequence of the growing popularity of no-load funds. A contributory factor was the spread of investment switches between funds operated by the same management company, which are made at modest cost to the investor (Figure 32).

Figure 32

ITALIAN SECURITIES INVESTMENT FUNDS ENTRY, EXIT AND MANAGEMENT FEES

(percentages)



(1) In relation to gross fund-raising. - (2) In relation to net assets.

The international diversification of funds' securities portfolios changed substantially in 1998. The share of lira-dominated bonds and government securities diminished by 5.7 percentage points, from 64.2 to 58.5 per cent. The fall was largely offset by the rise in the proportion of bonds denominated in foreign currencies, including those replaced by the euro. Almost half of the latter increase was attributable to the growth in holdings of euro area securities, which rose from 2.4 to 5.2 per cent of the total portfolio (Table 38). The change in the geographic composition of equities was smaller: the proportion of foreign shares rose by 0.8 percentage points, to 12.6 per cent of the total portfolio, as a result of the growth in holdings of euro area issues. The proportion of Italian shares diminished by 0.5 percentage points, to 11.4 per cent.

Net purchases of foreign securities totaled a substantial 122.1 trillion lire, more than twice as much as in 1997; around one third of the net investment was in euro area securities.

Table 38

ITALIAN INVESTMENT FUNDS: SECURITIES PORTFOLIO

(end-of-period market values; stocks in billions of lire)

	Securities									
	Bonds and government securities						Shares			Total (1)
	Italian issuers				Foreign issuers	Total	Italian issuers	Foreign issuers	Total	
	Public sector	Banks	Firms	Total						
	Lira securities									
1997 .	195,390	3,268	888	199,546	12,697	212,243	39,409	. .	39,409	251,652
1998 .	369,121	5,391	996	375,508	14,453	389,961	76,325	. .	76,325	466,286
	Euro area currency securities (2)									
1997 .	1,010	5	. .	1,015	6,844	7,859	. .	7,784	7,784	15,643
1998 .	671	12	329	1,012	33,842	34,854	. .	22,743	22,743	57,597
	Non-euro area currency securities (3)									
1997 .	2,901	23	. .	2,924	29,113	32,037	. .	31,190	31,190	63,227
1998 .	5,851	420	. .	6,271	75,170	81,441	. .	61,325	61,325	142,766
	Total portfolio									
1997 .	199,301	3,296	888	203,485	48,654	252,139	39,409	38,974	78,383	330,522
1998 .	375,643	5,823	1,325	382,791	123,465	506,256	76,325	84,068	160,393	666,649

(1) The difference vis-à-vis the total reported in Table 36 is due to the inclusion there of the item "Other financial assets". – (2) Excluding lira securities.

Portfolio management services and securities firms

The value of the assets entrusted to the portfolio management divisions of banks and securities firms rose to 542.2 trillion lire at the end of the year, an increase of 166.7 trillion, or 44 per cent, on 1997. Banks directly controlled 68 per cent of the sector's net assets.

As with investment funds, the increase came mainly from the flow of fresh funds, which totaled 145.5 trillion lire, compared with 85.4 trillion in 1997 (Table 39). Fund-raising was fueled by the rapid spread of investment-fund-based products, whose share in the sector's total portfolio expanded from 19.2 to 37.2 per cent.

Table 39

ITALIAN PORTFOLIO MANAGEMENT SERVICES: SECURITIES PORTFOLIO
(billions of lire)

	1997	1998 (1)	1996	1997	1998 (1)
	Net flows		End-of-period stocks *(percentage composition)*		
Italian government securities and bonds	**22,273**	**14,963**	**81.3**	**65.3**	**48.8**
Short-term and floating rate	–21,558	–8,148	43.0	23.8	14.6
Treasury bills	–7,763	1,666	7.3	2.9	2.3
Treasury credit certificates	–13,795	–9,814	35.7	20.9	12.3
Medium and long-term	43,831	23,111	38.3	41.5	34.1
Zero-coupon Treasury credit certificates	26,703	–6,342	5.2	11.2	6.4
Treasury bonds	16,837	30,586	23.8	24.0	23.8
Other	291	–1,133	9.2	6.3	3.9
Italian shares	**6,018**	**2,897**	**4.8**	**5.9**	**5.2**
Italian investment fund units	**46,141**	**94,851**	**3.4**	**18.1**	**34.6**
Foreign securities	**11,551**	**16,676**	**8.8**	**10.5**	**11.4**
Bonds	7,309	8,009	7.0	7.7	7.1
Shares	1,610	2,910	1.5	1.7	1.7
Investment fund units	2,632	5,757	0.3	1.1	2.6
Other financial assets	**–24**	**259**	**1.8**	**0.2**	**0.1**
Total	**85,959**	**129,646**	**100.0**	**100.0**	**100.0**
Memorandum items:					
Net fund-raising	**85,439**	**145,545**			
Banks	55,142	100,685			
Securities firms	30,297	44,860			
Securities portfolio			**244,082**	**350,685**	**514,088**

(1) Provisional.

The high proportion of investment fund units in total assets and the lack of complete information on the types of funds held make it impossible to reconstruct the composition of portfolio management services' holdings with certainty. On the assumption that the composition of the fund units in their holdings is in line with the average of Italian investment funds, equities held either directly or indirectly would account for some 11 per cent of managed portfolios, which is less than half of the proportion of equities in investment funds' portfolios.

After deducting net inflows of funds, the increase in the net assets of portfolio management services, which approximates the financial return to investors on the assumption that coupons are fully reinvested, came to 6.2 per cent, compared with 9.7 per cent in 1997. The yield gap compared with the average for investment funds (3.2 percentage points, against 2.1 the previous year) mainly reflects the lower propensity for risk implicit in the composition of managed portfolios, which are more heavily weighted towards short-term instruments and have a smaller proportion of shares. As in 1997, the result conceals differences in performance between securities firms and banks: the average rate of return of the former declined from 14.2 to 10.2 per cent; that of the latter decreased by less, from 8 to 4.6 per cent. The better average return of securities firms reflects the composition of their portfolios, which contain a higher proportion of fixed rate securities and shares than those managed by banks.

The spread of investment-fund-based products led to substantial net purchases of fund units, which rose from 48.8 to 100.6 trillion lire. Evaluating the geographic diversification of investments raises the same difficulties mentioned above. Assuming again that the composition of the funds held in managed portfolios coincides with that of Italian investment funds as a whole, the share of foreign securities directly or indirectly held in managed portfolios can be estimated to have increased by 6 percentage points to 20 per cent; bonds accounted for around 4 points of the growth.

Taking into account the fall of 0.7 percentage points in the share of Italian equities, the proportion of Italian and foreign equities, directly or indirectly held, in managed portfolios rose by 1.5 percentage points. The consequent decline in the proportion of bonds was accompanied by a change in the maturity composition: there was a contraction of 9.4 points in the proportion of short-term and floating rate lira-denominated securities (14.1 points including zero-coupon Treasury certificates as well as Treasury bills and Treasury credit certificates), partly offset by net purchases of medium and long-term foreign securities. As a result, the duration of managed portfolios lengthened in the course of the year.

Insurance companies and pension funds

Insurance companies. - Insurance companies' premium income amounted to 48.4 trillion lire in the casualty sector and 51.8 trillion in the life sector (Table 40). The rate of growth in premium income accelerated from 20.3 to 23 per cent overall, thanks to the pick-up in the casualty sector, where it increased from 6.7 to 8.9 per cent. In the life sector, the growth in premium income remained at the high levels of the previous year, touching 40 per cent. The strong expansion mainly reflected the policies offering yield-linked benefits, the insurance product most resembling investment funds and managed portfolios. A major contribution came from the increasing popularity of policies whose value is indexed to the performance of markets, equity markets above all. The role of the banks in the distribution of life policies expanded from just over 30 to 39 per cent of the total.

Table 40

INSURANCE COMPANIES: ASSETS AND LIABILITIES

(end-of-period balance sheet values in billions of lire)

	Assets						Liabilities		*Memorandum items* premium income (4)
	Deposits and cash (1)	Securities (1)	Loans & annuities (2)	Real estate	Other net assets	Total (1)	Technical reserves (3)	Net worth	
	Life sector								
1995	2,734	112,354	1,583	12,217	3,961	132,849	108,912	23,937	23,225
1996	2,012	137,856	1,808	10,319	4,226	156,221	130,890	25,331	26,063
1997	2,849	170,707	1,948	10,177	6,349	192,030	165,017	27,013	36,986
1998 (5) . .	2,943	214,762	1,886	5,011	13,679	238,281	202,360	35,921	51,759
	Casualty sector								
1995	3,047	58,043	188	12,210	8,752	82,240	61,315	20,925	39,594
1996	3,045	62,816	626	13,063	11,192	90,742	69,109	21,633	41,650
1997	2,929	66,634	1,603	13,183	14,301	98,650	75,267	23,383	44,450
1998 (5) . .	3,067	74,630	878	12,475	15,819	106,869	82,234	24,635	48,421
	Total								
1995	5,781	170,397	1,771	24,427	12,713	215,089	170,227	44,862	62,819
1996	5,057	200,672	2,434	23,382	15,418	246,963	199,999	46,964	67,713
1997	5,778	237,341	3,551	23,360	20,650	290,680	240,284	50,396	81,436
1998 (5) . .	6,010	289,392	2,764	17,486	29,498	345,150	284,594	60,556	100,180

(1) In lire and foreign currency; excluding securities entrusted to portfolio management services. Some securities are valued at cost, others at market. – (2) Net of corresponding liabilities. – (3) Excluding reinsurance. – (4) Italian direct insurance; includes premium income of offices in other EU countries. – (5) Partly estimated.

Total technical reserves rose from 240.3 to 284.6 trillion lire. Insurance companies' total assets increased from 290.7 to 345.2 trillion, mostly as a result of the growth in their securities portfolios, which amounted to 289.4 trillion at the end of the year. The decline of more than 5 trillion lire in real estate assets reflected divestiture by a leading life insurance company, which spun off its real estate holdings to a newly formed property company that was subsequently listed on the stock exchange.

The changes in the composition of insurance companies' securities portfolios partly coincided with those in the portfolios of other institutional investors. Like investment funds, insurance companies reduced the proportion of government securities in their portfolios by nearly 5 percentage points, to 52 per cent. The drop was most pronounced for short-term securities and floating rate paper, Treasury credit certificates in particular. By contrast, the proportion of bonds rose by 2 percentage points to over 17 per cent. The combined share of Italian and foreign equities remained virtually unchanged at 18 per cent. The overall duration of companies' portfolios lengthened slightly. Unlike investment funds, insurance companies only slightly increased the share of foreign securities in their portfolios - by 1 point, to 18 per cent (Table 41).

Table 41

INSURANCE COMPANIES: SECURITIES PORTFOLIO (1)
(end-of-period balance sheet values in billions of lire)

	Lira securities					Foreign currency securities		Investment fund units	Total
	Govern-ment securities	Bonds	Total bonds and government securities	Shares (2)	Total		*of which: shares* (2)		
					Life sector				
1995 ...	73,258	16,581	89,839	8,780	98,619	12,807	6,131	928	112,354
1996 ...	89,917	18,747	108,664	10,514	119,178	18,144	6,609	534	137,856
1997 ...	102,747	25,151	127,898	15,588	143,486	25,684	8,658	1,537	170,707
1998 (3)	118,502	35,742	154,244	21,479	175,723	35,316	9,998	3,723	214,762
					Casualty sector				
1995 ...	26,105	10,053	36,158	9,883	46,041	11,819	6,117	183	58,043
1996 ...	29,179	9,258	38,437	10,928	49,365	13,225	7,361	226	62,816
1997 ...	31,431	9,016	40,447	11,761	52,208	13,977	7,169	449	66,634
1998 (3)	31,522	11,400	42,922	14,420	57,342	16,374	7,366	914	74,630
					Total				
1995 ...	99,363	26,634	125,997	18,663	144,660	24,626	12,248	1,111	170,397
1996 ...	119,096	28,005	147,101	21,442	168,543	31,369	13,970	760	200,672
1997 ...	134,178	34,167	168,345	27,349	195,694	39,661	15,827	1,986	237,341
1998 (3)	150,024	47,142	197,166	35,899	233,065	51,690	17,364	4,637	289,392

(1) Including securities entrusted to portfolio management services. Since 1996 Eurolira securities are included in lira securities. – (2) Including equity participations. – (3) Partly estimated.

Pension funds. - The total assets of non-INPS pension funds and banks' supplementary funds - the intermediaries for which complete data are available - rose by nearly 10.8 trillion lire to stand at 114.9 trillion lire at the end of the year (Table 42). Non-INPS funds contributed most of the increase. The share of pension funds in households' gross financial assets diminished slightly, to 2.5 per cent.

Table 42

PENSION FUNDS: MAIN ASSETS (1)

(end-of-period balance sheet values in billions of lire)

	1996			1997			1998 (2)		
	Non-INPS funds	Credit sector funds	Total	Non-INPS funds	Credit sector funds	Total	Non-INPS funds	Credit sector funds	Total
Cash and deposits	13,147	2,106	15,253	14,168	1,272	15,440	15,268	971	16,239
Government securities	11,075	13,916	24,991	11,182	11,523	22,705	10,813	13,389	24,202
Corporate bonds .	2,006	1,902	3,908	2,147	1,593	3,740	2,920	1,536	4,456
Shares	472	1,982	2,454	589	1,942	2,531	872	2,278	3,149
Foreign currency securities	. .	932	932	38	1,500	1,538	38	1,992	2,030
Loans and other financial assets	10,882	1,603	12,485	11,876	2,649	14,525	12,961	2,726	15,687
Real estate	34,008	4,876	38,884	38,851	4,759	43,610	44,384	4,704	49,088
Total assets	**71,590**	**27,317**	**98,907**	**78,851**	**25,238**	**104,089**	**87,256**	**27,596**	**114,851**

(1) Provisional.

Financial assets and real estate contributed in almost equal measure to the growth in the funds' assets. There were marginal changes in the composition of securities portfolios; the proportion of government securities and lira bonds decreased slightly, to the benefit of shares and foreign currency securities.

THE SECURITIES MARKETS

Medium and long-term interest rates continued to fall rapidly last year, with the yield on 10-year Treasury bonds (BTPs) reaching a historic low of 3.9 per cent in the second half of December. The gradualness with which monetary conditions were eased and the consolidation of expectations of price stability fostered a further reduction in the already small differential between BTPs and Bunds. The narrowing of the yield gap was momentarily interrupted only in the periods of greatest tension in the international markets.

The Treasury increased the volume of net issues of government securities and intensified its policy of lengthening their maturity. Very large placements of 10 and 30-year BTPs brought the average residual maturity of the debt into line with that of the other main countries of the euro area. The volume of new issues of bank and corporate bonds decreased in 1998 and the first four months of this year.

Households continued to reduce their direct holdings of government securities and turned increasingly to institutional investors, above all investment funds. Foreign investors' demand grew further, shifting to securities of shorter duration.

The decline in real interest rates contributed to a significant rise in share prices, which was larger than that recorded in the main international markets, and the ratio of market capitalization to GDP approached the level in Germany. Owing to the rise in prices in 1998, the earnings ratio and dividend yield for the market as a whole declined compared with the end of 1997 and were also lower than in the other European markets. The upward movement of prices was not unchecked during the year; in the second half the financial crisis in Russia precipitated a flight from high-risk investments that spread to the equity markets of the main industrial countries, which registered sharp corrections and a large increase in volatility.

The launch of the single currency has considerably reduced the segmentation of the European financial markets and accelerated the integration that was already under way. In the spot and forward bond markets, the standardization of listed securities increased, with beneficial effects on the markets' depth and ability to attract international investors, accompanied by an intensification of competition among financial centres. The most significant development is the recent launch of EuroMts, the electronic market in the benchmark government securities of the euro area countries. In the equity markets, where national features remain important, integration among financial centres has proceeded more gradually.

Government securities and corporate bonds

Supply and demand. - Net issues of government securities rose from 18.7 trillion lire in 1997 to 39.7 trillion last year. Net bond issues by banks fell to 57.7 trillion, while those by firms, already small in 1997, turned negative. Accordingly, total net issues contracted from 117.9 to 97.3 trillion lire (Table 43).

The Treasury, helped by the fall in long-term interest rates, continued to lengthen the maturity of the debt. There were net redemptions of Treasury bills and CCTs amounting to 35.5 and 42.1 trillion lire, respectively. Net issues of BTPs rose by 80.8 trillion to 149.3 trillion; 10 and 30-year bonds again comprised the largest share, accounting for respectively 49 and 27 per cent of the total. In the case of CTZs, the Treasury renewed the amount falling due, with net issues of 6.6 trillion. Thanks to the lengthening of the average maturity of securities issued in recent years, the increase in net issues was accompanied by a decrease in gross issues, which fell from 880.3 to 846.6 trillion lire.

In 1998 the average residual maturity of the debt rose from 54 to 59 months, attaining a level comparable to that of France and Germany and surpassing that of Spain. The duration increased even more, from 25 to 32 months, as a result of the replacement of floating rate by fixed rate securities. The lengthening of maturities gained pace in the first four months of 1999, the average residual maturity reaching 63 months (Figure 33).

Net issues by the Treasury in the international market were almost halved, falling to 3.5 trillion lire; in order to enhance their liquidity, issues were made in tranches, as for lira securities. On 1 January 1999 the share of net issues in foreign currency, which had been 4.9 per cent of the total, was reduced by around one percentage point when bonds issued in the currencies replaced by the euro were redenominated.

There was a slowdown in the replacement of longer-term CDs with bank bonds, which had begun following the increase in the taxation of the former in 1996. Net issues of bank bonds declined from 97.2 trillion lire in 1997 to 57.7 trillion last year.

Table 43

BONDS AND GOVERNMENT SECURITIES: ISSUES AND STOCKS (1)

(billions of lire, in brackets, millions of euros)

	Gross issues			Net issues			Stocks (2)		
	1997	1998	Jan.-Apr. 1999 (3)	1997	1998	Jan.-Apr. 1999 (3)	1997	1998	April 1999 (3)
Public sector	**880,328**	**846,572**	**364,001**	**18,678**	**39,749**	**34,631**	**2,063,728**	**2,101,787**	**2,142,213**
			(187,991)			***(17,885)***			***(1,106,361)***
Treasury bills . . .	506,000	425,768	150,545	−82,310	−35,482	−2,072	302,250	266,768	264,697
			(77,750)			*(−1,070)*			*(136,705)*
Zero-coupon Treasury certificates	105,905	97,779	45,319	41,484	6,598	8,889	158,771	171,973	183,025
			(23,405)			*(4,591)*			*(94,525)*
Treasury credit certificates (4) .	64,404	42,502	18,399	7,982	−42,097	−22,716	567,875	525,403	502,519
			(9,502)			*(−11,732)*			*(259,529)*
Treasury bonds .	190,596	261,441	138,099	68,590	149,343	75,085	766,988	908,508	981,292
			(71,322)			*(38,778)*			*(506,795)*
Ecu Treasury credit certificates	0	0	0	−4,354	−12,448	−10,165	37,632	25,220	15,030
			(0)			*(−5,250)*			*(7,762)*
Republic of Italy issues	12,481	17,949	11,339	6,291	3,454	−6,729	99,396	102,717	102,115
			(5,856)			*(−3,475)*			*(52,738)*
Other	942	1,133	300	−19,004	−29,619	−7,661	130,816	101,198	93,535
			(155)			*(−3,957)*			*(48,307)*
Banks	**148,240**	**135,981**	**25,918**	**97,228**	**57,728**	**5,560**	**377,743**	**436,072**	**441,708**
			(13,386)			***(2,871)***			***(228,123)***
Firms	**7,186**	**1,734**	**290**	**2,023**	**−140**	**91**	**33,583**	**33,443**	**33,534**
			(150)			***(47)***			***(17,319)***
Total . . .	**1,035,754**	**984,287**	**390,209**	**117,929**	**97,337**	**40,282**	**2,475,054**	**2,571,302**	**2,617,455**
			(201,526)			***(20,803)***			***(1,351,803)***
	percentage composition (5)								
Public sector	**85.0**	**86.0**	**93.3**	**15.8**	**40.8**	**86.0**	**83.4**	**81.7**	**81.8**
Treasury bills . . .	57.5	50.3	41.4	−440.7	−89.3	−6.0	14.6	12.7	12.4
Zero-coupon Treasury certificates	12.0	11.5	12.5	222.1	16.6	25.7	7.7	8.2	8.5
Treasury credit certificates (4) .	7.3	5.0	5.1	42.7	−105.9	−65.6	27.5	25.0	23.5
Treasury bonds .	21.7	30.9	37.9	367.2	375.7	216.8	37.2	43.2	45.8
Ecu Treasury credit certificates	0.0	0.0	0.0	−23.3	−31.3	−29.4	1.8	1.2	0.7
Republic of Italy issues	1.4	2.1	3.1	33.7	8.7	−19.4	4.8	4.9	4.8
Other	0.1	0.1	0.1	−101.7	−74.5	−22.1	6.3	4.8	4.4
Banks	**14.3**	**13.8**	**6.6**	**82.4**	**59.3**	**13,8**	**15.2**	**17,0**	**16.9**
Firms	**0.7**	**0.2**	**0.1**	**1.8**	**−0.1**	**0.2**	**1.4**	**1.3**	**1.3**
Total . . .	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100,0**	**100.0**
As a percentage of GDP	*53.4*	*48.6*	*56.9*	*6.1*	*4.8*	*5.9*	*127.6*	*127.0*	*125.7*

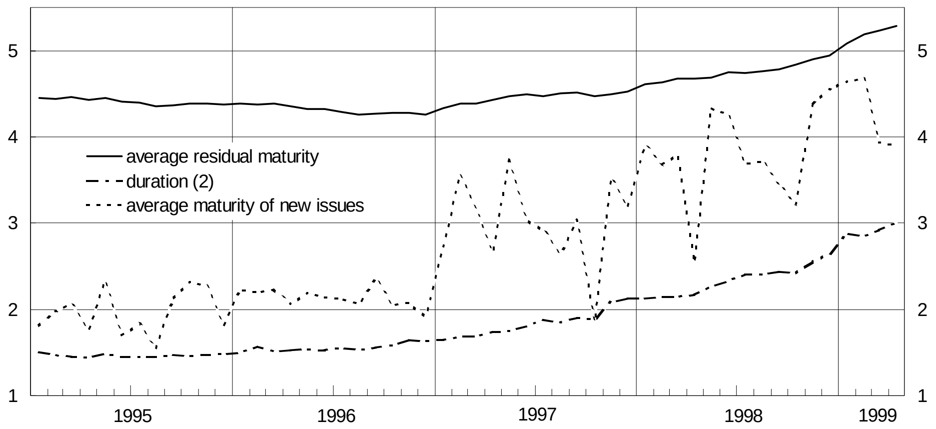
(1) Comprises Italian government securities and the lira issues of other issuers on the Italian market; excludes certificates of deposit. Rounding may cause discrepancies in totals. – (2) End-of-period face value. – (3) Provisional. – (4) Includes only variable-coupon certificates. – (5) The percentages shown for the various types of government security are ratios to the total of public sector securities.

Gross Eurolira market issues, including convertible bonds, contracted to 52 trillion lire. In line with Euromark and Eurofranc issues, they gradually decreased during the year owing in part to the fall in issues by the emerging countries in response to the rise in yields following the financial crisis in Russia. The reduction in issues denominated in the individual currencies was offset by the greater volume of issues in euros. These surged at the start of this year and amounted to 117 billion euros (225 trillion lire) in the first quarter.

Figure 33

AVERAGE MATURITY AND DURATION OF GOVERNMENT SECURITIES

(years)



(1) Of securities listed on MTS.

In Italy, the fall in interest rates was associated with very large net disposals of government securities amounting to 263.5 trillion by "other investors", primarily households (Table 44). However, these disposals were accompanied by a sharp increase in indirect demand via investment funds, the principal buyers of government paper, which made net purchases of 174 trillion lire, prevalently BTPs. There were further net disposals of government securities by the banks, albeit less than in 1997 (7.2 compared with 38.7 trillion lire). Foreign investors made net purchases of 151.9 trillion and altered the composition of their demand: whereas in 1997 they had concentrated on BTPs (82 per cent of the total), betting on the convergence of long-term interest rates, in 1998 they mainly preferred short-term or floating rate securities (67 per cent), which offered more attractive yields than those prevailing in the rest of the euro area on account of the gradualness with which monetary conditions were eased in Italy.

Table 44

NET PURCHASES AND STOCKS OF SECURITIES (1)

	Public sector						Corporate bonds	Total corporate bonds and government securities	Listed shares
	Treasury bills	Zero-coupon Treasury certificates	Treasury credit certificates	Treasury bonds	Other (2)	Total			
					Net purchases *(billions of lire)*				
1997									
BI-UIC	12,642	–1,409	–10,686	–10,967	–2,523	–12,943	–142	–13,085	360
Banks	–22,738	–975	2,603	–13,111	–4,435	–38,656	–17	–38,673	1,876
Insurance companies	–859	670	–14,458	30,907	–1,108	15,152	1,226	16,378	7,632
Investment funds	–10,929	42,201	7,564	29,429	1,572	69,837	1,586	71,423	6,166
Non-resident (3)	7,947	7,803	1,092	83,907	2,129	102,879	. .	102,879	16,028
Other (4)	–68,373	–6,806	21,867	–51,575	–12,703	–117,591	96,598	–20,993	–25,814
Total	**–82,310**	**41,484**	**7,982**	**68,590**	**–17,068**	**18,678**	**99,251**	**117,929**	**6,248**
1998									
BI-UIC	–14,136	487	4,436	–20,473	–745	–30,431	–61	–30,492	421
Banks	13,033	1,596	–16,576	–2,319	–2,889	–7,155	11,017	3,862	353
Insurance companies	1,045	–60	–3,189	17,144	–6	14,934	9,990	24,924	9,169
Investment funds	13,559	2,101	34,887	122,414	1,041	174,002	2,172	176,174	16,709
Non-resident (3)	52,909	22,239	49,572	23,712	3,422	151,855	. .	151,855	24,883
Other (4)	–101,892	–19,765	–111,227	8,865	–39,436	–263,456	34,470	–228,986	-37,784
Total	**–35,482**	**6,598**	**–42,097**	**149,343**	**–38,613**	**39,749**	**57,588**	**97,337**	**13,751**
					Stocks *(percentage composition)*				
December 1998									
BI-UIC	0.1	0.5	2.3	3.4	33.3	5.7	0.1	4.7	1.3
Banks	17.5	12.5	24.9	8.9	4.6	13.8	12.9	13.7	0.7
Insurance companies	0.5	2.1	6.3	10.4	1.5	6.4	7.7	6.7	3.9
Investment funds	11.4	41.8	14.4	19.3	2.5	17.1	1.6	14.3	8.3
Non-resident (3)	32.1	14.4	23.9	34.9	53.9	32.2	. .	26.3	11.5
Other (4)	38.4	28.7	28.2	23.1	4.2	24.8	77.7	34.3	74.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Total (billions of lire)	**266,768**	**171,973**	**525,403**	**908,508**	**229,018**	**2,101,787**	**469,515**	**2,571,302**	**931,472**

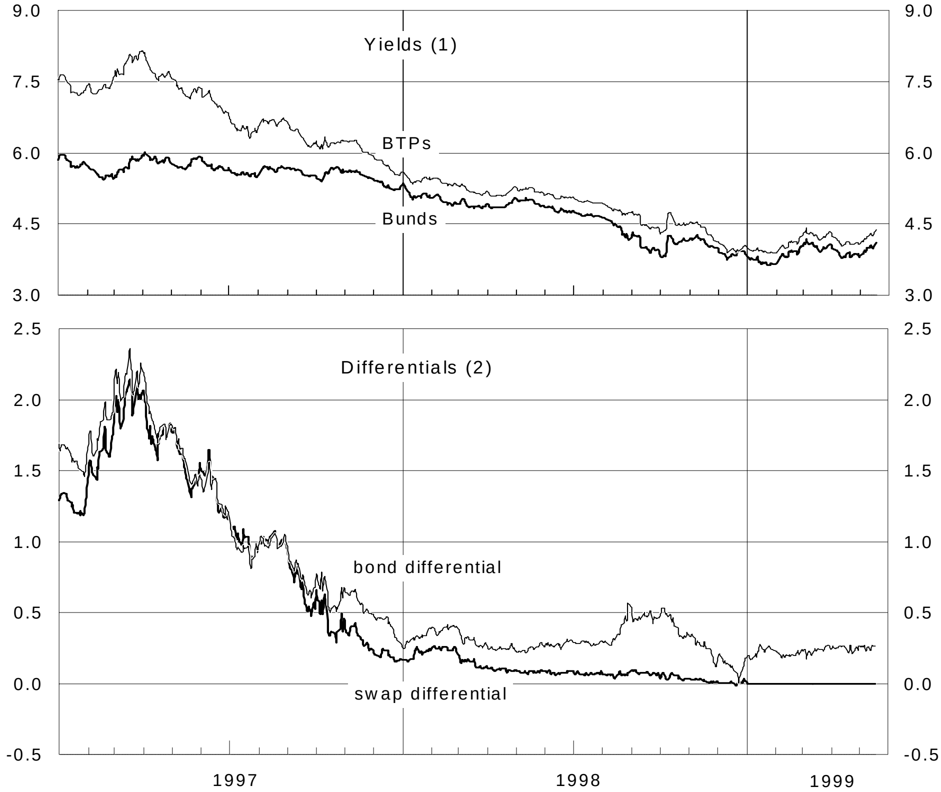
(1) Net purchases are valued at market prices. The composition of the holdings of stocks of government securities and corporate bonds is based on face values; that of shareholdings on market prices. – (2) Includes Republic of Italy issues, the composition of which is partly estimated. – (3) Treasury credit certificates include both floating and fixed rate credit certificates issued by the Treasury. – (4) Households, enterprises, social security institutions, the Deposits and Loans Fund, and Italian investment firms; the data on shares are partly estimated.

Interest rates. - There was a further pronounced fall in medium and long-term yields in 1998; that on 10-year BTPs came down from 5.6 per cent in December 1997 to a low of 3.9 per cent a year later (Figure 34). The downward trend, fostered by convergence towards the single currency and the consolidation of expectations of price stability, was paralleled by similar developments in the United States and in the other European countries, stemming in part from the financial crises in Asia and Russia.

Figure 34

GROSS 10-YEAR YIELDS IN LIRE AND MARKS

(daily data; percentages and percentage points)



(1) Source: BIS. Yields on benchmark 10-year securities. - (2) Difference between the 10-year yield in lire and that in marks.

The decline in interest rates was gradual in the first seven months of the year, but gathered pace in August and September, when the Russian crisis sparked a flight to quality from the emerging countries to those with more stable financial systems and from equities into bonds. After pausing briefly in October, rates came down again and reached 3.9 per cent in the second half of December. In the subsequent months the yields on 10-year securities turned upwards as fears of European and global recession receded. At the end of April they stood at 4.1 per cent.

The yield curve, which at the beginning of 1998 had a downward slope for maturities up to 2 years and a slightly upward slope for longer ones, shifted gradually as monetary conditions were eased; at the beginning of 1999 it was steeper and upward-sloping across the entire maturity spectrum.

The differential between the yields on 10-year BTPs and Bunds, equal to 0.4 percentage points in December 1997, narrowed slightly in the first few months of 1998 to stabilize at around 0.3 points until the summer. It temporarily widened to 0.5 per cent in August following the financial crisis in Russia. This increase, paralleled by developments in other European countries, was amplified by temporary mismatches between securities demand and supply caused by the rapid shift of capital towards less risky financial assets. From October onwards the easier conditions in international markets led to the yield differential narrowing to 0.1 percentage points in December. It subsequently widened again and stabilized at an average of 0.2 points in the first four months of 1999.

The secondary market. - Average daily turnover in the screen-based secondary market for government securities (MTS), which had risen uninterruptedly since the market's inception in 1988, fell by 39 per cent last year to 24.9 trillion lire. The decline, which was particularly sharp in the first six months, reflected the diminished importance of the turnover requirements intermediaries must meet in order to qualify as specialist dealers and the narrower differential between the yields on Italian and other euro area government securities. In addition, some participants may have shifted a portion of their business from the spot market to the new market in repurchase agreements. The largest declines in turnover occurred for BOTs and CCTs, down by 48 and 53 per cent respectively, although the average stock of listed securities increased by 10 per cent for the former and decreased by barely 3 per cent for the latter. Trading in BTPs benefited from the very large volume of new issues and remained substantial, with average daily turnover amounting to 17 trillion, a decrease of 33 per cent.

The government securities of the countries participating in the monetary union were converted into euros from 1 January of this year, *inter alia* with a view to increasing their fungibility. The contraction in volume on MTS seems to have come to a halt during the first quarter, when average daily turnover was down by just 1 per cent from the previous quarter. The largest declines during this period were again recorded by short-term and floating rate securities.

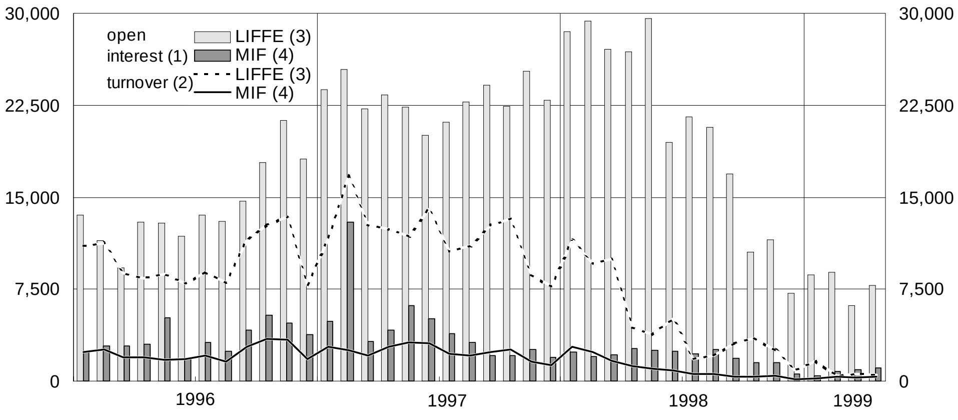
The trend in trading on the regulated market in government securities repos, which began in December 1997, was the mirror image of that on the spot market. Average daily turnover, already high in the second half of 1998 (19.4 trillion lire), rose further to 33 trillion in the first four months of this year.

On 29 March trading started on EuroMts, the European market in benchmark government securities set up by MTS S.p.A. together with a group of dealers active in the European bond markets. The market uses the same electronic trading platform as MTS and is based on market makers committed to quoting 8 securities each with narrow bid-ask spreads. At the end of April 46 issues were listed (19 German, 15 Italian and 12 French); the government securities of other euro area countries may be listed provided they meet certain requirements as to liquidity and amount outstanding (at least 5 billion euros). Although the market has been fully operational only since 9 April, average daily turnover in the first month of trading amounted to 2 billion euros, with the German, Italian and French securities accounting for 47, 24 and 29 per cent respectively.

Interest rate derivatives markets. - The outlook for the euro, with the increase in the correlation between the rates of return on Italian and European securities, played a part in reducing average daily turnover in futures on 10-year BTPs on LIFFE from 11.9 trillion lire in 1997 to 4.8 trillion last year, with a particularly marked decline from June onwards (Figure 35). Trading in futures on BTPs was also down sharply on MIF, where average daily turnover fell from 2.4 to 1 trillion. MIF’s share of the combined volume of the two markets was basically unchanged at 17 per cent. The higher volatility in 1998 of the differential between Italian short-term interest rates and the average rates prevailing in the euro area attenuated the fall in LIFFE’s average daily turnover in 3-month Eurolira futures, which contracted from 51.3 to 41.3 trillion.

Figure 35

FUTURES MARKETS: TURNOVER AND OPEN INTEREST
(billions of lire)



(1) End-of-period figures. - (2) Average daily figures. - (3) 10-year BTPs. - (4) 5, 10 and 30-year BTPs.

The equity market

Supply and demand. - The stock market's capitalization rose by 56 per cent to 931 trillion lire, or 45 per cent of GDP, thanks principally to the rise in share prices (Table 45), since the supply of new shares was limited. Gross issues by listed companies totaled 13.8 trillion lire, or 0.7 per cent of GDP, in line with the average for the five preceding years.

Table 45

MAIN INDICATORS OF THE ITALIAN STOCK EXCHANGE

	1994	1995	1996	1997	1998
Number of listed companies (1)	223	221	217	213	223
Total market capitalization (billions of lire) (1)	293,566	325,568	386,157	598,809	931,472
as a percentage of GDP	*17.9*	*18.4*	*20.6*	*30.7*	*45.3*
percentage breakdown:					
industry	*25*	*33*	*34*	*31*	*24*
insurance	*23*	*20*	*15*	*15*	*16*
banking	*18*	*17*	*15*	*19*	*27*
finance	*8*	*5*	*4*	*4*	*3*
services	*26*	*25*	*32*	*31*	*30*
Gross issues (billions of lire)	12,982	8,515	5,506	6,248	13,751
Market capitalization of newly listed companies (billions of lire) (2)	26,388	64,411	14,886	12,731	42,060
Distributed dividends (billions of lire)	5,105	6,180	9,786	12,112	13,601
Earnings/price ratio (percentages) (3)	4.6	5.8	6.3	4.6	3.8
Dividends/price ratio (percentages)	1.6	1.7	2.2	1.6	1.2
Turnover (billions of lire):					
stock exchange	*190,009*	*140,341*	*156,521*	*337,071*	*818,878*
futures	*4,543*	*166,838*	*400,951*	*919,010*	*1,889,174*
options	–	*1,697*	*71,457*	*242,073*	*517,274*
Annual change in prices (4)	3.3	–6.9	13.1	58.2	41.0

(1) At end-of-period. – (2) At the placement date. – (3) Source: Datastream. – (4) Percentage changes in the Mib index.

During the year there were 16 new listings, excluding two foreign companies, two spin-offs of listed companies and four companies that migrated from the second market. The value of new listings amounted to 15 trillion lire, or 0.7 per cent of GDP, compared with an average of 0.9 per cent in the five preceding years.

Public offerings raised 23 trillion lire, of which 17.6 trillion from the privatization of BNL and AEM and the sale of the fourth tranche of ENI shares.

Although a total of 67 companies have gone public since 1995, the number of listed companies has remained the same. Most of the delistings were of shares with a small float or those of companies involved in mergers or acquisitions.

The integration of equity markets induced by the introduction of the euro will probably proceed more slowly than that of the bond markets, since equity returns depend largely on the outlook for individual companies' earnings. There would appear to be two possible scenarios: in the first there would be a pan-European equity market for major companies' shares and in the second a plurality of markets with links for specific functions.

At the start of May 1999 Borsa Italiana S.p.A. established the New Market, the regulated market reserved for innovative small companies with high growth potential. Trading will presumably commence during the summer. To be listed, a company must have shareholders' equity of at least 2.5 billion lire and a minimum float of 20 per cent of total capital. For each listed security, a specialist dealer will ensure a liquid market. The market is part of the Euro.NM circuit, which now comprises Amsterdam, Brussels, Frankfurt and Paris and involved 207 companies at the end of April. The Euro.NM circuit has recorded higher turnover in 1999 than Easdaq, the other European market for small innovative companies, and it could assist venture capital activity in Europe and become an important channel of financing for smaller companies. The average index of Euro.NM share prices rose by 134 per cent in 1998 and by 19 per cent in the first four months of this year.

Net purchases of listed shares by investment funds, banks and foreign investors amounted to 17.9, 3.2 and 9.5 trillion lire respectively in the first six months of 1998. During the second half of the year, fears of a worsening of the international crisis triggered disposals aimed at realizing the substantial gains accumulated earlier in the year. Banks and investment funds made net disposals of 2.8 and 1.2 trillion lire respectively. On the other hand, foreign investors made further net purchases of 15.4 trillion, bringing their total for the year to 24.9 trillion (compared with 16 trillion in 1997; Table 44). Unlike the other sectors, households and enterprises made net disposals of equities amounting to 20.2 trillion lire for the year.

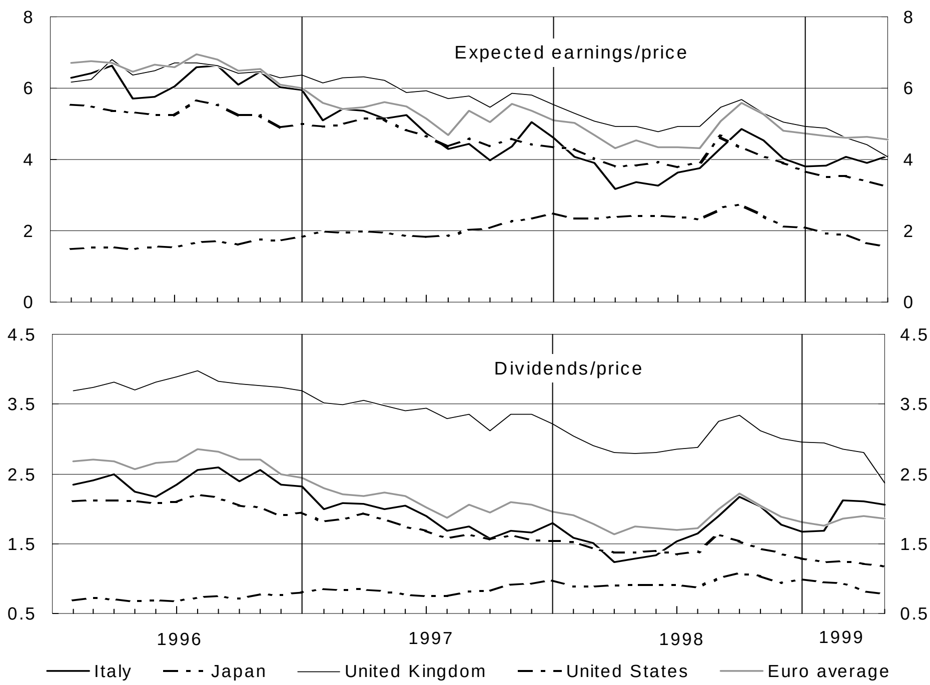
Share prices and turnover. - The share price index rose by 41 per cent, compared with 58 per cent in 1997 (Table 45). The Italian stock exchange's gain was larger than the average for the euro area (30 per cent) and the main industrial countries.

In the early months of the year the rise in prices, fueled by the results for 1997 and expectations of a reduction in real interest rates, brought the expected earnings/price ratio and the dividend yield to levels that were low both historically and by international standards (3.2 and 1.2 per cent respectively at the end of March; Figure 36). The sharp correction in April was followed by a period of particularly high and persistent volatility in Italy, with peaks of 40 per cent on an annualized basis, as against 25 per cent in France and Germany and less than 15 per cent in the United Kingdom and the United States (Figure 37). It was not until July that volatility in Italy subsided to near the average levels of the other markets. In August, the Russian crisis dealt a fresh blow to investors' confidence. Italian share prices retreated by 34 per cent between the second half of July and the start of October and the volatility of returns rose to a peak of 48 per cent, this time in line with developments in the leading markets.

Figure 36

PRICE RATIOS OF EXPECTED EARNINGS AND DIVIDENDS IN SELECTED COUNTRIES

(percentages)

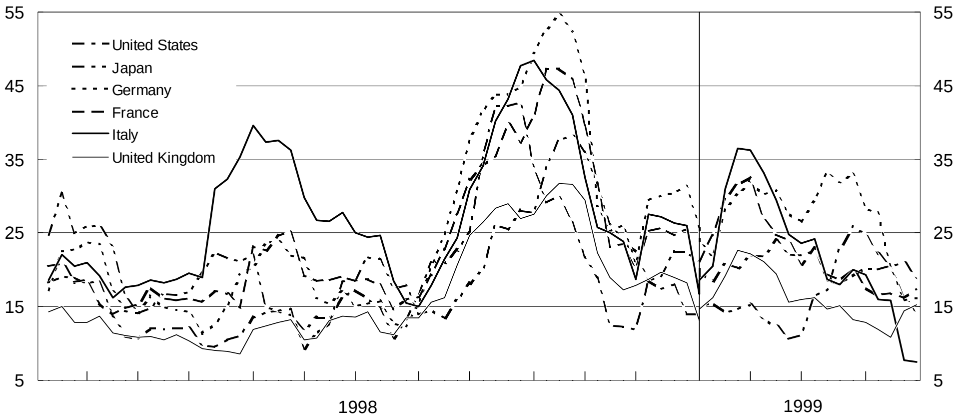


Source: Datastream.

From the beginning of October until the end of the year, the rapid decline in volatility fostered a sharp recovery in Italian share prices, which rose by 39 per cent, compared with an average gain of 35 per cent in the countries of the euro area. The expected earnings/price ratio, which had reached 4.9 per cent in September, fell back to 3.8 per cent by the end of the year, in line with the level prevailing in the United States and lower than that of the other main countries with the exception of Japan; the differential between the ratio and long-term interest rates narrowed from 2.4 to 1.5 percentage points, signaling the combination of a reduction in the equity risk premium demanded by investors and a further upward revision of expected corporate earnings, in contrast with the fears of a slowdown in economic activity and the pronounced volatility of share prices.

Figure 37

VOLATILITY OF SHARE PRICES
ON THE MAIN INTERNATIONAL STOCK EXCHANGES (1)
(percentages)



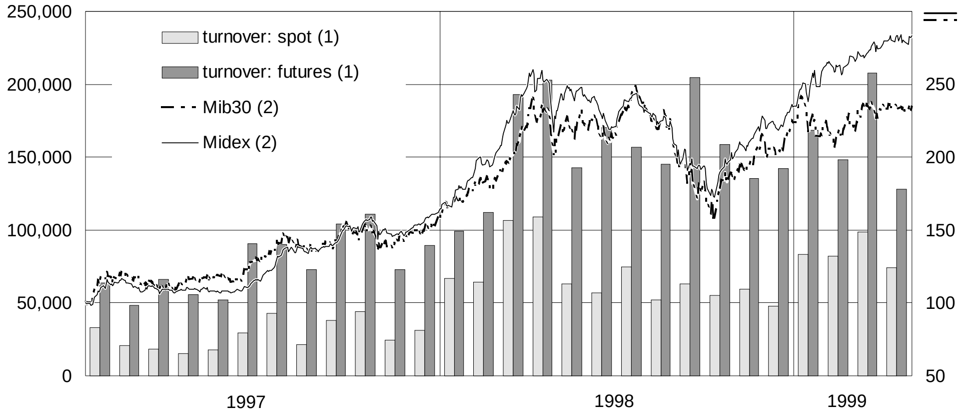
(1) Standard deviation of the last 21 daily returns of the price indices; annualized data.

In the first four months of 1999 the deterioration in the short-term economic outlook led to high volatility coupled with a price rise of 5.7 per cent.

Turnover grew by 143 per cent and the annual total rose from 69 per cent of market capitalization in 1997 to 99 per cent. This ratio is higher than those recorded in France, the Netherlands and the United States, but remains well below those of the United Kingdom and Germany (131 and 143 per cent respectively). The volume of trading was especially high in March and April, at the time of the surge in prices and the subsequent correction; average daily turnover rose to nearly 5 trillion lire, compared with 3.2 trillion in 1998 as a whole and 1.3 trillion in 1997 (Figure 38).

Figure 38

ITALIAN STOCK EXCHANGE: SPOT AND FUTURES MARKETS (1)



(1) Monthly turnover in billions of lire; left-hand scale. - (2) Indices, 31 December 1996=100; right-hand scale.

The equity-based derivatives market. - Turnover was sharply up on Idem, the market in equity-based derivatives, although for the first time since the market's inception the increase in volume was smaller than that on the spot market. In 1998 Idem ranked second among European equity-based derivatives markets behind Germany's Eurex. Average daily turnover in Mib30 stock index futures more than doubled to 7.5 trillion lire; as a ratio to turnover in the underlying shares, it fell from 350 to 303 per cent. Average daily turnover in options on the Mib30 index grew even more rapidly, from 0.97 to 2.05 trillion, but it too declined in relation to spot trading, from 91 to 83 per cent. Turnover in options on individual shares also increased, rising from 100 to 210 billion lire a day.

SUPERVISION OF BANKS AND NON-BANK INTERMEDIARIES

This section of the Report sets out the criteria and methods followed in the Bank's supervisory activities and describes the measures adopted in 1998. It fulfills the Bank of Italy's obligation to publish an annual report on its supervision of banks and non-bank intermediaries pursuant to Article 4 of the 1993 Banking Law (Legislative Decree 385 of 1 September 1993).

Since the beginning of this year, banking and financial supervision is set in the new context of European monetary union. Supervisory responsibility has remained with the national authorities under the principle of subsidiarity laid down in the Treaty, in recognition of the fact that the aims of supervisory activity are effectively attained by the national authorities. Procedures for the exchange of information and cooperation between the ESCB and the national supervisory authorities are provided for, in order to ensure the link between the single monetary policy for the euro area and supervisory activity. The ECB has advisory functions with respect to planned Community and national legislation affecting supervision.

Last year saw a significant improvement in the profitability of Italian banking and financial intermediaries and a diminution in credit risk. The restructuring of the banking system continued with the formation of larger groups, the implementation of reorganization programmes, the rationalization of production processes and the diversification of points of sale.

The shift in the pattern of banks' situations is revealed by the changes in the supervisory authority's evaluations. These improved for banks that had embarked on reorganization programmes, especially the large ones. They deteriorated somewhat for a number of mainly small banks that have not yet adapted their operations to the more competitive environment. However, most of these banks belong to groups whose overall situation is healthy.

For the banking system as a whole, the return on equity rose to 7.8 per cent, as against an average of 2.7 per cent in 1996-97. Returns higher than 10 per cent were recorded by banks accounting for 39 per cent of the system's total assets, compared with 6 per cent in 1997. The number of loss-making banks fell drastically. The improvement was entirely due to the increases of 18 and 60 per cent in income from securities trading and services.

Operating costs were affected by the failure to renew the banking industry's collective bargaining agreement. Excluding the effects of the introduction of the regional tax on productive activities, staff costs rose slightly. The number of employees continued to decline, falling by 1.3 per cent. The competitive gap on this front with respect to the banking systems of the other leading European countries nonetheless persists.

Technological innovation and the reorganization programmes under way have made rationalizing the use of productive factors all the more urgent. Over the last five years most of the overall reduction in personnel has occurred at banks involved in mergers. Outsourcing of traditional banking activities in addition to data processing is gaining in importance.

Higher corporate profits and an improvement in firms' financial structures helped to slow the growth in bad debts in 1998. They fell over the year from 9.2 to 8.8 per cent of total lending, and the pace of their expansion slowed further in the early months of 1999. The fact that many banks continued to upgrade their loan portfolios in 1998 was reflected in the volume of value adjustments, which continued at the high level registered in 1997.

New scope for loan management has been opened up by the recent law on securitization. The opportunities for Italian banks to provide consultancy services will increase.

The operating income of asset management companies increased by 60 per cent in 1998. The average volume of assets under management doubled, more than offsetting the decline in unit commissions caused by heightened competition. Bank-controlled firms accounted for 98 per cent of the sector's net fund-raising.

The gross revenues of securities firms rose by nearly 40 per cent, primarily in connection with trading for customer account and door-to-door sales of financial products. The firms belonging to banking groups achieved higher-than-average returns on equity.

The profitability of the financial companies entered in the special register improved compared with 1997, thanks mainly to income from services; the riskiness of their assets remained fairly low.

Intensifying competition in national markets and increasing international integration have prompted extensive reorganization and consolidation in the various segments of the financial industry everywhere.

In Europe, a 30 per cent decline in the number of banks since the start of this decade has been accompanied by the diversification of distribution networks involving not only an increase in the number of branches but also the expansion of ATMs and telephone and telematic services.

There were 54 concentrations in Italy in 1998. The market shares transferred were equivalent to 12 per cent of the banking system’s total assets, by far the highest value registered to date. Even so, the main banking groups remain smaller than their European counterparts: the top five groups in Germany, France and the United Kingdom account for more than 10 per cent of the European market, compared with 5.3 and 3.4 per cent for the five largest groups in Italy and Spain.

The reorganization programmes that Italian banking groups are implementing have in common a sharper separation between the production and the distribution of services, a clearer definition of the objectives and risk-return profiles of individual business units and greater decentralization of decision-making. Groups frequently consist of a parent bank responsible for direction and coordination and a number of sizable, legally independent subsidiary banks. In the asset management sector, there is a move towards the creation of a single management unit for each group.

The market share of banks controlled by public entities decreased from 25 to 18 per cent last year. This trend will be reinforced by the recent legislation on the disposal of controlling stakes by banking foundations. International comparison of the situation at the end of 1997 shows that there was significant public participation in only two of the top ten banking groups in Italy, as against four in Germany and Spain and three in France.

There is an important foreign presence in the share capital of Italian banks. Foreigners own significant interests in six Italian groups, which account for more than 50 per cent of the assets of the ten leading groups. In France and Spain the number of groups with foreign shareholders is smaller and their market share is less than half that registered in Italy; the foreign presence in German groups is negligible.

The growing complexity of intermediaries’ organizations and risk management operations means that the supervisory authority must continually update the regulatory framework and refine control procedures. Supervisory action now increasingly integrates quantitative rules with intervention on organizational arrangements, on the assumption that effective risk management requires adequate organizational and control arrangements. In 1998 the authorities introduced regulations intended to encourage the creation of adequate internal control systems in banks and banking groups, without violating entrepreneurial autonomy.

The supervisory analysis of credit risk has been enhanced by work to improve measurement and management techniques, including the integration of the available data bases. Methods of analysis of banks' organizational arrangements have been developed with the aim of assessing inconsistencies with their strategies and operations.

More meetings were held with managements to examine specific aspects of banks' operations; remedial action focused on credit risk, organizational adequacy and profitability. A total of 202 inspections were carried out in 1998, 185 of them at banks; the findings confirmed the three-year rise in the proportion of banks receiving positive assessments and the decline in intermediate assessments. Inspections at large banks involved in mergers sought to evaluate the results achieved during the implementation of the projects. The most serious problems were encountered at small banks. The liquidations of Sicilcassa and Isveimer continued in 1998, as did the disposal of the assets transferred from Banco di Napoli to the non-bank collection company SGA. Competitive procedures were also adopted for the transfer of troubled banks' assets and liabilities.

The Bank of Italy intensified its cooperation with other governmental bodies. In the field of economic crime prevention, cooperation consists mainly in the exchange of information with the judicial and law enforcement authorities.

The supervision of asset management companies included checking compliance with the limits on investment activities, verifying the requirements for access to the sector and approving management rules. As for securities firms, the methods of analysis were revised, while remedial action focused primarily on their organizational arrangements, profitability and capital adequacy. In small companies, the main problems involved internal controls. Special attention was paid, with the cooperation of professional associations, to improving the quality of the reports submitted by financial companies entered in the special register.

THE REGULATORY FRAMEWORK

Banking and financial supervision in the European Monetary Union countries

Relations between the European System of Central Banks and national supervisory authorities. - The organizational structure of prudential supervision in the European Union was set out in the Second Banking Coordination Directive, which came into force in January 1993. Underlying the single market for banking and financial services is home country supervision of intermediaries' activities throughout the European Union.

Article 105 (5) of the Maastricht Treaty establishes that the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. Supervision has remained the responsibility of national authorities under the principle of subsidiarity set out in Article 3b of the Treaty, in recognition of the fact that the aims of supervisory activity are effectively pursued by national authorities.

A number of important issues concerning the link between supervisory activity and the conduct of the single monetary policy in the euro area were addressed in preparation for Monetary Union, such as the exchange of information and cooperation between supervisory authorities and the ESCB.

The ESCB transmits to national supervisory authorities any information on individual institutions and markets collected in the course of its activities that may be useful to them in the exercise of their functions. National supervisory authorities may in turn pass information to the ESCB.

The supervisory authorities assist the Eurosystem in ascertaining possible infringements of the regulations binding counterparties in monetary policy operations, including the compulsory reserve requirement, and advise the ESCB of situations in which banks in difficulty could constitute a risk for the system.

Cooperation between national authorities and the ESCB is promoted by the Banking Supervision Committee at the ECB, which brings together representatives of the central banks and national banking supervisory authorities. The Committee is charged with examining macro-prudential issues, monitoring the development of the European banking and financial system and assisting the ECB in its role as an advisor on proposed Community and national legislation relating to supervision.

A Council Decision of 29 June 1998 established that this role shall regard provisions in matters of banking supervision with significant effects on the stability of financial institutions and the markets.

EU legislation and international cooperation. - At the European Union level, work continued on harmonizing the regulations governing banking and financial intermediation. Directive 98/26/EC on the finality of settlement in payment and securities settlement systems was approved; the European Commission submitted a proposed directive on distance selling of financial services and two proposed directives aimed at defining prudential rules for institutions that issue electronic money.

The Basle Committee has drawn up guidelines and proposals for the adaptation of supervisory arrangements in five main areas of internal control systems.

The Committee has begun the task of reviewing the Capital Adequacy Accord to take account of developments in the markets and in risk measurement and management procedures, with a view to increasing the degree to which capital requirements reflect the actual risk profiles of individual banks.

In order to improve cooperation between national and international institutions and authorities involved in ensuring the stability of the global financial system, the Financial Stability Forum has been established under the auspices of Group of Seven Finance Ministers and Governors. The Forum is composed of three members from each of the G7 countries, representing political authorities, central banks, and banking and financial supervisory authorities, together with representatives of international financial organizations and international supervisory committees.

Italian legislation

The Consolidated Law on Financial Intermediation. - The Consolidated Law on Financial Intermediation (Legislative Decree 58 of 24 February 1998) came into force on 1 July 1998. It provides a comprehensive regulation of securities intermediaries, financial markets and central depositories of financial instruments, and issuers.

The provisions governing intermediaries confirm the principle of assigning supervisory responsibilities according to objective, entrusting the Bank of Italy with safeguarding financial stability and Consob with ensuring transparent and proper conduct. The Bank of Italy is charged with defining the prudential rules for limiting risk that collective investment undertakings must follow.

The reform of bank foundations. - Law 461 of 23 December 1998 and the implementing decree of 14 May 1999, which reorganize the civil and tax law governing bank foundations and the tax treatment of bank restructuring operations, complete the regulatory aspects of the banking reform launched with the “Amato-Carli” law in 1990. The provisions govern the disposal of foundations’ holdings in the companies to which they transferred their banking businesses.

The foundations are supervised by a special authority - temporarily the Minister of the Treasury - which monitors compliance with legislation and bylaws, sound and prudent management, the return on capital and the effective protection of the interests enshrined in the bylaws. The authority is also responsible for establishing the minimum share of income in relation to capital to be spent on institutional activities.

Secondary legislation

Banks’ internal controls and the responsibilities of Boards of Auditors. - The rules issued last October set out a comprehensive regulatory framework aimed at encouraging banks and banking groups to establish effective and efficient internal control systems, without prejudicing their entrepreneurial independence. They are based on the general principles and best practices identified at the international level and adapted to the specific characteristics of the Italian banking system.

The compulsory reserves. - The supervisory rules have been adapted to take into account the ECB Regulation of 1 December 1998 establishing a uniform compulsory reserve regime for the euro area countries.

Authorization to engage in banking; holdings of capital in banks. - In the light of legislative developments, experience gained in the application of regulations and the demonstrated fragility of newly-established banks, the supervisory rules governing authorizations to engage in banking and holdings of capital in banks have been completely revised.

The minimum amount of capital required to establish a mutual bank has been raised to 2 million euros. In line with Directive 95/26/EC (the so-called post-BCCI Directive), one of the conditions for granting authorization is that both the registered office and the head office be located in Italy. Additional information is also required concerning the bank's programme of operations.

S*ecurities issues by banks*. - Legislative Decree 213 of 24 June 1998 and the Consob resolution of 23 December 1998, which govern the introduction of the euro in Italy, establish the criteria for redenominating and dematerializing financial instruments.

In accordance with these provisions, in December 1998 the 5 and 20 million lire minimum issue lots for bank bonds became 1,000 and 10,000 euros respectively. Issues of 1,000-euro bonds are subject to the same conditions formerly applied to those of 5 million lire.

Banks' solvency ratios. - A measure of 18 March 1999 transposed into Italian law Directive 98/32/EC, which amends the weights applied to real estate transactions in calculating banks' solvency ratios contained in Directive 98/647/EC.

Specifically, the 50 per cent weighting is extended to operations involving financial instruments secured by mortgage loans, leasing transactions and loans secured by mortgages on non-residential property.

The new edition of supervisory rules for banks. - The changes in primary legislation and the numerous supervisory provisions issued in recent years made it necessary to revise the rules completely. The new volume provides a homogeneous and rationalized collection of the supervisory rules issued by the Bank of Italy.

Implementation of the Consolidated Law. - The Consolidated Law on Financial Intermediation transfers a wide range of regulatory responsibility from primary legislation to administrative authorities (the Ministry of the Treasury, the Bank of Italy and Consob). The sector most affected by the revision of secondary regulation is collective portfolio management, with less drastic revisions being made to provisions regarding investment services since the Consolidated Law did not introduce major changes in this area.

Collective investment undertakings. - On 1 July 1998 the Bank of Italy issued a regulation implementing the innovations contained in the Consolidated Law concerning investment funds and SICAVs. The regulation grants considerable autonomy to asset management companies in their choice of services, products and productive processes.

The regulation implements the transfer of responsibility for the authorization of asset management companies and SICAVs from the Treasury Minister to the Bank of Italy, as provided in the Consolidated Law. The new regulation also envisages an assessment of intermediaries' organizational structure and programme of operations and the suitability of their parent group.

The minimum share capital for asset management companies and SICAVs has been standardized at 1 million euros; asset management companies must also have minimum capital related to the value of the assets under management or to their fixed operating costs in the previous financial year.

The issue and marketing of securities in Italy. - A provision of 15 December 1998 simplified the regulations governing the issue and marketing of securities in Italy to give greater operating autonomy to those engaged in these activities.

The financial statements of banks and financial institutions. - In order to improve transparency, the notes to banks' accounts now include information on the amount and behaviour of various types of doubtful debts and the corresponding value adjustments, as well as on the composition of own funds and supervisory capital. The report on operations must also describe the principal sources of credit risk, the marketing strategies pursued, control systems and accounting policies.

THE STRUCTURE OF THE FINANCIAL SYSTEM

Developments in 1998. - The share of banks and groups controlled by the State, local authorities and foundations in the total assets of the banking system fell further, from 25 to 18 per cent. Proceedings were begun to sell control of the Mediocredito Centrale group, which recently took over Banco di Sicilia, and to bring private investors into Monte dei Paschi di Siena and Banco di Sardegna, both of which are still wholly controlled by their respective foundations.

The privatization of Banca Nazionale del Lavoro was accomplished through the disposal by the Treasury of 25 per cent of the bank's ordinary shares via private placement, so as to create a stable group of core shareholders, and a public offering of the remaining shares held by the State to savers and Italian and foreign institutional investors.

Last year a number of concentrations between major Italian banks were completed: between Istituto Bancario S. Paolo di Torino and IMI; between Credito Italiano and the Unicredito group, creating the Unicredito Italiano group; between Ambroveneto and Cariplo, to form the Banca Intesa group. The new groups rank at the top in Italy for total assets, though they are still much smaller than the leading EU banks.

The restructuring of the system is also continuing among small and medium-sized banks against the background of changes in the competitive environment in local markets, in the demand for services and in the financial industry's production processes.

During last year 54 concentrations were completed, involving the transfer of market shares equal to more than 12 per cent of total assets, by far the highest annual figure recorded to date.

The number of banks operating fell last year by 14, to 921 (Table 46). Thirty new banks began operations, the same number as in 1997; one third resulted from the transformation of securities firms or financial companies and 9 were branches of foreign banks. The number of banking groups declined by 2 to 85, accounting for 87 per cent of total assets.. The groups include a total of 200 Italian banks, compared with 184 at the end of 1997.

The number of foreign banks with branches in Italy rose from 55 to 59. Ten Italian banks are owned by foreign banking groups, of which 5 are based in the EU.

Table 46

THE ITALIAN BANKING SYSTEM

	At end-1997			Changes in 1998 (1)		At end-1998		
	No. of banks	No. of branches		New registra-tions	Cancella-tions	No. of banks	No. of branches	
		Italy	Abroad				Italy (3)	Abroad
Limited company banks accepting short-term funds	190	18,026	93	25	8	207	19,009	91
Limited company banks accepting medium and long-term funds (2)	32	98	–	3	5	30	88	–
Cooperative banks (*banche popolari*)	69	4,357	9	1	14	56	4,275	9
Mutual banks (*banche di credito cooperativo*)	583	2,659	–	6	26	563	2,772	–
Central credit and refinancing institutions	6	28	–	–	–	6	30	–
Branches of foreign banks	55	82	–	9	5	59	84	–
Total	**935**	**25,250**	**102**	**44**	**58**	**921**	**26,258**	**100**
In the process of opening	6	449	1			8	578	3

(1) Includes changes due to the creation of new banks, closures, mergers and changes in institutional category. – (2) Includes *Istituto per il credito sportivo.* – (3) Includes branches of Banco di Sardegna resulting from the transformation of local agricultural credit banks.

The organizational structure of the leading banking groups. - All the major Italian banking groups have begun a review of their strategies and organizational arrangements, partly in connection with concentrations. The organizational configurations adopted have a number of principles in common: a tendency to separate the production and distribution of services; a precise definition of the operating scope and objectives of business units; broad delegation of decision-making, accompanied by subsequent assessment of the risk-return profiles of individual lines of business. The principal novelty is the so-called ‘federal’ group model, the hallmark of which is the presence of several large and legally independent subsidiary banks.

Outsourcing. - The review of banks’ production processes is leading to increased outsourcing, not limited to EDP, where the practice is most common. The early results of a survey covering banks other than mutual banks show that outsourcing, which previously involved mostly auxiliary activities such as accounting, is gradually spreading to the traditional sphere of banking activity.

Distribution. - The diversification of banks’ distribution networks continued in 1998. Telephone banking and the marketing of products through financial salesmen continue to expand, with new specialized banking intermediaries being established, sometimes within existing groups. The branch network continues to expand, albeit more slowly, and remains the cornerstone of relations with customers and corporate growth strategies. The number of new branches opened last year was 801.

Securities intermediaries

Asset management companies. - At the end of last year there were 71 registered asset management companies and one open-end investment company (SICAV). Fifty-eight asset management companies and one SICAV were operational in the field of open-end collective investment undertakings, an increase of 5 units compared with 1997. There were 706 operational funds and sectors (compared with 630 in 1997), of which 46 per cent were equity-based and 32 bond-based (Table 47).

Table 47

UNDERTAKINGS FOR COLLECTIVE INVESTMENT

	31.12.1997	31.12.1998
Italian open-end securities investment fund management companies and SICAVs:		
authorized	749	924
operational	630	706
of which: equity	*279*	*325*
mixed	*54*	*52*
bond	*202*	*224*
management	*95*	*105*
Italian closed-end securities investment fund management companies:		
authorized	9	11
operational	4	7
Italian closed-end real-estate investment fund management companies:		
authorized	1	2
operational	–	–
Italian open-end pension funds:		
authorized	–	25
operational	–	3
Foreign funds and sectors marketed in Italy	**675**	**938**
of which: equity	*335*	*478*
mixed	*33*	*57*
bond	*212*	*279*
money market	*69*	*86*
global	*26*	*38*

Net subscriptions continued to increase at a rapid pace, growing by 118.4 per cent to 313 trillion lire, while assets under management rose by 95.6 per cent to 720,823 billion.

The 39 bank-controlled management companies accounted for 98 per cent of net subscriptions and at the end of the year managed 93 per cent of the total assets of the system, compared with 83.4 per cent at the end of 1997. Companies not controlled by banks also raised the bulk of their fresh funds through banking networks (branches and banks' financial agents).

The degree of market concentration remained high, with the five largest companies accounting for 42.5 per cent of the assets under management.

Italian securities firms (SIMs). - The number of securities firms in operation continued to decline; the year-end total fell from 212 in 1997 to 191 last year, as a result of 29 firms ceasing activity and 8 new ones entering the market.

Compared with the end of 1993, the number of securities firms contracted by more than 40 per cent, with those not belonging to a group falling from 48 to 30 per cent of the total. At the end of last year 81 firms were controlled by banks, 21 belonged to insurance groups and 40 were controlled by foreign companies.

Half of the withdrawals from the market by firms not belonging to a group were made voluntarily by the owners in view of the unsatisfactory level of profits and the failure to win more than a very small share of the market.

Trading on behalf of customers and door-to-door selling are the only areas in which securities firms do more business than banks. The bank-controlled firms play a major role in all securities broking activities. The degree of concentration is high in all segments, with the exception of trading on behalf of customers, where it nonetheless increased in 1998.

Financial companies listed in the special register pursuant to Article 107 of the Banking Law

At the end of 1998 there were 206 registered financial companies subject to Bank of Italy supervision. Of these, 117 were bank-controlled and accounted for 69 per cent of such companies' total lending, 49 were industry-owned and accounted for 26 per cent of lending. The remaining companies on the register were “independent” firms, many of them active in merchant banking, foreign exchange broking or the issue and management of payment cards.

RISKS, PROFITABILITY AND CAPITAL ADEQUACY OF INTERMEDIARIES

Banks

Credit risk. - Gross of value adjustments, bad debts increased by slightly more than 3 trillion lire, rising by 2.5 per cent, as against 6.8 per cent in 1997. At the end of the year they amounted to 128 trillion lire or 8.8 per cent of total loans, as against 9.2 per cent at the end of 1997 (Table 48). In the early months of 1999 the growth in bad debts slowed further and in March it equalled to 0.5 per cent on a twelve-month basis. Doubtful debts declined in 1998 by 1.4 trillion lire. The moderate expansion in bad debts reflected the improvement in firms' profitability and financial structures. In addition to recoveries and disposals, the satisfactory trend in bad debts was due to 13.2 trillion lire of writeoffs.

Table 48

BANKS' BAD AND DOUBTFUL DEBTS AND TOTAL LENDING (1) (2)
(end-of-period amounts in billions of lire)

	Banks accepting short-term funds			Banks accepting medium and long-term funds			Total		
	Bad debts (3)	Doubtful debts	Total loans (4)	Bad debts (3)	Doubtful debts	Total loans (4)	Bad debts (3)	Doubtful debts	Total loans (4)
1995	98,987	42,940	1,071,652	15,063	6,490	189,992	114,050	49,430	1,261,644
1996	110,230	44,552	1,103,058	17,638	6,617	180,211	127,868	51,169	1,283,269
1997	106,273	39,964	1,185,078	18,607	5,991	179,173	124,880	45,955	1,364,251
1998	109,619	38,890	1,266,897	18,408	5,652	179,794	128,027	44,542	1,446,691

(1) Lending to resident customers of banks operating in Italy and Italian banks' branches abroad. – (2) The classification of banks is that which was in force at the end of 1998; merged banks have been considered as belonging to the category of the bank with which they were merged. – (3) Includes protested bills. – (4) Includes bad debts and protested bills.

A survey of 740 banks accounting for 97 per cent of total lending at the end of 1998 shows that the growth rates of bad debts were highly dispersed. The bad debts of 36 per cent of the sample banks (holding 43 per cent of the sample total) declined, since their new bad debts were small and because they wrote-off 10.4 trillion lire of uncollectible loans. The bad debts of 39 per cent of the banks (holding 31 per cent of the sample total) increased by more than 10 per cent, primarily because they recorded a large volume of new bad debts.

Value adjustments to bad debts rose from 39 per cent in 1997 to 41 per cent in 1998.

The concentration of lending by Italian banks to individual borrowers and groups decreased further in the twelve months to September 1998. Large exposures declined by 17 per cent to 98.7 trillion lire. The amounts in excess of the 40 per cent ceiling of supervisory capital applicable in 1997 and 1998 fell by almost 50 per cent from 9.4 to 4.9 trillion, some 80 per cent of which consisted of the loans of three banking groups to four large industrial companies in the Centre and North of Italy.

Lending to small customers. - The importance of small borrowers for the banking system has been increasing in Italy in the same way as in other leading countries. The credit lines granted to households and small businesses, for which the unit value of loans is now less than 500 million lire on average, rose from 37 per cent of total bank lending in the mid-eighties to 44 per cent last year.

Until the early nineties the shares of total lending of households and small businesses both increased. Subsequently, the share of the latter contracted, falling from 29 per cent in 1991 to 27 per cent in 1998. On the other hand, lending to households expanded at annual rates of around 10 per cent, or nearly twice as fast as total lending, and its share of total lending rose to 17 per cent. As their spreads have narrowed, banks have increased their lending to households, partly to take advantage of the opportunities offered by the expansion in their branch networks.

The proportion of bad debts in loans to households is 11 per cent, or 2 percentage points more than the overall average. In particular, the home mortgage market, which accounts for about 70 per cent of all lending to households, has seen a steady build-up of non-performing loans owing to the recent weakness of the real estate market and the lengthiness of repossession procedures.

Country risk. - In December 1998 Italian banks’ loans subject to the supervisory rules on country risk amounted to 23.9 trillion lire, including 4.9 trillion of short-term trade credits. The decline of 800 billion lire compared with the end of 1997 was due to the reduction in lending to the countries most severely affected by the financial crisis of 1997; in particular, that to the Asian countries fell by 50 per cent to 2 trillion lire. The exposure to Latin American and Caribbean countries increased by 1 trillion lire, while the value of trade credits remained essentially unchanged.

The new prudential rules which came into force in December 1998 and the increased riskiness of Russia and the emerging countries led to an increase of 1.56 trillion lire, or 83 per cent, in the required adjustments to supervisory capital. The exposure to “non-zero risk” countries grew by 2.6 trillion lire to 12.6 trillion and accounted for 53 per cent of all unsecured loans; the average ratio of the required adjustments to supervisory capital to the total claims on these countries rose from 19 to 27 per cent.

The new method of evaluating country risk makes greater use of market indicators and permits changes in the perception of a country’s solvency to be captured more rapidly; it also provides for a more detailed classification of countries at risk.

Profitability. - The profitability of Italian banks rose substantially in 1998. Their return on equity reached 7.8 per cent, compared with an average 2.7 per cent in 1996 and 1997. The segment consisting of banks with an ROE of more than 10 per cent grew considerably and included many of the major institutions; the proportion of loss-making banks fell sharply.

Though still far below that of banks in the Centre and North, the ROE of banks located in the South also improved, rising from 1.3 to 3 per cent.

Gross income rose by 11.7 per cent to 106.9 trillion lire. Income from services and securities trading grew from 20 to 26 per cent of gross income and accounted for the entire improvement. For the third successive year net interest income fell in absolute terms, contracting by 400 billion lire or 0.6 per cent as a result of the narrower spread between the return on assets and the cost of liabilities.

Staff costs fell by 3.7 per cent and 1.5 trillion lire owing to the suppression of health-care contributions with the introduction of the new regional tax on productive activities (Irap).

The number of bank employees declined by 1.3 per cent to around 338,000 at the end of last year; five years of contraction have reduced the staffing level by more than 6 per cent compared with the peak in 1993. Technological innovations and bank mergers have increased the need to rationalize the use of labour. At the bigger banks the number of employees fell by 15 per cent compared with 1993, whereas smaller banks steadily enlarged their staffs.

Net income rose by 40 per cent to 42.4 trillion lire (Tables 49 and a31).

Table 49

SELECTED INDICATORS FOR ITALIAN BANKS BY GEOGRAPHICAL AREA (1)

(amounts in billions of lire)

	Centre and North		South		Total	
	1997	1998	1997	1998	1997	1998
Net income	27,813	39,242	2,380	3,115	30,193	42,357
Loan losses	11,965	12,048	2,079	2,026	14,044	14,074
ROE *(%)*	*1.7*	*8.3*	*1.3*	*3.0*	*1.7*	*7.8*
Allocations to supervisory capital	848	6,734	54	133	902	6,867
Increases in share capital (2)	1,891	11,199	3,219	157	5,111	11,357
Supervisory capital (3)	193,967	210,995	18,301	17,893	212,269	228,887
Solvency ratio *(%)* (3)	*12.5*	*12.6*	*14.6*	*13.3*	*12.7*	*12.7*
Excess amounts (3)	71,496	78,446	8,407	7,255	79,903	85,700
Shortfalls (3)	1,444	946	138	126	1,582	1,072

(1) The classifications are those that were in force at the end of 1998. – (2) Net of buybacks. The figures for 1997 include amounts contributed by public shareholders under statutory provisions. – (3) The figures for 1998 are net of increases in supervisory capital resulting from banks acquiring majority interests in other banks.

Value adjustments to loans, including withdrawals from loan loss provisions and net of value readjustments, remained at the high level reached in 1997 and amounted to over 14 trillion lire.

Taxes totaled 12.8 trillion lire. The improvement in profitability was reflected in the sharp rise in dividends from 4.6 trillion lire in 1997 to a new high of 7.8 trillion in 1998.

The portion of net profit used to increase supervisory capital amounted to 6.9 trillion lire, compared with 0.9 trillion in 1997.

Capital adequacy. - The supervisory capital of the Italian banking system, computed on a consolidated basis with reference to June 1998, increased by 14.5 trillion or 7.6 per cent to reach 206 trillion lire. The overall solvency ratio, which has included capital charges for market risk since June 1997, was 11.6 per cent. Amounts in excess of the minimum capital requirements grew by nearly 2 trillion lire; shortfalls fell to less than 600 billion lire and only concerned 7 banks, as against 11 in 1997.

At the end of 1997 the solvency ratio of the 19 Italian banks that operate internationally was equal to 9.7 per cent and in an intermediate position with respect to the values of the other G10 countries.

In December 1998 supervisory capital, measured on a solo basis, amounted to 244.7 trillion lire (Table a32). The increment is attributable to an expansion of 22 trillion in primary capital and of 10.8 trillion in supplementary capital. The rise in the index of bank stocks provided an incentive to raise around 11 trillion of equity capital, of which 9.5 trillion was used to finance the main mergers. Issues of preference shares amounted to about 1.7 trillion.

The growth of supervisory capital on a solo basis also reflected the accounting effects of the concentrations that were carried out during the year. Net of these effects, it was about 8 per cent; the average solvency ratio on a solo basis was 12.7 per cent, as in 1997.

Investment fund management companies

Profitability. - Investment fund management companies' profits, after tax but before allocations to provisions and depreciation, rose by 59.5 per cent to 1.3 trillion lire, since the decline in net revenues in relation to assets under management was more than offset by the twofold increase in the latter.

Growing competition in the sector resulted in commissions coming under pressure, especially the entry and exit charges for money market and bond funds.

Securities firms

Profitability. - The net profits of Italian securities firms rose from 500 billion to 1.1 trillion lire. Loss-making firms were half the number recorded in 1997 and the majority were new entrants or had only a marginal market share.

Total revenues grew by 37 per cent, while operating costs rose by 10 per cent. Return on equity in the sector rose from 15 to 31 per cent.

Capital and risks. - The supervisory capital of securities firms increased by 6 per cent in 1998; tier-one capital declined slightly to 95.4 per cent of the total. The total capital requirement at the end of the year was about 800 billion lire, while firms' supervisory capital amounted to about 2.5 trillion lire; three firms had capital shortfalls.

Financial companies registered under Article 107 of the 1993 Banking Law

Credit risk. - Excluding newly-registered companies, disbursements by non-bank credit intermediaries grew by 14 per cent; at the end of the year total loans amounted to more than 123 trillion lire, net of value adjustments, which almost all concerned leasing, factoring, consumer credit and credit card business.

Bad debts grew by 6 per cent to 3.6 trillion lire, or 2.9 per cent of total lending. Net of value adjustments, they amounted to about 2 trillion lire or 1.6 per cent of performing loans. Instalments more than 120 days overdue fell from 7.7 to 6.9 per cent of outstanding credit.

Profitability. - Net profits rose by around 50 billion lire to 680 billion, while return on equity fell from 7 to 6 per cent.

Capital. - Financial companies' supervisory capital rose by 28 per cent to 11.4 trillion lire at the end of the year and consisted almost entirely of capital and reserves; excluding newly-registered companies, the increase was equal to 15 per cent. Their free capital rose from 2.1 trillion to 3.6 trillion and their risk asset ratio from 8.3 to 9.9 per cent.

SUPERVISORY CONTROLS

Banking supervision

Analytical tools. - Supervision and supervisory tools are increasingly directed towards the integration of rules, quantitative models and the analysis of organizational arrangements. Careful risk management presupposes that accurate methods of assessment are accompanied by organizational arrangements permitting strategic objectives to be obtained while complying with criteria of sound and prudent management. The effectiveness of supervision is enhanced by increasing the interaction with internal control structures (banks' boards of auditors, risk management and internal auditing units and external auditors).

The revision of the analytical methods for investigating organizational arrangements has been completed, in line with operational developments. The object of such investigations is to detect possible shortcomings in organizational arrangements and internal control mechanisms in relation to strategies and types of activity that could result in failure to recognize risks.

Analyses cover banks' operating environment, key strategies and managerial resources; as well as their organizational structure and operating systems for activities such as lending, securities business and internal control. Banks are rated with reference to both the principal components of the organizational system and the overall situation.

The reports banks submitted on their internal control systems in the early months of 1999 have provided important guidance for the supervision of their organizational arrangements.

Prudential analysis of banks' situations. - The distribution of scores assigned to banks in 1998, based mainly on information referring to 1997, reveals significant changes. The share of borrowed funds held by banks awarded a favourable evaluation (scores of 1 or 2) rose from 33 to 41 per cent, while in numerical terms such banks decreased from 48 to 45 per cent of the total. Banks with a negative evaluation (scores of 4 or 5) rose in numerical terms and in terms of borrowed funds, in both cases from 18 to 23 per cent. There were fewer banks with a score of 3, showing significant weakness in some technical indicators.

Remedial action. - Last year the Bank of Italy took action, in the form of letters or meetings, involving some 470 banks. The number of meetings rose by 44 to 475, of which 223 were arranged by head office supervisors and 252 by supervisors in branch offices.

The supervision of large banks focuses in particular on their strategic and operational plans for concentrations and privatizations, with special attention paid to compliance with prudential requirements, the strength of the balance sheet, the level of profitability and the adequacy of organizational arrangements.

The supervisory authority closely monitored the results of some leading groups whose problems had led to the adoption of rationalization measures, with close attention paid to the evolution of loan quality.

Scrutiny of market risk management and control systems continued, particularly for banks that had revised their strategies or embarked on organizational changes. The complexity of control procedures in this field calls for periodic checks on the state of progress of planned organizational changes.

Action involving medium-sized banks that head banking groups was largely directed at ensuring the adequacy of the groups' organization and verifying their ability to handle expansion while maintaining a strong balance sheet and sufficient profitability in the long term. Attention also focused on control systems, the optimization of the groups' productive processes and the availability of qualified managerial staff.

As regards smaller local banks, which are more affected by falling interest income and tougher competition, supervisory analysis focused on operating costs, with a view to soliciting measures to reduce their incidence. The supervisory authority played a major role in stimulating the introduction of organizational and internal control systems permitting the diversification of products and services and proper awareness in managing today's higher risk/return profiles.

In the specialized banking sector (network banking, securities banking, telephone banking) the aim of supervision is to identify the specific forms of risk (market, operating, reputation, legal risk and fraud, etc.), their potential impact on banks' situations and the possible remedial measures concerning organizational arrangements and control systems.

Most of the central credit institutions and banks accepting medium and long-term funds that are not part of banking groups are still encountering operational problems, attributable to the adverse effects of falling income from their traditional banking activities and their lack of independent distribution networks. Fragmented ownership structures make it difficult to reach agreement on solutions and strategies for handling crises. In the case of the former medium and long-term credit institutions, in particular, the return to a balanced situation appears to hinge on their becoming part of banking groups and selling and rationalizing their assets. Only in a few cases does product diversification appear a viable solution and even then it implies searching for the necessary expertise and developing efficient operations.

On-site controls

The total number of inspections carried out rose from 197 to 202, of which 62 were performed by head office supervisors, compared with 66 in 1997, and 140 by supervisors in branch offices, compared with 131 in 1997. An additional two controls were carried out on behalf of Consob within the cooperative framework established by Article 10 of the Consolidated Law on Financial Intermediation.

The banks subjected to inspection numbered 185 (plus one where the controls concerned the functions of depository bank), equal to 20 per cent of the system in terms of numbers and 11.4 per cent in terms of total assets (compared with 17 and 13 per cent respectively in 1997). The distribution by size of bank was: 2 major and large, 4 medium-sized, 11 small, 3 branches of foreign banks and 165 minor banks (135 of which were cooperative banks). The geographical distribution was: 92 in the North, 36 in the Centre and 57 in the South.

The problems found in smaller banks mostly concerned those in the South, which accounted for 61 per cent of unfavourable evaluations, compared with 25 and 11 per cent respectively in the Centre and North.

Crisis procedures. - Four mutual banks were placed in compulsory administrative liquidation in 1998.

The compulsory administrative liquidation of Sicilcassa substantially completed the process of valuing the assets and liabilities transferred to Banco di Sicilia under the contract signed in September 1997. The provisional shortfall agreed by the parties was of the order of 3.1 trillion lire, net of the Interbank Deposit Protection Fund’s contribution of 1 trillion lire. To cover the shortfall the Bank of Italy last year granted two advances to Banco di Sicilia, pursuant to the Ministerial Decree of 27 September 1974.

In December 1998 the liquidators deposited the statement of liabilities, against which appeals were lodged with the Palermo court.

The bad debts remaining on the books of the liquidation have a nominal value of 4.4 trillion lire; the liquidators are now administering these claims and have begun recovery proceedings. The largest exposures involve 37 groups that have been in difficulty for some time and have gross debts totaling around 3 trillion lire.

Given the bank's situation, the Palermo court adhered to the request made by the liquidators and declared the bank to be insolvent in February 1999. The liquidators have continued the action for liability against the former representatives of the bank initiated by the special administrators.

Special procedures. - Last year the voluntary liquidation of Isveimer continued, with the realization of assets and repayment of liabilities. This activity, together with the measures related to the laying-off of employees and the winding-up of the staff pension fund, enabled the liquidation to proceed rapidly.

The shortfall in the accounts had been made good by Banco di Napoli, which was granted two special advances by the Bank of Italy, as provided for in Article 3 of Law 588 of 19 November 1996 under the procedure established in a Ministerial Decree of 27 September 1974. The advances were granted in 1997 and extinguished towards the end of last year.

By the end of 1998 SGA, the company set up in accordance with Law 588 of 1996 to collect the non-performing loans acquired from Banco di Napoli, had realized 22 per cent of the claims transferred, or about 2.7 trillion lire, of which 1.4 trillion was recovered last year. Taking account of these recoveries, the interest accrued on the claims and the value adjustments made, SGA's total claims decreased from 11 trillion lire at the end of 1997 to around 9 trillion at the end of 1998.

In April 1999 SGA approved the accounts for its second year of operations, which closed with a loss of 1,482 billion lire that was made good by Banco di Napoli.

Supervision of securities intermediaries

Asset management companies. - On 1 July 1998 the Bank of Italy transferred the 66 registered investment fund management companies and the one existing SICAV to the new registers of asset management companies and SICAVs provided for in Articles 35 and 44 of Legislative Decree 58 of 24 February 1998.

Two new asset management companies were authorized in the second half of last year and the Bank of Italy sent its favourable opinion to the Minister of the Treasury for the authorization of 6 additional companies whose applications were submitted before the Consolidated Law came into force. In addition, the Bank authorized a merger between two asset management companies and a securities firm. At 31 December 1998 there were three asset management companies performing both collective and individual portfolio management.

Last year action was taken involving 10 asset management companies, in response to problems concerning their organizational arrangements or profitability and capital adequacy.

Securities firms. — A total of 88 measures were adopted last year involving securities firms, 19 of which took the form of meetings with corporate officers. The issues raised mostly related to profitability, capital adequacy and organizational structure.

Supervision of financial companies registered pursuant to Article 107 of the Banking Law

Last year the Bank of Italy examined 19 applications for inclusion in the special register of financial intermediaries subject to its supervision. Three applications were turned down because of insufficient size or volume of business with the public.

A total of 14 measures were adopted last year involving financial companies with problems. The majority of measures concerned credit risk, profitability and the correctness of the information provided to the supervisory authority on organizational matters.

Access to the securities market

Last year bond issues by Italian companies amounted to 136.8 trillion lire and issues of foreign securities to 22.3 trillion, a decline from the previous year of 8.6 and 41 per cent respectively. Issues of commercial paper totaled 585 billion lire and were almost all made by listed companies.

COMPETITION POLICY IN THE BANKING SECTOR

Technological progress, the globalization of financial markets, the reduction in the geographical fragmentation of banking and the need for banks to grow in order to achieve a critical mass that would permit savings to be managed with innovative instruments, have generated far-reaching changes in the banking system and given a further impulse to competition, which has also intensified as a result of the action taken by the supervisory authorities over the years.

The increase in competition in the domestic market is reflected in numerous statistical indicators: the average number of banking groups per province has risen to 26, every province except one has at least 10 banking groups and the number of branches increased by nearly 70 per cent between 1989 and 1998. The presence of foreign banks fosters the spread of financial techniques developed in more advanced markets and spurs competition in segments such as securities intermediation, asset management, corporate finance and housing mortgages. The branches and subsidiaries of foreign banks hold nearly 8 per cent of the total assets of the banking system and have an even larger share of certain market segments. Heightened competition has produced a significant reduction in the spread between lending and deposit rates, from 6.9 percentage points at the end of the eighties to 4 points last year, despite the increase in credit risk during the period. The fall has involved all categories of customer on average and every area of the country.

The contestability of bank ownership has also increased as Italian banks have listed large shares of their capital on regulated markets. Forty banks and banking groups accounting for about two thirds of total assets are currently listed. The increase in competition has stimulated banks to seek to improve their profitability and organizational structures to face the challenges of the market. Since 1990 there have been about 400 mergers in Italy, involving nearly one third of the total assets of the system at the start of the period. Last year such operations involved considerably larger banks. In most cases mergers were followed by intense competition for market share, despite the reduction in the number of players. In some instances, the increase in the market share of the bank resulting from the merger was balanced by similar operations by its main competitors. In other cases, mergers enabled banks to enter or strengthen their position in new markets, thereby reducing geographical and operational segmentation and broadening customers' choice of intermediaries and services.

Activity aimed at protecting competition was intense in 1998. The Bank of Italy examined 60 proposed mergers and acquisitions. In the case of Credito Italiano and UniCredito, the Bank authorized the operation subject to the condition that the parties dispose of five branches in the province of Belluno and two in the province of Verona in order to prevent a significant and lasting reduction in competition in the local deposit markets. In addition, UniCredito may not open new branches in these provinces for three years in order to facilitate the growth of competitors.

Two investigations were undertaken into resolutions adopted by banking associations that had the potential to restrict competition by providing for common yardsticks for the decisions of the individual members of the associations.

The first investigation concerned an agreement between banks promoted by Cogeban for the development of payment services at POS terminals using PagoBANCOMAT debit cards. The agreement established reciprocal obligations for the 552 member banks regarding the operation of the service, specifically defining certain charges and requiring members to use standardized contracts with customers and retailers. Two markets were identified as being affected: that in retail payment instruments and that in electronic payment services, which includes the operation of data transmission networks in the banking sector (in this case the national interbank network). The investigation identified three instances of possibly restrictive practices in the first market: the clauses establishing a ceiling on bank commissions and their differentiation by retail sector, the requirement to adopt standardized contracts and the rule forbidding discrimination between card and cash payments. The Bank found that the first clause restricted competition, since it limited banks' freedom to set charges, but granted a special authorization for five years in view of the benefits that would accrue to customers, while ruling that the clauses on sectoral differentiation would have to be modified. The standardization of contracts was found to be "incomplete" and deemed not to constitute collusion. The non-discrimination rule could potentially restrict competition since, in addition to reducing that between banks marketing the same brand of payment instrument, it also makes it impossible to reflect the effective cost of using cards or cash in the final price to consumers and inhibits competition between retailers, who could otherwise set different commissions. Nevertheless, given the limited diffusion of the PagoBANCOMAT card and the smallness of the percentage commission charged to retailers, the effect of the clause on competition in the market has been marginal and does not currently justify its annulment. As regards the market for electronic payment services, the investigation concluded that the national interbank network was an essential facility and that access to the network had to be complete and non-discriminatory for any body offering payment services to the public.

An investigation of the Federazione delle Cooperative Raiffeisen was launched on the basis of the findings of a supervisory inspection showing that the Federazione had issued a recommendation regarding the geographical division of markets. The agreement appeared potentially damaging to competition, considering that the Casse Raiffeisen hold a 45 per cent share of the deposit market in the province of Bolzano and a 35 per cent share of the loan market. The recommendation was forbidden on the grounds that it restricted competition. No sanctions were imposed in view of the fact that the Federazione took steps to rescind its recommendation during the investigation and that the accord does not appear to have significantly harmed competition during its short life. Consideration was also given to the fact that the mutual structure of the Casse Raiffeisen and the considerable overlap between members and customers typical of the local socio-economic fabric attenuated the adverse impact of the agreement.

In early 1999 two investigations were begun under Article 2 of Law 287/1990. One involved a recommendation issued by ABI at the end of 1998 suggesting that banks should adopt a transparent formula for the application of a commission to recover the costs of exchanging euro area currencies and indicating upper limits for both the fixed and variable portions of the commission.

The second investigation was undertaken following the discovery during a supervisory inspection at a bank of documentation regarding meetings between representatives of 13 banks. The meetings had been held for some time on a nearly monthly basis and had involved the discussion of strategic and commercial aspects of the individual participants' operations and the exchange of information on fund-raising, lending and the prices of various banking services, thereby potentially facilitating the coordination of the banks' commercial policies. Since the participants in the meetings included representatives of the largest banking groups in Italy, the arrangement could substantially affect competition in the markets concerned. Inspections were begun at some of the banks involved at the same time as the investigation.

MARKET SUPERVISION

The enactment of the Consolidated Law on Financial Intermediation (Legislative Decree 58 of 24 February 1998) established the general rules for financial markets. The principal criterion adopted for their regulation is the separation between the organizational function, entrusted to private management companies, and supervision, entrusted to the authorities. The Consolidated Law assigns the Bank of Italy supervisory duties for the wholesale markets in government securities (Article 76), the markets in interbank funds (Article 79), clearing, settlement and guarantee systems for transactions involving securities and derivatives (Article 77) and central depositories for financial instruments (Article 82).

The duties assigned to the Bank by Articles 76 and 79 reflect the importance of the markets in question for monetary policy. Supervision of the screen-based wholesale market in government securities (MTS) is to be performed "having regard to the overall efficiency of the market and the orderly conduct of trading". For the interbank deposit market (MID), the Bank is to "monitor the efficiency and proper operation of trading". The duties assigned by Articles 77 and 82 are intended to ensure the efficiency and orderly conduct of trading, in view of the close link between trading and settlement.

Supervision of market bodies

Market management companies. - To ensure the effectiveness of market supervision, the Bank of Italy has been assigned adequate powers of control over management companies with respect to data collection, examination of companies' principal acts and verification of their compliance with the rules.

Securities settlement systems. - The Bank of Italy is responsible for regulating and supervising securities settlement systems in view of their importance for the stability of the financial system.

Pursuant to Article 69 of the Consolidated Law the Bank, in agreement with Consob, regulates both gross and net securities settlement systems. With the exclusion of the settlement of the cash leg of transactions, which can only be performed by the Bank of Italy, these systems may be run by a private company.

Guarantee systems. - Articles 68, 69 and 70 establish the regulatory framework for guarantee systems that safeguard the efficient performance of securities trading and settlement in the event that an intermediary defaults.

Article 71 contributes to the certainty of securities settlement by providing for the finality of the measures adopted by systems governed by Articles 69 and 70 even after the initiation of bankruptcy proceedings.

Article 77 gives the Bank of Italy and Consob powers of supervision over the persons administering settlement and guarantee systems and over the systems themselves.

Central depositories of financial instruments. - In 1998 Consob and the Bank of Italy issued two regulations: one on the procedures for the performance of the activity, particularly as regards the administration of deposited instruments (both paper-based and dematerialized), the other on the related and instrumental activities that central depositories can perform (securities lending, guarantees, settlement services for transactions involving non-derivative financial instruments).

On 30 April 1999 the dematerialization of listed financial instruments was virtually complete.

Market supervision in 1998

The wholesale market in government securities (MTS). - On 30 June 1998 MTS S.p.A. was authorized to run the wholesale market in Italian and foreign government securities and securities issued by international organizations. MTS began to operate on 1 August under rules prepared by the management company and approved by the Treasury.

With the goal of creating a reference market for the euro area, MTS S.p.A. set up EuroMTS Ltd., incorporated under English law. In April 1999 trading in benchmark government securities for the euro area began on EuroMTS, where dealing is based on market makers. EuroMTS uses the same technology as MTS but has more stringent access requirements and larger minimum lots; the features of the securities listed on the two markets also differ.

Further developments regarding MTS are the introduction of remote market making (i.e. without having an establishment in Italy), the listing of German government securities and the start of a grey market.

The number of primary dealers in Italian government securities has gradually declined from 32 in 1997 to 27 in 1999 as a result of bank concentrations and the strong position acquired by larger intermediaries.

The Bank of Italy and the Ministry of the Treasury remain responsible for monitoring specialists in government securities following the transfer of the market to the private sector. In 1998 the 16 specialists played a major role in trading, accounting for 72 per cent of the total on the primary market and 52 per cent on MTS. The possibility of remote trading has so far led to three intermediaries dealing from financial centres in other European countries.

Last year saw a contraction of 39 per cent in the volume of trading, an increase in the degree of concentration by security and intermediary, and a further reduction in the bid-ask yield spread from 11 to 6 basis points.

The repo market. - This market, which opened on 12 December 1997 and runs on the MTS platform, has grown rapidly. In the early months of 1999 turnover was higher than on the MTS cash market.

The repo market has provided an important second channel, alongside the interbank deposit market, for the trading of funds among intermediaries and, by facilitating arbitrage, major support for the working of the secondary securities market. Average daily turnover in 1998 was around 15 trillion lire. In the first three months of 1999 it nearly doubled, with general collateral repos accounting for 64 per cent and special repos for 36 per cent.

The strips market. - In line with developments in other European countries a regulated market for government securities strips began operations in 1998. Stripping, which can be carried out in real time by intermediaries, is currently permitted for eight BTPs. Trading in strips began on the MTS platform at the end of July and accounts for only a small portion of total turnover in government securities.

The interbank deposit market. - Plans have been drawn up for a company to be set up to take over the running of this market.

Average daily turnover rose by nearly 5 per cent to over 32 trillion lire. Overnight business continued to predominate (65 per cent of the total). Analysis of the transactions carried out in the market shows that larger intermediaries were primarily borrowers and smaller intermediaries lenders.

The present Management Committee is seeking to extend the market's operations to the rest of the euro area by encouraging remote access, forming alliances with other markets and introducing new contracts.

The Italian derivatives market. - The Italian futures market has been privatized and is now a wholly owned subsidiary of Borsa Italiana S.p.A. The new company, MIF S.p.A., began operations in September. The Bank of Italy is required to give Consob its opinion on the rules the management company has proposed for the government securities futures and options markets.

Trading volumes in Italian derivatives are small, both for futures on MIF and for options on MTO. Over the last five years the average daily turnover of contracts on BTPs has declined from around 4.3 trillion lire to around 1 trillion. The average daily turnover of the short-term interest rate contract has fallen by one half since 1997, from 2.7 to 1.3 trillion.

Among the developments involving European markets in derivatives based on government securities and interest rates, an agreement has recently been reached between MIF in Italy, Matif in France and Meff in Spain to allow their members to trade in the contracts of all three markets.

OVERSIGHT OF THE PAYMENT SYSTEM

This section of the Report sets out the criteria and methods used and the actions taken by the Bank of Italy in conducting its oversight of payment and settlement systems pursuant to Article 146 of the 1993 Banking Law.

The oversight activity carried out during the year reflected the functions explicitly assigned in legislation to the Bank of Italy and the general guidelines set out in the *White Paper on Payment System Oversight. Guiding principles for performance of the function,* published in 1997. It also took account of discussions in Italy and in international cooperative fora on the conceptual framework underpinning the function and the range of oversight instruments and methods most frequently employed by central banks. The results of the Bank's studies will be presented in a forthcoming publication.

Oversight activities sought to promote the efficiency and reliability of the payment system as a means of pursuing the final objectives of public confidence in money, the overall stability of the financial system and the effective conduct of monetary policy. Given the advancing integration of markets within EMU and technological innovation, increasing emphasis has been placed on strengthening the competitiveness of the Italian payment system, especially its infrastructure. Special attention was paid to the key aspects of ensuring the certainty and transparency of payment services.

The Bank of Italy focused its actions on the legal, organizational and operational aspects of risk reduction, criteria of access to production and use of services, and the transparency and dissemination of information.

Although the Bank of Italy has the power to issue regulations in the field of payment systems, its actions in 1998 were primarily implemented by establishing the access and operational rules of settlement systems for interbank transactions and operations involving financial instruments and by exercising its guidance function in the cooperative fora in which payment system intermediaries define their strategies.

Oversight benefited significantly from cooperation with the authorities responsible for protecting competition in banking services and for supervising securities markets.

Guidance and control activities and the direct management of clearing and settlement services were performed in accordance with the indications provided at the international level.

In particular, oversight activity has taken account of the decisions of the European Monetary Institute and, since June 1998, the ESCB. The activity of these bodies focused on: constituting TARGET, the European payment system that serves as the infrastructure for the conduct of the single monetary policy and the efficient and secure settlement of cross-border payments in euros between EU countries; assessing the adequacy of the SWIFT network to form part of that infrastructure; verifying the ability of Euro1, the private clearing system run by the Euro Banking Association, to operate in euros; and defining the minimum standards of reliability for securities settlement systems used in monetary policy operations.

More recently, the ESCB has stepped up its efforts to define the framework of criteria and lines of action for oversight at the European level. The purpose is to identify the areas of primary importance and specify the division of responsibilities between the ECB and the national central banks. In practice, since the start of Stage Three oversight within the ESCB has been conducted under general guidelines laid down by the Governing Council of the ECB, leaving the national central banks broad responsibilities for their application and the management of national payment and settlement systems. The central banks have also been left independent powers of initiative in sectors of the system that are of primarily domestic interest without significant implications for the single monetary policy or the control of systemic risks.

Oversight issues are also being examined by the BIS, which is developing guidelines for organizing and conducting oversight of payment and settlement systems in the G10 countries and the emerging economies, aimed at updating and developing the standards established in 1990 to promote efficiency and reliability. Another relevant area is that of retail payment systems, where work to define the duties and roles of central banks is being conducted.

At the EU level, the Commission, the Council and Parliament continued their work on the adjustment of national legislation and the practices of payment service providers. Legislative action seeks to reduce the legal risk associated with settlement system operations by ensuring finality. Consumer protection is being pursued by promoting technical and operational arrangements to foster wider use of non-cash and innovative payment instruments, to improve funds transfer services in the EU area and to increase the transparency and fairness of contractual conditions.

The future action of the Bank of Italy and the behaviour of payment system participants will be influenced by the evolution of the payment system, notably the privatization of infrastructure, and the inclusion of oversight activities within the framework of international cooperative efforts.

Payment systems and infrastructures

Risk control. - A series of important measures were taken in 1998 to control risk within Italian cash and securities settlement systems by completing the specialization of circuits by type of transaction. Retail payments are handled on a net basis by BI-COMP, the Bank of Italy's clearing system; large-value payments are settled on a real-time gross basis by BI-REL. To prevent a shifting of settlement risk from the securities settlement system to the clearing system, since the end of November the cash balances arising in the former have been fed directly into BI-REL.

Further progress in risk reduction will be made with the transposition into Italian law of Directive 98/26/EC on settlement finality within payment systems and those dealing with transactions in financial instruments.

In addition, Monte Titoli S.p.A., in cooperation with SIA and Ced-Borsa, has begun designing a gross settlement system for financial instruments in line with the recommendations of the ESCB, which calls for such systems to operate on an intraday delivery-versus-payment basis. For cross-border transactions, the operation of the Monte Titoli circuit will be facilitated by its participation in the European network of central securities depositories in accordance with the procedures that win the favour of the market.

Promotion of efficiency. - Special attention was paid during the year to rationalizing the arrangements for the local clearing subsystem. In October the physical exchange of payment items, which used to take place at the Bank of Italy clearing houses throughout the country, was centralized in Milan and Rome. The decision was triggered by the banking system's intention to exchange all untruncated cheques in these two centres.

In keeping with the privatization of markets, the Bank of Italy took steps to transfer the operation of payment services other than settlement to the intermediaries concerned. A start was also made on the disposal of the CAT central depository for government securities, with a view to bringing this activity under one roof, as in other European countries.

As part of the general plan to ensure the efficiency and competitiveness of the Italian financial market, SIA and Ced-Borsa have merged, with effect from 1 June 1999; this will allow a single technological platform to be developed for market and payment system activities.

A significant advance has been made by permitting foreign intermediaries to participate directly, as of November 1998, in the clearing and settlement procedures for financial instruments and, as of January

1999, to hold settlement accounts with the Bank of Italy without having an establishment in Italy. The Bank published its guide to the procedures for remote access to services in April 1999.

Pricing policy. - In January 1999 BI-REL introduced the ECB's pricing scheme for cross-border transactions via TARGET. The fees decrease with intermediaries' transaction volumes and are as follows: e1.75 for each of the first 100 payments in a month, e1 for each of the next 900 transactions and e0.80 per transaction beyond 1,000. The average fee paid by Italian banks for cross-border payments via TARGET declined from e1.05 in January to e1.01 in March. Since just a few intermediaries handle the bulk of this business, the top five banks by number of transactions pay an average fee of e0.85.

In 1998 the Bank of Italy continued to use pricing policy to limit risk. Following the migration of the cash leg of securities transactions from BI-COMP to BI-REL, differential penalties were introduced for defaults to reflect the risk involved: ad valorem charges are applied for late settlement of multilateral cash balances in the securities settlement system and fixed charges for late settlement of BI-COMP clearing balances. In May 1999 penalties were also introduced for late settlement of final securities balances.

Retail payment instruments and services

Further steps were taken in 1998 to enhance the technical and legal reliability of cashless payment instruments and services and improve their efficiency.

The action taken by the Bank of Italy concerning the exchange of cheques was supplemented by that of the Interbank Convention on Automation (CIPA), which raised the truncation threshold for personal cheques from 2 to 5 million lire and introduced a single time limit of three working days for the communication of unpaid cheques.

To increase the security of cheques, Parliament enacted a law which, as part of the policy of decriminalizing minor crimes, provides for the introduction of a system-wide prohibition on issuing new cheques for persons who have written bad cheques. The law also provides for a computerized interbank archive to be set up at the Bank of Italy to store data on such persons, as well as on lost or stolen cheques and payment cards and persons whose authorization to use the latter has been revoked.

An important step towards the full integration of the banking and postal payment circuits was taken with the agreement between the Italian Bankers' Association (ABI) and the Post Office for the use of interbank procedures for the exchange and settlement of bank and postal cheques.

To foster more extensive and fully secure use of open networks - in particular the Internet - for transactions, including those involving payment orders, CIPA has begun the creation of an authentication infrastructure within the banking system that will operate in accordance with the rules governing digital signatures and electronic documents.

During the year CIPA also prepared an action plan for the migration of payment cards from the magnetic strip to microchip technology based on international standards.

The Bank of Italy activated two new procedures designed to improve efficiency: the single payment by taxpayers to the revenue service, INPS and the regions; and the electronic payment order for government departments. They will serve to automate and speed up government collections and payments in accordance with the guidelines laid down by legislative reform measures in this sphere. These call for the complete automation of the various tax collection systems and the use of electronic orders for all payments made by central government departments and their local agencies.

Adjustment to the euro and the year 2000

The successful start of operations in euros made by information systems and markets in Italy was the result of the intense effort to adapt interbank applications to the new currency that engaged ABI, CIPA and the Bank of Italy throughout 1998. Banks and non-bank intermediaries performing essential activities within the payment system were carefully monitored and asked to take all the measures necessary to ensure their trouble-free functioning in the new environment.

The effort made for the changeover to the single currency is now being repeated in order to adjust computer systems to the year 2000, especially within the financial community. In June 1998 the Bank of Italy formed a technical secretariat to coordinate the Bank's initiatives vis-à-vis the institutions subject to its supervision or oversight and to foster cooperation with the other authorities responsible for the financial system. In March 1999 the secretariat published a report on the financial system's state of readiness for the date change. The secretariat works closely with the government Year 2000 Committee in applying its guidelines. The Bank is represented on the committee, which was set up in the second half of 1998 with a mandate covering every sector of the economy.

The Bank of Italy's Year 2000 activities in the payment system field were carried out in close coordination with the other bodies responsible for the supervision of financial markets and focused on the adaptation of procedures and testing, including integrated tests. A start was also made on the preparation of contingency plans to cope with possible malfunctions, with the Bank committed to developing awareness of the problems, providing guidance and carefully monitoring participants' progress.

The adjustment of payment system procedures to the date change is now complete. The Bank of Italy has planned several test sessions involving all the components of the payment system, including settlement of financial market transactions. The first series of tests was conducted with a pilot group of banks and completed successfully in April 1999. The second, which is due to terminate in June, involves the entire banking system.

Contingency plans are being prepared by the Bank of Italy, financial intermediaries and providers of essential payment system services.

Oversight on the payment system concerning the year 2000 has also involved questionnaires and direct contact with intermediaries. In April 1999 the Bank of Italy circulated a questionnaire asking for the banks' own evaluation of the state of readiness of their contingency plans. The Bank will continue its drive to ensure that the measures taken by banks and non-bank intermediaries will permit the system to operate properly in the new millennium.

Developments in settlement circuits

The interbank clearing and settlement circuit. - The value of the transactions handled by the Bank of Italy's payment circuits amounted to 83,000 trillion lire in 1998, rising considerably both in absolute terms and in proportion to GDP (Table 50). The expansion of cross-border transactions and financial market trading more than offset the slowdown in trading on the screen-based interbank deposit market (MID). In January, gross settlement in central bank money was extended to all large-value payments. The payment flows handled by BI-REL were four times those entered into BI-COMP; in 1997, the latter had exceeded the former by a factor of sixteen.

Table 50

FLOWS OF FUNDS THROUGH THE CLEARING AND SETTLEMENT SYSTEMS

(billions of lire)

	Clearing systems (1)			BI-REL (2) (c)	Total flows	
	Gross flows (a)	Multilateral balances				
		BI-COMP	Securities settlement system (b)		(d)=(a+b+c)	(d)/GDP
1991	20,377	1,586	–	1,651	22,028	15.3
1992	29,053	2,411	–	3,004	32,057	21.1
1993	40,476	2,725	–	2,626	43,102	27.6
1994	48,832	2,627	–	2,623	51,455	31.1
1995	50,603	2,849	–	2,755	53,358	29.9
1996	62,112	2,568	–	2,723	64,835	34.2
1997	71,090	2,829	–	4,375	75,465	38.2
1998	15,537	3,291	352	67,488	83,377	40.5

Sources: Based on Bank of Italy, Interbank Company for Automation (SIA) and Istat data.
(1) Includes transactions of the Bank of Italy, its provincial Treasury departments and the Post Office. From 30 November onwards the cash leg of securities settlements was handled by BI-REL instead of BI-COMP. – (2) Net of clearing balances and intrabank transfers on the settlement account.

BI-REL handled a daily average of 42,000 payments and more than 270 trillion lire, using a very modest volume of intraday liquidity (2 per cent of total settlement volume). Payments lacking immediate cover - about 1 per cent of all payments - were held on queue for less than three minutes on average. The use of BI-REL's services increased: the number of subscribers to the package of on-line message handling services rose, as did the number of co-management agreements. In the first quarter of 1999, after the launch of TARGET, large-value payments (such as credit transfers, forex transactions and external lire interbank transfers) and outgoing cross-border transactions within the euro area diminished by about a quarter compared with the first quarter of 1998.

Clearing and settlement of securities transactions. - In 1998 the value of the securities handled by the securities settlement system rose by 26 per cent to 53,000 trillion lire. Settlements of shares and bonds increased by 100 and 65 per cent respectively. The distribution of settlement values by category of participant confirmed the increasing role of banks and the corresponding decrease in the relative importance of investment firms, whose number fell by 19 owing in part to the transformation of some Italian securities firms into banks.

With the launch of Economic and Monetary Union, significant and trouble-free use was made of the cross-border settlement and custody services the Bank of Italy made available for ESCB operations. In March 1999 the average daily volume of Italian securities utilized by foreign banks was e18.8 billion, or 34.2 per cent of the total recorded by the ESCB. Italian banks' use of these services was relatively modest and mostly involved Italian government securities issued abroad and held by Cedel and Euroclear.

Trends in the use of payment instruments and services. - The use of cashless payment instruments continued to increase; the number of transactions rose by 4.8 per cent in 1998 and their value by 12.5 per cent. Cash still played a significant role, however, and the volume of notes and coin in circulation increased as a ratio to GDP.

Cashless payments using bank instruments and credit cards increased, owing in part to the 30 per cent rise in the value of inward and outward cross-border payments. EU countries accounted for about 70 per cent of the total.

Payment orders issued using an electronic medium were about 50 per cent of the total, an increase of more than 10 percentage points since 1996. The share varies widely across intermediaries, ranging from 25 to 70 per cent depending on location and pricing policy. Network-based payments, which have lower unit operating costs, still represent only 5 per cent of the total.

The number of points of access to bank payment services continued to increase last year and the number of ATM and POS terminals handling foreign payment cards also rose. The diffusion of ATM and POS terminals in recent years has closed the gap with the other leading industrial countries and reduced the disparities in their distribution within Italy.

THE GOVERNOR'S CONCLUDING REMARKS

As Head of State during a seven-year term that was marked by economic and institutional instability in Italy, Oscar Luigi Scàlfaro worked, as the country's supreme guarantor, to ensure Italy's prestige in the international community.

He defended the Constitution.

In times of difficulty for the central bank, he reaffirmed its function and independence. He upheld the sound management of the currency and the protection of savings, a constitutional obligation.

The Bank of Italy pays homage to him and to his achievements.

On 13 May Parliament elected as President of the Republic Carlo Azeglio Ciampi, Governor of the Bank from 1979 to 1993.

His appointment to the highest office of State crowns a life committed to serving public institutions and the common good.

As it strives to complete and consolidate the economic renewal which he helped to formulate, the country can yet again rely on his eminent gifts of wisdom, balance and rectitude.

The Bank of Italy, which he led with authority, is confident that in performing his role as guarantor of the Constitution he will inspire confidence in the civil and economic progress of the country.

The euro has been the single currency of eleven European Union countries since the beginning of this year. The Bank of Italy is an integral part of the European System of Central Banks. Our institutional responsibilities are becoming more demanding and complex.

In monetary and exchange rate policy, the Bank is called upon to perform a dual function: to take part in the deliberations and decisions of the System and to implement measures at national level in accordance with the principle of subsidiarity.

The coming into force of the Consolidated Law on Financial Intermediation has widened and increased the Bank’s responsibilities for the supervision of intermediaries and market surveillance.

In the payment system, the national gross settlement procedures were swiftly and efficiently integrated into the European TARGET system between the end of 1998 and the beginning of this year. The systems for recording and monitoring payments have been overhauled. The Bank is preparing for the production of banknotes denominated in euros, which will come into circulation on 1 January 2002.

In the autumn of last year the Bank took on responsibility for central treasury operations on behalf of the State. During the same period government securities were dematerialized.

We have carried out a wide-ranging reorganization of the Bank’s central administration in the areas of central banking, markets and payment systems. The importance attaching to the independent protection of competition in the banking sector, supervision of the payment system, market surveillance, support for international relations and research in the field of economic law has been confirmed and emphasized.

The Italian Foreign Exchange Office has become an agency of the Bank for the management of the official foreign exchange reserves. The measures required to consolidate the new relationship between the Bank and the Office have been completed.

All sectors of the economy have to take effective action to adapt their data-processing systems and procedures to cope with the change of millennium. The Bank of Italy has long urged and encouraged banking and financial institutions to take steps in this direction.

The transfer of important departments to the Donato Menichella Centre in Frascati is nearing completion. The area in which the Centre is situated boasts several authoritative academic and research institutions; it is becoming a magnet for the development and production of advanced services. The complement of infrastructure, which the public authorities will not fail to complete, will contribute to the development of Rome and its metropolitan area.

The Bank is contributing expertise and ideas on an increasing scale in domestic and international fora. It is playing a valuable part in the reform of company law.

The Bank systematically reports on its actions and the reasons for its decisions to Parliament and other official institutions and in its publications.

The staff of the Bank, both at Head Office and in the branches, have once again demonstrated their ability to meet demanding objectives. The Directorate and the Board of Directors extend their sincere thanks to all the Bank’s employees at every level and grade.

The world economy

The growth of the world economy, which came to 2.5 per cent in 1998, is still being held back by the effects of the crisis that erupted in Asia in 1997. Spreading to Russia and Latin America, the crisis led to a discernible slowdown in growth in Europe as well from the middle of last year onwards.

The epicentre of the instability is Japan. In the nineties the rate of growth of the Japanese economy fell sharply, and grave problems emerged in the banking system. The launch of a rigorous plan for the structural adjustment of the public finances led to a contraction of domestic demand in the second quarter of 1997. Industrial output fell by 7 per cent in 1998. Gross domestic product declined at an annual rate of 4 per cent in the first half of the year in relation to the preceding period and 2 per cent in the second. Deflation became more pronounced.

Short-term interest rates were brought down to almost zero, and long-term rates fell to 1.3 per cent. A switch to an expansionary fiscal policy and an increase in liquidity brought relief for the banks but failed to revive investment and consumer demand.

The other Asian economies, which for several years had displayed external payments deficits, rigidity in exchange rate policy and shortcomings in corporate governance and banking supervision, sought to achieve new equilibria by curbing domestic demand and drastically devaluing their currencies. Their current accounts returned to surplus in 1998, helping to arrest the crisis in financial markets.

The slowdown in world demand induced a sharp fall in the prices of raw materials, adversely affecting the income of producer countries.

The economy of the United States, in its eighth year of uninterrupted expansion, grew by 3.9 per cent in 1998. Employment increased by 2.6 per cent and the unemployment rate declined to 4.2 per cent, its lowest level since the seventies.

The source of this good performance is a virtuous combination of rapidly growing high-technology investment, productivity gains, ample resources and labour market flexibility. The growing US current account deficit was readily financed, thanks partly to monetary expansion in Japan and capital inflows from the areas in crisis.

The dollar has appreciated steadily since the end of 1996; share and bond prices have risen very substantially; the cost of finance for productive investment has fallen.

Inflation diminished still further in 1998. Some pressures emerged in the early months of this year in connection with the rise in oil prices, the further expansion of domestic demand and a tightening of the labour market.

After decades of deficits, the federal budget recorded a surplus, thanks primarily to continuing economic growth.

Monetary policy became more expansionary in the latter part of 1998, easing strains in the international markets and helping to defuse the crisis in Latin America. Economic activity also strengthened. The recent upward pressure on prices and costs led to the announcement of a possible raising of interest rates by the Federal Reserve.

World economic growth was nearly 2 percentage points less than in 1997, owing to a contraction of about 3 per cent in Japanese GDP, slower growth in the rest of Asia and in Latin America, and difficulties in the countries of Eastern Europe.

World trade rose by 3.3 per cent, compared with 10 per cent in 1997.

Gross domestic product in the euro area increased by 2.9 per cent, compared with 2.5 per cent in 1997. Inflation slowed further as a consequence of the fall in commodity prices. The unemployment rate declined but remains two-and-a-half times as high as that of the United States.

A cyclical slowdown began to be perceptible in Europe in the second half of 1998, especially in Germany and Italy, and has become more pronounced in the first few months of this year. Following the interest rate reductions of 1998, the Eurosystem lowered the refinancing rate further in April, from 3 to 2.5 per cent.

The sluggishness of economic activity is having an adverse effect on the public finances. It must not be allowed to postpone achievement of the budgetary balance required by the Stability and Growth Pact, which is necessary to the stability of the currency.

Forecasts indicate a slowdown in the growth of activity in the industrial countries this year. In Europe the growth rate is expected to decline to 2 per cent. The world economy appears to have reached the bottom of the cycle during the last few months.

A definitive resolution of the financial crisis and a return to higher rates of world economic growth can be achieved only if there is an acceleration in activity in the European Union, continued growth in North America, albeit inevitably at a slower rate, and above all the beginnings of recovery in Japan.

International economic organizations forecast an acceleration in the pace of economic activity and world trade in 2000.

As the Finance Ministers and central bank Governors of the Group of Seven countries emphasized at their meeting in Washington last October, investment spending in Europe must be increased. Structural budget reforms and the elimination of labour market rigidities are indispensable. In Japan, domestic demand needs to be revived by means of effective expansionary fiscal measures.

The problems of the European economy

The robustness of growth in the United States and the weakness of the European and Japanese economies, and the disparity in their respective abilities to generate output and employment are reflected in the nature and growth of investment.

Between 1990 and 1998 gross fixed investment in the United States increased at an average annual rate of 5.8 per cent, more than twice the pace of the previous decade, and rose from 13 to 17 per cent of GDP. In Japan investment contracted by 1.8 per cent a year, compared with an average annual increase of 6.8 per cent in the eighties. In the euro area investment growth had been rapid in the eighties, but it slowed to 0.6 per cent a year in the nineties. The gap between the United States and Europe in investment in machinery, equipment and transport equipment is even wider.

The capital stock per employee has risen only slightly in the United States, since employment has increased. In Europe, where employment has stagnated, it has risen considerably, although it is still lower than in the United States. Capital intensity is especially high in Japan.

In the United States the number of persons in employment has risen by 1.8 per cent a year in the nineties. In the euro area it has remained broadly unchanged; in Germany and Italy it has declined. Between 1990 and 1997 Japan recorded an average annual increase in employment of 0.7 per cent; in 1998 there was a contraction for the first time in decades.

In the three largest continental European economies, investment began to decline in relation to GDP at the end of the sixties. A contributory factor was the steady reduction in construction investment. Productive investment was concentrated in manufacturing, which accounted for about 40 per cent of the total.

In the United States 30 per cent of investment is in industry, while the share in services is very high. In all sectors investment in information technology is increasing rapidly and now accounts for about 30 per cent of the total.

In Japan the ratio of investment to GDP touched 33 per cent in the past and is still very high at around 30 per cent, comparable to the levels witnessed in many Asian countries during the phase of rapid industrialization.

Japan appears to have an excess of productive capital, due partly to the low cost of borrowing over many years. Enormous productivity gains averaging 5.6 per cent a year from 1950 to 1990 enabled the country to increase its share of total world exports very considerably, leading to the progressive accumulation of net financial assets vis-à-vis the rest of the world. The outlook for growth is more uncertain now, given the slower growth of world demand and the steadily increasing proportion met by the newly industrializing economies.

The European economy, given the size of its medium-technology industries, is more vulnerable to competition from these countries, which can take advantage of their much lower labour costs, lower taxes and less restrictive regulation of economic activity.

In Italy, as in Germany and France, the cost of labour is affected not only by higher net wages but also by a tax wedge of about 50 per cent consisting of income taxes plus employers’ and employees’ social security contributions. In Spain the tax wedge is smaller, at 40 per cent; in the United Kingdom and the United States it is lower still. It is high in the Scandinavian countries, which like the three large continental countries provide a high level of social protection.

In Europe, in response to the oil shocks and wage pressures of the seventies and eighties, investment was directed largely towards restructuring plant. In the long run it became evident that the economy was incapable of creating jobs. The inadequacy of measures to remove structural rigidities and the lack of flexibility in the utilization of productive factors impeded the deployment of the resources released by the reduction of budget deficits.

The uncertain prospects for growth have lowered the propensity to invest. The decline was due in part to slower demographic growth and the ageing of the population. Terms of employment, labour costs and high taxation are reflected in Europe's low participation rate of 68 per cent for the population of working age. The United States has a far higher rate of 79 per cent; Italy's rate of 59 per cent is one of the lowest in the industrial world.

Economic growth in Europe and in Italy depends crucially on the ability to compete within the global economy.

Competitiveness cannot be improved by emulating the kind of social and economic arrangements to be found in emerging countries. Greater resources must be allocated to investment in research and technological innovation and to training. Output must be shifted towards services. The size and composition of government budgets must reinforce the potential for economic growth. The regulations governing business activities must be streamlined. The efficiency of the public administration must be increased.

International liquidity and finance

Global financial assets have grown much more swiftly than the world economy since the second half of the eighties.

Between 1985 and 1990 the volume of bonds in circulation, consisting largely of government securities, doubled to $15,000 billion in the Group of Ten countries. The value of listed shares increased more rapidly, from $2,800 billion to $6,300 billion, reflecting the rise in stock exchange indices. The combined value of bonds and shares rose from 122 to 134 per cent of the GDP of these countries. The pace has accelerated in the nineties: in 1997 the ratio rose to 220 per cent and the value of shares to $16,000 billion.

Held in check by increasingly stringent monetary policies, money supply growth in the industrial countries has been broadly in line with the increase in output.

The restrictive stance of monetary policies in the nineties, the far faster expansion in financial assets than in the money supply, the growth in financial transactions and greater asset price volatility have fostered a rapid increase in derivative products, the notional value of which rose from 26 per cent of world GDP in 1990 to 128 per cent in 1997.

Derivatives increase the ability to manage risk; they augment the velocity of circulation of domestic and international monetary instruments and hence the liquidity of the world economy; they have provided scope for a large increase in trading in the securities and foreign exchange markets. In the event of a crisis, they can heighten systemic instability.

The improvement in public finances, the reduction in expected inflation and, in the last two years, the slowdown in economic activity have caused nominal and real interest rates to fall throughout the world.

Declining bond yields and increased liquidity partly explain the high levels that share prices have reached. The low cost of capital and the inflow of financing have contributed to the growth of productive investment in the United States.

During the eighties the liberalization of short-term capital movements fueled a surge in cross-border bank deposits; an abrupt halt occurred at the beginning of the nineties in conjunction with the slowdown of the world economy and the drastic fall of share and property prices in Japan.

The decline in nominal short and medium-term interest rates in the early nineties was more pronounced in Japan and the United States. In the four years from 1991 to 1994 net outflows of bank capital from Japan amounted to $220 billion, equal to around half of the surplus on the current account of the balance of payments. The industrial countries absorbed half of these funds; the other half was redistributed to the emerging countries by the seven offshore centres reporting to the Bank for International Settlements.

Beginning in 1995, after the Mexican crisis, monetary expansion was boosted in Japan in order to correct the excessive appreciation of the yen and the depreciation of the dollar. The further reduction in interest rates and the increase in the supply of yen caused the Japanese currency to fall sharply and the dollar to rise from the summer onwards.

In the three years from 1995 to 1997 the net flow of financing in the form of Japanese bank loans to offshore centres and industrial countries amounted to $110 billion and $100 billion respectively. Almost all of these funds were redistributed to the emerging economies, first and foremost those in Asia.

The increasing indebtedness of those economies, the fall in demand in Japan in mid-1997 and the appreciation of the dollar sowed the seeds of the Asian crisis.

Monetary impulses are transmitted worldwide by the major players in the global market, which raise funds where liquidity is most abundant and invest them in bonds and shares, partly through the use of derivative products. Highly leveraged institutions have become especially important. Changes in the composition of their portfolios can destabilize even medium-sized economies. The withdrawal of the funds invested in the emerging economies of Asia aggravated the crisis and further increased the value of dollar-denominated assets.

In the first half of 1998 capital outflows from the emerging countries intensified, with those of bank capital reaching $30 billion. The outflow from Japan also increased. The funds were absorbed primarily by the United States.

The rouble crisis in August led to a further contraction in the flow of financing to the areas in difficulty, accentuating the pressure on the currencies and financial markets of Latin America. Over the summer funds continued to be withdrawn from the countries of Eastern Europe and to flow towards the United States; the outflow from Japan abated.

The financial turmoil in late August also affected the European currencies.

The signs of recovery in Asia strengthened in late 1998 and the early months of this year, whereas the crisis in Latin America had not yet been fully overcome. Monetary conditions began to be eased in the countries with the highest interest rates.

Global finance, with its enormous volume of transactions, is a key factor of efficiency in the allocation of resources, but it can also be a source of instability for the world economy.

The interventions by the International Monetary Fund in Korea and other Asian countries in 1997 and in Brazil in 1998 and at the beginning of this year, and the concerned attention it has paid to the development of the grave situation in Russia have prevented the crises from deepening and spreading, and thus from affecting world financial stability.

The action of the IMF has been aimed first of all at eliminating each economy's imbalances in its public finances and towards the rest of the world. Increasing weight is being attributed to the correct allocation of credit, to be achieved and maintained through the separation of banking from the productive sector and the public authorities. Countries are being asked to establish effective systems of banking and financial supervision and adequate corporate governance and bankruptcy procedures.

The activity of the Basle Committee for Banking Supervision has intensified since the Mexican crisis. The proposals for revising the Accord on banks' capital adequacy seek to allow a more precise measurement of credit risk by using methods developed by banks themselves or ratings from specialized firms. Criteria for the internal organization of banks and for the public disclosure of information have been defined.

A coordinated effort is being made by the Basle Committee, the IMF and the World Bank to encourage the introduction and ascertain the application of the international supervisory standards in all countries, and particularly in the emerging economies.

The rapid growth in the use of derivative products has made the situation of some categories of institutional investor precarious by allowing high degrees of leverage to be reached. In order to limit the systemic risk, banks must assess the creditworthiness of these investors carefully; it will be necessary to ensure the transparency of the total risk assumed. These are the requirements for preventing such investors from being transformed from agents of global resource allocation into causes of instability.

The debate on the appropriate degree of regulation and supervision is under way.

The new forms of intermediation are often based in offshore centres, where rules and prudential supervision are either lacking or absent and taxation is low.

The Group of Seven countries has established a Forum for world financial stability, in which representatives of the financial ministries, central banks and market supervisory authorities of these countries will take part. The offices of the chairman and secretariat are at the Bank for International Settlements in Basle.

Attention is being focused on the behaviour of highly leveraged institutional investors, short-term capital movements and offshore centres.

The results will be examined at the forthcoming meeting of the International Monetary Fund in the autumn.

In response to the need to give preventive support to economies that are at risk of contagion but are still basically sound, a new precautionary intervention instrument has been created at the IMF. The available credit will be disbursed at punitive interest rates. The direct involvement of the private sector will be a condition for the granting of credit.

In the background there remains the problem of the size and responsiveness of international financial flows, of the potentially unlimited ability of the financial markets to multiply credit and money.

The structure of international finance is evolving along lines that we prefigured and that recall the developments in the national financial and banking systems in the early decades of this century. Those developments led to a redefinition of central banks' responsibilities, instruments and sphere of autonomy. In the appropriate international fora and on other occasions, we have called for a strengthening of the analytical and operational functions of the IMF and the World Bank.

The creation of the European System of Central Banks and the single currency can make a significant contribution to monetary stability in Europe and consequently at the global level. It is essential that the structure of the budgets and the flexibility of the participating economies be consistent with this objective.

The banking and financial system

The Italian banking and financial system is becoming ever more integrated into the world economy, although it still differs in size from those of other industrialized countries.

The ratio between gross financial assets and GDP in 1985 was 5.7 in the United States, 6.4 in Japan and 7.6 in the United Kingdom; it rose considerably in subsequent years. For the four largest countries in the euro area the ratio averaged 4.5 in 1985 and gradually rose to 6.8; in Italy it is 5.5.

The growth of the Stock Exchange is still constrained by the low propensity of medium-sized and large firms to seek listing and the large number of small firms that do not raise finance in the market. The value of listed shares is equal to 45 per cent of GDP, compared with 48 per cent in Germany, 65 and 69 per cent in France and Spain respectively and 140 per cent in the United States.

In view of the limited recourse to supplementary pensions and the still high proportion of securities held directly by private investors, there is scope for an increase in intermediation. The high level of households' savings permitted the placement of a substantial and expanding volume of government securities; however, the growth of government expenditure and the rise in the budget deficit crowded out investment, especially in the eighties, with adverse effects on growth.

The balance of payments and capital flows

The surplus on the current account of the balance of payments amounted to 62 trillion lire in 1996 and 61 trillion in 1997, or 3.2 and 3.1 per cent of GDP respectively. In both years the surplus was only partially matched by an improvement in the external position, as half of it was absorbed by the errors and omissions item. The composition of this item cannot be identified precisely; it consists partly of holdings created abroad by residents and not recorded in capital flows.

The current account surplus declined last year to 39 trillion lire, affected by lower net income from merchandise trade. It was completely offset by the errors and omissions item.

The abundance of liquidity in the international markets at a time of wide interest rate differentials was reflected in recent years in a sharp rise in foreign investment in Italian securities. In 1995 this amounted to 61 trillion lire, with the inflow occurring mainly in the second half of the year after the worst of the lira crisis had been overcome; it rose to 125 trillion lire in 1996 and remained close to that figure in 1997. Last year non-residents' purchases of Italian securities reached 188 trillion lire.

The fall in yields on Italian government securities, the narrow range of financial instruments available in the domestic market and the tendency for investors to diversify their portfolios have gradually led to an increase in outflows of capital.

Portfolio investment abroad by non-banks, which was insignificant in 1995, rose to 52 trillion lire in 1996 and 113 trillion in 1997. The balance between inflows and outflows was positive from 1995 onwards but was gradually eroded, turning negative last year.

Direct foreign investment by Italian firms is also increasing: from 9 trillion lire in 1996 to 17.5 trillion in 1997 and 19 trillion last year. Inward direct investment amounted to 4.5 trillion lire last year, a decline in comparison with previous years. At the end of 1998 the stock of direct investment abroad by Italian firms stood at 273 trillion lire, against investment in Italy by non-residents of 174 trillion.

Italian firms are displaying their ability to diversify and showing interest in markets with lower production costs and more favourable prospects for an expansion in sales; however, this also to some extent entails a relocation of production, even to advanced economies. Italy’s ability to attract investment remains poor.

As in Germany, there are differences in costs and taxation even vis-à-vis other European countries. In Italy conditions are affected by the complexity of regulations on business activities, the poor level of infrastructure, shortcomings in public services and the low efficiency of the public administration.

In an economy that is totally integrated in the European and international financial system, the abundance of savings that has always been a distinguishing feature of the Italian economy is declining in importance as a factor for growth.

The ability to turn savings, whether formed in Italy or abroad, into productive investments able to guarantee the security of those savings, generate adequate yields and encourage growth and employment is even more important than it was in the past.

The persistent weakness of domestic demand, pockets of unemployment, the surplus on the external current account and the growing capital outflows point to the presence of structural factors hindering the use of savings for investment purposes.

The equity market

The smallness of the stock market is an indicator of the shortage of securities representing the ownership of firms and limits opportunities for portfolio diversification.

The strong growth in managed savings has fostered capital investment abroad. In 1998 residents' share transactions abroad generated a net capital outflow of 19 trillion lire. Italian investment funds are investing one third of their assets in the international markets and 60 per cent of the shares they hold are foreign.

The increase in the capitalization of the stock exchange from 31 to 45 per cent of GDP last year can be attributed essentially to the rise in share prices. Issues of new shares by existing listed companies amounted to 0.7 per cent of GDP, compared with an average of 0.4 per cent in the three years from 1995 to 1997.

The value of Italian firms admitted to listing last year, excluding those migrating from the second market or emanating from changes in the structure of listed companies, amounted to 0.8 per cent of GDP, compared with an average of 1.2 per cent in the three previous years. At the end of last year the number of listed firms was 223, the same as in 1994.

Important regulatory changes have been made in recent years to foster the expansion of the Stock Exchange and tax incentives have been granted to encourage listing. Far-reaching measures affecting the organization of the market have been taken; the transparency and liquidity of operations have increased considerably.

The commencement of trading on the recently established market for small innovative firms, which forms part of a wider European network, will help to increase the supply of securities.

The capital market needs to expand further and the stock exchange must be adapted to the importance of the economy.

Steps must be taken to remove the competitive disadvantages, most of which are of a tax nature, that have induced many intermediaries, including a number of major banks, to invest heavily in and move highly skilled staff to other financial centres within the euro area.

Italy's complete openness to international competition means that firms and banks must react swiftly to the new scenario.

The structure of the banking system

The relative underdevelopment of the Italian financial system is also reflected in the volume of banking business in relation to the real economy.

The ratio of banks' assets to GDP is 145 per cent, and it has fluctuated around this figure since the beginning of the eighties. In Germany the ratio was 140 per cent in 1980 and is now almost 270 per cent; in France it rose from 180 to 240 per cent over the same period. One of the reasons for the larger volume of business in other banking systems is a higher level of interbank activity; the disparity nonetheless remains considerable even when the comparison is based only on the volume of deposits and loans.

The number of banks has declined throughout Europe. In Italy there were 1,156 in 1990; today there are 921.

Consolidation in the banking sector has intensified in the nineties. Excluding operations carried out within existing groups, mergers and acquisitions up to 1998 involved 432 banks accounting for one third of total bank assets. Another 25 banks were involved in similar operations in the first five months of this year.

Despite these operations, the major Italian banks are still small by international standards. Within the European Union the five largest Italian banking groups have a market share of 5.3 per cent, far smaller than those of the leading German, French and British groups, which are 13, 12 and 10 per cent respectively.

In view of the need to create Italian banks able to compete in the euro area, we have consistently encouraged mergers between leading intermediaries. Spurred by competition, three such operations between highly efficient and profitable large banks were completed in the last two years. Two major operations were carried out in the South to deal with situations of instability.

Foreign banking and insurance groups have invested significant amounts of capital in mergers and privatizations. The entry of leading German, French, Spanish and Dutch companies not only strengthens the capital base but also fosters the exchange of financial skills and techniques that can benefit innovation and the growth of the market.

Foreign capital has contributed to the creation of stable and sufficiently broad core groups of controlling shareholders able to define effective strategies.

The process of concentration between major banks must continue; it must make it possible, on the basis of adequate negotiating strength, to establish equity and operational links with leading European banks in order to permit an expansion of business in the international market.

The sale of controlling or significant shareholdings in banks owned by the State and banking foundations continued at a rapid but orderly pace. The market share of banks in the public sector has fallen from 68 per cent in 1992 to 17 per cent.

Of 70 banks that were formerly savings or pledge banks, 38 are still controlled by the original foundations. Almost all are small and their volume of business amounts to 7.7 per cent of the total.

The new regulations for restructuring the foundations allow an appropriate period for them to relinquish control. Privatization can be accomplished in the time and manner deemed most favourable. As with earlier major operations, it can increase their capital base by bringing in new shareholders.

Profitability and prospects

The advent of the euro has further increased competition in the collection and lending of savings. The sound and prudent management of banks calls for the supply of high quality services at competitive costs.

In the last two years progress has been made in the management of households' savings. There remains scope for significantly greater earnings from business services.

In order to increase profitability and strengthen the stability of the banking system, two years ago we took a special initiative to heighten management's awareness of the need to reduce labour costs, both overall and per unit of output.

In February of last year, the Italian Bankers' Association and the trade unions reached an agreement aimed at reducing costs to the average for the other leading European countries over the four following years.

Ensuring the operational efficiency and soundness of broad sections of the banking system and safeguarding an adequate level of employment in the sector require firm action to reduce costs and increase competitiveness. It is necessary to complete negotiations on contracts that expired some time ago and closely correlate costs per employee to the productivity and profitability of each bank.

The Italian banking system, which is well-capitalized overall, was able to weather a period of serious instability in the nineties. The banking systems of many industrial countries had to cope with similar difficulties. In Italy the cost to the public purse of covering losses was small by comparison with that borne by other governments.

Although there was marked and asymmetric dispersion around the mean, banks' return on equity fell from 10 to 1.7 per cent between 1990 and 1997. The 1993 recession, the suspension of special assistance for Southern Italy, the crisis in the southern economy, loan losses and the lag in reducing costs in the face of rising competition all played a role in the decline.

The figures for 1998 show a recovery in the rate of return to 7.8 per cent, with about one percentage point of the increase being attributable to recent tax changes. A number of non-recurring factors also contributed, such as the realization of large capital gains on government securities. Income from asset management services for households also increased sharply.

Net interest income was affected by a further narrowing of the spread between lending and deposit rates, which was partly offset by an increase in lending. The average rate on short-term loans fell from 9 per cent at the end of 1997 to 5.7 per cent in April of this year.

Loan quality improved.

The flow of bad debts fell from 2.0 to 1.6 per cent of lending. Although credit risk for banks in the South was considerably lower than in the recent past, it is still higher than in the rest of the country; new bad debts in the region equaled 3.4 per cent of lending.

Operating costs continued to rise in 1998, despite a 1.3 per cent reduction in bank staff. The number of employees has fallen by 6 per cent from its peak in 1993 to 338,000 at the end of last year.

The reduction took place in the context of mergers and restructuring operations; to a large extent it involved voluntary incentive schemes for personnel close to retirement.

Annual labour costs per employee amounted to 118.4 million lire in 1997, 25 per cent higher than the average for the other European banking systems. In 1998 they declined to 114.2 million; the abolition of health service contributions, which were incorporated into the regional tax on productive activities, generated savings of 6.6 million.

The rationalization plans launched by major banks set ambitious objectives for the years to come. Achieving these goals will require a significant reduction in unit labour costs and a considerable increase in revenues from services.

Two years ago we indicated that Italian banks should aim to raise their return on equity towards the median for the other leading continental European countries, which was then around 7.5 per cent. In the meantime profitability in other major industrial countries has increased. The Italian banking system must consolidate the results obtained in 1998 and make further progress.

Supervision

The complex nature of the organizational arrangements and the financial instruments used in banking have made it necessary to refine the prudential rules and the methods for measuring risks, including those arising from organizational inadequacies. Regulations laying down the criteria which banks' internal systems of control must satisfy have been adopted.

In the three years from 1996 to 1998, a total of 534 banks accounting for 35 per cent of the system's total assets were inspected; in 395 cases the inspections were conducted independently by Bank of Italy branches. Assessments cover loan quality, credit disbursement and monitoring procedures, liquidity, capital adequacy, organizational structure, costs and profitability.

The assessment was entirely favourable for 231 banks and partly favourable for 161; it was unfavourable for 142, most of them small banks, with 3 per cent of total assets.

Between 1993 and 1995 inspections had been carried out at 546 banks accounting for 40 per cent of total assets. The assessment was entirely favourable in 194 cases and partly favourable in 186; it was unfavourable for 166 institutions, representing 13 per cent of the system, including the large southern banks.

In the long run the stability and growth of the banking system depend on the vitality and expansion of the economy and on corporate profitability.

If Italy's abundant savings are to be fully harnessed to generate growth and employment, strategic decisions on the allocation of credit have to be based on a thorough knowledge of the economy's productive structure and growth potential.

Significant advances have been made in the privatization, capitalization and size of Italian banks. The links established with important foreign institutions will permit major Italian banks to participate in the formation of large European groups able to compete in the new international setting.

Intensified merger activity under the impetus of competition has led in some cases to prospective takeover bids whose merits we could not examine because of the inconsistency between the purportedly amicable nature of the proposals and the opposition displayed by the governing bodies of the target banks.

In the United States and the leading European markets over a long span of time, nearly all mergers between banks have taken place on a friendly or agreed basis.

Supervisory rules and practice do not exclude hostile takeovers. However, operations of this kind give rise to processes of organizational integration and rationalization that are very laborious and not guaranteed to succeed, especially when the banks involved have a complex structure and are of comparable size. This can have repercussions on the management of credit, the intermediation of savings and the value of the companies itself.

The 1993 Banking Law, which complies with the European Community Directive of 1989, lays down procedures to be followed in order to safeguard the sound and prudent management of intermediaries and the integrity of credit and savings when the ownership of bank shares is transferred.

In Italy, the protection of savings is enshrined in the Constitution.

The very existence of prudential supervision stems from the acknowledged special nature of banks. Official controls and measures are intended to protect the stability of intermediaries and the integrity of the funds they administer, which are equal to a high multiple of capital and reserves.

As in the most important financial systems, each significant acquisition of bank equity must be examined and authorized in advance by the supervisory authorities.

The law requires a bank's leadership to provide information during the initial stage so that the authorities can establish, as a preliminary step, before any public announcement is made, that no impediment exists. Failure to follow the procedures can cause fluctuations in the market price of the securities involved.

The project is then examined to ascertain whether it is consistent with the objectives pursued and to evaluate its effects on the sound management of the funds under administration. Modifications are sometimes suggested in order to facilitate the success of the operation.

In performing this function we authorized the large number of concentrations mentioned earlier, with positive results for the strengthening of the system. In some cases, to avoid violations of banks' bylaws or to prevent instability, we denied authorization for acquisitions of significant equity interests.

The criteria and procedures for authorization are spelt out in the secondary legislation. As we announced to the Interministerial Committee for Credit and Savings, the prior notification procedure will be supplemented, so as to make it more stringent and correspond more closely in terms of swiftness and efficacy to the needs of intermediaries and the progress of the financial market.

The Italian economy

Output in the euro area increased by 2.9 per cent in 1998. Economic activity slowed down in the second half. Consumption rose steadily during the year, while the growth in investment decelerated in the last quarter.

After increasing rapidly in 1997 and continuing to grow for most of 1998, the area's exports fell in the final months of the year. Imports followed a similar pattern.

The German and Italian economies were especially affected by the weakness of economic activity, with output contracting in the fourth quarter.

The expectations of euro area firms were coloured by pessimism in the second half of the year and the first few months of 1999. Households remained moderately optimistic.

The twelve-month rate of inflation gradually declined to 0.8 per cent in the fourth quarter before rising to just over 1 per cent in March of this year. Inflation is higher in the economies experiencing the strongest growth.

The area’s surplus on the current account of the balance of payments remained high at nearly 80 billion euros, or 1.4 per cent of GDP, thanks in part to an improvement in the terms of trade. The behaviour of capital movements resembled that which we have already described with regard to Italy. The errors and omissions item is large. Outward foreign direct investment by residents of the area exceeded inward investment by non-residents by 100 billion euros. Portfolio investment outside the area amounted to 307 billion euros and inward portfolio investment to 216 billion.

Remaining in close step with each other, the currencies of the eleven countries depreciated by nearly 20 per cent against the dollar between mid-1996 and mid-1997; they then strengthened markedly until the autumn of 1998 before falling back to the very low levels recorded in the summer of 1997.

Economic activity and monetary policy

In Italy output increased by 1.3 per cent in 1998. The stimulus imparted by the government incentives introduced in 1997 to encourage purchases of transport equipment faded in the early months of the year.

The consequences of the exceptional effort to reduce the budget deficit in the last few years continued to weigh on the economy. Structural reforms to reduce current spending in relation to output have not been introduced. Cash disbursements were cut back, impinging on the activities of local authorities, public investment and the launch of programmes for Southern Italy.

The rate of increase in consumption fell from 2.6 per cent in 1997 to 1.7 per cent last year, reflecting the slowdown in spending on durable goods. Household confidence deteriorated in the second half of 1998. No longer restrained by tax increases as in previous years, disposable income grew more rapidly despite the slow growth in gross earnings. The rise should help sustain demand this year.

Investment in construction increased slowly, while that in machinery and equipment accelerated after two years of moderate growth.

Firms' spending plans were influenced by the strength of production and orders in 1997, the high level of capacity utilization and the sharp fall in interest rates. Investment was primarily focused on rationalizing production processes.

Fixed capital formation slowed down during the year in connection with the deterioration in the international and domestic situations.

After increasing in late 1997 and the first few months of 1998, inflation progressively declined to about 1 per cent at the end of the year.

The fall in the prices of imports, especially energy products, was a contributory factor. Excluding this component, the inflation rate fell by less, to just under 2 per cent. The decrease was confirmed by the fall in producer prices and an improvement in inflation expectations, which were consistently below 2 per cent.

Although wage increases were small, unit labour costs in manufacturing rose further as productivity gains were modest; in the other European countries, where wage increases were similar, labour costs continued to decline.

After reducing the discount rate by 0.75 points at the end of 1997, in January 1998 we stated that the primary objective of monetary policy for the year would be the exchange rate of the lira in the European Monetary System.

The continued turbulence in international markets was a concern. In Italy the money supply, especially the more liquid components, continued to grow too rapidly, exceeding target rates and the pace of expansion in the other European countries.

The European Monetary Institute's Convergence Report, which was approved unanimously by the fifteen central bank Governors and the President of the Institute and published on 25 March, recognized that Italy had complied with the convergence criteria for inflation, long-term interest rates and the budget deficit. The stability and persistent appreciation of the lira in relation to its central parity prefigured substantive compliance with the exchange rate requirement.

The Report called for additional rigorous measures to lend credibility to the objective of reducing the public debt to below the limit of 60 per cent of gross domestic product, albeit over a particularly long period.

In April the weakness of economic activity, the satisfactory behaviour of inflation and the public finances and the strength of the exchange rate made it possible to reduce the discount rate again.

We judged that expectations of a positive outcome to the verification of compliance with the criteria for participation in monetary union would prompt the markets to react favourably to the reduction in official rates.

In the following months the appreciation of the dollar facilitated cohesion between the EMS currencies.

The onset of the Russian crisis in August triggered speculative attacks, initially against the currencies of European countries outside the EU or which are not participating in monetary union. Speculators subsequently shifted their attention to a number of countries in the euro area, including Italy.

The rigour of monetary policy, the market's perception of the determination to defend the exchange rate and the approach of the definitive fixing of parities and the launch of the single currency made it possible to overcome the tensions by making modest interventions in the market.

At the beginning of the autumn the domestic political situation became more uncertain, notably with regard to the approval of the budget.

The threat that the financial crisis would spread to Latin America cast its shadow over the international monetary system.

The political crisis, which was rapidly defused, did not have a significant impact on the financial market or the exchange rate. The international tensions eased.

At the end of October we lowered the discount rate by one percentage point to 4 per cent.

At the meeting of the Governing Council of the European Central Bank in early December, given the absence of inflationary pressures and the rapid deterioration in economic conditions, we agreed that each country in the area would reduce official rates to 3 per cent, partly with a view to ensuring a stable market environment for the imminent launch of the single currency.

In Italy, the fact that official rates were higher than in the other countries made a gradual approach appropriate. We accordingly reduced the discount rate from 4 to 3.5 per cent and made the remaining adjustment in the final days of the year.

Employment and growth

The Economic and Financial Planning Document of last spring set a target of an increase in employment of about 600,000 labour units between 1998 and 2001. On the basis of expected growth of 2.5 per cent in 1998, GDP was forecast to rise by 2.7 per cent in 1999 and 2.9 per cent in each of the two subsequent years.

Gross fixed investment in machinery, plant and transport equipment was expected to grow at an annual rate of more than 7 per cent in 1998 and the subsequent three years.

We deemed the forecast for employment growth to be optimistic. Without major structural changes, empirical analysis suggested that the increase would be about half the size of that indicated in the Planning Document.

The gradual spread of the effects of the international crisis to the Italian economy made it necessary to revise growth forecasts repeatedly downwards.

On several occasions and in statements to Parliament on the state of the economy and the public finances we argued that a return to more rapid, stable growth called for a revival in public and private investment and structural changes. We insisted on the need to increase flexibility in the use of productive factors and to link labour costs more closely to productivity and corporate profitability.

The Planning Document envisaged an increase of 0.5 per cent in employment in 1998. Despite the fact that output growth was only half the forecast rate, the increase in the number of labour units employed was 0.7 per cent on the basis of the new national accounts.

Employment in services grew by less than expected and there was no increase in employment in construction. By contrast, employment in manufacturing rose by 1.5 per cent, well above expectations.

Employment growth in all sectors is closely dependent on the introduction of greater flexibility, which is gradually being incorporated into legislation and collective labour contracts.

The number of persons engaged on fixed-term contracts was very high. Employee turnover rose in industrial firms; in the largest, the increase in the number of temporary positions involved contracts of six months or less.

Fixed-term positions accounted for 8.9 per cent of total salaried employment in 1998, compared with 6.2 per cent in 1993. The average for the European Union is 13 per cent.

The proportion of part-time workers, currently 7 per cent, is also increasing, but it remains well below the European average; in France and Germany the share is equal to 17 and 18 per cent respectively.

The number of apprentices increased markedly, rising by about 30,000 during the year. Temporary employment is becoming more common. The number of persons employed in community service jobs increased by about 20,000.

The changes occurring in the labour market appear to constitute a structural adjustment.

With the number of hours worked per capita in industry higher than in previous years, the spread of more flexible contractual arrangements creates scope to increase employment and curb irregular work even at a time of slow economic growth. The emerging picture of labour market trends shows a decline in the number of full-time, permanent positions and an increase in less stable forms of employment.

Only sustained economic growth can reduce the precariousness of such forms of contractual relationship.

Employment in Italy, as in other countries with a relatively short industrial tradition, is characterized by a large number of self-employed workers and a high proportion of small firms.

Self-employment, which is especially common in the distributive trades, accounts for more than 25 per cent of total non-farm employment, or nearly twice the European average. The figure is 20 per cent in Portugal and Spain and rises to 33 per cent in Greece.

According to the 1996 census of industry and services, firms with fewer than 10 employees account for 95 per cent of the total in Italy and provide 47 per cent of all employment. At the beginning of the nineties the share of employment provided by such firms was equal to 21 per cent in Germany, 22 per cent in France and 27 per cent in the United Kingdom.

Large firms with more than 250 employees provide 20 per cent of employment in Italy and more than twice this figure in France and the United Kingdom. In Germany firms with more than 500 employees account for one third of employment.

Small firms sometimes display considerable expertise and innovative ability; above all, they offer larger ones the possibility of indirectly using organizational and, in many cases, contractual working arrangements that are flexible and less costly.

Small production units enhance the ability of the economy to respond to sudden changes in market conditions. In the last twenty years they have slowed the fall in industrial employment. Their contribution to exports is substantial, amounting to just under half the total in the manufacturing sector.

Many small firms are members of one of the 199 specialized industrial districts which have been identified in Italy — 59 in the North-West, 65 in the North-East, 60 in the Centre and 15 in the South — and which together account for 40 per cent of total manufacturing employment.

The concentration of particular activities in such districts stimulates product and process innovation, increases the professional skills and mobility of workers within the area and encourages the birth of new businesses. Operational and informational advantages increase the ability to adjust output to fluctuations in demand.

Pay is more closely related to productivity and the quality of work. The supply of labour adjusts promptly to changes in the business cycle and the situation of firms. There tends to be de facto employee participation in the fortunes of the firm, with resulting benefits for the return on capital and investments.

Compared with other countries, Italy has only a small number of medium-sized firms, the natural next stage in the growth of smaller firms. The obstacles to their development are legal, fiscal and financial.

The dearth of medium-sized and large firms limits the ability of the economy to make major investments that would expand production, improve competitiveness in international markets and sustain growth.

From the seventies onwards the Italian economy, like those of Spain and Portugal, has specialized in a small number of low and medium-technology sectors. Firms in Germany, France and the United Kingdom have expanded their already considerable presence in branches with a large technological content and high value added.

By increasing competition and the mobility of capital, the single currency may lead to productive activity being concentrated in the areas offering the best conditions for technological progress and the most robust financial and productive systems.

Growth requires firms producing innovative goods that can make their mark in international markets. This must be the leitmotif of the policies to provide incentives and support for research and the development of human capital.

Forecasts for the year 2000 show that the world economy could expand by up to 3 per cent; the growth of the eleven euro area countries would be significantly higher than the 2 per cent expected this year.

The expectations of a moderate recovery at the global level are based on the assumption that the Asian crisis will be overcome, that growth will resume in Japan, that the financial tensions in Latin America and Russia will abate and that cyclical conditions in Europe will improve. The economy of the United States appears set to slow down.

In Italy industrial production has continued to decline in the early months of this year. The figures for the first four months show a further fall in both exports and imports compared with the last part of 1998.

On the basis of firms' investment plans, the growth in capital spending seems likely to decelerate. The rise in exports will again be modest, despite their benefiting from the improvement in world demand and the lower exchange rate of the euro; it may pick up in the following years. Consumption is likely to expand by 2 per cent.

Gross domestic product cannot grow by much more than 1 per cent, partly owing to the unsatisfactory performance in the early months of the year. There is a risk that investment will remain weak in the years to come. The increase in employment is likely to continue to be modest.

It is necessary to launch a recovery in the second half of the year.

Growth closer to 1.5 per cent may be achieved if measures are taken to improve confidence and boost investment. This would create the conditions for a larger increase in GDP of around 2.5 per cent in 2000.

The flexibility introduced into employment contracts increased the number of jobs in industry last year and allowed the rise in value added to be distributed among a larger pool of workers.

Further steps can and must be taken. It is necessary to differentiate labour costs more clearly and structurally in relation to productivity, in part by redefining the content and role of national and company-level settlements.

If they are seen as permanent, such changes can increase business confidence.

The stimulus to growth must come from a substantial revival in private and public investment.

The growth potential of Southern Italy is considerable. The large increase in the number of construction contracts awarded last year must be followed by the commencement of work and the completion of projects.

The Government's plans for reviving productive activity must be implemented more rapidly. Projects must be finalized promptly, the efficiency of central and local government improved, Community funds utilized in full, public financing disbursed without delay and the private sector involved on a significant scale.

Infrastructure in the more developed parts of Italy is inferior to that in other European countries. The shortcomings are more severe in the South; often they concern essential services.

There has been an improvement in the utilization of funds made available by the European Union, but it is still limited; 55 per cent of the resources allocated for the period 1994-99 have been used.

In 1998 the European Investment Bank financed infrastructure projects in Italy costing 2.5 billion euros. In recent years other important Community countries have received a proportionally larger volume of loans. The amounts granted to Italy are limited by local authorities' inadequate ability to plan and carry out projects.

A start has been made on coordinating the various investment planning bodies more effectively. The involvement of the private sector in financing and operating infrastructure needs to be increased; project financing will provide a stimulus in this direction.

The public finances

The role of the public sector and the size and structure of the budget are fundamental in establishing the guidelines for the development of the Italian economy in the coming years.

The efforts to reduce the budget deficit, which were initiated with determination in the early nineties, were intensified in the run-up to the adoption of the single currency. The adjustment was based on an increase in revenue: the ratio of taxes and social security contributions to GDP rose from 39 to 44.8 per cent between 1989 and 1997 and then declined last year to 43.6 per cent.

Between 1989 and 1998 the average ratio for the other European countries rose by 0.7 percentage points to 43.5 per cent.

Expenditure excluding interest payments rose in Italy from 43.1 per cent of GDP in 1989 to 45.7 per cent in 1993; the ratio then declined to just over 42 per cent in the last four years. The fall that occurred between 1989 and 1998 was roughly equal to that in the ratio of public investment to GDP.

The pension reforms of 1992 and 1995, combined with cuts in transfers to non-state public bodies, have prevented primary current expenditure from rising faster than GDP in recent years. Public sector wages and salaries have been held in check by the incomes policy introduced in the early nineties and restrictions on recruitment.

Under present legislation, the rapid ageing of the population will cause spending on pensions to rise steadily in relation to GDP. The ratio of the population aged 65 and over to that aged between 15 and 64 has doubled since the beginning of the sixties and now stands at 25 per cent.

Action must be taken in good time to forestall the difficulties that will otherwise inevitably begin to arise in the second half of the next decade. It is necessary to act promptly to reduce pension benefits in relation to GDP from then onwards.

An early start on reform will have a positive effect on expectations. The measures will need to avoid disappointing the expectations of workers approaching retirement and creating major disparities of treatment between successive generations of pensioners. Workers will be able to obtain the cover they desire by taking out supplementary pensions.

The ageing of the population also increases the demand for health and welfare services. At present expenditure in these fields is curbed by restrictions on cash disbursements, with adverse effects on the quality and availability of services. In the medium term, keeping expenditure within limits compatible with the growth in national income and the supply of adequate services will require a socially acceptable revision of rights of access to benefits. Supplementary private insurance can make a contribution.

A slowdown in economic activity reduces government revenue, and in the medium term it tends to increase expenditure.

A rate of growth below that on which the Government based its medium-term plan last year raises the problem of formulating suitable measures to keep the public finances under control.

Budgetary policy in the next three years will have to confirm the guidelines laid down in last year's Economic and Financial Planning Document. In the medium term, the primary surplus will have to be large and stable.

The level of interest payments depends on interest rates in international markets; by its very nature, the recent downward trend is reversible.

If the undertakings entered into at European level are to be fulfilled, the budget must be balanced rapidly. The way to achieve this cannot involve a further increase in the ratio of taxes and social security contributions to GDP.

Major areas of public expenditure need to be reformed so as to lower the ratio over the medium term.

It is necessary to return to faster growth. Public investment programmes must be implemented rapidly, especially those that are part of plans for supporting the economy in the South.

It is essential to ensure permanently greater flexibility in the use of productive factors.

These are conditions for improving the climate of confidence and strengthening the expansion of private investment as well.

The annual average growth of the Italian economy during the nineties was a percentage point less than that for the euro area. In the three years from 1996 to 1998 gross domestic product increased by 2.6 per cent a year in the other ten countries of the area, whereas in Italy output rose by only 1.2 per cent a year.

This slower growth is reflected in the unsatisfactory employment figures, in a large surplus on the external current account that is completely offset by net capital outflows, and in the difficulties being encountered in reducing the budget deficit.

Last year the spread and continuation of the international crisis took their toll. The bottom of the economic cycle has been reached in recent months, but the recovery has yet to materialize in any strength.

Italy has the technical resources, entrepreneurs, manpower and savings to support greater investment, more vigorous growth and a recovery in employment. The weakness of effective demand is preventing the utilization of further potential resources, especially savings, that would contribute to the growth of the economy.

The propensity to invest remains tentative, despite the fact that conditions are now more favourable than in the recent past in terms of the cost and availability of credit and the level of taxation.

Changes in the public pension and health systems will ensure that over the medium term expenditure will be compatible with the growth in national income, the equilibrium of the pension funds and the safeguarding of benefits for all citizens, first and foremost those in greatest need or on low incomes.

Current expenditure must be reduced in order to permit a gradual easing of the tax burden and create scope for increased spending on infrastructure and investment in research, training and education.

Planned investment must be implemented swiftly, especially in the South, in order to revive demand and employment and ensure a greater supply of essential public services. The obstacles to the growth of small enterprises must be removed.

A functional and efficient public administration is indispensable for growth, but growth and employment must not and, more fundamentally, cannot be guaranteed by the public sector. It is firms that must provide them.

Industrial relations based on agreements between employers and trade unions must assign higher priority than in the past to the link with productivity and corporate profitability, even where permanent employment contracts are concerned.

It is necessary to create a regulatory, economic and social environment favourable to growth.

Frankness about economic policy matters and the conditions needed to improve the prospects for our country does not blind us to the fact that the economy is operating in a context in which grave acts of terrorist violence have recurred. Peoples who are geographically close to us, in the heart of Europe, are being ravaged by acts of war and genocide which we thought had been eradicated from our history.

A renewed spirit of cooperation among the political parties on major institutional decisions can be extended to the definition of economic policy strategies acceptable to all.

The right to work, which was made one of the cornerstones of the Italian Republic, is implemented by providing the necessary education and training to the willing and able, to the young people seeking opportunities in the labour market to participate fully in the economic and civil life of the country. It is implemented by fostering the economic conditions for sustained growth.

We are confident that the resources at our disposal can be harnessed to promote the economic and civil progress of our society.

STATISTICAL APPENDIX

LIST OF TABLES

Table a1

SOURCES AND USES OF INCOME AND HOUSEHOLDS' CONSUMPTION

(billions of lire at 1995 prices)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
SOURCES AND USES OF INCOME										
Sources										
Agriculture, forestry and fishing (1)	47,075	45,119	49,188	49,859	49,713	50,128	50,895	51,714	52,190	52,841
Industry (1)	535,568	545,392	551,022	554,465	534,368	553,516	575,170	574,982	588,115	603,487
Services (1)	1,031,602	1,056,282	1,067,653	1,079,777	1,090,277	1,109,040	1,133,458	1,148,415	1,161,832	1,171,985
Financial intermediation services indirectly measured (–)	68,592	71,082	71,045	75,505	76,549	78,942	77,180	78,219	81,378	84,881
VAT and indirect taxes on imports	99,749	102,176	104,393	105,554	101,191	102,764	104,938	105,854	108,704	110,504
Gross domestic product	1,645,403	1,677,885	1,701,210	1,714,149	1,699,000	1,736,505	1,787,278	1,802,746	1,829,464	1,853,934
Imports of goods and services	306,052	338,018	342,733	359,002	321,894	354,924	392,013	386,971	425,755	451,821
Total	1,951,455	2,015,903	2,043,943	2,073,151	2,020,894	2,091,429	2,179,291	2,189,717	2,255,219	2,305,755
Uses										
Investment in buildings and public works	161,856	168,804	171,508	169,176	157,879	147,888	149,202	151,769	149,057	149,201
Investment in machinery, equipment and transport equipment	161,491	167,838	168,663	166,548	140,872	150,558	166,665	170,099	175,033	185,036
Intangible assets	11,624	11,827	11,779	11,241	10,390	10,913	11,985	13,379	14,116	15,641
Households' consumption	985,134	1,004,266	1,033,071	1,046,852	1,019,186	1,041,953	1,064,471	1,070,315	1,097,837	1,116,746
Consumption of general government and non-profit institutions	321,955	329,895	335,481	337,382	336,676	333,942	326,933	331,435	329,842	333,971
Change in stocks and valuables	12,475	15,505	13,553	11,916	–554	13,710	17,829	3,862	18,148	28,319
Domestic demand	1,654,535	1,698,135	1,734,055	1,743,115	1,664,449	1,698,964	1,737,085	1,740,859	1,784,033	1,828,914
Exports of goods and services	296,920	317,769	309,888	330,036	356,445	392,465	442,206	448,858	471,186	476,842
HOUSEHOLDS' CONSUMPTION										
By type of consumption										
Durable goods	112,089	115,018	117,587	120,428	101,267	104,109	105,782	107,940	126,637	130,922
Non-durable goods	465,730	471,605	484,034	489,148	481,441	485,456	491,467	488,828	494,074	499,640
Services	407,315	417,643	431,450	437,276	436,478	452,388	467,222	473,547	477,126	486,184
By type of good										
Food products	193,293	194,652	195,977	196,657	193,147	190,580	186,966	185,009	185,699	187,156
Non-food products	791,841	809,614	837,094	850,195	826,039	851,373	877,505	885,306	912,138	929,590

Source: Istat, national accounts; based on the new European system of accounts, ESA95.
(1) Value added at market prices.

Table a2

INDUSTRIAL PRODUCTION BY ECONOMIC PURPOSE
(indices, 1995=100)

	Final investment goods				Final consumer goods				Intermediate goods				AGGRE-GATE INDEX
	For industry	Transport equipment	Multi-sector	Total	Durable	Semi-durable	Non-durable	Total	For industry	For consumer goods	Mixed purpose	Total	
1989	85.6	120.6	99.1	93.5	93.8	92.6	89.9	92.0	101.7	98.9	92.3	94.0	93.4
1990	87.5	125.5	96.2	95.2	92.4	92.3	93.5	92.9	102.6	97.0	91.5	93.3	93.5
1991	83.5	119.0	94.6	91.3	91.9	92.3	94.9	93.2	100.0	97.0	91.0	92.7	92.6
1992	81.9	106.4	91.5	87.7	89.0	92.7	97.9	93.9	99.1	98.3	91.4	93.0	92.4
1993	81.5	85.2	94.1	84.7	83.7	89.8	98.0	91.6	90.2	95.9	90.5	91.1	90.2
1994	85.9	87.8	94.0	87.8	93.6	95.9	99.0	96.7	90.7	99.8	96.2	96.1	94.9
1995	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1996	102.7	102.4	100.4	102.2	98.2	99.1	100.6	99.6	102.6	99.0	97.3	98.0	99.1
1997	103.0	111.1	97.3	103.0	104.1	100.8	105.1	103.2	101.7	102.3	101.9	101.9	102.4
1998	101.8	110.8	100.5	102.8	104.2	99.4	108.0	103.9	105.4	101.0	105.4	104.9	104.3

Source: Istat.

Table a3

TURNOVER IN INDUSTRY BY ECONOMIC PURPOSE
(indices, 1995=100)

	Final investment goods	Final consumer goods	Intermediate goods	AGGREGATE INDEX
1989	73.5	67.8	66.5	68.4
1990	76.4	73.3	67.2	71.3
1991	78.4	79.0	69.4	74.5
1992	77.1	83.9	70.1	76.0
1993	73.3	86.6	74.0	77.8
1994	83.4	91.1	82.9	85.6
1995	100.0	100.0	100.0	100.0
1996	106.6	100.2	95.7	99.7
1997	112.3	102.9	99.2	103.4
1998	114.5	107.5	99.7	105.6

Source: Istat.

Table a4

LABOUR COSTS PER UNIT OF OUTPUT AND VALUE ADDED PER UNIT OF LABOUR, BY BRANCH

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
	Labour costs per unit of output (1) *(current lire per thousand lire of value added at factor cost at 1995 prices)*									
Agriculture, forestry and fishing	**743**	**797**	**765**	**804**	**768**	**738**	**717**	**683**	**669**	**641**
Industry excluding construction	**520**	**562**	**608**	**623**	**651**	**633**	**640**	**678**	**687**	**666**
of which: manufacturing	*546*	*590*	*637*	*651*	*682*	*663*	*670*	*713*	*721*	*706*
Construction	**502**	**557**	**605**	**644**	**693**	**717**	**718**	**712**	**738**	**712**
Services (2)	**486**	**536**	**584**	**611**	**619**	**622**	**635**	**676**	**700**	**688**
Wholesale and retail trade, repair of household goods etc.	*540*	*572*	*621*	*631*	*649*	*636*	*641*	*674*	*686*	*696*
Hotels and restaurants	*517*	*562*	*610*	*683*	*719*	*740*	*808*	*840*	*889*	*883*
Transport, storage and communication	*552*	*582*	*619*	*643*	*632*	*601*	*606*	*629*	*631*	*608*
Financial intermediation	*470*	*497*	*544*	*614*	*568*	*566*	*586*	*597*	*605*	*568*
Sundry business and household services (2) (3)	*197*	*215*	*243*	*261*	*271*	*285*	*296*	*322*	*342*	*352*
Public administration (4)	*683*	*771*	*800*	*802*	*823*	*849*	*862*	*937*	*992*	*949*
Education	*656*	*771*	*843*	*890*	*900*	*932*	*970*	*1,069*	*1,130*	*1,156*
Health and social work services	*572*	*692*	*804*	*815*	*850*	*865*	*895*	*943*	*1,021*	*980*
Other public, social and personal services	*594*	*621*	*661*	*666*	*712*	*722*	*733*	*751*	*763*	*735*
Private households with employed persons	*665*	*730*	*805*	*856*	*911*	*938*	*1,000*	*1,040*	*1,091*	*1,117*
Total (2)	**515**	**564**	**611**	**636**	**649**	**647**	**657**	**693**	**712**	**695**
	Value added at factor cost per unit of labour (1) *(thousands of lire at 1995 prices)*									
Agriculture, forestry and fishing	**25,495**	**25,027**	**27,617**	**28,726**	**31,304**	**33,155**	**34,834**	**37,659**	**39,238**	**40,488**
Industry excluding construction	**67,953**	**68,355**	**69,346**	**72,271**	**72,716**	**77,218**	**80,029**	**80,067**	**82,402**	**83,953**
of which: manufacturing	*62,985*	*63,259*	*64,348*	*67,158*	*67,543*	*71,566*	*74,167*	*74,061*	*76,607*	*77,358*
Construction	**57,917**	**58,553**	**58,570**	**57,580**	**55,847**	**54,530**	**56,688**	**59,730**	**59,500**	**61,751**
Services (2)	**72,582**	**73,181**	**72,642**	**73,142**	**75,258**	**76,997**	**78,310**	**78,313**	**78,834**	**78,781**
Wholesale and retail trade, repair of household goods etc.	*56,170*	*57,616*	*58,179*	*59,119*	*60,307*	*63,742*	*67,085*	*66,149*	*68,223*	*67,767*
Hotels and restaurants	*49,316*	*48,909*	*47,498*	*47,918*	*48,695*	*48,357*	*48,847*	*49,761*	*49,426*	*50,050*
Transport, storage and communication	*72,250*	*75,548*	*78,360*	*80,205*	*83,117*	*86,953*	*92,319*	*91,550*	*93,093*	*96,253*
Financial intermediation	*146,772*	*149,353*	*145,360*	*140,484*	*156,800*	*166,173*	*159,928*	*171,805*	*171,372*	*174,102*
Sundry business and household services (2) (3)	*164,326*	*161,496*	*155,478*	*151,685*	*157,328*	*160,928*	*159,432*	*151,629*	*147,000*	*142,277*
Public administration (4)	*55,400*	*57,265*	*59,727*	*61,770*	*63,198*	*64,054*	*65,201*	*66,350*	*66,112*	*67,503*
Education	*54,374*	*53,770*	*53,020*	*53,569*	*54,541*	*53,798*	*53,101*	*52,832*	*52,219*	*50,277*
Health and social work services	*62,608*	*60,029*	*57,802*	*59,434*	*58,550*	*57,467*	*56,687*	*58,113*	*58,718*	*58,664*
Other public, social and personal services	*64,193*	*62,077*	*59,381*	*59,425*	*58,913*	*60,210*	*61,775*	*62,568*	*64,678*	*65,910*
Private households with employed persons	*19,110*	*18,716*	*18,276*	*18,663*	*18,498*	*18,624*	*18,687*	*18,554*	*18,539*	*18,208*
Total (2)	**66,288**	**66,888**	**67,102**	**68,184**	**69,903**	**72,240**	**74,128**	**74,741**	**75,790**	**76,450**

Source: Istat, national accounts; based on the new European system of accounts, ESA95.

(1) Includes indirectly measured financial intermediation services. – (2) Includes the old branch “Renting of buildings”, which is no longer available under ESA95. – (3) Includes real estate services, renting services, computer and related services, research and other business services. – (4) Includes defence and compulsory social security services.

Table a5

ITALIAN CONSUMER PRICE INDICES
(percentage changes on corresponding period)

	NIC (1)															WEH (2)
	Goods and services with unregulated prices									Goods and services with regulated prices						
	Non-food and non-energy products		Services	Total net of food and energy products and those with regulated prices	Food products			Energy products	Total	Goods (4)	Utility charges		Rents	Total	Overall index (5)	Overall index (5)
		of which: net of cars			Processed	Not processed	Total					*of which: energy products*				
Weights (2)	*31.2*	*27.2*	*28.3*	*59.5*	*10.3*	*7.5*	*17.8*	*3.5*	*80.8*	*4.8*	*11.1*	*3.0*	*3.3*	*19.2*	*100*	*100*
1990	4.6	4.7	8.0	6.1	6.3	6.0	6.1	13.8	6.5	4.8	7.1	9.3	6.1	6.4	6.5	6.1
1991	4.5	4.7	7.7	5.9	5.9	7.3	6.6	9.0	6.2	6.8	7.1	9.1	5.9	6.9	6.3	6.4
1992	4.0	4.0	7.5	5.5	5.0	5.1	5.0	0.6	5.2	3.6	6.2	1.3	6.5	5.6	5.3	5.4
1993	4.7	4.1	5.6	5.1	4.5	–0.2	2.2	5.5	4.4	8.7	4.7	3.4	7.6	6.1	4.6	4.2
1994	4.1	3.5	4.3	4.2	4.0	3.1	3.5	3.9	4.0	3.9	3.3	4.7	8.4	4.2	4.1	3.9
1995	4.9	4.2	5.2	5.0	6.8	5.4	6.1	7.5	5.4	2.8	4.5	4.4	7.6	4.6	5.2	5.4
1996	3.8	3.7	4.6	4.1	4.7	3.7	4.2	4.4	4.2	4.2	1.7	–0.2	8.3	3.4	4.0	3.9
1997	1.5	1.8	2.9	2.1	0.8	–0.8	0.0	1.5	1.6	5.4	2.8	2.3	6.6	4.0	2.0	1.7
1998	1.9	1.8	2.8	2.3	0.8	1.6	1.2	–2.7	1.8	4.5	1.1	0.0	5.2	2.6	2.0	1.8
1997 – Oct. .	1.4	1.5	2.8	2.0	0.1	–1.0	–0.4	0.4	1.3	6.6	4.1	4.7	5.7	5.0	2.0	1.6
Nov. .	1.5	1.8	2.5	2.0	0.2	–0.5	–0.1	–0.1	1.4	6.7	3.5	3.0	5.7	4.6	2.0	1.6
Dec. .	1.4	1.7	2.6	1.9	0.2	0.0	0.1	–0.5	1.4	6.7	3.3	2.7	5.7	4.5	1.9	1.5
1998 – Jan. .	1.8	1.7	2.7	2.2	0.2	0.8	0.5	–1.3	1.6	3.8	2.8	2.0	5.3	3.5	1.9	1.6
Feb. .	2.0	1.7	2.8	2.4	0.4	1.2	0.8	–2.1	1.8	3.5	2.7	1.7	5.3	3.4	2.1	1.8
Mar. .	2.0	1.8	2.9	2.4	0.6	1.2	0.8	–2.8	1.8	3.9	2.2	0.8	5.3	3.2	2.1	1.7
Apr. .	2.1	1.8	2.8	2.4	0.7	1.3	1.0	–2.3	1.9	4.0	2.0	0.7	5.8	3.1	2.1	1.8
May. .	2.0	1.8	2.8	2.4	1.0	1.4	1.2	–2.0	1.9	4.2	0.5	0.1	5.8	2.3	2.0	1.7
June	2.1	1.8	2.9	2.4	0.9	1.7	1.3	–2.2	2.0	4.1	0.6	0.2	5.8	2.3	2.1	1.8
July .	2.0	1.9	2.8	2.3	0.9	1.8	1.4	–1.9	1.9	5.3	0.5	–0.3	5.2	2.4	2.1	1.8
Aug. .	2.1	1.9	2.9	2.4	0.9	2.0	1.5	–2.6	2.0	5.3	0.6	–0.3	5.2	2.5	2.1	1.9
Sept.	2.1	1.9	2.7	2.3	1.0	2.1	1.6	–3.0	2.0	5.0	0.5	–0.6	5.2	2.4	2.0	1.8
Oct. .	1.7	1.8	2.6	2.1	1.0	2.1	1.5	–3.6	1.8	5.1	0.3	–1.0	4.5	2.1	1.9	1.7
Nov. .	1.4	1.5	2.7	2.0	0.9	1.8	1.3	–4.2	1.6	5.0	0.1	–2.0	4.5	2.0	1.7	1.5
Dec. .	1.4	1.5	2.7	2.0	0.9	1.8	1.3	–4.5	1.6	5.0	0.4	–1.9	4.5	2.2	1.7	1.5
1999 – Jan. .	1.3	1.3	2.6	1.9	0.8	1.8	1.3	–4.2	1.5	4.6	–0.6	–5.2	4.0	1.4	1.5	1.3
Feb. .	1.1	1.3	2.5	1.8	0.8	2.0	1.3	–2.9	1.5	4.6	–0.6	–5.2	4.0	1.4	1.4	1.2
Mar. .	1.1	1.3	2.4	1.7	0.8	2.1	1.4	–1.2	1.5	2.1	–0.7	–5.5	4.0	0.8	1.3	1.4

Source: Based on Istat data.

(1) Consumer price index for the entire resident population; 1995=100. Chain index as of January 1999. – (2) Consumer price index for worker and employee households, excluding tobacco products; 1995=100. Chain index as of January 1999. – (3) As chain index of January 1999 Istat changes the weights every year on the basis of estimates of households' final consumption in the previous year. The weights shown in the table are those for 1999. – (4) Medicines, salt and tobacco products. For medicines, the reference is to the aggregate calculated by Istat; around one third of this consists of products in the so-called "C band", the prices of which are unregulated. Drinking water, electricity and natural gas are included under utility charges. – (5) Percentage changes published by Istat and calculated on indices rounded to the first decimal place.

Table a6

HARMONIZED INDEX OF CONSUMER PRICES: ITALY (1)

(percentage changes on corresponding period)

	Non-food and non-energy products		Services		Total net of food and energy products	Food products				Energy products	Overall index
		of which: net of cars		*of which: net of rents*		Processed	Not processed	Tobacco products			
Weights	*35.3*	*31.0*	*36.6*	*33.3*	*71.9*	*9.9*	*9.2*	*2.0*	*21.1*	*7.0*	*100.0*
1997	1.7	2.0	3.3	3.0	2.5	0.7	–0.7	3.9	0.3	1.9	1.9
1998	2.1	2.0	2.7	2.5	2.4	0.7	1.6	5.4	1.5	–1.4	2.0
1997 – Jan.	2.4	2.7	3.5	3.2	3.0	2.5	1.6	0.0	1.9	1.7	2.6
Feb.	2.2	2.4	3.3	3.0	2.7	1.9	0.9	0.0	1.2	2.0	2.3
Mar.	1.9	2.2	3.4	3.1	2.6	1.5	0.3	4.7	1.2	1.9	2.2
Apr.	1.8	2.1	3.3	3.0	2.5	1.1	–0.7	4.7	0.5	0.5	1.9
May	1.6	1.9	3.5	3.2	2.5	0.5	–1.6	4.7	–0.2	0.7	1.8
June	1.5	1.9	3.4	3.1	2.4	0.4	–2.1	4.7	–0.5	1.0	1.6
July	1.4	1.8	3.3	3.0	2.3	0.2	–2.1	4.7	–0.6	3.5	1.7
Aug.	1.3	1.7	3.1	2.8	2.2	0.2	–1.9	4.7	–0.5	3.6	1.6
Sept.	1.4	1.8	3.0	2.7	2.2	0.1	–1.4	4.7	–0.2	2.7	1.6
Oct.	1.6	1.8	3.2	3.0	2.4	0.1	–0.8	4.7	0.0	2.5	1.9
Nov.	1.8	2.1	3.0	2.8	2.4	0.2	–0.4	4.7	0.3	1.4	1.8
Dec.	1.7	2.0	2.9	2.7	2.3	0.2	0.0	4.7	0.5	1.0	1.8
1998 – Jan.	2.0	1.9	2.9	2.7	2.4	0.2	0.7	4.7	0.8	0.3	1.9
Feb.	2.2	1.9	3.0	2.8	2.6	0.3	1.2	4.7	1.1	–0.2	2.1
Mar.	2.2	2.0	3.0	2.8	2.6	0.4	1.2	5.5	1.2	–1.1	2.1
Apr.	2.3	2.1	2.9	2.7	2.6	0.5	1.4	5.5	1.4	–0.8	2.2
May	2.3	2.1	2.6	2.4	2.5	0.8	1.5	5.5	1.6	–1.0	2.0
June	2.3	2.1	2.7	2.4	2.5	0.8	1.8	5.5	1.7	–1.0	2.1
July	2.3	2.2	2.6	2.4	2.4	0.8	1.9	5.5	1.7	–1.1	2.1
Aug.	2.4	2.2	2.7	2.4	2.5	0.8	2.1	5.5	1.9	–1.6	2.2
Sept.	2.3	2.1	2.7	2.5	2.5	0.9	2.1	5.5	1.9	–1.9	2.1
Oct.	2.0	2.1	2.5	2.3	2.2	0.8	2.1	5.5	1.9	–2.3	1.9
Nov.	1.7	1.7	2.6	2.4	2.1	0.8	1.8	5.5	1.7	–3.1	1.7
Dec.	1.6	1.7	2.7	2.6	2.2	0.8	1.8	5.5	1.7	–3.2	1.7
1999 – Jan.	1.5	1.5	2.6	2.4	2.0	0.8	1.8	5.5	1.6	–4.6	1.5
Feb.	1.2	1.5	2.5	2.4	1.9	0.7	2.0	5.5	1.7	–3.9	1.4
Mar.	1.2	1.4	2.4	2.2	1.8	0.8	2.1	0.0	1.3	–3.1	1.4

Source: Based on Eurostat data.
(1) 1996=100. Chain index. In January of each year the weight of each elementary item, determined initially with reference to the structure of consumption in 1996, is updated by Eurostat. The weights shown in the table are those for 1999.

Table a7

HARMONIZED INDEX OF CONSUMER PRICES: EURO AREA (1)

(percentage changes on corresponding period)

	Non-food and non-energy products		Services		Total net of food and energy products	Food products				Energy products	Overall index
		of which: net of cars		*of which: net of rents*		Processed	Not processed	Tobacco products			
Weights	*32.5*	*27.9*	*36.3*	*29.7*	*68.8*	*11.1*	*9.0*	*2.3*	*22.4*	*8.8*	*100.0*
1997	0.5	0.7	2.4	2.3	1.5	0.7	1.5	5.5	1.5	2.7	1.6
1998	0.9	0.7	2.0	1.9	1.4	0.9	1.8	4.1	1.6	−2.5	1.1
1997 – Jan.	0.7	0.9	2.5	2.4	1.6	0.9	2.7	4.9	2.0	5.1	2.0
Feb.	0.7	0.9	2.5	2.4	1.6	0.7	1.4	4.8	1.4	4.5	1.8
Mar.	0.5	0.8	2.5	2.4	1.6	0.5	−0.1	6.0	0.7	3.6	1.6
Apr.	0.5	0.7	2.4	2.3	1.5	0.4	−0.1	6.0	0.7	2.0	1.3
May	0.4	0.7	2.4	2.3	1.5	0.4	0.3	6.0	0.9	2.0	1.4
June	0.4	0.6	2.4	2.3	1.4	0.6	0.6	6.0	1.1	2.4	1.4
July	0.3	0.5	2.5	2.5	1.5	0.6	0.7	6.0	1.2	2.6	1.5
Aug.	0.4	0.6	2.5	2.5	1.5	0.7	1.5	5.5	1.5	4.1	1.7
Sept.	0.4	0.6	2.4	2.3	1.4	0.7	2.3	6.3	1.9	2.5	1.6
Oct.	0.4	0.6	2.2	2.2	1.4	0.8	2.6	6.3	2.0	1.4	1.5
Nov.	0.6	0.7	2.3	2.3	1.5	0.9	3.2	4.7	2.2	1.3	1.6
Dec.	0.6	0.7	2.3	2.2	1.5	0.9	3.0	3.6	2.0	0.6	1.5
1998 – Jan.	0.5	0.5	2.1	2.0	1.4	0.9	1.8	3.4	1.5	−1.2	1.1
Feb.	0.6	0.5	2.0	1.9	1.3	0.9	2.1	3.6	1.6	−1.3	1.1
Mar.	0.7	0.6	1.9	1.8	1.3	1.1	2.7	3.2	1.9	−1.5	1.1
Apr.	0.9	0.7	2.0	2.0	1.5	1.1	2.9	3.1	2.0	−0.9	1.4
May	0.9	0.8	1.9	1.9	1.4	1.1	2.3	4.8	2.0	−1.3	1.3
June	1.0	0.8	1.9	1.8	1.5	1.0	2.6	4.7	2.0	−1.6	1.4
July	0.9	0.8	1.9	1.8	1.4	0.9	2.3	4.8	1.8	−1.8	1.3
Aug.	1.0	0.8	1.9	1.9	1.5	0.8	2.1	4.8	1.8	−3.8	1.1
Sept.	1.1	0.9	1.9	1.9	1.5	0.8	1.3	3.9	1.3	−3.7	1.0
Oct.	1.0	0.9	2.0	2.0	1.5	0.7	0.9	4.2	1.1	−4.0	0.9
Nov.	0.9	0.8	2.0	2.0	1.5	0.6	0.4	4.3	0.9	−4.3	0.8
Dec	0.9	0.8	2.0	2.0	1.4	0.5	0.8	4.2	1.0	−4.7	0.8
1999 – Jan.	0.9	0.8	1.8	1.7	1.3	0.6	1.1	4.6	1.2	−4.4	0.8
Feb.	0.7	0.8	1.7	1.7	1.2	0.7	1.5	4.4	1.4	−4.3	0.8
Mar.	0.7	0.8	1.7	1.7	1.2	0.7	1.7	3.4	1.4	−2.8	1.0

Source: Based on Eurostat data.

(1) Weighted average of the indices of the euro area countries. The weights shown in the table are those for 1999.

Table a8

INDEX OF THE PRODUCER PRICES OF MANUFACTURES SOLD IN THE DOMESTIC MARKET

(percentage changes on corresponding period)

	Non-energy products								Energy products	Overall index
	Consumer goods					Investment goods	Intermediate goods	Total		
	Non-food products with unregulated prices (2)	of which: net of cars	Food products with unregulated prices (3)	Other goods (4)	Total					
Weights (1)	*18.5*	*16.4*	*12.3*	*4.1*	*34.9*	*9.5*	*41.0*	*85.4*	*14.6*	*100.0*
1990	2.7	2.5	3.0	3.1	2.8	4.1	1.7	2.6	16.2	4.1
1991	2.3	2.3	5.3	1.9	3.4	3.3	5.5	3.8	–2.4	3.3
1992	3.2	3.0	3.8	5.3	3.6	3.3	1.0	2.2	–0.4	1.9
1993	3.1	2.7	3.9	6.0	3.7	3.6	3.2	3.4	6.3	3.8
1994	3.2	2.6	3.6	5.0	3.5	2.9	4.2	3.8	3.2	3.7
1995	5.1	5.0	6.0	4.4	5.3	5.0	10.7	8.1	6.4	7.9
1996	3.4	3.2	2.8	3.5	3.2	3.6	–0.1	1.7	3.4	1.9
1997	0.7	1.0	1.1	0.9	0.9	1.8	0.5	0.8	4.3	1.3
1998	1.5	1.4	1.4	3.5	1.7	1.8	0.2	1.0	–5.1	0.1
1997 – Jan.	1.6	1.5	0.5	–0.1	1.0	2.3	–1.6	–0.1	6.5	0.9
Feb.	1.1	1.1	0.1	–0.2	0.6	2.1	–1.1	0.0	6.0	0.8
Mar.	0.8	0.9	0.4	0.9	0.7	1.8	–0.9	0.1	5.4	0.9
Apr.	1.0	1.2	–0.3	0.6	0.5	1.9	–0.1	0.4	3.7	0.8
May	0.9	1.1	0.1	0.8	0.6	1.9	0.4	0.7	4.4	1.1
June	0.6	1.0	0.7	0.8	0.7	1.8	0.8	0.9	6.0	1.6
July	0.3	0.8	1.2	0.8	0.7	1.4	0.7	0.8	7.2	1.7
Aug.	0.5	0.9	1.5	0.7	0.9	1.7	1.0	1.0	5.5	1.7
Sept.	0.5	0.9	2.0	0.9	1.1	1.7	1.2	1.2	3.7	1.6
Oct.	0.3	0.8	2.1	1.6	1.1	1.6	1.6	1.4	2.7	1.6
Nov.	0.6	1.0	2.6	2.1	1.5	1.6	1.7	1.6	1.2	1.6
Dec.	0.6	1.1	2.7	2.4	1.6	1.5	2.0	1.7	–0.5	1.5
1998 – Jan.	1.0	1.3	2.3	3.4	1.7	1.8	2.0	1.9	–2.3	1.3
Feb.	1.3	1.4	2.3	3.0	1.8	2.0	2.0	1.9	–2.7	1.3
Mar.	1.4	1.4	2.1	2.4	1.7	1.8	1.8	1.8	–3.6	0.9
Apr.	1.2	1.3	2.3	3.8	1.9	1.8	1.2	1.6	–3.1	0.9
May	1.4	1.4	1.9	3.7	1.8	1.8	0.6	1.3	–3.5	0.6
June	1.5	1.4	1.6	3.7	1.8	1.7	0.4	1.2	–4.0	0.4
July	1.7	1.5	1.4	3.6	1.8	1.9	0.4	1.1	–4.9	0.3
Aug.	1.7	1.4	1.1	3.6	1.7	1.8	–0.2	0.8	–6.1	–0.3
Sept.	1.5	1.2	0.8	3.6	1.5	1.7	–0.7	0.5	–6.4	–0.5
Oct.	1.8	1.5	0.5	3.7	1.5	1.8	–1.3	0.2	–7.4	–0.9
Nov.	1.6	1.5	0.2	3.7	1.3	1.8	–1.5	0.0	–8.7	–1.3
Dec.	1.6	1.4	0.2	3.7	1.3	1.8	–1.8	–0.1	–8.5	–1.3
1999 – Jan.	1.3	1.2	0.0	4.8	1.2	1.5	–2.1	–0.3	–9.3	–1.6
Feb.	1.1	1.1	0.2	5.0	1.2	1.2	–2.5	–0.5	–8.8	–1.8
Mar.	0.9	0.9	0.0	3.1	0.9	1.0	–2.6	–0.8	–8.1	–1.8

Source: Based on Istat data.

(1) With reference to 1995=100. – (2) Excludes medicines, the prices of which are subject to official control. In the absence of elementary indices for medicines, the reference is to the Istat aggregate "Chemical, pharmaceutical and medical products", which also includes goods with unregulated prices. – (3) Excludes tobacco products, the consumer prices of which are subject to official control. – (4) Includes tobacco and medicines.

Table a9

UNIT VARIABLE COSTS AND OUTPUT PRICES IN MANUFACTURING (1)
(percentage changes on corresponding period)

	Unit variable costs – Domestic components – Input costs	Unit variable costs – Domestic components – Unit labour costs – Components – Labour costs (3)	Unit variable costs – Domestic components – Unit labour costs – Components – Labour product-ivity	Unit variable costs – Domestic components – Unit labour costs	Unit variable costs – Domestic components – Total	Unit variable costs – Foreign components – of which: semi-finished products	Unit variable costs – Foreign components – of which: energy products	Unit variable costs – Foreign components – of which: (4)	Unit variable costs – Foreign components – Total	Unit variable costs – Total	Output prices – Domestic	Output prices – Foreign	Output prices – Total
Weights (2)	*24.9*	*–*	*–*	*49.6*	*74.5*	*5.0*	*10.4*	*5.1*	*25.5*	*100.0*	*72.0*	*28.0*	*100.0*
1990	7.4	8.5	0.4	8.0	7.8	–12.9	–1.9	17.3	–0.9	5.6	2.8	1.7	2.5
1991	7.4	9.8	1.7	7.9	7.7	–6.7	0.3	7.1	0.8	6.1	2.8	2.4	2.7
1992	3.3	6.7	4.4	2.2	2.5	–4.7	–0.9	–1.1	–0.9	1.8	2.7	2.0	2.5
1993	4.0	5.4	0.6	4.8	4.5	12.1	14.8	7.0	12.0	6.1	3.6	11.5	5.8
1994	3.0	3.1	6.0	–2.7	–1.0	11.9	3.3	4.3	6.9	0.8	3.6	3.1	3.4
1995	8.0	4.7	3.6	1.0	3.2	20.5	11.6	8.5	12.2	5.4	7.3	8.9	7.8
1996	5.3	6.3	–0.1	6.5	6.1	–9.4	–0.2	5.1	–	4.5	1.9	2.3	2.0
1997	0.7	4.6	3.4	1.1	1.0	–1.4	–1.7	2.4	–1.4	0.4	0.8	–0.7	0.4
1998	1.5	2.4	1.0	1.5	1.5	–4.5	–0.3	–5.0	–2.2	0.6	1.1	0.5	0.9
1997 – Jan.	1.8	. .	. .	. .	. .	–16.3	–8.3	7.7	–5.5	. .	0.2	–4.0	–1.1
Feb.	1.4	. .	. .	. .	. .	–12.1	–4.5	6.5	–3.4	. .	0.1	–3.0	–0.8
Mar.	0.8	. .	. .	. .	. .	–9.3	–4.1	3.9	–3.9	. .	0.2	–2.9	–0.7
Apr.	0.3	. .	. .	. .	. .	–5.4	–3.0	1.9	–3.5	. .	0.4	–0.7	0.1
May	0.6	. .	. .	. .	. .	–1.8	–1.3	1.7	–2.0	. .	0.6	–1.4	0.1
June	0.7	. .	. .	. .	. .	1.0	–1.2	3.0	–1.6	. .	0.8	–1.0	0.3
July	0.7	. .	. .	. .	. .	0.4	–0.4	4.6	–0.1	. .	0.8	–0.5	0.4
Aug.	0.8	. .	. .	. .	. .	4.3	–0.2	4.1	0.7	. .	0.9	0.2	0.7
Sept.	0.5	. .	. .	. .	. .	6.9	0.7	2.0	1.3	. .	1.1	1.0	1.1
Oct.	0.2	. .	. .	. .	. .	0.9	0.5	–0.8	0.6	. .	1.3	1.1	1.2
Nov.	0.5	. .	. .	. .	. .	8.7	0.1	–2.0	0.5	. .	1.5	2.1	1.7
Dec.	0.5	. .	. .	. .	. .	5.2	1.8	–3.2	0.5	. .	1.6	1.4	1.6
1998 – Jan.	0.7	. .	. .	. .	. .	6.9	3.1	–4.9	1.0	. .	1.8	2.4	2.0
Feb.	0.9	. .	. .	. .	. .	5.6	2.1	–4.3	0.9	. .	1.9	0.4	1.4
Mar.	1.3	. .	. .	. .	. .	0.9	0.8	–3.2	–0.3	. .	1.7	1.7	1.7
Apr.	1.5	. .	. .	. .	. .	–0.3	2.1	–3.0	0.2	. .	1.5	1.2	1.4
May	1.3	. .	. .	. .	. .	–3.0	–0.6	–3.3	–1.5	. .	1.3	1.3	1.3
June	1.5	. .	. .	. .	. .	–4.1	0.6	–3.8	–1.3	. .	1.2	2.7	1.6
July	1.9	. .	. .	. .	. .	–3.8	1.0	–4.8	–1.4	. .	1.1	0.9	1.0
Aug.	1.7	. .	. .	. .	. .	–8.4	–1.5	–5.5	–3.3	. .	0.9	–0.2	0.6
Sept.	1.8	. .	. .	. .	. .	–9.9	–1.8	–5.7	–4.0	. .	0.6	1.1	0.8
Oct.	1.8	. .	. .	. .	. .	–4.5	–2.6	–6.9	–4.8	. .	0.4	–1.2	–0.1
Nov.	1.7	. .	. .	. .	. .	–14.2	–1.6	–7.7	–5.7	. .	0.2	–1.3	–0.2
Dec.	1.7	. .	. .	. .	. .	–10.6	–4.6	–7.5	–5.9	. .	0.2	–2.3	–0.6

Sources: Based on Eni, OECD and Istat national accounts data (based on the new European system of accounts, ESA95).
(1) Net of intrasectoral transactions; compared with the aggregate for manufacturing industry, excludes energy products and transport equipment other than motor vehicles. – (2) Calculated on the basis of the intersectoral input-output tables for 1998 at 1980 prices). – (3) The figure for 1998 has been estimated by applying the change recorded in earnings per employee to labour costs per employee in order to take account of the introduction of Irap. – (4) Includes imported and domestically produced products.

Table a10

THE BALANCE OF PAYMENTS ACCORDING TO THE SCHEME IN FORCE UNTIL 1998 (1)
(billions of lire)

	Current account									
	Goods (*fob*)						Invisibles		Current account balance	
	Imports		Exports		Balance		Balance			
	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted	Unadjusted	Seasonally adjusted
1989	196,775		192,797		–3,978		–10,486		–14,464	
1990	205,513		203,515		–1,998		–17,060		–19,058	
1991	212,598		209,731		–2,867		–26,186		–29,053	
1992	219,703		219,435		–268		–34,774		–35,042	
1993	220,397		266,213		45,816		–30,544		15,272	
1994	257,381		308,045		50,664		–27,939		22,725	
1995	318,116		381,175		63,059		–19,469		43,590	
1996	305,585		388,885		83,300		–21,724		61,576	
1997	341,021		409,128		68,107		–7,182		60,925	
1998	358,852		420,764		61,912		–22,843		39,069	
1994 – I	62,315	59,382	73,292	73,506	10,977	14,124	–8,406	–7,201	2,571	6,923
II	64,954	61,959	77,312	74,707	12,358	12,748	–6,276	–7,171	6,082	5,577
III	58,161	65,737	73,794	78,390	15,633	12,653	–7,038	–8,038	8,595	4,615
IV	71,951	70,302	83,647	81,442	11,696	11,140	–6,219	–5,528	5,477	5,612
1995 – I	78,141	74,393	90,708	90,866	12,567	16,473	–6,035	–4,723	6,532	11,750
II	84,226	80,416	100,337	97,020	16,111	16,604	–3,232	–3,819	12,879	12,785
III	72,310	81,788	90,556	95,889	18,246	14,101	–2,968	–4,379	15,279	9,722
IV	80,440	81,520	99,574	97,400	16,134	15,880	–7,234	–6,548	8,900	9,332
1996 – I	82,987	79,683	97,935	98,507	14,948	18,824	–5,472	–4,198	9,476	14,626
II	77,245	74,120	99,738	96,495	22,493	22,375	–6,527	–6,745	15,966	15,630
III	66,723	74,726	91,430	96,131	24,707	21,405	–1,814	–3,631	22,893	17,774
IV	78,630	77,055	99,782	97,752	21,152	20,697	–7,911	–7,150	13,241	13,547
1997 – I	80,540	77,348	94,606	95,446	14,066	18,098	–290	810	13,776	18,908
II	88,251	84,683	105,492	102,187	17,241	17,504	–4,981	–4,620	12,260	12,884
III	79,458	88,159	99,942	104,289	20,484	16,130	–496	–3,060	19,988	13,070
IV	92,772	90,831	109,088	107,206	16,316	16,375	–1,415	–311	14,901	16,064
1998 – I	93,035	89,062	103,003	103,217	9,968	14,155	–6,775	–5,029	3,193	9,126
II	94,592	90,829	111,897	108,295	17,305	17,466	–4,265	–4,052	13,040	13,414
III	81,995	91,534	102,621	107,791	20,626	16,257	–3,230	–5,828	17,396	10,429
IV	89,230	87,426	103,243	101,461	14,013	14,035	–8,573	–7,934	5,440	6,101

(1) Rounding may cause discrepancies in totals. – (2) Changes in official reserves are given net of valuation adjustments. A minus sign indicates an increase in assets or a decrease in liabilities.

Table a10

Capital movements						Errors and omissions	Changes in official reserves (2)
Non-banking				Banking	Capital account balance		
Investment	Lending	Trade and other credits	Total				
4,721	18,145	−3,760	19,106	14,979	34,085	−4,235	−15,386
−1,778	31,416	−450	29,188	22,976	52,164	−17,950	−15,156
−13,700	5,738	−2,357	−10,319	39,369	29,050	−8,568	8,571
−2,085	2,960	−2,745	−1,870	12,187	10,317	−7,823	32,548
108,016	−4,469	−4,159	99,388	−84,589	14,799	−27,865	−2,206
−12,896	−27,827	−3,144	−43,867	21,594	−22,273	2,857	−3,309
48,134	5,212	−1,556	51,790	−58,102	−6,312	−34,368	−2,910
68,685	−25,002	−6,208	37,475	−47,394	−9,919	−31,060	−20,597
−4,887	−19,946	916	−23,917	11,679	−12,238	−25,847	−22,840
−18,595	−15,884	−2,899	−37,368	6,565	−30,803	−45,030	36,764
7,713	−8,284	−520	−1,091	−2,464	−3,555	5,174	−4,190
−20,980	−6,224	−232	−27,436	19,906	−7,530	2,378	−930
−14,417	−6,291	−1,077	−21,785	14,874	−6,911	−2,710	1,026
14,788	−7,028	−1,315	6,445	−10,722	−4,277	−1,985	785
−9,354	−2,293	2,230	−9,417	4,928	−4,489	−13,639	11,596
14,455	9,228	−3,089	20,594	−10,389	10,205	−3,656	−19,428
12,158	−1,731	−641	9,786	−19,564	−9,778	−12,069	6,568
30,875	8	−56	30,827	−33,077	−2,250	−5,004	−1,646
−12,410	−2,197	−983	−15,590	19,010	3,420	−12,480	−416
28,029	−4,343	−3,257	20,429	−14,465	5,964	2,150	−24,080
13,021	−12,069	−754	198	−11,401	−11,203	−12,931	1,241
40,045	−6,393	−1,214	32,438	−40,538	−8,100	−7,799	2,658
−10,634	−6,323	3,289	−13,668	24,627	10,959	−25,231	496
26,529	−6,489	−1,765	18,275	−42,089	−23,814	9,839	1,715
−245	−7,195	407	−7,033	14,019	6,986	−4,372	−22,602
−20,537	61	−1,015	−21,491	15,122	−6,369	−6,083	−2,449
−23,353	931	498	−21,924	34,583	12,659	−17,156	1,304
25,705	−1,414	−3,060	21,231	−37,929	−16,698	−9,833	13,491
−19,685	−3,841	−830	−24,356	7,960	−16,396	−16,135	15,135
−1,262	−11,560	503	−12,319	1,951	−10,368	−1,906	6,834

Table a11

ITALY'S EXTERNAL POSITION

(billions of lire)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
ASSETS	**282,239**	**325,362**	**392,553**	**527,926**	**681,897**	**747,585**	**851,770**	**1,004,833**	**1,288,615**	**1,567,507**
Non-bank capital	**167,769**	**209,656**	**267,807**	**358,897**	**442,552**	**524,989**	**594,340**	**676,489**	**939,380**	**1,195,412**
Investments	107,533	139,477	191,099	268,768	344,346	402,747	459,459	523,130	752,073	996,314
Direct	59,122	68,018	81,034	103,503	138,138	146,072	168,492	179,598	236,723	282,260
International organizations	3,903	3,304	3,672	4,068	4,550	5,084	5,497	6,260	6,854	8,818
Real estate	868	1,307	5,186	6,715	7,847	8,442	9,211	8,803	9,839	10,350
Other	54,351	63,407	72,176	92,720	125,741	132,546	153,784	164,535	220,030	263,092
Portfolio	48,411	71,459	110,065	165,265	206,208	256,675	290,967	343,532	515,350	714,054
Loans	14,013	18,671	23,325	32,811	37,277	51,144	55,781	72,860	102,423	115,482
Public	9,836	11,160	12,791	15,722	18,694	21,740	25,471	27,071	28,646	28,488
Private	4,177	7,511	10,534	17,089	18,583	29,404	30,310	45,789	73,777	86,994
Trade credits	46,223	51,508	53,383	57,318	60,929	71,098	79,100	80,499	84,884	83,616
Short-term	26,777	29,812	29,887	30,873	33,105	40,756	45,434	45,708	48,965	45,097
Medium and long-term	19,446	21,696	23,496	26,445	27,824	30,342	33,666	34,791	35,919	38,519
Bank capital	**114,470**	**115,706**	**124,746**	**169,029**	**239,345**	**222,596**	**257,430**	**328,344**	**349,235**	**372,095**
LIABILITIES	**434,973**	**525,599**	**610,068**	**759,328**	**911,238**	**956,864**	**1,027,766**	**1,165,402**	**1,420,127**	**1,690,650**
Non-bank capital	**229,226**	**296,294**	**334,075**	**399,141**	**544,685**	**581,021**	**661,801**	**786,231**	**999,379**	**1,246,074**
Investments	105,495	128,065	175,828	220,404	363,538	404,262	478,214	624,569	824,261	1,074,513
Direct	64,715	67,806	70,878	73,489	91,929	98,398	103,561	114,242	146,290	174,231
Real estate	1,964	2,274	2,194	2,203	2,471	2,558	3,002	3,244	3,540	3,807
Other	62,751	65,532	68,684	71,286	89,458	95,840	100,559	110,998	142,750	170,424
Portfolio	40,780	60,259	104,950	146,915	271,609	305,864	374,653	510,327	677,971	900,282
of which: government securities	*25,162*	*41,637*	*74,233*	*99,011*	*206,893*	*233,629*	*291,486*	*397,937*	*515,914*	*675,718*
BOTs	*1,715*	*2,622*	*2,884*	*2,891*	*4,286*	*5,387*	*10,355*	*24,169*	*32,255*	*85,590*
BTPs	*2,409*	*3,986*	*12,355*	*42,964*	*109,504*	*91,428*	*108,221*	*189,851*	*283,139*	*317,309*
CTEs	*8,338*	*18,426*	*19,325*	*23,824*	*28,667*	*31,183*	*33,850*	*30,981*	*30,550*	*24,036*
other government securities	*12,700*	*16,603*	*18,985*	*5,184*	*17,258*	*42,623*	*61,823*	*70,801*	*78,684*	*152,843*
Republic of Italy	*. .*	*. .*	*20,684*	*24,148*	*47,178*	*63,008*	*77,237*	*82,135*	*91,286*	*95,940*
Loans	94,100	133,700	124,200	143,500	146,458	135,045	136,128	119,012	127,167	127,767
Public	47,900	53,319	29,400	31,740	36,646	35,123	41,722	33,958	37,770	25,780
Private	46,200	80,381	94,800	111,760	109,812	99,922	94,406	85,054	89,397	101,987
Trade credits	29,631	34,529	34,047	35,237	34,689	41,714	47,459	42,650	47,951	43,794
Short-term	24,928	29,776	29,274	30,647	30,278	37,178	42,032	37,670	43,423	39,399
Medium and long-term	4,703	4,753	4,773	4,590	4,411	4,536	5,427	4,980	4,528	4,395
Bank capital	**205,747**	**229,305**	**275,993**	**360,187**	**366,553**	**375,843**	**365,965**	**379,171**	**420,748**	**444,576**
NET POSITION (excluding the central bank)	**–152,734**	**–200,237**	**–217,515**	**–231,402**	**–229,341**	**–209,279**	**–175,996**	**–160,569**	**–131,512**	**–123,143**
Non-bank capital	–61,457	–86,638	–66,268	–40,244	–102,133	–56,032	–67,461	–109,742	–59,999	–50,662
Bank capital	–91,277	–113,599	–151,247	–191,158	–127,208	–153,247	–108,535	–50,827	–71,513	–72,481
CENTRAL BANK										
Assets	94,814	104,928	95,913	76,539	86,566	93,897	95,593	108,653	135,619	90,329
of which: gold	*33,663*	*30,579*	*29,288*	*29,944*	*36,910*	*41,338*	*40,257*	*38,366*	*37,578*	*40,929*
Liabilities	1,573	1,529	1,575	9,240	2,629	2,461	4,117	1,912	1,975	1,728
Net position	**93,241**	**103,399**	**94,338**	**67,299**	**83,937**	**91,436**	**91,476**	**106,741**	**133,644**	**88,601**
OVERALL NET POSITION (including the central bank)	**–59,493**	**–96,838**	**–123,177**	**–164,103**	**–145,404**	**–117,843**	**–84,520**	**–53,828**	**2,132**	**–34,542**
Excluding central bank gold from the assets	**–93,156**	**–127,417**	**–152,465**	**–194,047**	**–182,314**	**–159,181**	**–124,777**	**–92,194**	**–35,446**	**–75,471**

Table a12

CONSOLIDATED ACCOUNTS OF GENERAL GOVERNMENT

(billions of lire)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Revenue										
Direct taxes	170,697	189,124	207,054	221,506	250,835	244,854	260,360	285,043	310,257	292,611
Indirect taxes	123,867	139,465	159,022	167,660	186,611	192,173	214,170	226,861	243,973	311,787
Actual social security contributions	149,754	168,953	187,193	200,031	212,816	213,679	231,671	277,061	293,799	263,527
Imputed social security contributions	17,718	20,356	22,761	26,157	27,799	30,588	30,174	5,717	7,106	7,395
Income from capital	7,525	8,459	8,820	9,412	9,177	8,516	9,481	10,901	13,259	11,715
Other	26,316	29,728	35,368	40,344	48,101	51,429	44,650	50,672	53,991	51,974
Total current revenue	**495,877**	**556,085**	**620,218**	**665,110**	**735,339**	**741,239**	**790,506**	**856,255**	**922,385**	**939,009**
Capital account revenue	4,470	3,366	5,188	33,783	14,115	7,573	16,340	9,771	18,574	12,865
Total revenue	**500,347**	**559,451**	**625,406**	**698,893**	**749,454**	**748,812**	**806,846**	**866,026**	**940,959**	**951,874**
as a percentage of GDP	*42.0*	*42.7*	*43.8*	*46.5*	*48.3*	*45.7*	*45.9*	*46.5*	*48.5*	*47.0*
Expenditure										
Compensation of employees	142,331	167,058	181,755	190,248	193,121	197,446	201,358	218,405	229,487	226,005
Intermediate consumption	58,634	63,328	70,042	75,608	79,923	82,371	87,214	92,673	93,962	99,375
Social services	209,963	238,585	261,320	290,578	302,873	319,464	336,746	361,878	385,746	395,849
Subsidies to firms	27,382	26,543	28,763	27,032	33,915	32,864	25,738	28,709	20,367	26,303
Interest payments	104,404	124,143	144,978	172,622	187,800	179,927	196,238	198,233	179,358	152,609
Other	13,807	12,205	15,212	16,288	21,824	19,076	12,717	16,115	16,280	28,378
Total current expenditure	**556,521**	**631,862**	**702,070**	**772,376**	**819,456**	**831,148**	**860,011**	**916,013**	**925,200**	**928,519**
Gross investment	39,784	43,141	46,587	45,454	41,104	37,907	37,873	41,801	45,819	50,740
Investment grants	20,267	26,172	19,112	23,410	26,616	24,387	23,918	22,970	20,010	20,947
Other	1,052	4,078	1,718	1,307	9,197	5,520	20,103	8,332	2,196	5,998
Total capital account expenditure	**61,103**	**73,391**	**67,417**	**70,171**	**76,917**	**67,814**	**81,894**	**73,103**	**68,025**	**77,685**
Total expenditure	**617,624**	**705,253**	**769,487**	**842,547**	**896,373**	**898,962**	**941,905**	**989,116**	**993,225**	**1,006,204**
as a percentage of GDP	*51.8*	*53.8*	*53.9*	*56.1*	*57.8*	*54.9*	*53.6*	*53.1*	*51.2*	*49.7*
Deficit on current account	**60,644**	**75,777**	**81,852**	**107,266**	**84,117**	**89,909**	**69,505**	**59,758**	**2,815**	**–10,490**
Net borrowing	**117,277**	**145,802**	**144,081**	**143,654**	**146,919**	**150,150**	**135,059**	**123,090**	**52,266**	**54,330**
as a percentage of GDP	*9.8*	*11.1*	*10.1*	*9.6*	*9.5*	*9.2*	*7.7*	*6.6*	*2.7*	*2.7*

Source: Based on the *Relazione generale sulla situazione economica del Paese.*

Table a13

FINANCING OF THE GENERAL GOVERNMENT AND PUBLIC SECTOR BORROWING REQUIREMENTS (1)

(billions of lire)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
GENERAL GOVERNMENT										
Medium and long-term securities	57,036	66,306	111,502	89,168	162,865	224,641	89,900	126,429	100,578	81,251
of which: BI-UIC and banks	*370*	*–8,579*	*56,478*	*73,964*	*–719*	*133,469*	*8,573*	*–6,137*	*–23,663*	*–25,617*
other holders	*56,667*	*74,885*	*55,025*	*15,204*	*163,584*	*91,172*	*81,327*	*132,565*	*124,241*	*106,868*
Treasury bills, in lire and ecus	42,615	40,338	12,161	45,339	5,331	11,311	–857	–27,174	–81,771	–35,371
of which: BI-UIC and banks	*–2,569*	*10,333*	*–1,205*	*–9,936*	*46,584*	*7,377*	*–35,561*	*6,114*	*–10,083*	*–1,084*
other holders	*45,184*	*30,005*	*13,366*	*55,275*	*–41,253*	*3,934*	*34,704*	*–33,288*	*–71,687*	*–34,287*
Post Office deposits	10,691	7,485	7,036	9,111	8,922	21,738	15,790	12,798	11,641	6,364
Lending by banks	9,426	6,431	20,080	12,856	13,813	–1,276	4,919	–2,813	1,694	–5,286
central government bodies	*5,295*	*2,721*	*5,952*	*8,545*	*1,899*	*–2,103*	*3,167*	*–3,726*	*–1,094*	*–2,991*
social security institutions	*–464*	*–221*	*266*	*817*	*–826*	*906*	*–898*	*–36*	*41*	*–195*
local authorities	*4,595*	*3,931*	*13,862*	*3,494*	*12,740*	*–78*	*2,649*	*950*	*2,747*	*–2,101*
Other net borrowing from BI-UIC	1,835	2,811	2,472	7,116	–34,512	–111,720	–8,440	17,674	–2,585	15,963
Other domestic debt	101	188	173	254	140	33	212	151	138	357
Debt issues abroad	8,359	14,876	5,484	151	12,358	9,554	25,584	15,632	7,230	–11,146
General government borrowing requirement	**130,063**	**138,434**	**158,908**	**163,995**	**168,917**	**154,282**	**127,109**	**142,697**	**36,924**	**52,132**
as a percentage of GDP	*10.9*	*10.6*	*11.1*	*10.9*	*10.9*	*9.4*	*7.2*	*7.7*	*1.9*	*2.6*
of which: settlements of past debts and privatization receipts	*600*	*3,000*	*1,900*	*800*	*10,808*	*513*	*–5,189*	*4,168*	*–26,108*	*–15,923*
debts of other bodies serviced by the government	*3,624*	*7,413*	*3,037*	*4,910*	*–2,118*	*94*	*1,232*	*552*	*–6,611*	*–10,795*
OTHER PUBLIC SECTOR BODIES										
Total financing (2)	67	20	648	79	–59	710	–131	–509	185	–200
of which: bond issues	*–82*	*–66*	*–36*	*–28*	*–*	*–*	*–*	*–*	*–*	*–*
bank loans	*149*	*86*	*685*	*107*	*–59*	*710*	*–131*	*–509*	*185*	*–200*
Public sector borrowing requirement	**130,131**	**138,454**	**159,556**	**164,074**	**168,858**	**154,992**	**126,978**	**142,188**	**37,109**	**51,932**
as a percentage of GDP	*10.9*	*10.6*	*11.2*	*10.9*	*10.9*	*9.5*	*7.2*	*7.6*	*1.9*	*2.6*

(1) Rounding may cause discrepancies in totals. – (2) Excludes debts serviced by the government.

THE PUBLIC DEBT (1)

(face value in billions of lire and percentage composition)

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
					Amounts outstanding					
GENERAL GOVERNMENT										
Medium and long-term securities, excluding BI portfolio	537,430	618,870	732,625	805,338	958,951	1,104,569	1,204,460	1,367,009	1,501,014	1,594,158
of which: held by banks	*133,729*	*131,542*	*182,242*	*236,679*	*212,298*	*263,304*	*262,350*	*280,369*	*263,157*	*240,462*
Treasury bills in lire and ecus, excluding BI portfolio	286,892	322,422	338,254	393,827	399,434	397,016	407,144	381,599	287,195	265,927
of which: held by banks	*26,035*	*31,394*	*33,901*	*33,273*	*79,459*	*73,101*	*48,506*	*56,256*	*33,519*	*46,552*
Post Office deposits	81,677	89,162	96,198	105,308	114,230	135,968	151,759	164,557	176,198	182,562
memorandum item: redemption value	*110,237*	*122,954*	*134,700*	*146,115*	*159,935*	*185,471*	*206,071*	*226,898*	*245,515*	*262,954*
Lending by banks	54,511	60,942	81,022	93,878	107,691	106,415	111,333	108,521	110,214	104,928
central government bodies	*18,047*	*20,767*	*26,719*	*35,264*	*37,163*	*35,060*	*38,227*	*34,501*	*33,407*	*30,416*
social security institutions	*1,104*	*883*	*1,149*	*1,966*	*1,140*	*2,046*	*1,148*	*1,112*	*1,153*	*958*
local authorities	*35,361*	*39,292*	*53,154*	*56,647*	*69,387*	*69,309*	*71,958*	*72,908*	*75,655*	*73,554*
Other domestic debt	2,844	3,032	3,205	3,458	3,599	3,632	3,844	3,995	4,133	4,490
Debt issued abroad	35,112	49,098	54,987	64,575	85,505	96,022	119,274	125,623	140,793	129,878
Total	**998,465**	**1,143,525**	**1,306,289**	**1,466,385**	**1,669,409**	**1,843,623**	**1,997,814**	**2,151,304**	**2,219,547**	**2,281,943**
of which: debts of other bodies serviced by the government	*27,236*	*34,483*	*37,439*	*43,621*	*42,703*	*43,024*	*44,827*	*44,625*	*38,583*	*27,464*
Borrowing from BI-UIC	143,193	141,080	142,858	167,385	176,990	203,541	204,061	171,018	154,834	121,132
of which: medium and long-term securities	*62,911*	*53,105*	*56,017*	*82,426*	*95,044*	*186,333*	*197,841*	*166,478*	*137,709*	*117,975*
Treasury bills in lire and ecus	*8,220*	*13,194*	*9,482*	*173*	*572*	*14,306*	*3,327*	*1,698*	*14,331*	*230*
Treasury accounts with BI	*68,155*	*71,063*	*73,074*	*80,780*	*76,206*	–	–	–	–	–
other	*3,907*	*3,718*	*4,285*	*4,006*	*5,169*	*2,902*	*2,893*	*2,842*	*2,794*	*2,927*
General government debt (EU definition) (2)	**1,141,658**	**1,284,605**	**1,449,147**	**1,633,770**	**1,846,399**	**2,047,163**	**2,201,875**	**2,322,322**	**2,374,382**	**2,403,075**
as a percentage of GDP	*95.8*	*98.0*	*101.5*	*108.7*	*119.1*	*124.9*	*125.3*	*124.6*	*122.4*	*118.7*
Treasury claims on BI-UIC	–1,081	–989	–1,095	–1,406	–32,507	–65,754	–74,184	–56,459	–58,997	–43,168
General government debt	**1,140,577**	**1,283,616**	**1,448,052**	**1,632,364**	**1,813,892**	**1,981,410**	**2,127,691**	**2,265,863**	**2,315,385**	**2,359,907**
OTHER PUBLIC SECTOR BODIES										
Total financing (3)	1,260	1,279	1,928	2,007	1,948	2,658	2,526	2,017	2,202	2,002
of which: bond issues	*130*	*64*	*28*	–	–	–	–	–	–	–
bank loans	*1,130*	*1,216*	*1,900*	*2,007*	*1,948*	*2,658*	*2,526*	*2,017*	*2,202*	*2,002*
Public sector debt	**1,141,836**	**1,284,895**	**1,449,980**	**1,634,371**	**1,815,840**	**1,984,067**	**2,130,218**	**2,267,880**	**2,317,587**	**2,361,910**
					Percentage composition					
General government debt (EU definition)										
Medium and long-term securities, excluding BI portfolio	47.1	48.2	50.6	49.3	51.9	54.0	54.7	58.9	63.2	66.3
Treasury bills in lire and ecus, excluding BI portfolio	25.1	25.1	23.3	24.1	21.6	19.4	18.5	16.4	12.1	11.1
Post Office deposits	7.2	6.9	6.6	6.4	6.2	6.6	6.9	7.1	7.4	7.6
Lending by banks	4.8	4.7	5.6	5.7	5.8	5.2	5.1	4.7	4.6	4.4
Other domestic debt	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Debt issued abroad	3.1	3.8	3.8	4.0	4.6	4.7	5.4	5.4	5.9	5.4
Borrowing from BI-UIC	12.5	11.0	9.9	10.2	9.6	9.9	9.3	7.4	6.5	5.0

(1) Rounding may cause discrepancies in totals. – (2) Based on the methodology established in European Council Regulation 3605/93. – (3) Excludes debts serviced by the government.

Table a15

STATE SECTOR BALANCES

(billions of lire)

	1995	1996	1997	1998
Revenue	525,419	550,320	622,037	595,025
Expenditure	641,579	681,799	600,295	657,795
State budget deficit	**–116,160**	**–131,479**	**21,742**	**–62,770**
Treasury operations	8,977	4,009	–53,304	11,322
Lending of the Deposits and Loans Fund	–12,923	–10,086	–911	1,327
Borrowing requirement of ANAS and the State Forests	–2,494	1,409	1,391	1,119
Borrowing requirement of other former autonomous government agencies	–	–	–	–
State sector borrowing requirement	**–122,600**	**–136,174**	**–31,081**	**–49,002**
State sector borrowing requirement excluding settlements of past debts and privatization receipts	**–126,869**	**–128,871**	**–52,670**	**–58,523**
as a percentage of GDP	*–7.2*	*–6.9*	*–2.7*	*–2.9*
DETAIL OF REVENUE				
Direct taxes				
Personal income tax	157,482	167,923	182,601	200,229
Corporate income tax	26,154	31,757	44,304	42,184
Local income tax	15,030	19,017	24,232	6,365
Withholding tax on interest income	34,382	41,215	36,403	17,828
Withholding tax on dividends	2,291	3,009	3,467	3,383
Direct tax condonation schemes	6,406	2,530	82	693
Other	17,100	14,935	25,054	19,225
Total direct taxes	**258,845**	**280,386**	**316,143**	**289,907**
Indirect taxes				
Value added tax	106,049	109,656	118,051	129,125
Other business taxes	29,485	33,539	39,004	36,640
Excise taxes on oil products	42,618	37,120	38,075	39,025
Other excise taxes	10,742	12,288	13,581	11,415
Sales taxes on tobacco products	9,554	10,512	10,587	11,735
Lotteries	6,988	9,476	11,439	13,191
Indirect tax condonation schemes	705	823	342	123
Other	2,992	3,407	3,234	3,003
Total indirect taxes	**209,133**	**216,821**	**234,313**	**244,257**
Total tax revenue				
EU levies	11,658	12,,060	9,896	11,448
Health care and other social security contributions	4,252	4,634	5,013	2,146
Other income	41,531	36,419	56,672	47,267
Total budget revenue	**525,419**	**550,320**	**622,037**	**595,025**

SOURCES AND USES OF MONETARY BASE (1)

(flows in billions of lire)

	Sources							Total	Uses				
	Foreign sector		Treasury accounts with the Bank of Italy	Other BI-UIC operations with the Treasury (3)	Open market operations (4)	Refinancing	Other sectors		Currency in circulation	Bank reserves			
										Deposits with BI		Other (6)	Total
	(2)	*of which: currency swaps*									*of which: compulsory reserves* (5)		
1989	14,971	–	1,842	6,608	–2,106	1,190	–2,019	20,486	10,477	9,733	9,567	276	10,009
1990	15,458	–	2,909	–4,292	2,392	1,261	–3,964	13,765	1,805	10,829	13,026	1,131	11,960
1991	–8,674	–	2,011	–11,468	27,172	2,679	–648	11,071	6,906	3,613	3,424	552	4,165
1992	–32,591	29,249	7,706	–10,402	42,781	106	822	8,422	9,263	69	1,012	–909	–841
1993	2,564	–2,055	–4,574	1,196	–14,098	–6,434	1,868	–19,479	4,152	–23,600	–24,131	–30	–23,630
1994	3,297	–813	–33,269	–21,474	47,451	238	–6,154	–9,911	6,452	–16,566	–13,332	202	–16,364
1995	2,915	10,592	–8,195	–25,174	15,455	4,857	–1,786	–11,928	2,060	–15,310	–18,728	1,322	–13,988
1996	20,449	–24,227	17,370	–23,834	6,291	–5,647	–10,477	4,152	1,826	684	–1,779	1,641	2,326
1997	22,829	–2,921	–3,020	–46,517	32,734	862	6,616	13,503	7,327	6,111	10,669	65	6,176
1998	–37,040	–13,724	15,578	–42,482	339	–942	8,184	–56,362	7,766	–65,084	–63,925	956	–64,128
1997 – Jan.	5,363	. .	–846	–2,493	–8,171	–145	–1,065	–7,358	–3,772	–397	1,866	–3,189	–3,586
Feb.	–1,608	. .	–6,949	–3,204	16,388	31	378	5,036	–620	5,863	5,889	–206	5,656
Mar.	–4,262	. .	9,692	–3,576	167	–36	–331	1,654	3,611	–2,858	–3,202	900	–1,958
Apr.	–2,131	. .	16,217	–2,275	–14,348	–18	–1,395	–3,951	–2,464	–1,286	289	–200	–1,486
May	1,570	. .	1,185	–4,146	7,716	–22	159	6,463	2,484	4,088	515	–110	3,979
June	–1,139	. .	–26,221	–3,915	19,978	12	7,801	–3,483	–1,653	–2,184	1,729	354	–1,830
July	12,124	–2,921	–23,491	–2,527	24,721	7	–1,689	9,143	3,716	5,336	–882	91	5,427
Aug.	4,801	. .	11,707	–2,124	–20,377	–114	4	–6,103	–2,526	–3,027	1,832	–550	–3,577
Sept.	5,673	. .	11,458	–5,797	–7,494	–85	–976	2,779	1,051	1,246	–264	482	1,728
Oct.	–2,393	. .	12,915	–5,974	418	133	–1,040	4,060	–772	5,017	438	–184	4,833
Nov.	832	. .	–6,357	–6,941	7,644	8	4,487	–327	4,076	–5,734	2,204	1,331	–4,403
Dec.	3,999	. .	–2,332	–3,543	6,092	1,092	283	5,590	4,196	48	256	1,346	1,394
1998 – Jan.	–4,362	. .	844	–3,745	8,416	–1,237	–1,224	–1,309	–3,814	4,948	1,633	–2,443	2,505
Feb.	3,815	. .	–5,349	–5,790	16,567	–29	67	9,280	–742	10,481	6,713	–458	10,023
Mar.	–750	. .	16,146	–3,460	–17,096	–4	–2,570	–7,734	2,153	–10,522	–3,073	635	–9,887
Apr.	–2,957	. .	13,390	–3,541	–1,970	–7	–299	4,617	608	4,012	1,513	–4	4,009
May	–5,715	–6,998	–7,328	–3,864	21,676	113	304	5,187	2,833	2,552	2,909	–199	2,353
June	–4,814	. .	–7,976	–1,598	–3,866	107	2,973	–15,174	–791	–14,830	–24,798	448	–14,383
July	–5,331	. .	–13,007	–1,455	21,603	–12	–7,887	–6,089	1,614	–8,425	–329	722	–7,703
Aug.	842	. .	–14,709	–1,650	–9,629	–438	–385	–25,968	–4,068	–21,747	–22,104	–153	–21,899
Sept.	–9,188	–6,726	11,693	–5,064	–3,762	–442	–926	–7,689	827	–8,234	–2,945	–282	–8,516
Oct.	–839	. .	23,703	–7,371	–15,896	45	1	–357	866	–1,073	–350	–150	–1,223
Nov.	–1,078	. .	3,121	–755	11,845	–28	1,062	14,167	245	11,722	1,286	2,200	13,922
Dec.	–6,663	. .	–4,950	–4,189	–27,549	991	17,068	–25,293	8,035	–33,969	–24,380	640	33,329

(1) Rounding may cause discrepancies in totals. – (2) Variation in the net external position of BI-UIC, net of exchange rate adjustments. – (3) Net purchases of government securities at issue by BI-UIC, state notes and coin in circulation or held by the Bank of Italy and other minor items. – (4) Excludes securities purchased with advances under the Ministerial Decree of 27.9.1974 and Law 588 of 19.11.1996. – (5) From October 1990 onwards average reserve requirement in the maintenance period (15th of the month indicated – 14th of the following month) and, until May 1991, compulsory reserves against net foreign currency deposits. – (6) Vault cash and undrawn margins on ordinary advance facilities.

Table a17

BANKS' ASSETS AND LIABILITIES (1)
(billions of lire and, in brackets, millions of euros)

	Assets								Memorandum item
	Bank reserves	Lending to residents	Securities	Bad debts & protested bills	Repurchase agreements	Shares & equity participations	Interbank accounts	External assets	Bad debts (estimated realizable value)
1993 – Dec.	108,514	1,028,446	349,770	70,185	30,351	43,427	171,104	229,057	*41,197*
1994 – "	92,691	1,039,792	385,969	91,108	16,846	50,067	165,436	201,953	*59,994*
1995 – "	78,996	1,073,410	352,260	110,269	14,771	51,205	151,979	231,119	*72,370*
1996 – "	80,892	1,090,928	383,583	123,117	22,264	57,667	182,128	295,728	*74,231*
1997 – Jan.	77,437	1,094,826	380,302	114,828	21,335	57,468	164,582	274,789	*67,031*
Feb.	82,939	1,095,930	385,317	115,701	22,276	57,389	156,502	283,104	*67,378*
Mar.	81,059	1,087,705	388,304	117,236	22,088	56,909	151,862	279,467	*66,955*
Apr.	79,564	1,092,582	377,216	118,061	18,878	57,385	151,042	282,662	*67,696*
May	83,493	1,095,922	377,976	118,685	21,553	58,419	156,244	292,544	*68,556*
June	84,134	1,118,399	359,838	118,701	20,884	58,288	159,979	312,416	*69,738*
July	86,901	1,126,880	361,481	119,375	23,776	58,273	149,656	319,199	*70,525*
Aug.	83,269	1,109,155	354,505	119,697	21,487	58,942	146,959	291,472	*71,110*
Sept.	85,117	1,111,782	349,517	117,327	18,698	58,843	156,640	313,060	*68,294*
Oct.	89,952	1,111,271	351,404	118,589	17,870	60,284	157,842	304,480	*69,643*
Nov.	85,227	1,120,270	351,953	118,565	18,241	61,420	164,091	305,012	*70,343*
Dec.	86,803	1,160,916	343,406	119,990	27,743	62,714	184,791	311,639	*70,911*
1998 – Jan.	89,279	1,150,123	350,998	119,833	34,016	72,418	162,897	297,524	*70,036*
Feb.	99,196	1,150,225	346,299	121,078	36,852	72,202	158,891	305,232	*64,682*
Mar.	89,335	1,158,109	348,132	121,697	37,355	73,651	168,167	319,422	*63,293*
Apr.	93,330	1,161,411	356,320	122,780	39,510	73,772	161,898	308,294	*64,869*
May	95,577	1,153,400	360,046	124,545	41,270	75,127	159,984	310,218	*65,703*
June	81,190	1,176,053	350,798	125,249	39,660	76,316	172,647	354,534	*66,379*
July	73,672	1,183,617	353,251	125,565	39,924	75,785	161,747	329,086	*67,707*
Aug.	52,344	1,169,813	345,347	125,428	40,981	75,886	160,571	326,694	*67,359*
Sept.	43,556	1,173,071	352,576	125,798	38,088	75,579	163,875	324,827	*68,204*
Oct.	42,337	1,168,174	362,038	126,239	43,215	80,518	168,283	333,481	*70,973*
Nov.	56,204	1,201,038	357,610	121,554	46,204	80,619	161,571	341,777	*69,831*
Dec.	22,269	1,230,406	347,123	122,629	42,362	81,663	192,880	325,839	*70,192*
1999 – Jan. (2)	25,643	1,234,440	343,457	122,755	36,729	83,187	166,867	337,166	*69,224*
	(13,243)	*(637,535)*	*(177,381)*	*(63,397)*	*(18,969)*	*(42,962)*	*(86,179)*	*(174,132)*	*(35,751)*
Feb. (2)	21,681	1,227,224	356,476	123,044	41,996	86,455	156,558	318,392	*67,212*
	(11,198)	*(633,809)*	*(184,104)*	*(63,547)*	*(21,689)*	*(44,650)*	*(80,855)*	*(164,435)*	*(34,712)*
Mar. (2)	21,645	1,230,460	346,911	122,982	45,565	92,104	152,901	303,137	*63,628*
	(11,179)	*(635,480)*	*(179,165)*	*(63,515)*	*(23,532)*	*(47,568)*	*(78,967)*	*(156,557)*	*(32,861)*

(1) Rounding may cause discrepancies in totals. – (2) Provisional. – (3) Deposits in lire until December 1998. As of January 1999 the data also include deposits in euros and other euro area

Table a17

Deposits of residents in lire/euros (3)	Bonds	Other domestic funds	Central bank refinancing	Repurchase agreements	Interbank accounts	Funds raised abroad	Capital and reserves	Other items	*Memorandum item* Supervisory capital	
919,115	194,113	19,425	2,722	140,386	179,086	369,979	206,017	10	*167,188*	Dec. – 1993
923,371	215,676	20,506	2,834	132,680	166,671	375,663	219,387	−12,925	*173,721*	” – 1994
935,199	215,286	22,820	7,989	164,501	166,069	343,580	232,439	−23,874	*171,776*	” – 1995
959,577	280,213	22,447	1,897	174,006	193,714	364,080	250,188	−9,815	*182,305*	” – 1996
919,505	288,857	22,218	1,881	174,287	176,839	362,373	254,986	−15,379	. . . .	Jan. – 1997
912,792	298,384	23,301	1,915	192,492	170,044	373,573	255,159	−28,501	. . . .	Feb.
900,544	305,219	23,861	1,877	189,617	164,635	375,454	256,374	−32,951	*184,052*	Mar.
890,630	313,263	23,864	1,849	178,095	162,993	369,615	257,953	−20,873	. . . .	Apr.
889,968	321,764	25,879	1,835	189,485	167,879	368,412	257,591	−17,975	. . . .	May
896,931	329,590	26,095	1,835	184,784	174,355	370,434	258,429	−9,814	*186,392*	June
871,197	335,631	27,434	1,817	213,021	163,684	369,794	258,140	4,822	. . . .	July
857,115	343,867	27,384	1,674	202,011	161,941	364,459	257,079	−30,044	. . . .	Aug.
867,734	353,384	26,507	1,699	175,250	166,215	381,329	256,096	−17,231	*185,366*	Sept.
860,945	363,118	27,184	1,751	170,134	175,169	374,085	252,375	−13,067	. . . .	Oct.
838,647	370,858	27,007	1,763	179,538	178,721	384,466	253,890	−10,111	. . . .	Nov.
881,329	377,743	25,898	2,854	172,454	200,333	392,738	257,052	−12,400	*187,485*	Dec.
850,552	380,882	28,730	1,617	198,186	174,526	404,015	267,711	−29,130	. . . .	Jan. – 1998
837,865	386,410	30,226	1,587	215,992	172,002	404,190	275,679	−33,976	. . . .	Feb.
855,399	396,467	26,581	1,587	179,060	177,201	429,194	279,113	−28,734	*186,840*	Mar.
855,823	400,717	28,515	1,580	177,548	168,914	423,632	276,031	−15,442	. . . .	Apr.
848,667	409,793	29,059	1,690	196,100	168,041	416,055	278,543	−27,780	. . . .	May
868,777	417,412	27,519	1,802	187,779	181,382	422,276	282,780	−13,282	*213,072*	June
828,448	417,234	26,585	1,677	197,529	173,035	418,172	282,117	−2,148	. . . .	July
817,212	421,640	29,070	1,591	195,809	167,512	402,309	282,567	−20,646	. . . .	Aug.
814,747	424,237	28,689	899	182,855	169,180	400,794	281,723	−5,754	*214,157*	Sept.
818,500	427,698	30,243	962	185,258	174,539	412,305	285,834	−11,054	. . . .	Oct.
814,119	431,696	29,957	924	183,092	169,837	418,707	281,269	36,974	. . . .	Nov.
877,146	436,072	27,894	2,068	144,343	200,363	391,440	283,092	2,753	*220,059*	Dec.
884,480	435,246	24,749	1,066	148,961	174,546	423,014	286,192	−28,010	. . . .	(2) Jan. – 1999
(456,796)	*(224,786)*	*(12,782)*	*(551)*	*(76,932)*	*(90,145)*	*(218,469)*	*(147,806)*	*(−14,466)*		
855,052	438,893	24,227	370	190,871	161,309	406,057	289,325	−34,277	. . . .	(2) Feb.
(441,598)	*(226,669)*	*(12,512)*	*(191)*	*(98,577)*	*(83,309)*	*(209,711)*	*(149,424)*	*(−17,703)*		
855,402	441,708	*24,030*	121	164,985	153,114	408,711	294,156	−26,522	*221,684*	(2) Mar.
(441,778)	*(228,123)*	(12,411)	*(63)*	*(85,208)*	*(79,077)*	*(211,082)*	*(151,919)*	*(−13,698)*	*(114,490)*	

currencies.

Table a18

BANKS: LOAN PORTFOLIO (1)
(billions of lire and, in brackets, millions of euros)

	Loans to residents						Loans to non-residents
	Short-term		Medium and long-term		Total		
		of which: in lire/euros (3)		*of which: in lire/euros* (3)		*of which: in lire/euros* (3)	
1993 – Dec.	559,308	468,053	469,138	404,495	1,028,446	872,549	22,312
1994 – ”	535,159	458,553	504,633	449,277	1,039,792	907,830	17,901
1995 – ”	556,942	496,539	516,468	472,383	1,073,410	968,922	16,124
1996 – ”	556,364	502,124	534,565	498,854	1,090,928	1,000,978	17,854
1997 – Jan.	554,906	493,876	539,919	507,574	1,094,826	1,001,451	17,052
Feb.	555,345	491,297	540,585	508,082	1,095,930	999,380	17,114
Mar.	548,728	483,427	538,977	506,705	1,087,705	990,131	15,699
Apr.	547,258	483,371	545,324	513,388	1,092,582	996,759	17,815
May	546,498	483,509	549,425	517,676	1,095,922	1,001,185	16,715
June	563,814	502,151	554,585	523,557	1,118,399	1,025,708	22,138
July	573,027	506,894	553,853	522,611	1,126,880	1,029,505	19,622
Aug.	556,218	493,333	552,938	522,170	1,109,155	1,015,502	18,101
Sept.	555,890	494,396	555,892	525,740	1,111,782	1,020,135	18,745
Oct.	552,547	492,877	558,724	528,811	1,111,271	1,021,689	18,596
Nov.	556,318	496,798	563,952	534,135	1,120,270	1,030,933	19,166
Dec.	590,716	530,778	570,200	540,684	1,160,916	1,071,462	23,181
1998 – Jan.	583,022	520,927	567,101	537,790	1,150,123	1,058,717	20,593
Feb.	579,190	514,044	571,035	541,610	1,150,225	1,055,654	20,943
Mar.	582,954	515,282	575,155	545,711	1,158,109	1,060,993	22,977
Apr.	583,082	517,111	578,329	549,029	1,161,411	1,066,140	22,869
May	573,063	509,400	580,337	551,322	1,153,400	1,060,723	21,335
June	591,819	527,967	584,234	557,109	1,176,053	1,085,076	26,715
July	601,282	535,547	582,335	555,244	1,183,617	1,090,790	24,439
Aug.	587,139	522,360	582,674	555,611	1,169,813	1,077,971	23,824
Sept.	587,754	524,393	585,317	559,023	1,173,071	1,083,416	23,699
Oct.	577,558	513,165	590,616	564,655	1,168,174	1,077,820	22,208
Nov.	604,542	538,516	596,496	570,072	1,201,038	1,108,588	26,275
Dec.	623,879	561,374	606,527	580,824	1,230,406	1,142,198	27,309
1999 – Jan. (2)	629,981	593,950	604,459	595,215	1,234,440	1,189,165	25,885
	(325,358)	*(306,750)*	*(312,177)*	*(307,403)*	*(637,535)*	*(614,152)*	*(13,369)*
Feb. (2)	619,497	582,069	607,728	598,882	1,227,224	1,180,952	25,422
	(319,943)	*(300,614)*	*(313,865)*	*(309,297)*	*(633,809)*	*(609,911)*	*(13,130)*
Mar. (2)	615,088	576,442	615,372	606,677	1,230,460	1,183,120	25,400
	(317,666)	*(297,708)*	*(317,813)*	*(313,323)*	*(635,480)*	*(611,030)*	*(13,118)*

(1) Rounding may cause discrepancies in totals. – (2) Provisional. – (3) Loans in lire until December 1998. As of January 1999, the data also include loans in euros and other euro area currencies.

Table a19

BANKS: SECURITIES PORTFOLIO (1)
(billions of lire and, in brackets, millions of euros)

	Government securities	of which: BOTs and BTEs	of which: CTZs	of which: CCTs	of which: BTPs	Other	of which: bonds issued by banks	Total
1993 – Dec.	294,657	74,863	–	140,032	76,766	55,014	49,206	349,770
1994 – ”	326,992	68,456	–	134,351	119,663	58,978	50,842	385,969
1995 – ”	301,552	44,650	10,222	133,268	107,090	50,708	47,576	352,260
1996 – ”	334,173	52,957	19,636	155,306	99,331	49,411	47,050	383,583
1997 – Jan.	332,707	44,207	20,590	165,200	95,176	47,596	45,412	380,302
Feb.	337,329	41,341	20,965	164,966	103,064	47,988	45,804	385,317
Mar.	340,005	36,117	21,691	162,278	113,003	48,299	45,763	388,304
Apr.	330,883	32,924	21,273	159,453	110,233	46,332	43,820	377,216
May	331,567	32,122	22,206	163,349	107,084	46,409	43,748	377,976
June	313,820	28,555	21,560	157,352	99,831	46,017	43,466	359,838
July	317,887	28,002	21,658	155,010	107,135	43,594	40,962	361,481
Aug.	310,092	26,688	19,651	154,098	103,679	44,413	41,833	354,505
Sept.	305,954	27,837	19,564	157,094	95,622	43,563	40,915	349,517
Oct.	306,424	30,429	17,688	155,265	97,088	44,980	42,324	351,404
Nov.	306,471	29,852	18,453	155,329	96,751	45,481	42,829	351,953
Dec.	296,481	32,094	18,661	154,455	86,220	46,925	43,491	343,406
1998 – Jan.	304,007	31,731	20,503	155,215	94,164	46,991	43,584	350,998
Feb.	296,788	33,680	20,236	150,703	88,672	49,511	45,815	346,299
Mar.	295,887	33,185	21,070	148,651	89,708	52,245	48,193	348,132
Apr.	301,992	34,416	22,646	142,599	99,382	54,328	47,623	356,320
May	304,884	39,007	21,833	137,785	103,161	55,162	47,827	360,046
June	294,068	39,729	21,963	136,555	92,894	56,729	53,564	350,798
July	297,328	43,885	24,508	134,583	91,452	55,924	52,459	353,251
Aug.	289,526	42,618	22,067	133,953	87,852	55,820	52,361	345,347
Sept.	297,032	44,192	24,511	136,417	88,883	55,544	52,224	352,576
Oct.	305,920	41,260	26,645	138,617	95,376	56,117	52,280	362,038
Nov.	299,947	42,928	23,302	136,328	93,376	57,663	53,700	357,610
Dec.	288,088	45,265	20,256	134,790	83,901	59,035	54,580	347,123
1999 – Jan. (2)	285,472	47,581	20,418	130,182	83,810	57,986	53,565	343,457
	(147,434)	*(24,574)*	*(10,545)*	*(67,233)*	*(43,284)*	*(29,947)*	*(27,664)*	*(177,381)*
Feb. (2)	297,995	45,866	23,855	132,088	92,037	58,481	52,801	356,476
	(153,902)	*(23,688)*	*(12,320)*	*(68,218)*	*(47,533)*	*(30,203)*	*(27,269)*	*(184,104)*
Mar. (2)	288,450	40,728	21,480	127,820	95,186	58,461	53,864	346,911
	(148,972)	*(21,034)*	*(11,093)*	*(66,013)*	*(49,159)*	*(30,193)*	*(27,819)*	*(179,165)*

(1) Rounding may cause discrepancies in totals. – (2) Provisional.

Table a20

PROFIT AND LOSS ACCOUNTS OF BANKS BY CATEGORY OF BANK (1)
(billions of lire)

	Interest receivable						Interest payable						Balance of derivative hedging contracts (2)	Net interest income (a)
	Deposits with BI-UIC & Treasury	Domestic lending in lire	Securities	Interbank accounts	Repos (2)	Claims on non-residents & on residents in foreign currency	Deposits	BI-UIC financing	Interbank accounts	Repos (2)	Bonds and subordinated liabilities	Liabilities to non-residents & to residents in foreign currency		
														Limited company
1993 . . .	5,885	104,132	28,015	6,461	4,574	24,826	55,363	183	7,221	9,819	21,881	24,993	−199	54,234
1994 . . .	5,163	92,485	27,494	4,528	2,620	19,154	45,055	185	7,004	9,544	20,756	18,410	−1,247	49,243
1995 . . .	4,242	104,942	28,552	6,292	1,905	19,810	46,674	430	7,717	12,080	23,200	21,468	−1,740	52,435
1996 . . .	3,596	104,601	27,099	7,206	1,745	18,410	47,832	173	8,440	11,405	23,678	17,790	−1,681	51,656
1997 . . .	3,635	90,690	21,131	5,659	1,164	19,736	34,838	87	6,564	9,354	24,514	17,442	−244	48,971
1998 (3)	2,849	80,984	15,902	4,885	1,882	17,693	21,884	67	5,344	7,275	24,391	16,908	736	49,061
														Cooperative banks
1993 . . .	1,210	13,662	5,556	1,544	588	2,106	9,919	19	969	1,821	10	1,809	−217	9,905
1994 . . .	1,045	12,063	5,765	1,094	373	1,818	8,291	16	872	1,803	79	1,460	−160	9,476
1995 . . .	811	15,495	6,361	1,500	277	2,001	9,085	20	1,251	2,575	619	1,607	−273	11,016
1996 . . .	638	15,744	5,576	1,655	413	1,644	9,051	19	1,115	2,455	971	1,258	−353	10,447
1997 . . .	672	14,207	4,322	1,471	409	1,825	6,581	9	895	2,039	1,924	1,351	−226	9,880
1998 (3)	475	12,475	3,004	1,068	488	1,828	3,920	8	713	1,380	2,416	1,615	−96	9,189
														Main mutual banks
1993 . . .	15	463	427	91	5	12	424	. .	8	137	. .	11	. .	433
1994 . . .	10	434	389	74	3	14	379	. .	5	124	. .	10	−1	404
1995 . . .	12	517	407	86	3	14	393	1	5	162	. .	10	−3	466
1996 . . .	12	570	398	102	10	9	429	1	4	159	12	5	. .	490
1997 . . .	15	548	340	69	8	13	331	1	6	108	78	6	−3	462
1998 (3)	18	533	268	53	4	25	221	0	7	71	112	9	−3	478
														Central credit
1993 . . .	23	424	927	679	87	535	63	38	1,302	201	11	482	−33	545
1994 . . .	7	316	882	495	5	339	54	37	868	191	12	396	−55	431
1995 . . .	24	294	998	598	10	428	65	50	1,141	253	13	433	−9	387
1996 . . .	32	242	1,068	863	43	340	66	43	1,503	213	31	373	−15	343
1997 . . .	33	192	827	714	127	325	69	33	1,132	232	91	345	4	320
1998 (3)	36	163	529	500	57	474	111	21	737	136	92	380	23	304
														Branches of
1993 . . .	26	1,237	1,054	615	188	1,080	137	9	1,514	152	. .	1,842	−438	108
1994 . . .	25	892	1,439	568	386	1,819	49	7	922	872	. .	2,354	−315	610
1995 . . .	29	1,215	1,465	819	315	2,753	101	12	1,051	814	. .	3,713	−318	589
1996 . . .	27	1,342	1,765	705	442	2,552	123	4	1,278	711	. .	3,783	−249	684
1997 . . .	29	1,219	1,465	554	577	2,980	70	5	1,334	669	. .	3,823	−378	545
1998 (3)	18	1,052	1,500	723	591	1,909	108	2	1,143	552	. .	3,391	−461	136
														Total
1993 . . .	7,159	119,918	35,980	9,390	5,442	28,559	65,906	249	11,014	12,130	21,902	29,138	−886	65,224
1994 . . .	6,250	106,191	35,969	6,758	3,387	23,143	53,828	245	9,671	12,534	20,847	22,630	−1,778	60,164
1995 . . .	5,118	122,463	37,783	9,295	2,511	25,006	56,318	512	11,165	15,882	23,831	27,230	−2,343	64,893
1996 . . .	4,305	122,500	35,906	10,531	2,653	22,954	57,501	241	12,341	14,944	24,692	23,209	−2,299	63,621
1997 . . .	4,384	106,856	28,085	8,468	2,284	24,878	41,889	135	9,932	12,401	26,606	22,967	−848	60,179
1998 (3)	3,396	95,208	21,204	7,229	3,021	21,929	26,244	99	7,944	9,415	27,012	22,304	199	59,168

(1) Rounding may cause discrepancies in totals. – (2) For the banks accepting medium and long-term funds, the figure is only available since 1994. – (3) Provisional.

Table a20

Other net income (b)	of which: trading	of which: services	Gross income (c)=(a)+(b)	Operating expenses (d)	of which: banking staff costs	Operating income (e)=(c)−(d)	Value adjustments and re-adjustments and allocations to provisions (f)	of which: for loan losses	Taxes (g)	Net profit (e)−(f)−(g)	Total resources	Number of staff	of which: banking
banks													
20,457	11,082	4,025	74,691	46,035	29,219	28,655	14,702	13,907	10,130	3,823	1,879,437	281,112	277,165
16,948	5,003	5,398	66,191	46,053	30,221	20,138	16,284	10,000	4,040	−185	1,966,214	281,139	276,301
16,680	4,640	5,137	69,115	47,854	30,830	21,260	16,199	14,178	5,969	−909	1,969,625	275,133	271,085
21,350	7,544	6,176	73,006	49,496	32,233	23,510	15,096	10,459	5,898	2,516	2,039,757	269,351	265,441
23,479	5,793	8,990	72,451	50,424	31,816	22,027	16,951	14,044	5,837	−761	2,137,814	264,610	260,903
32,612	7,032	14,423	81,673	49,395	30,609	32,279	11,696	11,411	10,081	10,502	2,250,539	260,604	256,667
(banche popolari)													
4,028	2,178	1,003	13,933	8,072	4,893	5,861	2,400	2,166	2,123	1,338	268,665	53,599	53,096
3,392	1,103	1,220	12,868	8,360	5,196	4,507	2,405	1,684	1,098	1,004	289,411	51,861	51,368
3,427	1,050	1,273	14,442	9,151	5,592	5,291	2,430	2,025	1,708	1,153	320,011	56,826	56,384
4,014	1,617	1,310	14,461	9,076	5,622	5,385	2,017	1,580	1,784	1,584	323,569	52,157	51,733
4,742	1,653	1,839	14,622	9,502	5,783	5,121	1,989	1,519	1,505	1,626	356,377	51,594	51,520
6,329	1,589	2,939	15,518	9,092	5,401	6,426	2,513	1,523	1,919	1,994	374,520	49,984	49,591
(banche di credito cooperativo)													
104	57	19	537	301	175	235	31	25	12	192	9,275	1,941	1,939
106	34	19	510	332	197	178	62	27	7	109	10,234	2,030	2,030
102	40	20	568	369	213	199	33	31	8	158	10,909	2,100	2,100
155	85	23	645	404	229	240	39	37	18	183	12,012	2,175	2,175
170	83	35	632	432	245	200	33	34	4	162	13,429	2,228	2,228
253	126	66	730	472	262	259	61	52	49	148	14,533	2,449	2,449
institutions													
421	266	122	967	475	247	492	206	171	154	132	33,743	1,557	1,557
342	83	149	773	391	187	382	217	175	67	99	30,939	1,549	1,549
286	122	131	673	404	193	269	109	99	74	85	31,658	1,545	1,545
370	187	154	714	404	200	310	133	88	88	89	37,410	1,543	1,543
414	201	174	735	418	208	316	244	114	67	5	39,729	1,543	1,543
431	180	224	735	418	197	317	129	35	85	103	38,677	1,596	1,596
foreign banks													
839	543	14	947	480	234	467	173	172	219	75	58,803	1,740	1,740
265	−102	269	875	548	268	327	−22	53	187	162	67,065	1,909	1,909
302	229	35	892	561	305	330	−43	53	233	141	76,351	1,852	1,852
153	85	−62	837	596	332	241	−82	64	169	154	91,650	1,822	1,822
223	96	78	768	630	346	138	−151	64	170	119	110,864	1,883	1,883
279	171	−22	415	663	346	−248	−555	62	92	215	107,259	1,850	1,850
banks													
25,850	14,127	5,183	91,074	55,364	34,769	35,710	17,512	16,441	12,639	5,560	2,249,923	339,949	335,497
21,053	6,122	7,056	81,217	55,684	36,070	25,533	18,947	11,940	5,399	1,188	2,363,863	338,488	333,157
20,796	6,081	6,596	85,690	58,340	37,133	27,349	18,728	16,386	7,992	629	2,408,554	337,456	332,966
26,042	9,518	7,603	89,662	59,976	38,617	29,686	17,202	12,228	7,957	4,528	2,504,398	327,048	322,714
29,029	7,826	11,116	89,208	61,406	38,398	27,801	19,067	15,775	7,583	1,151	2,658,212	321,858	318,077
39,903	9,098	17,631	99,070	60,038	36,816	39,032	13,845	13,082	12,225	12,962	2,785,529	316,483	312,153

Table a21

FINANCIAL MARKET: GROSS AND NET ISSUES OF SECURITIES (1)
(billions of lire)

	Bonds and government							
	Public sector							
	Government securities							Autonomous government agencies and State Railways
	Treasury bills	Zero-coupon Treasury certificates	Floating rate Treasury credit certificates (1)	Treasury bonds (1)	Treasury certificates in ecus	Other (2)	Total	
								Gross
1991	602,421	–	99,000	93,010	3,680	27,989	826,101	–
1992	675,055	–	83,426	95,519	4,759	21,461	880,220	1,500
1993	737,345	–	56,000	166,452	12,838	16,685	989,322	–
1994	679,500	–	60,767	167,574	17,665	81,801	1,007,306	4,000
1995	714,250	47,217	122,810	118,484	6,769	3,165	1,012,695	–
1996	665,023	59,924	105,945	148,917	3,913	10,395	994,117	4,000
1997	506,000	105,905	64,404	190,596	–	168	867,073	–
1998	425,768	97,779	42,502	261,441	–	38	827,527	–
								Rede
1991	588,527	–	88,275	4,846	2,144	10,590	694,382	160
1992	630,323	–	21,313	59,399	4,502	22,847	738,384	2,160
1993	730,866	–	34,387	27,521	13,719	16,801	823,293	2,000
1994	660,346	–	22,200	55,523	14,140	19,414	771,624	27
1995	715,750	–	148,917	15,844	14,797	10,746	906,054	1,200
1996	692,476	–	76,258	92,255	8,600	20,181	889,769	1,000
1997	588,310	54,275	56,213	120,963	4,354	19,923	844,038	–
1998	461,250	84,576	84,973	119,921	12,448	25,680	788,848	5,000
								Issue
1991	–	–	1,457	2,381	–104	77	3,812	–
1992	–	–	2,089	2,544	–62	–6	4,623	–
1993	–	–	915	446	–225	–35	1,102	–
1994	–	–	938	7,592	788	–	9,317	–
1995	–	8,918	2,763	6,715	135	–	18,531	–
1996	–	8,409	–773	–990	48	–	6,693	–
1997	–	10,146	209	1,043	–	–	11,398	–
1998	–	6,605	–374	–7,823	–	–	–1,593	–
								Net
1991	13,894	–	9,268	85,784	1,640	17,321	127,907	–160
1992	44,731	–	60,024	33,576	319	–1,437	137,213	–660
1993	6,480	–	20,698	138,485	–656	–80	164,927	–2,000
1994	19,155	–	37,629	104,458	2,736	62,386	226,363	3,973
1995	–1,500	38,299	–28,870	95,925	–8,163	–7,581	88,109	–1,200
1996	–27,453	51,515	30,460	57,652	–4,734	–9,786	97,655	3,000
1997	–82,310	41,484	7,982	68,590	–4,354	–19,755	11,637	–
1998	–35,482	6,598	–42,097	149,343	–12,448	–25,642	40,272	–5,000
								Cou
1991	38,483	–	52,103	23,519	4,767	9,289	128,161	1,254
1992	46,675	–	57,255	32,639	5,001	11,397	152,967	1,276
1993	40,959	–	69,167	39,387	5,121	10,146	164,780	1,369
1994	34,957	–	56,695	52,496	4,968	9,711	158,827	1,041
1995	41,250	–	58,837	61,265	4,879	9,320	175,551	1,114
1996	31,079	–	60,460	67,570	3,804	8,352	171,265	1,129
1997	18,669	10,471	48,894	70,695	3,138	6,018	157,885	876
1998	11,739	10,374	36,504	72,062	2,691	2,515	135,885	520

(1) The 1993 issues include 10,000 billion lire of CCTs and 21,000 billion of BTPs placed with the Bank of Italy in December to finance the new Treasury payments account. – (2) Includes: issued in November 1994 to consolidate the Treasury's overdraft on its current account with the Bank of Italy; excludes Republic of Italy loans. – (3) The total for the public sector differs by Autostrade-IRI. – (5) Gross issues for cash. The figure for 1998 is provisional.

Table a21

securities										Listed shares (5)	
			Banks	Firms and international institutions					Total bonds and government securities		
	Crediop on behalf of Treasury	Total (3)		ENEL	IRI ENI EFIM	Private firms	International institutions	Total (4)			
issues											
	–	826,101	32,307	2,253	4,902	507	400	8,062	866,470	4,497	 1991
	–	881,720	29,022	1,108	–	290	–	1,518	912,260	3,368	 1992
	–	989,322	44,185	2,111	1,000	1,289	–	4,950	1,038,457	15,230	 1993
	–	1,011,306	43,252	114	–	3,421	650	4,285	1,058,843	12,892	 1994
	–	1,012,695	28,355	117	–	963	1,000	2,080	1,043,130	8,515	 1995
	–	998,356	97,075	121	–	1,302	2,500	3,923	1,099,354	5,506	 1996
	–	867,847	148,240	124	–	1,422	5,640	7,186	1,023,273	7,933	 1997
	–	828,622	135,981	62	–	73	1,600	1,734	966,338	13,689	 1998
mptions											
	782	695,344	16,119	921	1,772	1,350	163	4,226	715,689	–	 1991
	493	741,053	16,995	1,533	1,796	1,220	424	4,973	763,021	–	 1992
	309	825,612	17,606	3,966	1,775	930	603	7,274	850,493	–	 1993
	74	771,730	20,705	2,174	2,669	1,030	460	6,333	798,768	–	 1994
	49	907,304	28,745	1,250	2,754	103	465	4,572	940,621	–	 1995
	40	890,809	32,148	800	467	–	250	1,517	924,475	–	 1996
	8	844,062	50,710	800	2,221	–	650	3,671	898,443	–	 1997
	–	793,921	77,652	1,300	24	–	500	1,874	873,447	–	 1998
discounts											
	–	3,812	250	17	–	–	7	24	4,085	–	 1991
	–	4,623	1,179	9	–	–	–	9	5,811	–	 1992
	–	1,102	365	17	–	–	–	17	1,484	–	 1993
	–	9,317	288	–	–	–	–	22	9,627	–	 1994
	–	18,531	131	–	–	–	–	–	18,662	–	 1995
	–	6,694	211	–	–	–	1,201	1,201	8,105	–	 1996
	–	11,398	302	–	–	–	1,493	1,493	13,192	–	 1997
	–	–1,593	601	–	–	–	–	–	–992	–	 1998
issues											
	–782	126,946	15,938	1,316	3,131	–843	230	3,813	146,697	4,497	 1991
	–493	136,045	10,848	–434	–1,797	–930	–424	–3,464	143,429	3,368	 1992
	–309	162,608	26,213	–1,872	–775	359	–603	–2,341	186,480	15,230	 1993
	–74	230,258	22,259	–2,060	–2,669	2,391	190	–2,070	250,447	12,892	 1994
	–49	86,859	–521	–1,133	–2,754	860	535	–2,492	83,847	8,515	 1995
	–40	100,854	64,715	–679	–467	1,302	1,049	1,205	166,774	5,506	 1996
	–8	12,388	97,228	–676	–2,221	1,422	3,498	2,022	111,638	7,933	 1997
	–	36,294	57,728	–1,239	–24	73	1,100	–140	93,882	13,689	 1998
pons											
	111	129,526	16,827	1,898	1,277	....	281	3,457	149,814	5,888	 1991
	60	154,303	19,458	1,899	1,507	....	315	3,721	177,484	6,031	 1992
	27	166,176	21,696	2,464	1,405	....	261	4,176	192,049	6,468	 1993
	9	159,877	20,395	1,367	952	....	183	2,561	182,834	5,105	 1994
	6	176,671	22,876	1,255	707	....	196	2,221	201,768	6,180	 1995
	6	172,400	23,317	1,130	459	....	142	1,833	197,550	9,786	 1996
	5	158,783	25,294	875	212	....	207	1,353	185,430	12,112	 1997
	4	136,463	25,519	646	93	....	178	967	162,949	13,601	 1998

securities issued by the Treasury to consolidate past debts; Treasury discount certificates, option certificates and bills in ecus; ordinary certificates and the 76,206 billion lire of securities from the sum of the individual components by the amount of bond issues by local authorities. – (4) The total differs from the sum of the individual components by the amount of bond issues

Table a22

INTEREST RATES ON SECURITIES

(average values before tax)

	Floating rate Treasury credit certificates	Treasury certificates in ecus	Treasury option certificates	Treasury bonds	Zero-coupon Treasury certificates	Straight bonds			
						Banks	State-controlled enterprises	International institutions	Total (1)
1989	13.12	9.60	12.17	12.78	–	12.94	12.06	11.09	11.59
1990	12.84	10.89	13.22	13.49	–	13.34	12.49	11.93	12.28
1991	12.60	10.09	12.91	13.14	–	12.96	11.62	11.40	11.79
1992	14.98	10.20	13.20	13.59	–	13.37	12.73	11.66	12.63
1993	11.77	7.81	11.12	11.32	–	11.28	10.90	10.02	11.09
1994	9.97	7.64	10.53	10.68	–	10.14	10.55	9.83	10.15
1995	11.60	8.82	11.64	11.94	11.40	11.58	11.35	11.00	11.45
1996	9.01	6.33	8.77	9.06	8.49	9.20	9.08	9.46	9.09
1997	6.81	5.42	7.17	6.76	6.45	7.41	7.07	7.17	7.14
1998	4.89	4.87	7.01	4.92	4.58	5.45	5.71	5.87	5.55
1997 – Jan.	6.93	5.48	6.96	7.02	6.69	7.54	7.07	7.50	7.17
Feb.	7.09	5.50	7.23	7.14	7.06	7.70	7.31	7.92	7.40
Mar.	7.34	5.48	7.67	7.73	7.29	7.96	7.71	8.02	7.73
Apr.	7.32	5.43	7.33	7.59	7.01	7.96	7.74	7.98	7.75
May	7.02	5.23	7.05	7.25	6.71	7.72	7.41	7.86	7.46
June	7.07	5.10	7.13	7.04	6.67	7.58	7.31	7.55	7.33
July	6.95	5.26	7.11	6.56	6.37	7.09	7.04	6.85	6.99
Aug.	7.01	5.14	7.06	6.71	6.45	7.15	7.07	6.83	7.01
Sept.	6.65	5.38	7.06	6.31	6.04	7.09	6.85	6.65	6.88
Oct.	6.36	5.67	7.18	6.12	5.97	6.93	6.61	6.40	6.67
Nov.	6.21	5.65	7.12	6.04	5.75	7.18	6.57	6.41	6.78
Dec.	5.77	5.67	7.14	5.67	5.34	6.98	6.21	6.05	6.50
1998 – Jan.	5.60	5.12	6.76	5.44	5.26	6.35	5.85	5.74	5.99
Feb.	5.98	5.00	6.84	5.37	5.45	6.52	6.09	5.82	6.18
Mar.	5.54	5.57	6.78	5.17	5.03	6.10	6.07	5.76	6.01
Apr.	5.17	5.63	7.67	5.13	4.90	5.68	6.03	5.64	5.76
May	5.04	5.51	–	5.17	4.80	5.56	6.04	5.74	5.71
June	4.98	5.30	–	5.07	4.83	5.52	5.97	6.14	5.72
July	4.89	5.00	–	4.97	4.57	5.26	5.66	6.12	5.49
Aug.	4.72	4.73	–	4.81	4.50	5.21	5.57	6.08	5.45
Sept.	4.65	4.48	–	4.62	4.37	5.14	5.45	5.96	5.36
Oct.	4.39	4.08	–	4.59	4.06	4.78	5.33	5.86	5.07
Nov.	4.13	4.09	–	4.52	3.78	4.69	5.24	5.89	5.01
Dec.	3.66	3.95	–	4.18	3.33	4.56	5.16	5.68	4.88
1999 – Jan.	3.11	4.12	–	4.03	3.03	4.31	4.88	5.54	4.64
Feb.	3.19	4.73	–	4.13	3.07	4.42	5.00	5.65	4.76
Mar.	3.20	4.26	–	4.31	3.07	4.57	5.18	5.73	4.92
Apr.	3.01	4.56	–	4.14	2.77	4.37	4.96	5.62	4.67

(1) Until September 1995 includes the bonds issued by autonomous government agencies and public enterprises.

INTEREST RATES ON BANK OF ITALY OPERATIONS

	Official					
	Current account (1)		Discount		Advances	
	Excess reserves	Compulsory reserves (2)	Ordinary bills	Agricultural working credits	Ordinary (base rate)	Fixed-term (surcharge) (3)
From: 4 Sept. 1984	0.50	5.50	16.50	8.50	16.50	–
4 Jan. 1985	”	”	15.50	”	15.50	–
8 Nov. 1985	”	”	15.00	8.00	15.00	–
22 Mar. 1986	”	”	14.00	7.50	14.00	–
25 Apr. 1986	”	”	13.00	7.00	13.00	–
27 May 1986	”	”	12.00	6.50	12.00	–
14 Mar. 1987	”	”	11.50	”	11.50	–
28 Aug. 1987	”	”	12.00	”	12.00	–
26 Aug. 1988	”	”	12.50	”	12.50	–
6 Mar. 1989	”	”	13.50	”	13.50	–
21 May 1990	”	”	12.50	”	12.50	–
13 May 1991	”	”	11.50	6.00	11.50	0
26 Nov. 1991	”	”	”	”	”	0.50
23 Dec. 1991	”	”	12.00	”	12.00	”
5 June 1992	”	”	”	”	”	1.00
6 July 1992	”	”	13.00	”	13.00	1.50
17 July 1992	”	”	13.75	”	13.75	”
4 Aug. 1992	”	”	13.25	”	13.25	”
4 Sept. 1992	”	”	15.00	”	15.00	”
9 Oct. 1992	”	”	”	”	”	1.00
26 Oct. 1992	”	”	14.00	”	14.00	”
13 Nov. 1992	”	”	13.00	”	13.00	”
23 Dec. 1992	”	”	12.00	”	12.00	”
4 Feb. 1993	”	”	11.50	”	11.50	”
23 Apr. 1993	”	”	11.00	”	11.00	”
21 May 1993	”	”	10.50	”	10.50	”
14 June 1993	”	”	10.00	5.50	10.00	”
6 July 1993	”	”	9.00	”	9.00	”
10 Sept. 1993	”	”	8.50	”	8.50	”
22 Oct. 1993	”	”	8.00	”	8.00	”
18 Feb. 1994	”	”	7.50	”	7.50	”
12 May 1994	”	”	7.00	”	7.00	”
12 Aug. 1994	”	”	7.50	”	7.50	”
22 Feb. 1995	”	”	8.25	”	8.25	1.50
29 May 1995	”	”	9.00	”	9.00	”
24 July 1996	”	”	8.25	”	8.25	”
24 Oct. 1996	”	”	7.50	”	7.50	”
22 Jan. 1997	”	”	6.75	”	6.75	”
30 June 1997	”	4.50	6.25	4.75	6.25	”
24 Dec. 1997	”	”	5.50	”	5.50	”
22 Apr. 1998	”	4.00	5.00	4.25	5.00	”
27 Oct. 1998	”	”	4.00	3.75	4.00	”
4 Dec. 1998	”	3.50	3.50	3.50	3.50	1.00
28 Dec. 1998	”	2.75	3.00	3.00	”	”

	Temporary operations (4)					
	Securities repos				Currency swaps	
	Purchases		Sales			
	Minimum	Average	Maximum	Average	Minimum	Average
1996 - Jan.	10.07	10.11	–	–	10.08	10.11
Feb.	9.98	10.04	–	–	9.89	9.90
Mar.	9.93	9.94	–	–	9.64	9.65
Apr.	9.66	9.69	–	–	9.59	9.61
May	9.32	9.33	9.29	9.23	8.93	8.95
June	9.13	9.20	–	–	8.84	8.86
July	8.94	9.01	–	–	8.88	8.90
Aug.	8.84	8.88	–	–	8.76	8.77
Sept.	8.47	8.50	–	–	8.37	8.39
Oct.	–	–	8.55	8.51	8.25	8.25
Nov.	7.97	7.99	8.12	8.05	7.34	7.36
Dec.	7.46	7.68	–	–	7.58	7.61
1997 - Jan.	7.45	7.50	–	–	7.34	7.36
Feb.	7.39	7.41	–	–	7.34	7.36
Mar.	7.40	7.42	–	–	7.37	7.39
Apr.	7.20	7.21	–	–	7.03	7.05
May	6.96	7.00	–	–	6.75	6.76
June	6.71	6.83	–	–	6.81	6.83
July	6.77	6.85	–	–	–	–
Aug.	6.80	6.83	–	–	6.76	6.79
Sept.	6.77	6.79	–	–	6.03	6.31
Oct.	6.86	6.87	–	–	–	–
Nov.	6.60	6.63	–	–	6.24	6.26
Dec.	6.16	6.20	6.29	6.24	5.80	5.86
1998 - Jan.	6.12	6.21	–	–	–	–
Feb.	6.07	6.14	–	–	6.02	6.03
Mar.	5.76	5.79	–	–	5.23	5.24
Apr.	5.67	5.67	6.50	6.04	–	–
May	5.54	5.57	–	–	–	–
June	5.23	5.27	–	–	5.00	5.04
July	4.96	4.98	–	–	4.95	4.97
Aug.	4.97	4.99	–	–	4.99	5.00
Sept.	5.13	5.14	–	–	–	–
Oct.	4.94	4.97	–	–	–	–
Nov.	3.73	3.78	4.26	4.26	–	–
Dec.	3.02	3.14	–	–	–	–

(1) Current accounts of banks, social security institutions, insurance companies and public corporations. – (2) On 28 December 1982 the rate of interest on the proportion of reserves corresponding to the ratio of certificates of deposit to total funds subject to reserve requirements was fixed at 9.5 per cent. The higher rate was subsequently extended to CDs with maturities of between 3 and 6 months in November 1986 and to variable rate CDs with maturities of at least 18 months in December 1989. The rate was reduced to 8.5 per cent in November 1986 and to 6.5 per cent in September 1993. As part of the May 1994 reform of the system, the return on reserves was equalized for all forms of deposit with effect from July 1994. – (3) Added to the base rate to determine the rate on fixed-term advances. Until 12 May 1991 the surcharge increased with the frequency of recourse to such refinancing. – (4) Average of the allotment rates on operations during the month.

Table a24

MONEY MARKET AND INTERBANK INTEREST RATES (1)

	Treasury bill yields (2)				Interbank accounts (3)	Interbank operations			
	3-month bills	6-month bills	12-month bills	Average		Overnight (4)	1-month (4)	3-month (4)	12-month (4)
1989	12.65	12.55	12.55	12.58	12.46	11.97	....	....	....
1990	12.28	12.33	12.53	12.38	11.83	10.93	11.92	12.10	....
1991	12.66	12.53	12.39	12.54	11.89	11.83	12.14	12.21	....
1992	14.48	14.38	14.02	14.32	14.29	14.38	14.42	14.02	....
1993	10.47	10.52	10.74	10.58	10.59	10.25	10.24	10.20	8.94
1994	8.84	9.13	9.50	9.17	8.43	8.20	8.33	8.51	9.17
1995	10.73	10.85	10.96	10.85	10.32	10.07	10.23	10.46	10.98
1996	8.61	8.48	8.31	8.46	9.44	9.10	8.99	8.82	8.42
1997	6.40	6.36	6.26	6.33	7.36	7.02	6.98	6.88	6.46
1998	4.96	4.59	4.37	4.59	5.62	5.23	5.19	4.99	4.34
1997 – Jan.	6.98	6.78	6.55	6.74	8.02	7.68	7.48	7.23	6.62
Feb.	6.75	6.87	6.67	6.76	7.83	7.51	7.48	7.36	6.84
Mar.	7.10	7.24	7.24	7.20	7.74	7.45	7.45	7.43	7.29
Apr.	6.69	6.55	6.78	6.67	7.64	7.27	7.18	7.13	7.05
May	6.39	6.46	6.45	6.44	7.46	6.99	6.95	6.83	6.78
June	6.65	6.52	6.45	6.54	7.29	6.99	6.94	6.88	6.61
July	6.52	6.60	6.37	6.49	7.27	6.99	6.95	6.89	6.50
Aug.	6.53	6.54	6.43	6.50	7.20	6.84	6.90	6.87	6.58
Sept.	5.81	5.94	5.73	5.82	7.08	6.80	6.78	6.66	6.24
Oct.	6.21	5.94	5.86	5.98	7.04	6.88	6.83	6.65	5.87
Nov.	5.96	5.80	5.59	5.76	7.02	6.61	6.65	6.49	5.81
Dec.	5.17	5.13	5.02	5.10	6.73	6.26	6.21	6.08	5.34
1998 – Jan.	5.62	5.59	5.20	5.43	6.43	6.33	6.25	6.09	5.25
Feb.	6.20	5.79	5.25	5.66	6.44	6.25	6.25	6.13	5.27
Mar.	5.73	5.12	4.71	5.10	6.27	5.91	5.81	5.62	4.77
Apr.	5.35	4.92	4.66	4.92	6.02	5.72	5.58	5.23	4.58
May	5.17	4.87	4.60	4.85	5.94	5.69	5.49	5.11	4.59
June	5.16	4.86	4.58	4.83	5.83	5.38	5.34	5.12	..
July	4.74	4.65	4.39	4.56	5.66	5.08	4.99	4.88	..
Aug.	4.72	4.60	4.24	4.49	5.30	5.14	5.04	4.89	4.24
Sept.	4.88	4.18	3.98	4.24	5.33	5.12	5.14	4.97	4.16
Oct.	4.65	3.94	3.91	4.11	5.23	4.94	4.82	4.53	3.76
Nov.	4.16	3.67	3.80	3.86	4.83	4.16	4.14	3.95	3.59
Dec.	3.18	2.85	3.16	3.07	4.14	3.08	3.41	3.38	3.14
1999 – Jan.	3.14	2.97	3.10	3.07	3.54	3.11	3.12	3.10	3.05
Feb.	3.04	3.01	3.02	3.02	3.52	3.13	3.10	3.07	3.02
Mar.	3.03	2.94	3.06	3.01	3.45	2.94	3.04	3.03	3.07
Apr.	2.61	2.58	2.70	3.63					

(1) Before tax; annual figures are the average of monthly values. – (2) Average of allotment rates at public auctions, before tax; for 3 and 6-month bills, compounded. – (3) Maximum rate applied to the sight deposits in lire (and from January 1999 onwards in other euro area currencies) of resident banks with a debit balance of more than 1 billion lire, monthly average of the rates reported at 10-day intervals. – (4) Weighted monthly average of the rates on transactions carried out on the interbank deposit market (MID).

BANK INTEREST RATES (1)

	Deposits (2)						Loans (2)		New medium & long-term loans to enterprises (7)	New medium & long-term loans to consumer households (7)	ABI prime rate (8)
				Certificates of deposit							
	Average: current accounts	Overall average	Maximum (3)	Overall average	Maturities up to 6 months (4)	Maturities from 18 to 24 months (5)	Overall average	Minimum (6)			
1989	7.29	*7.30*	9.33	....	*10.35*	....	14.26	11.95	....	....	13.83
1990	7.15	*7.39*	9.58	....	*10.62*	....	14.09	11.74	....	....	13.35
1991	6.99	*7.38*	9.33	....	*10.42*	....	13.90	11.33	....	....	12.84
1992	7.47	8.55	9.99	....	*11.20*	....	15.76	12.50	....	....	14.36
1993	6.46	7.79	8.86	....	*9.30*	....	13.87	10.51	....	....	11.40
1994	5.02	6.20	7.01	....	*6.88*	....	11.22	8.36	....	....	9.27
1995	5.49	6.45	8.00	8.46	8.37	8.89	12.47	9.60	11.44	13.37	11.03
1996	5.26	6.49	7.92	8.61	7.48	7.76	12.06	9.00	10.68	12.91	10.95
1997	3.73	4.83	6.11	7.29	5.43	5.33	9.75	6.79	8.26	10.65	9.21
1998	2.50	3.16	4.70	5.72	4.00	3.80	7.88	5.11	6.22	7.84	7.71
1997 – Jan.	4.36	5.60	6.81	7.99	6.08	6.04	10.64	7.31	8.84	11.50	9.63
Feb.	4.11	5.39	6.47	7.82	5.72	5.65	10.37	7.20	8.74	11.27	9.50
Mar.	4.07	5.28	6.40	7.69	5.67	5.58	10.20	7.15	8.84	11.27	9.38
Apr.	4.01	5.18	6.34	7.56	5.69	5.59	10.10	7.08	8.66	11.14	9.38
May	3.99	5.10	6.30	7.45	5.64	5.58	9.96	6.96	8.67	11.00	9.38
June	3.84	4.95	6.20	7.34	5.56	5.54	9.78	6.81	8.04	10.73	9.38
July	3.55	4.69	5.91	7.24	5.36	5.32	9.61	6.73	8.12	10.46	9.00
Aug.	3.44	4.55	5.83	7.12	5.21	5.15	9.46	6.67	8.35	10.54	9.00
Sept.	3.46	4.49	5.84	7.01	5.21	5.15	9.37	6.61	8.13	10.32	9.00
Oct.	3.29	4.29	5.66	6.89	5.04	4.86	9.27	6.45	7.98	10.17	9.00
Nov.	3.33	4.24	5.80	6.76	4.97	4.77	9.19	6.36	7.92	9.98	9.00
Dec.	3.37	4.19	5.79	6.63	4.95	4.72	9.01	6.12	6.90	9.38	8.88
1998 – Jan.	3.08	3.90	5.36	6.49	4.60	4.38	8.83	5.94	7.18	9.52	8.25
Feb.	2.93	3.74	5.22	6.32	4.49	4.21	8.69	5.88	7.29	9.20	8.25
Mar.	2.94	3.68	5.21	6.18	4.44	4.16	8.51	5.76	6.77	8.89	8.25
Apr.	2.78	3.48	5.02	6.02	4.28	4.06	8.33	5.53	6.66	8.62	7.88
May	2.51	3.21	4.69	5.87	4.06	3.90	8.12	5.31	6.46	8.20	7.88
June	2.53	3.16	4.73	5.72	4.01	3.84	7.89	5.14	6.19	7.61	7.88
July	2.47	3.08	4.64	5.60	3.97	3.76	7.73	4.99	6.15	7.39	7.88
Aug.	2.37	2.97	4.57	5.49	3.86	3.68	7.59	4.88	6.06	7.61	7.88
Sept.	2.37	2.93	4.57	5.40	3.87	3.68	7.55	4.85	6.01	7.24	7.88
Oct.	2.36	2.89	4.56	5.30	3.83	3.58	7.48	4.77	5.81	6.92	7.25
Nov.	1.97	2.55	4.12	5.18	3.47	3.30	7.17	4.41	5.57	6.68	6.88
Dec.	1.70	2.29	3.72	5.05	3.11	3.04	6.70	3.80	4.53	6.17	6.38
1999 – Jan.	1.44	2.00	3.25	4.88	2.67	2.77	6.28	3.36	4.78	6.13	5.88
Feb.	1.31	1.85	3.02	4.70	2.53	2.70	6.08	3.23	4.61	6.04	5.88
Mar.	1.31	1.82	2.99	4.55	2.50	2.67	5.85	3.17	4.49	5.98	5.88

(1) Before tax; annual figures are the average of monthly values. – (2) The rates shown are monthly averages of the rates reported at 10-day intervals. The "Overall average" rates are the weighted average of the rates on individual positions weighted with the relevant balances. The figures in italics refer to an earlier sample covering fewer banks. – (3) Rate applied to the last decile of freely available deposits in lire (and from January 1999 onwards in other euro area currencies) on current and savings accounts ranked according to the interest rate. – (4) Until 1994, average issue rate of 6-month CDs. – (5) Average issue rate of fixed-rate CDs in lire (and from January 1999 onwards in other euro area currencies) with an original maturity of between 18 and 24 months. – (6) Rate applied to the first decile of short-term loans in lire (and from January 1999 onwards in other euro area currencies) to enterprises ranked according to the interest rate. – (7) The rates are reported only for the last 10-day period of each month. – (8) The monthly data are end-of-period data.

Table a26

THE MONEY SUPPLY (1)
(stocks in billions of lire)

	End-of-period					
	Notes and coin	Sight deposits (2)		Other assets (3)	Total: M1	Postal savings accounts
		Banks	Post Office			
1989 – Dec.	67,644	356,375	9,388	18,681	452,088	19,733
1990 – ”	69,449	388,409	7,825	17,068	482,751	23,589
1991 – ”	76,354	435,150	7,017	19,429	537,950	26,924
1992 – ”	85,617	434,823	9,337	16,011	545,788	29,057
1993 – ”	89,769	465,071	9,479	14,760	579,078	30,861
1994 – ”	96,221	478,258	8,160	15,728	598,367	39,152
1995 – ”	98,281	482,902	8,494	15,971	605,649	43,936
1996 – ”	100,107	506,025	6,954	13,144	626,231	46,256
1997 – Jan.	96,334	475,796	8,385	11,167	591,681	46,880
Feb.	95,714	477,765	8,342	12,197	594,018	47,736
Mar.	99,325	474,162	7,240	9,616	590,343	48,168
Apr.	96,861	476,427	6,810	9,259	589,357	48,489
May	99,345	485,235	6,361	9,348	600,289	48,563
June	97,692	497,278	7,286	12,710	614,966	48,450
July	101,408	487,648	5,686	11,943	606,685	48,196
Aug.	98,883	481,770	5,561	6,557	592,771	49,092
Sept.	99,933	499,079	7,361	9,180	615,553	49,282
Oct.	99,161	503,919	7,047	10,116	620,243	49,344
Nov.	103,237	493,475	6,398	11,216	614,327	49,742
Dec.	107,433	538,103	5,921	14,095	665,552	51,993
1998 – Jan.	103,620	519,784	5,702	11,489	640,595	52,281
Feb.	102,877	518,372	5,200	9,278	635,728	53,171
Mar.	105,030	539,121	4,487	9,614	658,252	53,517
Apr.	105,638	549,898	3,880	10,208	669,624	53,715
May	108,472	553,907	4,673	9,884	676,936	53,942
June	107,680	574,075	3,139	13,542	698,436	53,964
July	109,295	543,697	2,485	10,901	666,337	53,727
Aug.	105,226	536,789	2,706	8,350	653,071	55,049
Sept.	106,053	541,777	2,143	9,529	659,502	55,428
Oct.	106,919	545,063	1,622	7,070	660,673	55,904
Nov.	107,164	546,739	467	7,563	661,934	56,415
Dec.	115,200	590,301	78	11,227	716,806	58,960

(1) Money held by the non-state sector. Rounding may cause discrepancies in totals. – (2) Demand deposits in lire and in foreign currency. – (3) Banker's drafts issued by banks and the Bank
months. – (6) For notes and coin, deposits and banker's drafts, averages of daily data; for the other items, two-period moving averages of end-of-month data. – (7) Includes the deposits of the

Table a26

data			Average data (6)			
Savings deposits of bank (4)	Short-term CDs (5)	M2 excluding longer-term CDs (5)	M1	M2 excluding longer-term CDs (5)	Extended M2 (7)	
182,090	57,568	711,479	415,018	668,520	669,519	.... Dec. – 1989
178,384	74,688	759,412	442,428	709,331	711,604	.... ” – 1990
161,798	81,164	807,836	488,712	750,765	754,376	.... ” – 1991
146,967	92,390	814,203	492,082	751,789	757,185	.... ” – 1992
144,091	87,286	841,316	529,612	780,319	786,096	.... ” – 1993
138,297	71,602	847,418	547,354	788,390	795,392	.... ” – 1994
121,047	63,518	834,149	554,785	773,115	784,517	.... ” – 1995
118,399	72,084	862,969	576,295	802,522	817,593	.... ” – 1996
117,014	75,439	831,014	599,580	833,731	848,527	.... Jan. – 1997
117,051	77,413	836,218	577,244	813,439	829,577	.... Feb.
117,508	79,018	835,037	577,049	815,101	831,313	.... Mar.
116,169	80,633	834,647	578,642	818,345	835,038	.... Apr.
116,215	82,450	847,516	590,363	831,924	847,825	.... May
116,777	83,500	863,693	583,592	826,125	841,374	.... June
116,794	84,530	856,206	593,965	838,132	854,004	.... July
118,615	85,578	846,055	590,785	837,734	852,839	.... Aug.
117,759	87,501	870,096	589,156	838,349	853,347	.... Sept.
117,313	88,844	875,744	601,414	851,898	869,313	.... Oct.
118,586	89,523	872,177	604,702	856,301	875,232	.... Nov.
121,433	91,249	930,228	620,540	874,796	892,455	.... Dec.
121,251	90,268	904,396	646,824	906,927	923,871	.... Jan. – 1998
121,198	88,299	898,396	625,831	883,816	901,063	.... Feb.
118,370	87,753	917,891	635,059	891,673	908,938	.... Mar.
117,465	86,301	927,105	652,583	906,630	923,846	.... Apr.
116,533	85,396	932,808	664,571	916,417	933,022	.... May
115,834	85,822	954,056	665,920	914,880	929,810	.... June
114,472	84,301	918,877	662,531	909,362	923,201	.... July
115,278	83,198	906,596	646,955	893,173	906,387	.... Aug.
114,581	82,314	911,825	645,405	891,896	904,741	.... Sept.
114,913	83,027	914,518	655,247	901,622	915,685	.... Oct.
114,842	81,817	915,008	659,117	905,960	920,747	.... Nov.
117,309	81,613	974,688	676,581	924,054	937,388	.... Dec.

of Italy and deposits with the Treasury. – (4) Savings accounts and tied current account deposits in lire and in foreign currency. – (5) Longer-term CDs are those not redeemable for at least 18
non-state sector with the foreign branches of Italian banks; excludes longer-term CDs.

Table a27

CREDIT (1)
(end of period stocks in billions of lire)

	Finance to the non-state sector				
	Short-term bank loans (2)	Medium and long-term bank loans (2)	Bonds placed domestically	Total domestic finance	Foreign finance (3)
1989 – Dec.	392,737	259,653	25,638	678,028	68,029
1990 – ”	455,671	300,933	23,453	780,057	93,504
1991 – ”	513,495	347,530	25,109	886,134	107,686
1992 – ”	570,627	384,286	20,510	975,423	128,680
1993 – ”	557,979	433,812	24,783	1,016,573	131,547
1994 – ”	531,853	474,804	21,873	1,028,530	124,660
1995 – ”	551,973	485,350	18,409	1,055,732	129,596
1996 – ”	554,157	510,655	17,957	1,082,769	122,955
1997 – Jan.	553,406	512,127	18,036	1,083,569	124,758
Feb.	553,774	512,494	17,873	1,084,140	126,692
Mar.	547,224	511,653	17,518	1,076,395	125,842
Apr.	545,851	513,647	17,729	1,077,228	126,551
May	545,227	516,914	16,841	1,078,981	127,515
June	562,202	524,101	14,407	1,100,710	128,476
July	571,826	522,955	14,666	1,109,447	132,218
Aug.	554,995	522,112	14,720	1,091,827	132,657
Sept.	554,559	525,693	14,832	1,095,083	132,116
Oct.	551,172	528,844	15,215	1,095,230	135,199
Nov.	554,976	534,437	15,557	1,104,971	135,694
Dec.	590,209	543,627	15,886	1,149,723	136,029
1998 – Jan.	582,151	540,705	13,667	1,136,522	140,285
Feb.	578,612	544,296	13,410	1,136,318	140,110
Mar.	582,479	548,322	12,824	1,143,625	142,264
Apr.	582,645	551,916	12,836	1,147,397	141,941
May	572,550	555,129	12,213	1,139,892	142,394
June	591,556	560,839	12,201	1,164,596	144,430
July	600,983	559,585	11,903	1,172,471	147,438
Aug.	586,809	560,409	11,623	1,158,841	148,279
Sept.	586,987	563,409	11,395	1,161,791	149,509
Oct.	577,168	568,787	11,920	1,157,875	152,351
Nov.	604,012	575,277	11,593	1,190,882	154,600
Dec.	623,375	586,704	11,816	1,221,896	154,421

(1) Rounding may cause discrepancies in totals. – (2) In lire and in foreign currency. – (3) Foreign loans and bonds. – (4) At face value. – (5) Domestic finance to the non-state sector and the

Table a27

	State sector debt (4)		Credit		
Total finance		*of which: domestic*	Total domestic (5)	Total (6)	
746,057	1,116,652	1,081,677	1,759,705	1,862,709	Dec. – 1989
873,561	1,259,875	1,210,878	1,990,935	2,133,436	” – 1990
993,820	1,411,919	1,357,010	2,243,144	2,405,739	” – 1991
1,104,103	1,595,007	1,530,498	2,505,921	2,699,110	” – 1992
1,148,120	1,765,403	1,679,954	2,696,527	2,913,523	” – 1993
1,153,190	1,931,738	1,835,757	2,864,287	3,084,928	” – 1994
1,185,328	2,073,509	1,954,264	3,009,996	3,258,838	” – 1995
1,205,723	2,205,112	2,079,788	3,162,556	3,410,836	” – 1996
1,208,327	2,207,210	2,079,382	3,162,951	3,415,537	Jan. – 1997
1,210,832	2,218,845	2,087,147	3,171,287	3,429,677	Feb.
1,202,236	2,243,573	2,111,472	3,187,867	3,445,809	Mar.
1,203,779	2,262,463	2,130,458	3,207,686	3,466,242	Apr.
1,206,497	2,278,781	2,142,222	3,221,203	3,485,278	May
1,229,186	2,251,526	2,114,539	3,215,249	3,480,711	June
1,241,665	2,247,893	2,104,496	3,213,943	3,489,559	July
1,224,484	2,247,668	2,105,806	3,197,633	3,472,151	Aug.
1,227,199	2,266,443	2,126,639	3,221,722	3,493,642	Set.
1,230,429	2,281,704	2,142,995	3,238,225	3,512,133	Oct.
1,240,664	2,271,946	2,133,405	3,238,376	3,512,610	Nov.
1,285,752	2,248,748	2,111,468	3,261,191	3,534,500	Dec.
1,276,806	2,244,784	2,108,544	3,245,066	3,521,590	Jan. – 1998
1,276,428	2,252,396	2,115,624	3,251,942	3,528,824	Feb.
1,285,889	2,274,838	2,137,903	3,281,528	3,560,727	Mar.
1,289,338	2,293,421	2,158,653	3,306,050	3,582,759	Apr.
1,282,285	2,308,435	2,172,597	3,312,489	3,590,720	May
1,309,026	2,298,009	2,162,846	3,327,442	3,607,035	June
1,319,909	2,280,089	2,152,896	3,325,367	3,599,998	July
1,307,120	2,274,569	2,145,626	3,304,467	3,581,690	Aug.
1,311,299	2,292,125	2,167,267	3,329,058	3,603,425	Sept.
1,310,226	2,312,671	2,183,111	3,340,986	3,622,897	Oct.
1,345,482	2,321,052	2,191,237	3,382,119	3,666,534	Nov.
1,376,317	2,290,204	2,163,870	3,385,766	3,666,521	Dec.

state sector. – (6) Domestic and foreign finance to the non-state sector and the state sector.

Table a28

ITALY’S FINANCIAL ASSETS AND LIABILITIES IN 1998 (1)

(stocks in billions of lire)

Institutional sectors / Financial instruments	Non-financial corporations		Financial corporations							
			Monetary financial institutions		Other financial intermediaries		Financial auxiliaries		Insurance corporations and pension funds	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Monetary gold and SDRs	–	–	41,112	–	–	–	–	–	–	–
Currency and transferable deposits, with:	**138,300**	–	**122,454**	**1,014,727**	**47,273**	–	**2,624**	–	**5,770**	–
MFIs	138,300	–	91,500	1,014,727	47,273	–	2,624	–	5,770	–
central government	. .	–	841	–	–	–	–	–	–	–
rest of the world	–	–	30,113	–	–	–	–	–	–	–
Other deposits, with	**19,373**	–	**246,147**	**608,836**	**31,963**	–	**730**	–	**1,407**	–
MFIs	17,668	–	117,657	608,836	31,963	–	730	–	1,407	–
central government	1,706	–	–	–	–	–	–	–	–	–
rest of the world	–	–	128,490	–	–	–	–	–	–	–
Short-term securities, issued by	**4,115**	**8,013**	**59,199**	**27**	**44,531**	**228**	**256**	–	**2,245**	–
MFIs	1,196	–	46,782	–	32,741	–	256	–	1,569	–
general government	40	8,013	3,834	27	1,108	228	–	–	–	–
rest of the world	2,879	–	8,583	–	10,681	–	–	–	676	–
Bonds, issued by	**63,867**	**24,767**	**486,940**	**436,072**	**529,690**	–	**6,138**	–	**197,702**	–
non-financial corporations	113	24,767	1,038	–	1,359	–	2	–	4,723	–
MFIs	13,567	–	56,672	436,072	11,214	–	233	–	31,080	–
central government: CCTs	10,642	–	152,466	–	81,365	–	961	–	33,667	–
central government: other	16,523	–	243,039	–	270,628	–	4,941	–	105,149	–
local government	6	–	1,429	–	42	–	. .	–	12	–
rest of the world	23,015	–	32,296	–	165,083	–	–	–	23,072	–
Derivatives	. . . .	. . . .	. . . .	. . . .	. . . .	. . . .	–	–	–	–
Short-term loans, of	**39,925**	**537,792**	**737,086**	**64,006**	**86,371**	**158,319**	–	**3,190**	–	**2,778**
non-financial corporations	39,925	–	–	–	–	–	–	–	–	–
MFIs	–	419,762	737,086	9,455	–	127,541	–	3,190	–	2,778
other financial corporations	–	34,997	–	880	86,371	–	–	–	–	. .
general government	–	–	–	–	–	–	–	–	–	–
rest of the world	–	83,032	–	53,671	–	30,778	–	–	–	–
Medium and long-term loans, of	–	**413,146**	**768,425**	**107,358**	**82,752**	**40,852**	–	**417**	**2,764**	**7,263**
non-financial corporations	–	–	–	–	–	–	–	–	–	–
MFIs	–	316,770	768,425	42,228	–	37,936	–	417	–	4,419
other financial corporations	–	50,296	–	839	82,752	–	–	–	2,764	149
general government	–	46,080	–	4,663	–	–	–	–	–	1,785
rest of the world	–	. .	–	59,628	–	2,916	–	–	–	910
Shares and other equity, issued by	**460,925**	**1,381,114**	**105,428**	**507,931**	**249,384**	**98,627**	–	–	**97,129**	**274,399**
residents	286,686	1,381,114	87,827	507,931	94,811	98,627	–	–	54,376	274,399
rest of the world	174,239	–	17,601	–	154,573	–	–	–	42,753	–
Mutual fund shares, issued by	**21,185**	–	–	–	**15,564**	**720,823**	–	–	**690**	–
residents	–	–	–	–	–	720,823	–	–	–	–
rest of the world	21,185	–	–	–	15,564	–	–	–	690	–
Insurance technical reserves	**15,624**	**126,768**	–	**35,016**	–	–	–	–	–	**292,061**
net equity of households	–	126,768	–	35,016	–	–	–	–	–	208,227
prepayments and other claims	15,624	–	–	–	–	–	–	–	–	83,834
Other accounts receivable/payable	**83,616**	**43,794**	–	–	–	–	–	–	–	–
Trade credits	83,616	43,794	–	–	–	–	–	–	–	–
Other	. . . .	–	. . . .	. . . .	. . . .	–	–	–	–	–
Total	**846,932**	**2,535,393**	**2,566,791**	**2,773,973**	**1,087,528**	**1,018,848**	**9,748**	**3,607**	**307,708**	**576,501**

(1) Provisional. Rounding may cause discrepancies in totals.

General government						Households and non-profit institutions serving households		Rest of the world		Total	
Central government		Local government		Social security funds							
Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
–	–	–	–	–	–	–	–	–	41,112	41,112	41,112
53,637	30,834	39,915	–	5,345	–	622,250	–	38,106	30,113	1,075,675	1,075,675
53,637	–	12,386	–	5,345	–	619,786	–	38,106	–	1,014,727	1,014,727
–	30,834	27,529	–	. .	–	2,464	–	–	–	30,834	30,834
–	–	–	–	–	–	–	–	–	30,113	30,113	30,113
836	184,971	1,757	–	1,235	–	408,962	–	209,886	128,490	922,298	922,298
836	–	1,757	–	1,235	–	225,697	–	209,886	–	608,836	608,836
–	184,971	–	–	–	–	183,266	–	–	–	184,971	184,971
–	–	–	–	–	–	–	–	–	128,490	128,490	128,490
2,308	266,768	161	–	332	–	103,411	–	84,369	25,890	300,926	300,926
2,308	266,768	161	–	332	–	97,054	–	84,369	–	266,768	266,768
–	–	–	–	–	–	3,286	–	–	–	8,268	8,268
–	–	–	–	–	–	3,071	–	–	25,890	25,890	25,890
4,360	1,836,833	3,185	1,866	16,376	–	800,064	–	547,090	355,876	2,655,413	2,655,413
3	–	2	–	154	–	1,084	–	16,289	–	24,767	24,767
3,963	–	612	–	2,138	–	314,213	–	2,380	–	436,072	436,072
142	563,145	400	–	5,955	–	101,910	–	175,635	–	563,145	563,145
251	1,273,689	719	–	7,399	–	272,252	–	352,787	–	1,273,688	1,273,689
. .	–	1	1,866	. .	–	375	–	. .	–	1,866	1,866
–	–	1,451	–	730	–	110,229	–	–	355,876	355,876	355,876
–	–	–	–	–	–	–	–	. . . .	. . . .	. . . .	. . . .
1,794	565	–	4,986	–	2,000	–	80,508	167,481	178,514	1,032,657	1,032,657
–	–	–	–	–	–	–	–	–	39,925	39,925	39,925
–	565	–	4,954	–	206	–	79,398	–	89,237	737,086	737,086
–	–	–	33	–	–	–	1,109	–	49,352	86,371	86,371
1,794	–	–	–	–	1,794	–	–	–	–	1,794	1,794
–	–	–	–	–	–	–	–	167,481	–	167,481	167,481
214,416	51,021	–	202,439	–	717	–	282,555	81,735	44,325	1,150,093	1,150,093
–	–	–	–	–	–	–	–	–	–	–	–
–	32,739	–	69,076	–	717	–	248,412	–	15,710	768,425	768,425
–	–	–	240	–	–	–	33,882	–	111	85,516	85,516
214,416	–	–	133,123	–	–	–	261	–	28,504	214,416	214,416
–	18,282	–	–	–	–	–	–	81,735	–	81,735	81,735
134,501	–	24,762	145	1,345	–	1,379,081	–	329,524	519,863	2,782,078	2,782,078
121,605	–	24,465	145	1,155	–	1,261,767	–	329,524	–	2,262,215	2,262,215
12,896	–	297	–	190	–	117,314	–	–	519,863	519,863	519,863
. .	–	67	–	21	–	746,002	–	7,955	70,661	791,484	791,484
–	–	–	–	–	–	712,868	–	7,955	–	720,823	720,823
. .	–	67	–	21	–	33,134	–	–	70,661	70,661	70,661
–	–	–	–	–	–	475,337	37,118	–	–	490,962	490,962
–	–	–	–	–	–	407,128	37,118	–	–	407,128	407,128
–	–	–	–	–	–	68,210	–	–	–	83,834	83,834
–	–	–	–	–	–	–	–	43,794	83,616	127,410	127,410
–	–	–	–	–	–	–	–	43,794	83,616	127,410	127,410
–	. . . .	–	–	–	–	. . . .	–	. . . .	. . . .	. . . .	. . . .
411,852	2,370,993	69,848	209,435	24,654	2,717	4,535,106	400,180	1,509,940	1,478,460	11,370,108	11,370,108

Table a29

ITALY’S FINANCIAL ASSETS AND LIABILITIES IN 1998 (1)

((flows in billions of lire)

Institutional sectors / Financial instruments	Non-financial corporations		Financial corporations							
			Monetary financial institutions		Other financial intermediaries		Financial auxiliaries		Insurance corporations and pension funds	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Monetary gold and SDRs	**–**	**–**	**8,257**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Currency and transferable deposits, with	**5,003**	**–**	**–113,374**	**–1,579**	**24,486**	**–**	**316**	**–**	**1,083**	**–**
MFIs	11,761	–	–65,366	–1,579	24,486	–	316	–	1,083	–
central government	–6,757	–	–504	–	–	–	–	–	–	–
rest of the world	–	–	–47,503	–	–	–	–	–	–	–
Other deposits, with	**–7,172**	**–**	**–28,971**	**–144,428**	**14,170**	**–**	**93**	**–**	**–144**	**–**
MFIs	–7,213	–	–31,149	–144,428	14,170	–	93	–	–144	–
central government	41	–	–	–	–	–	–	–	–	–
rest of the world	–	–	2,179	–	–	–	–	–	–	–
Short-term securities, issued by	**–659**	**3,321**	**–496**	**11**	**15,378**	**–33**	**–371**	**–**	**930**	**–**
MFIs	–721	–	–1,103	–	14,746	–	–371	–	1,074	–
general government	24	3,321	681	11	966	–33	–	–	–	–
rest of the world	39	–	–74	–	–334	–	–	–	–145	–
Bonds, issued by	**1,581**	**–1,240**	**–3,778**	**57,728**	**217,400**	**–**	**–5,255**	**–**	**28,007**	**–**
non-financial corporations	–400	–1,240	–218	–	–274	–	–165	–	1,374	–
MFIs	2,890	–	11,690	57,728	1,451	–	–869	–	9,031	–
central government: CCTs	–6,505	–	–21,096	–	34,588	–	–2,983	–	–4,464	–
central government: other	2,413	–	–4,743	–	107,358	–	–1,218	–	18,325	–
local government	–36	–	988	–	–67	–	–21	–	–130	–
rest of the world	3,219	–	9,601	–	74,343	–	–	–	3,871	–
Derivatives	....	....	....	....	....	....	–	–	–	–
Short-term loans, of	**10,553**	**28,920**	**–4,073**	**–1,648**	**10,472**	**19,962**	**–**	**–1,136**	**–**	**1,938**
non-financial corporations	10,553	–	–	–	–	–	–	–	–	–
MFIs	–	18,312	–4,073	1,151	–	12,909	–	–1,136	–	1,938
other financial corporations	–	7,181	–	–174	10,472	–	–	–	–	..
general government	–	–	–	–	–	–	–	–	–	–
rest of the world	–	3,427	–	–2,625	–	7,052	–	–	–	–
Medium and long-term loans, of	**–**	**11,036**	**46,974**	**3,422**	**7,353**	**–3,129**	**–**	**38**	**–787**	**1,603**
non-financial corporations	–	–	–	–	–	–	–	–	–	–
MFIs	–	9,280	46,974	13,976	–	–1,485	–	38	–	1,461
other financial corporations	–	2,616	–	–25	7,353	–	–	–	–787	–1
general government	–	211	–	–181	–	–	–	–	–	42
rest of the world	–	–1,071	–	–10,347	–	–1,644	–	–	–	101
Shares and other equity, issued by	**3,622**	**19,817**	**14,692**	**14,387**	**70,147**	**1,632**	**–**	**–**	**11,171**	**4,441**
residents	–3,214	19,817	10,730	14,387	17,323	1,632	–	–	9,354	4,441
rest of the world	6,836	–	3,962	–	52,824	–	–	–	1,817	–
Mutual fund shares, issued by	**8,093**	**–**	**–**	**–**	**4,490**	**313,085**	**–**	**–**	**492**	**–**
residents	–	–	–	–	–	313,085	–	–	–	–
rest of the world	8,093	–	–	–	4,490	–	–	–	492	–
Insurance technical reserves	**1,324**	**8,052**	**–**	**–1,462**	**–**	**–**	**–**	**–**	**–**	**44,989**
net equity of households	–	8,052	–	–1,462	–	–	–	–	–	37,898
prepayments and other claims	1,324	–	–	–	–	–	–	–	–	7,091
Other accounts receivable/payable	**–1,268**	**–4,157**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Trade credits	–1,268	–4,157	–	–	–	–	–	–	–	–
Other	....	–	....	....	....	–	–	–	–	–
Total	**21,076**	**65,749**	**–80,767**	**–73,569**	**363,896**	**331,518**	**–5,217**	**–1,099**	**40,751**	**52,972**

(1) Provisional. Rounding may cause discrepancies in totals.

Table a29

General government						Households and non-profit institutions serving households		Rest of the world		Total	
Central government		Local government		Social security funds							
Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
–	–	–	–	–	–	–	–	–	8,257	8,257	8,257
−14,788	−7,456	−1,166	–	992	–	38,555	–	2,354	−47,503	−56,539	−56,539
−14,788	–	−699	–	992	–	38,284	–	2,354	–	−1,579	−1,579
–	−7,456	−466	–	. .	–	271	–	–	–	−7,456	−7,456
–	–	–	–	–	–	–	–	–	−47,503	−47,503	−47,503
−161	12,509	−783	–	298	–	−95,628	–	−11,442	2,179	−129,741	−129,741
−161	–	−783	–	298	–	−108,096	–	−11,442	–	−144,428	−144,428
–	12,509	–	–	–	–	12,468	–	–	–	12,509	12,509
–	–	–	–	–	–	–	–	–	2,179	2,179	2,179
2,268	−35,482	70	–	−152	–	−102,481	–	52,909	−421	−32,603	−32,603
2,268	−35,482	70	–	−152	–	−104,202	–	52,909	–	−35,482	−35,482
–	–	–	–	–	–	1,628	–	–	–	3,300	3,300
–	–	–	–	–	–	93	–	–	−421	−421	−421
−3,461	72,665	313	968	−1,358	–	−92,635	–	98,802	109,495	239,616	239,616
−1	–	−102	–	−588	–	−3,319	–	2,453	–	−1,240	−1,240
−622	–	−402	–	64	–	34,803	–	−307	–	57,728	57,728
−238	−68,015	−502	–	−2,490	–	−134,801	–	70,475	–	−68,015	−68,015
−2,600	140,680	−45	–	1,460	–	−6,451	–	26,180	–	140,680	140,680
. .	–	−20	968	. .	–	254	–	. .	–	968	968
–	–	1,384	–	196	–	16,880	–	–	109,495	109,495	109,495
–	–	–	–	–	–	–	–	. . . .	. . . .	. . . .	. . . .
. .	134	–	34	–	−104	–	2,430	7,855	−25,723	24,808	24,808
–	–	–	–	–	–	–	–	–	10,553	10,553	10,553
–	134	–	11	–	−104	–	3,057	–	−40,345	−4,073	−4,073
–	–	–	23	–	–	–	−627	–	4,070	10,472	10,472
. .	–	–	–	–	. .	–	–	–	–	. .	. .
–	–	–	–	–	–	–	–	7,855	–	7,855	7,855
6,468	−13,207	–	5,042	–	−91	–	31,374	−22,846	1,076	37,163	37,163
–	–	–	–	–	–	–	–	–	–	–	–
–	−3,323	–	−1,635	–	−91	–	26,788	–	1,965	46,974	46,974
–	–	–	24	–	–	–	4,796	–	−844	6,566	6,566
6,468	–	–	6,653	–	–	–	−210	–	−46	6,468	6,468
–	−9,884	–	–	–	–	–	–	−22,846	–	−22,846	−22,846
−4,709	–	1,525	15	−232	–	−2,057	–	19,783	73,647	113,941	113,941
−5,497	–	1,290	15	−263	–	−9,211	–	19,783	–	40,293	40,293
788	–	235	–	31	–	7,154	–	–	73,647	73,647	73,647
. .	–	7	–	3	–	320,073	–	324	20,397	333,482	333,482
–	–	–	–	–	–	312,761	–	324	–	313,085	313,085
. .	–	7	–	3	–	7,312	–	–	20,397	20,397	20,397
–	–	–	–	–	–	52,853	2,598	–	–	54,177	54,177
–	–	–	–	–	–	47,086	2,598	–	–	47,086	47,086
–	–	–	–	–	–	5,767	–	–	–	7,091	7,091
–	–	–	–	–	–	–	–	−4,157	−1,268	−5,425	−5,425
–	–	–	–	–	–	–	–	−4,157	−1,268	−5,425	−5,425
–	. . . .	–	–	–	–	. . . .	–	. . . .	. . . .	. . . .	. . . .
−14,383	29,162	−34	6,059	−449	−195	118,680	36,402	143,581	140,134	587,135	587,135

Table a30

M2 AND ITS COUNTERPARTS (1)
(flows in billions of lire)

	M2 (excluding longer-term CDs) (2)	Counterparts				
		Net external position of BI-UIC (3)	Net external position of banks	Credit to the non-state sector (4)	Credit to the state sector (5)	Other (6)
1989	57,187	14,971	−14,979	112,370	9,076	−64,251
1990	47,933	15,458	−22,976	110,384	10,846	−65,779
1991	48,424	−8,674	−39,369	120,895	66,928	−91,355
1992	6,366	−32,591	−12,187	73,688	83,416	−105,960
1993	25,767	2,564	84,589	53,603	14,875	−129,864
1994	6,103	3,297	−21,594	10,198	27,004	−12,803
1995	−13,269	2,915	58,102	37,693	−25,489	−86,490
1996	28,820	20,449	47,394	50,609	3,254	−92,886
1997	67,258	22,829	−11,679	52,077	−51,076	55,107
1998	44,460	−37,040	−6,565	83,623	−31,836	36,279
1997 – Jan.	−31,955	5,363	−20,639	−18,550	4,600	−2,730
Feb.	5,204	−1,608	−937	444	2,355	4,950
Mar.	−1,181	−4,262	−3,051	−7,041	13,258	−85
Apr.	−390	−2,131	4,371	−342	4,659	−6,946
May	12,869	1,571	17,061	5,325	−627	−10,461
June	16,177	−1,139	20,657	24,815	−41,007	12,851
July	−7,487	12,124	647	8,008	−28,620	354
Aug.	−10,152	4,801	−11,963	−17,625	−521	15,157
Sept.	24,041	5,672	−2,703	−433	6,783	14,722
Oct.	5,649	−2,393	−656	771	11,735	−3,809
Nov.	−3,567	832	−16,613	9,336	−6,709	9,588
Dec.	58,051	3,999	2,147	47,368	−16,980	21,517
1998 – Jan.	−25,832	−4,362	−14,900	−9,350	8,790	−6,010
Feb.	−6,000	3,815	−2,932	349	−17,885	10,653
Mar.	19,496	−751	−16,751	7,744	9,543	19,710
Apr.	9,214	−2,957	−2,126	6,377	15,557	−7,637
May	5,703	−5,715	9,795	−2,355	−6,855	10,832
June	21,248	−4,814	30,260	23,730	−25,524	−2,405
July	−35,179	−5,331	−14,124	8,954	−39,624	14,945
Aug.	−12,281	842	11,039	−15,590	−18,579	10,007
Sept.	5,229	−9,188	−4,875	4,501	20,278	−5,487
Oct.	2,693	−839	−10,994	−5,091	20,647	−1,030
Nov.	490	−1,078	1,731	31,641	354	−32,158
Dec.	59,680	−6,633	7,312	32,712	1,461	24,857

(1) Rounding may cause discrepancies in totals. – (2) Domestic money supply of the non-state sector; end-of-period data. Longer-term CDs are those not redeemable for at least 18 months. – (3) Net of exchange rate adjustments. – (4) Claims of banks on the non-state sector. – (5) Claims of banks and the Bank of Italy on the state sector. – (6) Repo fund-raising, monetary base creation by “other sectors”, longer-term CDs, capital items and residual items in the balance sheets of banks.

BANKS: CONTRIBUTION OF OPERATIONS TO SUPERVISORY CAPITAL (1)
(billions of lire)

	Classification by type of bank						Total	Classification by size		Classification by location of head office	
	Limited cos. raising short-term funds	Limited cos. raising medium and long-term funds	Cooperative banks	Mutual banks	Central credit institutions	Branches of foreign banks		Major, large and medium-sized banks	Small and minor banks	Centre-North	South
						Net income					
1996	21,757	2,596	5,365	2,136	310	365	32,529	22,566	9,963	30,821	1,708
1997	20,892	1,994	5,010	1,981	316	176	30,369	21,640	8,729	27,989	2,380
1998	30,648	2,488	6,569	2,339	313	−164	42,193	31,793	10,400	39,078	3,115
						Extraordinary expenses, net					
1996	2,177	258	−71	−146	−1	−173	2,044	2,423	−379	1,694	350
1997	−850	−65	−61	−85	72	−330	−1,319	−585	−734	−618	−701
1998	−2,574	−632	249	−8	63	−633	−3,535	−2,783	−752	−3,141	−382
						Sundry provisions					
1996	2,067	−449	319	21	40	41	2,039	1,887	152	1,235	804
1997	3,612	−337	410	34	57	44	3,820	3,371	449	3,445	375
1998	3,051	−34	580	59	19	41	3,716	3,120	596	3,156	558
						Charges for loan losses					
1996	8,285	1,127	1,392	304	87	91	11,286	8,640	2,646	8,948	2,338
1997	11,103	1,005	1,479	344	113	94	14,138	11,497	2,641	12,059	2,079
1998	10,555	1,388	1,620	443	68	59	14,133	11,073	3,060	12,107	2,026
						Taxes					
1996	5,308	943	1,806	124	88	245	8,514	5,248	3,266	7,946	568
1997	5,399	842	1,459	85	67	253	8,105	5,348	2,757	7,667	438
1998	9,380	1,022	1,969	369	85	112	12,937	9,816	3,121	12,296	641
						Dividends					
1996	2,853	343	907	56	20	60	4,239	3,072	1,167	4,063	176
1997	3,265	325	952	48	18	19	4,627	3,463	1,164	4,492	135
1998	6,391	203	1,163	44	17	74	7,892	6,282	1,610	7,753	139
						Allocations to supervisory capital					
1996	1,067	374	1,012	1,777	76	101	4,407	1,296	3,111	6,935	−2,528
1997	−1,637	224	771	1,555	−11	96	998	−1,454	2,452	944	54
1998	3,845	541	988	1,432	61	183	7,050	4,285	2,765	6,917	133
						ROE					
1996	2.5	1.1	7.3	14.1	4.2	9.4	3.8	2.4	7.1	5.4	−12.0
1997	–	0.3	6.5	11.0	0.3	11.0	1.8	−0.1	5.8	1.8	1.3
1998	8.4	2.6	8.2	9.7	4.7	14.2	7.9	8.1	7.4	8.3	3.0

(1) Unconsolidated data. The classifications are those that were in force at the end of 1998; merged banks have been considered as belonging to the category of the bank with which they were merged.

BANKS: SUPERVISORY CAPITAL (1)
(billions of lire)

	Classification by type of bank					Total	Classification by size		Classification by location of head office	
	Limited companies raising short-term funds	Limited companies raising medium and long-term funds	Cooperative banks	Mutual banks	Central credit institutions		Major, large and medium-sized banks	Small and minor banks	Centre-North	South
					December 1997					
Supervisory capital	**135,109**	**30,010**	**28,931**	**16,385**	**1,833**	**212,269**	**147,972**	**64,296**	**193,967**	**18,301**
Primary capital	113,166	25,032	23,506	15,570	1,937	179,212	120,736	58,475	163,445	15,766
of which: capital and reserves	*118,182*	*23,412*	*24,212*	*15,492*	*1,952*	*183,251*	*125,336*	*57,914*	*167,052*	*16,199*
provision for general banking risks	*2,216*	*2,062*	*1,299*	*338*	*49*	*5,963*	*3,582*	*2,381*	*5,264*	*698*
intangible assets and goodwill	*3,324*	*101*	*1,890*	*168*	*19*	*5,502*	*4,503*	*998*	*5,192*	*309*
Supplementary capital	26,589	5,190	6,447	835	382	39,443	32,771	6,671	36,551	2,892
of which: subordinated liabilities (2)	*16,627*	*1,432*	*4,748*	*103*	*.*	*22,910*	*19,925*	*2,985*	*20,845*	*2,065*
revaluation losses on securities	*2*	*16*	*0*	*1*	*.*	*19*	*16*	*3*	*18*	*0*
loan loss provisions (3)	*158*	*67*	*81*	*5*	*.*	*311*	*169*	*143*	*305*	*7*
Unconsolidated equity interests and other deductions	4,645	212	1,022	20	485	6,385	5,536	850	6,029	357
Memorandum item:										
Excess provisions (4)	446	1,475	32	147	.	2,100	1,456	644	1,910	190
					December 1998 (5)					
Supervisory capital	**164,130**	**27,299**	**33,351**	**17,824**	**2,121**	**244,725**	**175,257**	**69,468**	**226,833**	**17,893**
Primary capital	131,464	22,277	28,437	16,965	2,074	201,218	136,784	64,433	185,352	15,866
of which: capital and reserves	*134,092*	*21,295*	*28,939*	*16,870*	*2,089*	*203,284*	*139,782*	*63,502*	*186,115*	*17,168*
provision for general banking risks	*3,054*	*1,414*	*1,432*	*329*	*57*	*6,287*	*3,657*	*2,630*	*5,589*	*697*
intangible assets and goodwill	*4,949*	*80*	*1,851*	*168*	*28*	*7,076*	*5,885*	*1,191*	*5,616*	*1,460*
Supplementary capital	37,034	5,450	6,498	879	348	50,210	43,728	6,482	47,865	2,345
of which: subordinated liabilities (2)	*27,825*	*1,342*	*4,954*	*146*	*.*	*34,267*	*31,281*	*2,987*	*32,553*	*1,714*
revaluation losses on securities	*27*	*10*	*4*	*4*	*.*	*44*	*37*	*7*	*43*	*1*
loan loss provisions (3)	*619*	*11*	*83*	*16*	*36*	*767*	*592*	*175*	*757*	*9*
Unconsolidated equity interests and other deductions	4,368	429	1,584	20	301	6,702	5,255	1,447	6,384	318
Memorandum item:										
Excess provisions (4)	365	642	24	136	–	1,167	607	560	1,049	119

(1) Unconsolidated data excluding branches of foreign banks. The classifications are those that were in force at the end of 1998 – (2) Includes “hybrid” capital instruments. – (3) Excludes “excess provisions”, which are not eligible for inclusion in supervisory capital. – (4) Loan loss provisions in excess of 1.25 per cent of risk-weighted assets. – (5) The figures for 1998 include increases in supervisory capital due to the acquisition of controlling interests in other banks.

Table a33

BANKS: CAPITAL ADEQUACY (1)
(billions of lire)

	December 1996			December 1997			December 1998 (2)		
	Number of banks	Billion lire	Average solvency ratio	Number of banks	Billion lire	Average solvency ratio	Number of banks	Billion lire	Average solvency ratio
Classification by size									
Major, large and medium-sized banks			11,0			10,9			12,1
Excess amounts	51	42,203		50	41,166		49	60,416	
Shortfalls	6	3,884		6	1,485		6	969	
Small and minor banks			21,2			20,0			18,7
Excess amounts	818	38,545		812	38,737		791	39,855	
Shortfalls	8	78		9	97		10	104	
Classification by type of bank									
Limited companies raising short term funds			11,5			11,3			12,4
Excess amounts	187	42,772		191	40,650		196	58,727	
Shortfalls	7	3,798		5	1,260		5	462	
Limited companies raising medium and long-term funds			17,1			16,8			17,2
Excess amounts	30	15,412		29	15,993		26	15,057	
Shortfalls	4	44		4	296		4	420	
Cooperative banks			13,8			13,2			13,6
Excess amounts	61	11,269		60	11,386		59	13,845	
Shortfalls	1	117		1	2		2	160	
Mutual banks			25,6			24,1			22,5
Excess amounts	587	10,273		578	10,967		555	11,493	
Shortfalls	2	2		5	25		5	31	
Central credit institutions			16,6			15,8			17,5
Excess amounts	4	1,023		4	907		4	1,149	
Shortfalls	–	–		–	–		–	–	
Classification by location of head office									
Centre-North			13,2			12,5			13,5
Excess amounts	616	73,480		622	71,496		619	93,017	
Shortfalls	6	301		7	1,444		6	946	
South			10,3			14,6			13,3
Excess amounts	253	7,268		240	8,407		221	7,255	
Shortfalls	8	3,661		8	138		10	126	
Banking system as a whole			**12,9**			**12,7**			**13,4**
Excess amounts	**869**	**80,749**		**862**	**79,903**		**840**	**100,271**	
Shortfalls	**14**	**3,962**		**15**	**1,582**		**16**	**1,072**	

(1) Unconsolidated data excluding branches of foreign banks. The classifications are those that were in force at the end of 1998. – (2) The figures for 1998 include increases in supervisory capital due to the acquisition of controlling interests in other banks.

BALANCE SHEET
AND PROFIT AND LOSS ACCOUNT
for the year ended 31 December 1998

BALANCE

AMOUNTS IN LIRE

ASSETS				1998	1997
GOLD					
I on hand			18,934,374,719,398		
II on deposit abroad			21,994,954,128,923	40,929,328,848,321	37,578,337,083,683
GOLD CLAIMS				—	9,394,584,267,999
CASH ON HAND				12,789,303,642	14,670,339,701
DISCOUNTS AND ADVANCES					
I bill portfolio			148,924,447,590		
II advances:					
— current account		—			
— fixed term		1,800,000,000,000			
— under Treasury Decree of 27.9.1974		30,932,366,845,700	32,732,366,845,700	32,881,291,293,290	21,254,022,066,906
EXTERNAL ASSETS IN FOREIGN CURRENCIES					
I loans in foreign currency			1,496,469,134,670		
II other:					
— banknotes and foreign currency bills		8,186,540,156			
— current accounts with correspondents		10,194,167,728,000			
— time deposits		10,001,255,000,000			
— other items		20,351,016,269,365	40,554,625,537,521	42,051,094,672,191	36,486,125,040,842
DOLLAR CLAIMS				—	6,484,776,926,164
UIC – current account (credit balance)				—	52,348,134,004,073
SUNDRY CLAIMS ON THE GOVERNMENT					
I under Art. 6.2c) of Law 483/1993			—		
II other			9,558,332,680	9,558,332,680	16,156,756,725
CLAIMS ARISING FROM SECURITIES REPURCHASE AGREEMENTS				4,123,929,030,600	33,744,740,930,479
SECURITIES					
I government and government-guaranteed securities:					
— freely available		4,709,890,126,834			
— freely available under Law 483/1993		76,205,757,000,000			
— investment of the provision for general risks		17,570,343,761,131			
— investment of statutory reserves		8,879,657,333,286			
— investment of revaluation reserves under Laws 72/1983, 408/1990 and 413/1991		2,615,699,612,472			
— investment of the special provision for the renewal of tangible fixed assets		3,487,238,835,667			
— investment of staff severance pay and pension funds		6,756,863,114,725	120,225,449,784,115		
II corporate and other bonds:					
— investment of statutory reserves		36,523,441,398			
— investment of staff severance pay and pension funds		365,469,510,365	401,992,951,763		
III shares and other equities:					
— subsidiaries					
a) investment of statutory reserves	3,418,413,248				
b) investment of staff severance pay and pension funds	195,063,844,926	198,482,258,174			
— associate companies					
a) investment of statutory reserves	24,001,779,410				
b) investment of staff severance pay and pension funds	—	24,001,779,410			
— other					
a) investment of statutory reserves	1,185,332,516,984				
b) investment of staff severance pay and pension funds	1,265,733,615,805	2,451,066,132,789	2,673,550,170,373	123,300,992,906,251	153,389,482,933,900
			carried forward . . .	243,308,984,386,975	350,711,030,350,472

SHEET

LIABILITIES			1998	1997
BANKNOTES IN CIRCULATION			122,411,382,958,000	114,074,089,041,000
BANK OF ITALY DRAFTS			914,082,711,738	1,195,468,796,244
OTHER SIGHT LIABILITIES			—	—
BANKS' COMPULSORY RESERVE DEPOSITS			12,788,630,195,797	78,633,627,484,348
OTHER COMPULSORY DEPOSITS			8,533,328,437	19,877,819,468
OTHER DEPOSITS				
I current account		338,158,978,510		
II time		761,000,000,000		
III for cashier's department services		82,416,104	1,099,241,394,614	281,463,767,784
INTERNATIONAL MONETARY FUND				
I IMF claims		4,128,149,442,636		
II IMF, assignment of SDRs		1,634,913,264,000	5,763,062,706,636	6,902,231,404,813
EXTERNAL LIABILITIES				
I deposits in foreign currencies		57,800,496,053		
II external accounts in lire		33,125,293,633		
III other		—	90,925,789,686	135,329,680,011
ECU LIABILITIES			—	15,879,361,194,163
ITALIAN FOREIGN EXCHANGE OFFICE (UIC) – current account			431,534,745,563	—
TREASURY PAYMENTS ACCOUNT			42,071,873,598,974	53,547,202,749,655
SINKING FUND FOR THE REDEMPTION OF GOVERNMENT SECURITIES			133,692,160,665	4,236,755,428,090
SUNDRY LIABILITIES TOWARDS THE GOVERNMENT			257,231,685,247	425,583,593,775
LIABILITIES ARISING FROM SECURITIES REPURCHASE AGREEMENTS			—	4,789,334,597,500
SUNDRY PROVISIONS				
I for gold price fluctuations under Decree Law 876/1976 and Art. 104.1b) of the income tax code		26,634,839,999,602		
II for losses on foreign exchange				
– under Decree Law 867/1976	1,200,795,276,401			
– exchange risk	2,977,217,897,418	4,178,013,173,819		
III for exchange rate adjustments under Art. 104.1c) of the income tax code		355,756,669,947		
IV for losses on securities		1,983,295,661,841		
V for insurance cover		600,000,000,000		
VI for taxation		2,146,000,000,000		
VII for staff severance pay and pensions		9,404,061,052,231		
VIII for grants to BI pensioners and their surviving dependents		2,634,245,953		
IX for severance pay of contract staff under Law 297/1982		2,417,602,507		
X for staff costs		128,151,000,000	45,435,169,405,900	64,582,676,054,872
		carried forward . . .	231,405,360,681,257	344,703,001,611,723

BALANCE

AMOUNTS IN LIRE

ASSETS			1998	1997
		brought forward . . .	243,308,984,386,975	350,711,030,350,472
UIC ENDOWMENT FUND			500,000,000,000	500,000,000,000
PARTICIPATION IN ECB			1,442,037,082,500	190,205,278,649
INTERNATIONAL MONETARY FUND				
I IMF, quota account		10,689,746,258,162		
II IMF, other assets in SDRs		183,067,250,387	10,872,813,508,549	—
INTANGIBLE FIXED ASSETS				
I procedures, studies and designs		73,450,035,561		
II other deferred charges		14,104,445,106		
III intangible fixed assets in production and advances		51,277,026,755	138,831,507,422	144,389,960,919
TANGIBLE FIXED ASSETS				
I buildings used by the Bank		3,458,692,926,402		
II buildings for investment of staff severance pay and pension funds		686,293,913,705		
III furniture and fittings		212,102,642,851		
IV equipment		453,979,291,440		
V coins and collections		2,457,923,038		
VI assets under construction and advances:				
— buildings for use by the Bank and related equipment	806,429,550,429			
— buildings for investment of staff severance pay and pension funds and related equipment	—	806,429,550,429		
less: **ACCUMULATED DEPRECIATION**		1,840,409,916,780	3,779,546,331,085	3,690,612,841,612
OTHER INVESTMENTS OF STAFF SEVERANCE PAY AND PENSION FUNDS			36,930,013,675	25,727,548,152
STOCKS OF THE TECHNICAL DEPARTMENTS				
I banknotes in production		11,161,965,234		
II other		14,654,974,461	25,816,939,695	25,502,013,180
SUNDRY ASSETS				
I suppliers for other advances		31,100,205,298		
II sundry debtors:				
— items arising from the former management of stockpiling bills (under Decree Laws 565/1993 and 423/1994, not ratified)	2,893,856,834,669			
— other	6,049,679,985,830	8,943,536,820,499		
III other items		184,091,274,552	9,158,728,300,349	10,408,382,892,616
ACCRUED INCOME			1,984,745,274,189	2,782,697,278,503
PREPAID EXPENSES			6,929,565,776	7,671,007,866
			271,255,362,910,215	368,486,219,171,969
MEMORANDUM ACCOUNTS				
I Securities and other valuables		3,500,738,533,198,425		
II Depositaries of securities and valuables		20,372,436,537,734		
III Unused overdraft facilities		—		
IV Debtors for securities, foreign exchange and lire receivable (BI forward sales)		6,216,410,192,150		
V Securities, foreign exchange and lire receivable (BI forward purchases)		5,897,000,000,000		
VI Securities, foreign exchange and lire receivable (order suspense accounts)		29,059,139,864,626		
VII Debtors for securities, foreign exchange and lire receivable (order suspense accounts)		19,257,531,562,387	3,581,541,051,355,322	2,940,534,292,120,682
		TOTAL . . .	**3,852,796,414,265,537**	**3,309,020,511,292,651**

Audited and found correct. – Rome, 22 April 1999

THE AUDITORS
GIUSEPPE BRUNI
MARIO CATTANEO
ENRICO NUZZO
MASSIMO STIPO
GIANFRANCO ZANDA

SHEET (cont.)

LIABILITIES		1998	1997
brought forward . . .		231,405,360,681,257	344,703,001,611,723
SUNDRY LIABILITIES			
I sundry creditors	221,773,411,073		
II other	320,977,926,399	542,751,337,472	923,124,436,773
ACCRUED EXPENSES		1,501,533,407	175,142,666,449
DEFERRED INCOME		1,690,521,985	413,618,235,864
PROVISION FOR GENERAL RISKS		17,616,323,954,266	4,845,006,748,480
SHARE CAPITAL AND RESERVES			
I Share capital	300,000,000		
II Ordinary reserve	5,474,279,948,121		
III Extraordinary reserve	5,480,817,283,628		
IV Revaluation surplus reserve under Law 72/1983	1,304,000,000,000		
V Revaluation surplus reserve under Law 408/1990	1,278,970,875,346		
VI Revaluation surplus reserve under Law 413/1991	32,766,651,690		
VII Reserve for accelerated depreciation (under Art. 67.3) of the income tax code)	50,108,163,184		
VIII Special provision for the renewal of tangible fixed assets	3,495,051,851,969	17,116,294,773,938	15,791,736,632,488
NET PROFIT FOR DISTRIBUTION		4,571,440,107,890	1,634,588,840,192
		271,255,362,910,215	368,486,219,171,969
MEMORANDUM ACCOUNTS			
I Depositors of securities and other valuables	3,500,738,533,198,425		
II Securities and valuables on deposit	20,372,436,537,734		
III Holders of unused overdraft facilities	—		
IV Securities, foreign exchange and lire for delivery (BI forward sales)	6,216,410,192,150		
V Creditors for securities, foreign exchange and lire for delivery (BI forward purchases)	5,897,000,000,000		
VI Creditors for securities, foreign exchange and lire for delivery (order suspense accounts)	29,059,139,864,626		
VII Securities, foreign exchange and lire for delivery (order suspense accounts)	19,257,531,562,387	3,581,541,051,355,322	2,940,534,292,120,682
TOTAL . . .		**3,852,796,414,265,537**	**3,309,020,511,292,651**

THE ACCOUNTANT GENERAL

VINCENZO PONTOLILLO

THE GOVERNOR

ANTONIO FAZIO

PROFIT AND LOSS

AMOUNTS IN LIRE

EXPENDITURE AND LOSSES			1998	1997
ADMINISTRATIVE COSTS				
central and local boards		3,628,534,631		
staff:				
– wages and salaries and related costs	1,167,925,934,658			
– pensions and severance payments	451,476,875,607	1,619,402,810,265		
services		249,009,983,986		
other		334,752,943,462	2,206,794,272,344	2,378,123,635,978
TAXES AND DUTIES				
stamp duty on the circulation of banknotes and Bank of Italy drafts		—		
taxes on income for the year and productive activities		1,966,000,000,000		
other		31,569,081,308	1,997,569,081,308	3,982,666,217,050
INTEREST PAID				
on banks' compulsory reserves		2,807,395,351,661		
on Treasury accounts:				
– Treasury payments account	2,407,020,054,054			
– other	157,350,827,180	2,564,370,881,234		
other		8,732,242,773	5,380,498,475,668	7,451,284,552,048
FINANCIAL COSTS ARISING PROM SECURITIES REPURCHASE AGREEMENTS			19,135,168,574	66,804,556,388
EXPENDITURE ON SECURITIES TRANSACTIONS			112,165,473	229,103,068
EXPENDITURE ON FOREIGN TRANSACTIONS			695,091,776	1,069,531,049
LOSSES ON SECURITIES			—	—
LOSSES ON FOREIGN EXCHANGE			—	—
LOSSES ON SUNDRY FINANCIAL TRANSACTIONS			5,409,020,588	—
LOSSES ON DISPOSALS				
securities		120,006,638		
buildings		—		
other		27,916,619	147,923,257	54,663,509
CONTRIBUTIONS TO CHARITIES AND SOCIAL AND CULTURAL ACTIVITIES			4,277,519,703	8,428,988,273
TECHNICAL DEPARTMENTS – INITIAL STOCKS			61,974,065,369	72,137,936,201
EXPENDITURE ON TRANSACTIONS WITH THE TREASURY			—	182,221,117,000
VALUE ADJUSTMENTS				
securities		—		
foreign exchange		—		
other		—	—	—
DEPRECIATION				
buildings		103,572,244,534		
furniture and fittings		15,922,999,487		
equipment		48,676,963,643		
procedures, studies and designs		67,263,805,744		
other deferred charges		10,633,712,769		
other		—	246,069,726,177	259,654,271,887
APPROPRIATION OF INVESTMENT INCOME TO RESERVES				
to the ordinary reserve		410,471,171,621		
to the extraordinary reserve		429,772,933,254	840,244,104,875	880,558,921,314
		carried forward	10,762,926,615,112	15,283,233,493,765

ACCOUNT

INCOME AND PROFITS				1998	1997
INTEREST RECEIVED					
on discounts and advances:					
– bill portfolio		8,566,993,403			
– advances		464,786,976,213	473,353,969,616		
on lending to the UIC			1,599,127,524,756		
on lending abroad			1,093,420,405,018		
other			98,844,903,085	3,264,746,802,475	3,195,398,841,274
INTEREST, PREMIUMS AND DIVIDENDS ON SECURITIES					
freely available					
interest-bearing securities:					
– Treasury bills	517,365,843,190				
– variable rate CCTs	209,444,540,763				
– other government securities	3,166,296,743,968	3,893,107,127,921			
– government-guaranteed securities		997,110,000	3,894,104,237,921		
investment of reserves and staff severance pay and pension funds					
interest-bearing securities:					
– government and government-guaranteed securities	1,058,502,020,834				
– other	21,609,542,275	1,080,111,563,109			
investments in:					
– subsidiaries	4,242,602,220				
– associated companies	945,440,280				
– other	148,364,972,829	153,553,015,329	1,233,664,578,438	5,127,768,816,359	9,357,338,715,294
FINANCIAL REVENUES ARISING FROM SECURITIES REPURCHASE AGREEMENTS				1,129,640,988,700	1,880,441,590,967
INCOME FROM PARTICIPATION IN THE UIC ENDOWMENT FUND				769,845,197,963	117,864,085,682
SECURITIES ISSUE AND PURCHASE DISCOUNTS/PREMIUMS				155,208,063,495	355,257,568,543
PROFITS ON SECURITIES TRADING				6,805,037,507,250	1,875,837,334,602
PROFITS ON FOREIGN EXCHANGE TRADING				799,135,244,814	1,245,888,580,482
carried forward . . .				18,051,382,621,056	18,028,026,716,844

PROFIT AND LOSS

AMOUNTS IN LIRE

EXPENDITURE AND LOSSES		1998	1997
brought forward . . .		10,762,926,615,112	15,283,233,493,765
ALLOCATIONS TO PROVISIONS			
for losses on foreign exchange	94,000,000,000		
for losses on securities	1,486,000,000,000		
for insurance cover	—		
for staff severance pay and pensions	1,555,551,376,380		
for grants to BI pensioners and their surviving dependents	163,286,123		
for severance pay of contract staff under Law 297/1982	285,008,967		
for staff costs in respect of wage negotiations	27,715,728,000		
for staff costs	128,151,000,000	3,291,866,399,470	3,008,333,721,288
PRIOR-YEAR ADJUSTMENTS . . . L,		2,228,808,986	8,882,405,246
»		14,057,021,823,568	18,300,449,620,299
TRANSFERS			
to the provision for general risks	12,771,317,205,786		
to the provision for staff severance pay and pensions	826,165,672,670	13,597,482,878,456	–
		27,654,504,702,024	18,300,449,620,299
NET PROFIT		4,571,440,107,890	1,634,588,840,192
TOTAL . . .		**32,225,944,809,914**	**19,935,038,460,491**

ALLOCATION
TO THE ORDINARY RESERVE
TO THE EXTRAORDINARY RESERVE
TO SHAREHOLDERS
TO THE TREASURY

Audited and found correct. – Rome, 22 April 1999

THE AUDITORS
GIUSEPPE BRUNI
MARIO CATTANEO
ENRICO NUZZO
MASSIMO STIPO
GIANFRANCO ZANDA

ACCOUNT

INCOME AND PROFITS		1998	1997
brought forward . . .		18,051,382,621,056	18,028,026,716,844
PROFITS ON SUNDRY FINANCIAL TRANSACTIONS		50,990,694,020	1,260,613,100,798
COMMISSIONS, RECOVERIES AND OTHER FINANCIAL INCOME		337,226,605,286	276,875,989,353
INCOME FROM BUILDINGS		28,576,658,792	26,584,468,707
PROFITS ON DISPOSALS			
securities	1,150,437,469		
buildings	1,582,732,026		
other	1,492,344,466	4,225,513,961	27,252,225,932
TECHNICAL DEPARTMENTS – FINAL STOCKS		25,816,939,695	25,502,013,180
TECHNICAL DEPARTMENTS – PROCEDURES, STUDIES AND DESIGNS COMPLETED AND IN PRODUCTION		76,080,899,467	97,867,164,818
VALUE READJUSTMENTS			
securities	19,751,683,895		
foreign exchange	—		
other	—	19,751,683,895	75,099,482,425
PRIOR-YEAR ADJUSTMENTS		34,410,315,286	117,217,298,434
		18,628,461,931,458	19,935,038,460,491
RECLASSIFICATION OF PROVISIONS		13,597,482,878,456	—
TOTAL . . .		**32,225,944,809,914**	**19,935,038,460,491**

OF THE NET PROFIT	
	914,288,021,578
	457,144,010,789
	30,000,000
	3,199,978,075,523
TOTAL . . .	**4,571,440,107,890**

THE ACCOUNTANT GENERAL

VINCENZO PONTOLILLO

THE GOVERNOR

ANTONIO FAZIO

NOTES TO THE ACCOUNTS (1)

The accounts for 1998 reflect the fall in interest rates in financial markets; the official discount rate was lowered in several steps by a total of 2.5 percentage points. On the external front, the lira remained stable against the other currencies participating in the Exchange Rate Mechanism, but fluctuated against the US dollar and the yen.

The accounts were also affected by the institutional, legal and operational changes connected with the preparations for the third stage of European monetary union. Among the most important of these changes were the attribution to the Bank of Italy, which is an integral part of the European System of Central Banks, of responsibility for managing the official reserves in accordance with Legislative Decree 43 of 10 March 1998 and the transformation of the UIC into an agency of the Bank in accordance with Legislative Decree 319 of 26 August 1998. The following events were linked to these changes: the transfer to the Bank of UIC's foreign exchange reserves; the Bank's participation in the European Central Bank; the fixing of the irrevocable conversion rates between the euro and the currencies of the countries participating in the Eurosystem; the reduction in the Bank's portfolio of freely available securities in line with the new monetary policy set-up; and the shift in the Bank's risk position, which entailed the reclassification of the related provisions.

The Bank's balance sheet contracted considerably compared with the previous, from 368,486 to 271,255 billion lire. On the liabilities side there were sharp falls in banks' compulsory reserve deposits and Treasury Ministry deposits.

The contraction in the Bank's total assets was the result of movements of opposite sign. There were increases in the value of gold, as a consequence of the definitive extinction of the three-month swap against ecus with the ECB, foreign currency assets, following the acquisition of the UIC's foreign exchange reserves (including the position in the International Monetary Fund), and advances granted under the Treasury Minister Decree of 27 September 1974. On the other hand, there were large decreases in

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(1) This abridged English version of the Bank's annual accounts does not contain all the information required by law in the Italian version. The original version of the balance sheet for the year ended 31 December 1998 has been audited by Reconta Ernst & Young. The annual accounts and the letter of the auditors are included in the Bank's Annual Report in Italian.

the securities portfolio, as a result of redemptions and net disposals to provide collateral for the advances referred to above, and claims arising from repurchase agreements. The acquisition of UIC's foreign exchange reserves also led to the replacement of the Bank's credit balance vis-à-vis that entity with a debit balance.

Operating income before allocations to provisions and taxes on income and productive activities rose from 8,531 to 9,829 billion lire. The result reflected the reductions, on the expenditure side, in interest paid and administrative costs and the absence of expenditure on transactions with the Treasury and, on the income side, the large increase in profits on securities trading.

Taxes for the year fell from 3,888 to 1,966 billion lire and the result after taxes accordingly amounted to 7,863 billion lire (4,643 billion in 1997). Allocations to provisions increased from 3,008 to 3,292 billion, so that the net profit for the year amounted to 4,571 billion (1,635 billion in 1997).

Layout of the accounts and valuation methods

In drawing up its annual accounts, the Bank of Italy has to comply with the provisions of special laws. For matters not covered by such provisions, it applies the rules laid down in the Civil Code, interpreted in the light of the accounting standards in force in Italy. Specifically:

- Royal Decree 204 of 28 April 1910, "Consolidated Law on the Bank of Issue and the Circulation of Banknotes", requires the layout of the Bank's annual accounts to be approved by a Treasury Ministry decree;
- Decree Law 867 of 30 December 1976, ratified as Law 42 of 23 February 1977, and the related Treasury Ministry decree of 23 March 1979 lay down the method for valuing gold;
- the income tax code, approved by Presidential Decree 917 of 22 December 1986, provides for revaluation gains and prior-year adjustments deriving from the inclusion in the accounts of gold at the price prevailing in the international market and from the inclusion of foreign exchange and securities, receivables and payables denominated in foreign currencies at current exchange rates to be stated in a special provision;
- Royal Decree 1067 of 11 June 1936 (the Statute of the Bank of Italy) and subsequent amendments lays down specific criteria for the allocation of the interest earned on the investment of the reserves.

The reference law is the Civil Code as amended by Legislative Decree 127 of 9 April 1991 and, for matters not governed thereby with characteristics comparable to the matters governed by Legislative Decree 87 of 27 January 1992, the provisions thereof. Transactions are recorded in the accounts on a settlement date basis.

The valuation methods described below have been agreed with the Board of Auditors where this is provided for by law. They are unchanged compared with the previous year except for the additions required by the transfer from the UIC to the Bank of the position in the IMF pursuant to Legislative Decree 319 of 26 August 1998. Furthermore, assets and liabilities denominated in euro area currencies have been stated in the annual accounts in accordance with the provisions of Legislative Decree 213 of 24 June 1998.

GOLD AND FOREIGN CURRENCY ASSETS

- gold is valued with reference to the price of the last swap of gold for ecus entered into with the ECB. Revaluation differences that arise are taken to the *provision for gold price fluctuations (under Decree Law 867/1976 and Art. 104.1b) of the income tax code)*;
- exchange rate gains and losses on foreign currency assets are determined by applying the LIFO method with annual intervals;
- assets and liabilities denominated in euro area currencies are translated at the irrevocable exchange rates of the euro in accordance with Article 18 of Legislative Decree 213/1998; positive and negative exchange differences with respect to cost are taken to the profit and loss account;
- assets and liabilities denominated in non-euro-area foreign currencies and those in SDRs are translated at year-end exchange rates.

  Where the cost of a currency is higher than the year-end exchange rate, the resulting exchange loss is charged to the *provision for foreign exchange losses*.

  Where a currency has appreciated, the resulting exchange gain is taken to the *provision for exchange rate adjustments (under Art. 104.1c) of the income tax code)*. In fact the Bank applies the same method for the valuation of the country's gold and foreign exchange reserves, in conformity with the accounting standards in force in Italy, and in its treatment of the economic component avails itself of the right provided for in the above-mentioned article.
- the part of the position in the IMF comprising the gold deposited in the name and on behalf of the Treasury Ministry, net of the quantities the Fund returned to Italy between 1977 and 1979, is stated in the accounts at a price of 1 SDR per gram of fine gold.

SECURITIES

Securities not held as financial fixed assets

- for the purpose of determining profits and losses, such securities are valued by applying the weighted average cost method;
- the valuation is effected as follows:

  a) for listed securities: at the lower of cost and market value, determined on the basis of the arithmetic mean of the market prices recorded in the last month of the year (the "normal value");

  b) for unlisted bonds: at the lower of cost and the "normal value" of listed securities with comparable features;

  c) for unlisted shares: at the lower of cost and the corresponding proportion of the shareholders' equity shown in the latest published accounts of the investee company;

The cost of listed and unlisted bonds acquired since 1 December 1983 includes the accrued portion of the issue discount (calculated as the difference between the issue price and the redemption value), net of withholding tax determined in accordance with Legislative Decree 239 of 1 April 1996 ("Changes to the tax regime for interest, premiums and other income from public and private sector bonds and the like").

Securities held as financial fixed assets

- for the purpose of determining profits and losses on disposals, such securities are valued by applying the specific cost;
- the valuation is effected as follows:

  a) for Treasury bills: at cost, determined as the face value plus or minus the difference between the interest entered in the books at the allotment rate and that actually earned at the rate corresponding to the purchase price.

  b) for listed and unlisted bonds: at cost or a lower value that takes account of special circumstances concerning the issuer;

  c) for listed shares: at the lower of cost and market value, determined on the basis of the arithmetic mean of the prices recorded in the last six months of the year;

  d) for unlisted shares: at the lower of cost and the corresponding proportion of the shareholders' equity shown in the latest published accounts of the investee company.

The cost of listed and unlisted bonds includes the accrued portion of the purchase discount/premium (calculated as the difference between the purchase price and the redemption value), net, for the part corresponding to the issue discount, of withholding tax determined in accordance with Legislative Decree 239 of 1 April 1996.

Both for securities not held as financial fixed assets and for those held as financial fixed assets:

- amounts written off as a result of the application of the foregoing methods are charged to the *provision for losses on securities*;
- amounts written off in prior years (starting from 1993, the year in which Legislative Decree 127/1991 came into force) are written back via the profit and loss account, up to the cost of the securities, when the conditions that determined the writedown no longer obtain.

INVESTMENTS

Investments in subsidiaries and associated companies classified as fixed assets are valued as follows:

- listed shares: at the lower of cost and market value, determined on the basis of the arithmetic mean of the prices recorded in the last six months of the year;
- unlisted shares: at the lower of cost and the corresponding proportion of the shareholders' equity shown in the latest published accounts of the investee company;
- the UIC endowment fund and the investment in the European Central Bank are valued at cost; the ECB investment is translated at year-end exchange rates.

Dividends received and the profits of the UIC accruing to the Bank are accounted for on a cash basis.

The Bank does not prepare consolidated accounts insofar as it is among those referred to in Article 25 of Legislative Decree 127/1991. The annual accounts of the UIC are attached to those of the Bank as provided for in Article 4 of Legislative Decree 319/1998.

INTANGIBLE FIXED ASSETS

Completed procedures, studies and designs

- are stated at cost, of purchase or production, and amortized on the basis of allowances corresponding to the estimated useful lives of the assets.

Procedures, studies and designs in production and advances

- are stated at purchase cost, for the part corresponding to advances paid to suppliers, and at production cost for those produced internally.

Other deferred charges

- software licence fees are stated at cost and amortized on a straight line basis over the period of the licence or, in the case of licences granted for an indeterminate or exceptionally long period, over the estimated useful life of the product, which is taken to be equal to three years;
- costs incurred in installing and enlarging communications networks and lump-sum payments under multi-year contracts are amortized on a straight line basis according to the estimated useful life of the network for the former and the duration of the contract for the latter;
- capitalized costs incurred in the restructuring of rented premises are amortized on a straight line basis over the residual duration of the contract.

TANGIBLE FIXED ASSETS

Buildings

- are stated at cost inclusive of the amounts of revaluations effected under specific laws. Depreciation of the buildings used by the Bank for its institutional purposes is charged on the basis of the estimated useful lives of the assets. The same method is adopted for buildings that represent staff severance pay and pension fund investments and which meet the requirements of Article 40.2 of the income tax code. The Bank again took advantage of the possibility provided by Article 67.3 of the code and subsequent amendments to charge accelerated depreciation. The amount in excess of the depreciation on an economic basis was taken to the *reserve for accelerated depreciation*.

Furniture and fittings and equipment

- are stated at cost. Depreciation is charged on the basis of the estimated useful lives of the assets.

STOCKS OF THE TECHNICAL DEPARTMENTS

Banknotes in production

- are stated at production cost.

Other (inventories)

- inventories are valued by applying the LIFO method.

Accruals and deferrals

Comprise the portions of income and expense items relative to two or more fiscal years determined on an accruals basis.

Provisions for staff severance pay and pensions

The amounts stated in the accounts, in accordance with Article 3 of the relevant regulation, comprise both the mathematical reserves corresponding to the position of staff with vested interests and pensioners and the severance pay matured by the entire staff at the end of the year.

Unless provided for differently, assets and liabilities are stated at nominal value. In the case of claims, the nominal value coincides with the estimated realizable value.

Memorandum accounts

Securities held by the Bank on deposit are stated at nominal value; where they are denominated in foreign currency, the amounts are translated at year-end exchange rates, except in a few limited cases in which recourse is made to conventional exchange rates.

Reclassification and renaming of provisions - withdrawals and allocations

The change in the institutional, legal and operational context in which the Bank operates altered the situation with regard to the risks it assumes; it has become more important to provide against the risks associated with its activities as a whole rather than specific items. In more detail:

- the *provision for diminution in value of foreign exchange*, renamed *provision for exchange risk*, has been reduced from 8,474 to 2,977 billion lire. The latter amount is net of the withdrawals made to cover revaluation deficits and includes the allocation for the year of 94 billion. This allocation results in the minimum amount determined by applying the VaR method (computed at a 95 per cent confidence level and taking 31 December 1999 as the time horizon) being exceeded slightly on prudential grounds. In fact, in assessing the appropriateness of the provision, consideration is also given to the amounts already set aside in the *provision for losses on foreign exchange under Decree Law 867/1976* (1,201 billion) and the *provision for exchange rate adjustments under Art. 104.1c) of the income tax code* (356 billion).

- the *provision for diminution in value of securities*, renamed *provision for losses on securities*, has been reduced 8,062 to 1,983 billion lire. The latter amount, which is net of the withdrawal of 3 billion and includes the allocation for the year of 1,486 billion, takes account of the foreseeable revaluation deficits in connection with the commitment to repurchase the securities that were sold to banks to provide collateral for advances granted under the Treasury Ministry Decree of 27.9.1974. The amount required was estimated assuming that the effective yields of the securities in question would remain unchanged;
- the *provision for losses on bill portfolio* has been reduced to nil, from 235 billion lire in 1997, and extinguished following the new definition of the instruments used for monetary policy within the Eurosystem;
- the *provision for insurance cover* has been reduced from 1,020 to 600 billion lire, in view of the fact that the Bank has recently taken out a policy that, albeit with deductibles, also covers some catastrophic events. The provision now serves basically to cover the risks associated with the transport of valuables:
- the *tax provision* has been reduced from 4,474 billion lire (which includes the 3,888 billion allocated in June 1998 in respect of 1997 taxes) to 2,146 billion. It covers the amount of taxes payable (including deferred taxation), determined on the basis of a realistic forecast of the liabilities arising from the application of current tax law and of those that may arise from disputes with the tax authorities;
- the *provision for staff severance pay and pensions* has been increased from 7,022 to 9,404 billion lire to take account of the updating of the method of calculating the Bank's commitments. The adjustment of 2,382 billion refers to the position of staff with vested interests and pensioners and is based on an average annual rate of return of 4 per cent, updated mortality tables and a new estimate of future wage dynamics. The adjustment was made by allocating 1,556 billion and transferring 826 billion of taxed amounts from other provisions via the profit and loss account;
- the *provision for contingent losses*, renamed *provision for general risks*, has been increased from 4,845 to 17,616 billion lire by transferring 12,771 billion of taxed amounts from other provisions via the profit and loss account. This provision is intended to protect against risks associated with the Bank's activities in general that cannot be

individually determined or objectively divided and for which specific provision has not been made. Allocations to and withdrawals from this provision are decided by the Board of Directors and made via the profit and loss account.

- the *provision for staff costs in respect of wage negotiations* has been extinguished following the movements described below:

  a) allocation of 28 billion lire, corresponding to the gain in the Bank's efficiency for the year (estimated to be equal to 2.5 per cent of total wages and salaries);

  b) withdrawal of 36 billion lire, corresponding to the increase for the year in wages and salaries resulting from the reform of the pay structure;

  c) transfer to the profit and loss account of the remaining amount as partial recovery of the portion of the cost of the pay reform borne in 1996-97 that was not covered by the allocations made earlier to finance the reform.

The above-mentioned transfer completes the financing of the pay reform out of efficiency gains.

- the *provision for staff costs* amounts to 128 billion lire and corresponds to the estimated value of the outstanding liabilities accrued at 31 December 1998 (annual bonus, attendance bonus and unused ordinary and extraordinary annual leave) and an amount prudentially set aside to cover the Bank's share of the prudentially estimated cost the supplementary pension fund instituted for employees recruited after 27 April 1973;

- the *provision for grants to BI pensioners and their surviving dependents* amounts to 3 billion lire following the allocation of 0.2 billion, determined taking into account the revenues referred to in Article 24 of the Pension Fund Rules;

- the *provision for severance pay of contract staff under Law 297/1982* amounts to 2 billion lire following the allocation of 0.3 billion.

Information on the balance sheet

Assets

The value of the Bank's *gold* rose by 3,351 billion lire, from 37,578 to 40,929 billion. The rise reflected the increase of 8,186 billion in respect of the definitive closure of the ecu swap with the ECB on 31 December and the consequent inclusion under gold of the entire amount of gold claims (corresponding to 518 tons) and the decrease caused by the fall of 12.9 per cent in the price of a gram of fine gold from 18,121.5 to 15,785.3 lire.

The closing out of the swap position reduced to nil not only gold claims but also the asset items ecus and dollar claims and the liabilities item ecu liabilities, equal to 9,394, 15,783, 6,485 and 15,879 billion lire respectively at the end of 1997.

The reduction in the price of gold resulted in the withdrawal of 6,056 billion lire from the provision for gold price fluctuations (4,846 billion in respect of gold held at the end of 1997 and 1,210 billion in respect of that which the Bank reacquired following the closure of the swap referred to above. The fund accordingly amounted to 26,635 billion at 31 December 1998.

In the first few days of 1999 the following reserve assets were transferred to the ECB in accordance with the ESCB Statute: 141 tons of gold, 6,647 million US dollars and 84,067 million yen, corresponding in total to 7,447.5 million euros.

Cash on hand, comprising notes and coins issued by the Treasury, amounted to 13 billion lire.

Discounts and advances include current account advances, which fell from 1,294 billion lire at 31 December 1997 to nil, fixed-term advances, which rose from 1,143 to 1,800 billion, and the *bill portfolio*, which declined from 259 to 149 billion.

Advances under the Treasury Minister Decree of 27.9.1974 totaled 30,932 billion lire, of which 7,163 billion granted to Banco di Napoli under Law 588 of 19 November 1996 in respect of losses recorded by SGA S.p.A. and 23,769 billion to Banco di Sicilia following its intervention to protect the depositors of Sicilcassa S.p.A., in compulsory administrative liquidation. The average amount outstanding in 1998 was 41,437 billion. At the end of 1997 there had been 18,558 billion of advances to Banco di Napoli in respect of losses incurred by Isveimer in liquidation.

External assets in foreign currencies rose by a total of 5,565 billion lire, from 36,486 to 42,051 billion; the increase was largely due to the acquisition of foreign exchange reserves from the UIC and to the closure of the ecu swap with the ECB.

April 1998 saw the definitive extinction of the long-term forward transactions consisting in forward commitments in connection with purchases of the foreign exchange proceeds of international loans to Italian borrowers.

The volume of transactions of this kind had already contracted considerably in 1997 to stand at US$600 million at the end of the year. In particular, in the same year US$4,182 million and DM 3,500 million of long-tem forward transactions were extinguished early.

The new subitem *foreign currency loans* (1,496 billion lire) refers to the loans in SDRs taken out by Italy in connection with its participation in the International Monetary Fund.

Other external assets in foreign currencies increased by 19,852 billion lire, from 20,703 to 40,555 billion, primarily owing to the increase of US$16,359 in dollar-denominated assets (from US$3,922 million to US$20,281 million) and that of ¥402,337 million in yen-denominated assets (from ¥3,922 million to ¥20,281 million). The exchange rate of dollar fell (1,759.19 to 1,653.10 lire), while that of the yen rose (from 13,576 to 14,375 lire). By contrast, the stock of assets denominated in Eurosystem currencies was small (4 billion lire on the basis of the irrevocable conversion rates); at the end of 1997 it had amounted to 12,032 billion lire. Turning to the subitems, current accounts rose from 5,743 to 10,194 billion lire, time deposits from 1,006 to 10,001 billion and foreign currency securities from 13,947 to 20,351 billion.

The foreign currency securities held by the Bank were almost all issued by the US Treasury, the Japanese Treasury and international organizations.

At the end of the year there were no foreign currency swaps outstanding, compared with a total of US$8 billion at the end of 1997.

In accordance with Legislative Decree 43/1998 and the agreement entered into with the UIC pursuant to Legislative Decree 319/1998, in December the Bank of Italy acquired the foreign exchange reserves held by the UIC - US$7,742 million and ¥361,060 million - for 12,818 and 5,160 billion lire respectively. The Bank also acquired the position in the International Monetary Fund for a net consideration of 6,670 billion.

The subitem *IMF quota account* of the new item *International Monetary Fund* refers to Italy’s quota, which had previously been held by the UIC and which amounted to 10,690 billion lire at the end of the year. The account, denominated in SDRs, comprised 2,532 billion lire, the quota paid in gold and SDRs, and 8,158 billion in respect of the part subscribed in the past in lire and made available to the Fund in an account in its name. The account, called *IMF claims,* is shown on the liabilities side and amounted to 4,128 billion at the end of the year.

The subitems *IMF, other assets in SDRs* (183 billion lire on the assets side) and *IMF, assignment of SDRs* (1,635 billion on the liabilities side) show the amounts available to Italy (79 million SDRs) and the amounts assigned by the Fund (702 million SDRs).

The acquisition of the UIC's foreign exchange reserves was settled on its 'ordinary' current account with the Bank up to the amount needed to cancel the debit balance thereon and the excess was paid into a new current account to be used for the settlement of the Bank's debit and credit positions with the UIC deriving from the latter's activity, including the payment of amounts due in foreign currency by governmental authorities. At the end of the year the UIC had a credit balance on this new current account of 432 billion lire, which is shown in the liabilities item *Ufficio italiano cambi - current account (credit balance)*. The agreement entered into with the UIC in December 1998 provides for interest on both debit and credit balances on the current account at the rate fixed within the Eurosystem for overnight deposits made with the national central banks at the initiative of the depositors.

The financial flows generated by the dealings between the Bank and the UIC are settled on the special current account devoted to this purpose. The main movements on this account in 1998 concerned:

a) sales and repurchases in relation to foreign currency swaps, 35,511 and 49,321 billion lire respectively;

b) the acquisition of UIC's foreign exchange reserves, including the position in the IMF, 24,648 billion;

c) the recovery by the UIC, under special agreements, of expenses it had incurred, 14 billion;

d) the interest payable on the UIC's endowment fund, 19 billion;

e) the interest payable on the debit balance on UIC's current account in the second half of 1997 and the first half of 1998, 2,026 billion;

f) the Bank's share of the UIC's profit for 1997, 751 billion.

Sundry claims on the government declined from 16 to 9 billion lire.

Claims arising from securities repurchase agreements fell from 33,745 billion lire at the end of 1997 to 4,124 billion at the end of the year, while the average amount outstanding declined from 27,090 to 21,442 billion.

The Bank's *securities* portfolio contracted by 30,088 billion lire (from 153,389 to 123,301 billion). In particular, its holdings of *freely available government and government-guaranteed securities* - which include those issued under Law 483 of 26 November 1993, unchanged at 76,206 billion - fell by 58,522 billion (from 139,438 to 80,916 billion). The factors contributing to the fall included net sales to allow the banks concerned to provide collateral for the advances referred to in the Treasury Ministry Decree of 27.9.1974, the utilization of securities for the investment of provisions and reserves, and redemptions, primarily of Treasury bills. Securities held for the investment of the reserves, the provision for general risks and the provision for staff severance pay and pensions rose from 13,951 to 42,385 billion.

The *UIC endowment fund* remained unchanged at 500 billion lire.

The *investment in the ECB,* translated at the year-end ecu exchange rate, amounted to 1,442 billion lire (744.7 million ecus). It corresponds to 14.895 per cent of the ECB's capital.

Intangible fixed assets declined from 144 to 139 billion lire and comprised 74 billion of procedures, studies and projects and 16 billion of other deferred charges, both net of amortization, and 51 billion of intangible fixed assets in production and advances.

Tangible fixed assets rose from 3,691 to 3,779 billion lire, net of 1,840 billion of accumulated depreciation, as detailed below:

- *buildings used by the Bank* rose from 3,444 to 3,459 billion, net of 1,266 billion of accumulated depreciation;
- *buildings for staff severance pay and pension fund investments* declined from 689 to 686 billion, net of 38 billion of accumulated depreciation;
- *furniture and fittings* and *equipment*: the former rose from 188 to 212 billion, net of 184 billion of accumulated depreciation, and the latter from 404 to 454 billion, net of 352 billion of accumulated depreciation;
- *coins and collections* remained unchanged at 2 billion lire;
- *assets under construction and advances* rose from 672 to 806 billion lire and referred entirely to *buildings for use by the Bank and related equipment*.

The item *other investments of staff severance pay and pension funds* rose from 26 to 37 billion lire and comprised severance pay advances and the related capitalized interest.

Stocks of the technical departments remained unchanged at 26 billion lire. In particular, banknotes in production amounted to 11 billion and other stocks to 15 billion.

Sundry assets declined by 1,250 billion lire (from 10,409 to 9,159 billion). Specifically, tax payments on account and tax credits and related interest receivable fell from 6,928 to 5,415 billion and withholding tax paid on interest, dividends and sundry revenues from 484 to 92 billion. The non-interest-bearing claim in respect of items arising from the Bank's former management of stockpiling bills remained unchanged at 2,894 billion. The settlement of this claim will require specific legislation since Decree Law 565 of 30 December 1993 and subsequent reiterations was not ratified.

Accrued income fell from 2,783 to 1,985 billion lire, primarily as a result of the decrease of 494 billion in bond interest, from 2,282 to 1,788 billion.

Prepaid expenses remained basically unchanged at 7 billion lire.

Liabilities

Banknotes in circulation increased by 8,337 billion lire, from 114,074 to 122,411 billion. In percentage terms the increase was equal to 7.3 per cent, compared with 7.5 per cent in 1997. The average value of notes in circulation rose by 8,015 billion lire, from 103,589 to 111,604 billion.

Outstanding *Bank of Italy drafts* decreased by 281 billion lire, from 1,195 to 914 billion. The fall of 283 billion in ordinary drafts was only marginally offset by the rise of 2 billion in special drafts.

Banks' compulsory reserve deposits fell by 65,845 billion lire, from 78,634 to 12,789 billion. The total excludes amounts that have been mobilized and includes those in excess of the reserve requirement. The average amount of compulsory reserves due from banks contracted by 11,960 billion lire or 15.2 per cent, from 78,432 to 66,472 billion.

Other compulsory deposits declined from 20 to 9 billion lire.

Other deposits rose from 281 to 1,099 billion lire, comprising 338 billion of current account deposits and 761 billion of time deposits. The latter amount refers to the overnight deposits made by banks at the end of the year.

External liabilities decreased by a total of 44 billion lire, from 135 to 91 billion, owing to the reductions of 19 and 25 billion lire respectively in deposits in foreign currencies and external accounts in lire.

The balance of the *Treasury payments account* fell by 11,475 billion lire, from 53,547 to 42,072 billion. The average balance showed an analogous contraction, from 42,677 to 36,474 billion.

The *sinking fund for government securities* fell from 4,237 to 134 billion lire and the average balance contracted from 4,438 to 2,709 billion.

Sundry liabilities towards the government fell from 426 to 257 billion lire and consisted almost entirely of the amount payable by the Bank as fiscal agent for Treasury credit certificates (166 billion, compared with 164 billion at the end of 1997) and the interest that accrued in the second half of the year on the sinking fund for government securities (83 billion, compared with 183 billion at the end of 1997).

Liabilities arising from securities repurchase agreements fell from 4,789 billion lire to nil; the average amount of this item showed a corresponding fall, from 993 to 338 billion.

The movements in *sundry provisions* are shown in Table 51.

Table 51

SUNDRY PROVISIONS

(*millions of lire*)

	Balance at end-1997	Movements			Balance at end-1998
		Transfers to/from other provisions	Withdrawals	Allocations	
For losses on bill portfolio	234,919	(1) −234,919	–	–	–
For foreign exchange losses	9,675,068	−4,974,273	616,782	94,000	4,178,013
under Decree Law 867/1976 ..	*1,200,795*	–	–	–	*1,200,795*
other (2)	*8,474,273*	(1) *−4,974,273*	*616,782*	*94,000*	*2,977,218*
For losses on securities (3)	8,062,125	(1) −7,562,125	2,704	1,486,000	1,983,296
For insurance cover	1,019,692	(4) −419,692	–	–	600,000
For staff severance pay and pensions	7,022,344	(5) 826,166	–	1,555,551	9,404,061
For grants to BI pensioners and their surviving dependents	2,570	–	99	163	2,634
For severance pay of contract workers (under Law 297/1982)	2,297	–	164	285	2,418
For staff costs in respect of wage negotiations	16,539	–	(6) 44,255	27,716	–
For staff costs	–	–	–	128,151	128,151
Subtotal ...	**26,035,554**	**−12,364,843**	**664,004**	**3,291,866**	**16,298,573**
For fluctuations in the price of gold (under Decree Law 867/1976 and Art. 104.1b) of the income tax code)	32,691,276	–	(7) 6,056,436	–	26,634,840
For exchange rate adjustments, under Art. 104.1c) of the income tax code (8)	1,381,372	–	1,381,372	355,757	355,757
For taxation (9)	4,474,474	(4) −406,474	3,888,000	1,966,000	2,146,000
Total ...	**64,582,676**	**−12,771,317**	**11,989,812**	**5,613,623**	**45,435,170**

(1) Transferred to the “provision for general risks”. – (2) In 1997 called “provision for diminution in value of foreign exchange”. – (3) In 1997 called “provision for diminution in value of securities”. – (4) Transferred to the “provision for staff severance pay and pensions”. – (5) Deriving from the transfer of the excess amounts of the “provision for insurance cover” and the “provision for taxation”. – (6) Of which 36.1 billion were used to finance the reform of the pay structure and the remained included in income. – (7) The movement was due entirely to the revaluation of gold at the new price of 15,785.3 lire per gram of fine gold (18,121.5 lire at the end of 1997). – (8) Attributable to the revaluation of foreign exchange holdings at year-end exchange rates. – (9) The amount set aside for 1998 taxes was allocated to this provision.

Sundry liabilities diminished by 380 billion lire, from 923 to 543 billion.

Accrued expenses declined from 175 to 1 billion lire; deferred income declined from 414 to 2 billion.

The *provision for general risks* amounted to 17,616 billion lire.

The new item *capital and reserves* includes the *ordinary reserve* of 5,474 billion lire and the *extraordinary reserve* of 5,481 billion, an increase of 1,318 billion or 13.7 per cent. The *reserve for accelerated depreciation (under Art. 67.3 of the income tax code)* rose from 44 to 50 billion.

The new item also includes the revaluation surplus reserves, unchanged at 2,616 billion lire, and the *special provision for the renewal of tangible fixed assets* of 3,495 billion, which replaces the provisions for building works and renewal of equipment.

The distribution of the holdings of the Bank's *share capital* at the end of December 1997 and 1998 are shown in Table 52. The movements in the *capital and reserves* are shown in Table 53.

Table 52

SHAREHOLDERS

	At 31 December 1998				At 31 December 1997			
	Number	Shares held (1)	%	Votes	Number	Shares held (1)	%	Votes
Shareholders with voting rights	80	299,934	100.0	755	83	299,934	100.0	758
Limited company banks	*72*	*253,434*	*84.5*	*630*	*75*	*253,434*	*84.5*	*633*
Social security institutions	*1*	*15,000*	*5.0*	*34*	*1*	*15,000*	*5.0*	*34*
Insurance companies	*7*	*31,500*	*10.5*	*91*	*7*	*31,500*	*10.5*	*91*
Shareholders without voting rights .	6	66	. .	–	6	66	. .	–
Total . . .	**86**	**300,000**	**100.0**	**755**	**89**	**300,000**	**100.0**	**758**

(1) Face value, 1,000 lire each.

Table 53

MOVEMENTS IN SHARE CAPITAL AND RESERVE
(millions of lire)

	Balance at end-1997	Increases	Decreases	Balance at end-1998
Share capital	300	–	–	300
Ordinary reserve	4,742,756	(1) 737,389	(2) 5,865	5,474,280
Extraordinary reserve	4,893,928	(1) 593,232	(2) 6,343	5,480,817
Revaluation surplus reserve (under Law 72/1983)	1,304,000	–	–	1,304,000
Revaluation surplus reserve (under Law 408/1990)	1,278,971	–	–	1,278,971
Revaluation surplus reserve (under Law 413/1991)	32,767	–	–	32,767
Reserve for accelerated depreciation (under Art. 67.3 of the income tax code)	43,963	6,145	–	50,108
Special provision for the renewal of tangible fixed assets	(3) 3,495,052	–	–	3,495,052
Total . . .	**15,791,737**	**1,336,766**	**12,208**	**17,116,295**

(1) The movement was due to the allocation of the net profit for 1997 and the return earned in 1998 on the investment of the reserve. – (2) The movement was due to the dividend paid to shareholders in respect of the return earned in 1997 on the investment of the reserve (under Art. 56 of the Bank's Statute). – (3) In 1997 this amount was included among "Sundry allocations", under "provision for building works" (2,523,802 million lire) and "provision for renewal of equipment" (971,250 million lire).

Information on the profit and loss account

Income and profits - excluding the 13,597 billion lire arising from the reclassification of provisions - declined from 19,935 to 18,629 billion, while expenditure and losses - excluding the 12,771 billion transferred to the provision for general risks and the 826 billion transferred to the provision for staff severance pay and pensions but including the 3,292 billion allocated to provisions (3,008 billion in 1997) - fell from 18,300 to 14,058 billion. The net profit rose by 2,936 billion, from 1,635 to 4,571 billion.

Income and profits

Interest received rose by 70 billion lire, from 3,195 to 3,265 billion, owing to the following changes compared with 1997.

Increases in interest received:

- of 269 billion lire *on discounts and advances*, from 204 to 473 billion, as a result of the increase of 312 billion on the advances granted pursuant to Law 588/1996 and the decreases of 39 billion for current account advances, 1 billion for fixed-term advances and 3 billion for the discounting of bills;
- of 17 billion *on lending abroad*, from 1,077 to 1,094 billion.

Decreases in interest received:

- of 212 billion *on lending to the UIC*, from 1,811 to 1,599 billion, as a result of the decrease in the average current account balance from 36,250 to 34,248 billion and the decline in the effective yield from 5 to 4.7 per cent;
- of 4 billion in respect of *other interest*, from 103 to 99 billion.

Interest, premiums and dividends on securities decreased by a total of 4,229 billion lire, from 9,357 to 5,128 billion, as a result of:

- a fall of 4,206 billion lire, from 8,100 to 3,894 billion, in interest and premiums on freely available government and government-guaranteed securities, owing to the reduction in the average stock from 151,234 to 113,434 billion and the decline in the average rate of return from 9.8 to 8.4 per cent, excluding the securities assigned to the Bank under Law 463/1993 to close the overdraft on the Treasury's former current account, which earn interest at the rate of 1 per cent;
- a decline of 23 billion lire, from 1,257 to 1,234 billion, in interest and dividends on the securities acquired for the investment of reserves and

staff severance pay and pension funds, owing to the decline in the average rate of return from 10 to 9.2 per cent, which more than offset the increase in the average stock from 12,563 to 13,386 billion.

Financial revenues arising from repurchase agreements fell by 750 billion lire, from 1,880 to 1,130 billion. as a result of the decrease in the average amount outstanding from 27,090 to 21,442 billion and the decline in the average rate of return from 6.9 to 5.3 per cent.

Income from participation in the UIC endowment fund rose by 652 billion lire, from 118 to 770 billion, as a result of the increase in UIC's net profit from 371 billion in 1996 to 3,004 billion in 1997.

Securities issue and purchase discounts/premiums declined from 355 to 155 billion lire.

Profits on securities trading rose by 4,929 billion lire, from 1,876 to 6,805 billion, primarily as a result of sales to banks of securities to be used to provide collateral for advances under a Ministerial Decree of 27.9.1974.

Profits on foreign exchange trading fell from 1,246 to 799 billion lire. Trading in US dollars and marks produced profits of 945 and 62 billion respectively, while trading in yens gave rise to a loss of 235 billion.

Profits on sundry financial transactions fell from 1,261 to 51 billion lire and consisted entirely of the gains produced by the early extinction of forward transactions in foreign exchange. Margin income from futures on government securities fell from 10 billion to nil.

Commissions, recoveries and other financial income increased from 277 to 337 billion lire. The item includes 54 billion of conversion differences produced by the alignment of euro area currencies to their irrevocable exchange rates.

Income from buildings rose from 27 to 29 billion lire.

Profits from disposals fell from 27 to 4 billion lire.

The item *technical departments - final stocks* remained unchanged at 26 billion lire. It no longer includes procedures in production, which as of 1998, are stated in the balance sheet under intangible fixed assets in production and included in the profit and loss account in the item commented on below.

The item *technical departments - procedures, studies and designs completed and in production* fell from 98 to 76 billion lire; it refers to the costs in respect of procedures, studies and designs in production and the those in respect of completed projects that are capitalized during the year.

Value readjustments to securities written down in prior years declined from 75 to 20 billion lire.

Prior-year adjustments declined from 117 to 34 billion lire.

The new item *reclassification of provisions* amounted to 13,597 billion lire and refers to the recording in the profit and loss account of the provisions that became available when the reclassification described above was carried out.

Expenditure and losses

Administrative costs decreased by 171 billion lire or 7.2 per cent, from 2,378 to 2,207 billion. In more detail:

- *wages and salaries and related costs* fell by 54 billion lire, from 1,222 to 1,168 billion, net of the 36 billion withdrawn from the provision for staff costs in respect of wage negotiations (18 billion in 1997);

- *pensions and severance pay* fell by 82 billion lire, from 533 to 451 billion. Severance pay decreased by 116 billion, from 185 to 69 billion, owing to the reduction in the number of terminations; on the other hand, pensions rose by 34 billion, from 348 to 382 billion.

As regards the remaining administrative costs, *expenditure* on *services* fell by 19 billion lire or 7 per cent, from 268 to 249 billion, primarily owing to the reduction in security and escort services (the latter had been boosted in 1997 by the back payments the Bank made under the agreement with the Carabinieri). *Other* administrative costs declined from 351 to 335 billion, while the costs in respect of the *central and local boards*, including the emoluments paid to the members of the Board of Directors and the Board of Auditors, remained unchanged at 4 billion lire.

Taxes and duties fell by 1,985 billion lire, from 3,983 to 1,998 billion. In 1997, in addition to 57 billion of stamp duty on the circulation of banknotes and Bank of Italy drafts, this item comprised: 2,623 billion of corporate income tax (Irpeg); 1,129 billion of local income tax (Ilor), subsequently abolished; and 174 billion of other taxes and duties, including 136 billion of tax on net worth, which was also subsequently abolished. The figure for 1998 comprises: 1,548 billion of corporate income tax (Irpeg), 418 billion in respect of the new regional tax on productive activities (Irap) and 32 billion of other taxes and duties. Stamp duty on the circulation of banknotes and Bank of Italy drafts fell to nil since the deductible items exceeded the circulation on average.

Interest paid fell by 2,071 billion lire, from 7,451 to 5,380 billion. In more detail:

- the interest paid *on the Treasury payments account* decreased by 775 billion, owing to the contraction in the average balance from 42,677 to 36,474 billion and the fall in the rate of return from 7.5 to 6.6 per cent. This subitem includes the differential amount of 753 billion payable to the Treasury pursuant to Article 4 of Law 483 of 26 November 1993 because the reference rate for paying interest on the account was lower than the yield on the securities the Bank had acquired in making the initial balance available on the account;
- the interest paid on the sinking fund for the redemption of government securities decreased by 160 billion lire owing to the fall in the average balance from 4,438 to 2,709 billion and that in the average rate of return from 7 to 5.5 per cent;
- the interest paid *on compulsory bank reserves* fell by 1,132 billion as a result of the contraction in the average amount banks were required to deposit from 78,432 to 66,472 billion and the fall in the effective rate of return from 5.02 to 4.22 per cent as a result of the measures that gradually reduced both the compulsory reserve requirement and the related rate of return.

Financial costs arising from securities repurchase agreements fell by 48 billion lire, from 67 to 19 billion, primarily owing to the smaller volume of such transactions effected during the year.

Losses on sundry financial transactions amounted to 5 billion lire and referred exclusively to the Bank's share of the loss that emerged in the final accounts of the European Monetary Institute.

Contributions to charities and social and cultural activities declined from 8 to 4 billion lire.

The item *technical departments - initial stocks* fell by 10 billion lire, from 72 to 62 billion.

Expenditure on transactions with the Treasury fell by to nil, from 182 billion lire, since the average rate of return on claims on the Treasury was lower that on banks' compulsory reserve deposits.

Legislative Decree 43/1998 has repealed, with effect from 1 January 1999, Article 11 of Law 483/1993, which provided for the payment of such sums on the basis of an agreement between the Bank of Italy and the Ministry of the Treasury.

Depreciation declined from 260 to 246 billion lire and referred mainly to buildings (104 billion, of which 6 billion of accelerated depreciation), procedures, studies and designs (67 billion) and equipment (49 billion). No depreciation is charged for buildings that the Bank does not use for business purposes.

The item *attribution of investment income to reserves* fell by 41 billion lire, from 881 to 840 billion; it refers to the income from the investment of the Bank's ordinary and extraordinary reserves, which has to be reinvested in the same reserves pursuant to the Statute.

As regards *allocations to provisions*, which totaled 3,292 billion lire, reference is made to the earlier section of the notes entitled "Reclassification and renaming of provisions - withdrawals and allocations".

Prior-year adjustments fell from 9 to 2 billion lire.

The new item *transfers*, totaling 13,597 billion lire, refers to the amounts of provisions that became available as a result of the reclassification described earlier, of which 12,771 billion was transferred to the *provision for general risks* and 826 billion to the *provision for staff severance pay and pensions*.

ALLOCATION OF THE NET PROFIT

Pursuant to Articles 54 and 57 of the Statute and after hearing the report of the Board of Auditors, the Board of Directors proposes the following allocation of the net profit for 1998 of 4,571,440,107,890 lire (amounts in lire):

–	20 per cent to the ordinary reserve	L.	914,288,021,578
–	an amount equal to 6 per cent of the share capital to shareholders	»	18,000,000
–	10 per cent to the extraordinary reserve	»	457,144,010,789
–	an additional amount equal to 4 per cent of the share capital to shareholders	»	12,000,000
–	the remaining amount to the Treasury	»	3,199,978,075,523
	TOTAL	L.	4,571,440,107,890

Pursuant to Article 56 of the Statute, the Board of Directors has also proposed the distribution to shareholders - drawing on the income earned on the ordinary and extraordinary reserves - of an additional 19,273.5 million lire, equal to 0.2 per cent (0.15 per cent last year) of the total reserves at 31 December 1997.

Accordingly, the total dividend is equal to 19,303.5 million lire, corresponding to 64,345 lire per share.

THE GOVERNOR
Antonio Fazio

LIST OF ABBREVIATIONS

ABI - *Associazione bancaria italiana*
Italian Bankers' Association

BI-COMP - *Banca d'Italia Compensazione*
Bank of Italy Clearing System

BI-REL - *Banca d'Italia Regolamento Lordo*
Bank of Italy real-time gross settlement system

BOT - *Buoni ordinari del Tesoro*
Treasury bills

BTP - *Buoni del Tesoro poliennali*
Treasury bonds

CCT - *Certificati di credito del Tesoro*
Treasury credit certificates

CIPA - *Convenzione interbancaria per i problemi dell'automazione*
Interbank Convention on Automation

Confindustria - *Confederazione generale dell'industria italiana*
Confederation of Italian Industry

Consob - *Commissione nazionale per le società e la borsa*
Companies and Stock Exchange Commission

CTO - *Certificati del Tesoro con opzione*
Treasury option certificates

CTZ - *Certificati del Tesoro* zero-coupon
Zero-coupon Treasury certificates

Iciap - *Imposta comunale per l'esercizio di imprese e di arti e professioni*
Municipal tax on businesses and the self-employed

Ilor - *Imposta locale sui redditi*
Local income tax

INAIL - *Istituto nazionale per l'assicurazione contro gli infortuni sul lavoro*
National Industrial Accidents Insurance Institute

INPS - *Istituto nazionale per la previdenza sociale*
National Social Security Institute

Irap - *Imposta regionale sulle attività produttive*
Regional tax on productive activities

Irpef - *Imposta sul reddito delle persone fisiche*
Personal income tax

Irpeg - *Imposta sul reddito delle persone giuridiche*
Corporate income tax

Isae - *Istituto di studi e analisi economica*
Institute for Economic Research and Analysis

Istat - *Istituto nazionale di statistica*
National Institute of Statistics

Isvap	-	*Istituto per la vigilanza sulle assicurazioni private e di interesse collettivo* Supervisory authority for the insurance industry
MIF	-	*Mercato italiano dei* futures Italian Futures Market
MTS	-	*Mercato telematico dei titoli di Stato* Screen-based secondary market in government securities
SACE	-	*Sezione per l'assicurazione dei crediti all'esportazione* Foreign Trade Insurance Services Agency
SIM	-	*Società di intermediazione mobiliare* Securities investment firm
TARGET	-	Trans-European Real-time Gross Express Transfer
UIC	-	*Ufficio italiano dei cambi* Italian Foreign Exchange Office

ADMINISTRATION OF THE BANK OF ITALY

AT 31 DECEMBER 1998

DIRECTORATE

Antonio FAZIO	- Governor and chairman of the board of directors
Vincenzo DESARIO	- Director general
Pierluigi CIOCCA	- Deputy director general
Antonio FINOCCHIARO	- Deputy director general and Secretary to the Board

BOARD OF DIRECTORS

Angelo BAROVIER
Francesco CONTI
Giampaolo de FERRA
Gaetano DI MARZO*
Paolo Emilio FERRERI*
Paolo LATERZA
Rinaldo MARSANO
Gavino PIRRI
Giulio PONZELLINI*
Mario SARDELLA
Nicolò SCAVONE
Alberto ZAPPONINI
Giordano ZUCCHI*

* Member of the Executive Committee

BOARD OF AUDITORS

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Mario CATTANEO
Enrico NUZZO
Massimo STIPO
Gianfranco ZANDA

ALTERNATE AUDITORS

Cesare BISONI
Angelo PROVASOLI

CENTRAL MANAGERS

Carlo SANTINI	- Central manager for economic research
Vincenzo PONTOLILLO	- Accountant general
Bruno BIANCHI	- Central manager for banking supervision
Stefano LO FASO	- Central manager for central bank operations
Cesare Augusto GIUSSANI	- Secretary general
Franco COTULA	- Central manager for historical research
Fabrizio SACCOMANNI	- Central manager for international affairs
Claudio CASAVOLA	- Central manager for property and purchasing