BANCA D'ITALIA

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31 MAY 2003

ABRIDGED REPORT FOR THE YEAR 2002

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THE INTERNATIONAL ECONOMY

In the first half of 2002 world economic activity accelerated, sustained in the leading industrial countries by the expansive stance of monetary and budgetary policy. The US economic recovery, already under way at the end of 2001 thanks to the prompt action of the Federal Reserve and the stimulus provided by public demand and tax reductions, helped the recovery in world trade, which mainly benefited the economies of Asia. From spring onwards renewed fears of terrorist attacks and worries over several cases of serious accounting irregularities at major US corporations gave rise to uncertainties over the prospects for growth in the United States, triggering massive portfolio adjustments by international investors. Share prices, which had more than recouped the losses suffered after 11 September, turned downwards again in March, as did long-term rates on government bonds. The rise in house prices continued and in some countries accelerated. The dollar depreciated significantly against the main currencies. From late 2002 to the beginning of March 2003 the prospect of a war with Iraq caused a slackening of world economic activity and a steep rise in oil prices. The markets' preference for low-risk assets was accentuated.

World output grew at an average rate of 3 per cent in 2002, up from 2.3 per cent in 2001 but below potential, which the IMF estimated at around 4 per cent. World trade, after stagnating in 2001, expanded by 2.9 per cent. The pick-up in trade was uneven. In Asia, including Japan and China, exports rose by nearly 10 per cent. In the euro area and Latin America they slowed to virtual stagnation. World trade expanded strongly in the middle two quarters but the growth slowed down significantly in the fourth, reflecting the slackening of productive activity.

In the course of 2002 oil prices were affected above all by the uncertainties of the evolving Iraqi crisis. In the last few months of the year, supply was also affected by the political crisis in Venezuela, which drastically reduced that country's output of crude oil for many weeks. From January to December the price of oil rose, albeit with large fluctuations, by about 50 per cent, reaching $30 a barrel. Further rises, which proved transitory, were registered early in 2003, as the outbreak of war with Iraq grew imminent.

In the emerging economies growth accelerated from 3.8 per cent to 4.5 per cent last year, the rate differing from area to area. Growth was fast in China, India and the newly industrialized economies of Asia. Output in Latin America stagnated, chiefly as a result of the severe recession in Argentina, which was struck by a violent currency and financial crisis at the start of the year. In Brazil, growth remained positive and picked up in the course of the year, thanks in part to a depreciation of the currency. In the ten Central and Eastern European and Mediterranean countries that will join the European Union in May 2004, economic activity, sustained mainly by domestic demand components, expanded by 2.4 per cent, slightly less than the year before. In Russia growth remained vigorous (4.3 per cent), though less so than in 2001.

The US growth rate accelerated from 0.3 to 2.4 per cent. The recovery, which began late in 2001, was favoured by powerful support from economic policy, made possible by the flexibility of America's allocation mechanisms and the soundness of its public finances. During 2002 monetary conditions remained very easy. In November the worse-than-expected weakening of the economy and the heightened uncertainty in connection with the aggravation of international political tensions led the Federal Reserve to lower its reference rate by half a point to 1.25 per cent. Real short-term interest rates were near zero until autumn and then turned negative. Fiscal policy was also definitely expansive. The ten-year tax reduction bill of May 2001 and the measures of stimulus adopted after 11 September and in March 2002, combined with GDP growth that fell short of potential, resulted in a significant deterioration of the federal budget, which registered a deficit of 1.5 per cent of GDP in the fiscal year ending in September 2002, compared with surpluses of 2.4 per cent in fiscal 2000 and 1.3 per cent in fiscal 2001. The long-term outlook for the public finances has also worsened perceptibly. At the start of March 2003 the Congressional Budget Office estimated that under current legislation the federal government would run deficits every year through 2007 and create a total shortfall of nearly $400 billion in the ten years from 2002 to 2011. In February the Administration presented a new long-term plan (2003-2013) centred on tax cuts for a total of $750 billion. The plan called for the exclusion of dividends from personal income tax returns to end the double taxation of this form of income. The present rules induce firms to raise funds by borrowing rather than increasing their share capital, which heightens their financial vulnerability during cyclical slowdowns. They also encourage opaque and inefficient corporate governance. After a delicate legislative passage, Congress approved a plan for tax cuts and spending increases totaling about $350 billion over the next ten years, significantly less than the Administration's original proposal. There is growing concern over the future of the public finances, which will also be burdened in the next few years by the costs, which are hard to quantify, of the reconstruction of Iraq.

US labour productivity, despite a significant slowdown in the second half, improved by 4.8 per cent in 2002, the best performance in forty years. This resulted in a reduction in unit labour costs and permitted satisfactory wage growth, which had the effect of bolstering earnings against the repercussions of the contraction in employment. Consumption increased by 3.1 per cent on average for the year, thanks in part to the increase in purchasing power deriving from consumers renegotiating home mortgages on better terms as long-term interest rates declined sharply and taking larger mortgages as the value of homes soared. Mortgage renegotiations, which were very substantial in 2001, expanded to exceptionally high levels last year. This resulted in an increase in the total debt of households but also allowed its restructuring, with a shift towards mortgage debt, which is less expensive and not subject to the risk of interest rate increases. The hoped-for recovery in investment did not materialize. Investment was curbed above all by the performance of corporate profits, which was not as good as had been expected, and by the climate of growing uncertainty.

The return to faster domestic demand growth than in the other main industrial regions and some emerging economies with close trade relations with the United States produced a further deterioration in the external accounts. The deficit on current account widened to 4.8 per cent of GDP, considerably larger than it had been in the mid-1980s at the culmination of the dollar’s appreciation. The worsening of the external imbalance began in earnest in the mid-1990s, reflecting the pick-up in domestic demand due to the exceptional expansion of investment in connection with the introduction of information and communications technology. From 1995 to 2000 the value of US imports of high-technology products rose by 12 per cent per year. The improvement in the medium-term growth outlook has fueled consumption as well, as the result of more rapidly rising expectations for future disposable income. Despite the substantial build-up of net external liabilities, the balance on investment income did not turn negative until 2002, and even then only slightly, because yields on US assets abroad, consisting mainly in direct investment, have historically been higher than those on foreign assets in the United States. This situation, together with the good performance of the economy, has limited the rise in the ratio of the net foreign debtor position to GDP. The weakness of the dollar, in the view of the markets, appears to be due in part to the unresolved uncertainty over the timing and strength of the economic upturn and the magnitude of the current account deficit.

The Japanese economy recovered significantly after the decline in activity in the second half of 2001, sustained by the rise in foreign demand. Domestic demand remained slack. Because of the negative momentum from

2001, GDP increased in 2002 by just 0.2 per cent, year-on-year. The decline in prices continued, although it did moderate in the course of the year. Major restructuring undertaken by many firms to restore satisfactory profitability resulted in a significant contraction in employment and a fall in nominal wages that was greater than the decline in prices. The share of long-term unemployed increased, as did that of older unemployed workers, who will have greater difficulty in finding new jobs.

Given the persistent weakness of domestic demand, policy makers struggled to implement the plans for economic reform, in particular reform of the financial system, while seeking at the same time to sustain economic activity. The Bank of Japan continued to provide abundant liquidity to the banking system at practically zero cost. The quantity target adopted in March 2001, based on the balance on financial institutions' current accounts with the central bank, was raised repeatedly. The amount of monthly outright purchases of government securities was also increased, and the range of instruments eligible for repos with the central bank was broadened. Fiscal policy also remained expansive. According to the OECD, the cyclically adjusted budget deficit increased by nearly a full percentage point in 2002 to 6.7 per cent of GDP. At the end of October a new recovery plan for the financial sector was initiated, designed to halve the major banks' very high bad debt ratio by March 2005. To increase the efficiency of the allocation of credit, stricter standards for evaluating the quality of loan portfolios were introduced. As part of the plan, a public agency was instituted to acquire the banks' bad loans to firms in difficulty but considered potentially salvageable and to assist their financial restructuring.

The slow growth in the industrial countries and international investors' diminished willingness to take risks, owing in part to the losses occasioned by the financial crises of recent years, slowed financing to the emerging economies. Those of Latin America in particular suffered a worrying drop in foreign direct investment. By contrast, the build-up of reserves by the Asian economies continued and indeed accelerated. Against a backdrop of renewed inflows of private capital, this countered the appreciation of the area's currencies and contributed to an increase in current payments surpluses.

As in 2001, investors differentiated the terms for international credit according to the borrower country's economic fundamentals. The risk premium for dollar-denominated bonds remained relatively modest for the emerging economies of Asia and for the countries of Central and Eastern Europe and fell very low for Russia; it increased during the summer, however, for Turkey and Brazil, owing to the uncertainty over the outcome of the autumn elections. Afterwards, the financial conditions of these two countries improved. Argentina was excluded from the international capital market.

At the Washington meetings in April 2003 the finance ministers and central bank governors of the leading industrial countries reaffirmed their commitment to strengthen measures for financial crisis prevention and management. They recommended the use of market mechanisms in crisis management. The G-7 countries were called on to set an example by including clauses in their debt securities specifying the procedures for any restructuring. The Mexican government's issue of securities carrying such clauses and subject to the legal jurisdiction of the state of New York was endorsed.

The risks weighing down the world economic outlook this year have not been entirely dissipated by the conclusion of the war with Iraq. There remain uncertainties over the chances for a rapid political stabilization in the Middle East. The price of oil has come down to a level that will not hinder economic recovery in the industrial countries. Its decline could also induce a reduction in inflation, which is very low in the main industrial countries and actually negative in Japan. The monetary authorities of the leading countries recently expressed their concern that declining prices might put the recovery in economic activity at risk and pledged to counteract excessive reductions in the rate of inflation.

The latest IMF estimates, released in April and assuming a short war, put world economic and trade growth in 2003 at 3.2 and 4.3 per cent respectively. The smallness of the improvement with respect to 2002 is ascribed mainly to the relatively poor results expected in the first half of the year. Only in the second half will economic activity pick up appreciably. The United States should continue to lead the world economy. Growth in the major industrial countries should be about the same as in 2002 at 1.7 per cent; in the United States it should be 2.2 per cent, slightly less than in 2002, owing to this year's unfavourable growth profile. In Japan activity should expand by 0.8 per cent, a modest result reflecting structural weaknesses. Growth in the euro area should be 1.1 per cent, only slightly more than 2002. The performance of the emerging economies will be uneven. Those of Asia, which account for 26 per cent of world output, should register growth of 6 per cent, led by an expansion of 7.5 per cent in China. However, a recent assessment by the World Bank warns that the direct and indirect effects of the SARS epidemic that broke out in March could diminish the area's growth by about half a percentage point. In the EU accession countries of Central and Eastern Europe and the Mediterranean, growth should accelerate from 2.4 to 3.1 per cent and in Russia it should continue at 4 per cent. Latin America should return to positive growth (1.5 per cent), thanks chiefly to the recovery of economic activity in Argentina and Brazil.

Developments in the first few months of 2003 have been basically in line with the foregoing scenario. In the first quarter GDP rose at an annual pace of 1.9 per cent in the United States. Slightly below economists' forecasts, this result was due in part to the fall in purchases of consumer durables and the stagnation of investment, which were the expenditure components most strongly affected by the situation of great uncertainty. Nevertheless, the quarter saw a substantial rise in investment in information and communications technology, driven by continuing technical progress. The latest data on the performance of the economy in the second quarter are mixed. Household confidence improved in April and May, but the situation in manufacturing industry remains weak. The hoped-for recovery in employment, too, has hardly materialized. Nevertheless, the fall in the price of oil should bolster households' disposable income and spending. Continuing low interest rates, the good state of the banking system and the improved liquidity of firms should encourage a recovery in investment and thus employment, enabling the US economy to return to faster growth in the latter part of the year.

THE INTERNATIONAL FINANCIAL MARKETS

The equity, bond and foreign exchange markets

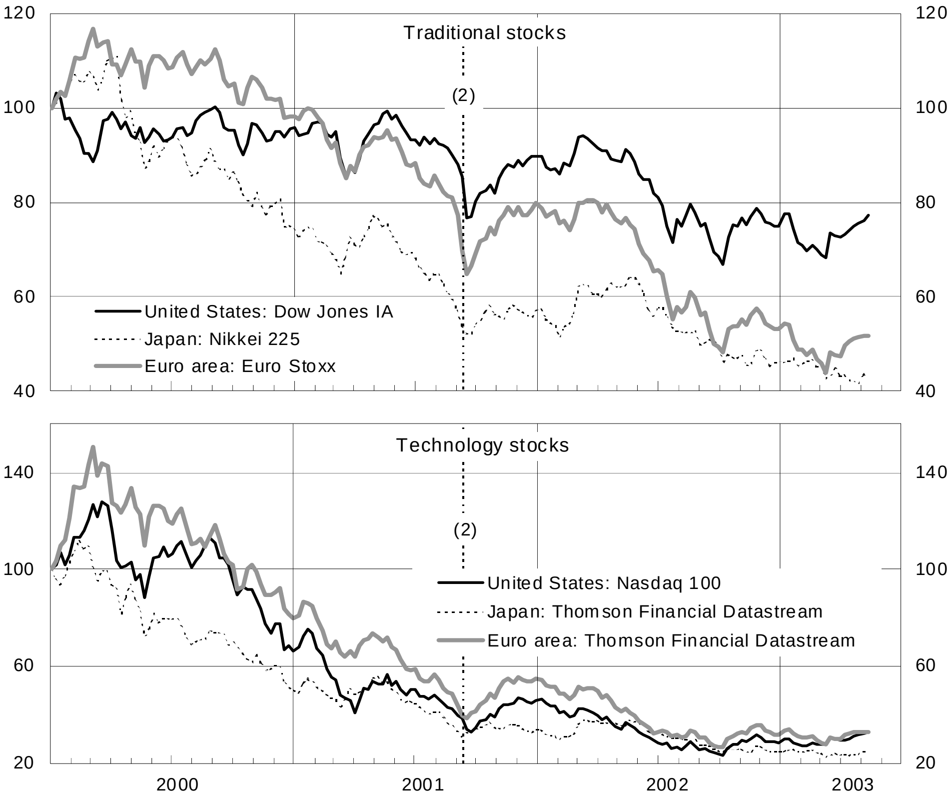
The long stock market correction that had begun in March 2000 in the technology sector intensified in 2002, spreading to the shares of companies in traditional sectors. From March 2000 to mid-May 2003, the world's stock markets lost around one third of their capitalization; equity prices fell by between 40 and 50 per cent in all the main industrial and emerging countries.

After collapsing in the wake of the terrorist attacks of 11 September 2001, the international financial markets recovered rapidly, thanks to the prompt action of monetary and fiscal policies that restored investor confidence. From the spring of 2002 onwards the serious accounting irregularities with which some important US companies were charged and the heightening of international political tensions created uncertainty about the growth prospects of the United States. A phase of massive portfolio reallocation ensued as investors shifted into what were considered safer assets. This caused share prices and the yields on the government bonds of the leading industrial countries to decline rapidly until October, the rate of increase in housing prices to accelerate in some countries, and the dollar to depreciate sharply. From mid-October, share prices and government bond yields fluctuated widely. Initially, the further easing of monetary conditions by the Federal Reserve and the Eurosystem helped to sustain investor confidence. Later, growing uncertainty about the evolution of the Iraqi crisis caused equity prices and government bond yields to move lower again until the beginning of March 2003, on the eve of military operations in Iraq. The subsequent upturn has brought share prices back to their levels of last December.

In the United States share prices rebounded strongly after the events of 11 September 2001; by mid-March 2002 the Dow Jones Industrial Average, composed mainly of the shares of companies in the traditional sectors, had risen by around 30 per cent. From mid-March onwards the problems of accounting irregularities, which had first come to light in December 2001 in the Enron case, involved other large companies, denting confidence in American corporate governance and sending share prices sharply lower. There was a pause in the decline in equities in August, following the decision of the US Congress to tighten some of the provisions of company law regarding accounting practices. In September, the intensification of international political tensions led to a fresh fall in equities across the board. Between the middle of March and 9 October 2002, the Dow Jones Industrial Average lost more than 30 per cent; the technology-oriented Nasdaq 100 index lost nearly 50 per cent, and was down by more than 80 per cent from March 2000 (Figure 1).

Figure 1

SHARE PRICES IN THE UNITED STATES, JAPAN AND THE EURO AREA
(*weekly averages; indices, first week of January 2000 = 100*) (1)



Source: Thomson Financial Datastream.
(1) The latest available data are for the week ending on 16 May 2003. – (2) Attacks in the United States (11 September 2001).

From the end of March 2002 onwards the adjustment of investors' portfolios favoured US Treasury securities. Despite the increase in supply due to the worsening of America's public finances, the yield on ten-year Treasury notes came down from around 5.5 per cent to 3.6 per cent in early October, the lowest level in more than forty years. Long-term yields also fell in real terms: deflating nominal long-term yields with long-term inflation expectations derived from *Consensus Forecasts*, between April and October 2002 real rates fell in the United States by more than one percentage point, to 1.4 per cent; yields on securities indexed to inflation came down by the same measure, to 2 per cent.

US share prices and government bond yields began to display marked fluctuations in mid-October. An initial upturn, which is thought to have been assisted by signs of economic recovery and the further monetary easing by the Federal Reserve in November, was followed by a new downturn due to the fears kindled by the possibility of a conflict with Iraq. Between December 2002 and the beginning of March 2003 the Dow Jones Industrial Average lost 15 per cent, while yields on ten-year Treasury notes came down by 0.4 percentage points to 3.6 per cent. Subsequently, share prices and government bond yields turned upwards and at the beginning of May both had regained their December levels. On 6 May the Federal Reserve expressed concern about a further reduction in inflation and altered its assessment of the risks, assigning greater weight to those of a weakening of the economy. This drove down the yield on ten-year government paper, which in mid-May had fallen to 3.4 per cent; share prices continued to rise in the middle part of the month.

In Japan share prices rallied temporarily between February and May 2002, but over the rest of the year and in the first four months of 2003 they returned to the downward trend that had emerged at the turn of 2000. Between January 2002 and April 2003 the Nikkei 225 index lost 28 per cent, returning to the levels of 1983. The decline in bank shares was larger (39 per cent). Share prices have recovered slightly since the beginning of May, with the Nikkei up by 6 per cent and bank shares by 7 per cent.

From the start of 2002 yields on ten-year Japanese government bonds have come down by 0.9 percentage points, to 0.6 per cent. Neither the large increase in Japan's public debt nor the debt downgrade announced in the spring of 2002 by the major rating agencies (Moody's and Standard and Poor's) have affected bond prices.

In the foreign exchange markets a period of dollar depreciation began in March 2002, ending a rise that had changed the US currency's external value significantly; according to the indicator calculated by the Federal Reserve, in February 2002 the dollar was around 25 per cent stronger in real effective terms than at the beginning of 1997. Concern over the large expansion in the US current account deficit, which exceeded $500 billion in 2002, has recently contributed to the weakness of the dollar. Between February of 2002 and mid-May of this year the dollar depreciated by 25 per cent against the euro, to a value of $1.16 per euro; over the same period its depreciation against the Japanese yen and the Canadian dollar was equal to 12 and 15 per cent, respectively. In nominal effective terms the US currency's depreciation between February 2002 and April 2003 came to only 5 per cent; the real effective exchange rate also weakened by the same measure. The dollar's broad stability against the Asian currencies helped to curb the changes in the effective exchange rate: China, Hong Kong and Malaysia maintained their respective pegs with the dollar, while the currencies of Taiwan, South Korea, Singapore and Thailand registered modest gains, ranging between 1 and 7 per cent. To curb the appreciation of their currencies, the authorities of the Asian countries augmented their official reserves substantially. In addition, the currencies of the main Latin American countries weakened against the dollar: the Mexican peso by 14 per cent, the Brazilian real by 22 per cent, the Argentine peso by 32 per cent and the Venezuelan bolivar by 44 per cent.

International banking and the derivatives markets

There was a slowdown in international banking activity in 2002, above all for banks operating in the euro area and Japan. The decline in euro-area banks' lending abroad reflected a fall in demand and, in the case of German banks, the more prudent lending policies adopted in response to earnings and balance-sheet weaknesses. The latter also explain the retrenchment of Japanese banks' international operations, extending a trend that has now been under way for several years.

Investors' stronger preference for less risky instruments penalized international issues of private-sector bonds. The acute uncertainty caused by the accounting irregularities that emerged at the start of the year and, subsequently, by mounting international political tensions increased the variability of the prices of financial assets and, with it, the demand for hedging with derivative instruments, which expanded strongly again last year.

Net of exchange rate variations, the stock of cross-border credit (loans, equities, public and private-sector bonds) granted by banks resident in BIS reporting countries – that is, the industrial countries and the major offshore centres – grew by around $430 billion in the first three quarters of 2002, compared with $630 billion in the same period of 2001. The substantial decline in new lending from ($450 billion to $130 billion), particularly on the part of Japanese and German banks and involving both bank and non-bank counterparties, was accompanied by an appreciable increase in net purchases of securities (from $170 billion to $300 billion). Banks' exposure to the emerging economies continued to fall, albeit more slowly.

Turning to the derivatives markets, turnover and the year-end stock of contracts outstanding remained at the high levels they had reached in 2001, a year of exceptional expansion. The notional value of exchange-traded futures, nearly all of them involving interest rates, rose by 7 per cent to $10.34 trillion. That of options, more than four fifths of which are based on interest rates, fell by 4 per cent to $13.54 trillion, after increasing by 240 per cent in 2001.

An important development in the derivatives markets in recent years has been the very substantial growth in recourse to techniques for transferring credit risk. Among the instruments used, credit derivatives, consisting almost entirely of credit default swaps, are those spreading most rapidly in over-the-counter markets; unlike traditional derivatives, which allow banks to transfer market risks, such as exchange rate and interest rate risk, credit default swaps make it possible to transfer the credit risk associated with the core activity of lending, which banks had previously found difficult to dispose of in the market.

A qualitative survey conducted by the central banks of the G-10 countries and published in January 2003 evaluated the scale of the phenomenon and its implications for the functioning and stability of the financial system. The survey suggests that while some banks give up credit risk and others take it on, the banking system as a whole is a net buyer of “protection”; the latter is typically sold by the insurance industry. The survey interviews do not provide evidence of an excessive concentration of the risk among investors, a view apparently borne out by the absence of severe instability on the occasion of traumatic events such as the crisis in Argentina and the Enron affair at the start of 2002. On the other hand, there appears to be a high degree of concentration in the intermediation of credit derivatives, with a consequent increase in counterparty risk.

Financial markets in the emerging countries

The performance of the financial markets in the emerging countries last year varied markedly from region to region. The main countries of Asia benefited from the relative stability of their currencies and very favourable terms of access to the international markets, partly as a consequence of the positive performance of their respective economies, the absence of pronounced macroeconomic disequilibria and the progress made in implementing structural reforms. The variations in the exchange rates of their currencies against the dollar were limited and yield differentials between their dollar-denominated bonds and the corresponding US securities remained at historically low levels, averaging four percentage points. The Asian stock markets moved virtually in parallel with the US market; between the start of 2002 and mid-May of this year they lost 11 per cent, a figure similar to that registered in the United States. The SARS epidemic, which struck some countries of East Asia this spring, has not yet had major repercussions on the financial markets. In Russia the continuation of rapid economic growth and the large budget surplus led to a further improvement in financial conditions. Since the beginning of 2002 the yield differential between Russian bonds denominated in dollars and the corresponding US securities has narrowed by 3.5 percentage points to 3.2 points, while the stock market index has risen by more than 70 per cent. The cost of borrowing abroad also remained low for the countries of Central and Eastern Europe and the Mediterranean that will join the European Union on 1 May 2004. By contrast, financial conditions deteriorated in some countries of Latin America and in Turkey, although they have improved significantly since the turn of the year.

Argentina has yet to reach an agreement with creditors on the restructuring of its massive foreign debt, following the crisis that exploded in December 2001 with the moratorium on foreign debt and culminated in January 2002 with the abandonment of the currency board regime. Consequently, the country has been unable to tap the international capital markets.

In the first half of 2002 Argentina's currency depreciated by nearly 75 per cent against the dollar, falling to 3.9 pesos per dollar; in the second half the exchange rate stabilized at around 3.6 pesos to the dollar and since the start of this year it has strengthened by 13 per cent, to 3. The improvement in the trade balance, the upturn in production and the restrictive stance of monetary and budgetary policy have contributed to this recovery. In addition, in January 2003 Argentina benefited from the grant of $6.8 billion of IMF financing, consisting of a standby loan and a twelve-month extension of the payments due in respect of loans disbursed in earlier years.

In Brazil, the financial markets came under heavy speculative pressure from the spring of 2002 onwards. From the middle of March to the end of September, the yield differential between long-term dollar-denominated bonds issued by the Brazilian Treasury and the corresponding US bonds widened by more than 17 percentage points to exceed 24 points; over the same period the exchange rate against the dollar weakened by around 40 per cent. The uncertainty surrounding the outcome of the presidential election of October and continuance with stringent economic policies fueled concerns about the sustainability of the public debt, partly owing to the large proportion that was indexed to financial and foreign-currency parameters. With a view to restoring the confidence of the markets, in September the IMF granted Brazil a financial assistance programme of more than $30 billion, the largest in the history of the Fund. This support and the subsequent dissipation of political uncertainty helped to ease the tensions. By mid-May 2003 the exchange rate of the real had strengthened by 26 per cent compared with the end of September and the interest rate differential had narrowed to a still onerous 8.3 percentage points.

In Turkey, the intensification of political uncertainty during the run-up to the November elections caused the yield differential between Turkish government bonds denominated in dollars and the corresponding US securities to widen to more than 10 percentage points in the summer and led to a sharp slide of the Turkish lira against the dollar (15 per cent between the end of May and the end of July). The outcome of the elections and the resulting prospects of economic stability helped to narrow the yield differential to 5.7 points at the beginning of December. In the final months of 2002 the rapid deterioration of the international political situation led to a new worsening; in mid-May 2003 the yield differential stood at 7.6 points, having touched 11.5 points in March.

In the last two years the international community has been engaged in major efforts to prepare mechanisms guaranteeing the timely and orderly restructuring of sovereign debt. In November 2001 the IMF proposed amending the Fund’s Articles by introducing a Sovereign Debt Restructuring Mechanism, to be activated when a country’s financial situation was demonstrably “unsustainable”. The proposal did not gain the support needed for formal adoption by the Fund’s Board of Governors, however, and so in the recent Washington meetings it was decided that the Fund’s work in the coming months should focus on significant aspects of the restructuring process without regard to this specific proposal.

Meanwhile, work has gone forward on defining and promoting collective action clauses, i.e. contractual standards aimed at facilitating the aggregation and representation of private creditors and precluding the possibility for minority creditors to obstruct the debt restructuring process with legal action.

The governing bodies of the international organizations have also agreed to stimulate the diffusion of collective action clauses in the debt contracts of the emerging countries, particularly through the inclusion of these clauses in the government securities of the advanced countries. The aim of the initiative is to create a critical mass of government securities denominated in foreign currency and issued in international markets, thereby attenuating the emerging countries’ reluctance to include the clauses for fear of incurring an increase in their borrowing costs. On the occasion of the informal meeting of the Ecofin Council in Copenhagen in September 2002, the European authorities undertook to introduce collective action clauses in their respective government securities issued in foreign jurisdictions. The commitment was reaffirmed at the meetings in Washington.

Primarily at the initiative of the European countries and several private-sector organizations, a third approach has been developed in parallel with these efforts. In the absence of a more structured legal framework, it seeks to use the scope for “informal” action and for dialogue in order to formulate a “code of conduct” for creditors and debtors.

RECENT DEVELOPMENTS AND ECONOMIC POLICIES

Economic developments in the industrial countries

The world cyclical upturn that began in the fourth quarter of 2001 was led by resurgent demand in the United States, where average GDP growth increased from 0.3 per cent in 2001 to 2.4 per cent in 2002. But the recovery slackened progressively in the second half of the year, due to heightened geopolitical tensions and the negative performance of the financial markets. US growth slowed sharply in the fourth quarter and remained barely positive in the first quarter of 2003. The year-on-year expansion of economic activity in the euro area slowed from 1.4 per cent in 2001 to 0.8 per cent in 2002, and with a decelerating trend in the course of the year. In the United Kingdom, by contrast, growth remained relatively robust. In Japan the cyclical improvement, which depended exclusively on stronger foreign demand, remains fragile given the continuing weakness of domestic demand.

The United States. – After three successive quarters of contraction, the US economy began to expand once more in the fourth quarter of 2001. In 2002 growth was sustained by exceptionally expansive monetary and fiscal policy (Table 1). The increase in consumption and public investment contributed one third of total growth. However, the performance of the economy was discontinuous, owing in part to renewed fears of terrorist attacks and the emergence of concerns over the soundness of corporate governance. Late in the year the completion of the inventory cycle and the uncertainty associated with the worsening of the Iraqi crisis slowed GDP growth to 1.4 per cent.

Consumption, having increased by 2.5 per cent in 2001, continued to be the prime engine of aggregate demand in 2002 as well, with an increase of 3.1 per cent. Household spending benefited from rapid growth of real disposable income (4.3 per cent), sustained by tax cuts passed in 2001 and rising real wages. Some impetus was also provided by a substantial increase in mortgage renegotiations prompted chiefly by the sharp decline in interest rates, which enabled consumers to exploit the rise in real estate values in recent years in order to take out more debt. Strong housing demand, financed by new mortgages, fueled residential investment, which rose by 3.9 per cent on average for the year. The ratio of household debt to disposable income rose from 95.9 per cent at the end of 2001 to 99.8 per cent a year later. The decline in households' net wealth under way since the second half of 2000 as a result of the fall in share prices had repercussions on the growth of consumption. Net wealth fell from 586.6 per cent of disposable income in 2000 to 553.1 per cent in 2001 and 500 per cent at the end of last year.

Table 1

GROSS DOMESTIC PRODUCT AND DEMAND IN THE LEADING INDUSTRIAL COUNTRIES

(at constant prices; unless otherwise indicated, annualized percentage changes on previous period)

	2001	2002	2002				2003
			Q1	Q2	Q3	Q4	Q1
United States							
GDP	0.3	2.4	5.0	1.3	4.0	1.4	1.9
Household consumption (1)	2.5	3.1	3.1	1.8	4.2	1.7	2.0
General government expenditure (2)	3.7	4.4	5.6	1.4	2.9	4.6	0.3
Gross fixed private investment	–3.8	–3.1	–0.5	–1.0	–0.3	4.4	–0.2
Change in stocks (3)	–1.2	0.7	2.6	1.3	0.6	0.3	–0.5
Net exports (3)	–0.2	–0.7	–0.8	–1.4	. .	–1.6	0.9
Japan							
GDP	0.4	0.2	. .	5.2	3.1	1.9	. .
Household consumption (1)	1.7	1.4	1.7	1.4	2.6	. .	1.4
General government expenditure	2.6	2.3	1.3	0.5	3.4	1.2	3.4
Gross fixed investment	–0.9	–4.6	–5.0	1.7	1.3	4.5	0.9
Change in stocks (3)	. .	–0.4	–1.8	2.0	1.6	–0.9	–0.8
Net exports (3)	–0.7	0.7	1.9	1.8	–0.9	1.4	–0.7
Euro area							
GDP	1.4	0.8	1.7	1.5	1.4	0.3	. . . .
Household consumption (1)	1.8	0.6	–0.5	1.1	2.0	1.6	. . . .
General government expenditure	2.1	2.6	3.7	3.0	1.7	0.8	. . . .
Gross fixed investment	–0.6	–2.6	–2.7	–5.0	0.6	0.2	. . . .
Change in stocks (3) (4)	–0.3	–0.1	0.4	0.3	–0.6	0.5	. . . .
Net exports (3)	0.5	0.6	1.5	1.1	0.4	–1.3	. . . .
United Kingdom							
GDP	2.1	1.8	0.5	2.4	4.3	1.5	0.6
Household consumption (1)	4.1	3.8	2.5	4.5	3.1	4.3	1.6
General government expenditure	2.5	3.8	8.7	–5.3	1.5	4.2	5.8
Gross fixed investment	1.0	–3.2	–8.5	3.6	–1.0	1.8	–0.5
Change in stocks (3) (4)	–0.7	–0.1	0.4	–3.4	3.8	2.6	–0.3
Net exports (3)	–0.6	–0.9	–1.7	3.1	–1.7	–5.2	–1.1

Sources: Eurostat and national statistics.

(1) Comprises spending on consumption of resident households and that of non-profit institutions serving households. – (2) Includes public investment. – (3) Contribution to GDP growth in percentage points. – (4) Includes net acquisitions of valuables.

The labour market remained sluggish throughout 2002. Payroll employment, which had already contracted significantly in the second half of 2001, continued to decline in the first quarter of 2002, albeit more slowly, before stabilizing in the second and third. In November and December it contracted again. Between June 2001 and December 2002 total payroll employment in the non-farm private sector diminished by 1,893,000 (457,000 in 2002), the steepest fall occurring in manufacturing (1,294,000, including 608,000 in 2002). Over the same period public employment increased by 455,000 (237,000 in 2002). In 2002 the unemployment rate ranged between 5.6 and 6 per cent, its rise limited by a modest decline in labour market participation.

The expected investment recovery in 2002 did not materialize. Fixed investment other than in residential construction continued to decline in the first two quarters, steadied in the third and turned moderately upwards only in the fourth, with growth of 2.3 per cent after eight consecutive quarterly contractions. The persistent weakness of non-residential investment in 2002, despite the recovery in economic activity, is ascribable mainly to a climate of pessimism triggered by international political tensions and a loss of confidence in US corporate governance. Another contributing factor was poorer-than-expected profit performance.

A study by the Federal Reserve, however, holds that an investment recovery was not impeded by generalized excess capacity, despite the exceptional investment boom of the second half of the 1990s. Overcapacity, according to the study, is found only in construction (plants and office space). Investment in this sector, which accounts for 15 per cent of private sector fixed investment, again contracted sharply last year. Nevertheless, the proportion of vacant non-residential buildings continued to increase. Investment in machinery, by contrast, returned to growth in the second quarter, reflecting the recovery in investment in digital equipment. Investment in these goods, which had powered the protracted expansion of the 1990s before diminishing sharply in 2001, resumed growth in the first quarter of 2002, thanks to the steady fall in their relative prices. The year-on-year increase of 9.1 per cent was nevertheless decidedly lower than the annual average of 17 per cent from 1992 to 2000.

The profits of non-financial corporations as defined by the national accounts recorded a sharp upturn in the fourth quarter of 2001 and then continued to expand moderately last year, with a twelve-month increment of 5.7 per cent in the fourth quarter. The growth of profits, which benefited from lower unit labour costs as productivity outpaced wages, was curbed by the downward trend in the GDP deflator, owing to weak demand and the high degree of market competition. Even this modest increase in earnings, combined with slack investment, enabled firms to keep their financial position from worsening. The debt-to-equity ratio, after rising from 51.3 per cent in 2000 to 55.7 per cent in 2001 (at market prices) only edged up to 56.1 per cent at the end of 2002.

Consumer price inflation, very low in the first half of the year, accelerated from 1.1 per cent in June to 2.4 per cent in December. The increase was accounted for entirely by the reversal in the twelve-month trend in energy prices (from –11.1 to +10.7 per cent). Core inflation (excluding energy and food products), which is generally considered a better indicator of domestic price pressures, continued to abate from 2.6 per cent in January to 1.9 per cent in December and 1.5 per cent in April 2003. The reduction was due partly to a slowdown in service prices, whose twelve-month rise eased in those same months from 3.9 to 3.4 to 2.9 per cent.

Productivity continued to improve. In the non-farm private sector, labour productivity rose by 4.8 per cent on average for the year, after a gain of 1.1 per cent in 2001, powered in part by the cyclical upturn. From 1996 to 2002, the average annual rate of productivity growth was 2.6 per cent, about 1.2 points higher than the average for 1974-1995.

Economic activity remained sluggish in the first quarter of 2003. GDP grew at an annual rate of 1.9 per cent. Investment was curbed by uncertainty over the course and duration of the conflict with Iraq. A 4.8 per cent contraction in non-residential investment and a slackening of the build-up in stocks trimmed about one percentage point from growth. Investments in digital equipment and residential construction were not affected by the general weakening and grew by 7.4 and 11 per cent respectively. Consumption growth was slack (2 per cent), owing in part to the effect of the jump in oil prices on real disposable income, whose growth was 2.3 per cent compared with 2.4 per cent in the fourth quarter of 2002. Hourly wages in the non-farm private sector rose by 3.5 per cent in nominal terms but declined by 0.3 per cent in real terms.

Japan. – Economic activity registered a weak recovery after the recession of 2001, fueled by a sharp acceleration in exports, which increased by a yearly average of 8.2 per cent in 2002 following the previous year's steep decline of 6.1 per cent. Nevertheless, GDP growth was limited to a very modest 0.2 per cent, as more than half of the strong contribution from the external sector was offset by the weakness of domestic demand components (Table 1).

Consumption growth slowed from 1.7 to 1.4 per cent in 2002, as households' disposable income diminished for the fourth consecutive year (by 1.2 per cent), reflecting worsening labour market conditions. The contraction in employment sharpened from 0.5 to 1.3 per cent. Real wages decreased by 1.3 per cent, 1 point more than in 2001. Despite a reduction in the labour force, the average unemployment rate for the year rose from 5 to 5.4 per cent. The Tankan survey of 9,000 non-financial firms found that the job losses were accounted for chiefly by large firms (those with more than 1,000 employees), whose work force was reduced by 4 per cent in 2002, and to a lesser extent by small firms. Employment in medium-sized firms increased slightly (0.7 per cent).

A gradual recovery in corporate profits, most notably in manufacturing, ascribable largely to the containment of staff costs, prompted a resumption of investment late in 2002. Even so, private non-residential investment decreased by 4.5 per cent year-on-year, reflecting the downswing of 2001.

Prices and wages declined for the fifth year running. The consumer price index, net of the most volatile component of fresh food products, declined by 0.8 per cent on average for the year, as in 2001. The reduction in nominal wages steepened, from 1.1 to 2.4 per cent.

In the first quarter of 2003 GDP was unchanged from the fourth quarter of 2002, under the impact of a contraction of exports and the negative contribution of stock-building.

The United Kingdom. – After the relatively limited deceleration of 2001 (to growth of 2.1 per cent from 3.1 per cent in 2000), British GDP growth held at 1.8 per cent last year. As in 2001, the factors sustaining economic activity were the considerable growth of consumption (3.8 per cent) and the pick-up in public spending. Fixed corporate investment remained the principal weakness in demand, registering a contraction of 8 per cent. Household spending continued to benefit from the rise in real-estate prices. The Halifax House Price Index rose by an average of 21 per cent in 2002, compared with an average of 8.5 per cent over the previous three years. As a result households had greater capacity to borrow, and mortgage debt increased by 11.2 per cent, following the 7.5 per cent rise of 2001; the ratio of total household debt to disposable income is estimated to have risen from 87.9 to 96.5 per cent. Despite the slowdown in economic growth, the unemployment rate remained virtually unchanged at just over 5 per cent according to the harmonized international definition. However, the number of hours worked per capita decreased. The consumer price index, excluding mortgage interest, accelerated significantly starting in mid-year, from a twelve-month rate of 1.5 per cent in June to 3 per cent in March 2003. The acceleration reflected rises in energy prices and in the imputed maintenance cost of owner-occupied dwellings.

Economic policies in the leading industrial countries

Fiscal policies. – Last year the United States intensified the expansive fiscal stance it had adopted in mid-2001. The federal budget swung from overall surpluses of $236.4 billion in the fiscal year ending in September 2000 and $127.3 billion in fiscal 2001 to a deficit of $157.8 billion or 1.5 per cent of GDP in 2002. The deterioration of nearly 4 per cent of GDP in two years was comparable to that of the early 1980s and, earlier still, of the two years following the first oil shock. In international terms, the worsening was comparable, in proportion to GDP, to that experienced by Germany with reunification or by Japan in 1992-93. Net of the social security surplus, the budget deficit amounted to $317.5 billion in 2002, compared with $33.4 billion in 2001. Private-sector holdings of federal debt increased for the first time since 1993, from 33.1 to 34.3 per cent of GDP.

The rapid widening of the deficit in 2002 stemmed in equal measure from revenue reductions ($146 billion) due to tax cuts and slow growth and from spending increases ($138 billion), about a third of which went to defence.

In May 2003 the Congressional Budget Office estimated that owing in part to the allocations for the war with Iraq passed by Congress in April (a total of $79 billion, $40 billion of it in the current fiscal year), the federal deficit in fiscal 2003 would exceed $300 billion or about 3 per cent of GDP.

On 23 May Congress passed a set of tax cuts totaling $320 billion in the ten years from 2003 to 2013. The programme presented by the Administration in February had called for even larger cuts totaling $750 billion (not counting the effects of the extension beyond 2010 of the measures included in the Employment Growth and Tax Relief Reconciliation Act of 2001). The most important measure in the original package was the tax exemption for dividend income. As passed, however, the measure subjects dividends, only until 2008, to withholding tax at the same rate as the capital gains tax. Expenditures of about $30 billion were also enacted, consisting in transfers to state and local governments and to low-paid workers. The deficits of the next few years will also reflect the cost of peacekeeping and reconstruction in Iraq. The amount of these costs is quite uncertain, current estimates ranging anywhere between $100 billion and $600 billion over ten years.

In Japan, after the budget cut of 2001, fiscal policy adopted a more expansive stance. According to the OECD, the public deficit, including the social security balance, rose from 6.1 to 7.1 per cent of GDP in 2002. On a cyclically adjusted basis it increased by 0.8 percentage points. At the end of 2002 gross public debt amounted to 140.6 per cent of GDP, compared with 131.4 per cent a year earlier.

The budget for the current fiscal year beginning in April was passed in March 2003. It limits real total expenditure to the previous year's amount, makes only slight reductions in investment and public works and provides for employment measures. On the revenue side, there are tax cuts worth ¥1.8

trillion or 0.4 per cent of GDP in the form of temporary investment subsidies, lower taxes on financial transactions and tax reductions for small and medium-sized enterprises.

The United Kingdom also adopted an expansive fiscal stance in 2002. In April the Treasury estimated the overall public sector deficit, including capital expenditure, at 2.3 per cent of GDP in the 2002-03 fiscal year (ending in March), compared with balance the previous year and a surplus of 1.7 per cent in 2000-01. The deterioration in the last year was due chiefly to a revenue decline of 1.2 percentage points of GDP caused by the poor performance of the financial market, and a 0.9-point rise in current expenditure, mostly on social security, health and education.

Despite the recent worsening, the UK public finances remain sound, especially by comparison with the other EU countries. The gross debt of the public sector came to 38 per cent of GDP in March 2003, far below the EU average of 62.7 per cent at the end of 2002. The Treasury calculates that the worsening in the last two years should not jeopardize the fiscal policy constraint set in 1998, namely medium-term budget balance on current account.

Monetary policies. – In the United States, after repeated reductions in the official interest rates totaling 4.75 percentage points in 2001, monetary conditions remained strongly expansive last year. Over the first ten months the Federal Reserve kept the target federal funds rate and the discount rate at their December 2001 levels of 1.75 and 1.25 per cent. On 6 November, against a background of slackening economic activity, low inflation and deepening uncertainty, the Federal Open Market Committee again lowered the rates by 0.5 percentage points. At the same time the Fed announced a shift in its assessment of risks, assigning the same importance to inflation as to the weakening of the economy, which until then had been considered prevalent.

In the first half of 2002 the real short-term interest rate, deflated by the rise in the consumer price index over the previous 12 months, was 0.5 per cent. From mid-year it began to decline again, owing partly to the increase in inflation. It turned negative in October, and by April 2003 was around –1 per cent. In the light of partly inconsistent recent trends in the economic indicators, on 6 May the Open Market Committee decided to keep interest rates unchanged. Fears of a decline in the core inflation rate from its low current level nevertheless prompted the Fed to revise its previous risk assessment, assigning greater weight to the possible further weakening of the economy.

In Japan, despite the slight pick-up in economic activity, persistent deflationary pressure led the authorities to continue to sustain the economy and step up measures for the direct expansion of liquidity. The target for financial institutions' current account balances with the central bank was raised repeatedly, from ¥10-15 trillion in December 2001 to ¥27-30 trillion at the end of May 2003. This kept very-short-term interest rates close to zero.

The monthly ceiling on the Bank of Japan's outright purchases of government securities was raised from ¥800 billion in December 2001 to ¥1.2 trillion at the end of October 2002. In December, in order to provide indirect support for bank lending to firms, the range of instruments banks may use as collateral or contra-items for refinancing with the central bank was extended. As announced on 18 September, the central bank began a programme of purchases of shares held by commercial banks. In April 2003, the Bank of Japan said it was considering, as an extraordinary measure, the purchase of asset-backed securities based on banks' loans to small and medium-sized enterprises and the latter's receivables from other firms.

Despite the strong expansive impulse from the central bank, the growth of the broad monetary aggregate (M2 + CDs) continued to be slow. The twelve-month rate of increase held at around 3.7 per cent in the course of 2002 but then declined to 1.4 per cent by April 2003, reflecting persistent serious problems for the banking system. Credit to the private sector, even including written-off uncollectable claims, continued to contract. In December 2002 it was 2.5 per cent lower than a year earlier.

At the end of October the Government presented a financial recovery programme with a more systematic and effective approach than in the past to banks' bad loans. The aim is to halve the ratio of the major banks' bad loans to assets by the end of the 2004 fiscal year. At the end of September, according to official estimates, the banking system's bad loans, gross of provisions, amounted to ¥40 trillion or 8.3 per cent of loan assets, compared with ¥36.8 trillion and 7.6 per cent a year earlier. As part of the plan the Financial Supervisory Authority required the major banks to institute, immediately, stricter standards in rating loan quality and also ordered special inspections as the closure of the annual accounts drew near.

On 17 May 2003 Resona Bank, Japan's fifth largest, informed the supervisory authorities that it had failed to meet the capital adequacy requirements at the end of the financial year on 31 March. The Government and the supervisory authorities accordingly decided to recapitalize the bank, under a legal provision that allows the commitment of public funds to intermediaries whose troubles threaten to cause systemic instability.

The action to restore soundness to bank balance sheets was complemented by action to deal with corporate financial difficulties. In April 2003 the Industrial Revitalization Corporation, a government agency with a mandate to work for the restructuring of corporations that are in financial trouble but are still considered viable, was instituted.

In December 2002 the decision, announced in the autumn, to postpone to April 2005 the revocation of the unlimited public guarantee of current account deposits was converted into law.

In the United Kingdom, after the two-point reduction in the reference rate in 2001 to 4 per cent, the Bank of England kept monetary conditions unchanged in 2002. The real short-term interest rate, which averaged 1.75 per cent for the year, was 53 basis points higher than in the euro area. This less accommodating British stance is explained by the rapid growth in household consumption and debt, fueled by the continuing rise in house prices. In November, moreover, the rate of consumer price increase net of mortgage interest went above the central bank's 2.5 per cent target.

On 6 February, against the backdrop of sharpening international political tensions and the weakening of domestic demand and the international business cycle, the Bank of England lowered its reference rate by 0.25 points to 3.75 per cent.

The emerging countries

In the first half of 2002 the recovery in world trade mainly benefited the Asian economies, both the newly industrialized ones (South Korea, Hong Kong, Singapore and Taiwan) and the developing economies most heavily dependent on exports of IT products (Malaysia, the Philippines and Thailand). In these countries as a group, GDP growth increased from 1.7 per cent in 2001 to 4.4 per cent in 2002.

In China, whose share of world output on a PPP basis was 12.7 per cent, growth picked up from 7.3 to 8 per cent. Domestic demand was fueled mainly by public expenditure and private spending on consumer durables. A sharp upturn in exports, whose dollar value rose by 22 per cent, was accompanied by a comparable speed-up in imports. The inflow of foreign direct investment expanded to $53 billion, $10 billion more than the average over the six previous years.

In Latin America, as a consequence of the foreign exchange and financial crisis in Argentina and the emergence of unfavourable financial conditions during the year, output stagnated overall in 2002, after expanding by barely 0.6 per cent in 2001. An export recovery in several countries fostered by currency depreciations in the first half of the year was accompanied by generally slack domestic demand. Despite the difficult economic situation, most countries maintained or adopted rigorous economic policy stances, which helped to keep Argentina's abandonment of the currency board regime early in the year from resulting in hyperinflation.

In Turkey economic activity expanded by 7.8 per cent, practically recouping the 7.5 per cent decline registered in 2001 following the February financial and foreign exchange crisis. In the year to February 2003 the twelve-month inflation rate was reduced from 73.1 to 27.1 per cent, below the limit set in the financial assistance agreement with the IMF signed in February 2002.

Under the decision of the Copenhagen summit in December 2002, ten countries of Central and Eastern Europe and the Mediterranean will become members of the European Union on 1 May 2004. Two more, Bulgaria and Romania, should complete the negotiations envisaged in order to join in 2007.

INTERNATIONAL TRADE AND THE BALANCE OF PAYMENTS

Trade and the prices of raw materials

The growth in world trade, which had come to an abrupt halt in 2001 as a result of the worst performance since 1982, turned positive again in the first half of last year. Trade in goods and services at constant prices increased by 2.9 per cent in 2002 as a whole, compared with 0.1 per cent in 2001.

The recovery in demand in the United States and the quickening of that in the emerging Asian countries were the spur to the growth in trade. However, the weakness of domestic demand in Europe and Japan throughout the year and the fall in domestic demand in much of Latin America curbed the recovery in global trade flows. The situation was exacerbated in the second half of the year by a general weakening of international economic activity.

Merchandise trade alone grew by 3.1 per cent, whereas it had contracted by 0.5 per cent the previous year. This was slow by comparison with the average of 5.8 per cent over the last twenty years. Trade increased at almost the same rate as world output, in contrast to the 1990s, when on average it had grown twice as fast. The low elasticity of trade with respect to GDP in 2002 was attributable partly to the weakness of economic activity and internal trade in the euro-area countries, whose share of world merchandise exports (30.6 per cent in 2002) is almost twice as large as their share of world output (15.7 per cent), and partly to the absence of a recovery in world demand in the capital goods sector, which is highly integrated internationally.

The exports of Asian countries grew strongly, thanks to high price competitiveness aided by the undervaluation of their currencies, and to the sustained level of economic activity on the continent. In the other leading economies and regions, however, exports generally stagnated.

The index of the dollar prices of world exports of manufactures rose for the first time since 1995; part of the increase of 3.1 per cent was due to the nominal effective depreciation of the dollar. The index of non-fuel commodity prices showed a larger rise of 3.8 per cent, but it began from a historically depressed level; as a result, the terms of trade of non-oil-exporting developing countries improved by 1.3 per cent, the first such gain since 1995, after a cumulative deterioration of 6 per cent in the previous six years.

The price of crude oil (average for the three main grades), which had fallen by a substantial 14 per cent year-on-year in 2001, rose by more than 50 per cent in the course of 2002 to stand at around $30 a barrel at the end of the year, compared with $19.50 twelve months earlier. Oil prices continued to rise until the first half of March, when they reached more than $34 a barrel, fluctuating widely owing to uncertainty about the course and duration of the conflict in Iraq. In the middle of that month, with the war under way, they first fell sharply to around $25 a barrel and then recovered temporarily to over $28. By the beginning of April the risk of significant destruction of production capacity in Iraq and neighbouring countries or a temporary halt to exports from the Middle East had faded, and for a time oil prices fluctuated around an average of $25.40 a barrel. Towards the end of the third week of May they rose again to around $27 a barrel, owing partly to the announcement of a cut in OPEC production.

At the fourth Ministerial Meeting of the World Trade Organization in Doha in November 2001 a programme had been unveiled that aimed to bring about a further substantial multilateral liberalization of world trade in goods and services. Little of that plan has been implemented so far. Continued profound differences among the leading countries about the way to liberalize the farm sector are just one of the issues that could jeopardize the success of the next Ministerial Meeting to be held in September in Cancun, Mexico, which is an important stage if negotiations are to be completed by the end of 2004.

Balance-of-payments developments

In 2002 the current account deficit of the United States began to widen considerably again, reflecting the large positive differential that had re-opened between demand growth in that country and in the other leading economies (Table 2). As a counterpart to that deficit, the current account surplus of Asian countries increased substantially, returning to the peak recorded in 1998 after the financial crisis in some economies in the area. The emerging countries in the region, and especially China, whose currencies are pegged to the dollar, enjoyed a further gain in international competitiveness due to the depreciation of the US currency. The deficit of Latin American countries showed the largest correction since 1983, mainly as a result of the fall in domestic demand in the region.

After having decreased slightly the previous year, the United States' current account deficit rose to $503 billion (4.8 per cent of GDP), compared with $393 billion in 2001 (3.9 per cent of GDP).

Table 2

CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS OF THE MAIN GROUPS OF COUNTRIES

	Billions of dollars			As a percentage of GDP		
	2000	2001	2002	2000	2001	2002
Advanced countries						
United States	–410.3	–393.4	–503.4	–4.2	–3.9	–4.8
Japan	119.6	87.8	112.8	2.5	2.1	2.8
Euro area	–61.0	–17.5	60.1	–1.0	–0.3	0.9
Newly industrialized Asian economies (NIEs)(1)	44.0	55.5	69.7	4.3	5.8	7.0
of which: South Korea	*12.2*	*8.6*	*6.1*	*2.7*	*2.0*	*1.3*
Developing countries						
Latin America	–47.7	–53.3	–16.8	–2.4	–2.8	–1.0
of which: Argentina	*–8.8*	*–4.4*	*8.6*	*–3.1*	*–1.7*	*8.3*
Brazil	*–24.6*	*–23.2*	*–7.6*	*–4.1*	*–4.6*	*–1.7*
Mexico	*–18.1*	*–17.9*	*–14.1*	*–3.1*	*–2.9*	*–2.2*
Venezuela	*–24.6*	*–23.2*	*–7.6*	*10.7*	*3.1*	*8.1*
Asia	44.2	34.5	51.2	2.0	1.5	2.1
of which: ASEAN-4 (2)	*31.7*	*20.7*	*25.1*	*7.2*	*5.0*	*5.3*
China	*20.5*	*17.4*	*23.3*	*1.9*	*1.5*	*1.9*
India	*–4.3*	*–0.1*	*4.4*	*–0.9*	. .	*0.9*
Middle East (3)	65.4	50.3	28.5	7.9	6.3	3.5
Central and Eastern Europe	**–21.2**	**–20.0**	**–21.1**	**–5.3**	**–4.6**	**–4.4**
Russia	**44.6**	**32.4**	**30.4**	**17.2**	**10.5**	**8.8**
Memorandum items:						
Oil-exporting developing countries	**106.1**	**60.5**	**41.7**	**14.7**	**8.2**	**5.9**
Non-oil-exporting developing countries	**–37.1**	**–27.1**	**16.1**	**–0.8**	**–0.6**	**0.3**
Japan, NIEs and Asian developing countries	**207.8**	**177.8**	**233.7**	**2.6**	**2.4**	**3.1**

Sources: Based on ECB and IMF data and national statistics.
(1) Hong Kong, Singapore, South Korea and Taiwan. – (2) Indonesia, Malaysia, the Philippines and Thailand. – (3) Including Malta and Turkey.

The improvement in the competitiveness of US products in world markets was small, 3.1 per cent in relation to the previous year on the basis of producer prices. It was the result of the modest depreciation of the dollar in effective terms, both because the currencies of emerging Asian countries remained broadly stable against the dollar and because those of the largest Latin American countries also weakened. Between 1995 and 2001 the international competitiveness of US products had deteriorated by 18.8 per cent.

The current account surplus of the Asian countries as a group rose from $178 billion in 2001 to $234 billion in 2002, the largest increase since 1998. Japan's surplus began to grow again, rising from $88 billion to $113 billion, equal to 2.8 per cent of GDP; this reflected an increase in the trade surplus from $70 billion to $94 billion generated by a strong recovery in exports, mainly to emerging Asian countries and the United States. Japan's net international investment position had risen to $1,370 billion at the end of 2001, equal to 35.3 per cent of GDP. The current account surplus of the newly industrialized countries rose from $56 billion to $70 billion (7 per cent of GDP); China's increased from $17 billion to $23 billion (1.9 per cent of GDP) and that of the ASEAN-4 countries rose from $21 billion to $25 billion (5.3 per cent of GDP).

The aggregate current account deficit of Latin American countries fell from $53 billion in 2001 to $17 billion last year, and from 2.8 to 1 per cent of GDP. As a percentage of output, the decrease was more than that recorded in 1999 (1.3 points) and the largest since 1983, when the deficit had come down by more than five points. The correction in Argentina was exceptionally large, a deficit of $4.4 billion giving way to a surplus of $8.6 billion, equal to 8.3 per cent of GDP; Brazil's deficit also decreased substantially, from $23.2 billion to $7.6 billion, and from 4.6 to 1.7 per cent of GDP.

The euro area recorded a current account surplus for the first time since 1997; it amounted to $60 billion, equal to 0.9 per cent of GDP, and contrasted with a deficit of $18 billion in 2001.

The Central and Eastern European countries, however, continued to run a large deficit of $21 billion, equal to 4.4 per cent of GDP. Despite the rise in oil prices, Russia's surplus contracted from $32 billion to $30 billion (8.8 per cent of GDP) as a result of rapid growth in imports of consumer goods.

In 2002 the gross capital flows in the balance of payments of the United States continued to be affected by the weakness of the financial markets. There was a further decline in gross inflows (from $753 billion to $630 billion) and an even larger one in gross outflows (from $366 billion to $152 billion). The composition of the capital flows financing the external imbalance also changed. For the first time since 1996 there were net outflows of $93 billion in respect of direct investment, caused by a sharp reduction in gross inflows ($30 billion, compared with $131 billion in 2001 and an average of $260 billion a year between 1998 and 2000). By contrast, there was an increase in net inflows on account of portfolio investment and other types of investment, which are more volatile than direct investment: net inward portfolio investment grew from $331 billion to $378 billion and the "other investment" residual, which includes bank capital, rose from $52 billion to $193 billion. These increases reflected an exceptionally large decrease in gross outflows, from $238 billion to $29 billion.

Net capital flows to emerging countries

Net private capital inflows to emerging countries increased in 2002 after having fallen for two years, but there were marked differences in growth rates between regions and between types of investment. The overall total rose from $39 billion in 2001 to $86 billion, close to the level recorded in 1999 before the crises in Turkey and Argentina (Table 3) but still far short of the peak of $218 billion a year recorded in 1995 and 1996. Official financing fell from $39 billion to $26 billion.

The greatest beneficiaries of the recovery in private capital flows were the emerging Asian countries, where net inflows rose from $16 billion to $70 billion, the highest level since 1996; the countries of Central and Eastern Europe and the former USSR benefited to a smaller degree, recording an increase from $21 billion to $34 billion.

Net foreign direct investment in emerging countries fell from a peak of $171 billion in 2001 to $139 billion in 2002 but remained by far the largest source of external finance. The decline, which was also substantial in relation to the average of $152 billion for the previous five years, affected mainly the countries in Latin America and to a lesser extent those in Africa and the Middle East.

In Asia the increase in capital flows can be attributed partly to a rise in net direct investment from $47 billion to $55 billion and partly to a further appreciable improvement in the net position on account of “other investment”, which includes movements of bank capital; here net outflows of $18 billion in 2001 gave way to net inflows of $32 billion, probably because the effects of the region’s serious banking crisis in 1997-98 had finally dissipated. The increased current account surplus and larger capital inflows to these countries intensified the upward pressure on their currencies, which the authorities countered by increasing their intervention purchases of foreign currency. Countries in the region added $167 billion to their official reserves last year, twice as much as in 2001. Excluding gold, the stock of reserves held by these countries stood at $975 billion at the end of the year, compared with $518 billion in 1997. On the basis of the latest survey by the IMF, 68 per cent of world foreign exchange reserves were held in US dollars at the end of 2001 and 13 per cent in euros, not dissimilar to the proportion held in German marks before the launch of the single European currency. The proportion of euros probably increased in 2002, partly as a result of the declared desire of some countries to make greater use of the currency for reserve purposes.

In Latin America, by contrast, net inflows virtually dried up ($2 billion in 2002, against $35 billion in 2001 and $51 billion in 2000), owing partly to lower net direct investment ($39 billion, compared with $66 billion in 2001) and partly to net outflows of portfolio investment for the first time since the 1980s ($7 billion).

Table 3

NET CAPITAL FLOWS TO EMERGING COUNTRIES (1)

(billions of dollars)

	Average 1995-96	1997	1998	1999	2000	2001	2002
	All emerging countries						
Net private flows	218.4	75.7	53.4	96.0	51.1	38.8	85.9
Direct investment	*102.3*	*136.0*	*148.8*	*156.8*	*149.0*	*170.5*	*139.2*
Portfolio investment	*71.7*	*48.5*	*1.7*	*41.4*	*12.1*	*–38.5*	*–36.6*
Other investment	*44.4*	*–108.8*	*–97.1*	*–102.2*	*–110.1*	*–93.2*	*–16.7*
Net official flows	12.8	56.3	83.0	14.0	–3.8	38.8	25.8
Memorandum item: Change in reserves (2)	–113.7	–62.0	–53.5	–86.8	–113.3	–118.5	–209.0
	Asia (3)						
Net private flows	110.8	12.0	–44.9	6.3	–18.3	15.5	69.5
Direct investment	*53.2*	*56.4*	*59.3*	*60.3*	*53.0*	*46.5*	*55.3*
Portfolio investment	*27.8*	*7.1*	*–17.9*	*14.4*	*4.3*	*–13.5*	*–18.1*
Other investment	*29.9*	*–51.5*	*–86.3*	*–68.4*	*–75.5*	*17.6*	*32.3*
Net official flows	–4.2	17.1	26.1	4.2	3.2	–6.0	–10.2
Memorandum item: Change in reserves (2)	–44.9	–15.0	–67.9	–78.9	–49.0	–84.6	–166.9
	Latin America						
Net private flows	52.2	58.7	63.3	50.2	50.5	34.7	2.1
Direct investment	*28.1*	*51.1*	*56.1*	*58.1*	*57.1*	*65.9*	*38.5*
Portfolio investment	*25.6*	*28.3*	*23.7*	*19.6*	*21.2*	*2.8*	*–6.5*
Other investment	*–1.5*	*–20.8*	*–16.5*	*–27.5*	*–27.8*	*–33.9*	*–29.8*
Net official flows	12.0	14.6	15.5	0.7	–4.3	23.7	18.4
	Africa						
Net private flows	10.7	9.0	10.4	13.7	4.8	6.0	5.5
Direct investment	*2.7*	*7.8*	*6.3*	*9.4*	*7.8*	*22.4*	*8.9*
Portfolio investment	*2.7*	*7.0*	*3.7*	*8.2*	*–2.2*	*–9.1*	*–1.2*
Other investment	*5.3*	*–5.9*	*0.4*	*–3.9*	*–0.8*	*–7.3*	*–2.3*
Net official flows	1.8	3.2	4.2	2.0	3.0	1.6	2.2
	Middle East (4)						
Net private flows	8.9	16.9	10.2	–3.9	–18.8	–38.3	–25.3
Direct investment	*5.6*	*5.2*	*6.2*	*5.3*	*7.7*	*10.5*	*7.3*
Portfolio investment	*1.9*	*–0.9*	*–13.2*	*–3.2*	*–13.4*	*–22.0*	*–14.2*
Other investment	*1.4*	*12.6*	*17.1*	*–6.0*	*–13.1*	*–26.9*	*–18.4*
Net official flows	5.2	5.9	3.6	3.7	–2.5	6.3	12.5
	Central and Eastern Europe and former Soviet Union						
Net private flows	35.8	–20.9	14.5	29.8	32.9	20.9	34.1
Direct investment	*12.7*	*15.5*	*20.8*	*23.8*	*23.4*	*25.2*	*29.2*
Portfolio investment	*13.9*	*6.9*	*5.4*	*2.4*	*2.4*	*3.2*	*3.4*
Other investment	*9.4*	*–43.3*	*–11.8*	*3.6*	*7.1*	*–7.4*	*1.5*
Net official flows	–1.9	15.5	33.7	3.5	–3.1	13.2	2.9

Source: IMF.

(1) Capital inflows less outflows. Other investment comprises bank loans and trade credit, foreign currency deposits and other assets and liabilities; it may also include some official flows. Rounding may cause discrepancies in totals. – (2) A minus sign indicates an increase in reserves. – (3) Includes Southern and Eastern Asia, excluding Japan and Hong Kong. – (4) Including Malta and Turkey.

INCOME, PRICES AND THE BALANCE OF PAYMENTS

Economic activity in the euro area

Euro-area GDP grew by just 0.8 per cent in 2002, less than in the previous year, when the expansion was 1.4 per cent (Table 4). The incipient recovery in economic activity in the first quarter did not gain strength during the rest of the year owing to the uncertainty generated by geopolitical tensions. The deceleration in GDP growth was basically attributable to the weakness of national demand in the countries of the area; the contribution of net exports remained positive.

In Germany and Italy output stagnated over the year as a whole, while in the other major countries it slowed down slightly. In France economic activity slackened as the year progressed, until it contracted in the last quarter.

Economic policy was only moderately expansionary in the euro area, in contrast with the United States. Most of the fiscal stimulus came from built-in stabilizers and the tax allowances introduced in previous years. Monetary policy eased towards the end of 2002 as inflationary pressures abated. The growth in output was considerably weaker than in the United States (Figure 2).

After hitting a low in November 2001, the area’s index of industrial production turned upwards and by the spring of 2002 was close to the average levels of the previous year. Thanks in part to the strong recovery in the United States, a degree of optimism spread concerning the prospects of faster growth. The subsequent cooling of growth in the US and the sharpening of international tensions awakened renewed uncertainty. Economic conditions worsened: the index of industrial production remained stationary throughout the summer and into the autumn, then dropped sharply in December. GDP growth came to a halt in the fourth quarter of 2002.

Table 4

GDP AND ITS MAIN COMPONENTS IN THE MAJOR EURO-AREA COUNTRIES

(at constant prices; seasonally adjusted data; percentage changes on the preceding period unless otherwise indicated)

	2000	2001	2002	2002			
	Year	Year	Year	Q1	Q2	Q3	Q4
				GDP			
Germany	2.9	0.6	0.2	0.3	0.2	0.3	. .
France	3.8	2.1	1.2	0.7	0.5	0.3	−0.1
Italy	3.1	1.8	0.4	. .	0.2	0.3	0.4
Spain	4.2	2.7	2.0	0.5	0.5	0.8	0.3
Euro area	3.5	1.4	0.8	0.4	0.4	0.3	0.1
				Imports			
Germany	10.5	1.0	−2.1	−3.6	1.7	2.1	1.9
France	14.6	1.3	0.6	1.7	0.9	0.7	−0.7
Italy	8.9	1.0	1.5	−0.6	3.7	2.4	2.1
Spain	10.6	3.5	2.2	−0.8	−0.1	4.2	4.0
Euro area	11.3	1.4	−0.4	−1.3	1.5	1.9	0.7
				Exports			
Germany	13.7	5.0	2.6	0.6	1.2	2.9	0.3
France	12.6	1.6	1.5	1.4	2.0	0.8	−0.5
Italy	11.7	1.1	−1.0	−3.9	5.2	3.3	−0.1
Spain	10.1	3.4	1.4	−2.3	1.4	5.9	1.1
Euro area	12.6	2.8	1.2	−0.2	2.1	2.0	−0.2
				Household consumption (1)			
Germany	1.4	1.5	−0.6	−0.7	0.2	0.4	0.1
France	2.6	2.8	1.2	0.3	0.4	0.5	0.3
Italy	2.7	1.0	0.4	−0.3	0.2	0.8	1.0
Spain	3.9	2.5	1.9	0.3	0.3	0.2	1.0
Euro area	2.5	1.8	0.6	−0.1	0.3	0.5	0.4
				Gross fixed investment			
Germany	2.5	−5.3	−6.7	−1.9	−3.5	−0.2	0.8
France	7.7	2.0	−1.6	. .	−0.4	−0.7	−1.2
Italy	7.1	2.6	0.5	−1.5	0.5	2.8	2.1
Spain	5.7	3.2	1.4	0.8	1.0	1.4	−0.6
Euro area	4.9	−0.6	−2.6	−0.7	−1.3	0.2	. .
				National demand			
Germany	1.8	−0.8	−1.5	−1.1	0.3	−0.1	0.5
France	4.1	2.0	0.9	0.8	0.2	0.3	−0.1
Italy	2.3	1.8	1.1	1.0	−0.2	. .	1.1
Spain	4.4	2.7	2.2	0.9	. .	0.4	1.3
Euro area	2.9	0.9	0.2	0.1	0.1	0.3	0.4
				Net exports (2)			
Germany	1.0	1.4	1.6	1.4	−0.1	0.4	−0.5
France	−0.2	0.1	0.3	. .	0.3	. .	. .
Italy	0.9	0.1	−0.7	−1.0	0.4	0.3	−0.6
Spain	−0.3	−0.1	−0.3	−0.4	0.4	0.4	−1.0
Euro area	0.6	0.5	0.6	0.4	0.3	0.1	−0.3

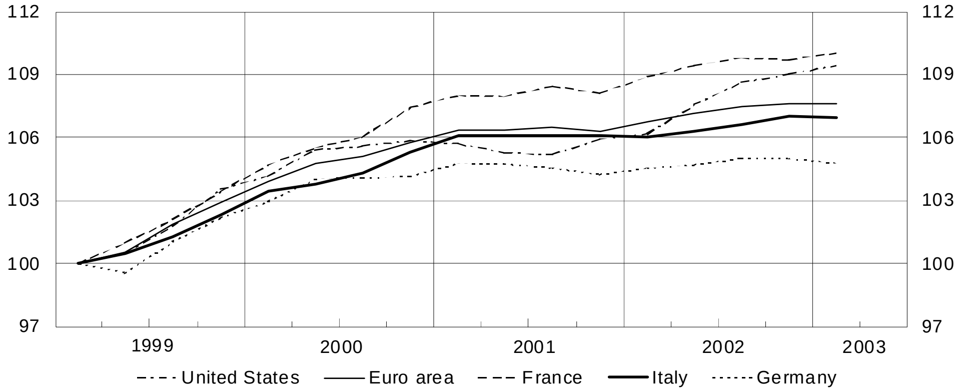
Sources: Based on Eurostat and national statistics.

(1) Comprises expenditure of resident households and of non-profit institutions serving households. – (2) Contribution to the growth on the preceding period in percentage points.

Figure 2

GROSS DOMESTIC PRODUCT

(at constant prices; indices, first quarter 1999=100)



Sources: Based on national statistics and Eurostat data.

Gross fixed investment declined further, by 2.6 per cent in 2002. From the end of 2000, when the previous expansion peaked, purchases of capital goods in the euro area fell by more than 4 per cent in real terms. Capital formation was negative in France and, above all, in Germany. The decline did not come to a halt until the second half of the year.

Private consumption continued to slow, from growth of 1.8 per cent in 2001 to 0.6 per cent in 2002. After falling in the first quarter, household spending began to grow again, but slowly, at rates of less than 0.5 per cent. This caution in spending reflected the rapid deterioration in consumer confidence from the middle months of the year onwards. The slowdown was largest in Germany, where consumption declined by 0.6 per cent on average for the year, compared with an increase of 1.5 per cent in 2001. In both France and Italy consumption rose at less than half its previous rate.

The business cycle affected employment growth, which slackened gradually over the year. The unemployment rate, which has been rising since the end of 2001 in almost all the euro-area countries, reached 8.7 per cent in March of this year.

Inflation, measured by the harmonized consumer price index, was equal to 2.2 per cent in 2002, 0.2 percentage points less than in 2001. While the growth rate of the more volatile components decreased, core inflation rose by 0.6 percentage points, from 1.9 to 2.5 per cent. In some of the major countries this increase was due to a sharp rise in unit labour costs; the moderate wage trend only compensated in part for the weaker growth in labour productivity. The introduction of the euro had a minor overall impact on consumer prices and one that was concentrated in only a few sectors, notably services. As perceived by households, the impact was substantially greater.

The slowing of growth in Germany and Italy

Between 1995 and 2002 the average annual rate of growth in the euro area was 2.2 per cent, one percentage point less than in the United States. The gap is largely attributable to the modest expansion of output in Germany and Italy, whose combined average was 1.5 per cent a year, about half the figure recorded in the rest of the area (2.8 per cent).

Factors that act as a brake on growth are at play in both countries, some of them also shared by the rest of the euro area. In particular, the rapid ageing of the population is aggravating the problem of the financial sustainability of the existing welfare state and also depressing aggregate demand. The spread of new technologies, especially IT, is being retarded by the rigidities that prevent much-needed corporate reorganization and hinder the sectoral and geographical redistribution of factors of production.

In Germany national demand is especially weak; in Italy, there is a progressive loss of competitiveness.

Germany shows the effects of the enormous economic effort that followed unification. Despite the increase in the tax burden, very substantial government intervention in favour of eastern Länder in the form of transfers to households and grants for the restructuring of the productive apparatus has caused a serious deterioration in the public finances over the years. Lately, the decision to postpone cuts in direct taxes, together with expectations that the often-announced reform of the costly welfare state was imminent – including the reorganization of social security, health and unemployment benefits – have helped to curb spending by households and firms.

The weakness of national demand led to a drop of more than 2 per cent in German imports of goods and services in 2002. The decline was particularly pronounced in imports of goods from the United States; the repercussions on exports from other euro-area countries were also substantial. Italy was among those hit hardest; its exports to Germany falling by almost 10 per cent.

In Italy, the expansion of economic activity has been dampened in recent years by the disappointing performance of exports: after the recovery triggered by the lira's devaluation in the early 1990s, the country's share of world exports dropped by one fifth between 1995 and 2002. This trend is evidence of persistent difficulties tied to Italy's model of specialization and the capacity of its firms to innovate, as well as to external factors. It is compounded by a slowdown in productivity growth that stems in part from delays in adopting new technologies and putting them to efficient use.

According to the initial results of a joint study being conducted by the Bank of Italy and Istat, so-called total factor productivity, or TFP – i.e. the residual economic growth after computing the part due to an increase in the quantity and quality of capital and labour used – has averaged about 0.5 percentage points a year in the past twenty years. In the second half of the 1990s, TFP appears to have fallen to half its previous value, despite a higher rate of economic growth; the slowdown occurred mainly in manufacturing, whereas considerable progress was made in some branches of the service sector, notably financial intermediation and public utilities.

Cyclically adjusted estimates by the OECD indicate that Italy's TFP decreased by two thirds between the first and the second half of the 1990s, from 0.6 to 0.2 percentage points a year. In Germany it fell much less, from 0.9 to 0.7 points a year, while in France and, more particularly, the US, it actually increased.

In Italy, the decline in this indicator of productive efficiency is attributable to the greater difficulty of firms in carrying out corporate reorganization. Innovation and the adoption of new technologies have been further hindered by the fragmentary nature of Italy's productive system, in which irregular firms are able to elude the step-up in the tax and regulatory burden. Another factor contributing to the productivity slowdown has been the accumulation of delays in infrastructural investment, training and use of qualified human resources, reform of the regulations governing product and factor markets, and investment in R&D.

Economic developments in Italy in 2002

Output growth declined more sharply in Italy than in the rest of the euro area in 2002: GDP increased by only 0.4 per cent, falling below the average for the other countries (Table 5).

Over the year, GDP growth picked up slowly from the standstill of the first quarter to an annualized rate of 1.7 per cent in the fourth, partly thanks to government incentives for consumption and investment.

Manufacturing activity followed a different pattern of development but overall deteriorated more than GDP. The seasonally and calendar adjusted index of industrial production climbed slowly until July then slipped back, hovering around the levels recorded at the start of the year (Figure 3). On average in 2002, it decreased by 1.4 per cent.

Exports fell by 1 per cent notwithstanding the recovery in world trade. Sales abroad were affected by the very modest growth in the main outlet markets and by two years of accumulated loss of price competitiveness, amounting to almost five percentage points in terms of average unit values, more than in the other major euro-area countries.

Table 5

ITALY: RESOURCES AND USES OF INCOME

	Percent-age of GDP in 2002	2001			2002		
		Percentage changes		Contribu-tion to the growth in GDP at constant prices	Percentage changes		Contribu-tion to the growth in GDP at constant prices
		Values at constant prices	Deflators		Values at con-stant prices	Deflators	
Resources							
GDP	–	1.8	2.7	–	0.4	2.7	–
Imports of goods *fob* and services (1)	28.7	1.0	2.0	–0.3	1.5	–2.4	–0.4
of which: goods	*22.2*	*0.6*	*1.6*	*–0.1*	*0.8*	*–3.5*	*–0.2*
Uses							
National demand	98.9	1.8	2.3	1.7	1.1	2.4	1.1
Consumption of resident households	59.8	1.0	2.7	0.6	0.4	3.0	0.3
Consumption of government and non-profit institutions serving households	18.0	3.5	3.9	0.6	1.7	1.0	0.3
Gross fixed capital formation	20.8	2.6	1.8	0.5	0.5	2.2	0.1
machinery, equipment and transport equipment	*11.4*	*2.2*	*1.1*	*0.2*	*0.6*	*0.9*	*0.1*
construction	*8.5*	*3.2*	*2.6*	*0.3*	*0.3*	*3.9*	*. .*
intangible assets	*0.9*	*2.7*	*2.7*	*. .*	*1.3*	*1.6*	*. .*
Change in stocks and valuables (2)	0.4	–	–	. .	–	–	0.4
Exports of goods *fob* and services (3)	29.8	1.1	3.7	0.3	–1.0	–1.0	–0.3
of which: goods	*24.0*	*0.9*	*3.8*	*0.2*	*. .*	*–1.9*	*. .*

Source: Istat, national accounts.
(1) Includes residents' expenditure abroad. – (2) Includes statistical discrepancies. – (3) Includes non-residents' expenditure in Italy.

Italy's external current account showed a deficit of €7.3 billion in 2002, equal to 0.6 per cent of GDP, whereas it had been broadly in balance the year before. Although the trade surplus remained unchanged, thanks to the improvement in the terms of trade, there was a deficit of about €3.7 billion on services. This was the first since 1990 and it was due for the most part to a sharp reduction in the balance on tourism.

Gross fixed investment continued to slacken in 2002, not only in construction but also in other sectors. Against a background of weak growth in demand and increasing uncertainty about the economic outlook, the better performance of investment in Italy than in the rest of the euro area, especially France and Germany, was due to the resilience of corporate self-financing and the availability of substantial tax incentives, most of which were utilized in the second half of the year.

The results for household consumption were very similar to those for gross fixed investment. Again, the average growth in 2002 was almost nil at 0.4 per cent (Table 5), but with a strong recovery in the second half of the year, when the annual rate of increase was close to 3 per cent. The tax relief granted on purchases of motor vehicles contributed to this.

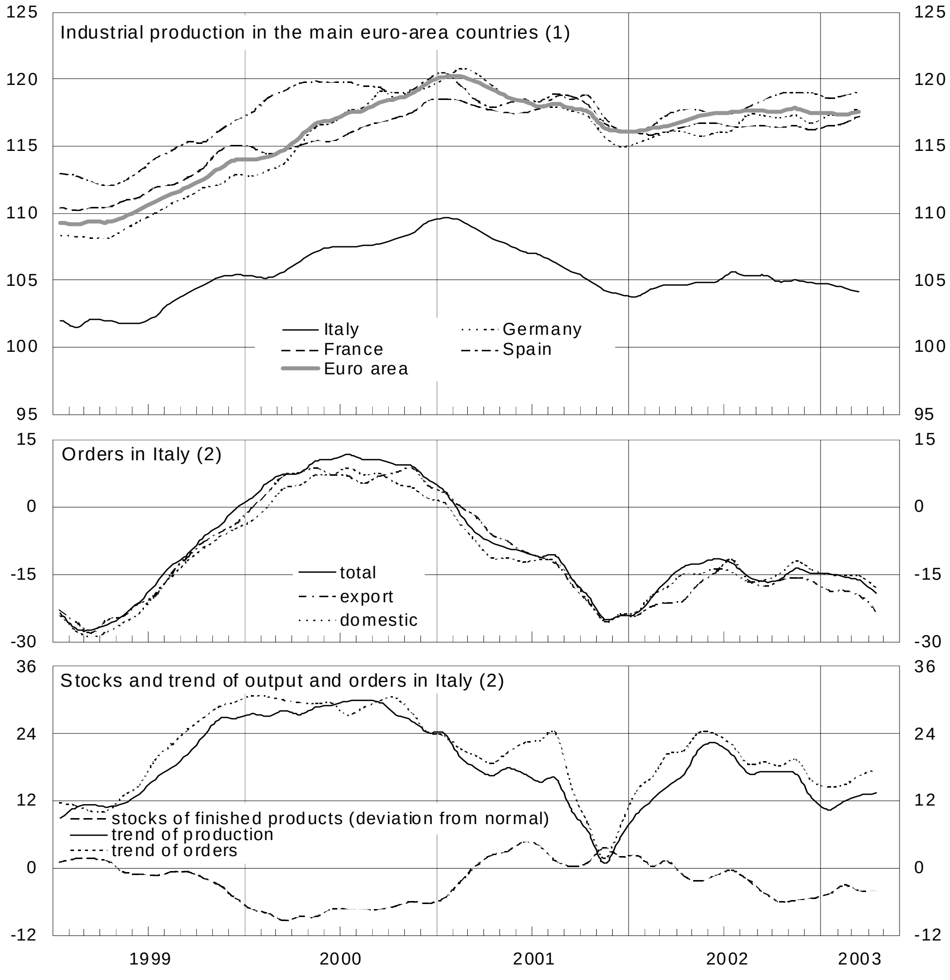
The growth of disposable income at constant prices was sustained above all by the rise in employment. Households' average propensity to save increased in 2002, rising to 12.5 per cent; it had declined considerably throughout most of the 1990s.

Despite the appreciable slowdown in economic growth, the labour force survey found that the number of persons in work, permanent employees in particular, rose by 1.4 per cent on average for the year. For several years, wage moderation and more flexible work contracts have been helping to boost employment, albeit mostly in low-productivity sectors.

Figure 3

INDUSTRIAL PRODUCTION, DEMAND AND STOCKS

(moving averages for the three months ending in the reference month)



Sources: Based on Istat, Eurostat and ISAE data.

(1) Indices, 1995=100; seasonally adjusted data for all countries. – (2) Differences between the percentage of positive replies ("high", "increasing") and negative replies ("low", "decreasing") to ISAE business opinion surveys. Seasonally adjusted except for stocks of finished products.

Inflation, measured by the harmonized index of consumer prices, inched up from 2.6 per cent in 2001 to 2.7 per cent; this was 0.4 points higher than in the rest of the euro area. Core inflation rose to 2.9 per cent, from 2.4 per cent the year before. The slight acceleration can be ascribed to higher unit labour costs, given the fall in productivity, and to the changeover to the euro.

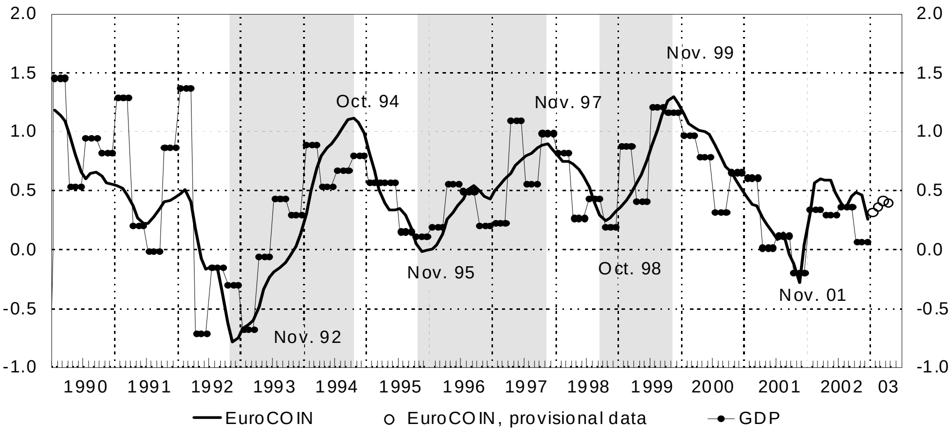
Recent developments

In the euro area, the EuroCOIN coincident indicator shows clearly that the signs of recovery in the early months of 2002 have given way to a period of cyclical weakness (Figure 4). According to Eurostat estimates, the area's GDP in the first quarter of this year remained stalled at its end-of-2002 level; information on the current quarter does not indicate any significant change.

Figure 4

EUROCOIN INDICATOR OF THE EURO-AREA BUSINESS CYCLE AND GDP (1)

(three-month percentage changes)



Source: Center for Economic Policy Research.

(1) GDP is estimated on the basis of that of Germany, France, Italy, Spain, the Netherlands and Belgium, which account for about 90 per cent of the area's total. The shaded areas denote cyclical upturns.

The economic situation is similar in all the major euro-area countries. With business and consumer confidence low, economic activity contracted slightly in Germany and Italy in the early months of this year, while it increased in France. Although the tensions caused by international terrorism persist, the end of the war in Iraq and the drop in oil prices towards the level prevailing in April of last year have lifted some of the uncertainty weighing on business and household spending decisions.

The principal international institutions predict that on average in 2003 euro-area GDP will grow only marginally more than last year owing to a small increase in all the main components of demand. Other risks weigh on this scenario, however. A further appreciation of the euro would adversely affect the expected stimulus from export demand. This factor might be accompanied by the recessionary effects of a rapid spread of the SARS virus in the emerging countries of the Far East.

It is expected that inflation will continue to slow gradually during 2003, falling back below the 2 per cent threshold.

On the macroeconomic level, there is likely to be little difference between developments in Italy and the rest of the euro area. Preliminary estimates by Istat indicate that GDP decelerated sharply in the first quarter of the year, contracting by 0.1 per cent from the previous period as a result of a stagnation in the service sector and a decline in manufacturing output.

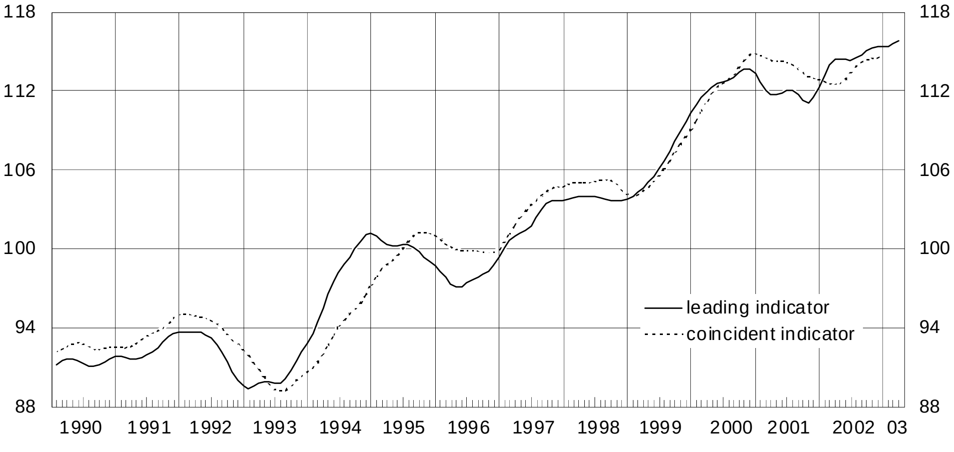
The investment plans of industrial and service companies, observed at the start of this year by the annual survey conducted by the Bank of Italy's branches, remain marked by pessimism. The likely decline in investment might reflect the decision to bring purchases of capital goods forward to the end of last year to exploit tax incentives before their expiry.

In the second quarter of this year the economic situation shows little change, suggesting broadly stagnant GDP. According to estimates based on electricity consumption, the index of industrial production in April and May fluctuated around the same low averages as in the first quarter. Growth rates may pick up towards the end of the year, according to the leading indicator of the Italian business cycle (Figure 5). An upturn in world trade would help to boost exports, leading to a gradual recovery in investment and household spending, which the fall in inflation would help to sustain.

Figure 5

INDICATORS OF THE ITALIAN BUSINESS CYCLE

(indices, 1995=100)



Sources: Based on Istat, ISAE and Bank of Italy data.

DEMAND

The euro area

Household consumption

The slowdown in household spending in the euro area sharpened in 2002; the rate of growth, which had averaged 3 per cent annually between 1997 and 2000, fell from 1.8 to 0.6 per cent (Table 4). The deterioration was less in France and Spain, which recorded expansion of 1.2 and 1.9 per cent respectively, and much more pronounced in Germany, where private consumption actually contracted for the first time in twenty years, by 0.6 per cent.

In the leading euro-area countries household demand was curbed by the reduction in spending capacity coupled with heightened uncertainty. According to the data released to date, disposable income at constant prices decreased by 0.3 per cent in Germany, after growth of 1.8 per cent in 2001, and slowed sharply in France (1.5 per cent, down from 3.7 per cent). Greater uncertainty about the prospects for the economy, especially the labour market, led to a severe loss of confidence. Against this background, German households' propensity to save continued to increase, rising by almost 1 per cent overall between 2001 and 2002 to 10.4 per cent. In France it rose by about the same amount to 16.7 per cent in 2002, the highest level in the euro area.

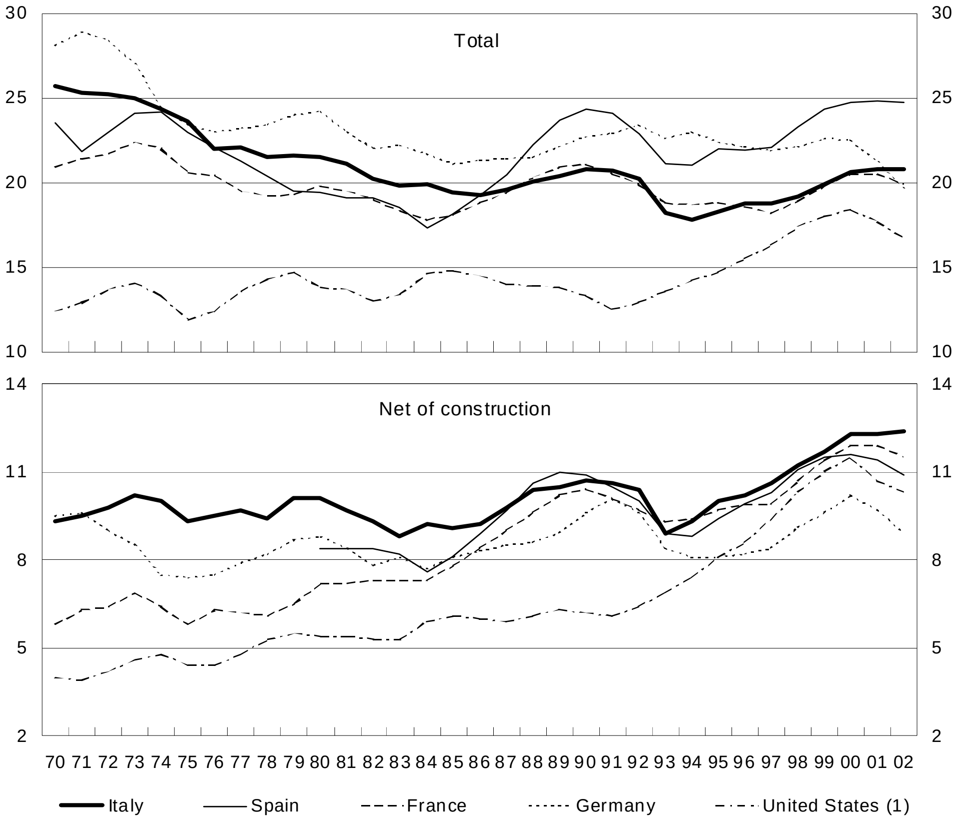
Investment

After contracting slightly in 2001, gross fixed investment in the euro area fell sharply last year for the first time since the 1993 recession, with a decline of 2.6 per cent. This can be attributed to the decrease in Germany, which came to 6.7 per cent compared with 5.3 per cent in 2001, and in France (1.6 per cent). Investment continued to grow in Spain (1.4 per cent) but at half the previous year's rate, and in Italy, by 0.5 per cent compared with 2.6 per cent in 2001.

Figure 6

RATIO OF GROSS FIXED INVESTMENT TO GDP IN THE MAJOR EURO-AREA COUNTRIES AND THE UNITED STATES

(constant prices; annual data; percentages)



Sources: Based on OECD and Eurostat data.
(1) Private sector.

The ratio of gross fixed investment to GDP declined for the third year running in Germany, from 21.2 to 19.7 per cent (in 1999 it had been 22.6 per cent). This was mainly due to the reduction in spending on capital equipment, which dropped from 9.7 to 8.9 per cent of GDP. The overall investment ratio diminished less in France, from 20.5 to 19.9 per cent, and remained virtually unchanged in Spain at 24.7 per cent. In both countries investment in capital equipment decreased by almost 0.5 per cent of GDP, to 11.5 and 10.9 per cent respectively (Figure 6).

According to national accounts data, in 2002 the change in stocks and valuables had a negative effect of 0.4 percentage points on GDP growth in France. Surveys of manufacturing firms indicate that most of the destocking took place in the first half of last year. In Germany and Spain, however, as in the euro area as a whole, the effect of stocks was negligible.

Exports and imports

In 2002 the growth in exports of goods and services by the euro area as a whole – which in the national accounts include intra-area trade – slowed from 2.8 to 1.2 per cent at constant prices. The highest rate, albeit only half that of 2001, was achieved by Germany at 2.6 per cent, only slightly less than the growth in world trade. In France and Spain, the growth was more moderate (1.5 and 1.4 per cent respectively), while in Italy exports contracted by 1 per cent. In all the major euro-area countries exports grew during the first nine months of the year and then slackened in the last quarter as world demand weakened.

In response to the slowdown in national demand, imports of goods and services fell by 0.4 per cent in the euro area and by 2.1 per cent in Germany. They increased by 0.6 per cent in France and 2.2 per cent in Spain, where net exports subtracted 0.3 percentage points from GDP growth. By contrast, their contribution was slightly positive in France and more substantial in the area as a whole, especially Germany (0.3, 0.6 and 1.6 percentage points respectively).

The Italian economy

Household consumption

In 2002 household spending in Italy increased by 0.4 per cent at constant prices, much less even than the modest 1 per cent growth of the previous year (Table 6). Including the contraction in non-residents' spending in Italy, which fell by 3.8 per cent, and excluding the steep rise (17.7 per cent) in resident households' spending abroad – resulting in a deterioration of the net balance on travel – domestic consumption actually contracted by 0.1 per cent, compared with growth of 0.9 per cent in 2001.

Spending on all the main categories of consumer goods diminished, in contrast with that on services, which continued to rise although less fast (0.7 per cent compared with 1.8 in 2001). Over three years this component increased by more than 1 per cent of total consumption, to 44.8 per cent in 2002. Spending on non-durable goods, especially non-food products, declined slightly, that on durable goods fell more substantially by 2.8 per cent compared with 0.6 per cent in 2001. About half this contraction was due to a sharp reduction in spending on cars, which occurred only in the first half of the year; the partial recovery that followed was prompted by the introduction of temporary tax incentives.

Table 6

ITALIAN HOUSEHOLD CONSUMPTION

(at 1995 prices; percentage changes)

	% share in 2002	1999	2000	2001	2002
Non-durable goods	43.6	1.4	1.6	0.5	–0.3
of which: food and beverages	*15.9*	*–0.1*	*2.1*	*–0.2*	*0.5*
Durable goods	11.7	5.1	5.8	–0.6	–2.8
of which: furniture and repairs	*3.7*	*4.3*	*2.8*	*–1.3*	*–4.2*
electrical household appliances and repairs	*1.3*	*10.0*	*1.1*	*1.9*	*–0.3*
television sets, photographic, computer and hi-fi equipment	*1.4*	*18.8*	*14.6*	*6.5*	*2.3*
transport equipment	*3.8*	*–0.8*	*2.8*	*–2.0*	*–3.8*
Services	44.8	2.7	4.0	1.8	0.7
of which: hotel and restaurant	*9.4*	*3.4*	*8.6*	*2.5*	*–0.2*
communication	*4.1*	*19.2*	*18.4*	*4.1*	*3.9*
recreational and cultural	*2.7*	*5.1*	*5.9*	*–0.8*	*0.7*
Total domestic consumption	**100.0**	**2.4**	**3.1**	**0.9**	**–0.1**
Residents' consumption abroad	(1)	2.1	–3.2	–5.3	17.7
Non-residents' consumption in Italy	(1)	–2.3	8.5	–5.7	–3.8
Total national consumption	**-**	**2.6**	**2.7**	**1.0**	**0.4**
Memorandum item:					
Deflator of national consumption	–	2.2	2.9	2.7	3.0

Source: Istat, national accounts.

(1) Residents' consumption abroad and non-residents' consumption in Italy amounted to 2.8 and 3.9 per cent, respectively, of total domestic consumption.

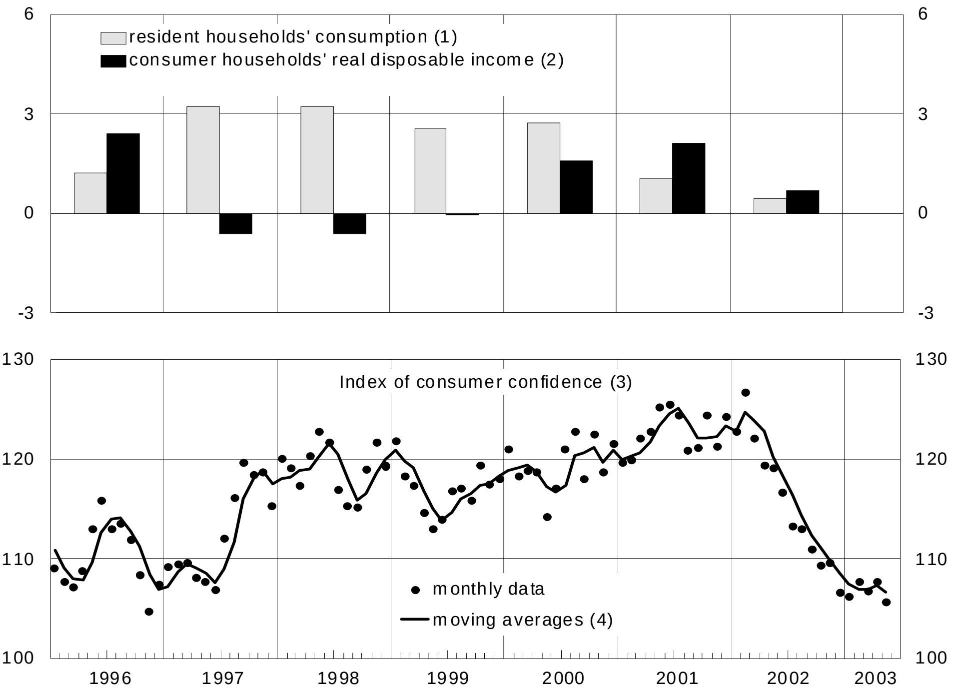
Over the last year household spending continued to be affected by the sluggish growth in disposable income and enduring pessimism about economic prospects in general and family finances in particular. According to the ISAE opinion survey, after an initial improvement consumer confidence slumped, hitting an all-time low in December and, albeit with some fluctuations, staying fundamentally unchanged over the first five months of 2003 (Figure 7).

In 2002 the gross disposable income of Italian households grew by 0.6 per cent at constant prices and by 3.6 per cent at current prices, considerably less than in 2001. Factoring in the erosion of the purchasing power of net financial assets due to expected inflation, the increase at constant prices was of similar magnitude, compared with 2.1 per cent in 2001 (Table 7).

The slowdown in disposable income growth is ascribable mainly to the scant increase in labour income, from salaried employment and self-employment, compounded by the decline in investment income. Net investment income, which accounts for about 25 per cent of the total, fell by 0.7 per cent, after rising by 2.9 per cent in 2001. One cause of this was the

Figure 7

CONSUMPTION, REAL INCOME AND CONSUMER CONFIDENCE IN ITALY



Sources: Based on Istat and ISAE data.

(1) At 1995 prices; percentage changes on previous year. – (2) Percentage changes over previous year in gross disposable income, divided by the resident households' consumption deflator. – (3) Indices, 1980=100; seasonally adjusted data. – (4) For the three months ending in the reference month.

decrease (15.5 per cent) in households' net interest income, itself reflecting the general decline in yields that was only partly offset by the increase in holdings of outstanding fixed-interest securities as share prices weakened. The decrease in income from net financial assets was not fully offset by higher earnings from property rentals, which rose by 7.7 per cent thanks to a jump in rents that available estimates set at about 13 per cent, compared with under 2 per cent in 2001.

General government made a positive contribution of around 1 per cent to the growth in households' disposable income at current prices.

According to national accounts data, in 2002 Italian households' propensity to save increased for the second year running, rising to 12.5 per cent from a low of 11 per cent two years earlier, although when income is adjusted for expected inflation, it remained practically unchanged at 9.6 per cent. This confirms that, except for the brief downturn in 2000, the propensity to save has stabilized since the late 1990s.

The growth in nominal disposable income of the private sector also slowed in 2002, from 4.5 to 3.4 per cent. Calculated at constant prices and adjusted for expected inflation, it virtually came to a halt (after a gain of 1.5

per cent in 2001), partly as a result of the downturn in the retained earnings of firms. The propensity to save of the private sector thus showed no change with respect to 2001 (24.6 per cent). The national saving rate fell slightly, from 20.2 to 19.9 per cent, following the decline in general government saving from 1 to 0.7 per cent of gross national disposable income (Table 8).

Table 7

GROSS DISPOSABLE INCOME AND PROPENSITY TO SAVE IN ITALY

(at current prices unless otherwise specified)

	1999	2000	2001	2002
	Percentage changes			
Earnings net of social contributions charged to workers	4.2	5.2	5.8	3.8
Income from salaried employment per standard labour unit	*2.5*	*3.0*	*3.1*	*2.3*
Total social contributions (1)	*0.7*	*0.3*	*0.5*	*0.0*
Standard employee labour units	*1.0*	*1.9*	*2.2*	*1.5*
Income from self-employment net of social contributions (2)	1.1	3.8	6.1	1.5
Income from self employment per standard labour unit	*2.3*	*2.8*	*5.3*	*1.4*
Total social contributions (1)	*–0.7*	*–0.4*	*0.3*	*0.2*
Standard self-employed labour units	*–0.5*	*1.4*	*0.5*	*–0.1*
Net property income (3)	–2.7	8.1	2.9	–0.7
Social benefits and other net transfers	4.4	2.6	3.6	6.9
of which: net social benefits	*4.4*	*2.8*	*3.9*	*6.6*
Current taxes on income and wealth (–)	5.8	4.6	1.6	–0.1
Households' gross disposable income (4)	**1.4**	**4.9**	**5.3**	**3.6**
at 1995 prices (5)	–0.8	2.0	2.5	0.6
at 1995 prices, adjusted for expected inflation (6)	–2.6	2.0	2.1	0.6
at 1995 prices, adjusted for past inflation (7)	–2.0	2.0	3.3	–0.3
Private sector gross disposable income	**1.9**	**5.2**	**4.5**	**3.4**
at 1995 prices (5)	–0.3	2.2	1.8	0.4
at 1995 prices, adjusted for expected inflation (6)	–1.8	2.4	1.5	0.2
at 1995 prices, adjusted for past inflation (7)	–1.3	2.4	2.3	–0.4
	Percentages			
Households' average propensity to save (4) (8)	**11.7**	**11.0**	**12.3**	**12.5**
calculated on income adjusted for expected inflation	9.1	8.5	9.5	9.6
calculated on income adjusted for past inflation	8.4	7.7	9.7	9.1
Private sector average propensity to save (8)	**23.9**	**23.5**	**24.0**	**24.0**
calculated on income adjusted for expected inflation	24.4	24.0	24.6	24.6
calculated on income adjusted for past inflation	24.6	24.1	24.5	24.7

Sources: Based on Istat data and Bank of Italy's estimates.

(1) Contribution in percentage points of social contributions to the change in net income; negative values indicate an increase in social contributions relative to income. – (2) Includes mixed income and income withdrawn by members of quasi-corporations. – (3) Includes gross operating result (essentially actual and imputed rents), net rents of land and intangible goods, actual net interest, dividends and other profits distributed by corporations. – (4) Consumer households. - (5) Deflated using the resident households' consumption deflator. – (6) Gross disposable income net of expected losses on net financial assets due to inflation (estimated on the basis of the *Consensus Forecasts* survey), deflated using the resident households' consumption deflator. – (7) Gross disposable income net of actual losses on net financial assets due to inflation; deflated using the resident households' consumption deflator. – (8) Ratio between the saving (gross of depreciation and amortization and net of the change in pension fund reserves) and the gross disposable income of the sector.

Table 8

GROSS SAVING AND INVESTMENT IN ITALY

(as a percentage of gross national disposable income)

	Average 1981-1990	Average 1991-2000	Average 1993-2002	1999	2000	2001	2002
General government saving	–6.4	–3.3	–1.6	1.8	1.5	1.0	0.7
Private sector saving	28.8	24.1	22.5	19.1	18.8	19.2	19.2
of which: consumer households	*21.9*	*14.0*	*11.9*	*8.0*	*7.5*	*8.5*	*8.6*
Gross national saving	22.4	20.7	20.9	20.9	20.3	20.2	19.9
Gross investment	23.3	19.9	19.6	19.9	20.5	19.9	20.2
Memorandum item:							
Balance of current account transactions with the rest of the world	–0.9	0.8	1.3	1.0	–0.2	0.3	–0.3

Sources: Based on Istat and Bank of Italy data.

Investment

In 2002 gross fixed investment slowed for the second year, to growth of 0.5 per cent at constant prices, after the previous year's abrupt slowdown from 7.1 to 2.6 per cent growth. As a percentage of GDP it remained steady at 20.8 per cent, about the same as before the 1992-93 recession (Table 9; Figure 6).

Table 9

FIXED INVESTMENT IN ITALY

(at 1995 prices; percentage changes and percentages)

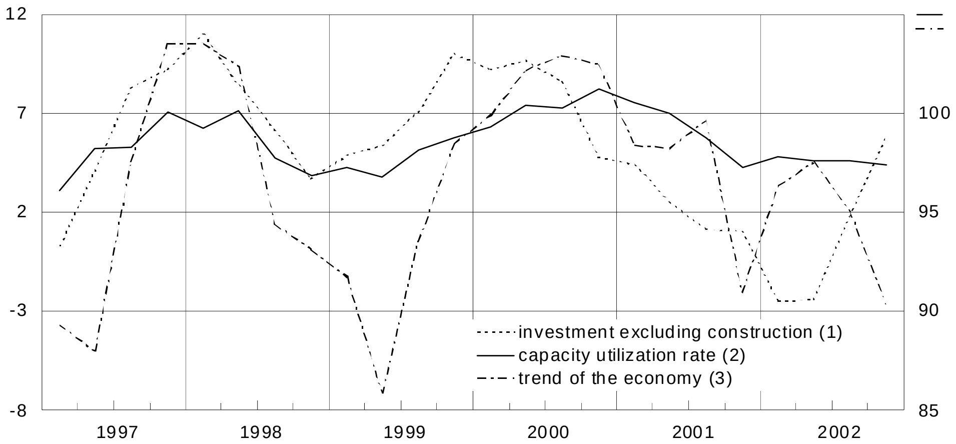
	Percentage change			As a percentage of GDP		
	2000	2001	2002	2000	2001	2002
Construction	5.9	3.2	0.3	8.3	8.5	8.5
residential	*5.3*	*1.7*	*0.9*	*4.6*	*4.6*	*4.6*
other	*6.7*	*5.1*	*–0.3*	*3.8*	*3.9*	*3.9*
Machinery and equipment	7.7	0.8	0.7	8.9	8.8	8.8
Transport equipment	9.6	7.3	0.2	2.5	2.6	2.6
Intangible assets	6.2	2.7	1.3	0.9	0.9	0.9
Total gross fixed investment	**7.1**	**2.6**	**0.5**	**20.6**	**20.8**	**20.8**
Total excluding residential buildings	7.7	2.9	0.4	16.0	16.2	16.2
Total excluding construction	8.0	2.2	0.6	12.3	12.3	12.4
Total net fixed investment (1)	**16.4**	**2.4**	**–4.4**	**7.1**	**7.1**	**6.8**

Source: Istat, national accounts.
(1) Net of depreciation.

Figure 8

INVESTMENT, CAPACITY UTILIZATION RATE AND TREND OF THE ECONOMY IN ITALY

(quarterly data)



Sources: Based on Istat and ISAE data.

(1) Percentage changes on corresponding period of previous year at constant prices. Left-hand scale. – (2) Average of Bank of Italy's indicators (Wharton) and ISAE indicators for industrial sectors; index, 1989=100. Right-hand scale. – (3) Three-month moving average of seasonally adjusted differences between the percentage of positive replies ("increasing") and negative replies ("decreasing") regarding the 3-4 month trend of output to ISAE business opinion surveys; index, 2000=100. Right-hand scale.

Capital formation, which declined by 1.4 per cent in the first six months of 2002, picked up in the second half, rising by 4.1 per cent, presumably because of the impending expiry, at the end of the year, of the tax allowances granted under the so-called second Tremonti law (Law 383 of 18 October 2001). While borrowing conditions remained favourable, capital formation was discouraged by the prolonged weakness of demand relative to productive capacity (Figure 8).

In 2002 average capacity utilization in manufacturing fell to its lowest level since the middle of the 1990s. The decline worsened progressively for the export and consumer goods industries; for the rest, capacity utilization steadied after the sharp downturn in 2001.

According to ISAE surveys, in the early months of 2002 Italian industrial firms' assessments of the current level of domestic and foreign demand recovered from the sharp deterioration of the previous autumn but then worsened once more. The composite confidence index followed a similar pattern, and by the end of 2002 had fallen back to the lows recorded prior to 11 September.

The steady expansion of investment in construction, which increased by 3.9 per cent annually between 1998 and 2001, came close to a halt in 2002. The slowdown was less pronounced in residential building, from 1.7 to 0.9 per cent. The housing sector continued to benefit, although less so than in previous years, from building renovation and extraordinary maintenance work stimulated by the tax credits introduced in 1998. Applications for the credits increased by 12.3 per cent, compared with 16.6 per cent in 2001. Real-estate demand continued to expand, leading to a sharp jump in prices, which rose by 11.6 per cent, or 9 per cent net of consumer price inflation. This was probably caused by the tighter constraints on supply, especially in the centre of the principal cities, at a time when the number of sales was decreasing.

Exports and imports

Exports. – In 2002 Italy's exports of goods and services went down for the first time in ten years, by 1 per cent at constant prices (Table 10). This was mainly attributable to exports of services, notably business services and foreign travel, which fell by 4.9 per cent. Exports of goods ceased to grow owing to the momentum effect of the trend during 2001. After remaining virtually stationary in the first six months of 2002, they picked up strongly in the second half, rising by 5.7 per cent.

Table 10

ITALY'S EXPORTS AND IMPORTS OF GOODS AND SERVICES

(percentage changes on previous year unless otherwise specified)

	2000			2001			2002		
	Goods	Services	TOTAL	Goods	Services	TOTAL	Goods	Services	TOTAL
Exports (1)									
At current prices	17.8	12.3	16.6	4.8	5.0	4.8	–1.9	–2.2	–2.0
At 1995 prices	12.0	10.7	11.7	0.9	1.8	1.1	. .	–4.9	–1.0
Deflators	5.1	1.5	4.3	3.8	3.1	3.7	–1.9	2.8	–1.0
Imports (2)									
At current prices	25.7	12.2	22.4	2.3	5.6	3.0	–2.7	4.9	–0.9
At 1995 prices	10.3	4.2	8.9	0.6	2.1	1.0	0.8	4.1	1.5
Deflators	14.0	7.6	12.4	1.6	3.4	2.0	–3.5	0.8	–2.4
Exports/imports									
At current prices, % ratio	106.1	94.9	103.6	108.8	94.3	105.4	109.6	87.9	104.3
At 1995 prices, % ratio	108.8	96.7	106.2	109.1	96.4	106.3	108.3	88.0	103.7
Terms of trade; indices, 1995=100	97.5	98.2	97.6	99.7	97.9	99.2	101.2	99.9	100.6
Contribution of net exports to real GDP growth (3)	*0.5*	*0.3*	*0.9*	*0.1*	*. .*	*0.1*	*–0.2*	*–0.6*	*–0.7*

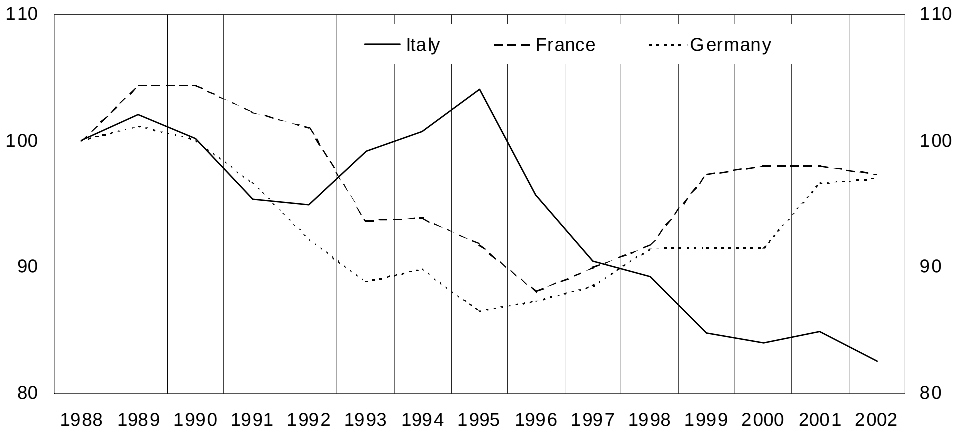
Source: Istat, national accounts.
(1) Includes non-residents' consumption in Italy. – (2) Includes residents' consumption abroad. – (3) Percentage points.

The year-on-year stagnation of exports of goods was set against a 3 per cent growth in world trade, causing Italy's share to fall to 3.6 per cent at constant prices. The differential with respect to Germany and France continued to widen (Figure 9).

Figure 9

EXPORTS OF THE MAJOR EURO-AREA COUNTRIES AS A SHARE OF TOTAL WORLD TRADE

(exports of goods at constant prices; indices, 1988=100)



Sources: Based on national and IMF statistics.

In part, Italy's export performance reflected the loss in price competitiveness over the past two years. Measured on the basis of average unit values, the loss amounted to almost 8 percentage points between the end of 2000 and the end of 2002, more than in Germany or France. One reason for this was that Italian exporters were less able to compensate for the nominal appreciation of the euro, partly because of a more unfavourable trend in unit labour costs concomitant with a sharp slowdown in productivity (Figure 10 and Table 11).

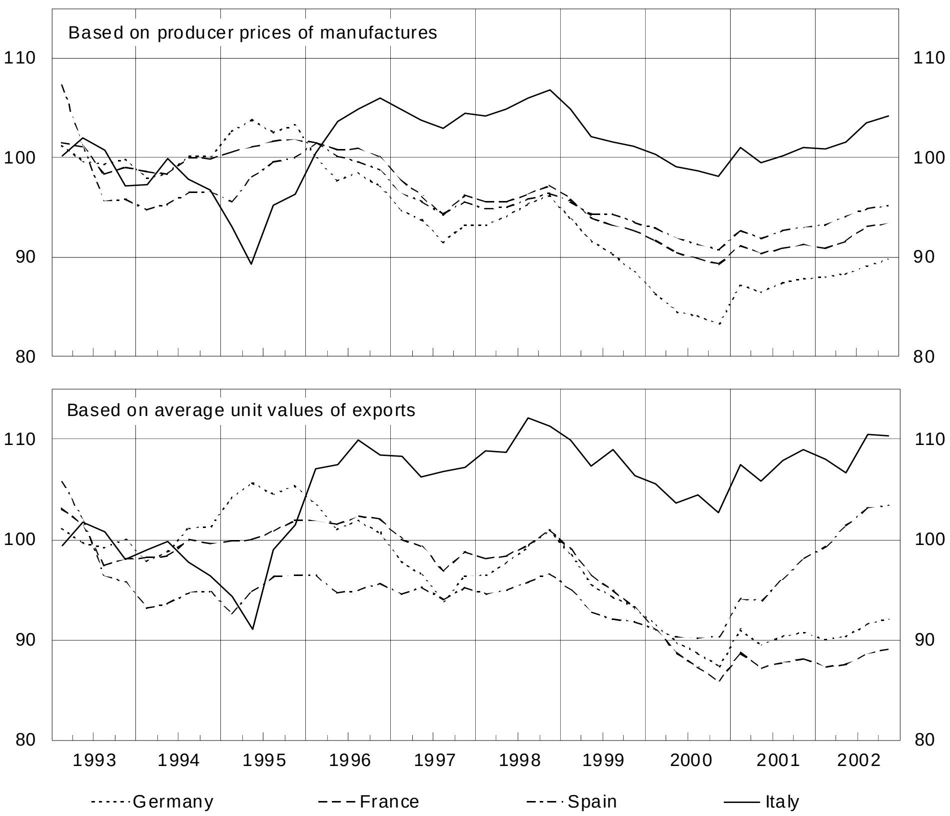
The weakness of Italian exports of goods and services in 2002 reflected a prolonged period of slow growth in the main markets, most especially vis-à-vis Germany (Table 11). This was compounded by the structural brake inherent in Italy's productive specialization, focusing as it does on the less dynamic components of demand and lower-tech industries that are more vulnerable to competition from producers in the emerging industrial countries.

The growth in Italian exports to non-EU markets fell by half in 2002, to 2 per cent at constant prices, and the contraction in those to other EU countries worsened by 3 per cent, compared with 1.9 per cent in 2001. About half this contraction was due to the exceptionally large reduction in exports to Germany, which went down by 9 per cent even though Germany's total imports edged up by 1 per cent. Italy's market share thus continued to contract, falling to 7.2 per cent at current prices in 2002, whereas it had been 10 per cent in 1996. This result contrasts with the strong gains made by the Central and Eastern European countries and China, which compete in the same product sectors as most Italian exporters: their shares of total German imports almost doubled between 1996 and 2002, to 10.3 and 2.5 per cent respectively.

Figure 10

INDICATORS OF COMPETITIVENESS OF THE MAJOR EURO-AREA COUNTRIES COMPARED WITH ALL COMPETITOR COUNTRIES (1)

(monthly data; indices, 1993=100)



Sources: Based on national statistics and IMF.
(1) Real effective rate of exchange; an increase indicates a loss of competitiveness.

In 2002 Italian fashion exports continued to disappoint, especially those to other European countries. The risks inherent in Italy's model of specialization are borne out by the fact that the non-industrial countries' share of world exports in the traditional sectors of textiles, clothing, leather goods and footwear has risen, at current prices and in current dollars, by more than 10 percentage points in the past decade, reaching 60 per cent in 2000.

Table 11

EXPORTS AND IMPORTS OF GOODS AND SERVICES OF THE MAJOR EURO-AREA COUNTRIES AND INDICATORS OF DEMAND AND COMPETITIVENESS

(at constant prices; percentage changes)

	1998	1999	2000	2001	2002
Germany					
Imports of goods and services	9.1	8.5	10.5	1.0	−2.1
Exports of goods and services	7.0	5.6	13.7	5.0	2.6
Outlet markets (1)	8.2	7.6	11.6	0.5	1.3
Indicators of competitiveness (2)					
overall	1.5	−3.8	−7.1	3.1	1.8
export	1.8	−4.4	−8.0	3.3	2.4
import	1.2	−3.0	−6.0	2.9	1.1
France					
Imports of goods and services	11.6	6.2	14.6	1.3	0.6
Exports of goods and services	8.3	4.3	12.6	1.6	1.5
Outlet markets (1)	8.5	8.2	10.9	0.7	0.6
Indicators of competitiveness (2)					
overall	0.1	−2.3	−3.8	0.6	1.5
export	0.5	−3.1	−4.8	1.0	2.1
import	−0.3	−1.5	−2.8	0.3	0.9
Italy					
Imports of goods and services	8.9	5.6	8.9	1.0	1.5
Exports of goods and services	3.4	0.1	11.7	1.1	−1.0
Outlet markets (1)	8.5	8.2	11.8	0.6	0.5
Indicators of competitiveness (2)					
overall	1.4	−2.9	−3.3	1.4	2.1
export	1.8	−3.7	−4.5	1.7	2.8
import	0.9	−1.8	−1.7	1.0	1.2
Spain					
Imports of goods and services	13.2	12.7	10.6	3.5	2.2
Exports of goods and services	8.2	7.7	10.1	3.4	1.4
Outlet markets (1)	9.0	7.5	11.5	0.7	0.5
Indicators of competitiveness (2)					
overall	..	−1.1	−2.9	0.9	2.0
export	0.3	−1.8	−3.8	1.1	2.5
import	−0.2	−0.6	−2.1	0.8	1.5

Sources: Based on national statistics.

(1) Average of the changes in imports of goods and services of the principal importing countries, weighted using their respective weights in the indicator of competitiveness. – (2) Based on the producer prices of manufactures. A positive value indicates a loss of competitiveness.

Against a background of limited world trade growth and cyclical slowdown in the main markets, the size distribution of Italian firms had serious repercussions on exports.

Imports. – Last year Italian imports of goods and services increased by 1.5 per cent at constant prices, compared with 1 per cent in 2001. Two thirds of this was ascribable to the step-up in imports of services from 2.1 to 4.1 per cent, while the growth in imports of goods remained virtually stationary at 0.8 per cent. Both components accelerated in the second half of the year, more steeply in the case of goods (from 0.3 to 5.7 per cent with respect to the first half). A major contributory factor was the improvement in overall demand, which accelerated from growth of 0.2 per cent to 1.7 per cent, coupled with the lagged effects of the loss in price competitiveness of imports, which amounted to some 6 percentage points between the autumn of 2001 and that of 2002.

According to foreign trade statistics, imports of goods increased by 1.3 per cent at constant prices in 2002, after stagnating in 2001. Both imports from non-EU countries and, to a slightly lesser extent, those from EU countries were affected. Outside the EU, imports from China, which had slowed in 2001, began to rise again at a rate of more than 20 per cent.

DOMESTIC SUPPLY

Economic sectors

In Italy the rate of increase in value added at factor cost came down from 2 per cent at constant prices in 2001 to 0.5 per cent in 2002 (Table 12). While remaining stationary in industry, value added grew by almost 1 per cent in services, which thus contributed 70 per cent of the national total.

In the euro area industrial production contracted by 0.6 per cent on an annual average basis after rising by 0.5 per cent in 2001. It fell by 1.4 per cent in Italy (0.8 per cent in 2001) and by a similar amount in France and Germany, while in Spain there was almost no change, with a rise of 0.2 per cent.

In the service sector the largest gains in production came in services provided to businesses and households (3 per cent) and in health and social services (2.6 per cent).

The value added of agriculture, forestry and fishing declined by 2.6 per cent, following a fall of 0.7 per cent in 2001, and thus slipped from 2.9 to 2.8 per cent of total Italian value added.

Italy's gross energy requirement showed no change from 2001, halting the rising trend of recent years. Domestic production of energy declined by 4.6 per cent, causing an increase in foreign dependency from 83.7 to 84.4 per cent. However, thanks to the drop in oil prices, the "energy bill" (total expenditure on primary energy imports) was less than in the previous year, down from 2.3 to 2.1 per cent of GDP.

The crisis in Italy's car industry. – According to data from the industry association, ANFIA, new car registrations continued to decline in 2002, falling by 5.6 per cent, compared with 0.4 per cent in 2001. Demand for Italian cars contracted sharply, by 17.5 per cent, while there was a slight pick-up in demand for foreign vehicles. The market share of Italian manufacturers contracted by a further 4.3 percentage points to 30.3 per cent.

The Fiat Group continued to lose market share throughout Western Europe, where registrations of Italian cars fell by 16.7 per cent. Its share dropped from 9.6 to 8.2 per cent and from 4.7 to 4 per cent excluding the domestic market.

Table 12

VALUE ADDED AT FACTOR COST IN ITALY

Branch	2001		2002		Percentage changes			
	Current values in millions of euros	Share of value added (%)	Current prices in millions of euros	Share of value added (%)	Volumes		Deflators	
					2001	2002	2001	2002
Industry	**305,668**	**27.7**	**310,263**	**27.3**	**1.5**	**0.0**	**3.1**	**1.5**
Industry excluding construction	**251,518**	**22.8**	**253,702**	**22.3**	**1.0**	**–0.1**	**3.2**	**0.9**
Extractive industries	4848	0.4	4,705	0.4	–6.7	0.8	–6.2	–3.8
Manufacturing	221,502	20.1	223,900	19.7	0.8	–0.7	3.0	1.8
Production and distribution of electricity, gas, steam and water	25,168	2.3	25,097	2.2	3.6	6.0	7.6	–6.0
Construction	**54,150**	**4.9**	**56,561**	**5.0**	**4.1**	**0.5**	**2.8**	**3.9**
Services	**767,399**	**69.4**	**796,156**	**69.9**	**2.3**	**0.9**	**3.5**	**2.8**
Wholesale and retail trade, repairs	144,373	13.1	147,047	12.9	1.0	–0.6	3.8	2.5
Hotels and restaurants	40,337	3.7	42,299	3.7	2.9	–0.5	4.8	5.4
Transport, storage and communication services	83,092	7.5	82,560	7.3	5.6	0.5	1.8	–1.2
Financial intermediation services (1)	64,115	5.8	67,530	5.9	–1.1	–1.4	1.9	6.9
Services to businesses and households (2)	220,927	20.0	234,427	20.6	3.2	3.0	3.1	3.0
Public administration (3)	58,449	5.3	60,288	5.3	0.8	0.8	4.9	2.3
Education	55,669	5.0	56,810	5.0	0.3	0.8	6.1	1.2
Health and other social services	52,495	4.7	54,926	4.8	5.9	2.6	1.5	2.0
Other community, social and personal services	39,242	3.5	41,087	3.6	1.5	0.6	6.6	4.1
Private households with employed persons	8,700	0.8	9,182	0.8	2.8	1.7	1.6	3.7
Agriculture (4)	**31,875**	**2.9**	**31,973**	**2.8**	**–0.7**	**–2.6**	**3.3**	**2.9**
Value added at factor cost (5)	**1,104,942**	**100.0**	**1,138,392**	**100.0**	**2.0**	**0.5**	**3.4**	**2.5**

Source: Istat

(1) Includes insurance and pension funds. – (2) Includes real-estate, renting, computers, research and other professional and business services. – (3) Includes defence and compulsory social security services. – (4) Includes forestry and fishing. – (5) Gross of indirectly measured financial intermediation services.

By the end of 2001 the gradual deterioration in Fiat's profitability and financial situation had prompted it to take extraordinary measures to restructure the Group, restore economic and financial health and revive core industrial activities. Major changes in senior management were made at the same time.

Large sales of non-strategic assets were made during 2002; the whole of Fiat’s holding in General Motors (approximately 6 per cent) was sold, as well as a 34 per cent interest share in Ferrari and its 14 per cent holding in Italenergia Bis. Over the year such operations totaled some €3 billion. In January Fiat S.p.A. increased its capital by more than €1 billion and in July a group of banks backed its restructuring programme with a three-year €3 billion loan convertible into the company’s shares.

Following the measures decided at the end of 2001 the Group terminated the employment of 2,887 workers, most of them belonging to Fiat Auto, under redundancy arrangements agreed with the trade unions (CGIL excepted) in July 2002. Similar agreements involving a further 300 workers were reached by some of the other Fiat Group companies in Italy.

In October the Group presented a new plan for its reorganization and recovery designed to reduce costs and increase capacity utilization while renewing its product range through additional investment in R&D.

According to the plan the Group had 8,066 excess workers, equal to 8.5 per cent of all its employees in Italy on 30 June 2002. The Government authorized it to make recourse to extraordinary wage supplementation for a maximum of 5,600 workers from December 2002 and to other measures involving a further 2,000 workers from July 2003. Another 500 workers can be made redundant by the end of the year.

Company demographics. – According to the Chamber of Commerce register of companies, entries of non-farm companies outnumbered exits by almost 100,000 in 2002, raising the number of registered firms at the end of the year by 2.1 per cent, from 4,726,000 to more than 4,823,000, and confirming a trend under way since 1994. The increase, which is the third largest in the past ten years, is the balance between more than 281,000 exits and over 378,000 entries, nearly as many as the previous year’s record number.

For the sixth year running there was net creation of new businesses in the South, with the number of registered companies growing faster than in other parts of the country. The southern regions’ contribution to the overall balance rose from 37.9 to 44.6 per cent.

About 12 per cent of the businesses set up in 2002 as sole proprietorships or partnerships are owned by people born outside the EU. Excluding companies and other forms of incorporation, some 9 per cent of all new businesses are owned by non-EU citizens, three times the percentage of such immigrants in Italy’s population. About half of these owners come from just five countries: Morocco, China, Albania, Switzerland and Romania.

The European countries and the objective of the knowledge-based economy

The growing importance of a digital technology-based system entails a great effort of research and innovative investment and a major improvement in the level of skill training. At the Lisbon summit meeting in March 2000 the EU member countries agreed on the objective for the following decade of turning the Union into “the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion”.

The various EU countries’ progress towards the objective set out in the Presidency Conclusions is monitored yearly against a set of indicators of structural reforms in the labour, goods and capital markets prepared by the European institutions. The indicators of the member states’ innovation capacity are divided into the following categories: human resources, knowledge creation, knowledge transmission and application, innovation financing, results and markets. All the indicators of the innovation economy show the EU overall lagging well behind both the United States and Japan.

The United States has the highest percentage of workers with post-secondary education (36.5 per cent), followed by Japan with 29.9 per cent and at some distance the EU with 21.2 per cent (Figure 11). Europe’s poorer innovation capacity shows up not only in the indicators of the drive to innovate, for example the ratios to GDP of spending on R&D and spending on ICT, but also in those of results, such as applications to the European Patents Office. In addition to the characteristics of its labour force and its level of innovation capacity, Europe has considerably less specialization in high-tech sectors than the United States.

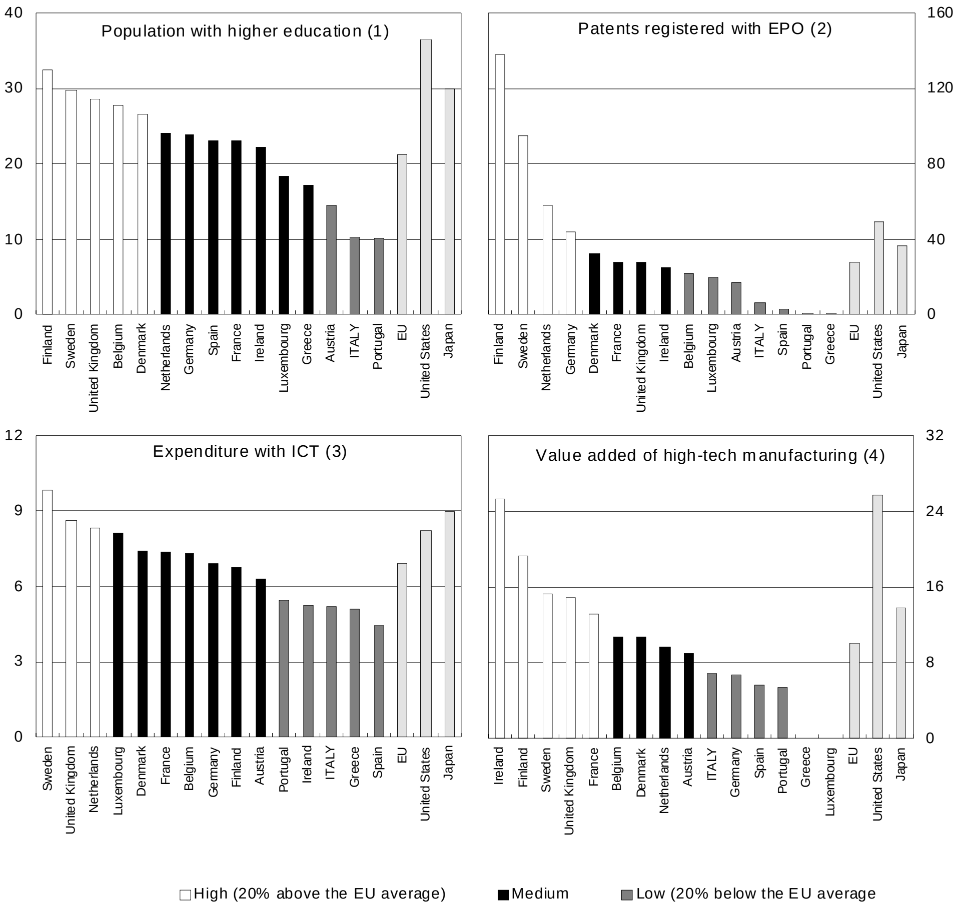
The degree of backwardness varies considerably within the European Union. Basically, there are three levels of progress: one group of north European countries shows values close to those of the United States, a group of continental countries occupies a middle position, and the Mediterranean countries come last.

Italy belongs to the most backward group, particularly as regards the educational level of its labour force. Italian firms also have a low propensity to patent innovations. Moreover, the manufacturing value added of high-tech sectors is below the European average, as are the ICT penetration indicators. Similar, if less one-sided, signals emerge from the long-term performance of these indicators.

All the indicators for Italy calculated by the European Commission are below the Union averages. It is in innovation activity that firms tend to perform worst, with the growth of patents in high-tech sectors and, to a smaller extent, that of spending on R&D falling below the EU averages. However, the trend appears better with regard to science and engineering graduates, public spending on R&D and expenditure on ICT.

Figure 11

INDICATORS OF INNOVATION CAPACITY



Source: Eurostat.

(1) Percentage of working age population (25-64 years old) with post-secondary educational qualification (in 2001). – (2) Number of patent applications deposited with the European Patent Office in the high-tech categories per million inhabitants (in 2000). – (3) Total expenditure on ICT as a percentage of GDP. Includes expenditure on hardware, software and telecommunication services (in 2001).– (4) Share of manufacturing value added of the pharmaceuticals, office machinery, telecommunications machinery and aerospace sectors (in 1999).

Privatizations, market regulation and company law

Privatizations. – No major progress was made in 2002 in the process of privatizing publicly-owned companies, partly owing to the fall in share prices.

Only some very small holdings were sold. Law 488\1999, which streamlines procedures for the sale of holdings worth less than €100 million in companies no longer publicly controlled, was applied between March and April 2002 to sell the remaining public holding in INA. The operation, which began in 2001, yielded net proceeds of €76 million.

At the beginning of December 2002 the Ministry for the Economy sold its remaining shares in Telecom Italia, amounting to 3.46 per cent of the ordinary share capital and 0.66 per cent of the savings share capital, grossing around €1.4 billion. Thus the state bowed out of all direct presence in the telephony sector. The Ministry for the Economy nevertheless still holds a golden share giving broad discretionary power over changes in the control structure of Telecom Italia. In the early months of 2003 the European Commission started an infringement inquiry into states' golden shares in privatized companies on the grounds that they limit the free circulation of capital in the EU. The second major telephone company, Wind-Infostrada, is controlled by the public group, ENEL.

The Italian state still retains considerable holdings in large corporations and overall a substantial part of economy the is still publicly owned (Table 13).

Table 13

MAIN STATE SHAREHOLDINGS AT 31 DECEMBER 2002

Company	Sector	Turnover in 2001 (million euros)	Number of employees in 2001 (1)	State shareholding (%)
Alitalia	Transport	7,549	21,294 (3)	53.01
ENAV	Transport	500	3,280	100.00
Enel	Energy	28,240	72,661	67.58
ENI	Energy	48,837	70,948	30.33
ETI	Tobacco	2,418 (2)	4,576 (3)	100.00
Ferrovie dello Stato	Transport	9,225	109,922	100.00
Finmeccanica	Defence and aerospace	6,717	41,093	32.45
Poste Italiane	Postal services	7,220	157,677	100.00
Rai Holding	Television and multimedia	2,880	11,509	100.00
Seat	Publishing	1,991 (2)	7,715 (3)	0.10

Source: Ministry for the Economy and Finance.
(1) Data taken from Mediobanca, *R&S*, 2002; company balance sheets; Cerved. – (2) In 2002. – (3) Employees in 2002.

Market regulation. – The deregulation of the electricity sector continued to go forward in 2002. ENEL made further sales of power generation capacity and in March concluded the sale of Eurogen to the

Edipower consortium led by Edison for €3.7 billion. The sale of Interpower, the smallest (2,611 MW) of the three generating companies spun off from ENEL, to a consortium consisting of ACEA, Electrabel and Energia Italia for €853 million was completed in January of this year. It is estimated that this sale reduced ENEL's share of total generating capacity to about 52 per cent.

In order to increase power generating capacity, the Decree Law containing urgent measures to safeguard the national economy was converted into Law 55/2002; it introduces simplified authorization procedures for the construction of new power plants.

At the end of April 2003, when the third generating company was sold, freedom to select their supplier was granted to all customers consuming more than 100,000 kWh per year, that is, an estimated 160,000 final users. The electricity exchange market, which was due to become operational by the beginning of 2001, is still well behind schedule.

On 1 January 2003 all sales of gas to final users were liberalized. The provision was part of legislation designed to fully open up the sector to competition, which includes recent measures by the sectoral authority to regulate conditions of access to the networks and charges for transport and distribution services. Under the measures to guarantee access to the market for other operators, ENI split off its transport network management business, later putting part of it up for sale, and its stockpiling activities.

In the telecommunications sector, where liberalization began, the benefits are more evident, with telephony prices close to EU averages. In fixed telephony, access by new competitors to the so-called "last mile" remains problematic. The considerable market power of former monopoly holders continues to pose a problem in other European countries as well. The financial crisis affecting the sector world-wide reduces the flow of financing to the detriment of investment in infrastructure.

Company law. – In Italy the reform of company law that began in 1998 continued with the approval in January 2003 of two legislative decrees amending Enabling Law 366/2001. Legislative Decree 5/2003 speeds up the resolution of company disputes and increases the scope for private settlement. Legislative Decree 6/2003 modernizes the law on companies and cooperatives.

The reform alters the overall structure of Italian company law and defines the features of limited liability companies more precisely, distinguishing them from other types; it calibrates the rules, for companies limited by shares as well, according to the ownership structure and the method of financing; it modifies the rules governing cooperatives. The innovations affect all the most important aspects of corporate life: constitution, shareholders' rights, management and supervisory bodies, financial instruments, shareholders' agreements, annual accounts, extraordinary corporate actions, and groups.

The new provisions make the existing legislation simpler and more flexible; they ensure more satisfactory settlement of conflicting interests and more effective protection of the providers of financing; they also broaden the financing options. The reform comes into force on 1 January 2004, after which there will be one more year for further amendments and additions to the text of the legislative decrees.

It will be possible to revise some crucial aspects. In the case of bond issues the solutions adopted could have reflected more closely the experience of other industrialized countries that do not set quantitative limits on issues by companies limited by shares but place the emphasis on the provision of correct information to the public. There is a large and delicate area of uncertainty surrounding the premises for applying the new provisions regarding groups. The rules governing the new systems of management and supervision raise problems of interpretation.

Furthermore, Italy still lacks a reform of the law on bankruptcy and receivership procedures. The rules on corporate failures have serious repercussions ex ante on investment decisions, risk taking and the cost of borrowing.

Regional economic developments and regional policy

Regional economic developments. – Svimez (the Association for Industrial Development in Southern Italy) estimates that output in the South increased by 0.8 per cent last year (1.9 per cent in 2001), registering a smaller slowdown than in the rest of Italy (from 1.8 to 0.2 per cent), which is more responsive to the international business cycle.

The difference in GDP growth between the two areas reflects divergences in gross fixed investment, which the Association estimates grew by 1 per cent in the South and by 0.3 per cent in the Centre and North, while final household consumption grew by 0.3 per cent in both parts of the country.

The value of exports decreased in all regions compared with 2001, but particularly in the North West and the South, where it fell by 4.6 and 3.7 per cent respectively. In the North East the fall was 1.1 per cent, while in the Centre it was 0.8 per cent.

The productive structure of the South. – According to regional accounts data, productive activity in the South is more heavily concentrated in the service sector, which accounts for 75 per cent of total value added, and in agriculture (Table 14). The share of value added of industry excluding construction is about half the figure for the northern regions.

Table 14

SECTORAL DISTRIBUTION OF VALUE ADDED BY GEOGRAPHICAL AREA IN 2000

	Agriculture, forestry and fishing	Industry			Services	Total	Absolute values (1)
		Excluding construction	Construction	Total			
North West	1.76	28.92	4.24	33.16	65.08	100.00	352,897
North East	3.13	27.15	5.41	32.56	64.31	100.00	241,778
Centre	1.91	19.47	4.16	23.63	74.46	100.00	225,967
South	4.56	14.83	5.64	20.47	74.97	100.00	258,374
Italy	**2.76**	**23.22**	**4.82**	**28.04**	**69.20**	**100.00**	**1,080,292**

Source: Based on Istat data.
(1) Value added at basic prices, gross of indirectly measured financial intermediation services. The total is not equal to the sum of the separate areas owing to value added not assigned on a geographical basis.

A more detailed breakdown of the service sector shows that its size in the South is due to the prevalence of activities associated with the public sector. Public administration and education produce more than 22 per cent of total value added in the South compared with 12 per cent in the Centre and North (Table 15).

Comparing the service sector's percentage of value added in the two parts of the country it emerges that services most closely associated with other productive activities, such as transport and financial intermediation, as well as wholesale and retail trade and tourism, have a greater relative weight in the Centre and North.

In industry, output in the southern regions is concentrated in construction and, among the manufacturing sectors, in branches that are natural-resource intensive such as the food industry and crude oil processing, and in branches producing intermediate goods for construction, such as non-metallic mineral products. In the sectors producing typical Made-in-Italy goods, such as textiles and clothing and machinery and metal products, their share of total value added in manufacturing is 15-20 per cent lower in the South than in the Centre and North.

Table 15

VALUE ADDED BY BRANCH OF ACTIVITY AND GEOGRAPHICAL AREA

(percentage shares; year 2000)

	Centre and North	South	Ratio South/ Centre & North
	Manufacturing industry		
Food products, beverages and tobacco	8.69	17.08	1.97
Textiles and clothing	11.38	8.90	0.78
Leather and leather products	2.79	2.67	0.96
Paper, printing and publishing	6.93	5.01	0.72
Coke, refined petroleum products, chemicals and pharmaceuticals	9.56	10.54	1.10
Non-metallic mineral products	6.34	8.70	1.37
Basic metals and fabricated metal products	13.80	11.69	0.85
Mechanical, electrical and optical machinery and equipment; transport equipment	28.57	24.86	0.87
Wood, rubber and other manufactured products	11.94	10.55	0.88
Total	**100.00**	**100.00**	
	Services		
Wholesale and retail trade, motor vehicle repairs	19.33	17.89	0.93
Hotels and restaurants	5.56	4.17	0.75
Transport, storage and communication services	10.82	9.45	0.87
Financial intermediation services	10.11	5.78	0.57
Real estate, renting, computers, research and other services	29.30	27.35	0.93
Public administration and defence services, social security services	6.64	10.73	1.62
Education	5.79	11.61	2.01
Health and social services	6.30	7.89	1.25
Other community, social and personal services	4.94	4.39	0.89
Private households with employed persons	1.21	0.74	0.61
Total	**100.00**	**100.00**	

Source: Based on Istat data.

The current sectoral distribution of employment in manufacturing in Italy is the result of widely diverging geographical trends. In the Centre and North, where textiles and engineering already dominated in the 1951 Census, productive concentration has remained practically unchanged; in the southern regions the traditional sectors of food, leather goods and footwear and wood, which were the uncontested leaders in 1951, have progressively lost ground. Partly owing to investments by publicly-owned companies, up to 1981 Italy's productive specialization focused on energy-intensive sectors such as metals, chemicals and petrochemicals and transport equipment. Afterwards the sectoral distribution of employment began to move into line with that in the Centre and North, chiefly as a result of the substantial growth of engineering, based mainly in the Campania region, and transport equipment (Basilicata and Campania), and the resilience of the textile industry, located for the most part along the Adriatic coast.

If the branches of manufacturing industry are grouped according to spending on R&D their weight in the two parts of the country can be graded according to technology intensity, as calculated by the OECD. In the South, in 1996 employment was relatively greater in low-tech sectors. In the advanced sectors, which throughout the country employ a very small percentage of the manufacturing labour force, the South lags behind mainly in the medium-high-tech industries (Table 16).

Table 16

DISTRIBUTION OF EMPLOYMENT IN MANUFACTURING INDUSTRY BY TECHNOLOGY LEVEL AND GEOGRAPHICAL AREA

(percentage shares)

Area	Low	Medium	Medium-high	High
Centre and North	40.51	28.49	25.39	5.61
South	51.31	27.83	15.76	5.10
Ratio South/Centre and North	1.27	0.98	0.62	0.91

Source: Based on Istat data, *Censimento generale dell'industria e dei servizi*, 1996.

In the South the larger relative employment in low-tech sectors is due to the heavy concentration of firms in the food and wood products sectors. Among the high-tech sectors communications equipment and aircraft manufacturers have a greater relative weight. The indices of relative concentration, in which the sectors are ordered by average wages, produce a very similar picture: low-paid activities are more frequent in the South and medium-paid ones in the Centre and North. High-wage sectors, which account for less than 10 per cent of employment, are evenly distributed throughout the country.

The productive structure of the South is also made up of smaller units on average. A comparison of data from the eighth census of industry and services with the previous two shows that the size gap between firms in the Centre and North and in the South is fairly constant, at respectively 5.1 and 4.1 workers in 1981 and 4.2 and 3.1 in 2001. The gap tends to widen in industry, from respectively 7.7 and 6.5 workers in 1981 to 6.8 and 4.7 in 2001, to remain practically unchanged in wholesale and retail trade, albeit with a slight increase in average firm size in the Centre and North, and to disappear in other services, which includes the public administration. In the period from 1981 to 2001 the number of local units increased slightly as a percentage of the population in all parts of the country and all economic activities, with the geographical differences remaining large and constant (respectively 69.1 and 47.3 per cent in the Centre and North and the South in 1981 and 76.8 and 53.4 per cent in 2001).

Another singular feature of the South is the scale of the underground economy, with irregular labour units accounting for 22 per cent of the total labour units in 2000, about twice Istat's estimate for the North. The greatest incidence of irregularity in the South is found in Calabria, Campania and Sicily, where it equals 29, 25 and 24 per cent respectively, while only in Abruzzo is it below the national average (Table 17). A similar trend can be observed in the proportion of underground activity in terms of value added, regional estimates of which are only available up to 1998.

Table 17

INCIDENCE OF IRREGULAR ECONOMIC ACTIVITY BY REGION (1)

(percentages)

	1995	1996	1997	1998	1999	2000
Piedmont	10.3	10.8	10.6	10.2	10.5	11.2
Valle d'Aosta	16.0	15.3	15.7	17.5	16.7	15.9
Lombardy	11.4	11.2	11.1	10.9	10.6	10.5
Trentino-Alto Adige	12.8	13.8	14.1	14.9	12.8	13.0
Veneto	11.2	11.0	10.9	11.4	11.2	11.2
Friuli-Venezia Giulia	11.5	11.5	11.1	11.4	13.1	13.2
Liguria	12.8	13.5	13.3	13.8	13.8	13.3
Emilia-Romagna	10.7	10.5	10.6	10.8	10.7	10.1
Tuscany	11.9	12.3	12.9	12.9	13.1	13.2
Umbria	14.7	14.1	15.2	14.4	15.1	16.6
Marche	11.7	11.7	12.0	12.0	12.9	13.8
Lazio	16.5	16.5	17.0	17.2	16.7	17.4
Abruzzo	12.1	12.8	12.9	13.4	13.3	14.1
Molise	14.2	15.6	15.9	16.5	16.4	18.1
Campania	23.8	23.8	25.0	26.2	25.5	24.7
Puglia	19.4	19.5	19.4	19.4	19.4	20.0
Basilicata	17.1	17.5	18.1	19.9	20.1	22.0
Calabria	28.1	27.3	27.5	28.3	27.9	29.2
Sicily	20.3	21.1	21.9	23.4	23.5	23.6
Sardinia	16.4	17.5	18.7	19.7	19.5	18.3
Italy	**14.5**	**14.5**	**14.8**	**15.1**	**15.0**	**15.1**
North West	11.3	11.3	11.2	11.0	10.9	11.0
North East	11.2	11.1	11.1	11.5	11.4	11.2
Centre	14.2	14.2	14.8	14.9	14.9	15.5
South	20.7	20.9	21.6	22.5	22.3	22.4

Source: Based on Istat data.
(1) The incidence is calculated as the percentage of irregular labour units in total labour units.

The difference in the sectoral distribution of activity between the two parts of the country does little to explain the difference between the percentages of irregular activity. In the South in particular, the estimated effect on the rate of irregular activity of a more pronounced sectoral specialization in agriculture and services can be set at 1.4 percentage points.

From 1995 to 1999 the differences between the incidence of irregular labour units in the various parts of the country continued to grow. The input of irregular labour spread in the South and the Centre but diminished in the North. If the effects of the change in sectoral distribution are excluded, the incidence of irregular units grew substantially in the southern regions, by 2.4 percentage points, compared with 2 points if those effects are included.

Regional policies. – In 2002 no new territorial pacts were approved. According to Ministry for the Economy data, but 200 of the 230 pacts approved in 1996 were still active in December. They involve almost €13 billion of investments in infrastructure and business projects, a third of which will receive public funding. The results of monitoring by the public administration show that the so-called employment pacts completed the investment programme approved by the European Commission, spending almost all the funds allocated. For national pacts, spending of contributions proceeded at very different rates and was faster on average for pacts located in the South and first generation pacts approved before 2000.

After approval by the European Union, which authorized the use of negotiated planning in the period 2000-06, the programme contracts signed by the public administration and large firms or consortiums of small and medium-sized firms to finance specific business projects entered stage three, with 38 approvals. The related incentives represent about half the projected €3.7 billion investment.

Of the various incentives available for private investment those granted under Law 488/1992 involve the largest financial commitment. About €2.7 billion of incentives have been granted for 2003, 92 per cent of which is for investment projects in the South. Incentives granted to industry and services, which account for some 75 per cent of total funds, are down by 30 per cent compared with 2001.

Initially, very little use was made of the tax credits introduced with the 2001 Finance Law and granted automatically to firms investing in new projects in depressed areas. Last year, after Law 178/2002 had been passed allowing the incentives to be cumulated with those available under the second Tremonti law (Law 383/2001), the amount of tax credits granted rose to over €1.9 billion, compared with €570 million in 2001.

The Community Support Frameworks for 2000-06 approved in August 2000 can count on more than €50 billion of available resources, most of which is to be spent between 2004 and 2006. By June 2002, two thirds of the expenditure targets programmed for that date had been achieved, equal to about €4.75.

The programming for 1994-99 closed with actual spending of appropriations totaling more than 95 per cent.

THE LABOUR MARKET

The euro area

The slowness of economic growth last year resulted in another pronounced deceleration in the expansion of euro-area employment. According to estimates based on national accounts, the average number of persons employed rose by 0.5 per cent in 2002, compared with 1.3 per cent in 2001 and 2.1 per cent in 2000. As in 2001, the decline in net job creation was due above all to stagnation of economic activity in Germany, where employment contracted by 0.6 per cent, continuing the trend that began in early 2001 (Figure 12). In the rest of the area employment increased by 0.9 per cent thanks to good if decelerating job growth in the larger economies: 1.3 per cent in Italy and Spain and 0.8 per cent in France (down from 1.7, 2.4 and 1.8 per cent respectively in 2001). The weakness of activity showed up in rising unemployment rates in all area countries except Italy, Greece and Finland.

In the last five years net job creation in the largest European economies has been greater than would have been expected on the basis of the historic relationship with output growth. This greater elasticity of employment can be ascribed to wage moderation and increased flexibility in the utilization of workers, which have also spurred the development of such labour-intensive activities as services to businesses and households. In Italy these trends and the diminished contribution of technical progress with respect to the past, as indicated by the slowdown in total factor productivity (Table 18), have been reflected in a gradual deceleration in labour productivity that has intensified during the recent economic stagnation.

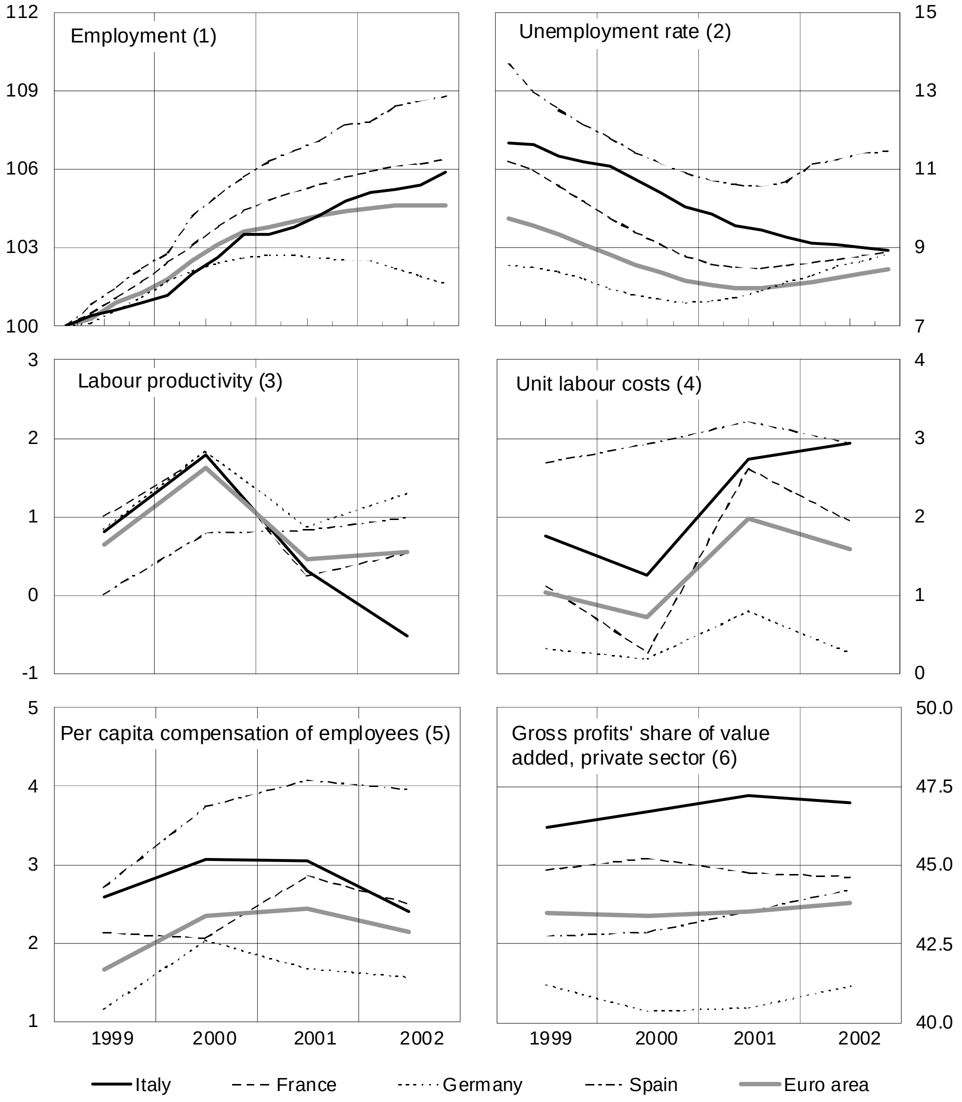
Value added at base prices per person employed was 0.5 per cent higher on average in 2002 than in 2001. Inversely to employment, labour productivity rose most sharply in Germany (1.3 per cent), increased in line with the area-wide average in France (0.5 per cent), and declined in Italy (–0.5 per cent). Given similar and generally moderate rises in employees' earnings, unit labour costs reflected the developments in productivity, rising by just 0.3 per cent in Germany, by 1.9 per cent in France and by 2.9 per cent in Italy.

In Italy the rise in producer prices nearly offset that in unit labour costs, curbing the reduction in profit margins. In the private sector, net of rentals the share of gross profits in value added (at base prices) fell to 34.3 per cent from 35.1 per cent in 2001. Despite the economic slowdown, the share of profits remained at the historically high levels that had been reached at the peak of the previous upswing. When for international comparability one includes rentals and measures labour input by number of persons rather than standard labour units, the share in Italy still declined by a small amount. In the last two years it has declined in France but risen in Spain and slightly in Germany as well.

Figure 12

THE LABOUR MARKET IN THE EURO AREA

(seasonally adjusted data)



Sources: Based on Istat and Eurostat, national accounts and labour force surveys.

(1) Index: 1st quarter 1999=100. Partly estimated. – (2) Percentages. – (3) Percentage change in value added at 1995 base prices per worker. – (4) Percentage change in the ratio of per capita employee income to value added per worker at 1995 base prices. – (5) Percentage change. – (6) Percentages. Value added at base prices less total compensation of labour (including labour income imputed to self-employed workers based on earnings of employees in the same sectors) divided by total value added.

Table 18

LABOUR COSTS AND PRODUCTIVITY IN ITALY

(annual percentage changes)

	Value added at 1995 base prices	Total standard labour units	Output per standard labour unit	Earnings per standard employee labour unit	Labour costs per standard employee labour unit (1)	Unit labour costs (1)	Labour's share of value added at base prices (1) (2)	Total factor productivity (3)	
								Unad-justed	Ad-justed
					Industry excluding construction				
Average 1981-1985	0.1	–2.8	3.0	15.8	16.2	12.8	66.9	1.3	1.8
Average 1986-1990	3.2	0.6	2.5	7.3	8.0	5.3	64.6	1.9	0.8
Average 1991-1995	1.5	–1.7	3.2	5.8	5.9	2.6	67.2	2.1	1.3
Average 1996-2000	1.1	0.1	1.1	3.4	2.6	1.5	64.2	0.4	. .
2000	2.6	. .	2.6	2.8	3.0	0.4	63.1	1.7	0.1
2001	0.9	–0.7	1.6	3.0	2.9	1.3	61.7	0.5	1.6
2002	–0.1	0.4	–0.4	2.8	2.6	3.0	63.0	–1.1	–0.9
					Construction				
Average 1981-1985	0.1	–1.3	1.4	15.9	15.1	13.5	63.5	0.2	–
Average 1986-1990	1.9	–0.4	2.3	9.9	10.4	7.9	66.0	2.0	–
Average 1991-1995	–1.2	–0.6	–0.6	4.5	4.5	5.2	70.1	–0.5	–
Average 1996-2000	1.2	0.8	0.4	3.4	2.3	1.9	70.4	–0.2	–
2000	2.8	2.9	–0.2	2.5	2.7	2.9	71.2	–0.4	–
2001	4.1	4.8	–0.7	1.8	1.5	2.2	70.7	–0.5	–
2002	0.5	1.6	–1.1	2.2	2.1	3.2	70.3	–1.7	–
					Market services (4) (5)				
Average 1981-1985	3.0	3.7	–0.7	14.0	13.4	14.2	75.5	–0.6	–
Average 1986-1990	3.7	1.7	2.0	7.0	7.3	5.1	71.2	1.4	–
Average 1991-1995	1.7	–0.3	1.9	5.7	5.5	3.5	70.3	1.0	–
Average 1996-2000	3.4	2.2	1.2	3.2	2.2	1.0	65.4	0.9	–
2000	7.2	3.5	3.6	3.0	2.8	–0.8	64.2	3.3	–
2001	2.8	2.5	0.3	2.9	2.7	2.4	64.1	–0.2	–
2002	0.9	2.0	–1.1	2.3	2.1	3.3	64.8	–1.7	–
					Private sector (5)				
Average 1981-1985	1.5	–0.2	1.6	15.4	15.3	13.4	74.5	1.0	–
Average 1986-1990	3.2	0.4	2.7	7.4	7.9	5.0	71.3	2.0	–
Average 1991-1995	1.4	–1.2	2.6	5.8	5.7	3.0	71.5	1.7	–
Average 1996-2000	2.4	0.9	1.5	3.4	2.5	1.0	66.8	1.0	–
2000	4.9	1.9	2.9	2.8	2.8	–0.1	65.5	2.4	–
2001	2.1	1.6	0.5	2.8	2.6	2.1	64.9	. .	–
2002	0.4	1.2	–0.8	2.6	2.4	3.1	65.7	–1.3	–
					Total economy (5)				
Average 1981-1985	1.6	0.5	1.1	15.2	15.1	13.9	77.5	0.6	0.3
Average 1986-1990	2.8	0.7	2.1	8.1	8.5	6.3	74.8	1.5	1.2
Average 1991-1995	1.2	–0.8	2.0	5.0	5.3	3.1	75.1	1.4	0.9
Average 1996-2000	2.2	0.8	1.4	3.5	2.8	1.4	70.9	0.9	0.6
2000	4.1	1.7	2.3	3.2	3.1	0.7	69.6	1.9	1.8
2001	2.1	1.7	0.4	3.3	3.0	2.6	69.1	0.1	. .
2002	0.6	1.1	–0.5	2.6	2.4	2.9	69.7	–0.9	–1.1

Source: Based on Istat, national accounts.

(1) The introduction of the regional tax on productive activities (IRAP) and the simultaneous elimination of some employers' contributions in 1998 caused a break in the series. – (2) Percentages. – (3) Total factor productivity represents the growth in output attributable to technical progress and is calculated as the difference between the rate of growth in value added at factor costs and those in labour input and capital stock, weighted according to their respective shares in the distribution of value added. Adjusted productivity takes account of the improvement in the quality of labour input and, for industry only, also of the change in the number of hours worked and capacity utilization. For 2002, partly estimated. – (4) Includes wholesale and retail trade, hotel and restaurant services, transport and communications, financial intermediation services and sundry services to businesses and households. – (5) Net of rental of buildings.

The composition of employment and labour policies in Italy

Payroll employment continued to grow in Italy in 2002, while self-employment contracted slightly. The number of permanent jobs increased again. Fixed-term positions returned to grow, notably in the second half of the year in view of the continued sluggishness of the economy and the suspension from July onwards of the tax credit for permanent hirings. According to Istat's labour force survey – which unlike the national accounts excludes workers living in institutions, conscripts and non-resident aliens – the average number of persons employed last year increased to 21.8 million, a gain of 315,000 or 1.5 per cent compared with 2.1 per cent in 2001. The number of employees with open-ended contracts rose by 284,000, including 66,000 part-time workers, and that of fixed-term employees by 48,000. Self-employment declined by 17,000. Between January 2002 and January 2003 the overall increase was smaller (179,000 or 0.8 per cent), confirming the slowdown in employment growth (Table 19).

Table 19

STRUCTURE OF EMPLOYMENT IN ITALY

	2002 (1)		Change 2002/2001 (1)		Change January 2003/January 2002	
	Thousands of persons	Percentage share	Thousands of persons	Percentages	Thousands of persons	Percentages
Self-employed	5,980	27.4	–17	–0.3	20	0.3
full-time	*5,555*	*25.5*	*–15*	*–0.3*	*32*	*0.6*
part-time	*425*	*1.9*	*–2*	*–0.5*	*–12*	*–3.0*
Employees	15,850	72.6	332	2.1	159	1.0
permanent	14,287	61.1	284	2.0	123	0.9
full-time	*13,301*	*60.9*	*218*	*1.7*	*103*	*0.8*
part-time	*986*	*4.5*	*66*	*7.2*	*20*	*2.0*
fixed-term and temporary	1,563	6.7	48	3.2	36	2.6
full-time	*1,104*	*5.1*	*58*	*5.6*	*27*	*2.7*
part-time	*459*	*2.1*	*–10*	*–2.1*	*9*	*2.1*
Total	**21,830**	**100.0**	**315**	**1.5**	**179**	**0.8**

Source: Istat, labour force surveys.
(1) Average of quarterly surveys conducted in January, April, July and October.

The proportion of part-time workers rose slightly, from 8.4 per cent in 2001 to 8.6 per cent in 2002 for the entire economy and from 8.2 to 8.3 per cent excluding agriculture. After the small decline in 2001, the share of fixed-term workers in payroll employment remained broadly stable at 9.9

per cent overall and 9 per cent for the non-farm economy (9.8 and 8.9 per cent in 2001).

Between October 2000 and July 2002 a significant boost to permanent positions came from the tax credit instituted by Law 388 of 23 December 2000. Utilization of the incentive was far greater than had been expected, and the consequent budgetary impact prompted the Government to suspend it at the start of July, reinstating it in January 2003 but with substantial restrictions. The Ministry of Labour and Social Policies estimates that when it was suspended the relief covered 250,000 jobs, half of them in the South.

Total spending for active labour policies rose from 0.66 per cent of GDP in 2000 to 0.73 per cent in 2001. Preliminary data suggest that it fell to 0.60 per cent in 2002 (Table 20). Hiring incentives, including the tax credit, formed the largest active labour policy item, accounting for over 40 per cent of the total in 2001. Spending on passive policies, i.e. unemployment and early retirement benefits, stabilized at just over 0.6 per cent of GDP.

Table 20

PUBLIC EXPENDITURE FOR LABOUR POLICY IN ITALY

(as a percentage of GDP)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002 (1)
Active policies	0.86	0.76	0.66	0.64	0.62	0.69	0.68	0.66	0.73	0.60
of which: employment incentives	*0.24*	*0.26*	*0.24*	*0.25*	*0.28*	*0.40*	*0.45*	*0.50*	*0.60*	*0.55*
Passive policies	1.22	1.21	0.98	0.97	0.85	0.76	0.68	0.63	0.62	0.63
Unemployment benefits	0.90	0.92	0.69	0.67	0.62	0.58	0.55	0.52	0.53	0.55
Early retirement .	0.32	0.29	0.29	0.30	0.23	0.18	0.13	0.11	0.09	0.08
Total . .	**2.08**	**1.97**	**1.64**	**1.61**	**1.47**	**1.45**	**1.36**	**1.29**	**1.35**	**1.23**

Sources: Based on data from Ministero del Lavoro e delle politiche sociali. *Monitoraggio delle politiche occupazionali e del lavoro*. 2003.

On the basis of Istat estimates, the proportion of workers classed as “irregular” in the national accounts held steady in 1999-2000 at 15 per cent, compared with 13.5 per cent in 1992. In 2000 irregular workers numbered more than 3.5 million. The measures to encourage the regularization of underground labour introduced in 2001 (see the Annual Report for 2001) and amended several times in 2002 apparently had an extremely modest impact, far less than the original forecast of 900,000 workers. All told, the regularization programme attracted some 2,700 firms, many of which were already registered with INPS.

Labour input and sectoral developments in Italy

Labour input, measured in standard labour units, rose by an average of 1.1 per cent in 2002, or 255,000 units (Table 21), compared with the increase of 322,000 or 1.4 per cent in the number of persons employed in Italy, including non-residents. The difference was due not only to the spread of atypical employment but also to an increase in Wage Supplementation for short-time working. The expansion of labour demand involved all branches except agriculture and fishing, financial intermediation and general government.

Table 21

SECTORAL DISTRIBUTION OF LABOUR INPUT IN ITALY

(standard labour units; percentage shares of total and percentage changes)

	Total employment				Salaried employment			
	Share		Change		Share		Change	
	1992	2002	2002/1992	2002/2001	1992	2002	2002/1992	2002/2001
Agriculture, forestry and fishing	**8.3**	**5.5**	**–31.6**	**–2.3**	**4.4**	**3.1**	**–24.6**	**–0.8**
Industry excluding construction	**23.0**	**21.7**	**–3.2**	**0.4**	**27.4**	**25.4**	**–2.0**	**0.3**
of which: manufacturing	*22.1*	*21.0*	*–2.2*	*0.5*	*26.0*	*24.5*	*–0.9*	*0.5*
Construction	**7.0**	**6.9**	**1.9**	**1.6**	**6.3**	**5.8**	**–3.3**	**3.8**
Services	**61.7**	**65.9**	**9.6**	**1.5**	**62.0**	**65.7**	**11.6**	**2.0**
Wholesale and retail trade, repair of personal and household goods	15.5	15.2	0.7	0.4	9.8	11.4	22.5	**3.7**
Hotels and restaurants	4.8	5.5	17.2	0.7	3.8	4.3	20.8	–0.8
Transport, storage and communications	6.1	6.1	4.0	0.8	6.7	6.6	3.7	0.6
Financial intermediation	2.7	2.6	–0.3	–1.3	3.5	3.3	0.7	–0.7
Services to businesses and households (1)	7.6	10.8	46.3	6.7	6.2	8.4	44.1	8.1
Public administration (2)	6.3	5.7	–7.7	–0.9	9.2	8.0	–7.7	–0.9
Education	6.9	6.6	–1.5	0.7	9.4	8.6	–3.8	0.5
Health and other social services	5.2	5.6	9.9	0.8	6.1	6.3	8.4	1.1
Other community, social and personal services	3.7	4.4	21.8	2.5	3.2	4.1	32.0	3.5
Private households with employed persons	2.8	3.3	17.7	1.6	4.1	4.6	17.7	1.6
Total	**100.0**	**100.0**	**2.7**	**1.1**	**100.0**	**100.0**	**5.4**	**1.5**

Source: Istat, national accounts.

(1) Includes real-estate, renting, computer and research services and other professional and business services. — (2) Includes defence services and compulsory social security services.

Nearly two thirds of the increase in labour input came in market services to businesses and households, which used 164,000 additional labour units, a rise of 6.7 per cent. The share of labour utilized by this sector has risen steadily from 7.5 per cent in 1994 to 10.8 per cent last year. Note that the figure includes employees of temporary employment agencies who actually work in other sectors. According to calculations by the Ministry of Labour and Social Policies based on INPS data, the agencies employed an average of 136,000 persons in the first half of 2002, accounting for labour input equivalent to 90,000 full-time workers. This was 26 per cent more than in the first half of 2001, which itself had registered a 61 per cent increase over the year-earlier period.

Services to households contributed almost one fourth of the total increment in labour input in 2002 (60,000 standard units or 1.3 per cent). The number of labour units employed increased by 0.7 per cent in education services, 0.8 per cent in health and other social services, 2.5 per cent in other community social and personal services and 1.6 per cent in domestic services. Together, these sectors account for one fifth of all employment.

Labour input rose by 1.6 per cent in construction, continuing the expansion under way since 1999. It also increased, albeit less markedly than in 2001, in wholesale and retail trade (0.4 per cent), hotels and restaurants (0.7 per cent) and transport and communications (0.8 per cent).

In industry excluding construction, despite the decline in production labour input returned to growth last year (19,000 units or 0.4 per cent). Istat's survey of large firms and the Bank of Italy's survey of firms with 20 or more workers found that on average for the year hours per capita decreased slightly and the incidence of overtime was unchanged (Table 22).

Unemployment and labour supply in Italy

The average annual unemployment rate fell from 9.5 to 9 per cent in 2002, with long-term unemployment declining from 5.9 to 5.3 per cent. The reduction came in the South (from 19.3 to 18.3 per cent) and the Centre (from 7.4 to 6.6 per cent), while the rate in the North was unchanged at 4 per cent despite a slight rise in the second half of the year. The nationwide rate for men declined from 7.3 to 7 per cent and for women from 13 to 12.2 per cent.

Labour market participation increased last year. The labour force grew by 211,000, or 0.9 per cent, to almost 24 million. The average participation rate for persons aged 15 to 64 rose from 60.4 to 61 per cent. Participation increased in all parts of the country but most sharply in the Centre and North, thus further exacerbating geographical disparities; the rate is 54 per cent in the South, 64.8 per cent in the rest of the country. The male participation rate turned upwards (from 73.6 to 74 per cent), while the female rate grew again, albeit more slowly than in years previous (from 47.3 to 47.9 per cent).

Table 22

EMPLOYMENT AND WORKING HOURS IN ITALIAN INDUSTRY EXCLUDING CONSTRUCTION: FIRMS WITH AT LEAST 20 EMPLOYEES

(percentages)

	2001	2002								
		Total	Size class (number of workers)				Geographical area (1)			
			20-49	50-199	200-499	500+	North-West	North East	Centre	South and Islands
	Salaried employment									
Salaried employment (2)	−0.1	−1.2	0.1	−0.9	−1.1	−2.9	−1.8	−0.6	−0.5	−1.7
Average employment (2)	−0.7	−1.0	−0.3	−0.9	−0.8	−1.9	−1.7	−0.2	−0.6	−1.0
Employment at end of year (2) Proportion of fixed-term workers at end of year ...	6.4	6.3	6.9	6.3	5.8	6.0	5.4	6.9	6.4	7.7
	Turnover (3)									
Turnover (4)	34.0	31.2	34.3	33.7	30.0	26.1	24.9	35.0	31.0	42.8
Hirings	16.6	15.1	17.0	16.4	14.6	12.1	11.6	17.4	15.2	20.9
permanent	*7.2*	*6.4*	*8.1*	*6.7*	*5.6*	*4.9*	*5.6*	*7.1*	*5.8*	*8.3*
at fixed term	*9.4*	*8.7*	*8.9*	*9.7*	*9.0*	*7.2*	*6.0*	*10.3*	*9.4*	*12.6*
Separations	17.3	16.1	17.3	17.3	15.4	14.0	13.3	17.6	15.8	21.9
for expiry of fixed-term contract	*9.6*	*8.8*	*8.9*	*9.7*	*9.7*	*7.3*	*6.1*	*10.3*	*9.9*	*12.7*
for other reasons	*7.7*	*7.3*	*8.4*	*7.6*	*5.7*	*6.7*	*7.2*	*7.3*	*5.9*	*9.2*
	Actual working hours									
Hours worked per employee (2)	−0.8	−0.8	−0.9	−0.6	−1.5	−0.5	−0.8	−0.6	−0.9	−0.8
Overtime (5)	4.1	4.1	3.8	4.0	4.4	4.5	4.3	4.2	3.8	3.9
Temporary employment (5) (6)	1.2	1.3	....	1.3	1.4	1.2	1.2	1.5	1.2	1.0
Wage Supplementation (5) (6)	1.2	1.3	....	1.1	1.5	1.5	1.5	0.6	1.6	2.0
	Unionization rates									
Percentage of firms with company-level union representation	....	55.5	44.4	78.1	93.8	97.7	58.7	57.0	57.0	53.9
Percentage of union members	....	37.8	30.6	38.6	39.0	43.5	36.4	34.9	43.4	43.1

Source: Banca d'Italia. *Indagine sulle imprese dell'industria in senso stretto*.

(1) Actual location of emplyees. − (2) Percentage changes on previous year. − (3) Ratio of hirings and separations in the year to the average of employment at the beginning and at the end of the year. − (4) Sum of hirings and separations. − (5) As a percentage of total hours actually worked by firms' employees. − (6) Total refers only to firms with at least 50 employees.

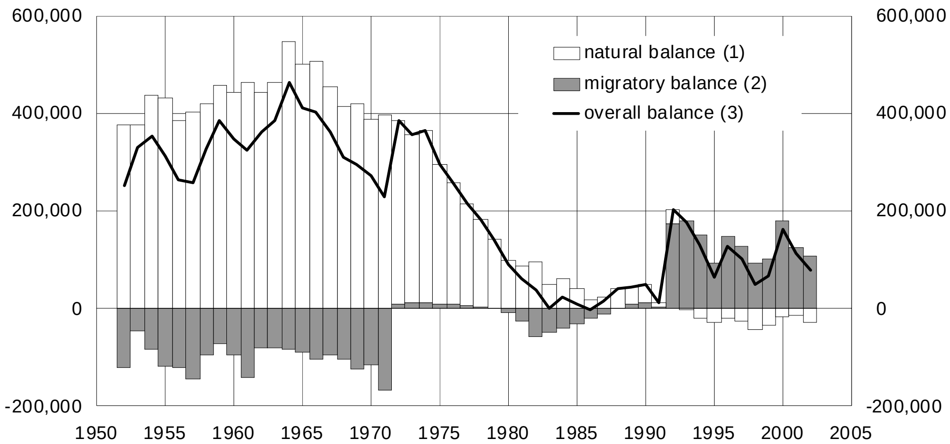
On 8 April 2003 Istat released the definitive data from the fourteenth general census of the resident population and housing in Italy as of 21 October 2001. The resident population numbered 56,995,744, an increase of 217,713 (0.4 per cent) since the 1991 census. The increase was entirely accounted for by the North-East (where the population grew by 2.5 per cent), while the other parts of the country showed slight declines. The population of the cities larger than 500,000 (Turin, Milan, Genoa, Rome, Naples and Palermo) diminished by 540,595 (7.2 per cent), falling from 15.2 to 13.9 per cent of the total population. The census figure is 850,000 lower than the total of civic registers as of 1 January 2001, compared with a discrepancy of 970,000 at the 1991 census.

In the 1990s the Italian population grew solely by virtue of immigration. According to the civic registers, the natural demographic balance, i.e. the difference between live births and deaths, was negative by an annual average of 24,000 between 1993 and 2002, against net immigration of 131,000 a year (Figure 13).

Figure 13

CHANGES IN RESIDENT POPULATION OF ITALY

(number of persons)



Source: Ministero dell'Economia e delle finanze, *Relazione generale sulla situazione economica del Paese - (2002),* vol. III, Appendice PD.3.

(1) Difference between number of live births and number of deaths. – (2) Based on residence data from civic registers. – (3) Sum of natural and migratory balances.

Between December 1993 and December 2000 the number of foreigners resident in Italy according to municipal civic registers increased by 835,000 (802,000 coming from non-EU countries) to 1,465,000. Their share of the population thus rose from 1.1 to 2.5 per cent. At the end of 2001 the number of residence permits in being or in course of renewal – which does not correspond to civic register figures because the permits do not count minors separately and short-term permits do not entail entry in the register – was 1,448,000, including 1,308,000 held by non-EU citizens. These figures do not include foreigners lacking a valid residence permit. Law 189 of 30 July 2002, which tightened the immigration rules, provided for the regularization of immigrant workers already present in Italy who had current employment relationships. By the November deadline, more than 700,000 applications for regularization had been submitted, including 340,000 for persons engaged in domestic work or personal care. Net of double-counting of applications for the same worker presented by more than one employer, the number of immigrants awaiting regularization is estimated at 600,000. In the two previous rounds of regularization, 256,000 applications were submitted in 1995 (of which 246,000 were accepted) and 323,000 in 1998.

Wages and the cost of labour in Italy

Changes in earnings in the private and public sectors came back into line with one another in 2002 following two years of much faster growth in the latter. Earnings per standard employee labour unit (actual earnings as measured in the national accounts) rose by an average of 2.6 per cent in both sectors (Table 18), equal to the rise in the consumer price index. As in 2001, the cost of labour – gross earnings plus employer social contributions – per standard employee labour unit rose less than unit earnings (2.4 per cent), owing to a reduction in social contribution rates.

In the second half of the 1990s wage differentials between North and South remained stable in the private sector and widened in industry excluding construction. According to the regional accounts, the cost of one standard employee labour unit (including employer social contributions) rose by 2.9 per cent per year in the South between 1995 and 2000 compared with 2.3 per cent in the rest of the country. Gross unit earnings increased at a rate of 3.3 per cent in both areas, so that earnings in the South remained at 82 per cent of those in the Centre and North. In industry, however, gross unit earnings in the South fell from 92 to 87 per cent of those in the Centre and North, owing to much slower growth (2.5 against 3.5 per cent annually). Annual labour cost increases were similar in the two areas (2.6 per cent in the South, 2.7 per cent in the rest of the country), leaving the ratio unchanged at 84 per cent. In southern industry, therefore, the impact on labour costs of higher contribution rates – with the phasing out of social security contribution relief beginning in 1994 – was offset by slower wage growth than in the North. The Bank of Italy’s survey of household income and wealth also indicates a widening of geographical disparities between 1995 and 2000. Monthly take-home pay in the South fell from 89 to 81 per cent of that in the Centre and North in the private sector and from 89 to 83 per cent in industry. Neither the amplitude of the earnings gap nor its evolution depends on the demographic or sectoral composition of employment.

Industrial relations in Italy

Contract renewals in 2002 (in the construction, chemical, credit, wood and furniture, textile and clothing, gas, and water industries) called for raises in line with the target inflation rate for the two years covered and substantial recouping of the differential between actual and target inflation over the previous two years. The few private sector contracts concluded in the early part of 2003 (in the glass, ceramics, printing and engineering industries) and the union demands in negotiations under way (food, wholesale and retail trade, tourism), however, are based on forecast inflation rates of around 2 per cent for 2003 and 2004, higher than the Government's targets of 1.4 and 1.3 per cent.

For the engineering industry the new contract calls for a wage increase of 5.8 per cent over 2003 and 2004, plus a lump-sum payment of €220 in compensation for the late renewal of the contract. The last instalment of the increase, payable in December 2004, is designated as an advance against the expected difference between actual and target inflation in 2003 and 2004, which will have to be taken into account in the subsequent contract. In the public sector, contracts signed in February for ministerial personnel and in May for the school system provided for increases totaling 6.5 and 8 per cent respectively to be phased in for 2002-2003, following raises of 5.1 and 7 per cent over the previous two years.

The number of hours lost to strikes rose sharply in the early part of 2002 in connection with the proposal for reform of the rules governing individual dismissals set out by the Government in November (see the Annual Report for 2001). The climate of industrial relations has remained strained, in part because of divisions between the leading trade unions, but has not yet resulted in an increase in contract and work-related disputes.

On 5 July 2002 the Government, employers and labour unions (except the CGIL) signed the so-called Pact for Italy, an agreement containing measures regarding the structure of taxation, the labour market and intervention in southern Italy. The labour market measures were included in two enabling laws (see *Economic Bulletin*, No. 35, November 2002, box on "Labour market measures in the Pact for Italy"). The first law, definitively approved by the Senate in February 2003, commits the Government to reform public and private employment agencies, contracts that provide for training, part-time work and various forms of occasional employment. The second, still before Parliament, concerns the more controversial matters: reordering of hiring incentives, the reform of social shock absorbers, the experimental suspension of Article 18 of the Labour Rights Law of 1970, and arbitration of individual disputes.

PRICES AND COSTS

In the euro area the harmonized consumer price index rose by 2.2 per cent in 2002, compared with 2.4 per cent the previous year. In Italy it increased by 2.6 per cent (2.7 per cent in 2001). The slight slowdown was due to a sharp deceleration in the prices of the more volatile items, such as energy and unprocessed food products. By contrast, core inflation, measured by the general index excluding these items, accelerated from 1.9 to 2.5 per cent in the euro area and from 2.4 to 2.8 per cent in Italy.

The behaviour of consumer prices in the euro area reflected that of domestic costs, as the prices of imported goods and services fell (Figure 14). The GDP deflator rose by 2.4 per cent in the euro area and by 2.7 per cent in Italy. The changeover to the euro had a temporary effect, especially in services; according to estimates by both Eurostat and the European Central Bank, the impact was small, although larger than had been assumed in the more optimistic forecasts. This effect also appears to be the reason for the disparity observed in 2002 between the inflation rate actually recorded by statistical institutes and subjective perceptions of price behaviour captured in consumer surveys.

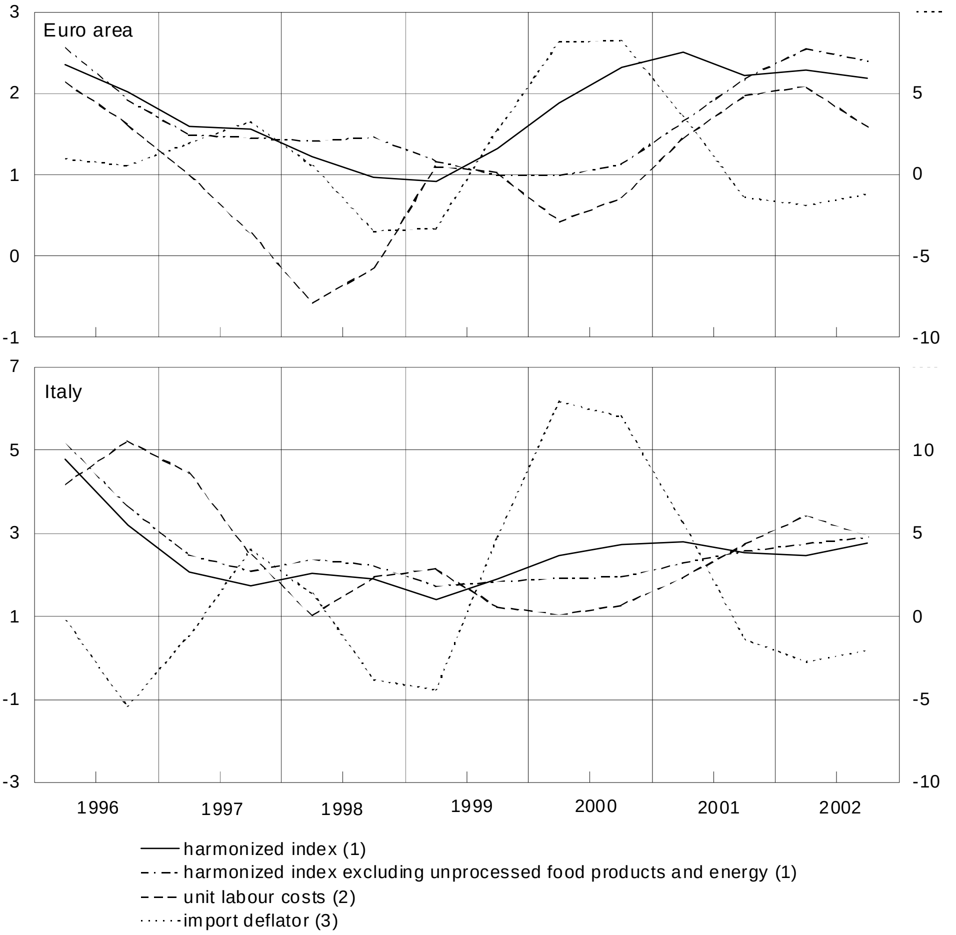
The dispersion of the inflation rates of euro-area countries has been increasing since the end of the 1990s, both including and excluding the more volatile items; in 2002 it approached the levels recorded in the first half of the last decade. On the basis of the harmonized consumer price data recently revised by Eurostat, the differential between inflation in Italy and the average for the other euro-area countries remained broadly unchanged in 2002 at just under 0.5 percentage points; the differential was similar for core inflation.

Professional forecasters expect consumer price inflation to decrease slightly in 2003, to around 2 per cent in the euro area and 2.5 per cent in Italy, owing to an easing of tensions in the oil market and the appreciation of the euro coupled with a modest recovery in activity. The average rate of increase in consumer prices is expected to fall significantly below the 2 per cent threshold next year.

Figure 14

INFLATION INDICATORS IN THE EURO AREA AND ITALY

(half-yearly data; percentage changes on the year-earlier period)



Source: Based on Eurostat data.

(1) Harmonized index of consumer prices. Left-hand scale. – (2) For the entire economy. The changes are calculated from the moving average of the two half-years ending in the reference period. The changes for the euro area are calculated from the values for France, Germany, Italy and Spain; for Italy and Spain unit labour costs are based on standard labour units. Left-hand scale. – (3) Right-hand scale.

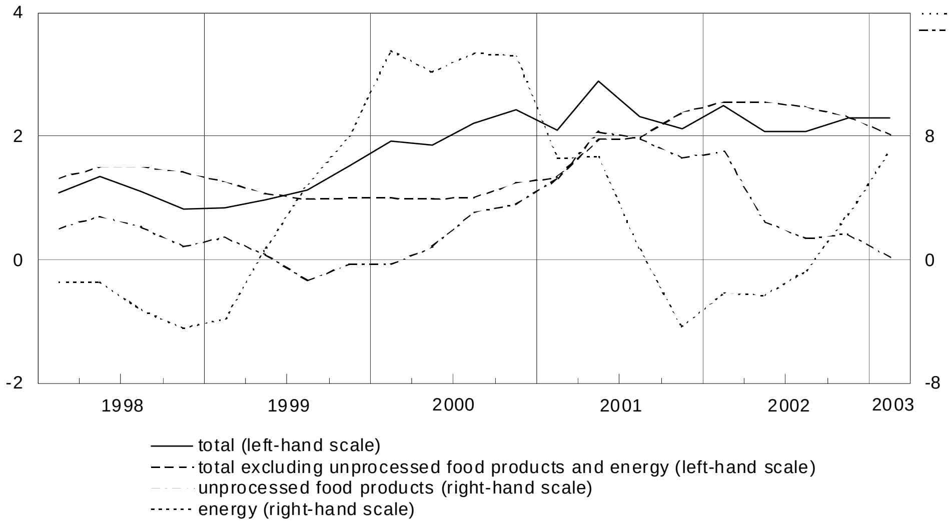
Prices and costs in the euro area

Consumer prices. – Consumer price inflation in the euro area was 2.2 per cent in 2002 as a whole but fluctuated during the year owing to the more volatile components. The twelve-month rate of increase in the harmonized index rose to an average of 2.5 per cent in the first quarter, compared with 2.1 per cent in the last quarter of 2001 (Figure 15); the acceleration in consumer prices was due in part to a sharp increase in the prices of fruit and vegetables (13.4 per cent in the first quarter), which was ascribable to bad weather and the changeover to the euro. As the effects of these temporary factors petered out, inflation slowed down to 2.1 per cent in the second quarter. The slight pick-up to 2.3 per cent in the final quarter was triggered by an acceleration in the prices of energy products.

Figure 15

HARMONIZED INDEX OF CONSUMER PRICES IN THE EURO AREA

(quarterly data; percentage changes on the year-earlier period)



Source: Based on Eurostat data.

Core inflation rose to 2.5 per cent in 2002 as a whole, compared with 1.9 per cent the previous year. However, it edged downwards in the course of the year, by 0.2 percentage points between January and December. This seems a small decrease, given the continued weakness of economic activity and the nominal effective appreciation of the euro by 3 per cent in 2002, compared with one of 1.8 per cent in 2001. During the last period of slower growth (1998-99) core inflation was on average more than one point lower than last year.

The rise in unit labour costs over the past two years, which was attributable mainly to the slowdown in the growth of productivity per employee, sustained the core rate of inflation. In 2001-02 the rise in unit labour costs was on average around 1.5 percentage points higher than the very modest increase recorded in 1998-99, when earnings in the economy as a whole increased very little.

Among the major euro-area countries, consumer price inflation fell appreciably in Germany (to 1.3 per cent, compared with 1.9 per cent in 2001; Table 23), as unit labour costs increased much less than in the other major countries of the area; the prices of non-food and non-energy products declined slightly in that country from the end of 2002 onwards. The inflation rate remained virtually unchanged in France and Italy, at 1.9 and 2.6 per cent respectively.

Table 23

HARMONIZED INDICES OF CONSUMER PRICES IN THE EURO AREA

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

	Italy			Germany			France			Euro area		
	2001	2002	2003 Q1	2001	2002	2003 Q1	2001	2002	2003 Q1	2001	2002	2003 Q1
General index	2.7	2.6	2.8	1.9	1.3	1.1	1.8	1.9	2.3	2.4	2.2	2.3
Core inflation (2)	2.4	2.8	2.6	1.2	1.5	0.8	1.5	2.2	2.1	1.9	2.5	2.0
Processed food	2.5	2.2	2.4	2.2	2.5	2.1	3.4	3.3	4.0	2.8	3.1	3.2
Non-food and non-energy products	1.8	2.4	1.7	0.2	0.5	–0.5	0.9	0.9	0.5	0.9	1.5	0.7
Services	2.9	3.4	3.5	1.7	2.0	1.4	1.5	2.8	2.8	2.4	3.1	2.7
Unprocessed food products	5.8	4.9	2.6	7.0	–0.1	–4.6	7.4	2.9	–0.4	7.0	3.1	0.2
Energy products	1.6	–2.6	5.4	5.7	0.3	7.6	–1.5	–1.5	7.4	2.2	–0.6	7.0

Source: Based on Eurostat data.

(1) For Italy the percentage changes for 2001 are calculated from the indices that do not take account of the new method of recording promotional offers. – (2) General index excluding unprocessed food and energy products.

Producer and export prices. – Producer prices in the euro area remained stable between 2001 and 2002 as a whole, with those of intermediate goods, especially energy products, falling by 2.2 per cent. This restraining effect lessened as the year progressed, so that the twelve-month rate of change in producer prices gradually turned positive again, rising to 1.3 per cent in the fourth quarter compared with –0.7 per cent in the first. The fall in the prices of intermediate goods also kept producer prices broadly unchanged over the year as a whole in the major countries of the area except Spain, where there was a modest increase; in the second half of the year, however, they began to rise again everywhere.

The index of the producer prices of non-food and non-energy products for final consumption, which tends to move several months before changes occur in the corresponding consumer price index, rose by 2.1 per cent in 2002, compared with 1.9 per cent in 2001; in the course of the year there was a slight slowdown from 2.2 per cent in the first quarter to 1.9 per cent in the fourth.

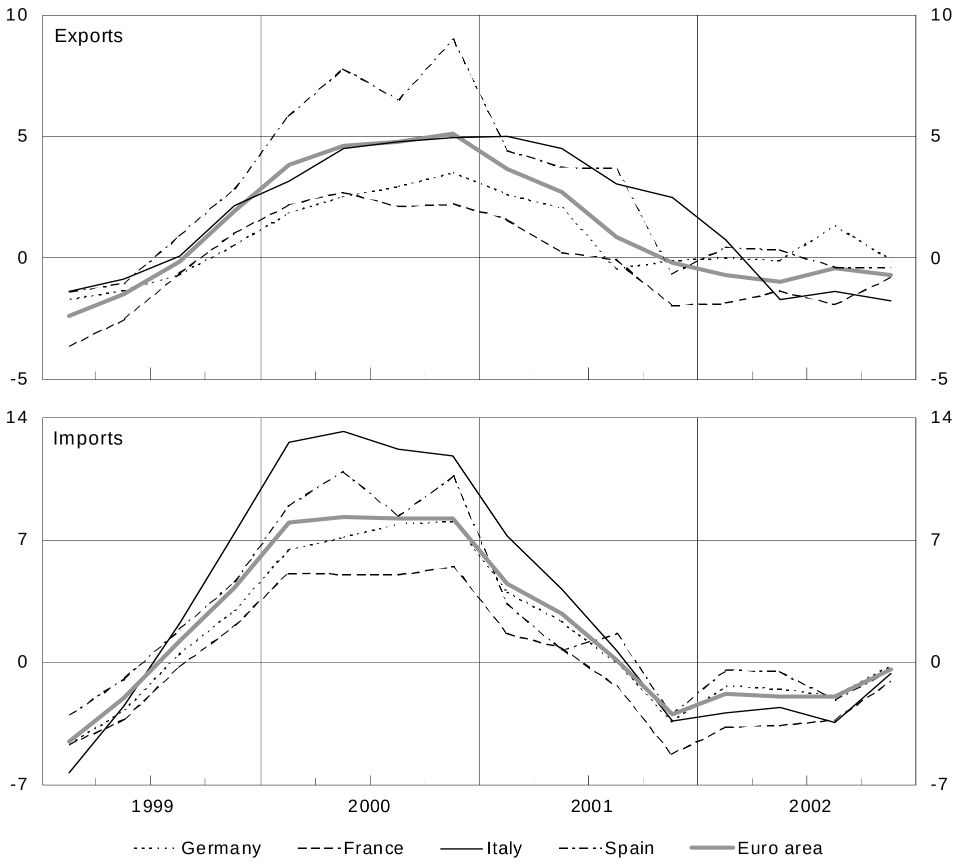
Last year the prices of euro-area countries' exports were affected by the weakness of world demand and the further nominal appreciation of the euro.

According to national accounts data, the price deflator of exports of goods and services fell by 0.7 per cent for the area as a whole, compared with an increase of 1.7 per cent in 2001 (Figure 16). Italian and French producers reduced their export prices for manufactured goods by annual averages of 1 and 1.6 per cent respectively while keeping domestic prices broadly unchanged. Part of the reason for the smaller reduction in the prices charged by Italian exporters was that unit labour costs have risen more rapidly in Italy than in the area's main trading partners over the past two years. German producers, by contrast, raised their export prices by an average of 0.3 per cent, despite benefiting from a much smaller rise in domestic costs than the other major euro-area countries.

Figure 16

EXPORT AND IMPORT DEFLATORS IN THE EURO AREA

(percentage changes on the year-earlier quarter)



Sources: Based on Istat and Eurostat data.

Costs. – With economic activity weak, the nominal appreciation of the euro last year increased the pressure on firms to hold down their prices in the domestic market as well as those for exports in order to defend their market share against competition from producers outside the area. At the same time it curbed the cost of imported inputs. The implicit import price deflator declined by 1.6 per cent in the area as a whole in 2002, whereas it had risen by 1 per cent the previous year, when the effects of the long depreciation of the euro and the rise in oil prices were still being felt (Figure 16).

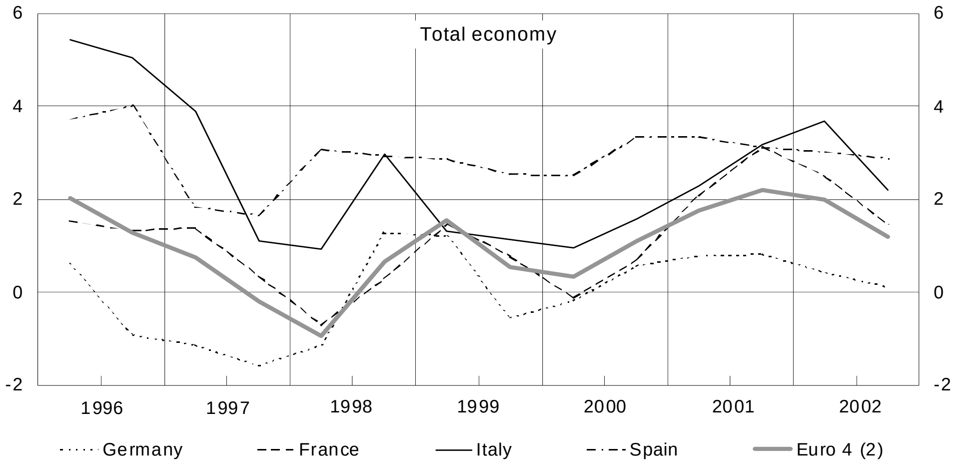
During 2002 Reuters' monthly surveys of firms' purchasing managers showed costs in industry and services in the euro area rising in the first half of the year but slowing down thereafter, aided by the appreciation of the euro against the dollar by more than 10 per cent between the two halves. The dollar prices of non-energy raw materials on world markets remained almost unchanged in the second half of the year, whereas the heightening of tensions in the Middle East caused a renewed rise in oil prices to an average of $26.90 a barrel for Brent grade in the second half, compared with around $23 in the first.

In the four largest euro-area countries unit labour costs in the economy as a whole rose by an average of 1.6 per cent, compared with 2 per cent the previous year (Table 24). The slight slowdown was attributable to a marginally lower increase in nominal per capita incomes (2.1 per cent, compared with 2.4 per cent) and to slightly larger productivity gains than in 2001, although they were still extremely small (0.5 per cent, against 0.4 per cent). The average rise of 1.8 per cent in unit labour costs in the last two years compares with an average annual increase of around 0.5 per cent in the three years from 1998 to 2000 (Figure 17), when a much more modest rise in per capita incomes had been accompanied by more sustained growth in labour productivity.

Figure 17

UNIT LABOUR COSTS (1)

(half-yearly data; percentage changes on year-earlier period)



Sources: Based on Istat and Eurostat data.

(1) Based on standard labour units for Italy and Spain. – (2) Changes calculated on the basis of the values for France, Germany, Italy and Spain (weighted average based on GDP).

Table 24

UNIT LABOUR COSTS AND THEIR DETERMINANTS IN THE MAJOR EURO-AREA COUNTRIES

(*percentage changes on the previous year*)

	Labour costs per employee (1)		Labour productivity						Unit labour costs	
					Value added (2)		Employment (1)			
	2001	2002	2001	2002	2001	2002	2001	2002	2001	2002
	Industry excluding construction (3)									
Germany	1.8	1.7	0.3	2.0	0.4	−0.2	0.1	−2.1	1.5	−0.2
France	2.2	2.6	1.6	1.9	2.7	0.2	1.1	−1.7	0.6	0.7
Italy	2.9	2.6	1.6	−0.4	0.9	−0.1	−0.7	0.4	1.3	3.0
Spain	4.1	4.3	0.0	1.5	1.4	1.0	1.4	−0.5	4.1	2.7
Euro 4 (4)	2.2	2.1	0.9	1.1	1.2	0.1	0.4	−1.1	1.4	0.9
	Services (5)									
Germany	1.6	1.7	0.7	1.0	2.0	1.4	1.3	0.4	0.9	0.7
France	3.0	2.7	0.1	0.2	2.1	1.8	2.0	1.6	2.9	2.5
Italy	3.3	2.3	0.3	−0.5	2.6	1.0	2.2	1.5	3.0	2.9
of which: private	*2.7*	*2.1*	*0.3*	*−1.1*	*2.8*	*0.9*	*2.5*	*2.0*	*2.4*	3.3
public	*4.0*	*2.5*	*0.3*	*0.5*	*2.1*	*1.3*	*1.8*	*0.8*	*3.6*	2.0
Spain	4.2	3.7	1.6	0.4	4.0	2.7	2.4	2.3	2.5	3.3
Euro 4 (4)	2.6	2.3	0.5	0.3	2.3	1.6	1.8	1.3	2.1	2.0
	Total economy									
Germany	1.7	1.6	0.7	1.3	1.1	0.7	0.4	−0.6	1.0	0.3
France	2.9	2.5	0.2	0.5	2.0	1.4	1.8	0.8	2.6	1.9
Italy	3.0	2.4	0.4	−0.5	2.1	0.6	1.7	1.1	2.6	2.9
Spain	4.1	4.0	0.8	1.0	3.2	2.3	2.4	1.3	3.2	2.9
Euro 4 (4)	2.4	2.1	0.4	0.5	1.8	1.0	1.4	0.5	2.0	1.6

Source: Based on Eurostat data.

(1) Standard labour units for Italy and Spain. – (2) At 1995 base prices. – (3) By contrast with the “manufacturing sector”, also includes mining and electricity generation and distribution. – (4) Changes calculated on the basis of the values for France, Germany, Italy and Spain (weighted average based on GDP). – (5) For Italy services exclude the renting of property.

In 2002 unit labour costs rose by 2 per cent in services, whereas in industry excluding construction, where productivity gains were far larger, they increased by 1 per cent (Table 24). Among the major euro-area countries, the rise in unit labour costs in the economy as a whole was particularly small in Germany (0.3 per cent), where the slowdown in economic growth was reflected in an immediate fall in employment, especially in industry. Unit labour costs increased much more rapidly in France (1.9 per cent) and Italy (2.9 per cent), as employment in these countries was less responsive to the cyclical downturn.

The ratio of profits to value added in the service sector remained broadly stable in 2002, both in the area as a whole and in the three largest countries. In industry excluding construction it was also more or less the same as in 2001 in the area as a whole; it fell by about one percentage point in France and Italy but rose in Germany, reflecting the more moderate growth in labour incomes against the background of a fall in employment.

The first few months of 2003. – In the first few months of this year the twelve-month rate of consumer price inflation in the euro area remained just above 2 per cent; in April it rose to 2.1 per cent, compared with 2.3 per cent in December. The slowdown in the prices of services and non-food and non-energy products was partly offset by a steep increase in energy prices, which reflected the transitory strains in world oil markets. The raising of tobacco tax in some countries caused the rate of increase in the prices of processed foods in the area as a whole to rise to 3.4 per cent in April, compared with 2.7 per cent in December 2002.

The dispersion of inflation rates. – The dispersion of inflation rates among euro-area countries, measured in terms of the unweighted standard deviation, fell to a low in 1997-98, when countries were making strenuous efforts to meet the Maastricht convergence criteria (Figure 18). This measure of dispersion, which does not include Greece until January 2001, then rose again, to stand at more than one percentage point last year.

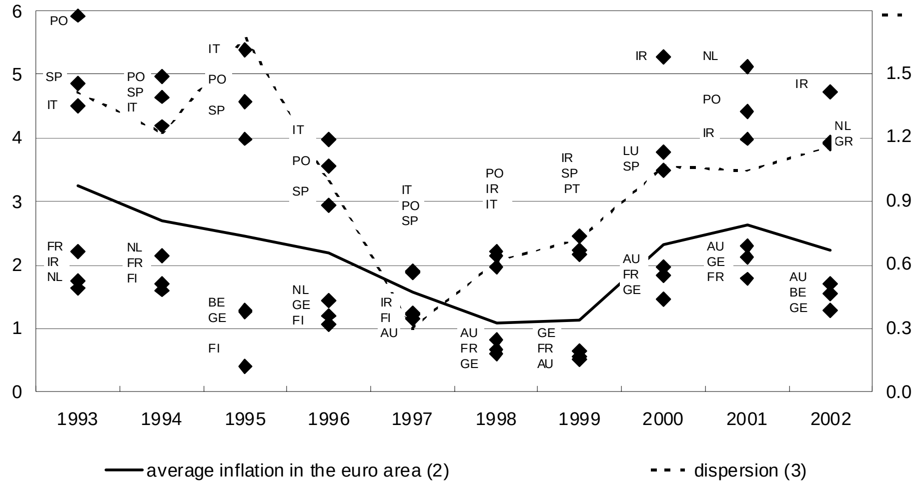
The countries with the highest and lowest inflation rates were almost invariably the same ones. The first group consisted of Portugal, Ireland, Spain and Italy until the end of the 1990s, when they were joined by the Netherlands, where the overall index was affected by measures relating to certain controlled prices, and Greece. By contrast, the countries with the lowest average annual inflation rates were predominantly Germany, France and Austria. Average inflation in the euro area was held in check by the behaviour of consumer prices in the two largest countries — France and especially Germany — which together account for around half of the entire area. The inflation expectations of professional forecasters indicate that average inflation in the area this year and next is likely to continue to reflect the moderate price trend in these two countries.

From 1997 onwards the dispersion of core consumer price inflation rates increased in parallel with that for the general index. Hence the halt in the convergence of inflation rates from 1998 onwards was due only marginally, and in specific periods, to the shocks that affected the more variable components of consumer prices in later years, in particular the prices of crude oil and meat.

Figure 18

DISPERSION OF CONSUMER PRICE INFLATION RATES AMONG THE EURO-AREA COUNTRIES (1)

(percentage changes on previous year and percentage points)



Source: Based on Eurostat data.

(1) Excluding Greece until December 2000. – (2) The data for the three countries with the highest inflation and the three with the lowest inflation are also shown for each year. Left-hand scale. – (3) Unweighted standard deviation, in percentage points, between the inflation rates of the countries in the area. Right-hand scale.

Differences in the behaviour of domestic costs were the main reason for inflation differentials. The dispersion in the rise in unit labour costs in the euro-area countries decreased substantially in 1998 and 1999 owing to the convergence of rates of growth in labour incomes but increased again thereafter; this pattern is in line with movements in national inflation rates.

Inflation expectations. – From the beginning of last year onwards the professional forecasters surveyed by Consensus Forecasts were predicting an inflation rate of around 2 per cent in the euro area in 2003 (Table 25).

Expectations of inflation in Italy were slightly higher, rising in early 2003 to 2.4 per cent on the basis of the survey conducted in May. The differentials between consumer price inflation in Italy and the corresponding rates in France and Germany are expected to narrow only slightly this year, to 0.5 and 1.2 percentage points respectively. In 2004 inflation in the area as a whole is expected to fall below the 2 per cent threshold, whereas in Italy it is likely to remain about half a point higher.

Table 25

EXPECTATIONS CONCERNING CONSUMER PRICE INFLATION IN THE EURO AREA IN 2003 AND 2004 OBSERVED BY *CONSENSUS FORECASTS*

(*percentage changes on previous year*)

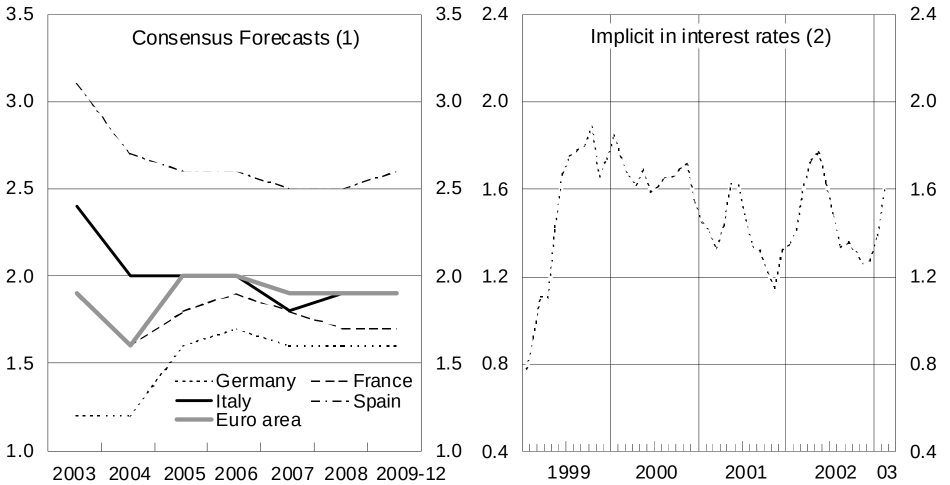
	Forecasts for 2003 made in the period indicated				Forecasts for 2004 made in the period indicated	
	January 2002	June 2002	December 2002	May 2003	January 2003	May 2003
Germany	1.5	1.7	1.2	1.2	1.4	1.2
France	1.4	1.6	1.7	1.9	1.6	1.5
Italy	1.9	2.0	2.1	2.4	2.0	2.0
Spain	2.6	2.8	3.1	3.1	2.7	2.7
Euro area	1.8	1.9	1.8	2.0	1.7	1.6

Source: *Consensus Forecasts.*

Over longer time spans, the expectations of professional forecasters and those that can be deduced from the financial markets confirm that inflation in the euro area will remain stable at less than 2 per cent (Figure 19).

Figure 19

LONG-TERM INFLATION EXPECTATIONS IN THE EURO AREA



Sources: *Consensus Forecasts* and based on Datastream data.

(1) Expectations recorded in April 2003 regarding percentage changes in consumer prices in relation to the previous year for the years indicated on the horizontal axis. – (2) Difference in percentage points between the yield to maturity on fixed-rate French government securities (*obligations assimilables du Trésor, OATs*) maturing in 2013 and that on comparable securities with a coupon indexed to consumer prices in France.

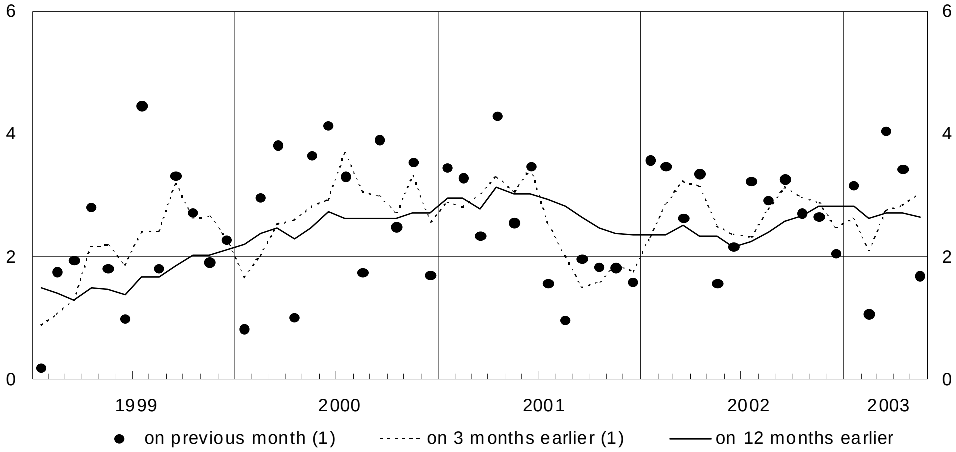
Prices and costs in Italy

Prices. – Inflation in Italy, measured by the general consumer price index, came down from 2.7 per cent in 2001 to 2.5 per cent in 2002 (the slowdown on the basis of the harmonized index was from 2.7 to 2.6 per cent). The twelve-month rate was below 2.5 per cent until the summer but rose to 2.8 per cent in the last two months of the year in connection with the acceleration in energy prices; in the first five months of this year it was around 2.7 per cent (Figure 20).

Figure 20

ITALY: GENERAL CONSUMER PRICE INDEX

(percentage changes)



Source: Based on Istat data.
(1) Seasonally adjusted and annualized.

In Italy the general consumer price index is preferred to the harmonized index for the purposes of economic analysis because it is available for a long time span, at disaggregated as well as aggregated level, and makes it possible to distinguish precisely between items that are subject to price controls and those that are not. Furthermore, since the beginning of 2002 the Italian harmonized index has been far more erratic than the general index because of the different method of recording promotional offers imposed by Eurostat for calculating the harmonized index, which makes its use for short-term analysis inadvisable.

The prices of services not subject to price controls rose appreciably, by 3.9 per cent compared with 3.2 per cent in 2001; this rate of increase, the highest since the middle of the 1990s, was due partly to the temporary effects of the changeover to the euro and the sustained rise in unit labour costs, which have a strong impact on the sector's total unit variable costs.

In 2002 items subject to price controls rose by only 0.3 per cent, thus making a significant contribution to containing inflation. Regulated energy prices, which tend to follow movements in the world prices of oil products, declined and the prices of other items rose only moderately.

In 2002 the rise in the producer prices of industrial goods in Italy was very small (0.2 per cent, compared with 1.9 per cent in 2001), in line with developments in the rest of the area. The prices of non-food and non-energy products for final consumption increased by 2.5 per cent, compared with 2.2 per cent the previous year, although the twelve-month rate came down by 1.3 percentage points between January 2002 and March 2003.

Costs and margins. – On the basis of the input-output price indicators compiled by Istat, the sharp fall of 2.2 per cent in the cost of the manufacturing sector's imported inputs (compared with a rise of 2.5 per cent in 2001) offset the acceleration in the rise in the cost of labour inputs from 3 to 3.9 per cent (Table 26). The sector's unit variable costs rose by 1 per cent overall, compared with 1.6 per cent in 2001, whereas output prices increased by 0.5 per cent. Manufacturing firms' profit margins thus contracted last year, after having increased slightly in 2001.

Table 26

UNIT VARIABLE COSTS AND OUTPUT DEFLATOR IN ITALY (1)

(percentage changes on previous year)

	Manufacturing			Services excl. public services		
	% weight in 1995	2001	2002	% weight in 1995	2001	2002
Unit variable costs	100.0	1.6	1.0	100.0	2.8	2.6
Labour inputs	35.9	3.0	3.9	73.6	2.3	2.8
Other inputs	64.1	0.8	−0.5	26.4	3.9	2.3
Domestic	38.3	−0.5	0.9	19.9	3.6	3.1
Imported	25.8	2.5	−2.2	6.5	4.6	−0.3
Output prices	100.0	2.4	0.5	100.0	2.9	1.9
Domestic	58.3	1.0	3.0	91.3	2.8	1.8
Imported	41.7	3.8	−1.9	8.7	3.9	2.3

Source: Istat.
(1) Indicators calculated net of intrasectoral transactions.

Profit margins in the service sector also decreased last year owing to a rise of 2.6 per cent in unit variable costs, in contrast to one of 1.9 per cent in output prices.

Italy's inflation differential. – In 2002 the rise in the harmonized consumer price index in Italy was still slightly larger than that in the other countries of the area (the difference was 0.4 percentage points, compared with 0.3 points in 2001), partly on account of the core components of inflation (a differential of 0.4 points, as against one of 0.5 points in 2001); however, the narrowing of the latter differential was reversed in the first quarter of this year.

Taking a wider perspective, over the last two years the differential between core consumer price inflation in Italy and that in the rest of the area has more or less halved by comparison with the end of the 1990s to 0.5 points, primarily because the rise in the prices of services was more in line with that in the other countries, thanks partly to increases in public utility charges that were well below the general rate of inflation.

The impact of the changeover to the euro on consumer prices

According to estimates by the European Central Bank, the changeover to the new currency had a small overall impact on consumer prices in the euro-area countries. On the basis of an analysis of the harmonized consumer price indices for around 80 categories of goods, Eurostat has estimated an impact of between zero and 0.2 percentage points for the area as a whole in the first half of the year, with most of the effect being concentrated in the service sector. These findings essentially confirm the ex ante projections prepared by national central banks and statistical institutes, even though the changeover made a larger contribution to the area’s inflation than had originally been estimated in the most favourable scenario.

For Italy, the Bank of Italy and Istat examined a specific aspect of the changeover, namely the inflationary impact of the migration of prices towards “psychological” levels, such as €9.99 instead of €10.00, or towards “rounded” amounts in the new currency. The exercise was carried out for each month between January and October 2002 on around one third of the base price quotes used in calculating the general consumer price index, which represent 61 per cent of the items in the basket.

In the period in question the proportion of “attractive” prices (“psychological” or “rounded” prices) steadily increased from around one fifth to more than half of the total price quotes considered, indicating a gradual adjustment of prices to the new currency. Between January and October the cumulative effect of the changeover on consumer prices as a result of prices reaching “attractive” thresholds was estimated at between 0.3 and 0.9 percentage points, depending on the estimation method used. Istat calculates that the general consumer price index rose by 2.4 per cent over the same period. For 2002 as a whole, the one-off effect accounted for between 0.1 and 0.5 points of the total inflation rate of 2.5 per cent (see the box

“*Changeover to the euro and consumer price inflation in Italy*”, Economic Bulletin, No. 36, March 2003).

The effect of the changeover was evident almost exclusively in the prices of items sold via traditional distribution channels, which rose much more during the period in question than did the prices charged by modern outlets (supermarkets, hypermarkets, etc.).

Overall, these results are in line with the ex ante estimates made jointly by Istat and the Bank of Italy in 2001. Estimates of the impact of the changeover on consumer price inflation have been published for only a few countries; it is put at 0.2 points in France and 0.6 points in the Netherlands.

THE BALANCE OF PAYMENTS AND THE NET INTERNATIONAL INVESTMENT POSITION

Italy's current account deficit rose from €0.7 billion in 2001 to €7.3 billion in 2002, equal to 0.6 per cent of GDP (Table 27). The increase was due to a deterioration in the balance on services, which had been in broad equilibrium in 2001 but showed a deficit of €3.7 billion in 2002, and to a widening of the deficit on income from €11.6 billion to €15.4 billion. The reduction in the deficit on current transfers from €6.5 billion to €5.6 billion only partly mitigated the deterioration in the overall balance. The trade surplus stood at €17.3 billion, essentially the same as in 2001, when it had amounted to €17.4 billion.

Table 27

ITALIAN BALANCE OF PAYMENTS

(balances in billions of euros)

	2000	2001	2002
Current account	**–6.3**	**–0.7**	**–7.3**
Goods	10.4	17.4	17.3
Exports	*260.9*	*273.6*	*268.3*
Imports	*250.5*	*256.2*	*251.0*
Services	1.2	. .	–3.7
Income	–13.1	–11.6	–15.4
Transfers	–4.7	–6.5	–5.6
EU institutions	*–4.9*	*–5.6*	*–5.7*
Capital account	**3.2**	**0.9**	**0.8**
Intangible assets	–0.1	–0.3	–0.2
Transfers	3.3	1.2	1.0
EU institutions	*3.6*	*1.7*	*1.6*
Financial account	**4.3**	**–3.3**	**8.5**
Direct investment	1.1	–7.4	–2.7
Portfolio investment	–26.3	–7.6	16.1
Financial derivatives	2.5	–0.5	–2.7
Other investment	30.0	11.7	1.0
Banks (1)	*29.5*	*27.6*	*–41.7*
Change in official reserves	–3.1	0.5	–3.1
Errors and omissions	**–1.2**	**3.1**	**–2.1**

(1) MFIs, excluding the Bank of Italy.

The surplus on the capital account, which had declined sharply in 2001, was almost unchanged, at €0.8 billion compared with €0.9 billion the previous year.

The financial account showed net inflows of €8.5 billion, compared with net outflows of €3.3 billion in 2001; errors and omissions were small, giving rise to a net outflow of €2.1 billion.

The largest contribution to the improvement in the financial account came from portfolio investment, which swung from net outflows of €7.6 billion in 2001 to net inflows of €16.1 billion last year; in addition, net outflows on account of direct investment decreased from €7.4 billion to €2.7 billion. By contrast, the balances for derivatives and "other investment" deteriorated, the change in the latter being particularly large.

At the end of the year Italy had a net debtor position of €70.6 billion in respect of international investment, equal to 5.6 per cent of GDP, whereas it had had a net creditor position of 2.5 per cent of GDP in 2001. This substantial deterioration can be attributed largely to a fall in the value of resident non-banks' external assets, mostly consisting of equities, caused in part by the appreciation of the euro but above all by the fall in share prices.

Trade

The trade surplus, which amounted to €17.3 billion on an *fob-fob* basis (1.4 per cent of GDP), was the same as in 2001, while total trade declined in value terms: imports contracted by 2 per cent and exports by 1.9 per cent. The decrease in exports was caused by a fall of 1.9 per cent in average unit values, as the volume of shipments remained unchanged. The contraction in imports was also caused solely by a fall in average unit values, which went down by 3.6 per cent, while the volume of imports rose by more than 1 per cent. The terms of trade therefore showed a further improvement, although the gain of 1.8 per cent was smaller than that recorded in 2001. Import prices benefited from the appreciation of the euro against the dollar (by 5.6 per cent on an annual average basis), the currency in which the world prices of most raw materials are denominated.

In 2002 exports by almost all of the main sectors in which Italy is specialized decreased in value: electrical equipment and precision instruments by 10.8 per cent, leather and footwear by 8.7 per cent, textiles and clothing by 4.7 per cent, furniture by 3.5 per cent and mechanical machinery and equipment by 2.8 per cent. There were increases only in exports of food products, beverages and tobacco (5.7 per cent), chemicals

(3.8 per cent) and transport equipment, thanks entirely to an increase in exports to non-EU markets (2.2 per cent, despite a fall of 5 per cent in exports of motor vehicles).

The decline in the value of imports occurred mainly in mineral fuels, electrical equipment and precision instruments, metals and metal products, and mechanical machinery and equipment, which were more strongly affected by the fall in domestic production. By contrast, imports of transport equipment and chemicals increased.

The value of imports of mineral fuels declined by 8.8 per cent, reducing the sector's deficit from €26.4 billion to €24 billion and from 2.2 to 1.9 per cent of GDP. As the volume of energy imports more or less stagnated in view of the downturn in industrial production, the decrease in value terms reflected a fall in average unit values, which in turn react with a slight lag to movements in the prices of oil and other primary energy products. The dollar price of oil, which had fallen to a low last June, began to rise again, although it fluctuated with the ebb and flow of the geopolitical crisis that culminated in the war in Iraq this March. In dollar terms, oil prices were on average 2.2 per cent higher than in 2001, but the appreciation of the euro against the dollar outweighed this increase, leading to a fall of 3.4 per cent in the euro prices of oil.

Within Italy's unchanged overall trade balance, the deficit with the EU increased from €2.5 billion to €5.1 billion while the surplus with non-EU countries rose. The deterioration in trade with EU countries was due mainly to a further rise in the deficit with Germany from €7 billion to €9.3 billion on a *cif-fob* basis, while the improvement in the balance with non-EU countries was chiefly the result of a fall in the value of imports from OPEC countries.

Both exports to and imports from Germany fell last year, by 9.7 and 3.4 per cent respectively. All the main branches of activity (fashion, mechanical engineering, chemicals, transport equipment and "other manufactured products", which include furniture) were affected by the decrease in the value of exports, which was due entirely to a contraction in volume.

The trade surpluses vis-à-vis France and Spain also declined in 2002, from €4 billion to €3.3 billion and from €5.8 billion to €5 billion respectively. In the case of France exports decreased by more than imports (by 4.5 per cent compared with 2.6 per cent), while in that of Spain exports fell and imports rose. The surplus vis-à-vis the United Kingdom increased further, from €4.9 billion to €5.4 billion; the fall in imports, which was substantial as far as mechanical engineering products were concerned, was larger than that in exports, which was concentrated in transport equipment, especially motor vehicles.

Italy's trade surplus with the countries of Central and Eastern Europe decreased slightly, from €5.6 billion to €5.3 billion. Since trade with this area was growing much more slowly, imports increased in value terms almost twice as fast as exports. In particular, there was a sharp slowdown in imports of textile products and clothing, and leather and footwear, which include a substantial amount of re-imports and are therefore susceptible to changes in Italian production in these branches of activity; by contrast, the rate of increase in imports of electrical machinery accelerated. The deficit with the states of the former Soviet Union contracted by €0.8 billion; imports fell by 2.6 per cent, owing mainly to a decline in purchases of oil and gas in value terms, which more than offset a sharp slowdown in exports. The deficit on trade with China was more or less the same as in 2001; although slowing down, exports continued to grow much more rapidly than imports (by 22.7 per cent, compared with 11 per cent). The trade surplus with the United States remained unchanged, despite a contraction in trade. The decline in exports was due to a fall in average unit values that exceeded the appreciation of the euro against the dollar; all the main exporting sectors except the transport equipment sector saw the value of sales to this market decline. Exports to countries in the Far East (except Japan) also decreased owing to the downturn in the fashion and mechanical engineering sectors.

Services, income and transfers

Services. – In the year under review the services account showed a deficit of €3.7 billion, whereas it had been balanced in 2001 and in surplus throughout the 1990s. The deterioration was caused mainly by a decrease in the surplus on travel from €12.4 billion to €10.4 billion and an increase in the deficits on transport and services to government. After two years of growth, total receipts fell by 1.6 per cent to €63.6 billion. The receipts of the two largest sectors – travel and "other business services" – decreased by 2.7 and 5.3 per cent respectively and those of the communications sector also fell, but earnings from transport and insurance rose. Expenditure increased from €64.6 billion to €67.2 billion, although the rise of 4 per cent was less than the rate of growth in 2001; all the major sectors were affected, apart from "other business services".

In 2002 the surplus on foreign travel amounted to €10.4 billion, or 0.8 per cent of GDP, €2 billion less than in the preceding year. The deterioration was due partly to a further fall of 2.7 per cent in receipts, following one of 3.2 per cent in 2001, and partly to a strong recovery of 7.6 per cent in spending: after falling by 2.8 per cent in 2001, and even more sharply in the latter part of that year owing to fear of terrorist attacks, Italian spending on foreign travel again grew at a brisk pace, encouraged to some extent by the appreciation of the euro against the leading currencies.

Both the number of Italian travelers abroad and that of foreign visitors to Italy increased, after falling in 2001. Per capita spending by Italian travelers abroad began to rise again, while that by foreign tourists in Italy continued to decline.

Income. – The deficit on the income account, which had decreased in 2001, rose again last year, from €11.6 billion to €15.4 billion; both investment income and labour income deteriorated. The deficit on labour income, which had been practically eliminated in 2001, widened to €0.9 billion. The deficit on investment income increased from €11.6 billion to €14.5 billion, reflecting the growth in the deficit on income from portfolio investment, whereas that on income from "other investment" declined and income from direct investment swung back into a small surplus.

Current account transfers. – Italy's deficit in respect of current account transfers fell from €6.5 billion in 2001 to €5.6 billion last year. An increase in the deficit on private sector transfers – and especially those classed as "other transfers", which include casualty insurance premiums and claims – was more than offset by a reduction in the deficit on public transfers, due almost entirely to a larger surplus on transfers involving "other non-residents", which include taxes and duties, pensions and social security contributions. The deficit towards EU institutions remained unchanged, an increase in outflows on account of "other transfers" being offset by higher receipts from the Guarantee Section of the EAGGF and lower transfers of VAT to the EU.

The capital account

The capital account surplus was almost unchanged, at €0.8 billion compared with €0.9 billion in 2001. There were slight improvements in private sector transfers and intangible assets, but the surplus on public transfers fell from €1.2 billion to €0.8 billion, partly as a result of the cancellation of the debt of highly indebted countries.

The financial account

Direct investment. – Direct investment gave rise to net outflows of €2.7 billion last year, €4.7 billion less than in 2001, reflecting a fall in Italian investment abroad from €24.2 billion to €18.2 billion; foreign investment in Italy contracted by 7 per cent to €15.5 billion. The decline in the net outflow on account of Italian investment abroad was due entirely to a contraction in net flows to countries outside the euro area, with the result that net investment in the countries of the Monetary Union, which has risen for three years, exceeded 70 per cent of the total. Net inward investment from countries outside the euro area also fell while that from the euro area increased.

Portfolio investment and derivatives. – Residents' portfolio investment abroad, which had peaked in 1999, showed a further sharp decrease to €17 billion; inward investment stabilized at €33.1 billion, roughly the same as in 2001, but this too was well below the levels of recent years; a similar contraction occurred in France and Germany. Portfolio investment gave rise to net overall inflows of €16.1 billion, compared with net outflows of €7.6 billion in 2001.

Residents had bought an extremely large volume of foreign equities in 1999 and 2000, but they began to scale down their holdings in 2001, and growing uncertainty about the timing of the world economic recovery caused them to make further reductions last year; they also greatly decreased those of foreign debt securities, as it appeared increasingly likely that the interest rate differentials in favour of the euro would last for some time. Foreign investors also disposed of Italian equities but increased their purchases of Italian bonds, especially government paper.

"Other investment". – Italy recorded net inflows of €1 billion of "other investment", well down on the figure of €11.7 billion recorded in 2001. Net fund-raising abroad by Italian banks had generated inflows of €29.5 billion in 2000 and €27.6 billion in 2001, but these gave way to a large outflow of €41.7 billion last year, mainly as a result of an increase in external assets coupled with a decrease in liabilities, most of which occurred in the second half of the year.

The official reserves and the net international investment position. – Italy's official reserves stood at €53 billion at the end of 2002, compared with €52.4 billion a year earlier. Flows during the year led to an increase of €3.1 billion, €2.5 billion of which was offset by exchange rate and value adjustments.

Italy had a net debtor position of €70.6 billion in respect of international investment at the end of the year, equal to 5.6 per cent of GDP; in 2001 it had recorded a net creditor position of €30.7 billion, or 2.5 per cent of GDP. A small part of the deterioration (€8.5 billion) was due to the balance on the financial account, but the bulk of it (€92.8 billion) was caused by value and exchange rate adjustments. Downward adjustments affected mainly assets held by the non-bank sector (€108.6 billion, equal to 11 per cent of the stock at the end of 2001) and were associated with the fall in equity prices and the appreciation of the euro against leading currencies. By contrast, the net debtor position of the Italian banking system, which had been increasing since 1999, contracted from €124.9 billion to €72.1 billion, thanks mainly to an increase in external assets (Table 28).

Table 28

ITALY'S NET INTERNATIONAL INVESTMENT POSITION
(millions of euros)

	Stock at end-2001 (1) (a)	January-December 2002					Stock at end-2002 (1) (a)+(d)
		Flows (2) (b)	Value adjustments (c)	Exchange rate (3)	Other	Change in stocks (d)=(b)+(c)	
			Resident non-banks				
Assets	**958,264**	**6,887**	**–108,639**	**–33,765**	**–74,874**	**–101,752**	**856,512**
Direct investment	191,630	16,739	–38,214	–10,360	–27,854	–21,475	170,155
Portfolio investment	588,912	12,939	–72,652	–21,711	–50,941	–59,713	529,199
of which: equities	*262,712*	*4,721*	*–68,500*	*–14,279*	*–54,221*	*–63,780*	*198,932*
Other investment	174,347	–27,586	2,227	–1,694	3,921	–25,359	148,988
Derivatives	3,375	4,795	. .	. .	. .	4,795	8,170
Liabilities	**876,866**	**52,432**	**–18,747**	**–7,983**	**–10,764**	**33,685**	**910,551**
Direct investment	121,701	15,367	–17,362	–59	–17,303	–1,995	119,706
Portfolio investment	621,083	35,038	823	–6,308	7,131	35,861	656,944
of which: equities	*40,557*	*–7,381*	*–5,041*	*–24*	*–5,017*	*–12,422*	*28,135*
Other investment	130,491	92	–2,212	–1,616	–596	–2,120	128,371
Derivatives	3,591	1,935	4	. .	4	1,939	5,530
Net investment position	**81,398**	**–45,545**	**–89,892**	**–25,782**	**–64,110**	**–135,437**	**–54,039**
			Resident banks				
Assets	188,615	40,699	180	–7,222	7,402	40,879	229,494
Liabilities	313,555	–6,192	–5,818	–12,161	6,343	–12,010	301,545
Net investment position	**–124,940**	**46,891**	**5,998**	**4,939**	**1,059**	**52,889**	**–72,051**
			Central bank				
Assets	76,761	–7,025	–3,316	–4,694	1,378	–10,341	66,420
Liabilities	2,493	2,859	5,556	–243	5,799	8,415	10,908
Net investment position	**74,268**	**–9,884**	**–8,872**	**–4,451**	**–4,421**	**–18,756**	**55,512**
OVERALL NET INTERNATIONAL INVESTMENT POSITION	**30,726**	**–8,538**	**–92,766**	**–25,294**	**–67,472**	**–101,304**	**–70,578**

(1) At end-of-period prices and exchange rates. – (2) At prices and exchange rates obtaining on the transaction date. – (3) Calculated on the basis of currency composition.

Between 1998 and 2000 Italian residents had made portfolio investments in foreign equities worth €170 billion in view of the progressive opening-up of the international financial system and high equity prices. Although purchases decreased considerably thereafter, the composition of the private non-bank sector's portfolio became more akin to that of other industrial countries as regards the proportion of foreign equities.

As foreign direct investment also consists mostly of shares, it can be concluded that equities are the preferred medium for Italian investment abroad, accounting for about 35 per cent of assets at the end of 2001. Italian liabilities, by contrast, consist mainly of government securities (50 per cent of the total at the end of 2001), with shares making up only 14 per cent. In a year in which the leading world stock market indices fell by between 20 and more than 30 per cent, this marked asymmetry in the composition of Italy's assets and liabilities led to a large reduction in the market value of assets but much smaller downward adjustments in liabilities. Adjustments to the market value of assets came to €74.9 billion, equal to 8 per cent of the stock held by resident non-banks at the end of 2001; in addition, the appreciation of the euro against the leading currencies led to exchange-rate losses of €33.8 billion (again with reference to resident non-banks). As regards liabilities, on the other hand, there was a slight increase of €12 billion in the value of debt securities and a valuation loss of €5 billion on the modest stock of equities, but a larger loss of €17 billion on direct investment in Italy. A further €8 billion was written off liabilities owing to the depreciation of the foreign currencies in which some of them are denominated.

THE PUBLIC FINANCES

General government net borrowing in the euro area rose in 2002 for the second successive year. The increase, from 1.6 to 2.2 per cent of GDP, was mainly due to the slowdown in economic activity. The balance deteriorated in most countries; in Germany and France the deficit exceeded the threshold of 3 per cent of GDP. The decline in the ratio of debt to GDP came to a halt.

The performance of the public finances in 2002 and the less favourable economic prospects led governments to revise their stability programme objectives and make them less ambitious; the goal of budgetary balance in the area has been postponed from 2004 to 2006. According to the forecasts of the European Commission and the leading international organizations, in many countries the new objectives for 2003-04 will not be achieved either.

In October an agreement was reached within the Eurogroup whereby the countries that have not yet achieved a balanced budgetary position or a surplus must improve their underlying budget balances by at least 0.5 per cent of GDP every year.

In March 2003 the European Council reaffirmed the validity of the budgetary rules introduced in the Maastricht Treaty and the Stability and Growth Pact and specified that achievement of the medium-term objective of a position close to balance or in surplus was to be evaluated with reference to the underlying budget balance, defined as the balance adjusted for the effects of the economic cycle, with consideration given on a case-by-case basis to the role of measures producing temporary effects. The same balance is to be used to assess fulfilment of the commitment entered into by the Eurogroup countries in October. The Council stressed the need to take account of the special aspects of each country’s situation and to give greater consideration to the sustainability of the public finances in the long term, *inter alia* in relation to the consequences of population ageing.

Observance of the budgetary rules established at the European level will allow countries to cope with unfavourable cyclical developments without prejudicing the sustainability of the public finances and rapidly reduce debt in relation to GDP. It will help to create conditions conducive to growth and an increase in employment.

In Italy general government net borrowing declined to 2.3 per cent of GDP, down from 2.6 per cent in 2001 (compared with a preliminary figure of 1.4 per cent). The original objective for 2002, equal to 0.5 per cent of GDP, had been revised upwards to 1.1 per cent in July and to 2.1 per cent in September. The primary surplus was affected by the weak performance of the economy and contracted by 0.4 percentage points to 3.4 per cent of GDP. The level of the primary surplus in 2002 was the lowest of the last eight years. Interest payments fell by 0.7 percentage points to 5.7 per cent of GDP.

The increase in current expenditure, from 37.8 to 38.2 per cent of GDP, contributed to the deterioration in the primary surplus in 2002. Taxes and social security contributions fell by 0.5 percentage points to 41.6 per cent of GDP. The proceeds of sales of public buildings rose from 0.1 to 0.9 per cent of GDP.

Investment expenditure increased by 6.9 per cent, after rising by 10.2 per cent in 2001.

Action to curb the deficit was stepped up in the last part of the year. The adjustment measures contained in the budget for 2002, the net effects of which were estimated at 0.7 per cent of GDP, were supplemented by others amounting to about 0.5 per cent adopted in the second half of the year. The temporary nature of most of the measures limited their restrictive impact on economic activity.

The recourse to one-off measures increased. Including the sales of buildings, they reduced the borrowing requirement by more than 2 per cent of GDP and net borrowing by about 1.5 per cent, compared with a reduction of about 0.5 per cent in 2001. These estimates do not take account of the effects of the investment incentives introduced, which are hard to quantify.

The general government borrowing requirement, net of privatization receipts and settlements of past debts, declined from 3.1 to 2.7 per cent of GDP. When the effects of one-off measures are excluded, the amount by which the net borrowing requirement exceeded net borrowing increased to about 1 per cent of GDP.

In 2002 the ratio of debt to GDP fell by 2.8 percentage points to 106.7 per cent. Of the total fall 1.9 points was attributable to the conversion of the bonds assigned to the Bank of Italy in 1994 to replace the overdraft on the Treasury’s current account with the Bank.

For 2003 a budgetary adjustment of the order of 1 per cent of GDP has been approved; the forecast increase in revenues derives primarily from tax regularization measures.

The performance of the public finances continues to be weighed down by the weakness of economic activity and delays in making structural corrections to current expenditure.

In the update of the Forecasting and Planning Report and the Quarterly Report on the Borrowing Requirement published in April, the Government lowered the forecast rate of economic growth in 2003 by more than 1 percentage point to 1.1 per cent. The estimate of net borrowing was raised from 1.5 per cent of GDP in the November update of the Stability Programme to 2.3 per cent and that of the primary surplus was lowered from 4.3 to 3.2 per cent.

The Quarterly Report on the Borrowing Requirement also raised the forecast of the public sector net borrowing requirement from 2.8 to 3.2 per cent of GDP (2.1 per cent in 2002). The state sector borrowing requirement gross of settlements of prior debts was estimated at 4.4 per cent of GDP. The ratio of debt to GDP is expected to fall by 0.8 percentage points to 105.9 per cent.

The forecast for net borrowing contained in the Quarterly Report on the Borrowing Requirement is based on the assumption that one-off revenues in 2003 will amount to more than 1 per cent of GDP.

Turning to the two years 2004-05, the November update of the Stability Programme set targets for the deficit of respectively 0.6 and 0.2 per cent of GDP. For 2006 it set a target of a surplus of 0.1 per cent of GDP. The primary surplus is expected to rise above 5 per cent in 2005, when the ratio of debt to GDP is expected to fall below 100 per cent.

In these estimates, which still assumed a deficit of 1.5 per cent of GDP this year, achieving the target for 2004 required an adjustment equal to 1.6 per cent of GDP. It is desirable that earlier one-off measures be replaced by others of a permanent nature.

Structural measures aimed at curbing expenditure in the medium term are the necessary condition for simultaneously achieving a lasting fiscal consolidation and a gradual reduction in the tax burden. The ratio of primary current expenditure to GDP has remained basically unchanged since the mid-1990s. The primary surplus must be restored to a level that will bring a reduction in the ratio of debt to GDP that is both certain and significant.

The decentralization of governmental functions can contribute to increasing the efficiency with which public resources are administered. In order to guarantee tighter control over disbursements, the decentralization needs to be based on a closer link between responsibility for spending and responsibility for resources and on budgetary rules that are binding for all levels of government.

BUDGETARY POLICY IN 2002

The euro area

In 2002 general government net borrowing rose further, to 2.2 per cent of GDP, compared with 1.6 per cent in 2001 and 1 per cent in 2000 (Table 29). In unfavourable cyclical conditions, nearly all the euro-area countries allowed built-in stabilizers to work to the full. In some countries tax receipts were reduced as reliefs granted in earlier years came to produce their full effects and as a consequence of the fall in share prices over the last two years. The worsening of the budget deficit was kept in check by the further fall in interest payments, from 3.9 to 3.7 per cent of GDP. The European Commission's estimate of the ratio of the cyclically-adjusted primary surplus to GDP declined from 1.8 to 1.5 per cent.

Table 29

GENERAL GOVERNMENT NET BORROWING AND DEBT IN THE EURO-AREA COUNTRIES (1)
(*as a percentage of GDP*)

	1999		2000		2001		2002	
	Borrowing	Debt	Borrowing	Debt	Borrowing	Debt	Borrowing	Debt
Germany	1.5	61.2	1.4	60.2	2.8	59.5	3.6	60.8
France	1.8	58.5	1.4	57.2	1.6	56.8	3.1	59.1
Italy	1.7	114.9	1.8	110.6	2.6	109.5	2.3	106.7
Spain	1.2	63.1	0.9	60.5	0.1	56.9	0.1	54.0
Netherlands . . .	−0.7	63.1	−1.5	55.8	−0.1	52.8	1.1	52.6
Belgium	0.5	114.9	−0.1	109.6	−0.3	108.5	−0.1	105.3
Austria	2.3	67.5	1.9	66.8	−0.3	67.3	0.6	68.7
Finland	−2.0	47.0	−6.9	44.5	−5.1	43.8	−4.7	42.7
Greece	1.8	105.1	1.9	106.2	1.9	107.0	1.2	104.9
Portugal	2.8	54.3	3.1	53.3	4.2	55.6	2.7	58.1
Ireland	−2.3	49.3	−4.3	39.3	−1.2	36.8	0.3	33.3
Luxembourg . .	−3.5	6.0	−6.1	5.6	−6.4	5.6	−2.6	5.3
Euro area (2) .	**1.3**	**72.7**	**1.0**	**70.2**	**1.6**	**69.2**	**2.2**	**69.2**

Source: Based on European Commission data.
(1) The data on net borrowing do not include the proceeds of sales of UMTS licences but include the effects of swaps and forward rate agreements. – (2) To permit uniform comparison, Greece is included in the euro area in all the years considered.

Total revenue dropped from 46.5 to 46.2 per cent of GDP, mainly owing to the decline in the ratio of direct taxes from 12.5 to 12.3 per cent. Indirect taxes and social security contributions remained virtually unchanged in relation to GDP.

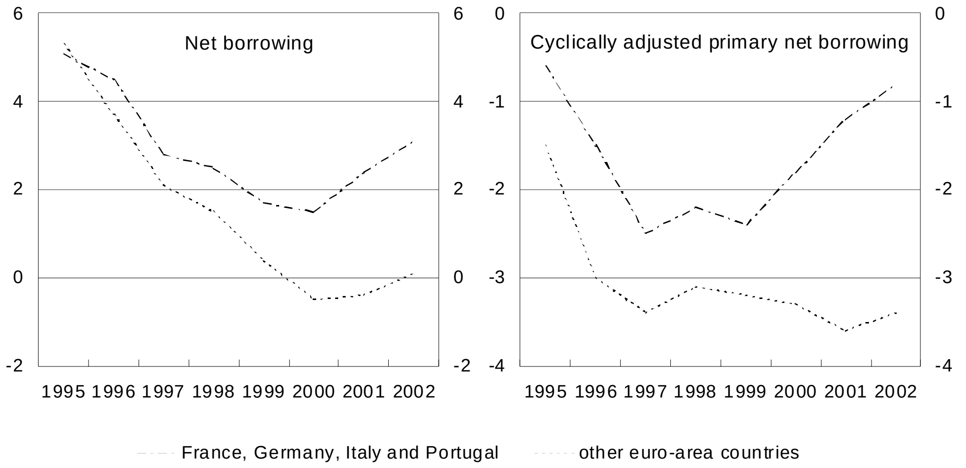
The primary expenditure ratio rose by 0.5 percentage points to 44.7 per cent. The rise was almost entirely due to the slowdown in economic activity: the slower rate of increase in the denominator was accompanied by a slight acceleration in outlays, partly as a consequence of the rise in unemployment benefits. Investment expenditure declined from 2.5 to 2.4 per cent of GDP; excluding the receipts from privatizations in Belgium, Italy and Portugal, which are accounted for as reductions in investment expenditure, the ratio was unchanged.

The largest deficits were recorded by Germany (3.6 per cent of GDP), France (3.1 per cent), Portugal (2.7 per cent) and Italy (2.3 per cent). Compared with 2001 the ratio of net borrowing to GDP worsened in France and Germany and improved in Italy, thanks to the fall in interest payments, and in Portugal, following the substantial adjustment measures introduced to bring the ratio below 3 per cent.

The large deficits of Germany, France, Portugal and Italy reflect not only the recent weak economic conditions but also the inadequate progress towards achieving the objective of a budgetary position close to balance or in surplus between 1998 and 2000, when the macroeconomic situation was relatively favourable (Figure 21).

Figure 21

GENERAL GOVERNMENT NET BORROWING IN THE EURO-AREA COUNTRIES (1)
(*as a percentage of GDP*)



Source: Based on European Commission data.
(1) To permit uniform comparison, Greece is included in the euro area in all the years considered.

In 1995 the average net borrowing of France, Germany, Italy and Portugal was much the same as that of the other euro-area countries, at about 5 per cent of GDP. In 1999 the figures for the two groups were respectively 1.7 and 0.4 per cent; in 2000 they had diverged further with an average deficit in the four major countries of 3.1 per cent and near balance in the other euro-area countries. The widening of the gap was largely due to budgetary policies: between 1999 and 2002 the cyclically-adjusted primary balance steadily worsened in the first group of countries but remained virtually unchanged in the second.

According to the stability programme updates submitted in late 2001 and early 2002, the euro-area deficit should have fallen in relation to GDP by 0.2 percentage points last year (see *Economic Bulletin*, No. 34, 2002). The majority of countries failed to achieve their objectives. In Finland the outcome was better than planned; in Belgium and Spain it was as planned. The gap between objectives and results was largely due to economic conditions having been less favourable than those on which budgets were based.

For the first time since 1997 the debt ratio failed to fall, remaining unchanged at 69.2 per cent. It rose in Austria, France, Germany and Portugal; in Germany it exceeded the 60 per cent threshold. In the other euro-area countries the ratio declined; in Belgium, Greece and Italy it is still above 100 per cent.

In January 2003, in view of the budget outturn expected for 2002, the EU Council declared Germany to have an excessive deficit. At the same time it issued an early warning to France in view of the budget outturn then expected for 2002, which was much worse than had originally been projected, and of the risk that the 3 per cent threshold would be crossed in 2003. In the light of the preliminary results for 2002, the excessive deficit procedure was initiated for France as well. In November 2002 the Council had declared Portugal's 2001 deficit to have been excessive; in 2002 it returned below the 3 per cent threshold.

Agreement was reached within the Eurogroup in October 2002 and within the European Council in March 2003 on ways to make the application of the EU budgetary rules more effective.

Italy

Net borrowing. – General government net borrowing fell to 2.3 per cent of GDP, from 2.6 per cent in 2001 (the estimate of the latter figure made in March 2002 had been 1.4 per cent). A contribution to the decline came from the fall in interest payments (Tables 30 and a15 and Figure 22).

Table 30

MAIN INDICATORS OF THE GENERAL GOVERNMENT CONSOLIDATED ACCOUNTS IN ITALY (1)
(*as a percentage of GDP*)

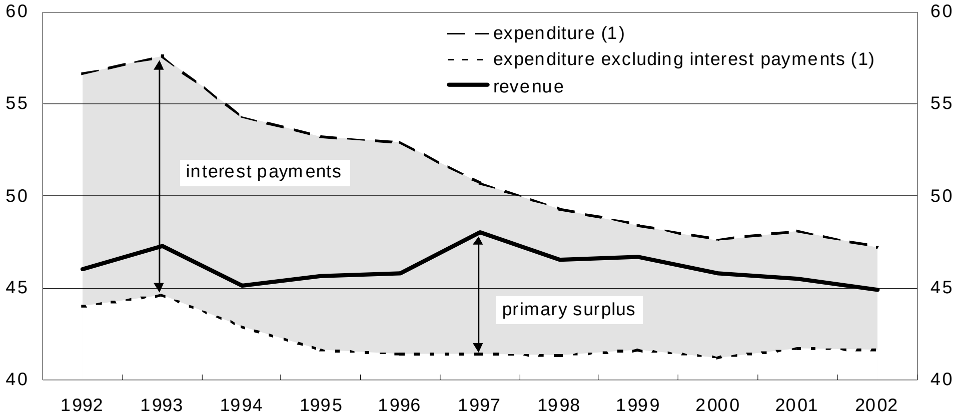
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Revenue	46.0	47.3	45.1	45.6	45.8	48.0	46.5	46.7	45.8	45.5	44.9
Expenditure (2) (3)	56.6	57.6	54.3	53.2	52.9	50.7	49.3	48.4	47.6	48.1	47.2
interest payments	*12.6*	*13.0*	*11.4*	*11.5*	*11.5*	*9.4*	*8.0*	*6.7*	*6.5*	*6.4*	*5.7*
Primary surplus (3)	2.0	2.8	2.1	3.9	4.4	6.7	5.2	5.0	4.6	3.8	3.4
Net borrowing (3)	10.7	10.3	9.3	7.6	7.1	2.7	2.8	1.7	1.8	2.6	2.3
Total borrowing requirement	10.8	10.8	9.7	7.2	7.5	1.9	2.5	1.2	2.2	3.5	3.0
Borrowing requirement net of settlements of past debts and privatization receipts	10.8	10.2	9.5	7.5	7.2	3.0	3.0	2.6	3.1	3.1	2.7
Debt	107.6	118.1	124.2	123.7	122.6	120.2	116.3	114.9	110.6	109.5	106.7

Source: The general government consolidated accounts items are based on Istat data.
(1) Rounding may cause discrepancies. – (2) This item includes, with a negative sign, the proceeds of the sale of public assets. – (3) The figure for 2000 does not include the proceeds of the sale of UMTS licences, which were also deducted from expenditure in the national accounts. See Table a15 in the Statistical Appendix.

The primary surplus declined from 3.8 to 3.4 per cent of GDP, owing in part to the effects produced by the automatic stabilizers in a period of unfavourable economic conditions. The tax reliefs granted in the last few years also contributed to the contraction in the surplus, while the increase in the proceeds from the sale of public buildings acted in the opposite direction.

Figure 22

GENERAL GOVERNMENT REVENUE AND EXPENDITURE IN ITALY
(*as a percentage of GDP*)



Source: Based on Istat data.
(1) This item includes, with a negative sign, the proceeds of the sale of public assets. The figure for 2000 does not include the proceeds of the sale of UMTS licences, which were also deducted from expenditure in the national accounts. See Table a15 in the Statistical Appendix.

The weak performance of the economy is estimated to have accounted for about 0.4 percentage points of the worsening of the ratio of the general government primary surplus to GDP between 2001 and 2002. This estimate is based on a methodology that takes account not only of the overall level of GDP but also of changes in its composition (see the chapter on Budgetary Policy in 2000 in the Annual Report for the year 2000). Setting on one side the composition effects, which in 2002 mainly reflected the relatively favourable trends in payroll employment and per capita earnings, the negative impact of economic activity on the primary surplus amounted to 0.6 percentage points.

The deterioration in the primary surplus in relation to GDP was the result of the increase of 0.4 percentage points in the primary expenditure ratio and the fall of 0.7 points in the current revenue ratio. These negative developments were partly offset by the improvement of 0.7 points in the ratio of the balance of capital revenue and expenditure, which was entirely due to the increase in proceeds from the sale of public buildings (Table a15).

The proceeds of the disposal of public buildings amounted to €10.8 billion in 2002. Of the total, €6.6 billion came from a securitization and €4.2 billion from direct sales (of which about half referred to buildings that were the subject of the securitization carried out in 2001, the proceeds of which were not included in the calculation of the net borrowing requirement for that year). The proceeds of public building disposals included in the accounts for 2000 and 2001 amounted to respectively €1 and €1.6 billion and derived entirely from direct sales.

On 3 July 2002 Eurostat established that securitizations were to be considered as sales and not loans if a) the ratio of the initial payment made by the buyer to the market value of the assets sold exceeded 85 per cent; b) no government guarantees were issued in respect of the risk incurred by the buyer; and c) the transaction did not concern future flows of revenue unrelated to balance sheet items. The securitizations carried out in 2001 did not satisfy these conditions; in particular, the sale of buildings had been made at a price that was less than 85 per cent of their market value, while the securitization of lotto and enalotto receipts did not refer to balance sheet items. The proceeds of the two transactions, equal to respectively 0.25 and 0.31 per cent of GDP, were therefore excluded from the general government accounts for 2001, with a consequent upward revision of the estimate of net borrowing.

The rise in the ratio of primary expenditure to GDP was basically due to the rapid growth in social benefits. Among the outlays on capital account, private investment rose from 1.3 to 1.4 per cent of GDP and direct general government investment from 2.6 to 2.7 per cent, excluding the proceeds of the sale of public assets, which are included in this item with a negative sign.

The decline in the ratio of current revenue to GDP reflected the sharp drop in the direct tax ratio, from 15 to 14.1 per cent. The reduction in receipts of corporate income tax was particularly pronounced, in connection with the performance of corporate profits and the application of temporary investment incentives.

Temporary measures are estimated to have reduced the ratio of net borrowing to GDP by about 1.5 percentage points in 2001, with sales of public buildings accounting for 0.9 points. In 2001 such measures had brought a reduction of about 0.5 percentage points, with sales of public buildings contributing 0.1 points. These estimates refer to the main budget adjustments; they do not take account of temporary revenue shortfall incurred in connection with investment incentives, which is hard to quantify.

The budget probably had a slightly expansionary effect on economic activity in view of the fall in the primary surplus and the changes in its composition. In particular, there were significant increases in investment, which has a direct effect on aggregate demand, and in revenue of a temporary nature, which presumably has a less restrictive effect on the spending decisions of the private sector than that of a permanent nature.

Budgetary policy. – The Economic and Financial Planning Document of July 2001 had set the objective for net borrowing in 2002 at 0.5 per cent of GDP, on the assumption of GDP growth of 3.1 per cent.

In September 2001 the Forecasting and Planning Report for 2002 revised the estimate of GDP growth in that year down to 2.3 per cent, but left the objective for net borrowing unchanged. The update of Italy's stability programme in November confirmed this planning scenario.

In order to achieve the objective set for 2002, the Government submitted a budget bill to Parliament designed to reduce the GDP ratio of the deficit on a current programmes basis by 0.7 percentage points. The measures included reductions in revenue and increases in expenditure that were mostly of a permanent nature and others aimed at increasing revenue that were mostly of a temporary nature. In particular, provision was made for sales of buildings amounting to 0.6 per cent of GDP. Parliament made only limited changes to the bill.

The preliminary estimate of net borrowing in 2001 issued by Istat at the beginning of March 2002 amounted to 1.4 per cent of GDP, which was 0.3 percentage points higher than the Government's estimates in the previous autumn.

Istat revised its estimate three times in the twelve following months: in June 2002 to 1.6 per cent, as a consequence of corrections involving mainly health expenditure, transfers to firms and tax revenue; in July of the same year to 2.2 per cent, as a result of the application of Eurostat's decision on securitizations; and in February 2003 to 2.6 per cent, as a consequence of corrections involving mainly withholding tax on public sector employees' earnings, intermediate consumption, interest payments and health expenditure.

Although it was kept down by the corrective measures adopted in the second part of the year, net borrowing in 2001 was close to the figure estimated by the Bank of Italy on a current programmes basis in the summer of that year, which was included as a prudential hypothesis in the Economic and Financial Planning Document of July 2001.

In the early months of 2002 the borrowing requirement was larger than expected. In April the Quarterly Report on the Borrowing Requirement again confirmed the objective of 0.5 per cent of GDP for net borrowing in 2002. In the same month, in order to reduce spending on pharmaceuticals, the Government issued a decree law that reduced the price paid by the National Health Service for most drugs by 5 per cent.

In July 2002 the Government raised the estimate of net borrowing in 2002 to 1.1 per cent of GDP in the Economic and Financial Planning Document for 2003-06. The Document recognized the delay in the start of economic recovery and reduced the forecast of GDP growth by one percentage point to 1.3 per cent. It also took account of the fact that the estimate of net borrowing in 2001 had been raised in the meantime to 2.2 per cent of GDP.

In the summer the divergence of the borrowing requirement from the results of the previous year grew wider, primarily in connection with the fall in receipts of self-assessed taxes. In order to avoid a large overshoot of net borrowing with respect to the objective, from July onwards the Government adopted a series of corrective measures to curb expenditure and boost revenue. With the aim of bringing about a significant reduction in the ratio of the debt to GDP, a series of financial operations were undertaken aimed at reducing the borrowing requirement and the level of liabilities.

In September the Forecasting and Planning Report for 2003 raised the estimate of the ratio of general government net borrowing to GDP in 2002 to 2.1 per cent and reduced that of GDP growth to 0.6 per cent.

The corrective measures adopted in the second half of 2002. – From July onwards the Government adopted a series of corrective measures, almost entirely of a temporary nature, that were expected to reduce the ratio of net borrowing to GDP by about half a percentage point and that of the borrowing requirement by more than one point. The measures were concentrated in the last quarter. In addition, the securitization of the sale of buildings provided for in the budget for 2002 was completed in the last two months of the year.

In July measures were introduced to limit the automatic use of tax credits, initially introduced in the Finance Law for 2001, for investments in backward areas and the recruitment of personnel. The banks serving as tax collection agents were required to make a payment on account at the end of the year in respect of receipts of amounts entered in the tax rolls. In addition, some INPS claims for social security contributions were securitized. These measures reduced the borrowing requirement but not net borrowing, except for that concerning tax credits, which produced effects on both balances, albeit much larger for the borrowing requirement.

In September a decree was issued to strengthen expenditure control mechanisms, whereby, in the event of a significant divergence from the objectives for the public finances established in the Economic and Financial Planning Document, the Minister for the Economy and Finance may restrict the use of budget appropriations for discretionary expenditure items. In addition, changes were made to the ways of determining the base for corporate income tax that would increase the yield of the second instalment payable in 2002. The size of the payment on account due by tax collection banks was increased for some indirect taxes. Lastly, rules were introduced (subsequently amended in November) to boost the tax receipts from insurance companies.

In the last quarter some financial transactions were carried out to reduce the borrowing requirement. They included: the securitization of Cassa Depositi e Prestiti claims, the sale of bonds held by the same body, and the bringing forward of the January 2003 payment of excise duties on mineral oils. In December banks were required to repay part of the incentives granted under Law 461/1998. The payment on account due by tax collection banks was increased further. Some buildings were sold to the company Fintecna.

In December a bond conversion was carried out involving the securities assigned to the Bank of Italy in 1994 in exchange for the overdraft on the Treasury's former current account with the Bank. The transaction, which reduced the ratio of the debt to GDP by 1.9 percentage points, had no effect on the borrowing requirement or net borrowing.

Financial balances and the public debt. – The general government total borrowing requirement fell from €43.3 billion in 2001 to €37.4 billion in 2002, and from 3.5 to 3 per cent of GDP (Tables 30, 31 and a16).

Table 31

ITALY: GENERAL GOVERNMENT BALANCES AND DEBT

(*millions of euros*)

	1999	2000	2001	2002
Net borrowing (1)	19,125	21,359	32,229	29,059
Total borrowing requirement	12,899	25,141	43,262	37,415
Borrowing requirement net of settlements of past debts and privatization receipts (2)	29,281	35,989	37,301	33,516
Debt	1,273,243	1,290,459	1,336,038	1,342,887
Memorandum items:				
Settlements of past debts (2)	6,259	4,601	10,291	5,929
Privatization receipts (–) (2)	–22,641	–15,450	–4,329	–2,031

Source: For net borrowing, Istat.
(1) The figure for 2000 does not include the proceeds of the sale of UMTS licences (€13,815 million). – (2) The figures for settlements of past debts and privatization receipts refer to central government.

Privatization receipts were down, from €4.3 billion to €2 billion, as were settlements of past debts, from €10.3 billion to €5.9 billion. Excluding these items, which do not affect net borrowing, the borrowing requirement declined from 3.1 to 2.7 per cent of GDP. Temporary measures are estimated to have reduced the ratio of the net borrowing requirement by more than two percentage points, compared with more than half a point in 2001.

Net issues of medium and long-term securities on the domestic market amounted to €22.2 billion, compared with €13.6 billion in 2001. Net issues of short-term securities were virtually nil, compared with €11.3 billion in 2001. As a result of the above-mentioned bond conversion, the average residual maturity of medium and long-term government securities shortened, from 5 years and 10 months at the end of 2001 to 5 years and 6 months at the end of 2002.

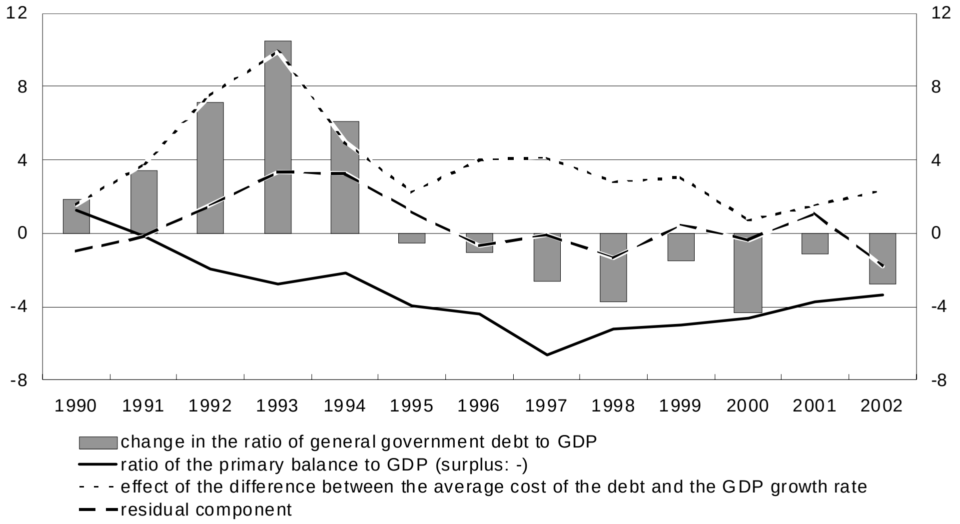
The ratio of general government debt to GDP fell by 2.8 percentage points to 106.7 per cent (Table 29 and Figure 23). Two thirds of the reduction deriving from the primary surplus was offset by the increase ascribable to the difference between the average cost of the debt and the GDP nominal growth rate. This difference widened from 1.4 percentage points in 2001 to 2.2 points: the fall in the average cost, from 6 to 5.3 per cent, was much smaller than that in the GDP growth rate, from 4.6 to 3.1 per cent. The residual component, which basically reflected the above-mentioned bond conversion, reduced the ratio by nearly two percentage points.

There have been very substantial variations, over the past thirty years, in the differential between the average cost of the debt and the nominal rate of GDP expansion, owing above all to the swings in the latter. The average cost of the debt has changed relatively modestly from one year to the next, adapting with a lag to changes in nominal interest rates. The differential was regularly negative in the 1970s and the first half of the 1980s, in four years by more than 15 percentage points, and then fluctuated around zero until 1989. In the 1990s it was always positive, with a peak of more than 9 percentage point in 1993. From 1995 to 2002 it averaged 2.3 points. In the future, the stability of prices and yields stemming from Italian participation in Economic and Monetary Union should limit the variability of the differential.

Figure 23

ITALY: CHANGE IN THE RATIO OF THE PUBLIC DEBT TO GDP AND ITS COMPONENTS (1)

(*percentage points*)



(1) For the methodology, see the note to Figure 18 in the *Abridged Report for the year 2000*.

Public finance indicators. – The main indicators for the analysis of the general government accounts are net borrowing, the borrowing requirement and the debt.

Net borrowing is the balance of transactions of a non-financial nature carried out by public bodies. It is calculated by Istat with reference to general government on the basis of the guidelines contained in ESA95, which values most transactions on an accrual basis. The Ministry for the Economy and Finance calculates a balance (known simply as the deficit) with reference to the public sector that differs from net borrowing as calculated by Istat owing both to the adoption of a different definition of non-financial transactions and to their valuation on a cash basis. The composition of the sectors considered is basically the same.

The borrowing requirement on the formation side is the sum of the balance of non-financial transactions and the balance of transactions involving financial assets. It is calculated by the Ministry for the Economy and Finance with reference to the public sector by summing the above-mentioned budget deficit and the balance on transactions in financial assets, net of privatization receipts and the changes in the accounts held by the Treasury with the Bank of Italy (primarily the Treasury payments account and the sinking fund for the redemption of government securities).

The borrowing requirement on the financing side is the balance of the transactions carried out to finance the activity of public bodies through the market. It is calculated by the Bank of Italy with reference to general government by subtracting the change in the accounts held by the Treasury with the Bank from the flow of financial liabilities (the balance of liabilities issued and redeemed). The Bank of Italy also calculates the net borrowing requirement, which measures the amount it would have been necessary to finance through the market in the absence of settlements of prior-year debts and privatization receipts.

In principle the borrowing requirement measured on the formation side coincides with that calculated on the financing side. However, the borrowing requirement calculated by the Ministry may differ from that calculated by the Bank of Italy owing not only to the exclusion of privatization receipts but also to differences in the definition of general government transactions (the liabilities considered by the Bank of Italy are those that make up the debt according to the definition adopted for the excessive deficit procedure). Potentially significant discrepancies may also stem from the sources used: the Ministry's figures are based on the data provided by each individual public body, while those of the Bank of Italy are collected on the financial market or from the counterparties of the transactions carried out by public bodies. As mentioned earlier, the effects of the differences between the sectors considered are of little importance.

Lastly, the debt is calculated by the Bank of Italy as the face value of the stock of financial liabilities outstanding, in accordance with the methodology agreed at European level.

The difference between the borrowing requirement calculated by the Bank of Italy, considered net of privatization receipts (so as to obtain an aggregate comparable with that calculated by the Ministry) and net borrowing calculated by Istat can be divided into three components: a) the difference between the borrowing requirement calculated by the Bank of Italy and that calculated by the Ministry; b) the balance on transactions in financial assets calculated by the Ministry; and c) the difference between the deficit of the public sector calculated by the Ministry and net borrowing calculated by Istat.

The average difference between the borrowing requirement net of privatization receipts calculated by the Bank of Italy and net borrowing was

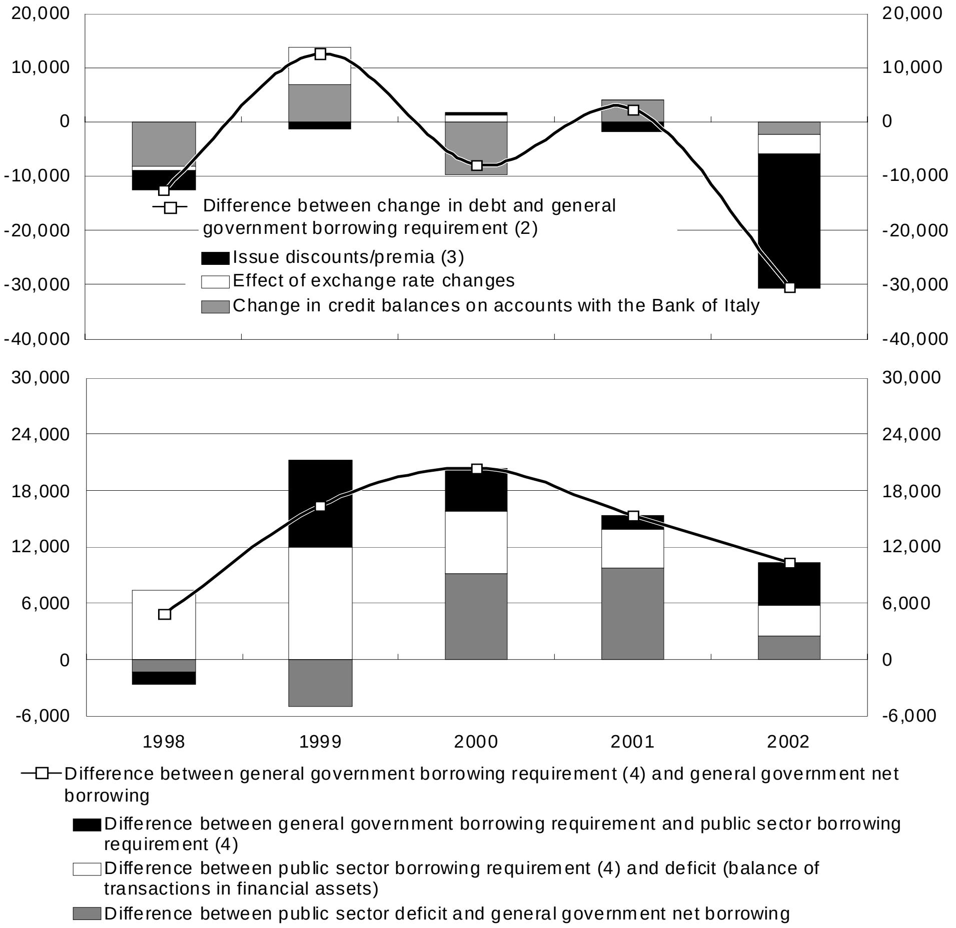
€4.6 billion per year between 1994 and 1998; it then rose to €17.4 billion in the three following years, with a peak of €20.3 billion in 2000. In 2002 it fell to €9.7 billion.

The large size of the gap in 1999 reflected the divergence between the borrowing requirements calculated by the Bank of Italy and the Ministry (which was due only in part to the different treatments of the securitization in that year of INPS social security contribution receivables) and the balance on transactions in financial assets, which was significantly larger than in 1998 (Figure 24). In the two following years these two factors became much less important and the persistence of a large gap was due to the increase in

Figure 24

ITALY: DIFFERENCES BETWEEN THE CHANGE IN THE DEBT AND THE BORROWING REQUIREMENT AND BETWEEN THE BORROWING REQUIREMENT AND NET BORROWING (1)

(*millions of euros*)



Sources: For the public sector borrowing requirement, balance of transactions in financial assets and deficit, Ministry for the Economy and Finance, *Relazione trimestrale di Cassa*, various years; for the general government debt and borrowing requirement, Bank of Italy; for net borrowing, Istat. The data on the effect of exchange rate changes and issue premia/discounts are partially estimated.

(1) The data on the borrowing requirement and net borrowing in 2000 exclude the proceeds of the sale of UMTS licences. – (2) Total borrowing requirement. – (3) The figure for 2002 includes the effect of the conversion of the securities assigned to the Bank of Italy in 1994 to replace the overdraft on the Treasury's current account with the Bank in 1993. – (4) Borrowing requirement net of privatization receipts.

the difference between the deficit calculated by the Ministry and net borrowing calculated by Istat (caused primarily by the differences between the valuations on a cash and an accrual basis). In 2002, primarily as a consequence of temporary measures, the difference between the deficit and net borrowing also decreased considerably.

The difference between the change in the debt and the general government borrowing requirement, both of which are calculated by the Bank of Italy, reflects: a) the changes in the balances held by the Treasury with the Bank of Italy, which affect the borrowing requirement but not the debt, since this is defined exclusively in terms of liabilities; b) issue premia/discounts or in other words the differences between the par values of securities, which are used in calculating the debt, and the prices actually paid by subscribers, which are used in calculating the borrowing requirement; and c) the effects of exchange rate movements on the value of the debt denominated in foreign currencies (for the borrowing requirement reference is made to the exchange rate obtaining when securities are issued/redeemed while for the debt reference is made to the exchange rate obtaining at the valuation date of the outstanding liabilities).

The difference between the change in the debt and the borrowing requirement was positive between 1990 and 1994 in connection with the devaluation of the lira in 1992-93 and the opening and initial replenishment of the Treasury payments account in 1993-94. From 1995 to 2001 the difference fluctuated, with positive peaks that were nonetheless below the levels recorded in 1993-94. The outcome was influenced by the changes in the balances held by the Treasury with the Bank of Italy and the movements in exchange rates. The effect of issue premia/discounts, which were especially pronounced in 1995 owing to the issue of the first zero-coupon bonds, gradually diminished.

In 2002 the debt increased by €6.8 billion, which was €30.6 billion less than the borrowing requirement. The breakdown of the difference is as follows: issue premia/discounts contributed €24.8 billion, including the effects of the conversion of the bonds assigned to the Bank of Italy in 1994 to replace the Treasury’s overdraft on its former current account; the revaluation of the euro contributed €3.6 billion and the fall in the liquid balances held by the Treasury with the Bank of Italy the remaining €2.2 billion.

The size of the discrepancies between the public finance indicators for 2000 and 2001 was reduced by the revisions made by the three institutions involved in their compilation. The revisions are partly the result of the work of the committee set up at the Prime Minister’s Office to examine the reconciliation of the different indicators. In view of the fact that the discrepancies are still large, it is important that the committee should continue its work.

REVENUE AND EXPENDITURE IN ITALY

Revenue

In 2002 general government revenue grew by 1.8 per cent to €565.2 billion; in relation to GDP it decreased by 0.6 percentage points to 44.9 per cent (Tables 30 and a15). The ratio of taxes and social security contributions to GDP declined by 0.5 percentage points to 41.6 per cent (Table 32 and Figure 25).

Current revenue declined from 45.2 to 44.5 per cent of GDP, reflecting the reduction in direct taxes. Capital revenue rose from 0.3 to 0.4 per cent of GDP owing to receipts associated with the repatriation and regularization of assets held abroad (€1.5 billion) and the repayment by banks of reliefs obtained under Law 461 of 23 December 1998 (€0.7 billion).

Table 32

GENERAL GOVERNMENT FISCAL REVENUE (1)
(as a percentage of GDP)

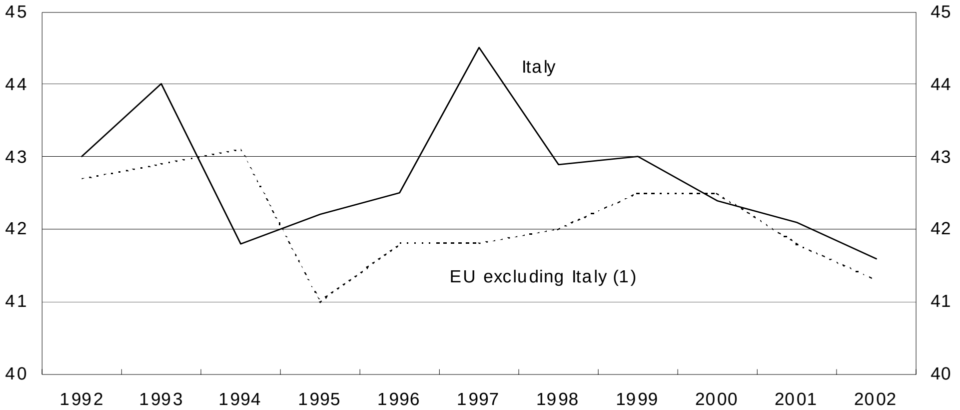
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Direct taxes	14.6	16.0	14.9	14.7	15.3	16.0	14.4	15.0	14.6	15.0	14.1
Indirect taxes	11.3	12.0	11.8	12.1	11.8	12.4	15.3	15.1	15.0	14.5	14.6
Current tax revenue	**25.9**	**28.0**	**26.7**	**26.8**	**27.1**	**28.5**	**29.7**	**30.1**	**29.6**	**29.4**	**28.7**
Actual social security contributions	13.4	13.5	13.2	13.0	14.6	14.9	12.5	12.4	12.4	12.3	12.4
Imputed social security contributions	1.7	1.8	1.9	1.7	0.4	0.4	0.4	0.3	0.3	0.3	0.3
Current fiscal revenue	**41.0**	**43.3**	**41.7**	**41.6**	**42.2**	**43.8**	**42.5**	**42.9**	**42.3**	**42.1**	**41.3**
Capital taxes	2.0	0.7	0.1	0.6	0.3	0.7	0.4	0.1	0.1	0.1	0.2
Fiscal revenue	**43.0**	**44.0**	**41.8**	**42.2**	**42.5**	**44.5**	**42.9**	**43.0**	**42.4**	**42.1**	**41.6**

Source: Based on Istat data.
(1) Rounding may cause discrepancies. See also Table a15 in the Statistical Appendix.

Figure 25

TAX REVENUE AND SOCIAL SECURITY CONTRIBUTIONS

(*as a percentage of GDP*)



Sources: Based on Istat and European Commission data.
(1) GDP-weighted average. There is a break in the series between 1994 and 1995 owing to the switch to ESA95.

The following analysis of individual taxes, with the exception of the regional tax on productive activities (IRAP), is based on receipts shown in the central government accounts, while that of IRAP refers to revenues received by the Bank of Italy's provincial offices.

Direct taxes. – Revenue from this source fell by 2.9 per cent, or €5.4 billion, and from 15 to 14.1 per cent of GDP. It was affected by the economic downturn, tax reliefs and incentives granted over the last two years, the fall in revenue from the tax on capital gains from sales of firms and equity investments and the decline in receipts from the tax on the revaluation of corporate fixed assets.

Revenue from personal income tax declined by 0.7 per cent, or €0.8 billion. The self-assessed part fell by 8.7 per cent, or €1.9 billion, owing partly to the absence of the payment of the balance on incomes from "coordinated and continuous collaboration", which were assimilated to income from payroll employment in 2001. Withholding tax on payroll incomes increased by 2.6 per cent (€2.3 billion), around two percentage points less than the growth in gross earnings; part of the difference was due to the higher deductions for dependent children included in the 2002 budget, which is estimated to have reduced revenue by €1.1 billion.

Corporate income tax receipts declined by 9.5 per cent, or €3.1 billion, affected by the economic downturn and the measures introduced in recent years aimed at reducing the tax burden. The measures passed last September worked in the opposite direction (see the box "The corrective measures introduced during the year” in *Economic Bulletin*, No. 35, November 2002). Another factor was the Tremonti-bis Law (Law 383 of 18 October 2001), which introduced temporary investment incentives. In view of the timetable for payment of this tax, the reductions in receipts relating to investments carried out in 2001 and 2002 were concentrated in 2002. The large-scale take-up of this concession appears to be confirmed by the acceleration in gross fixed investment in the second half of 2002 as the expiry of the tax incentive approached. Other smaller reductions in receipts were the result of reliefs granted recently and which were not claimed in the payments on account made in 2001, such as the reduction in the corporate tax rate from 37 to 36 per cent and the measures to tighten up dual income tax (increase in the multiplier and elimination of the minimum average rate).

Receipts of withholding tax on interest income and capital gains fell for the second consecutive year, declining by €2.6 billion. Of the total, €1.7 billion was attributable to the tax on capital gains from the sale of businesses and equity investments, receipts of which had been temporarily boosted in 2001 by changes in the law. The remainder reflected the decline in interest rates and share prices and the use of tax credits accruing from 2000 onwards on managed assets. Receipts of tax on interest income from bank and post office deposits rose by €0.4 billion.

The yield from other direct taxes fell by 12.5 per cent, or €1.1 billion. A decrease of €3.5 billion in receipts of tax on the revaluation of corporate assets was only partly offset by revenue from the temporary withholding taxes introduced in the budget for 2002 and the tax on insurance companies adopted at the end of last year, which yielded €1.7 billion and €0.5 billion respectively.

Indirect taxes. – Indirect tax revenue grew by 4 per cent, or €7.1 billion; in relation to GDP it increased from 14.5 to 14.6 per cent.

VAT receipts rose by 3.2 per cent, or €3 billion; the increase was broadly in line with the growth of 2.9 per cent in consumption. The revenue from other business taxes increased by 13.5 per cent, or €2 billion. Receipts of excise duties on oil products rose by 2.8 per cent, or €0.6 billion, in connection with the bringing forward of a payment due in January 2003 to last December under a provision introduced in the last two months of 2002; the amount of this advance payment (€0.8 billion) has not been included among indirect taxes in the consolidated accounts of general government. The yield of other excise and sales taxes fell by 9.3 per cent, or €0.5 billion, owing partly to the permanent reductions in duties on methane for domestic uses.

IRAP revenue collected by the Bank of Italy’s provincial offices rose by 3 per cent, or €0.9 billion.

Social security contributions. – Actual social security contributions rose by 3.7 per cent, compared with an increase of 4.2 per cent in total gross earnings; in relation to GDP they rose from 12.3 to 12.4 per cent.

Actual contributions paid by private-sector employers rose by 3.7 per cent (and from 5.7 to 5.8 per cent of GDP), compared with an increase of 4.6 per cent in gross earnings; those paid by general government rose by 3.1 per cent, more or less in line with the increase in earnings. The contributions paid by employees rose by 3.9 per cent and those by the self-employed by 4.6 per cent, owing partly to the effect of increases in contribution rates of 0.2 percentage points for professionals and traders and 0.5 percentage points for agricultural workers.

Expenditure

General government expenditure amounted to €594.3 billion, an increase of 1.2 per cent by comparison with 2001; it decreased from 48.1 to 47.2 per cent of GDP (Tables 33 and a15). Excluding the proceeds of sales of public-sector real estate (€10.8 billion in 2002 and €1.6 billion in 2001), which in the accounts are deducted from capital outlays, overall expenditure increased by 2.8 per cent, declining from 48.3 to 48.1 per cent of GDP. Interest payments decreased from 6.4 to 5.7 per cent of GDP. Primary current expenditure rose from 37.8 to 38.2 per cent (Figure 26) and capital outlays, excluding the proceeds of sales of real estate, from 4.1 to 4.3 per cent.

Interest payments. – The ratio of this item of expenditure to GDP showed a substantial decrease of 0.7 percentage points, after small reductions in the preceding two years. The average cost of the debt (the ratio between interest payments and the average stock of liabilities), which had remained more or less stable at 6 per cent in the three years from 1999 to 2001, came down to 5.3 per cent, reflecting the decline in interest rates and the redemption of relatively high-yielding securities (Figure 27); swap operations contributed €1.9 billion to the reduction.

The average gross rate on the three maturities of Treasury bills decreased from 5.1 to 2.7 per cent between October 2000 and the end of 2002 and had fallen to 2.2 per cent by the middle of May 2003. The gross yield on ten-year Treasury bonds, which had risen to 5.8 per cent at the beginning of 2000, came down to 5.2 per cent at the end of 2001 and 4.4 per cent at the end of last year; by mid-May 2003 it stood at 4 per cent. A total of €30.2 billion of ten-year Treasury bonds with coupons of around 12 per cent matured in 2001 and 2002.

Table 33

GENERAL GOVERNMENT EXPENDITURE (1)

(*as a percentage of GDP*)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Compensation of employees	12.4	12.3	11.9	11.2	11.5	11.6	10.7	10.6	10.6	10.7	10.7
Intermediate consumption	5.1	5.2	5.2	4.8	4.8	4.7	4.8	4.9	5.0	5.1	5.0
Purchases of social benefits in kind	2.5	2.4	2.2	2.0	2.0	2.1	2.1	2.1	2.4	2.6	2.6
Social benefits in money	16.5	17.0	17.3	16.7	16.9	17.3	17.0	17.1	16.8	16.6	17.1
Interest payments	12.6	13.0	11.4	11.5	11.5	9.4	8.0	6.7	6.5	6.4	5.7
Other current expenditure	2.8	3.3	2.7	2.3	2.5	2.2	2.9	2.8	2.8	2.8	2.8
Total current expenditure	**52.1**	**53.3**	**50.6**	**48.5**	**49.1**	**47.2**	**45.4**	**44.4**	**43.9**	**44.2**	**43.8**
Gross fixed investment (2)	3.0	2.6	2.3	2.1	2.2	2.2	2.4	2.4	2.4	2.5	1.8
Other capital expenditure (3)	1.5	1.7	1.5	2.5	1.6	1.3	1.5	1.6	1.3	1.4	1.6
Total capital expenditure (2) (3)	**4.6**	**4.3**	**3.7**	**4.6**	**3.8**	**3.5**	**3.9**	**4.0**	**3.7**	**3.9**	**3.4**
Total expenditure (2) (3).	**56.6**	**57.6**	**54.3**	**53.2**	**52.9**	**50.7**	**49.3**	**48.4**	**47.6**	**48.1**	**47.2**
of which: expenditure excluding interest payments (2) (3)	*44.0*	*44.6*	*42.9*	*41.6*	*41.4*	*41.4*	*41.3*	*41.6*	*41.2*	*41.7*	*41.6*

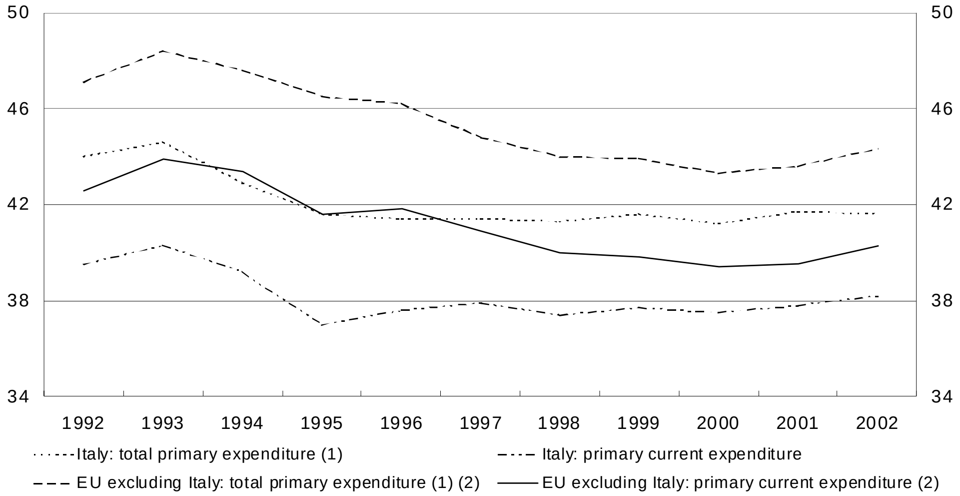
Source: Based on Istat data.

(1) Rounding may cause discrepancies. See also Table a15 in the Statistical Appendix. – (2) The figure for 2001 does not include the securitization of the proceeds of sales of public buildings (0.3 per cent of GDP). In the national accounts these receipts are entered as a reduction in investment expenditure. – (3) The figure for 2000 does not include the proceeds of sales of UMTS licences (1.2 per cent of GDP). In the national accounts these receipts are entered as a reduction in the item "Other capital expenditure".

Figure 26

TOTAL AND CURRENT EXPENDITURE

(*as a percentage of GDP*)

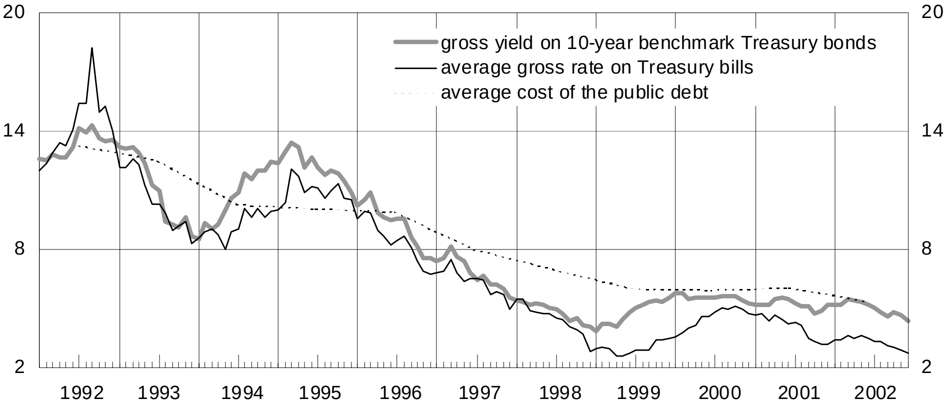


Sources: Based on Istat and European Commission data.

(1) The proceeds of sales of public assets are recorded as a deduction from this item; the item does not include the proceeds of sales of UMTS licences, which are also entered as a reduction in expenditure in the national accounts. – (2) GDP-weighted average. There is a break in the series between 1994 and 1995 owing to the switch to ESA95.

Figure 27

**AVERAGE COST OF THE PUBLIC DEBT,
AVERAGE GROSS RATE ON TREASURY BILLS AND
GROSS YIELD ON 10-YEAR TREASURY BONDS**



The extinction of relatively high-yielding securities is continuing. Ten-year Treasury bonds worth €24.8 billion with coupons of between 8.5 and 12 per cent will mature in 2003 and a further €65 billion with coupons of between 8 and 10.5 per cent will be redeemed between 2004 and 2006.

Social benefits in cash. – The ratio of these disbursements to GDP rose by 0.5 percentage points to 17.1 per cent. The increase of 6.5 per cent (compared with 3.5 per cent in 2001) reflected the rise in expenditure on pensions and annuities of both an insurance and a welfare nature, which increased by 6.6 per cent, as against 4.3 per cent the previous year.

In relation to GDP total benefits of this kind rose from 15 to 15.5 per cent, with welfare benefits rising from 1 to 1.2 per cent.

The rise in spending on pensions and annuities was due to a number of factors: a) the automatic adjustment of pensions by 3 per cent to account for the rise in prices (2.7 per cent for inflation in 2001 plus a final upgrade of 0.3 per cent for the difference between actual inflation in 2001 and the rate used for the provisional adjustment), compared with 2.5 per cent in 2001; b) the increase in some pension and welfare payments to €516.46 a month under the Finance Law for 2002, subject to recipients meeting certain income and age requirements; and c) the increase in the number of pensions, which was curtailed to some extent by the raising of the pensionable age of public and private-sector employees and self-employed persons in 2001.

Expenditure on unemployment benefits and wage supplementation, which had fallen in the two preceding years, rose by 12.1 per cent overall, owing partly to the downturn in the economy. The rise of 11.9 per cent in outlays on unemployment benefits was also due in part to the full implementation of the increase granted in the Finance Law for 2001. Expenditure on family allowances fell by 1 per cent. Outlays on severance pay for general government employees remained almost constant.

Spending on welfare benefits other than pensions increased from €1.1 billion in 2000 to €1.7 billion in 2001 and €1.9 billion in 2002 owing to measures introduced in previous years, such as the experimental minimum income supplement, allowances for families with three or more minors, maternity benefits paid by municipalities and housing allowances.

Compensation of employees. – The increase of 2.8 per cent in general government staff costs was contained by the non-renewal of labour agreements for the two years 2002-03. The ratio to GDP remained constant at 10.7 per cent. Gross earnings rose by 2.9 per cent, compared with 6.6 per cent in 2001; employer social security contributions rose less rapidly (by 2.3 per cent), as the additional state contribution to the budget of INPDAP, the State Sector Employees' Social Security Institute, remained virtually unchanged. The increase in gross earnings reflected that of around 2.8 per cent in gross wages and salaries per full-time equivalent employee (excluding military conscripts), compared with a rise of 4.7 per cent in 2001; employment remained more or less unchanged, after having risen by 1.9 per cent in 2001 as a result of a large increase in appointments in the education system.

Other current expenditure. – The ratio of these items to GDP decreased by 0.2 percentage points to 10.3 per cent. There was a particularly small rise of 0.3 per cent in intermediate consumption, down from 7.5 per cent in 2001, owing to the effect of measures introduced late last year to strengthen the mechanisms for controlling expenditure. Subsidies to firms decreased by 13.7 per cent, owing mainly to the reduction in transfers to public-sector service undertakings from the central government budget.

Social benefits in kind rose by 4.8 per cent, compared with 13.8 per cent in 2001; the rate of increase mirrored the rise of 5 per cent in the part relating to health spending (compared with 14.1 per cent in 2001), which represents around 95 per cent of the total.

In the general government accounts total health spending is recorded mainly under compensation of employees, intermediate consumption and social benefits in kind. The following analysis is based on data compiled by the Ministry of Health.

Health spending rose by 3.7 per cent in 2002 and increased from 6.2 to 6.3 per cent of GDP. The GDP ratio declined substantially between 1991 and 1995, from 6.4 to 5.2 per cent, but thereafter health spending increased more rapidly than output, with rates of growth of 11.1 and 8.6 per cent in 2000 and

2001 respectively. In 2002 spending on goods and services increased by 8.1 per cent and staff costs by 2.6 per cent. The growth in expenditure on pharmaceuticals slowed down sharply to 1.8 per cent, compared with 33.3 per cent in 2001, as a result of the measures contained in the budget for 2002, the Decree Law of April 2002 capping the prices of pharmaceuticals and a number of measures taken by regional authorities, first and foremost being the reintroduction of copayments, the reclassification of some medicines in the pharmacopoeia and the direct distribution of pharmaceuticals (the disbursements in connection with direct distribution are recorded as spending on the purchase of goods and services). Assessments of the trends in health expenditure may be revised when the accounts of the National Health Service agencies are closed.

Health spending in the South amounted to 8.6 per cent of the area's product, whereas in the North and Centre it came to 5.3 and 5.9 per cent respectively. In terms of per capita resources, however, expenditure in the South is lower than in the North and Centre (€1,270, compared with €1,410 and €1,390 respectively).

The reforms of the last decade have increased the role of the regional authorities in the organization of the health sector, but central government remains responsible for determining the nature, appropriateness and adequacy of services provided by the National Health Service. A range of different organizational arrangements have been adopted under the regional health plans approved so far. Some offer patients a wide choice of accredited public and private operators acting as suppliers to the local health authority, while others operate more strongly regulated systems in which performance levels and a financing ceiling are set for each establishment. Systems of the latter kind are constructed mainly around the local health authorities and public hospitals. The two models present different characteristics: in a system based on keen competition among suppliers there is a greater incentive to provide a quality service, and where there is a high degree of planning there is typically greater control over expenditure. Differentiation between organizational models permits experimentation, which may lead to an improvement in the efficiency of the service.

Capital expenditure. – In the accounts, investment spending is reduced by deducting the proceeds from the disposal of public real estate by means of securitization operations and ordinary sales. In 2002 the securitization operation carried out at the end of the year raised €6.6 billion and ordinary sales of property €4.2 billion, of which around half related to properties securitized in 2001 but not included in the general government accounts for that year. In 2001 receipts had amounted to €1.6 billion and had stemmed entirely from ordinary sales. Net of these proceeds, investment expenditure increased by 6.9 per cent, compared with 10.2 per cent in 2001; in relation to GDP it rose from 2.6 to 2.7 per cent.

"Other capital expenditure" rose by 11.7 per cent and from 1.4 to 1.6 per cent of GDP. Investment grants, which are included in this item, increased by 14.6 per cent, as against 18 per cent in 2001, in connection with the concessions for investment in disadvantaged areas and employment that were granted in the form of tax credits in the budget for 2001. Other components of the item decreased considerably, falling from 0.2 to 0.1 per cent of GDP.

The national accounts for 2002 show expenditure of €1.4 billion on tax credits for investment in disadvantaged areas and €2.8 billion on credits for the hiring of additional staff. These figures also include a total of about €1.4 billion in credits that accrued in the second half of the year but have not yet been used.

Local government

The net borrowing of local government increased from 0.2 to 0.6 per cent of GDP and from €2.3 billion to €7.9 billion.

Revised data for 2001, which were published at the same time as the consolidated local government account for 2002, show that in 2001 local authorities had a deficit equal to 0.2 per cent of GDP, whereas the figures published last year had indicated a surplus of 0.5 per cent. The revision is the result of a reduction of €4.8 billion in revenue, due largely to a decrease in current transfers from other public entities, and an increase of €3.6 billion in expenditure, which was attributable mainly to higher staff costs and spending on social benefits in kind.

Local government revenue decreased by 0.3 per cent in 2002. Current revenue declined by 0.6 per cent (€0.9 billion); within that aggregate transfers from other public entities fell by 6.5 per cent (€4 billion), most of the change involving transfers to the regions. As regards tax revenue, receipts of indirect taxes increased by 2.8 per cent (€1.6 billion), chiefly reflecting an increase in receipts of IRAP, and direct taxes rose by 4.7 per cent (€1 billion).

On the basis of cash data, revenue from the regional surtax on personal incomes rose from €4.6 billion to €5 billion. Receipts of IRAP increased from €30.6 billion to €31.5 billion, while the regions' share of excise duties on fuel fell from €2.2 billion to €1.6 billion. Revenue from the municipal surtax on personal incomes rose from €0.7 billion to €1 billion.

Capital revenue increased by 2.1 per cent (€0.4 billion); the increase in investment grants (14 per cent, or €1.6 billion) was only partly offset by reductions in other items.

Transfers from public entities diminished from 44.5 to 42.4 per cent of total revenues, while the share consisting of tax receipts increased from 44.7 to 46.3 per cent.

Expenditure grew by 2.8 per cent (€5 billion), broadly reflecting the rise of 3.3 per cent in current disbursements. The largest increases were in staff costs (3.4 per cent), intermediate consumption (4.1 per cent) and social benefits in kind (4.8 per cent); the bulk of the latter item related to the health sector. Other current expenditure fell by 1.3 per cent. Capital spending rose by 0.7 per cent; a large part of the growth in investment spending and grants was offset by reductions in other transfers.

In relation to GDP, local government debt to creditors other than general government increased from 3.4 to 3.7 per cent in 2002 (Table 34). The ratio fell in the first half of the nineties and increased by 1.5 percentage points between 1996 and 2002, most of the increase being attributable to the regions. The debt increased significantly in central Italy (from 3.2 to 6.4 per cent of the area's GDP) and in the Islands (from 2.2 to 4.1 per cent), but more moderately in the North and South.

Table 34

ANALYSIS OF LOCAL GOVERNMENT DEBT
(as a percentage of GDP)

	1996	2002		1996	2002
Level of government (1)			**Geographical area** (2)		
Regions	0.8	1.8	North-West	1.8	3.1
Provinces	0.1	0.3	North-East	1.9	2.6
Municipalities	1.0	1.2	Centre	3.2	6.4
Producers of health services and local health authorities	0.1	0.4	South	2.4	2.6
Other local government bodies	0.2	0.1	Islands	2.2	4.1
Instrument (1)			**Domestic/External** (1)		
Bank loans	2.2	2.5	Domestic	2.2	2.7
Bonds	0.0	1.2	External	0.0	1.0
Total	**2.2**	**3.7**	**Total**	**2.2**	**3.7**

(1) As a percentage of national GDP. – (2) As a percentage of the GDP of the area in question. For 2002, the estimates of GDP for the geographical areas are from Svimez.

The composition of local government debt has changed significantly. Between 1996 and 2002 the proportion of bonds rose from 1 to 31 per cent and that of bank loans fell from 99 to 69 per cent. Over the same period the percentage of debt raised abroad increased from 1 to 27 per cent; in the case of the regions it rose from virtually nil in 1996 to around 50 per cent in 2002.

THE OUTLOOK

Budgetary policy in the euro area

In their latest stability programme updates most countries announced new, less ambitious objectives for the next few years. The revisions reflect the poor results for the public finances in 2002 and the worsening outlook for economic growth. The forecasts of the European Commission and the leading international economic organizations suggest that many countries will fail to attain even the revised targets.

According to the programmes, many of which contain estimates for 2002 that are basically in line with the budget outturns, the area's general government net borrowing in 2003 should fall from 2.2 to 1.8 per cent of GDP (Table 35). The projection is for near balance in 2006. This scenario assumes significant deficit reductions in Germany, France and Italy.

Table 35

GENERAL GOVERNMENT NET BORROWING AND DEBT IN THE EURO AREA
(as a percentage of GDP)

	2002	2003	2004	2005
Net borrowing				
National stability programme update objectives	2.2	1.8	1.1	0.7
Outturn and forecasts				
European Commission	2.2	2.5	2.4	–
IMF	2.2	2.4	2.0	–
OECD	2.3	2.5	2.4	–
Debt				
National stability programme update objectives	69.7	68.7	66.8	65.4
Outturn and forecasts				
European Commission	69.2	69.9	69.6	–
IMF	69.4	69.9	69.3	–
OECD	–	–	70.0	–

Sources: European Commission (*Spring Forecast*, April 2003), the IMF (*World Economic Outlook*, April 2003), the OECD (*Economic Outlook*, April 2003) and the updates to national stability programmes submitted beginning in late 2002.

European Commission forecasts released in April 2003 indicate an increase of 0.3 percentage points in area-wide general government net borrowing this year to 2.5 per cent of GDP. Germany, France and Portugal are again projected to run deficits of more than 3 per cent, compared with targets of 2.8, 2.6 and 2.4 per cent respectively. Among other factors, the disparities reflect different macroeconomic assumptions. The OECD and IMF forecasts are similar to those of the Commission.

The Commission indicates a slight improvement in the area's budgetary position in 2004, due mainly to the stronger economic growth predicted. It estimates net borrowing for that year at 2.4 per cent of GDP, compared with the figure of 1.1 per cent that results from the stability programme updates. France, Italy and Portugal are expected to have deficits above the 3 per cent threshold (3.5, 3.1 and 3.2 per cent respectively).

The Commission forecasts a reduction in the area-wide primary budget surplus of 0.4 percentage points between 2002 and 2004 to 1.1 per cent of GDP, accompanied by a fall in interest payments of 0.2 points to 3.5 per cent of GDP. The forecast reduction in the primary surplus stems from a decline of 0.3 points in revenue and an increase of 0.1 points in expenditure. The cyclically adjusted primary surplus is expected to remain roughly unchanged at 1.5 per cent of GDP.

The ratio of general government debt to GDP in the area is expected to rise by 0.4 percentage points to 69.6 per cent in 2004, when it is projected to be significantly above the 60 per cent threshold in Italy (104.7 per cent), Belgium (98.9 per cent) and Greece (97 per cent).

In order to ensure compliance with the European budget rules, in October 2002 an agreement was reached within the Eurogroup whereby the countries that have not yet achieved a budgetary position close to balance or in surplus must improve their underlying balances by at least 0.5 per cent of GDP every year.

On 24 October the ECB Governing Council reaffirmed the importance of the budgetary rules laid down in the Treaty of Maastricht and the Stability and Growth Pact. It stressed that budgets near balance or in surplus provide scope for dealing with the impact on the public finances of population aging and permit the full operation of built-in stabilizers, thus helping to bring about conditions of stability favourable to non-inflationary growth.

In November the Commission advanced several proposals to make the application of the present rules more effective. In March 2003 the EU Council examined them and reaffirmed the validity of the current budget standards but acknowledged the need for more effective implementation. The Council emphasized the importance of monitoring nominal balances and specified that achievement of the medium-term objective laid down in the Stability and Growth Pact was to be evaluated with reference to the cyclically-adjusted budget balance, with case-by-case consideration of measures producing temporary effects. The same standard is to be used to assess achievement of the annual reduction of 0.5 per cent of GDP in the underlying deficit as agreed by the Eurogroup countries in October. The Council called for full utilization of the procedures designed to avoid pro-cyclical policies, especially during expansions, and to achieve adequate reductions in the debt ratio where it was still above 60 per cent. The Council stressed the need, in applying the rules, to pay greater heed to the special aspects of each country's situation and the quality and sustainability of the public finances.

Early in 2003, in assessing the stability programme updates, the Council noted that the macroeconomic assumptions behind the objectives of the leading countries could prove over-optimistic. If German and French growth should be less than forecast, their deficits could exceed 3 per cent of GDP again in 2003.

For Germany the Council, acknowledging the Government's commitment to comply with the October 2002 agreement and achieve an "underlying" budget nearly in balance by 2006, stressed that two factors would contribute to its achieving this goal: containing expenditure within the limits set in the programme, which are particularly ambitious towards the end of the planning period, and how the phases of the tax reform plan scheduled for 2004 and 2005 are implemented. For France the Council criticized the deferral of the adjustment of the underlying balance to 2004 because of tax cuts in 2003 not offset by sufficient curbs on spending. On the Italian programme the Council emphasized that most of the adjustment measures were temporary and urged Italy to guarantee the full efficacy of its budgetary action, so as to improve the underlying balance by at least 0.5 per cent of GDP each year.

The Council reiterated the need to reduce the debt-to-GDP ratio and to move rapidly towards structural budget balance by reforms of the main expenditure items in order to face the budgetary effects of population aging starting from sound fiscal positions.

The 2001 European Council in Stockholm agreed on a three-pronged strategy for dealing with the foreseeable impact of demographic developments on the public finances by: increasing employment rates, rapidly reducing the public debt and reforming pension systems, among other things by the gradual development of funded schemes. On this third point the Laeken Council specified that pension reform must pursue the following aims: a) to improve the ability of pension systems to prevent high rates of old-age poverty and assure that retired workers can maintain their standard of living; b) to achieve financial sustainability by increasing employment rates, raising the average actual retirement age, modifying contribution rates and benefits, and expanding the funded component; and c) to further adapt retirement provisions to take account of the increase in flexible forms of employment and discontinuous careers, especially among women.

In 2002 the EU Member States produced national reports on their pension policies. The Council noted that all the Member States had begun to carry out reforms. In most, however, action had been partial and further measures were necessary to guarantee long-term sustainability. The Council hoped that the reforms would be part of a common process in the framework of the strategy for growth laid down at the Lisbon summit in 2000. Uniform indicators based on reliable up-to-date data are considered necessary to gauge the progress made.

Budgetary policy in Italy

The outlook for 2003. – The July 2002 Economic and Financial Planning Document set a target for general government net borrowing of 0.8 per cent of GDP for 2003 (Table 36). On a current programmes basis the deficit was projected at 1.6 per cent, with forecast GDP growth of 2.9 per cent.

Table 36

OBJECTIVES AND ESTIMATES OF BUDGET BALANCES AND INTEREST PAYMENTS FOR 2003

(billions of euros and percentages)

	State sector	Public sector	General government			*Memorandum items:*	
	Net borrowing requirement (1)		Net borrowing	Primary surplus	Interest payments	Real GDP growth rate (2)	Nominal GDP
Current-programmes estimates							
Planning Document (July 2002)	....	....	21.7	57.3	79.0	2.7	1,325.3
as a percentage of GDP			*1.6*	*4.3*	*6.0*		
Objectives							
Planning Document (July 2002)	36.0	....	10.8	67.6	78.4	2.9	1,325.4
as a percentage of GDP	*2.7*		*0.8*	*5.1*	*5.9*		
Planning Document update and Forecasting and Planning Report (September 2002)	36.0	....	19.6	58.6	78.2	2.3	1,305.0
as a percentage of GDP	*2.8*		*1.5*	*4.5*	*6.0*		
Stability programme update (November 2002)	....	....	....	....	....	2.3	....
as a percentage of GDP			*1.5*	*4.3*	*5.8*		
Current estimates							
Quarterly Report on the Borrowing Requirement (April 2003)	42.0	46.5	30.1	41.3	71.4	1.1	1,307.1
as a percentage of GDP	*3.2*	*3.6*	*2.3*	*3.2*	*5.5*		

(1) Net of settlements of past debts and privatization receipts. – (2) Percentage changes.

In September the Forecasting and Planning Report for 2003 and the Planning Document update lowered the growth forecast to 2.3 per cent and raised the estimate of net borrowing on a current programmes basis by 0.7 points. The target for the deficit in 2003 was revised upwards to 1.5 per cent of GDP. The revision was due almost entirely to the expected contraction of the primary surplus from 5.1 per cent of GDP, as indicated in July, to 4.5 per cent. The public debt was forecast to be 105 per cent of GDP, half a point higher than in the original Planning Document.

To attain the objectives, the Government submitted a budget to Parliament calling for an adjustment of about 1 per cent of GDP (*Economic Bulletin* No. 35, November 2002, and No. 36, March 2003). The composition of the package reflected the unfavourable economic situation. As in 2002, the expected revenue increases in 2003 will come largely from temporary measures, thus limiting the impact of the correction on economic activity. About €8 billion is to come from tax regularization schemes.

Parliament made some changes to the budget. Both expenditure and revenue increases were passed, the latter partly offset by greater tax reliefs. According to official estimates, the Finance Law as passed will result in a net reduction in expenditure of nearly €4.7 billion and a net increase in revenue of €4.3 billion. Additional savings of €3.3 billion are expected from measures outside the Finance Law that involve public enterprises, primarily the transformation of the National Road Agency into a limited company, thus removing it from the general government aggregate.

The Finance Law provides for a set of tax regularization schemes for the income and assets of individuals and firms, aimed at finalizing the positions of the taxpayers who take advantage of them or resolving disputes already under way. The measures include a procedure for the automatic and final assessment of taxable income, a tax conciliation scheme, and an amended tax return scheme. To permit the adaptation, in terms of civil and tax law, of the balance sheets of companies availing themselves of these facilities, the notion of “accounting regularization” is also introduced. The main schemes can also be used by firms to regularize untaxed income earned or transferred abroad and assets held abroad. The rules for the repatriation and regularization of assets held abroad by individuals were also reintroduced, with modifications. Other minor regularization schemes are provided for. Local governments are given permission to introduce schemes of their own.

The effects of some of the measures are uncertain. In the past, measures to curb health and local government spending have not always produced the full effects expected. The achievement of the budgeted savings from measures affecting public enterprises depends on a significant increase in their self-financing. By contrast, preliminary data for May suggest that the revenue from the tax regularization schemes could be substantially greater than originally estimated.

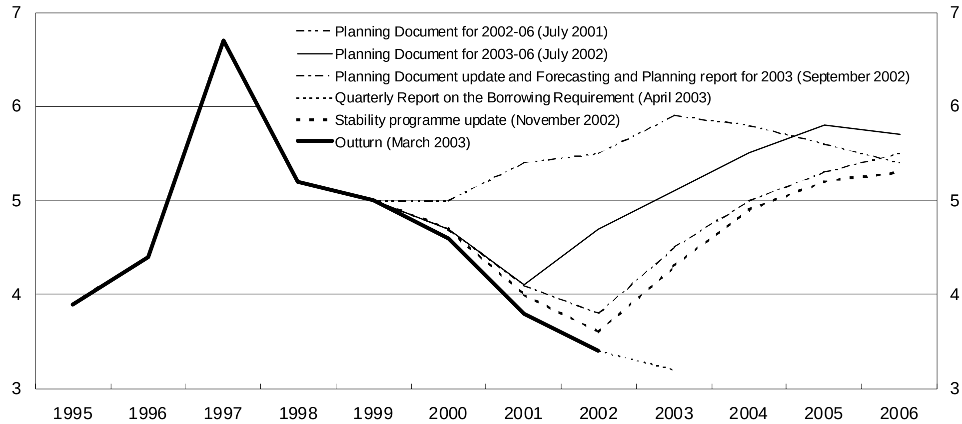
The stability programme update in November 2002 kept the target for net borrowing unchanged but reduced the projected primary surplus by a further 0.2 per cent of GDP, offset by a more optimistic forecast for interest expenditure (down from 6 per cent of GDP to 5.8 per cent). The calendar for the reduction of the public debt was also revised, with the achievement of a GDP ratio of under 100 per cent postponed from 2004 to 2005.

The April 2003 Quarterly Report on the Borrowing Requirement and Forecasting and Planning Report update raised the estimate of general government net borrowing for the year to 2.3 per cent of GDP, despite a further cut of 0.3 points in interest expenditure. According to this estimate the primary surplus would contract to 3.2 per cent of GDP, its lowest level since 1995 (Figure 28). The ratios to GDP of primary current expenditure and of tax and social security contribution revenue were both projected to rise by 0.2 points, to 38.4 and 41.8 per cent respectively. The debt-to-GDP ratio was revised upwards to 105.9 per cent, 0.8 points less than at the end of 2002.

Figure 28

PRIMARY BUDGET SURPLUS: OBJECTIVES AND OUTTURNS

(as a percentage of GDP)



The new forecasting framework set out in the Quarterly Report takes account of the worse-than-expected performance of the economy (the growth forecast is reduced further, from 2.3 to 1.1 per cent) and of the outturn for net borrowing in 2002 (2.3 per cent of GDP rather than the 2.1 per cent expected in November).

With projecting net borrowing unchanged in 2003 at 2.3 per cent of GDP, the Report forecasts a substantial rise in the state sector borrowing requirement. Net of settlements of past debts and privatization receipts, the borrowing requirement is expected to rise from €26 billion to €42 billion, or from 2.1 to 3.2 per cent of GDP. The public sector borrowing requirement is also projected to worsen, from 2.3 to 3.6 per cent of GDP. The Report forecasts €10.5 billion in settlements of past debts. Including these, the public sector borrowing requirement is seen as rising to 4.4 per cent of GDP, compared with 2.8 per cent in 2002. The disparity between the borrowing requirement and net borrowing would thus become wide again.

The incidence of transitory budgetary adjustments remains significant in 2003. Counting expected revenue from the disposal of public buildings (€6.5 billion) and the temporary measures enacted in the last two years, total transitory measures are likely to exceed 1 per cent of GDP, slightly less than in 2002. This estimate does not consider the cost of investment incentives, which is hard to evaluate.

In the first four months of 2003 the state sector borrowing requirement amounted to €33.1 billion, an increase of €5.5 billion on the same period of 2002. However, in April 2002 the borrowing requirement had been reduced by €4 billion by a swap. Allowing for the different timing of the corrective measures adopted in the two years, the borrowing requirement for the first four months appears to be broadly consistent with the Quarterly Report's projection for the year. In the first three months of 2003 the general government borrowing requirement amounted to €19.6 billion, nearly €2 billion less than in the first quarter of 2002.

The outlook for the medium term. – The Economic and Financial Planning Document released in July 2002 called for a deficit of 0.3 per cent of GDP in 2004 and a basically balanced budget in the two following years. The primary surplus was seen as rising to 5.5 per cent of GDP in 2004 and then stabilizing around 5.7 per cent in 2005 and 2006. The public debt was to come steadily down, falling below 100 per cent of GDP in 2004 and reaching 94.4 per cent in 2006.

The Planning Document update set less ambitious objectives. Net borrowing was put at 0.6 per cent of GDP in 2004 and the primary surplus lowered to 5 per cent. Acknowledging the delay in the economic upturn, the Document deferred achievement of a budgetary position close to balance by a year and somewhat flattened the profile of the reduction in the ratio of debt to GDP. The new path for financial adjustment was confirmed in the stability programme update in November, albeit with a more modest improvement in the primary surplus, projected to reach 5.3 per cent of GDP in 2006. In that planning framework, which assumed a deficit of 1.5 per cent of GDP in 2003, corrective measures were envisaged amounting to 1.6 per cent of GDP in 2004, 1.4 per cent in 2005 and 0.8 per cent in 2006. The transitory measures will have to be gradually replaced by permanent ones.

A medium-term planning framework for the public finances incorporating the Quarterly Report's revised estimates for 2003 will be presented in the Economic and Financial Planning Document in July.

Since 1998 the trend has been for a progressive contraction in the primary surplus and a decline in interest expenditure owing to the fall in interest rates under way since the mid-1990s. Over this period the ratio of primary current expenditure to GDP has remained at around 37.5 per cent. In the last two years, with the cyclical weakness of the economy, it has risen slightly. A lasting correction of the trend in this component of expenditure requires structural intervention, not least in view of the prospect of increased outlays on pensions and healthcare as a result of the aging of the population. In the years to come, as the effects of the sharp fall in interest rates dwindle, the savings on interest payments will diminish.

The reduction in the debt-to-GDP ratio that began in the second half of the 1990s benefited significantly from extraordinary revenue, such as privatization receipts. The ratio was lowered by 17.5 percentage points between 1994 and 2002, from 124.2 to 106.7 per cent. The reduction of 2.8 points in 2002 was entirely due to the conversion of bonds in the Bank of Italy's portfolio, privatizations and sales of buildings. The reduction planned for 2003 is 0.8 points, to come to a large extent from measures that will have a temporary effect on the borrowing requirement and net borrowing.

The large public debt represents a constraint on Italian economic policy. It heightens the budget's vulnerability to interest rate shocks, makes it harder to find the resources to cope with population aging and reduces the scope for easing the tax burden.

In these circumstances, achieving a basically balanced budget while reducing the incidence of taxes will require a policy aimed at lowering the ratio of primary current expenditure to GDP through structural reforms modifying its long-run dynamics. The improvement in the primary balance will make it possible to decrease the debt ratio more rapidly. The saving on interest payments will help to consolidate the easing of the tax burden.

THE SINGLE MONETARY POLICY, FINANCIAL INTERMEDIARIES AND THE MONEY AND FINANCIAL MARKETS

The signs of recovery that had emerged in the euro area at the beginning of 2002 weakened from the second quarter onwards in conjunction with the fall in share prices and the heightening of international political tensions. In the fourth quarter the economy weakened further and inflationary pressures abated. The European Central Bank reduced official interest rates by 0.5 percentage points on 5 December and by a further 0.25 points on 6 March 2003, partly in response to the appreciation of the euro, bringing the rate on the main refinancing operations to 2.5 per cent. Real short-term interest rates in the euro area fell by 0.8 percentage points in the course of 2002 to 1 per cent and decreased again in the first quarter of 2003 to 0.6 per cent, the lowest level since the introduction of the euro.

The nominal exchange rate of the euro rose substantially in the second quarter and in the last part of the year. It appreciated by 8.8 per cent in effective terms in 2002, more than half of the rise being due to the weakness of the dollar. The euro continued to appreciate in 2003, gaining a further 7.2 per cent by the middle of May.

The growth in euro-area M3 remained high throughout 2002, reflecting savers' preference for liquid assets and a sharp increase in currency in circulation following the changeover to the euro. The rate of increase in credit to the private sector, which had begun to slow down in 2001, continued to ease; there was a deceleration in Italy as well, but the rate was still higher than in the rest of the area and greater than the growth in GDP.

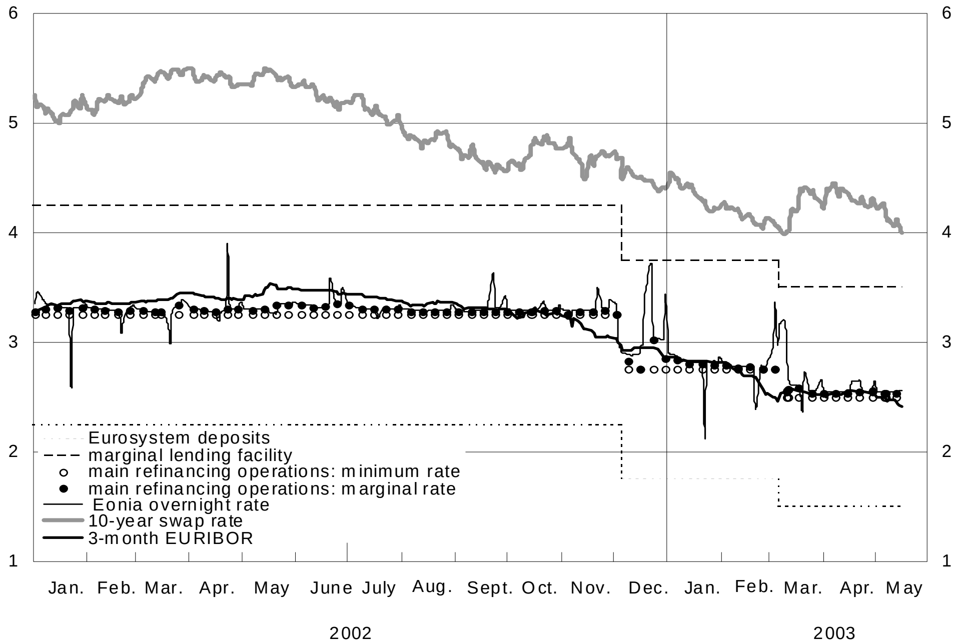
Interest rates and the exchange rate

In the early months of 2002 cyclical indicators pointed to a quickening of growth before the end of the year. Inflation, though diminishing, was still over 2 per cent. In the spring the signs of recovery began to fade; share prices now fell, even in traditional sectors. In the summer the effects of the euro's appreciation since April and the persistent weakness of demand acted as a brake on prices and undermined expectations of growth, which deteriorated again in the fourth quarter as tension between the United States and Iraq sharpened. On 5 December the ECB reduced the rate on its main refinancing operations by 0.5 percentage points to 2.75 per cent (Figure 29).

Figure 29

OFFICIAL INTEREST RATES AND MONEY AND FINANCIAL MARKET RATES IN THE EURO AREA

(*daily data and percentages*)



Sources: European Central Bank, Reuters, Telerate.

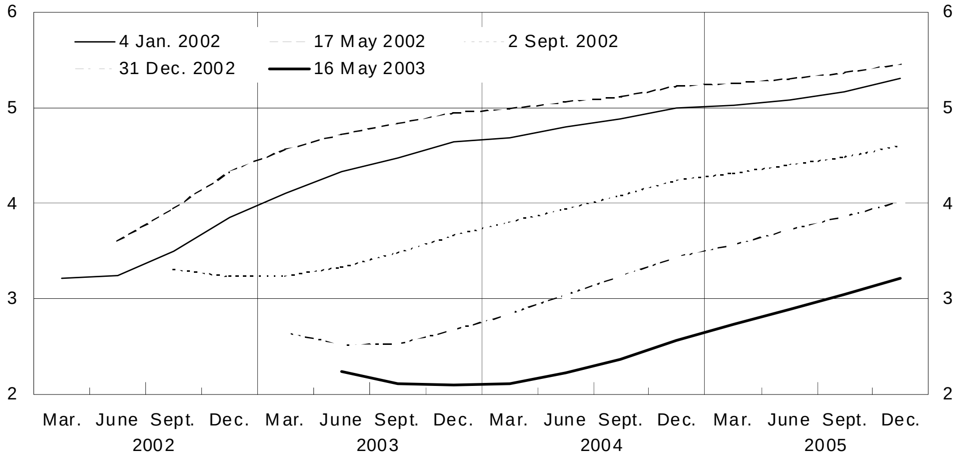
On 6 March 2003, against a background of cyclical weakness, uncertainty triggered by international tensions, and a further appreciation of the euro, the ECB cut the rate by another 0.25 percentage points to 2.5 per cent.

In 2002 macroeconomic developments influenced financial market expectations and short-term euro yields. In the first half of the year the prospects of a recovery helped to shift the forward yield curve upwards for all maturities (Figure 30); with monetary policy remaining generally relaxed, the curve was positively sloped, signaling expectations that short-term interest rates would rise in the second half of the year. During the summer the prospects of a recovery progressively dimmed, prompting an adjustment of interest rate expectations. Forward yields declined; in September the curve became negatively sloped for the shortest maturities. At the end of the year it indicated that rates would fall by the middle of 2003.

Figure 30

RATES OF FUTURES CONTRACTS ON 3-MONTH EUROMARKET DEPOSITS (1)

(*percentages*)



Source: Reuters.

(1) Each curve relates to the contract date indicated in the legend. The horizontal axis shows the settlement dates for the futures contracts to which the yields refer.

The downward shift of the yield curve halted in the middle of March 2003 as the commencement of armed conflict in Iraq approached. When the war ended the curve returned to the same level as in early February. However, in the second half of April it slipped back down in response to the deterioration in business confidence and the appreciation of the euro. In mid-May it signaled expectations that short-term rates would fall again by the end of the year.

In the second half of 2002 long-term euro yields fell to historically very low levels. Yields on ten-year interest-rate swaps, which had risen to 5.5 per cent in the first five months of the year, gradually fell again, to 4.4 per cent in December (Figure 29). Yields on long-term government securities followed a similar course. The reduction reflected the diminishing prospects of economic recovery, expectations that inflation would stay below 2 per cent, and a shift in portfolio composition towards less risky securities.

Long-term euro yields continued to fall in the early months of 2003, to 4 per cent at the beginning of March. After picking up briefly they dropped back to the same level in the middle of May.

With inflation expectations broadly stable, the decline in nominal interest rates passed through to real rates. In 2002 the short-term euro rate, deflated using inflation expectations from *Consensus Forecasts* surveys, gradually declined from 1.8 per cent in March to 1 per cent in December. In March 2003 it reached 0.6 per cent. In Italy the fact that inflation expectations remained higher than in the euro area as a whole meant that the real interest rate was lower (0.5 per cent in December and 0.1 per cent in March 2003).

The euro appreciated throughout 2002, gaining 8.8 per cent in nominal effective terms. More than half of this was due to its appreciation against the dollar, which amounted to 19 per cent; against the yen and sterling it went up by 7.9 and 6.9 per cent respectively.

As the euro strengthened there was a net investment inflow to the area amounting to €65.1 billion in 2002, the first since stage three of EMU began. The total breaks down into €110.6 billion of net inflows of portfolio investment (compared with €64.7 billion in 2001) and €45.5 billion of net outflows of direct investment (against €102.8 billion in 2001).

The euro continued to appreciate in 2003. Between the beginning of January and the middle of May the nominal effective exchange rate rose by 7.2 per cent.

At its meeting on 8 May 2003 the Governing Council of the ECB undertook a thorough evaluation of its monetary policy strategy in the light of the public debate and the studies carried out by staff of the Eurosystem. It judged the experience to date to have been positive. The definition of price stability announced in October 1998 was reaffirmed: "a year-on-year increase in the Harmonized Index of Consumer Prices (HICP) for the euro area of below 2 per cent ... over the medium term". At the same time, the Council agreed that in the pursuit of price stability it would aim to maintain inflation rates close to 2 per cent over the medium term; this clarification underlines the ECB's commitment to provide a sufficient safety margin to guard against the risks of deflation.

The money supply and credit

In 2002 M3 expanded at a rapid pace. The twelve-month growth rate averaged 6.9 per cent in the last quarter of the year, lower than a year earlier, when it had been 7.6 per cent; it rose to 7.7 per cent on average in the first quarter of 2003.

The rapid expansion in the money supply can be attributed almost entirely to the growth in demand, which was fueled by a number of factors. The high volatility of the financial markets during the year prompted investors to increase the share of monetary assets in their portfolios. The switch to more liquid assets was also encouraged by the uncertainty stemming from international tension and by low short and long-term interest rates.

With regard to the counterparts of M3, the twelve-month growth rate in total lending to euro-area residents by monetary financial institutions fell from 6.7 per cent in 2001 to 4.7 per cent in 2002. It stabilized in the first quarter of 2003; in March the growth rate was 4.6 per cent.

The rate of growth in the monetary aggregates was higher in Italy than in the rest of the area, mainly because of a particularly marked shift in the composition of households' asset portfolios. Excluding currency in circulation (which can no longer be measured on a national basis since the introduction of euro banknotes and coins), the twelve-month increase in the Italian contribution to euro-area M3 was 9.5 per cent in 2002, compared with 9.3 per cent in 2001. This growth mainly reflected the performance of the shorter-term components, such as current accounts, deposits at fixed terms of up to two years and units of money-market investment funds. In the early months of 2003 the growth of Italy's contribution to M3 slowed.

The rate of increase in total credit to the private sector in Italy slowed from 11 per cent in 2001 to 8.6 per cent in 2002, reflecting a slackening of the growth in bank loans and a sharp slowdown in bond issues. Since supply conditions were easy, the slowdown in credit growth is explained by the weakness of demand. The total financial assets of the private sector increased by 3 per cent in 2002.

Money-market operations

In 2002 the excess reserves of Italian credit institutions were equivalent on average to 0.43 per cent of their reserve requirements, almost the same as in the previous year (0.45 per cent). The corresponding figure for the euro area, however, increased from 0.55 to 0.61 per cent, owing partly to extraordinary factors in January and February associated with the introduction of euro banknotes and coins. During that period of uncertainty and tight liquidity, the Eonia rate remained above the minimum offer rate for main refinancing operations.

The volatility of money-market rates was small over the year as a whole: the standard deviation of daily variations in the Eonia rate was 11.5 basis points, compared with 14.6 basis points in 2001.

In 2002 the daily volume of net financing provided via main refinancing operations averaged €132 billion, compared with €158 billion in 2001; on average, financing received by Italian counterparties amounted to 6.1 per cent of the total, against 8.3 per cent the previous year. The average number of participants at the auctions fell from 410 to 307 in the area as a whole and from 25 to 18 in Italy, partly reflecting the narrowing of the differential between the Eonia rate and the allotment rate from an average of 6.7 basis points in 2001 to one of 2.3 basis points in 2002. The differential was essentially nil last year if one excludes the days of high volatility following the last main refinancing operation of the maintenance period and the days subsequent to the emergence of a shortage of demand for funds at auction (underbidding).

The daily average volume of funds distributed in the euro area by means of longer-term refinancing operations was €55 billion in 2002, compared with €57 billion the previous year. On average, 176 euro-area banks participated in these operations, against 225 in 2001. Italian banks made very limited use of longer-term refinancing operations: on average three Italian banks (seven in 2001) were allotted a share of 0.1 per cent of the funds distributed (1 per cent in 2001).

THE HOUSEHOLD AND CORPORATE SECTORS

Against the background of limited growth in disposable income and an increase in spending for the purchase of housing, the financial surplus of the household sector in Italy decreased from 8.7 to 5.9 per cent of GDP in 2002. There was further adjustment of financial portfolios in favour of bonds and liquid assets. The sharp fall in share prices caused equities to decline as a proportion of total financial assets and financial wealth to contract; the negative effect on households' total wealth was partly offset by the rise in house prices. Though continuing to expand rapidly, household debt remains low.

Non-financial firms' operating profit decreased slightly in relation to value added. While there was a decrease in interest charges, attributable to the decline in interest rates, self-financing remained virtually unchanged as a proportion of value added; it fell in relation to investment (including stocks). Firms' financial deficit was equal to 2.6 per cent of GDP, compared with 3.3 per cent in 2001. Their financial debt grew more slowly, reflecting the combination of a contraction in the short-term component and an acceleration in medium and long-term borrowing. The corporate sector's leverage (the ratio of debt to the sum of debt and equity) rose, partly as a consequence of the decline in share prices.

The financial statements on file with the Company Accounts Data Service, which are available up to 2001, show that the net profits of the companies surveyed contracted that year from 1.9 to 1.1 per cent of total assets; the decline involved mainly larger firms. Profitability differed by geographical area, being higher for firms in the Centre and North than for those in the South (1.2 and 0.1 per cent of assets, respectively).

Italy's total stock of financial assets amounted to €8.7 trillion or 6.9 times GDP at the end of 2002, a ratio similar to that of a year earlier.

The financial accounts of households

The financial surplus of the household sector (comprising consumer households, sole proprietorships with up to five employees and private

Table 37

ITALY: FINANCIAL BALANCES (1)

(millions of euros and percentages)

	1999	2000	2001	2002
Households	71,637	79,724	106,071	74,209
of which: external balance	*33,029*	*31,943*	*22,314*	*–11,582*
Non-financial corporations	–10,662	–60,861	–40,305	–32,775
of which: external balance	*6,836*	*9,819*	*7,093*	*18,155*
General government	–26,180	–7,350	–30,273	–32,191
of which: external balance	*–98,721*	*–49,525*	*–10,481*	*–27,764*
Monetary financial institutions	–6,526	–3,042	–9,601	5,890
of which: external balance	*–33,798*	*–28,516*	*–25,179*	*36,665*
Other financial intermediaries (2)	1,631	3,004	–26,707	–31,390
of which: external balance	*88,822*	*38,366*	*–3,232*	*–23,349*
Insurance companies (3)	–23,740	–12,640	–2,732	13,868
of which: external balance	*9,992*	*–3,251*	*5,940*	*5,487*
Rest of the world account	–6,160	1,165	3,547	2,389
	As a percentage of GDP			
Households	6.5	6.8	8.7	5.9
Non-financial corporations	–0.9	–5.2	–3.3	–2.6
General government	–2.4	–0.6	–2.5	–2.6
Financial institutions (4)	–2.6	–1.1	–3.2	–0.9
Rest of the world account	–0.6	0.1	0.3	0.2
	As a percentage of GDP, adjusted for inflation (5)			
Households	4.3	4.4	6.7	3.9
Non-financial corporations	–0.3	–4.3	–2.5	–1.7
General government	–0.1	1.9	–0.5	–0.6

Source: Bank of Italy.

(1) Rounding may cause discrepancies in totals. – (2) Includes financial auxiliaries. – (3) Includes pension funds. – (4) Monetary financial institutions, other financial intermediaries and insurance companies. – (5) Only financial instruments denominated in national currencies, with a fixed monetary value at maturity, are taken into consideration in calculating the adjustment for inflation.

social institutions) fell from €106.1 billion in 2001 to €74.2 billion last year (Table 38). The reduction reflected the small growth in disposable income and a greater propensity to invest in property.

Table 38

FINANCIAL ASSETS AND LIABILITIES OF ITALIAN HOUSEHOLDS (1)
(millions of euros and percentage composition)

	End-of-period stocks			Flows	
	December 2002	Percentage composition		2001	2002
		December 2001	December 2002		
ASSETS					
Cash and sight deposits	433,350	15.3	17.2	18,959	31,646
of which: bank deposits	*384,664*	*13.4*	*15.3*	*29,147*	*32,963*
Other deposits	288,532	10.6	11.4	12,304	11,572
bank	*101,248*	*3.9*	*4.0*	*–3,161*	*–836*
post office	*187,284*	*6.7*	*7.4*	*15,465*	*12,408*
Short-term securities	14,209	1.0	0.5	3,452	–17,731
Medium and long-term securities	510,370	16.7	20.3	47,646	56,261
of which: government	*204,188*	*6.7*	*8.1*	*9,230*	*20,613*
Investment fund units	309,342	13.5	12.3	–8,547	–736
Shares and other equity	351,810	18.7	14.0	–71	350
External assets	194,049	9.7	7.7	22,314	–11,582
of which: deposits	*10,180*	*1.1*	*0.4*	*949*	*–20,395*
short-term securities	*124*	*0.0*	*0.0*	*56*	*–733*
medium and long-term securities	*91,976*	*3.5*	*3.7*	*14,992*	*5,640*
shares and other equity	*67,298*	*3.6*	*2.6*	*11,384*	*5,726*
investment fund units	*24,469*	*1.5*	*1.0*	*–5,065*	*–1,823*
Insurance and pension fund reserves (2)	401,911	13.9	16.0	36,107	36,418
Other financial assets (3)	15,094	0.6	0.6	–6,052	746
Total assets	**2,518,667**	**100**	**100**	**126,112**	**106,944**
LIABILITIES					
Short-term debt (4)	54,944	14.9	13.6	330	–304
of which: bank	*54,237*	*14.8*	*13.5*	*353*	*–351*
Medium and long-term debt (5)	249,390	60.1	61.9	16,909	27,396
of which: bank	*228,016*	*54.6*	*56.6*	*16,651*	*26,490*
Other financial liabilities (6)	98,633	25.0	24.5	2,802	5,644
Total liabilities	**402,967**	**100**	**100**	**20,041**	**32,735**
Balance	**2,115,700**			**106,071**	**74,209**

Source: Bank of Italy.

(1) Consumer households, non-profit institutions serving households, and sole proprietorships with up to 5 employees. Rounding may cause discrepancies in totals. – (2) Includes insurance reserves of both the life and casualty sectors, pension funds and severance pay entitlements. – (3) Trade credit and other minor items. – (4) Includes finance provided by factoring companies. – (5) Includes finance provided by leasing companies, consumer credit from financial companies and other minor items. – (6) Staff severance pay provisions and other minor items.

In a period of stock market turbulence and uncertainty about the world economic cycle, households again substantially increased their holdings of medium and long-term securities (by €61.9 billion, compared with €62.6 billion in 2001) and sight bank deposits (by €33 billion, compared with €29.1 billion the previous year). On the other hand, they made €2.6 billion of net disposals of investment fund units and reduced their net purchases of shares from €11.3 billion to €6.1 billion. Their holdings of short-term securities decreased. Equities accounted for 16.6 per cent of households' total financial assets at the end of the year, down from 22.3 per cent at the end of 2001 and 28.1 per cent at the end of 2000. The decline, which was largely attributable to the fall in the stock market, paralleled developments in the other main industrial countries.

Holdings of foreign assets decreased by €11.6 billion, whereas in 2001 they had increased by €22.3 billion. The disposals came in the first part of the year, in concomitance with the measure facilitating the repatriation of assets held abroad.

Households once again increased their gross debt, largely for the purchase of housing. The annual growth in liabilities rose from €20 billion to €32.7 billion. In particular, debt to banks and other credit intermediaries rose by €27.1 billion, compared with €17.2 billion in 2001. The ratio of financial liabilities to assets rose to 16 per cent, well below the figures in the other major industrial countries (28 per cent on average for the main euro-area countries in 2001, 25 per cent in the United States and 29 per cent in the United Kingdom).

The composition of households' financial wealth and its geographical distribution

According to preliminary estimates based on the financial accounts and the national accounts, at the end of 2001 Italian consumer households' net wealth amounted to just under €6.4 trillion, or five times GDP. Real assets (houses, land and durable goods) made up 64.4 per cent of gross wealth and financial assets the rest; the amount of financial liabilities was limited.

In the period from 1991 to 2001, marked by large fluctuations in the prices of financial and real assets, households' wealth grew by about 5 per cent annually in nominal terms, outpacing consumer price inflation by 2 percentage points. The financial component grew at a nominal average annual rate of 7 per cent, compared with 5 per cent for real assets.

Amounts and trends in wealth differ regionally. In 2001 per capita wealth was higher than the national average (€110,300; Table 39) in nearly all the regions of the Centre and North and fell short of that mark in the South. In that year the net wealth of households in the South was equal to 4.8 times the area's GDP, compared with a ratio of 5.4 in the Centre and North.

Table 39

HOUSEHOLD WEALTH BY GEOGRAPHICAL AREA

(2001 data and amounts in thousands of euros at current prices unless otherwise specified)

	North	Centre	South	Italy
Per capita real assets (1) (a)	89.00	82.99	48.87	73.40
Per capita financial assets (b)	56.21	40.03	21.65	40.65
Per capita debt (c)	4.48	4.51	2.44	3.75
Per capita net wealth (a) + (b) – (c)	140.73	118.52	68.08	110.30
Percentage ratios				
Financial assets/total assets	38.7	32.5	30.7	35.6
Risky securities (2)*/financial assets* (3)	*43.8*	*29.4*	*17.9*	*37.2*
Shares and other equity/financial assets (3)	*12.9*	*6.2*	*7.8*	*10.9*
Households with risky assets (2) (3)*/total households*	*32.2*	*19.7*	*6.4*	*21.1*

Sources: Estimates based on the financial accounts for 2001, the Bank of Italy's survey of household income and wealth and the national accounts for 2001.

(1) Housing, land and durable goods. – (2) Bonds issued by private-sector issuers, loans to cooperatives, Italian shares, investment fund units and portfolio management accounts. – (3) The ratios are calculated on the basis of the data for 2000 from the Bank's survey of household income and wealth; simple averages of the sample values extrapolated to the universe.

The financing of enterprises and their liquidity

The weakness of economic activity was reflected last year in a slight decrease in the profitability of enterprises, whose gross operating profit fell from 37 to 36 per cent of value added. The reduction in interest rates led to a diminution in net interest expense (Figure 31), from 5.5 to 5.2 per cent of value added, a very low level historically.

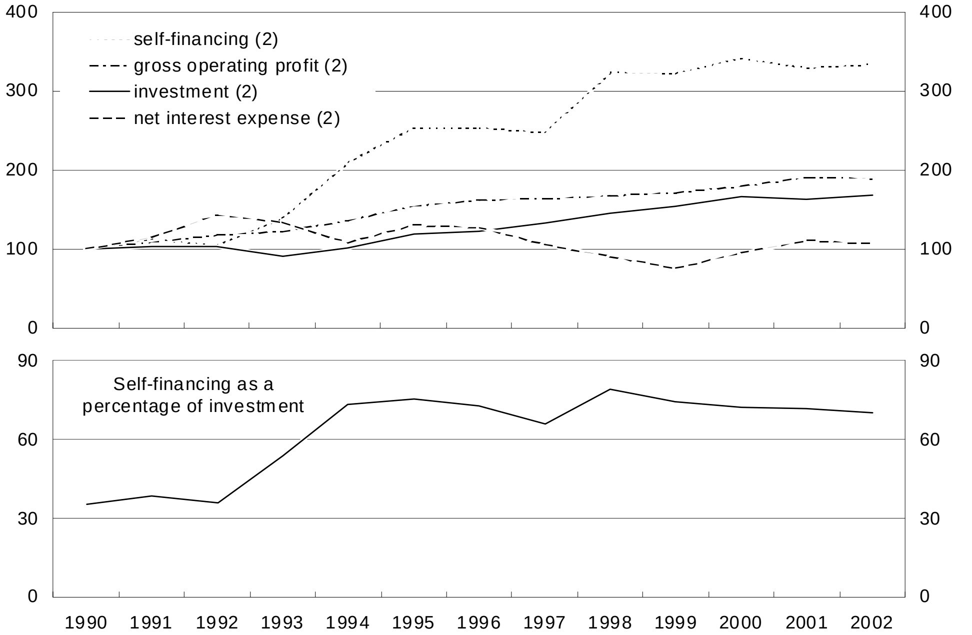
Self-financing remained stable as a percentage of value added (14.6 per cent). Against the background of a slowdown in gross fixed investment and an increase in stocks, the proportion of investment covered by internally generated funds edged downwards from 71.7 to 70.1 per cent. The corporate sector's financial deficit amounted to €32.8 billion (Table 40).

Italian firms’ financial liabilities were equal to about 180 per cent of GDP at the end of 2002. In 2001 this ratio was lower in Italy than in the other major industrial countries except for Germany. Net of financial assets, the stock of liabilities amounted to 71 per cent of GDP in Italy, against an average of 86 per cent in the four major euro-area countries, 112 per cent in the United States and 143 per cent in the United Kingdom.

Figure 31

THE EXTERNAL FUNDING REQUIREMENT OF ITALIAN FIRMS (1)

(annual data)



Sources: Bank of Italy and Istat.

(1) Estimate based on national accounts data for the sector “non-financial corporations”, 1990-2001. The data for 2002 are estimated on the basis of the national accounts for the year. Investment includes stocks. – (2) Indices, 1990=100.

Firms’ gross financial liabilities rose by €114.6 billion last year after increasing by €95.5 billion in 2001. The increase in financial debt (in the form of loans or securities) amounted to €42.6 billion, down from €55.4 billion in 2001. Outstanding short-term loans fell by 2 per cent, after rising by 3 per cent in 2001; in the second half of that year their pace had begun to slacken with the slowdown in corporate mergers and acquisitions, often covered by short-term borrowing. Medium and long-term borrowing grew by 14 per cent in 2002, compared with 12 per cent in 2001. The growth in this component’s share, under way since the second half of the 1990s, reflects both structural factors, such as the despecialization of banking, and the reduction in the cost of medium and long-term credit; more recently the restructuring of the financial liabilities of several large corporations has also contributed. Net bond issues slowed down from €10.8 billion in 2001 to €9.3 billion last year.

Table 40

FINANCIAL ASSETS AND LIABILITIES OF ITALIAN ENTERPRISES (1)

(millions of euros and percentage composition)

	End-of-period stocks			Flows	
	December 2002	Percentage composition		2001	2002
		December 2001	December 2002		
ASSETS					
Cash and sight deposits	111,869	8.8	8.1	9,191	6,305
Other deposits	8,903	0.8	0.6	−1,954	−166
of which: bank	*7,868*	*0.7*	*0.6*	*−2,001*	*−218*
Short-term securities	129	0.0	0.0	−1,168	−578
Medium and long-term securities	31,723	2.3	2.3	−7,596	−5,217
of which: government	*16,491*	*1.2*	*1.2*	*385*	*1,726*
Shares and other equity	693,225	43.7	50.2	52,057	32,593
Investment fund units	4,302	0.4	0.3	−119	−10
Trade credit	223,804	16.1	16.2	−9,951	30,422
Other financial assets (2)	48,776	4.1	3.5	−2,243	−1,332
External assets	259,572	23.8	18.8	16,939	19,824
of which: deposits	*732*	*0.8*	*0.1*	*−2,493*	*−3,573*
trade credit receivable	*69,202*	*5.1*	*5.0*	*919*	*8,570*
securities	*21,348*	*1.8*	*1.5*	*1,213*	*688*
shares and other equity	*111,332*	*11.6*	*8.1*	*15,134*	*9,798*
Total assets	**1,382,303**	**100.0**	**100.0**	**55,156**	**81,841**
LIABILITIES					
Domestic liabilities	**1,980,576**	**87.4**	**88.4**	**85,615**	**112,947**
Short-term debt (3)	316,759	14.8	14.1	17,661	−261
of which: bank	*287,891*	*13.6*	*12.8*	*16,452*	*−2,164*
Medium and long-term debt (4)	324,184	13.3	14.5	31,889	42,156
of which: bank	*252,953*	*10.4*	*11.3*	*22,333*	*32,554*
Securities	21,577	0.6	1.0	4,497	6,709
of which: medium and long-term	*17,701*	*0.5*	*0.8*	*3,918*	*6,005*
Shares and other equity	988,907	44.9	44.1	35,920	29,075
Trade credit payable	228,371	9.2	10.2	−10,154	31,043
Other financial liabilities (5)	100,778	4.6	4.5	5,802	4,225
External liabilities	**260,563**	**12.6**	**11.6**	**9,846**	**1,669**
of which: trade credit payable	*36,144*	*1.4*	*1.6*	*−75*	*5,687*
financial debt	*101,597*	*4.9*	*4.5*	*1,337*	*−6,019*
of which: medium and long-term securities	*22,637*	*0.9*	*1.0*	*6,843*	*3,303*
shares and other equity	*119,498*	*6.1*	*5.3*	*9,215*	*5,876*
Total liabilities	**2,241,139**	**100**	**100**	**95,461**	**114,616**
Balance	**−858,836**			**−40,305**	**−32,775**

Source: Bank of Italy.

(1) The data refer to non-financial corporations. Rounding may cause discrepancies in totals. – (2) Insurance technical reserves, domestic derivatives and other minor items. – (3) Includes finance provided by factoring companies. – (4) Includes finance provided by leasing companies. – (5) Staff severance pay provisions and other minor items.

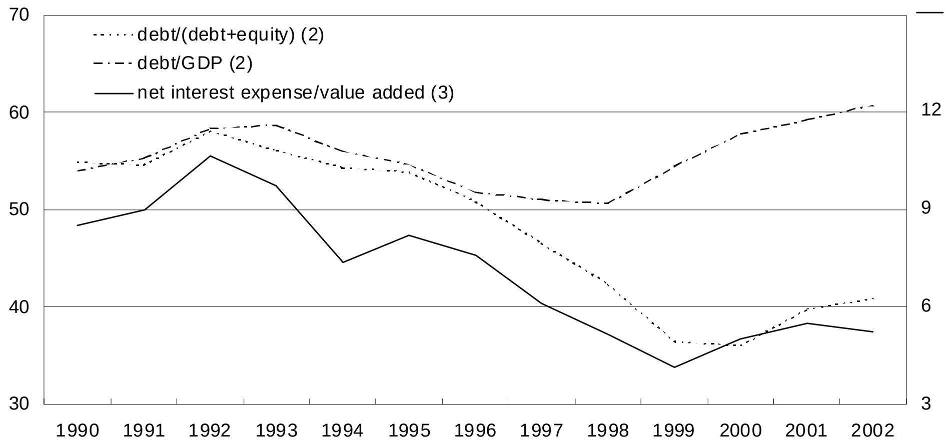
The net amount of equity capital raised by firms decreased last year from €35.9 billion to €29.1 billion in the domestic market and from €9.2 billion to €5.9 billion abroad.

Given the fall in share prices and the growth in firms' stock of debt, leverage, measured by the ratio of debt to the sum of debt and equity, rose by around 1 percentage point, to 40.8 per cent (Figure 32). Italian firms are still less highly leveraged than in the first half of the 1990s, when the ratio was close to 55 per cent, but more highly than the average for companies in the major euro-area countries (36 per cent in 2001).

Figure 32

ITALIAN CORPORATE SECTOR FINANCIAL DEBT AND INTEREST EXPENSE (1)

(annual data; percentages)



Sources: Bank of Italy and Istat.

(1) The data refer to "non-financial corporations". From 1995 they refer to the new definitions of instruments and sectors of economic activity introduced by ESA95. – (2) Left-hand scale. – (3) Right-hand scale. Value added for 2002 is estimated on the basis of national accounts data.

Domestic and foreign trade credit payable rose by €36.7 billion and made up 11.8 per cent of the total stock of financial liabilities at the end of 2002, compared with 10.6 per cent a year earlier (Table 40).

On the asset side, firms' holdings of shares and other equity grew far more slowly than in 2001, with the domestic component increasing by €32.6 billion (compared with €52.1 billion) and the foreign component by €9.8 billion (compared with €15.1 billion). This was partly a consequence of the contraction in mergers and acquisitions.

The profitability and financial structure of Italian firms by size class and geographical area

During the recession of the 1990s non-financial corporations in Italy recorded a decline in operating profit in relation to total assets, an increase in net interest expense in relation to gross operating profit and a sharp reduction in profits; their debt burden reached high levels. Subsequently, gains in competitiveness stemming from the depreciation of the lira, the cyclical recovery and wage moderation favoured an increase in operating profitability. The reduction in interest rates during the period curbed net interest expense; the growth in profits was accompanied by a sharp contraction in debt, which in the first half of the decade was partly a consequence of the stagnation in capital spending.

For the firms surveyed by the Company Accounts Data Service, between 1990 and 2001 net interest expense fell from 24.4 to 3.4 per cent of gross operating profits. Profits followed a cyclical pattern, bottoming out in 1993, when the rate of return on assets was negative (–1.2 per cent) and peaking in 1999, when it was 2.4 per cent. In 2001 the return on assets fell back to 1.1 per cent, which was still higher than the average of 0.4 per cent for the years from 1990 to 1995. In the period under review, the leverage ratio fell from 57.5 to 50.7 per cent (Table 41).

Although the improvement in profitability and financial position in the last decade was quite general, the conditions of firms continue to differ considerably according to size and location.

For companies with fewer than 50 workers, the ratio of net interest expense to gross operating profit stayed constantly around 10 percentage points higher than the average, partly owing to their greater indebtedness. Between 1990 and 2000 the profits of large companies were higher; in 2001, however, owing to the difficulties of some major groups, the decline in profits was concentrated among larger companies.

The reduction in leverage between 1990 and 2001 was sizable for larger companies (from 56.4 to 46.9 per cent) but negligible for companies with fewer than 50 workers (from 60.7 to 59.8 per cent). The proportion of debt consisting of bank loans remains higher for smaller companies. In 2001 it was 75.6 per cent for firms with fewer than 50 workers, compared with 53.7 per cent for those with 200 or more.

Significant differences are also found among firms located in the different parts of Italy. The profitability of southern firms is lower: in 2001 their gross operating profits amounted to 6.4 per cent of total assets, compared with 9.1 per cent for firms in the Centre and North; the gap is larger for larger companies. During the last decade the ratio of net financial expense to gross operating profit remained generally higher in the South than in the rest of the country, by about 10 percentage points.

Over the entire period in question, the average ratio of debt to value added was higher in the South than in the Centre and North for firms of every size class. The gap is particularly pronounced for smaller companies, having reached almost 65 percentage points in 2001.

Table 41

PROFITABILITY AND DEBT OF ITALIAN ENTERPRISES

(weighted averages; percentages)

	Centre and North				South				Italy			
	1990	1995	2000	2001	1990	1995	2000	2001	1990	1995	2000	2001
					Gross operating profit/total assets							
1-49 employees	9.7	10.3	7.9	7.9	8.3	6.8	6.0	7.2	9.5	9.8	7.7	7.8
50-199 employees ...	10.0	11.1	8.8	8.9	7.7	8.2	6.9	6.8	9.7	10.7	8.6	8.7
200+ employees	10.0	11.7	9.2	9.8	6.2	9.1	7.7	6.2	9.7	11.5	9.1	9.5
Total enterprises	**9.9**	**11.1**	**8.7**	**9.1**	**7.1**	**7.8**	**6.8**	**6.4**	**9.6**	**10.8**	**8.5**	**8.9**
					Net interest expense/gross operating profit							
1-49 employees	37.4	25.1	15.0	14.7	48.1	37.5	24.6	20.9	38.9	26.4	16.0	15.4
50-199 employees ...	28.1	18.7	7.5	8.3	30.5	20.4	12.6	11.7	28.4	18.9	8.0	8.6
200+ employees	18.8	12.0	−3.5	−1.7	23.9	16.4	5.1	5.8	19.0	12.2	−3.0	−1.4
Total enterprises	**23.6**	**16.3**	**2.0**	**2.8**	**33.3**	**25.7**	**12.3**	**12.2**	**24.4**	**17.0**	**2.8**	**3.4**
					Return on assets (1)							
1-49 employees	1.4	1.4	1.5	1.7	0.8	0.2	1.2	2.3	1.3	1.2	1.5	1.8
50-199 employees ...	1.5	1.6	1.4	1.2	0.5	1.1	1.1	1.4	1.4	1.5	1.4	1.2
200+ employees	1.5	1.9	2.4	1.2	0.0	0.7	1.1	−2.0	1.4	1.9	2.3	0.9
Total enterprises	**1.5**	**1.7**	**2.0**	**1.2**	**0.3**	**0.5**	**1.1**	**0.1**	**1.4**	**1.5**	**1.9**	**1.1**
					Financial debt/value added							
1-49 employees	141.7	146.6	176.4	180.4	208.3	231.3	282.8	245.1	149.6	155.0	186.5	187.2
50-199 employees ...	110.2	108.1	127.4	132.9	157.0	153.2	137.2	139.0	114.5	112.0	128.3	133.5
200+ employees	125.0	112.8	116.5	121.0	130.8	123.7	114.3	143.2	125.4	113.4	116.3	122.1
Total enterprises	**124.8**	**116.6**	**127.8**	**131.2**	**157.8**	**160.4**	**151.9**	**162.9**	**127.3**	**119.5**	**129.6**	**133.3**
					Financial debt/(financial debt + equity)							
1-49 employees	60.7	62.6	60.9	59.7	61.2	61.3	63.2	60.6	60.7	62.3	61.2	59.8
50-199 employees ...	58.6	57.1	54.7	55.8	56.2	55.3	52.6	52.1	58.3	56.9	54.5	55.4
200+ employees	56.5	52.6	45.1	46.9	54.7	50.0	40.6	46.7	56.4	52.4	44.8	46.9
Total enterprises	**57.5**	**55.4**	**49.9**	**50.6**	**57.4**	**56.1**	**50.5**	**52.1**	**57.5**	**55.4**	**49.9**	**50.7**
					Bank debt/financial debt							
1-49 employees	81.4	84.2	75.2	74.8	85.9	85.4	82.5	80.8	82.2	84.4	76.2	75.6
50-199 employees ...	80.7	76.7	71.1	71.5	83.9	75.9	71.3	71.9	81.1	76.7	71.2	71.5
200+ employees	64.1	61.7	54.6	52.6	73.5	77.2	70.6	70.4	64.7	62.5	55.5	53.7
Total enterprises	**70.0**	**69.5**	**62.2**	**60.6**	**79.9**	**80.6**	**74.7**	**73.9**	**71.0**	**70.6**	**63.3**	**61.8**

Source: Based on Company Accounts Data Service data.
(1) Before accelerated depreciation and other adjustments and revaluations.

The composition of debt also differs by geographical area. Overall, southern firms make more extensive use of bank loans, which accounted for 73.9 per cent of their total debt in 2001, compared with 60.6 per cent for companies in the rest of Italy; the disparity is especially marked for large companies, while for medium-sized businesses there is no appreciable difference between the two areas. In 2001 bank debt amounted to 198 per cent of value added for southern firms with fewer than 50 workers, compared with 135 per cent for firms of the same size in the Centre and North.

BANKS AND OTHER CREDIT INTERMEDIARIES

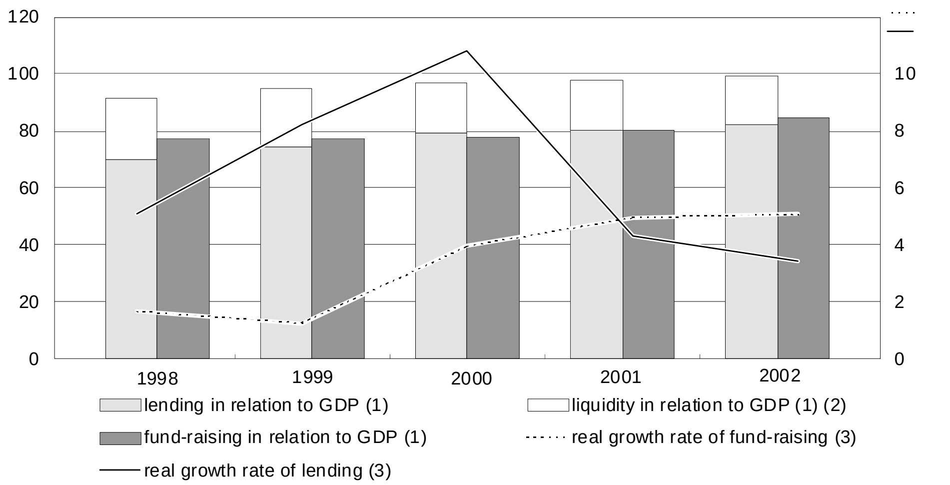
The activity of euro-area banks in 2002 was affected by the slowdown in economic activity, the fall in share prices, the financial crises of some large corporations and the difficulties of some emerging countries. The Italian banking system was among the most resilient, thanks to the efficiency gains achieved with the reorganization that began in the mid-1990s. The increase in credit risk was moderate, far smaller than that in earlier economic downturns. Profitability diminished, primarily owing to provisioning against the risks arising from exposure to Latin American countries and large multinational corporations, but it nonetheless remained above the average for the 1990s.

In Italy, lending growth slowed down until November 2002 but then picked up. The increase of 6.3 per cent for the year exceeded both the average for the euro area and the nominal growth in GDP; the ratio of lending to GDP rose by two percentage points to 82.3 per cent (Figure 33).

Figure 33

BANKING INTERMEDIATION IN ITALY

(*year-end data; percentages)*



Sources: Based on statistical and supervisory reports and Istat data.
(1) Left-hand scale. – (2) Cash and securities. – (3) On previous year; right-hand scale. Year-end stocks deflated using the GDP deflator.

The growth in lending was faster for firms based in the South (7.2 per cent, around 2 percentage points more than in the rest of Italy). It was also strong for small firms (7.2 per cent, compared with 4 per cent for other companies). Buoyed by the low level of medium and long-term interest rates, lending to households continued to expand rapidly, especially home mortgages. The stagnation of output weakened corporate demand for short-term loans, especially in manufacturing.

In the first few months of 2003 the rate of growth in lending accelerated further; in March it was 6.8 per cent (Table 42).

Table 42

MAIN ITEMS IN THE BALANCE SHEETS OF ITALIAN BANKS (1)
(*end-of-period data*)

	Percentage changes								Balances (millions of euros)
	On 12 months earlier			On previous quarter, annualized (2)					
	Dec. 2001	Dec. 2002	March 2003	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	December 2002
Assets									
Securities	−11.7	−15.6	−12.8	−2.1	−20.0	−22.7	−16.4	11.8	164,295
government securities	*−16.4*	*−19.8*	*−19.1*	*−1.0*	*−26.9*	*−26.3*	*−22.3*	*2.2*	*103,128*
Loans	7.2	6.3	6.8	6.2	7.8	4.4	6.7	8.4	1,035,947
of which: (3)									
short-term (a)	*6.4*	*0.5*	*1.3*	*−2.4*	*3.4*	*−1.7*	*2.5*	*1.0*	*465,483*
medium and long-term (b)	*9.0*	*11.7*	*11.8*	*14.2*	*11.6*	*11.2*	*10.1*	*14.1*	*514,770*
(a)+(b)	*7.7*	*6.1*	*6.6*	*5.7*	*7.5*	*4.8*	*6.4*	*7.8*	*980,253*
repos	*−18.3*	*−7.2*	*−2.9*	*83.5*	*13.6*	*−40.7*	*−40.1*	*120.6*	*6,300*
bad debts (4)	*−12.7*	*1.9*	*4.0*	*−2.3*	*5.0*	*3.1*	*2.2*	*5.6*	*46,298*
Memorandum item:									
net bad debts	*−13.6*	*−0.4*	*−4.4*	*−4.3*	*−9.9*	*5.8*	*9.4*	*−23.4*	*21,160*
External assets	−8.2	20.0	13.5	29.1	20.2	4.3	28.2	3.2	212,637
Liabilities									
Domestic funding (5)	7.8	8.0	5.8	11.4	8.9	6.3	5.3	2.7	1,064,146
Deposits	6.4	6.7	4.3	10.7	4.4	7.1	4.6	0.9	696,177
of which: (6)									
current accounts	*9.4*	*7.2*	*7.0*	*12.9*	*6.3*	*7.9*	*1.5*	*11.8*	*488,027*
fixed-term	*−11.7*	*−8.6*	*−11.3*	*−7.8*	*−15.4*	*−1.0*	*−9.6*	*−18.4*	*50,046*
repayable at notice	*0.1*	*5.4*	*6.0*	*14.3*	*4.6*	*2.6*	*1.0*	*16.5*	*61,726*
repos	*11.6*	*17.2*	*−2.2*	*12.5*	*8.0*	*10.9*	*35.9*	*−45.1*	*89,269*
Bonds (5)	10.6	10.3	8.7	12.6	17.7	4.8	6.6	6.1	367,969
External liabilities	4.1	−4.1	5.6	−1.6	−2.3	−18.2	7.7	44.6	266,968

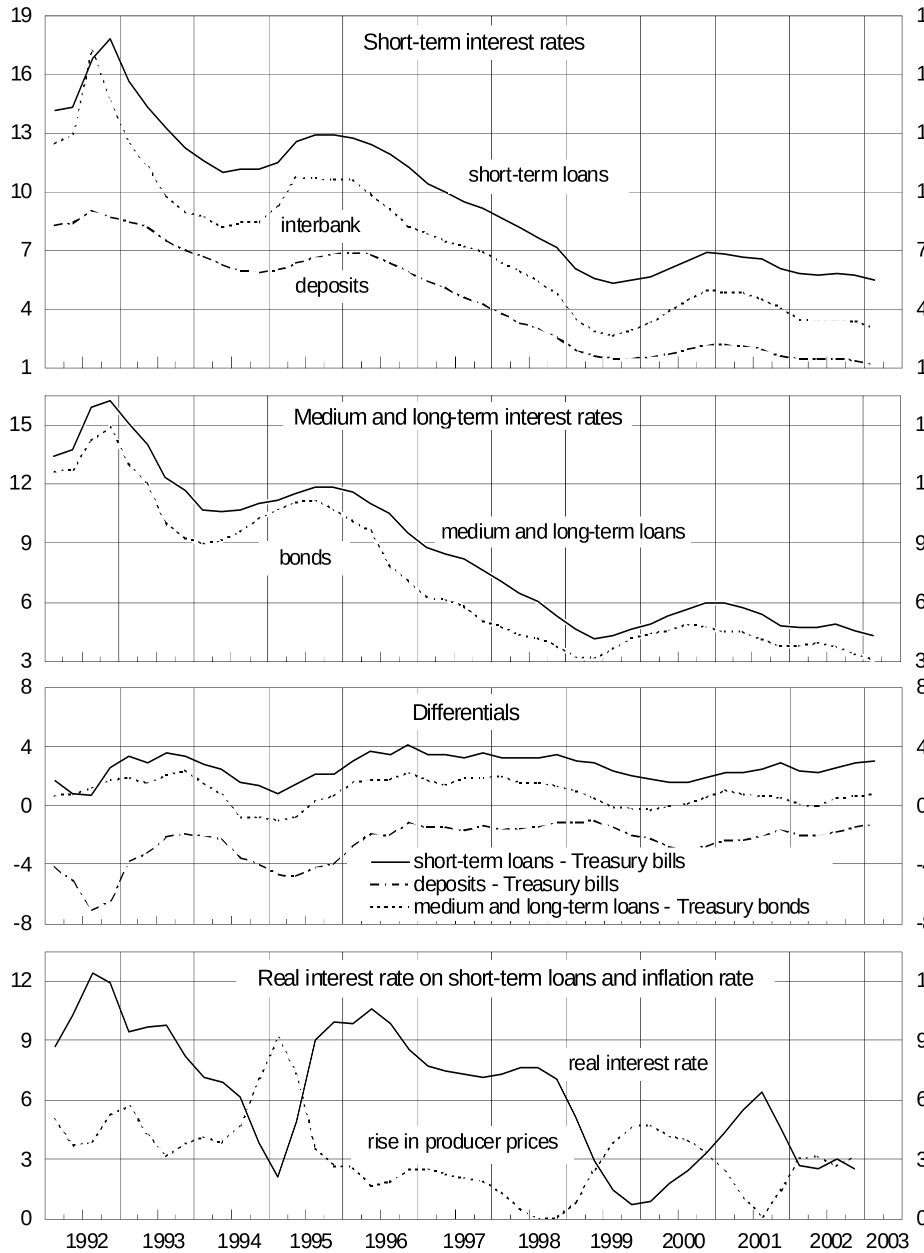
(1) The figures for March 2003 are provisional. The percentage changes are net of changes due to reclassifications, exchange rate variations, value adjustments and other variations not due to transactions. – (2) Calculated on data adjusted for seasonal variations where appropriate. – (3) Some minor items are not shown in the breakdown. – (4) The percentage changes are not adjusted for debt cancellations and assignments. – (5) Including bonds held by non-residents. – (6) Excluding those of central government.

Banks' lending conditions were generally easy. The average rate on short-term loans fell by 0.3 percentage points during the year and by another 0.4 in the first quarter of 2003 to reach 5.3 per cent (Figure 34), adjusting in the customary gradual fashion to changes in money market conditions. In the fourth quarter the real short-term lending rate was 2.5 per cent, very low by historical standards. The undrawn margin on credit facilities remained large; the incidence of overdrawn credit lines remained very low.

Figure 34

BANK INTEREST RATES AND DIFFERENTIALS IN RELATION TO YIELDS ON GOVERNMENT SECURITIES IN ITALY (1)

(quarterly data; percentages and percentage points)



Sources: Based on 10-day statistical and supervisory reports to the Bank of Italy and Istat data.
(1) The yield on Treasury bonds refers to exchange-traded bonds with a residual maturity of at least one year.

Domestic fund-raising increased by 8 per cent in 2002, as in the previous year. The growth in current accounts slackened in the final part of the year, when households started to purchase investment fund units again. Banks continued to increase their bond issues, which they placed mainly with customers resident in Italy. The increase in the risk premiums demanded in international markets was a factor curbing Eurobond placements. Net foreign liabilities fell sharply.

The return on equity declined to 6.2 per cent. Profitability was curtailed by the reduction in fee income from securities intermediation, the large provisions made against foreign exposures and the increase in costs arising from the staff-reduction plans undertaken by the principal banking groups.

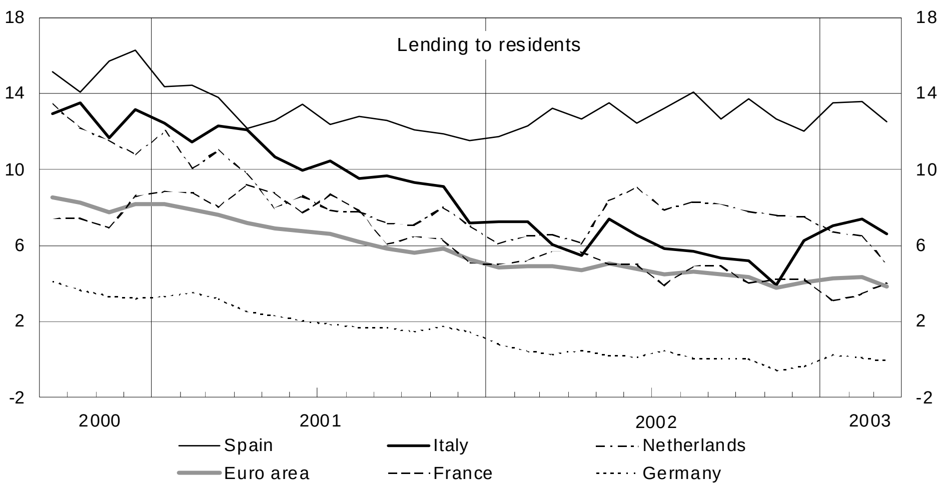
Lending

In Italy the rate of growth in lending came down from 7.2 to 6.3 per cent last year. Among the major euro-area countries the expansion in bank lending was significantly greater only in Spain, where GDP growth was higher (Figure 35).

Figure 35

LENDING BY MONETARY FINANCIAL INSTITUTIONS IN THE EURO AREA (1)

(monthly data; 12-month percentage changes)



Sources: Based on ECB data and national statistics.
(1) Lending of monetary and financial institutions (MFIs) of the euro area, excluding the Eurosystem, to non-MFI resident customers.

The slowdown in credit in Italy, which began early in 2001, intensified in 2002 during the summer and the early part of the autumn. It was concentrated in the short-term component, which showed almost no growth

(0.5 per cent in the twelve months to December, compared with 6.4 per cent in the previous year; Table 42). Medium and long-term lending continued to increase at a fast pace (11.7 per cent, compared with 9 per cent in 2001).

Lending to firms. – The slowdown in credit mainly involved lending to firms, with growth falling from 8 to 5.5 per cent. It was especially pronounced in manufacturing industry, where lending contracted by 0.2 per cent, after expanding by 3.9 per cent in 2001, and the service sector, where the annual growth fell from 10.5 to 6.4 per cent.

By contrast, lending to construction firms and holding companies with major interests in the real-estate sector accelerated. In 2002 lending to the construction industry and real-estate companies accounted for nearly half of the growth in lending to enterprises. Including loans to households for the purchase of housing, around two thirds of the total growth in lending was connected with the property market.

The slowdown was sharper in lending to large corporations, which in 1999 and 2000 had drawn heavily on bank credit to finance corporate restructurings. The rate of increase in lending to companies with credit lines of more than €25 million fell from 13.5 to 4.7 per cent.

Lending to small businesses (sole proprietorships and partnerships with fewer than 20 employees) increased by 7.2 per cent in 2002, compared with 4 per cent for other non-financial firms.

The maturity composition of bank lending to enterprises changed markedly in 2002. Loans with less than eighteen months maturity contracted by 1.2 per cent (they had increased by 5 per cent in 2001), while the growth in medium and long-term lending rose from 12.6 to 15.3 per cent. The lengthening of maturities reflects a trend that began in the second half of the 1990s for firms of all sizes; in 2002 an important contributory factor was the restructuring of the financial liabilities of several large corporations.

The maturity of firms' bank debt has been lengthening in most of the euro-area countries since 2001. The proportion of loans with an original maturity of more than one year rose from 64 per cent at the end of 2000 to 66.8 per cent in 2002. In Italy it rose by 3.7 points to 51.3 per cent, the largest contribution coming from loans with an original maturity of more than 5 years, whose share increased to 30.1 per cent.

The differences in the behaviour of lending according to the sector and size of borrowers produced significant changes in the market shares of the different categories of bank in 2002. That of "small" banks (with assets of between €1 billion and €7 billion) and "minor" banks (assets of less than e1 billion), excluding those deriving from the transformation of finance companies, rose by 1.8 percentage points to 29.6 per cent.

In 2002 leasing credit granted by banks picked up sharply (Table 43); that disbursed by finance companies slowed down, partly as a consequence of securitizations. After rising appreciably in 2001, the volume of claims assigned to banks through factoring fell substantially, while the volume assigned to finance companies supervised by the Bank of Italy, which account for most factoring business, grew moderately.

Table 43

LEASING, FACTORING AND CONSUMER CREDIT IN ITALY
(end-of-period data; millions of euros and percentages)

	Percentage changes on previous year			Outstanding 2002 (1)	Percentage of total
	2000	2001	2002 (2)		
			Leasing		
Total credit	22.7	15.8	12.5	60,431	100.0
Finance companies	22.8	18.6	11.7	47,705	78.9
Banks	21.9	5.3	15.4	12,726	21.1
			Factoring		
Total credit	17.1	14.2	2.5	39,453	100.0
Finance companies	17.3	12.9	3.7	35,964	91.2
Banks	14.8	32.1	–8.9	3,489	8.8
			Consumer credit		
Total credit	12.1	6.6	8.9	45,244	100.0
of which: credit cards	*26.3*	*18.2*	*32.4*	*6,119*	*13.5*
Finance companies	14.2	6.5	10.3	18,591	41.1
of which: credit cards	*27.7*	*14.7*	*26.7*	*4,055*	*9.0*
for purchases of motor vehicles	*11.2*	*3.7*	*5.4*	*10,709*	*23.7*
Banks	10.5	6.7	8.0	26,653	58.9
of which: credit cards	*22.7*	*26.9*	*45.4*	*2,064*	*4.6*
Memorandum item:					
Other loans to consumer households excluding those for home purchases	8.2	12.0	–3.5	56,648	

Source: Based on supervisory reports.
(1) Provisional.

Lending to households. – Lending to consumer households grew by 10.8 per cent, compared with 9.2 per cent in 2001. The acceleration was largely attributable to loans for the purchase of housing, whose growth rose from 7.1 to 19.5 per cent. Mortgage loans totaling about €37 billion were disbursed, three quarters of them indexed to market rates.

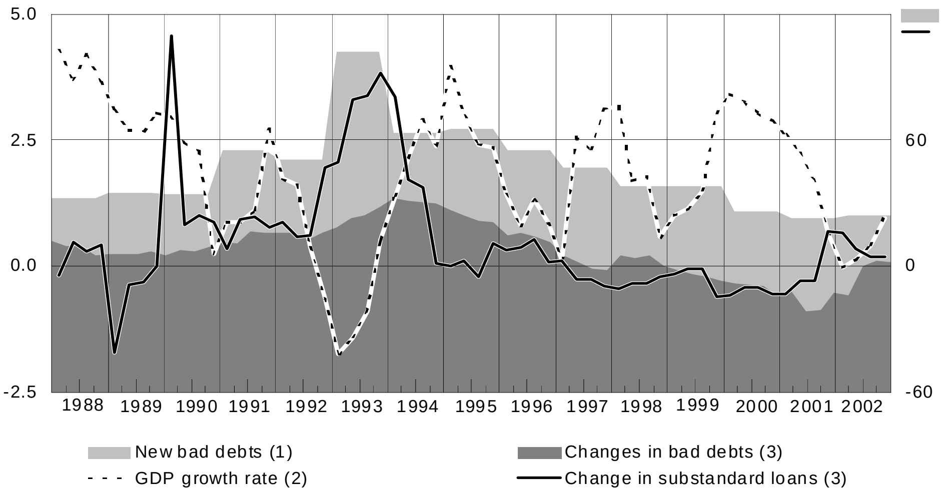
Consumer credit expanded at a faster pace, with the growth in the component granted by banks rising from 6.7 to 8 per cent and that granted by finance companies increasing from 6.5 to 10.3 per cent. The share of credit card loans rose from 11.2 to 13.5 per cent.

Bad debts. – New bad debts (under the broad definition of adjusted bad debts) amounted to 1 per cent of lending in 2002, up slightly from 0.9 per cent in 2001 *(*Figure 36); the ratio rose both for non-financial corporations and sole proprietorships (from 1.2 to 1.3 per cent) and for consumer households (from 0.8 to 1.1 per cent). The stock of bad debts grew by 1.9 per cent, but in relation to total lending it fell by 0.2 percentage points to 4.5 per cent.

Figure 36

BAD DEBTS AND SUBSTANDARD LOANS OF ITALIAN BANKS

(percentages and percentage changes)



Sources: Central Credit Register, supervisory reports and Istat.

(1) As a percentage of the stock of loans (net of adjusted bad debts) outstanding at the end of the preceding year; annual data; left-hand scale. – (2) At constant prices in relation to the corresponding quarter of the preceding year; left-hand scale. – (3) In relation to the corresponding quarter of the preceding year; not adjusted for debt cancellations and assignments; right-hand scale.

The banks' exposure to customers in temporary difficulty (so-called substandard loans) grew by 4.6 per cent, compared with 2 per cent in 2001; in relation to performing loans it remained stable at 2.1 per cent.

Lending conditions

Analysis of a large set of indicators does not find any evidence that credit supply tightened in Italy, although banks did become more prudent in evaluating the risk of some customer segments, notably those whose borrowing had increased substantially in the last few years.

Interest rates on short-term loans declined over the year by 0.3 percentage points to 5.7 per cent, a reduction similar to that recorded in the euro area (Figure 37). Rates on long-term loans fell by 0.5 points for households and by 0.3 points for firms, to 5.4 and 4.4 per cent respectively; in the euro area they declined by 0.4 points for both households and firms.

Figure 37

BANK LENDING RATES IN ITALY AND THE EURO AREA (1)
(monthly data; percentages)

Sources: Based on ten-day statistics and ECB data.
(1) Weighted averages of national interest rates. The curves indicate trends rather than relative levels of rates, as they are based on non-harmonized data.

There was no appreciable increase last year in the differential between bank lending rates and money market rates, such as occurs in periods of credit tightening. The gap between short-term lending rates and the three-month interbank rate narrowed during the first half of the year and then widened slightly in the last few months. The average differential for the year (2.5 percentage points) was in line with that of the period from 1998 to 2001. There is no evidence that banks applied more stringent conditions to higher-risk categories of customer. The spread between the average short-term lending rate and the minimum rate held steady at around 2.4 percentage points. The percentage of business loans backed by collateral also remained broadly unchanged.

The variations in the percentage of overdraft facilities drawn and the figures on breaches of overdraft ceilings do not indicate the onset of more stringent liquidity constraints than in the recent past. The ratio of credit drawn to that granted on overdraft facilities was 42.6 per cent on average for the year, one percentage point lower than in 2001 and close to the low of the last decade. Undrawn margins increased in the manufacturing sector, where the slowdown in lending was sharper, whereas they decreased in the service sector. An analysis of the non-financial corporations reporting to the Company Accounts Data Service shows that those with a ratio of credit drawn to credit granted exceeding 80 per cent made up 15 per cent of the sample, similar to the proportion that prevailed between 1998 and 2000, when credit conditions were very expansive.

Finally, there was no shift in the composition of bank assets towards less risky assets, of the kind that occurred in periods of credit tightening in the past. Holdings of government securities continued to decline in relation to the sum of government securities, loans and other bonds; in December 2002 the ratio was 8.6 per cent, down from 10.6 per cent a year earlier. Despite the fall in profitability, banks' capital base remains solid.

At the end of 2002 the Eurosystem inaugurated a quarterly survey of bank lending in the euro area (see the March and April 2003 issues of the ECB's *Monthly Bulletin*). The survey collects the evaluations of a sample of banks, including the largest, by means of a questionnaire addressed to the persons responsible for lending policy. According to the information supplied by the Italian participants (seven banks heading the country's leading banking groups), between the last quarter of 2002 and the first quarter of 2003 credit standards as applied to the approval of loans and credit lines tightened only with respect to large firms, in the face of an increase in the perceived risks. By contrast, the banks reported that the standards they applied in granting loans to households had remained basically unchanged.

Developments in lending in the South

The slowdown in lending in 2002 only involved customers resident in the regions of the Centre and North, for whom the growth rate fell from 8 to 6 per cent (Table 44). By contrast, lending to customers resident in the South accelerated, its rate of growth rising from 5.1 to 7 per cent. If new bad debts are included in total loans, bank lending in the South outpaced that in the North by two percentage points.

Table 44

LENDING, BAD DEBTS AND INTEREST RATES OF ITALIAN BANKS BY GEOGRAPHICAL AREA AND SECTOR OF ECONOMIC ACTIVITY (1)

(percentages and millions of euros)

	General gover-nment	Finance and insurance companies	Enterprises	Enterprises: Holding companies	Enterprises: Non-financial corporations	Non-financial corporations: Manu-facturing industry	Non-financial corporations: Construc-tion	Non-financial corporations: Services	Households: Consumer house-holds	Households: Sole proprietor-ships	Total
	12-month percentage changes in lending (2)										
2001 – Dec.											
Centre-North	–4.5	14.0	8.3	1.1	8.9	3.8	8.2	10.8	9.4	3.8	8.0
South	–0.5	–11.4	5.3	27.2	5.2	4.1	1.2	7.3	8.4	2.9	5.1
2002 – Dec.											
Centre-North	–4.3	5.6	5.3	22.9	3.9	–0.3	9.3	5.7	11.3	8.8	6.0
South	6.7	–14.3	7.2	1.2	7.2	0.4	8.4	11.0	8.8	7.0	7.0
	Bad debts as a percentage of total loans (3)										
2001 – Dec.											
Centre-North	0.0	0.4	3.5	1.3	3.7	3.2	8.2	3.3	3.8	8.1	3.2
South	0.8	3.3	14.7	11.0	14.7	10.9	27.0	12.8	10.9	27.5	14.0
2002 – Dec.											
Centre-North	0.0	0.4	3.6	1.0	3.8	3.4	8.3	3.4	4.0	7.7	3.3
South	0.9	3.5	13.0	20.3	13.0	11.1	21.3	11.6	9.4	24.4	12.4
	Interest rates on short-term loans (4)										
2001 – Dec.											
Centre-North	4.83	4.44	6.33	5.08	6.43	6.26	7.67	6.57	7.66	9.16	5.96
South	5.44	4.45	7.73	6.10	7.73	7.69	8.38	7.69	8.30	9.99	7.73
2002 – Dec.											
Centre-North	4.00	3.82	6.05	4.44	6.14	5.93	7.61	6.42	7.70	9.24	5.68
South	4.38	4.41	7.33	5.87	7.33	7.21	8.41	7.51	8.45	9.73	7.35
	Interest rates on medium and long-term loans (4) (5)										
2001 – Dec.											
Centre-North	5.84	4.62	5.11	4.18	5.17	4.99	5.34	5.27	5.23	5.47	5.03
South	5.70	7.08	5.80	–	5.80	5.62	5.75	6.04	5.62	6.01	5.78
2002 – Dec.											
Centre-North	3.93	3.32	4.72	4.88	4.72	4.58	4.82	4.73	4.65	4.96	4.43
South	3.88	4.11	5.25	–	5.25	5.01	5.40	5.38	5.00	5.79	5.20
	Outstanding loans										
2002 – Dec.											
Centre-North	49,217	113,247	487,866	42,826	445,039	158,400	47,918	197,402	162,317	45,042	857,688
South	6,333	3,295	57,365	309	57,056	16,771	8,701	25,364	42,858	12,713	122,565
Italy	55,550	116,543	545,230	43,136	502,095	175,170	56,620	222,766	215,175	57,755	980,253

(1) The data on loans exclude repos, bad debts and some minor items that are included in the Eurosystem's harmonized definition. – (2) Calculated net of changes due to reclassifications, exchange rate variations, value adjustments and other variations not due to transactions. – (3) The denominator includes bad debts. – (4) Average data of the last quarter of the year indicated. Source: Central Credit Register. – (5) Interest rates charged on disbursements, excluding loans at supported rates.

After the severe crisis that followed the recession of 1993, there was a far-reaching transformation of the ownership structures and branch networks of the banking system in the South. Between 1991 and 2001 lending to customers resident in the South grew at an average annual rate of 5 per cent, three percentage points lower than the increase recorded in the rest of Italy. Over the same period, however, new bad debts amounted to an average of 3 per cent of lending in the South, compared with 1 per cent in the Centre and North. Including new bad debts in total loans, the rate of increase in bank lending in the South was close to that in the Centre and North. A small divergence is to be found only for the four years between 1998 and 2001, in concomitance with the rapid growth in loans connected with corporate restructurings in the Centre and North and the slowdown in lending to finance companies in the South.

The faster expansion of bank lending in the South last year is largely attributable to lending to enterprises, whose growth accelerated from 5.3 to 7.2 per cent in the South while slowing from 8.3 to 5.3 per cent in the Centre and North. In particular, the growth in lending to firms in the service sector rose from 7.3 to 11 per cent in the South while slowing from 10.8 to 5.7 per cent in the rest of Italy. Credit to the manufacturing sector grew by 0.4 per cent in the South, whereas it contracted by 0.3 per cent in the Centre and North. Lending to construction firms accelerated faster in the South.

The acceleration in lending to firms in the South was accompanied by an increase in the undrawn margin on credit facilities. In 2002 the ratio of credit drawn to that granted for non-financial corporations and sole proprietorships fell by just under one percentage point in both the South and the Centre and North, to 57.4 and 46.7 per cent respectively.

In 2002 the volume of outstanding credit granted by finance companies supervised by the Bank of Italy grew by 12 per cent in the South, compared with 7.8 per cent in the Centre and North. The expansion was fastest in leasing credit, disbursed largely to firms, which rose by 15.8 per cent in the South and 11.6 per cent in the rest of Italy.

The interest rates on short-term bank loans to non-financial corporations and sole proprietorships came down by 0.3 percentage points in the South and by 0.4 points in the Centre and North, to 7.9 and 6.3 per cent respectively. For manufacturing firms the fall was more marked in the South than in the other regions (0.6 against 0.3 points).

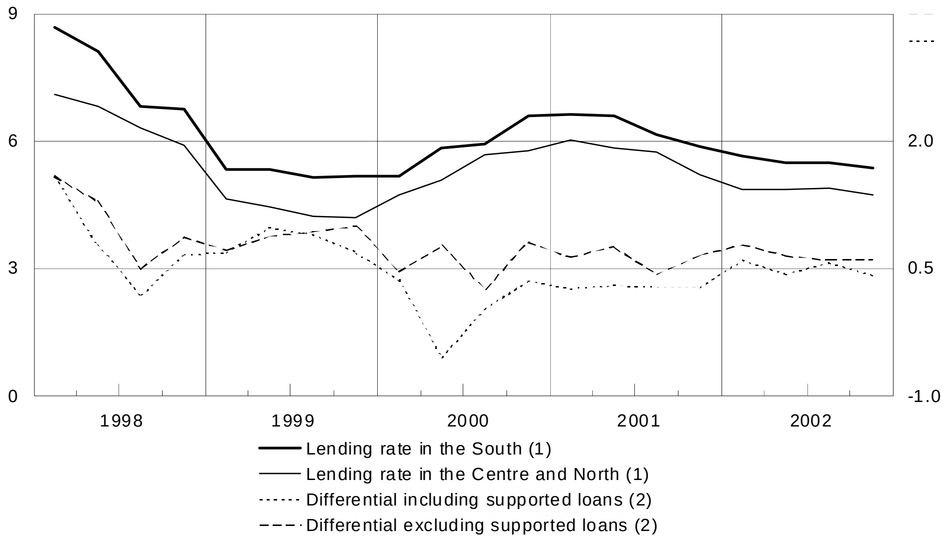
The difference between short-term lending rates for enterprises in the South and in the rest of Italy has narrowed from 1996 onwards, from 2.3 points to figures that are very small even by historical standards. The higher cost of credit in the South than in the Centre and North is partly a consequence of the different characteristics of borrower firms in the two parts of the country. In the southern regions small firms are more numerous and high-risk sectors figure more prominently. If the average interest rate for firms in the South is calculated applying the composition by sector and firm size of lending to enterprises in the Centre and North, the differential in 2002 is equal to 0.9 percentage points, the lowest figure for the fifteen years for which comparable data are available. After adjusting for the different compositions of firms by sector and size, the remaining differential reflects the higher riskiness of businesses in the South, due to the external diseconomies that weigh on production in that area. The share of loans marked down as bad debts every year is structurally higher in the South than in the Centre and North, even after adjusting for the sectoral and size characteristics of the borrower firms in the two areas. In 2002 new bad debts amounted to 2.3 per cent of total loans in the South (2.1 per cent if the sectoral and size composition of the Centre and North is applied), compared with 1.3 per cent in the rest of Italy.

The average interest rate on unsupported medium and long-term loans to non-financial corporations and sole proprietorships fell in 2002 by 0.5 percentage points both in the Centre and North and in the South, to 4.7 and 5.4 per cent respectively (Figure 38). The difference between the rates applied in the two areas decreased by 0.3 points with respect to the end of 1998. Taking supported loans into account, the cost of credit was 0.4 points higher in the South than in the Centre and North.

Figure 38

MEDIUM AND LONG-TERM LENDING RATES IN THE SOUTH AND IN THE CENTRE AND NORTH

(quarterly data; percentages and percentage points)



Source: Central Credit Register.
(1) Left-hand scale. – (2) Right-hand scale.

Deposit rates on households' current accounts in the South are now in line with those in the Centre and North. The differential in remuneration, which averaged 0.3 percentage points in the first half of the 1990s, gradually disappeared in the subsequent years.

Domestic fund-raising

The stock of funds raised by banks in the form of deposits and bonds rose in Italy by 8 per cent, compared with 7.8 per cent in 2001 (Table 42); in the euro area it increased by 4.3 per cent, compared with 7.1 per cent the previous year.

In Italy the rate of growth in deposits accelerated slightly, from 6.4 to 6.7 per cent, as a consequence both of the large increase in securities repurchase agreements and the positive trend in savings deposits. The deposits of the Italian branches of foreign banks more than doubled and their market share rose from 0.7 to 1.3 per cent.

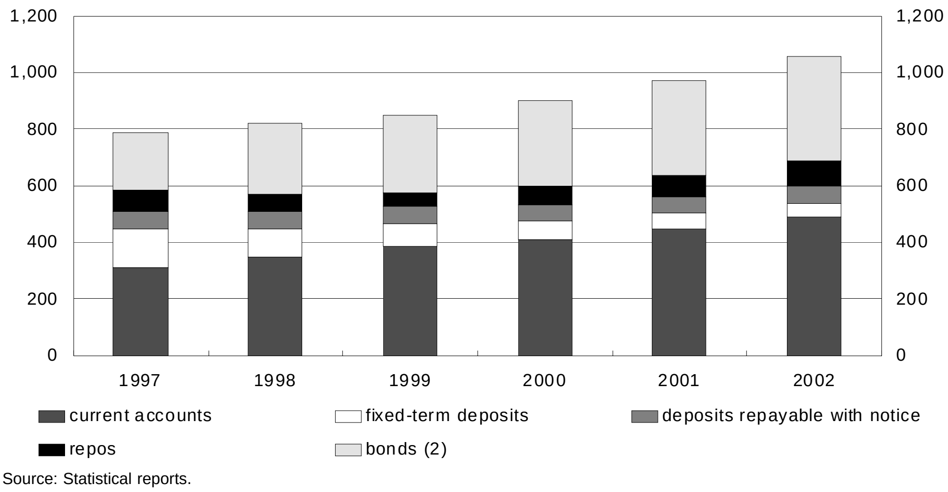
Current accounts grew rapidly in the first half of 2002 but slowed down in the closing months of the year in connection with the upturn in households' purchases of investment fund units. The growth in such accounts over the year amounted to 7.2 per cent, which is in line with forecasts based on the change in deposit rates, GDP and market rates.

Deposits repayable at notice ended a prolonged decline, growing by 5.4 per cent, compared with 0.1 per cent in 2001 (Figure 39). Funds raised by means of securities repos increased by 17.2 per cent, as against 11.6 per cent in 2001, with a surge in the final part of the year that was largely attributable to transactions with investment firms, trust companies and investment funds.

Figure 39

BANK FUND-RAISING IN ITALY (1)

(year-end data; billions of euros)



Source: Statistical reports.
(1) Net of deposits of central government departments. – (2) Includes those held by non-residents.

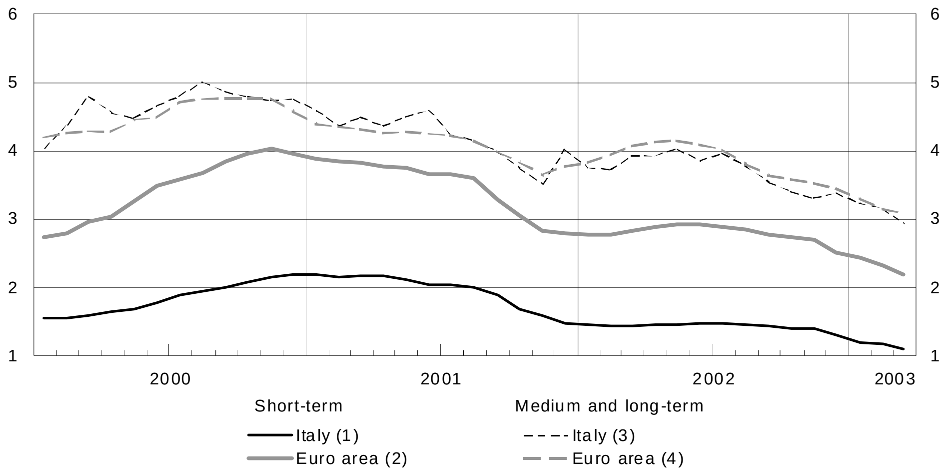
The volume of funds raised by banks with bond issues maintained a high rate of growth (10.3 per cent, compared with 10.6 per cent in 2001); bonds' share of total funding rose slightly, to 34.6 per cent. Subordinated bonds recorded further rapid growth of 11 per cent, bringing their share of banks' bond issues to 12.2 per cent.

The rates on short-term funds came down slightly in the final part of the year (Figure 40). Current account deposit rates diminished by 0.1 percentage points in the twelve months to December, to 1.3 per cent. Net of the differences in taxation, the differential between the yields on Treasury bills and current accounts narrowed by 0.3 percentage points to 1.5 points. The net yield on fixed-rate bank bonds decreased by 0.6 points to 3.4 per cent; despite the reduction in these bonds' average term to maturity, the yield differential in relation to five-year Treasury bonds diminished slightly, from 0.4 to 0.3 points.

Figure 40

BANK FUNDING RATES IN ITALY AND THE EURO AREA

(monthly data; percentages)



Sources: Based on ten-day statistics and ECB data.

(1) Average rate on deposits in euros. – (2) Rate on fixed-term deposits up to one year. – (3) Fixed-rate bond issues. – (4) Rate on fixed-term deposits with a maturity of more than two years.

In the euro area the rates on both short-term and medium and long-term bank liabilities decreased by 0.3 percentage points.

Other balance sheet items: the securities portfolio and banks' net external position

In 2002 the value of banks' securities portfolios fell by €14.7 billion, or 8.2 per cent. Net of the variations in securities prices, the decrease amounted to 15.6 per cent and principally involved government securities, whose share of the total fell by 5.9 percentage points to 62.8 per cent. The ratio of liquid assets (cash and marketable securities) to the aggregate of liquid assets and loans diminished by 1.4 points to 15.5 per cent.

Net of writedowns of their shareholdings and excluding investments made on behalf of staff pension funds, the book value of banks' equity investments in non-bank companies resident in Italy rose by €5.7 billion to €29.4 billion; nearly three quarters of the €6 billion of holdings in non-financial corporations were in unlisted companies. Shareholdings in other banks decreased by €0.8 billion to €40 billion, while those in finance companies increased by €4.4 billion to €18.1 billion.

Italian banks' net external liabilities, which had expanded rapidly in the three previous years, fell in 2002 by €47.6 billion, or 44.9 per cent. The availability of funds deriving from the sale of securities and from the greater growth in domestic funding than lending contributed to the contraction. In December 2002 Italian banks' net external debtor position of €54.3 billion (down from €106 billion a year earlier) was equal to 2.6 per cent of total bank liabilities, similar to the percentage recorded in 1998.

Profit and loss accounts

Reflecting the growth in lending, Italian banks' net interest income rose by 5.2 per cent, compared with 5.6 per cent in 2001 (Table 45). The spread between the average rate on loans and the average cost of funds fell to 3.8 percentage points, its lowest level since the 1960s.

Income from services declined by 7.7 per cent, after falling by 12.7 per cent in 2001. A reduction of 22 per cent in net fee income from asset management services more than offset the growth in fees from collection and payment services (14 per cent) and income from the distribution of third parties' services (26.9 per cent).

Net income from other financial operations decreased by 19.8 per cent, largely owing to a contraction of 25 per cent in dividends on shareholdings. More than half of the dividends came from shareholdings in banks; dividends on investments in other companies amounted to €3.6 billion, or 44 per cent of the total.

Excluding dividends on shareholdings in banks, gross income fell by 0.2 per cent, whereas it had risen by 1.5 per cent in 2001.

Total staff costs rose by 4.9 per cent, with an acceleration from 1 per cent in 2001 due mainly to the cost of early severance incentives. Excluding the latter, costs per employee rose by 2 per cent, in line with the provisions of the collective labour contract for the banking industry.

Table 45

PROFIT AND LOSS ACCOUNTS OF ITALIAN BANKS (1)

	1999	2000	2001	2002	1999	2000	2001	2002
	As a percentage of total assets				Percentage changes			
Net interest income (a)	**1.95**	**1.93**	**1.93**	**1.91**	**–6.4**	**7.8**	**5.6**	**5.2**
Non-interest income (b) (2)	**1.60**	**1.76**	**1.75**	**1.46**	**17.8** ***(11.6)***	**20.6** ***(16.6)***	**4.1** ***(-3.7)***	**–12.2** ***(-7.5)***
of which: trading	*0.18*	*0.14*	*0.13*	*0.07*	*–41.3*	*–13.6*	*–18.0*	*–42.8*
services	*0.73*	*0.81*	*0.67*	*0.59*	*22.6*	*21.4*	*–12.7*	*–7.7*
other financial operations (2)	*0.42*	*0.52*	*0.67*	*0.51*	*90.8* (65.3)	*35.5* (22.1)	*34.7* (17.4)	*–19.8* (–7.1)
Gross income (c=a+b) (2)	**3.55**	**3.69**	**3.68**	**3.37**	**3.2** ***(0.5)***	**13.5** ***(11.5)***	**4.9** ***(1.5)***	**–3.1** ***(-0.2)***
Operating expenses (d) (3)	**2.15**	**2.06**	**2.03**	**2.02**	**2.7**	**4.8**	**4.0**	**4.5**
of which: banking staff costs (3)	*1.26*	*1.16*	*1.11*	*1.10*	*–0.4*	*1.0*	*1.0*	*4.9*
Operating profit (e=c–d) (2)	**1.40**	**1.63**	**1.65**	**1.35**	**3.8** ***(-3.1)***	**26.9** ***(23.0)***	**6.1** ***(-2.2)***	**–12.5** ***(-7.5)***
Value adjustments, readjustments and allocations to provisions (f) (2)(4)	**0.40**	**0.36**	**0.66**	**0.56**	**–15.0** ***(-6.8)***	**10.4** ***(0.9)***	**91.3**	**–10.1**
of which: loan losses	*0.44*	*0.35*	*0.37*	*0.38*	*–1.5*	*–11.8*	*11.0*	*7.5*
Profit before tax (g=e–f) (2)(4)	**1.01**	**1.27**	**0.99**	**0.80**	**13.7** ***(-0.9)***	**33.4** ***(34.9)***	**–17.9** ***(-34.2)***	**–14.1** ***(-4.9)***
Tax (h) (5)	**0.40**	**0.48**	**0.39**	**0.30**	**–4.6**	**32.5**	**–14.4**	**–18.8**
Net profit (g–h) (4)	**0.61**	**0.79**	**0.59**	**0.49**	**30.0**	**41.9**	**–20.1**	**–11.1**
Dividends distributed	0.37	0.43	0.39	0.33	49.4	27.7	–3.7	–12.0
	Other data							
	Profit before tax				Net profit			
Profit as a percentage of capital and reserves (ROE) (5)	15.3	18.4	14.5	10.5	9.6	11.5	8.8	6.2
	Amounts				Percentage changes			
Total assets *(millions of euros)*	1,632,225	1,785,475	1,889,724	1,998,447	3.8	9.7	5.5	5.8
Average total number of employees	343,090	343,037	345,194	342,536	–1.2	0.1	0.5	–0.7
of which: banking staff	*338,785*	*339,054*	*342,279*	*340,541*	*–1.2*	*0.1*	*0.8*	*–0.4*
Total assets per employee *(thousands of euros)*								
at current prices	4,757	5,205	5,474	5,834	5.0	9.7	5.0	6.5
at constant prices (6)	4,325	4,614	4,723	4,911	3.3	7.0	2.2	3.9
Staff costs per employee (3) *(thousands of euros)*								
at current prices (7)	59.1	60.5	61.1	62.4	0.2	2.2	0.8	2.0
at constant prices (6)(7)	53.7	53.6	52.7	52.5	–1.5	–0.4	–1.9	–0.6
Memorandum items: (8)								
Total assets *(millions of euros)*	1,635,415	1,789,484	1,893,413	2,006,174	3.5	9.4	5.8	6.0
Total number of employees (9)	340,711	344,348	343,812	341,584	–0.9	1.1	–0.2	–0.6
of which: banking staff (9)	*336,487*	*340,884*	*341,295*	*340,409*	*–0.9*	*1.3*	*0.1*	*–0.3*

(1) Rounding may cause discrepancies in totals. The data for 2002 are provisional. – (2) The rates of increase calculated net of dividends on shareholdings in other banks, if included in the aggregate, are shown in brackets. – (3) Comprises wages and salaries, costs in respect of severance pay, social security contributions and sundry bonuses paid to banking staff; also includes the extraordinary costs incurred in connection with early severance incentive schemes. The number of banking staff is obtained by deducting tax collection staff and staff seconded to other entities from the total number of employees and adding employees of other entities on secondment to banks. – (4) The percentage changes for 2000 are calculated including deferred and prepaid taxes for the year among extraordinary income in order to ensure consistency with the data for 1999. – (5) Profit includes the net income of foreign branches and the change in the fund for general banking risks. – (6) Deflated using the general consumer price index (1995=100). – (7) Excluding the extraordinary costs incurred in connection with early severance incentives. – (8) Data for the entire banking system, including banks that have not reported information on their profit and loss accounts. – (9) End-of-period data.

A survey of the twenty largest banking groups (which account for 78 per cent of all bank employees) shows that the charges to the 2002 profit and loss account for early staff severance amounted to €760 million, of which €494 million refers to schemes managed by the banking industry's solidarity fund. The costs are attributable to 5,250 employment relationships terminated last year, 3,300 terminated in previous years and 3,800 involved in restructuring plans still to be implemented.

The average number of bank employees decreased by 0.4 per cent; the increase in staff due to the expansion of smaller banks and the founding of new institutions virtually counterbalanced the reduction in personnel in the principal banking groups.

Administrative expenses other than staff costs grew by 4.1 per cent; the growth in purchases of goods and professional services and in net leasing and rental expense contributed to the increase, most notably in the case of the larger banks.

Operating profit fell by 7.5 per cent last year, after decreasing by 2.2 per cent in 2001. Net value adjustments, which had nearly doubled in 2001, fell by 10.1 per cent. Compared with the two years 1999 and 2000, their amount remains high (Table a24), especially in connection with writedowns and allocations to provisions in respect of foreign assets. Net value adjustments to loans increased by 7.5 per cent, compared with 11 per cent in 2001.

Profit before tax declined by 4.9 per cent after falling by 34.2 per cent in 2001. Return on equity decreased from 8.8 to 6.2 per cent, in part because of the losses reported by foreign branches (€457 million, compared with net income of €188 million in 2001).

INSTITUTIONAL INVESTORS

Institutional investors' consolidated net fund-raising rose by 5.6 per cent to €37 billion in 2002 (Table 46). Consolidated assets under management remained virtually unchanged, partly owing to the large fall in the value of equities; as a ratio of GDP they declined by 1.7 percentage points to 77.3 per cent. Asset management products' share in Italian households' financial assets remained stable at 32.8 per cent (Table 47).

Table 46

ITALIAN INSTITUTIONAL INVESTORS:
NET FUND-RAISING AND ASSETS UNDER MANAGEMENT
(millions of euros; percentages)

	Net flows		End-of-period stocks			
	2001	2002 (1)	2001	2002 (1)	Percentage composition 2001	Percentage composition 2002 (1)
Investment funds (2) .	−20,365	−12,339	403,689	360,557	35.9	32.7
Insurance companies (3)	32,273	35,205	248,756	283,961	22.1	25.7
Pension funds and non-INPS social security funds (3) .	−8,971	−2,410	60,446	58,036	5.4	5.3
Portfolio management services	27,343	5,715	410,406	401,755	36.5	36.4
Total . . .	**30,280**	**26,171**	**1,123,297**	**1,104,309**	**100.0**	**100.0**
Consolidated total (4)	**35,050**	**37,011**	**963,943**	**973,016**	**-**	**-**

(1) Provisional. − (2) Harmonized investment funds and SICAVs. − (3) Technical reserves and total balance sheet assets for insurance companies and pension funds respectively. The figures for 2002 are estimated. − (4) Net of investments between the different categories of intermediary.

Between 1999 and 2001 the proportion of households' financial assets managed by institutional investors held constant in Italy and the United States at 33 and 39 per cent respectively, while rising by over 4 percentage points in France and Germany, to 35 and 41 per cent. In the three main euro-area countries the share of households' financial assets held in the form of insurance policies increased substantially; in Italy there was a sharp fall in the share consisting of investment fund units.

Table 47

FINANCIAL ASSETS OF INSTITUTIONAL INVESTORS IN THE MAIN EURO-AREA COUNTRIES AND THE UNITED STATES

(end-of-period data; percentages)

	1999				2001 (1)				2002 (1)
	Italy	France	Germany	United States	Italy	France	Germany	United States	Italy
	Percentage shares in households' financial assets (2)								
Investment funds (3)	18.6	8.7	10.2	8.8	15.0	9.1	11.7	9.0	13.3
Insurance companies	6.1	21.8	24.5	6.8	8.3	25.7	27.1	7.1	8.9
Pension funds	0.9	–	1.8	19.9	1.0	–	1.8	20.0	1.1
Other institutions (4)	7.7	–	–	3.2	8.3	–	–	3.2	9.5
Total	**33.3**	**30.5**	**36.5**	**38.7**	**32.6**	**34.8**	**40.6**	**39.3**	**32.8**
	As a percentage of GDP (5)								
Unconsolidated financial assets .	99.4	124.2	76.9	207.8	92.6	131.8	81.0	191.0	88.9
Consolidated financial assets (6)	85.1	....	....	....	79.5	....	....	....	78.5
	Composition by category of intermediary (5)								
Investment funds .	43.2	45.6	47.9	32.6	35.7	47.7	44.9	34.3	32.3
Insurance companies	18.6	54.4	47.9	20.5	24.4	52.3	51.0	21.2	28.2
Pension funds	4.6	–	4.1	35.8	3.5	–	4.1	32.9	3.7
Other institutions (4)	33.6	–	–	11.1	36.3	–	–	11.5	35.9
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
	Composition by type of financial asset (5)								
Bonds	53	47	40	31	54	47	42	35	60
Loans	..	3	28	8	..	3	28	9	..
Shares	22	42	28	51	18	43	24	44	13
Other (7)	25	8	4	10	28	7	6	12	27
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Sources: OECD, Eurostat and Bank of Italy.

(1) Provisional. – (2) Ratio of institutional investors' net assets held by households to households' total financial assets. The data for investment funds, insurance companies and pension funds are taken from the national financial accounts for Italy, France and Germany and from OECD for the United States. – (3) For Italy, France and Germany, includes foreign funds (for Italy, controlled by Italian and foreign groups). – (4) For Italy, individually managed portfolios net of investments in investment fund units; includes the portfolios of institutional sectors other than households. – (5) For Italy, the figures for pension funds include non-INPS social security funds. – (6) Net of investments between the different categories of intermediary. – (7) Cash, deposits and other items.

There was a further net outflow of savings from Italian investment funds, extending a trend under way since the fourth quarter of 1999. By contrast, foreign investment funds controlled by Italian intermediaries recorded a net inflow. Subscribers continued to show a marked preference for funds that invest primarily in short-term assets, the only category for which subscriptions significantly exceeded redemptions. The average return on investment funds was negative for the third successive year (–9.1 per cent).

Portfolio management services recorded a considerably smaller net inflow of fresh funds than in the past. They purchased a substantial volume of government securities and sold investment fund units, whose share in their total assets fell further. The services' financial result remained negative (–3.4 per cent).

The premium income of insurance companies showed substantial growth compared with the preceding year. In the life sector, a considerable part regarded life policies with profits, which guarantee the insured capital and, normally, a minimum return. The life sector's share of total technical reserves rose from 78.8 to 80.4 per cent. The increase in the proportion of government securities in insurance companies' portfolios reflected the reduction in those of equities and investment fund units.

Pension funds' assets grew by 3.4 per cent. The volume of resources managed by the funds established after the 1993 reform increased further, rising from 12.2 to 16.5 per cent of the sector's total assets. Occupational pension funds and open pension funds had negative average returns of –3.4 and –13.1 per cent respectively.

Securities investment funds

Fund-raising and net assets. – In 2002, Italian investment funds recorded a net outflow of savings for the third consecutive year. Redemptions amounted to €202.6 billion (compared with €238.9 billion in 2001), exceeding purchases by €12.3 billion (€20.4 billion in 2001). The net fund-raising of foreign investment funds controlled by Italian intermediaries remained positive, although by a smaller margin (€4.4 billion, compared with €18.1 billion in 2001).

The wide fluctuations in securities prices during the year penalized bond, equity and balanced funds, which recorded net outflows of savings of respectively €19 billion, €9.8 billion and €7.2 billion. By contrast, the preference for short-term assets sustained the net fund-raising of money-market funds, which amounted to €24 billion.

Econometric analyses for the period running from 1989 to 2002 indicate a negative correlation between the level of interest rates on government securities and the gross and net fund-raising of Italian investment funds. Savers tend to invest in the assets that have given the highest returns over the previous months, so that when bond returns rise the inflow into bond funds increases; stock-market returns have a similar effect on equity funds. The variability of stock-market indices has a negative effect on the net fund-raising of equity funds and a positive one on that of bond funds. A deterioration in cyclical variables, such as industrial production and households' confidence, tends to boost the net fund-raising of bond and money-market funds, whose returns are less affected by short-term economic developments.

The drop in share prices and the substantial volume of net redemptions led to a decline of 10.6 per cent in the total net assets of Italian harmonized funds to €361 billion (Table 48). The net assets of Italian-controlled foreign investment funds decreased by only a few points less. From their peak of August 2000, the total net assets of all investment funds established in Italy or abroad by Italian intermediaries were down 20.5 per cent at the end of 2002.

Table 48

NET ASSETS OF INVESTMENT FUNDS
IN THE MAIN EUROPEAN COUNTRIES AND THE UNITED STATES (1)
(end-of-period data in billions of euros)

		Italy (2)	Germany	France	Luxembourg and Ireland (3)		Euro area (3) (4)	UK	US
						of which: controlled by Italian intermediaries			
Net assets	2001	404	240	800	1.066	105	2,977	355	7,824
	2002	361	199	806	1.005	98	2,826	275	6,095
as a % of GDP ..	*2001*	*33.2*	*11.6*	*54.9*			*43.7*	*21.9*	*69.2*
	2002	*28.7*	*9.5*	*53.5*			*40.1*	*17.2*	*61.2*
		Composition by sector							
Equity funds	2001	111	125	207	318	46	937	253	3,788
	2002	73	80	173	223	31	697	205	2,543
domestic	2001	17	29	104	....	5	200	149	3,392
	2002	9	2	..	....	2	15	16	....
European ...	2001	38	35	33	....	15	152	28	....
	2002	11	3	..	....	7	18	13	....
other	2001	56	61	70	....	26	268	76	....
	2002	52	75	173	....	22	441	176	....
Bond funds	2001	159	60	139	331	47	821	42	1,050
	2002	153	64	148	351	51	864	46	1,073
Balanced funds .	2001	87	18	197	62	9	445	30	393
	2002	59	15	181	55	9	378	23	312
Money market funds	2001	47	34	258	91	3	496	2	2,593
	2002	76	39	304	88	6	590	2	2,166
Other funds	2001	..	3	..	51	..	64	28	..
	2002	..	2	..	49	..	59	..	..

Sources: Based on FEFSI, ICI and Assogestioni data.

(1) The data refer to open-end investment funds that invest in securities and are offered to the public; funds of funds are not included. – (2) In order to compare the Italian data with those of the other countries, the fund classification adopted in this table is that of FEFSI and therefore differs from that used in the other tables in the Report. – (3) The sum of the sub-sectors is not equal to the total because data on the composition are not available for Ireland. – (4) The available data for the Netherlands refer to December 2001.

In the euro area resources managed by investment funds contracted overall by 5.1 per cent last year, to €2.8 trillion. At the end of 2002 the market share of Italian-controlled investment funds was 16.2 per cent, 0.9 percentage points less than a year earlier.

Supply-side developments. – In 2002 the number of traditional Italian investment funds decreased for the first time since the sector came into being in 1984. On the other hand, new types of investment fund continued to develop, such as non-harmonized open funds, hedge funds and closed-end funds. Italy's first hedge funds that implement their own investment strategy directly instead of investing in units of foreign hedge funds came into operation and at the end of 2002 had total net assets of €100 million.

In September 2002 the Italian stock market saw its first exchange-traded funds (ETFs), instruments for the collective investment of savings that are traded on regulated markets and hence easily sold or purchased in the same way as shares. Their distinctive features are low fees and passive investment strategies designed to replicate financial indices. EFTs were first offered in the United States in the early 1990s and introduced in the European markets in 2000. At the end of 2002 there were 113 EFTs in the United States with $102 billion of assets under management. At the same date in Europe EFTs managed $11 billion of assets. In Italy, at the end of March 2003 ten EFTs were listed, four of which were based on euro-area indices, three on European indices and the remaining three on US indices; their market capitalization amounted to $3.3 billion.

Ethical investment schemes wedding normal financial objectives with social and environmental goals began to appear in Europe during the 1990s. At the end of 2002 there were twelve funds in Italy that explicitly selected their investments according to ethical principles; their net assets totaled e1.1 billion, equal to about 0.3 per cent of those of Italian funds as a whole. According to a survey of eighteen countries, 280 ethical funds were operating in Europe at the end of 2001, accounting for less than 0.5 per cent of the total assets of European investment funds; Italian funds had the third-largest volume of assets under management after those of the United Kingdom and Netherlands. The criteria commonly adopted either rule out investments in the stock of firms operating in specific sectors, such as arms, tobacco, alcohol and those with a negative environmental impact, or choose the best firms according to specific quality assessments of their relations with shareholders, employees, suppliers and the community where they operate.

Returns and fees. – In 2002 the average return on Italian investment funds was negative, as it had been in the previous two years. Over the twelve months the value of the general index lost 9.1 per cent, compared with 8 per cent in 2001.

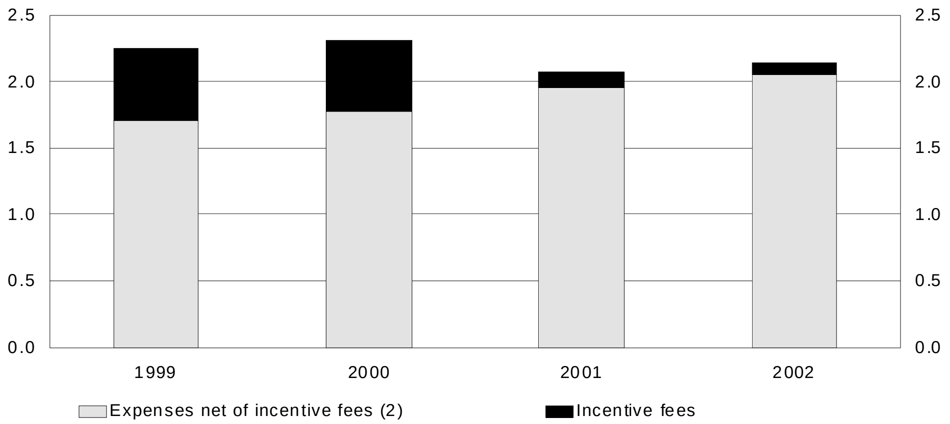
From 1991 to 2001 the average annual return on Italian short-term bond funds was 7 per cent, less than the gross yield on Treasury bills on the secondary market, while that on medium and long-term bond funds was 7.9 per cent, also lower than the main benchmarks. However, the comparison should take into account that the return on the funds is net of management fees and operating expenses and taxes while that on the benchmark financial indices is not. Adjusting for this factor, the yield differential with the respective benchmarks is still negative for both types of fund, although much less so. The conclusions are similar if the funds and their benchmarks are compared taking account of their riskiness. These results are in line with those for other countries.

In 2002 the total expenses paid by Italian harmonized investment funds decreased by 18.3 per cent to €4.9 billion; those paid to management companies amounted to €4.3 billion. The ratio of total expenses (fixed management fees, incentive fees, fees to depositary banks and other expenses) rose by 0.06 percentage points to 1.75 per cent of average annual net assets. Taking management fees alone, the ratio was 1.44 per cent, compared with 1.42 per cent in 2001.

The total expenses of equity funds were equal to 2.14 per cent of their net assets (Figure 41). Of that total, management fees amounted to 1.73 per cent (compared with 1.70 per cent in 2001) and incentive fees to 0.09 per cent (compared with 0.12 per cent in 2001 and 0.54 per cent in 2000). The expense ratios of balanced, bond and money-market funds were 1.74, 1.34 and 0.85 per cent respectively.

Figure 41

ITALIAN EQUITY INVESTMENT FUNDS:
TOTAL OPERATING EXPENSES (1)
(percentages)



(1) Total operating expenses as a percentage of average annual net assets. The data are for harmonized investment funds and SICAVs. Some of the data for the last year are provisional. – (2) Includes management fees and amounts paid to other intermediaries, including the depositary bank.

Portfolio composition. – In 2002 Italian investment funds made €11.8 billion of net disposals of securities. The heavy concentration of net subscriptions of units within funds with short-term investment objectives led to substantial net purchases of short-duration securities and large sales of shares and medium and long-term bonds. As a result of these portfolio shifts and above all the sharp fall in share prices, equities fell further as a proportion of Italian investment funds' financial assets, from 34.8 to 26.1 per cent, to the benefit of Italian government securities, whose share rose from 33.3 to 40.9 per cent (Table 49). During the year the percentage of euro-denominated assets grew from 71.6 to 78.1 per cent, partly owing to the currency's appreciation.

Table 49

ITALIAN INVESTMENT FUNDS: SECURITIES PORTFOLIO BY TYPE OF ISSUER AND CURRENCY (1)

(market values; end-of-period data in billions of euros)

	Securities denominated in euros			Securities denominated in non-euro-area currencies			Total portfolio		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Bonds and government securities									
Italian issuers									
Public sector	124.9	120.3	126.8	2.2	2.9	2.7	127.1	123.2	129.5
Banks	5.3	5.3	4.9	0.1	..	..	5.3	5.3	4.9
Firms	2.3	4.6	5.4	..	..	..	2.3	4.6	5.4
Foreign issuers									
Euro area	54.2	65.8	64.6	1.4	1.6	1.1	55.7	67.4	65.7
of which: government securities	*41.8*	*52.1*	*49.8*	*0.2*	*0.2*	*0.1*	*42.0*	*52.3*	*50.0*
Other	12.9	13.7	10.6	34.7	26.6	17.5	47.6	40.3	28.0
Shares									
Italian issuers	44.2	26.1	18.1	..	..	..	44.3	26.1	18.1
Foreign issuers									
Euro area	42.7	28.8	16.4	0.6	1.5	0.1	43.2	30.3	16.5
Other	0.1	0.1	0.1	91.8	72.5	48.0	91.9	72.5	48.1
Total	**286.6**	**264.6**	**246.9**	**130.8**	**105.1**	**69.4**	**417.4**	**369.7**	**316.2**

(1) Data refer to harmonized investment funds and SICAVs.

Portfolio management services

The net flow of savings to portfolio management services declined from €27.3 billion in 2001 to €5.7 billion last year (Table 50). Services run by banks and investment firms recorded net outflows of €13 billion and €1.5

billion respectively, those operated by asset management companies a net inflow of €20.3 billion. Total assets under management decreased by 2.1 per cent to €401.8 billion. Banks' market share continued to contract, falling from 44.9 to 40.9 per cent.

Table 50

ITALIAN PORTFOLIO MANAGEMENT SERVICES: SECURITIES PORTFOLIO

(millions of euros and percentages)

	2000	2001	2002 (2)	2000	2001	2002 (2)
	Net flows			**End-of-period stocks** *(percentage composition)*		
Italian bonds and government securities	**–3,561**	**21,028**	**13,921**	**31.9**	**39.6**	**47.1**
Short-term and floating-rate	–2,601	745	12,641	7.7	8.3	12.6
BOTs	–523	217	1,721	0.6	0.6	1.2
CCTs	–2,078	528	10,920	7.1	7.7	11.4
Medium and long-term	–960	20,282	1,280	24.1	31.2	34.5
CTZs	–392	–1,252	–211	1.1	0.9	1.3
BTPs	–625	16,250	–2,457	16.4	21.2	22.5
Other government securities	57	273	1,606	0.6	0.7	0.8
Bonds	. .	5,012	2,343	6.0	8.4	10.0
Italian shares	**–1,272**	**–3,451**	**–2,735**	**5.8**	**5.3**	**3.3**
Italian investment fund units	**15,516**	**–6,832**	**–11,980**	**44.7**	**35.6**	**29.0**
Foreign securities	**18,008**	**4,523**	**12,136**	**17.0**	**18.9**	**20.1**
Bonds and government securities	–1,518	–1,006	6,363	5.1	4.5	6.0
Shares	1,729	–1,903	2,025	2.5	2.0	1.6
Investment fund units	17,797	7,432	3,748	9.4	12.4	12.6
Other financial assets	**1,909**	**–7,393**	**–8,631**	**0.7**	**0.6**	**0.5**
Total portfolio	**30,600**	**7,875**	**2,711**	**100.0**	**100.0**	**100.0**
Memorandum items:						
Net fund-raising	**33,087**	**27,343**	**5,715**	**–**	**–**	**–**
Banks	–7,303	–22,391	–13,034	–	–	–
Investment firms	–110	2,853	–1,537	–	–	–
Asset management companies	40,500	46,881	20,286	–	–	–
Portfolio	**–**	**–**	**–**	**381,644**	**398,645**	**388,661**
Total assets under management	**–**	**–**	**–**	**392,112**	**410,406**	**401,755**

(1) Provisional.

In 2002 the sector's financial result (measured by the increase in net assets less new funds raised, which approximates the return on the portfolio on the assumption that all income is reinvested) was negative at –3.4 per cent, compared with –2.4 per cent in 2001.

The losses of these services were smaller than those of investment funds thanks to the small proportion of equities in their portfolios, which was further reduced during the year from 7.3 to 4.9 per cent, essentially because of the fall in Italian share prices. Italian government securities rose from 31.2 to 37.1 per cent of their portfolio, mainly to the detriment of Italian investment fund units, whose share fell from 35.6 to 29 per cent.

Insurance companies and pension funds

Insurance companies. – In 2002 the premium income of insurance companies grew by a substantial 15 per cent (Table 51). The increase was larger in the life sector (19.4 per cent) than in the casualty sector (8.3 per cent). As in the previous year, most of the growth was in life policies with profits (32.1 per cent), compared with a moderate increase in unit-linked or index-linked policies (4.1 per cent).

Table 51

ITALIAN INSURANCE COMPANIES:
MAIN ASSETS AND LIABILITIES (1)
(balance-sheet values; end-of-period data in millions of euros)

	Assets						Liabilities		*Memorandum item:* premium income (5)
	Deposits and cash (2)	Securities (2)	Loans & annuities (3)	Real estate	Other net assets	Total	Technical reserves (4)	Net worth	
				Life sector					
1999	2,237	144,207	739	2,232	4,121	153,536	137,627	15,909	35,597
2000	4,535	174,008	953	2,174	4,069	185,739	166,959	18,780	39,784
2001	5,723	201,275	995	1,889	5,522	215,404	196,099	19,305	46,329
2002 (6) . .	6,684	231,335	1,133	903	8,346	248,401	228,214	20,187	55,298
				Casualty sector					
1999	1,680	42,578	268	6,207	8,683	59,416	45,851	13,565	26,246
2000	1,825	47,907	313	6,161	9,034	65,240	49,524	15,716	27,875
2001	2,883	54,969	–3,454	5,909	7,988	68,295	52,657	15,638	29,926
2002 (6) . .	2,849	58,733	–2,507	4,575	8,578	72,228	55,747	16,481	32,417
				Total					
1999	3,917	186,785	1,007	8,439	12,804	212,952	183,478	29,474	61,843
2000	6,360	221,915	1,266	8,335	13,103	250,979	216,483	34,496	67,659
2001	8,606	256,244	–2,459	7,798	13,510	283,699	248,756	34,943	76,255
2002 (6) . .	9,533	290,068	–1,374	5,478	16,924	320,629	283,961	36,668	87,715

Sources: Based on Isvap and ANIA data.

(1) Excluding the agencies of companies based in other EU countries and including those of companies based in non-EU countries. – (2) Including assets entrusted to portfolio management services. – (3) Net of corresponding liabilities. – (4) Net of reinsurance. – (5) Italian direct insurance; includes premium income of offices in other EU countries. – (6) Partly estimated.

Savers tended to prefer life policies that guarantee either the insured capital or a minimum return. Life policies with profits, in particular, increased from 34.9 to 39.3 per cent of total premium income over 2001 and 2002. In September 2002 the bulk of insurance company investments linked to these policies was in bonds (86 per cent), with a far smaller percentage placed in shares (5 per cent).

Table 52

ITALIAN INSURANCE COMPANIES: SECURITIES PORTFOLIO (1)
(balance-sheet values; end-of-period data in millions of euros)

	Securities denominated in euros					Securities denominated in non-euro-area currencies		Investment fund units	Total
	Bonds and government securities			Shares (2)	Total		*of which: shares* (2)		
	Government securities	Private-sector bonds	Total						
				Life sector					
1999 . .	65,205	35,645	100,850	18,463	119,313	10,951	3,198	13,943	144,207
2000 . .	69,928	45,816	115,744	22,810	138,554	9,575	3,283	25,879	174,008
2001 . .	81,981	58,967	140,948	18,713	159,661	6,441	1,756	35,173	201,275
2002 (3)	103,570	68,466	172,036	16,861	188,897	4,507	1,382	37,931	231,335
				Casualty sector					
1999 . .	18,479	6,648	25,127	14,445	39,572	2,358	796	648	42,578
2000 . .	19,692	7,783	27,475	16,986	44,461	2,354	1,039	1,092	47,907
2001 . .	21,724	8,880	30,604	21,153	51,757	1,706	856	1,506	54,969
2002 (3)	25,237	9,230	34,467	22,058	56,525	1,099	656	1,109	58,733
				Total					
1999 . .	83,684	42,293	125,977	32,908	158,885	13,309	3,994	14,591	186,785
2000 . .	89,620	53,599	143,219	39,796	183,015	11,929	4,322	26,971	221,915
2001 . .	103,705	67,847	171,552	39,866	211,418	8,147	2,612	36,679	256,244
2002 (3)	128,807	77,696	206,503	38,919	245,422	5,606	2,038	39,040	290,068

Sources: Based on Isvap and ANIA data.

(1) Including assets entrusted to portfolio management services. The breakdown of the data on the portfolio of assets relating to pension funds and to unit-linked and index-linked products is partly estimated. Excluding the agencies of companies based in other EU countries and including those of companies based in non-EU countries. – (2) Includes participating interests. – (3) Partly estimated.

According to data from COVIP, the Pension Fund Supervisory Authority, at the end of 2002 insurance technical reserves connected with individual pension plans, which were introduced in January 2001, amounted to €610 million, compared with €193 million in 2001, 64 per cent of which relating to products linked to investment funds and 36 per cent to with-profits policies. Despite tripling from the previous year, these reserves still represented no more than 0.3 per cent of the life sector's technical reserves.

At the end of 2002 insurance companies' technical reserves totaled €284 billion, an increase of 14.2 per cent with respect to 2001. As in previous years, reserves in the life sector grew at a faster pace than in the casualty sector (respectively 16.4 and 5.9 per cent). The proportion of securities in the assets of insurance companies increased from €256.2 billion to €290.1 billion and that of liquid assets from €8.6 billion to €9.5 billion, while the real-estate component continued to decline, from €7.8 billion to €5.5 billion.

The proportion of equities in the portfolios of insurance companies contracted further from 16.6 to 14.1 per cent, while that of government securities rose from 40.5 to 44.4 per cent (Table 52). For the first time since 1997 the share of investment fund units fell, albeit only slightly (from 14.3 to 13.5 per cent).

For several European insurance companies in the life sector the fall in share prices caused substantial revaluation losses because of the large equity component in their portfolios. Insurance companies in a number of countries were also faced with the burden of contracts providing for payment of a minimum guaranteed return to the insured. The profitability of companies in the casualty and reinsurance sectors was hit not only by the deterioration in their result on financial operations but also by an increase in outlays connected with terrorist acts and the floods in central Europe.

Pension funds and non-INPS social security funds. – The assets managed by pension funds and non-INPS social security funds contracted to €58 billion at the end of the year, from €60.4 billion at the end of 2001 (Table 53). While the total assets of social security funds declined from €33.9 billion to €30.6 billion, those of pension funds grew by 3.4 per cent to €27.4 billion, owing largely to the rise from €3.2 billion to €4.5 billion recorded by funds set up after the 1993 reform. The increase was particularly large in the case of occupational funds (from €2.3 billion to €3.3 billion).

According to COVIP data, occupational and open funds continued to grow in 2002, albeit more slowly than in the past. At the end of 2002 participants in occupational and open funds totaled 1,021,000 and 338,000 respectively, while 36 occupational and 91 open funds had received authorization to operate. The participation rate in occupational funds geared to payroll employees was 15.4 per cent of their potential members.

The proportion of liquid assets in the portfolios of newly instituted pension funds declined by 4.4 percentage points to 18.6 per cent while the share of bonds rose by 3.5 points to 52.4 per cent and that of investment fund units by 0.6 points to 9.4 per cent.

Table 53

ITALIAN PENSION FUNDS AND NON-INPS SOCIAL SECURITY FUNDS: MAIN ASSETS (1)

(balance-sheet values; end-of-period data in millions of euros)

	2001				2002 (2)			
	Non-INPS social security funds	Pension funds		Total	Non-INPS social security funds	Pension funds		Total
		Formed before the reform of 1993	Formed after the reform of 1993 (3)			Formed before the reform of 1993	Formed after the reform of 1993 (3)	
Cash and deposits	4,694	3,258	742	8,694	4,788	3,283	840	8,911
Bonds	7,412	10,401	1,579	19,393	7,783	10,853	2,368	21,005
of which:								
government securities (4)	*3,842*	*1,196*	. . . .	. . . .	*4,034*	*1,188*	. . . .	. . . .
Shares	906	1,610	614	3,130	815	1,255	856	2,927
Investment fund units	341	1,719	286	2,346	358	1,240	427	2,025
Loans and other financial assets .	3,728	2,429	7	6,164	4,245	2,512	28	6,785
Real estate	16,856	3,863	–	20,719	12,642	3,742	–	16,384
Total . . .	**33,937**	**23,281**	**3,228**	**60,446**	**30,631**	**22,885**	**4,519**	**58,036**

(1) The composition is partly estimated. – (2) Provisional. – (3) Includes the Bank of Italy and UIC employees' pension funds. – (4) For funds formed before the reform of 1993, the data relate only to intermediaries supervised by the Bank of Italy.

According to statistics published by COVIP, in 2002 the average return on occupational funds and open funds was negative by –3.4 and –13.1 per cent respectively. The greater losses recorded by open funds reflect the higher incidence of equity and balanced sub-funds. At the end of 2002, 32.4 per cent of their total assets consisted of bonds and 25.6 per cent of shares, while investment fund units accounted for 34.4 per cent.

THE SECURITIES MARKET

Share prices in Italy fell sharply again in 2002. As in the other major industrial countries, the large decline in equities reflects their previous overvaluation, as well the gradual deterioration in expectations of world economic recovery and the greater uncertainty connected with international political tensions. The drop in the stock market index was smaller in Italy than elsewhere in the euro area. The earnings/price ratio, in Italy as in the rest of the area, rose to approach the prevailing values of the first half of the 1990s, before the prolonged bull market. The continuing negative performance of shares discouraged new listings and capital increases. The capitalization of the Italian stock exchange fell from 48 to 36 per cent of GDP, after the peak of 70 per cent reached in 2000.

Medium and long-term interest rates on Italian government securities fell substantially, from 5.2 to 4.4 per cent for the ten-year maturity. The ten-year yield continued to come down in early 2003, declining to 4 per cent in mid-May. In real terms, long-term yields in the euro area, derived from French government securities indexed to consumer prices, fell from 3.2 to 2.4 per cent during 2002. The yield differential between Italian government securities and German and French government bonds narrowed. Net issues of Italian government securities diminished slightly from the previous year, in contrast with the large increase registered in the euro area. Banks made further net disposals of government securities, while non-resident investors increased their net purchases.

With a larger number of firms becoming insolvent and the credit-worthiness of issuers worsening, the international bond market suffered a sharp contraction. Placements by banks and firms decreased markedly both in Italy and in the euro area as a whole. During the middle months of the year the risk premiums rose for borrowers with low credit ratings and companies in the automobile and telecommunications sectors, despite the fact that the decline in the yields on government securities had led to a generalized reduction in the cost of financing. The market in credit derivatives continued to expand rapidly.

Government securities

Supply and demand. – In 2002 net issues of Italian government securities decreased by €2.4 billion to €28.7 billion (Table 54), reflecting the smaller overall general government borrowing requirement.

Table 54

BONDS AND GOVERNMENT SECURITIES: ISSUES AND STOCKS IN ITALY (1)

(millions of euros)

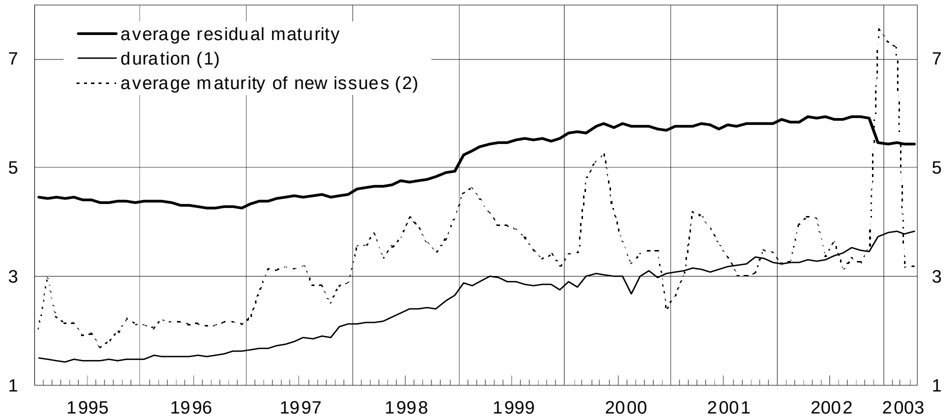
	Gross issues			Net issues			Stocks		
	2001	2002	Q1 2003 (2)	2001	2002	Q1 2003 (2)	December 2001	December 2002	March 2003 (2)
Public sector	**397,447**	**440,599**	**131,887**	**31,173**	**28,725**	**36,624**	**1,151,660**	**1,154,668**	**1,189,631**
BOTs	188,677	208,761	65,798	11,717	−70	18,713	113,810	113,740	132,453
CTZs	35,528	32,556	11,460	−16,476	8,335	2,259	48,577	59,193	61,977
CCTs (3)	28,330	44,535	12,286	−9,812	−12,290	592	225,961	213,218	213,651
BTPs	119,929	133,646	31,846	38,006	42,364	5,763	630,765	670,615	675,516
CTEs	. .	−	−	−1,500	−	−	. .	−	−
Republic of Italy issues	22,529	16,135	9,759	9,049	4,388	9,730	79,809	81,007	89,571
Other	2,454	4,966	738	189	−14,002	−433	52,738	16,895	16,463
Banks	**95,777**	**92,346**	**23,555**	**31,834**	**32,941**	**5,280**	**334,672**	**367,969**	**373,336**
Firms	**58,001**	**44,400**	**9,469**	**51,652**	**34,984**	**4,218**	**136,765**	**171,835**	**176,070**
Total	**551,226**	**577,344**	**164,910**	**114,659**	**96,651**	**46,121**	**1,623,097**	**1,694,472**	**1,739,037**
Memorandum item:									
Buybacks of government securities (4)	**13,244**	**. .**	**. .**	**−**	**−**	**−**	**−**	**−**	**−**
	Percentage composition (5)								
Public sector	**72.1**	**76.3**	**80.0**	**27.2**	**29.7**	**79.4**	**71.0**	**68.1**	**68.4**
BOTs	47.5	47.4	49.9	37.6	−0.2	51.1	9.9	9.9	11.1
CTZs	8.9	7.4	8.7	−52.9	29.0	6.2	4.2	5.1	5.2
CCTs (3)	7.1	10.1	9.3	−31.5	−42.8	1.6	19.6	18.5	18.0
BTPs	30.2	30.3	24.1	121.9	147.5	15.7	54.8	58.1	56.8
CTEs	. .	−	−	−4.8	−	−	. .	−	−
Republic of Italy issues	5.7	3.7	7.4	29.0	15.3	26.6	6.9	7.0	7.5
Other	0.6	1.1	0.6	0.6	−48.7	−1.2	4.6	1.5	1.4
Banks	**17.4**	**16.0**	**14.3**	**27.8**	**34.1**	**11.4**	**20.6**	**21.7**	**21.5**
Firms	**10.5**	**7.7**	**5.7**	**45.0**	**36.2**	**9.1**	**8.4**	**10.1**	**10.1**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
As a percentage of GDP	*45.2*	*45.9*	*13.0*	*9.4*	*7.7*	*3.6*	*133.0*	*134.7*	*137.0*

(1) Rounding may cause discrepancies. The data on net issues of BTPs and other government securities in 2002 differ from those published earlier because buybacks and conversions previously calculated at nominal value are recorded at their actual price. − (2) Provisional. − (3) Comprises only variable-coupon Treasury credit certificates. − (4) Made by means of the sinking fund for the redemption of government securities. − (5) The percentages shown for the various types of government securities are ratios to the total of public-sector securities.

Figure 42

AVERAGE MATURITY OF OUTSTANDING ITALIAN GOVERNMENT SECURITIES AND OF NEW ISSUES

(monthly data; years)



(1) Calculated on securities listed on MTS. – (2) Moving average for the three months ending in the month indicated.

For the first time in three years the Ministry for the Economy and Finance made net issues of CTZs amounting to €8.3 billion, after net redemptions of €16.5 billion in 2001. Net placements of BOTs were practically nil, compared with €11.7 billion in 2001, while net redemptions of CCTs increased from €9.8 billion to €12.3 billion, as did net issues of BTPs, up from €38 billion to €42.4 billion. The share of BTPs rose from 54.8 to 58.1 per cent of total government securities at the end of the year, and that of CTZs rose from 4.2 to 5.1 per cent, while the proportion of CCTs declined further, from 19.6 to 18.5 per cent.

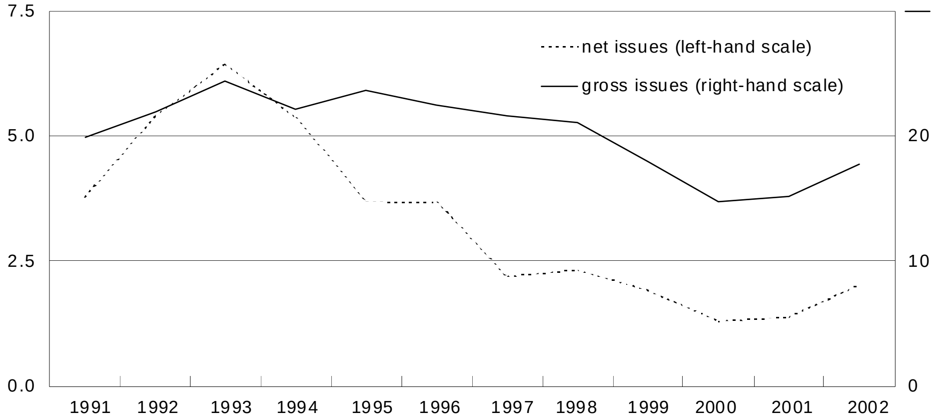
In the euro area net issues of government securities grew substantially from €96.7 billion to €149 billion (from 1.4 to 2 per cent of GDP; Figure 43). The increase was particularly marked in France and Germany, which recorded sharply rising public deficits, partly due in Germany to the absence of the previous year’s extraordinary revenues from the sale of UMTS licences. At the end of 2002 the stock of outstanding government securities issued by euro-area countries amounted to €3,752 billion and 53 per cent of GDP.

Disposals of Italian government securities by domestic banks continued, with €21.9 billion in net sales, while foreign investors made further net purchases worth €24.4 billion. For the first time since 1998 investment funds made net purchases, which amounted to €6.3 billion. The private non-financial sector, mainly consisting of households, disposed of €16.8 billion of BOTs and €5.9 billion of BTPs and purchased CCTs worth €12 billion. At the end of 2002 non-residents held 43.3 per cent of the stock of Italian government securities, compared with 42.1 per cent a year earlier.

Figure 43

GOVERNMENT SECURITIES ISSUES IN THE EURO AREA (1)

(as a percentage of GDP)



Source: ECB.
(1) The data refer exclusively to the issues of government securities denominated in euros or euro-area currencies.

Interest rates. – Interest rates in the euro area declined for all maturities last year, with those on three- and five-year benchmark BTPs falling by about one percentage point to 3.0 and 3.5 per cent respectively and those on ten-year BTPs by 0.8 points to 4.4 per cent (Figure 44). The decline reflected a deterioration in expectations of economic recovery and a switch-over by investors to less risky financial assets in view of the international tensions and turbulent stock markets.

Medium and long-term nominal yields in the euro area rose further in the first quarter of 2002, continuing the trend that had begun in the last two months of 2001 following the successful outcome of military operations in Afghanistan and the improvement in forecasts of world economic growth. From mid-May to the end of September the deterioration in the macroeconomic outlook and the increased variability of equity prices pushed funds into bonds, causing a sharp fall in rates. Towards the end of the year the escalation of the Iraqi crisis continued to drive rates down until military operations began in early March. In mid-May the yield on ten-year benchmark BTPs stood at 4 per cent.

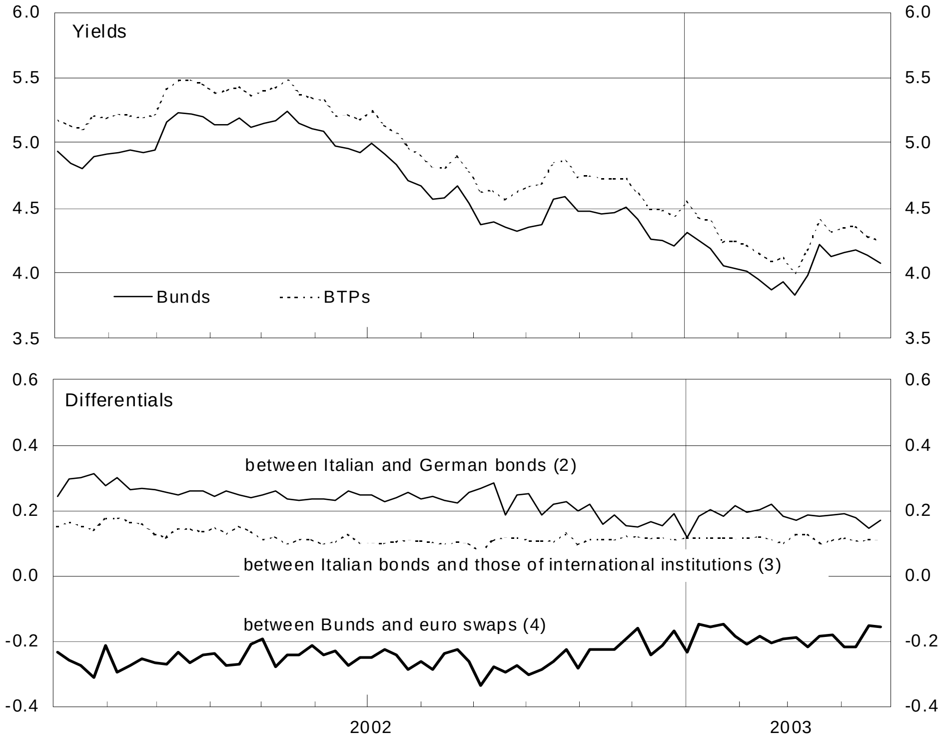
The weakness of the economy was reflected in a flatter euro yield curve. The differential between Italian BTPs and German and French government securities continued to decrease (Figure 44), narrowing especially sharply in the last quarter owing to the substantial deterioration in those two countries' public accounts.

Real long-term rates in the euro area, derived from the prices of French ten-year government bonds indexed to euro-area consumer prices, stood at 2.4 per cent at the end of the year, representing a decline of about 0.8 percentage points.

Figure 44

GROSS YIELDS ON 10-YEAR ITALIAN AND GERMAN SECURITIES AND MAIN INTEREST RATE DIFFERENTIALS

(weekly data; percentages and percentage points)



Source: BIS.
(1) Yields on benchmark ten-year bonds. – (2) Differential between ten-year BTP and the corresponding Bund. – (3) Simple average of yield differentials between Republic of Italy issues and IBRD bonds with similar characteristics. – (4) Differential between ten-year Bunds and ten-year euro swaps.

The volatility implied by the prices of options on ten-year Bund futures diminished in the first four months of the year before increasing sharply in the second half (Figure 45).

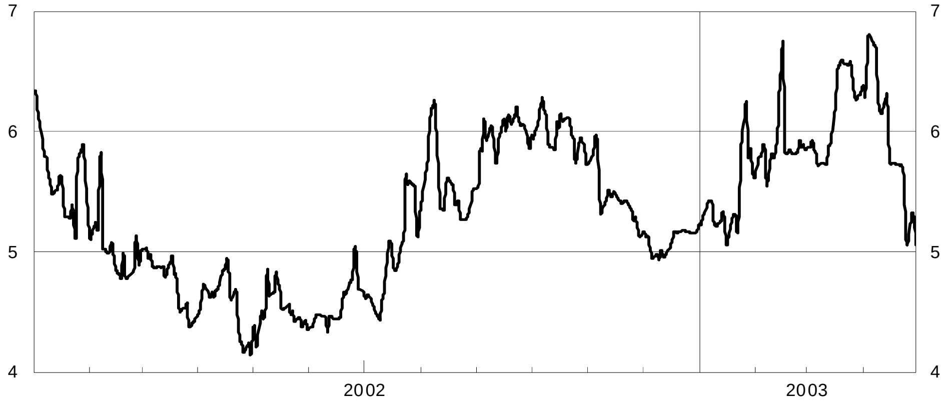
The secondary market. – Average daily turnover on the screen-based market in government securities (MTS) declined by 5.8 per cent to €8.6 billion, while on the MOT segment of the Italian Stock Exchange it rose by 16.5 per cent to €0.5 billion. Repo trading on MTS increased further, with daily turnover rising from €27.9 billion to €42.9 billion. Turnover in euro-area government securities on EuroMTS in London fell from €3.8 billion to €2.9 billion.

Markets in interest-rate derivatives. – Marked uncertainty about the real economic outlook and the consequent fluctuations in security prices fueled trading in interest-rate derivatives. Average daily turnover in ten-year Bund futures rose by 7.4 per cent and that in three-month euro-deposit futures by 17.2 per cent.

Figure 45

EXPECTED VOLATILITY OF 10-YEAR BUNDS (1)

(daily data; percentages on an annual basis)



Source: Bloomberg.
(1) Volatility implied by options on futures quoted on EUREX.

Bank and corporate bonds

Net issues of medium and long-term bonds by Italian banks and firms amounted to €64.5 billion, 40.4 per cent less than in 2001 (Table 55). Net placements by non-financial firms fell from €27 billion to €5.7 billion and those by banks and non-bank financial corporations respectively from €46.1 billion to €32.7 billion and from €35.2 billion to €26.1 billion. The substantial fall-off in net issues by non-financial firms mainly reflected the smaller volume of funds raised on the international market by major private issuers in the telecommunications and automobile sectors. Public sector issues associated with securitizations amounted to some €9.6 billion.

The decline in bond issues affected all the leading economies. In the euro area as a whole, net issues by banks and firms fell by 32 per cent, from €437.9 billion to €298 billion, with a particularly sharp decline in issues by banks and non-financial firms, down by 29 per cent and 70 per cent respectively, and a more modest one in the case of non-bank financial corporations (3 per cent). In the United States, they diminished overall by 27 per cent, from €809.1 billion to €588.9 billion. International market placements by euro-area issuers were 31 per cent less than in the previous year, diminishing from €590.8 billion to €405.9 billion, although the share of international bonds in total outstanding private sector securities continued to grow, from 63 to 68 per cent.

The contraction in bond issues in 2002 broke off the expansion that had been under way since the single currency's launch in 1999. Between that year and 2001 average annual private sector placements in the euro area amounted to €411.2 billion compared with €154.9 billion in the previous three-year period. In the United States they rose from €383.1 billion to €553.3 billion. At the end of 2002 the stock of outstanding bonds in the euro area amounted to 59 per cent of GDP, against 37 per cent in 1995, while in the US the ratio rose from 38 to 60 per cent. The increase was greatest in the non-financial sector, largely owing to the boom in international market placements. Net issues of international bonds by euro-area companies averaged €483.8 billion a year between 1999 and 2001, compared with €142.4 billion in the previous three-year period; in the United States they amounted to €537.5 billion against €165.3 billion.

Table 55

MEDIUM AND LONG-TERM BONDS OF BANKS AND FIRMS IN ITALY AND THE EURO AREA (1)

(at face value; millions of euros)

	Net issues (2)			Stocks			as a % of GDP (3)
	2000	2001	2002	2000	2001	2002	2002
				Italy			
Banks	36,097	46,095	32,669	324,338	370,429	402,262	32
Other financial corporations	16,263	35,189	26,130	29,718	65,102	90,915	7
Non-financial corporations (4)	7,555	27,029	5,718	61,700	88,114	92,988	7
Total	**59,915**	**108,313**	**64,517**	**415,756**	**523,645**	**586,165**	**46**
of which: international market (5)	*49,389*	*75,590*	*35,051*	*138,863*	*212,950*	*248,214*	*20*
Memorandum item: public sector	36,165	21,347	8,821	1,014,996	1,037,474	1,038,457	83
				Euro area			
Banks	239,162	225,621	159,319	2,689,467	2,929,233	3,047,287	43
Other financial corporations	102,865	112,839	109,104	362,162	477,582	566,500	8
Non-financial corporations (4)	92,116	99,472	29,567	421,846	524,907	536,008	8
Total	**434,143**	**437,932**	**297,990**	**3,473,475**	**3,931,722**	**4,149,795**	**59**
of which: international market (5)	*467,171*	*590,836*	*405,902*	*1,869,451*	*2,460,497*	*2,808,001*	*40*
Memorandum item: public sector	123,036	97,532	136,186	3,379,114	3,478,314	3,601,435	51

Sources: For the euro area, based on ECB and BIS data.

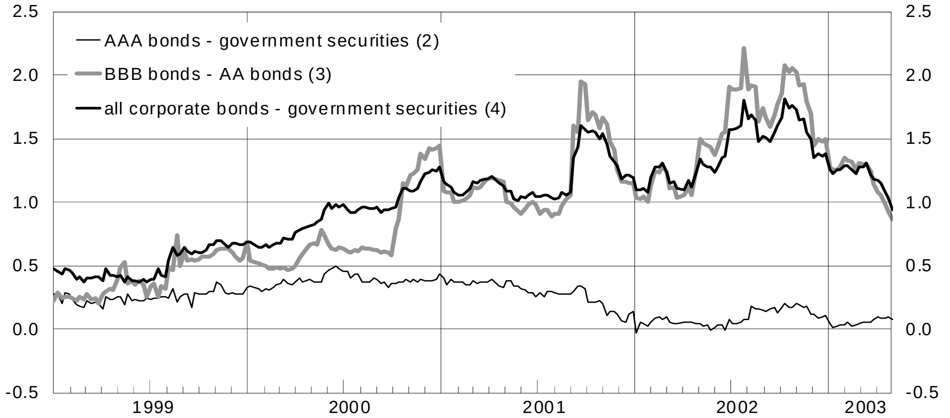
(1) Partly estimated. The nationality and sector are those of the parent company and not of the issuer. The distribution according to sector is affected by differences in the classification systems used by the ECB and the BIS. – (2) Difference between nominal value of placements and redemptions. – (3) Percentages. – (4) For Italy, includes issues by the State Railways. – (5) The international market consists of bond issues sold partly to residents of countries other than that of the issuer.

The yield on euro-denominated bonds of non-financial companies on the international market fell by 0.9 percentage points during 2002 to 4.7 per cent. The decline affected all ratings, with AAA bonds losing 1.2 points and BBB 0.8. During the middle months of the year risk premiums rose sharply for some categories of issuer and were partly responsible for the large reduction in non-financial firms' net issues (Figure 46).

Figure 46

CORPORATE BOND YIELD DIFFERENTIALS (1)

(daily data; percentage points)



Source: Based on Merrill Lynch data.

(1) Yields on fixed-rate euro-denominated Eurobonds with a residual term to maturity of not less than one year issued by non-financial corporations resident in countries whose long-term foreign currency debt bears a rating not lower than Baa3 or BBB-. – (2) Yield differential between AAA-rated bonds and government securities (French and German).– (3) Yield differential between BBB-rated and AA-rated bonds. – (4) Yield differential between all bonds issued by the non-financial sector and government securities (French and German).

The past five years have seen strong growth in the market for credit derivatives. The British Bankers' Association estimates that at the end of 2002 they had reached a notional value of nearly $2 trillion and were increasing fast, although not yet to the level of over-the-counter interest-rate and exchange-rate derivatives, which amounted to $60 trillion and $16 trillion respectively. Most of the trading takes place on the New York and, to a smaller extent, the London and Tokyo markets and is handled by a tight group of international banks; the issuers obtaining coverage now number nearly 2,000. The most common form of credit derivative is the credit default swap, which is similar to an option and entitles the purchaser to receive from the seller the nominal value of a security issued by a given company when it runs into solvency difficulties.

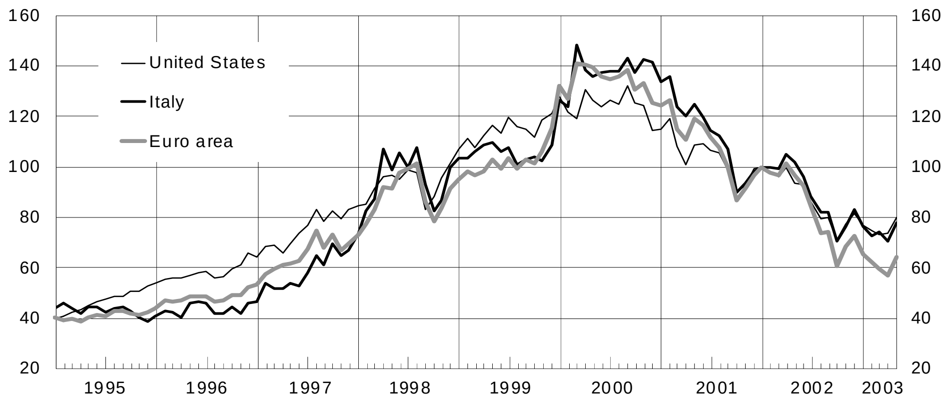
The equity market

Share prices and trading. – In 2002 share prices fell sharply in the euro area. The Dow Jones Euro Stoxx index of the shares of the area's largest companies in terms of market capitalization declined by 35 per cent, after falling by 20 per cent during 2001 (Figure 47). The drop was particularly sharp in Germany and France (43 and 34 per cent respectively). In Italy and Spain it was less pronounced, similar to that in the United Kingdom and United States (about 25 per cent). At the end of April 2003 the stock-market indices were down from the peak values of 2000 by 61 per cent in Germany, 57 per cent in the euro area, 49 per cent in Italy and 40 per cent in the United States. As in the preceding two years, huge losses were recorded in the prices of technology stocks: 63 per cent in the Neuer Markt, 53 per cent in the Nouveau Marché and 50 per cent in the Nuovo Mercato. Firms in traditional sectors also suffered a sharp drop in share prices, particularly in the third quarter of the year.

Figure 47

SHARE PRICES (1)

(end-of-month data; indices, 31 December 2001=100)



Source: Bloomberg.
(1) Indices: MIB for Italy, Dow Jones Euro Stoxx for the euro area, Standard & Poor's 500 for the United States.

The large decline in equities in the euro area was due above all to their previous overvaluation, compounded in 2002 by the gradual deterioration in expectations of economic recovery in the leading industrial countries and the consequent downward revision of corporate earnings forecasts. In a number of countries share prices were also affected by the discovery of accounting irregularities in large corporations, which prompted doubts about the reliability of information made public on listed companies. Other factors were the growing tensions in the Middle East and, to a smaller extent, the persistent tensions in Central Asia. After picking up briefly in October and November, equities began to slip again in December as the imminence of armed conflict in Iraq fueled uncertainty about the duration and repercussions of the international crisis.

The fall in equities during recent years has reached considerable proportions by historical standards. The decline in real terms in the general US stock-market index in 2000-2002 was equal to 44 per cent, not far from the 47 per cent recorded in 1972-1974 with the first oil shock and smaller only than at the start of the Great Depression, when it fell by 61 per cent between 1929 and 1931. In Italy, on the other hand, the general stock-market index decreased in real terms by 46 per cent in 2000-2002; excluding the two world wars, this was very close to the 47 per cent decline registered in 1929-1931 but less than in 1962-1964 (54 per cent) or 1974-1976 (57 per cent).

The volatility implied by the prices of options on share indices became extremely high between June and September 2002, more so than after the 11 September attacks. At the end of April of this year prices in some euro-area indices remained extremely volatile.

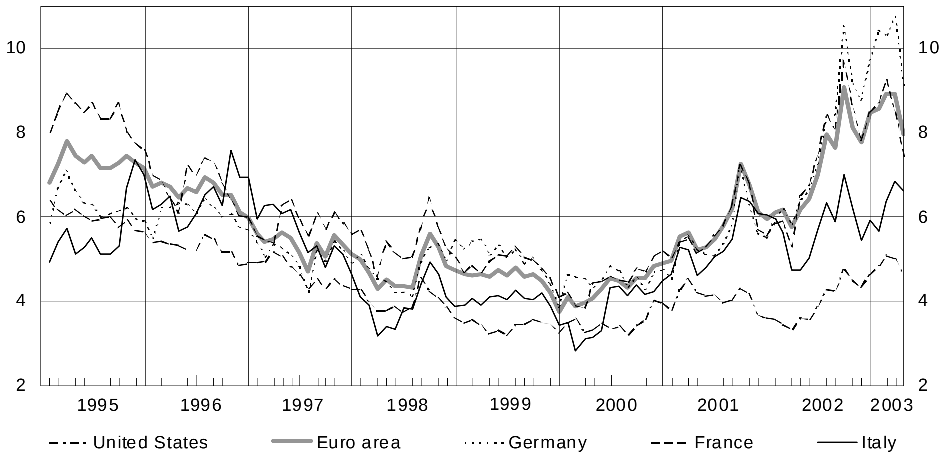
The experience of past years has shown that financial analysts' forecasts for corporate earnings tend to be over-optimistic. Forecasting errors may involve the variability as well as the level of expected earnings, and affect the volatility of prices. Empirical analyses of a sample of listed Italian securities suggest that the phenomenon may be anything but negligible.

The large decline in share prices in the euro area pushed the earnings/price ratio above the average for the first half of the 1990s, when prices had not yet begun their sharp climb (Figure 48).

Figure 48

CURRENT EARNINGS/PRICE RATIOS IN SELECTED INDUSTRIAL COUNTRIES

(end-of-month data; percentages)



Source: Thomson Financial.

The industrial sectors in the euro area where share prices fell most sharply in 2002 were computers, electronics, mass media, pharmaceuticals and telecommunications. More moderate decreases occurred in automobiles and, above all, electricity and oil products. The losses in bank and insurance company shares, which went down by 24 and 46 per cent respectively, were much greater than in the United States, where they fell by 8 and 16 per cent.

The better performance of Italy's stock market in 2002 compared with those of the other main euro-area countries reflects the substantial rise in the value of energy stocks, which declined elsewhere, and the smaller fall in telecommunications and insurance. However, in the automobile and electricity sectors equities fell more than the area averages.

The prices of insurance company equities declined less in Italy than in the other main euro-area countries, 30 per cent compared with 40 per cent in France and 57 per cent in Germany. This can be partly ascribed to the small proportion of shares in the portfolios of Italian companies.

The average daily turnover of equities in the Italian stock market edged down slightly, from €2.5 billion to €2.3 billion. The proportion involving shares on the MIB30 index rose from 82 to 89 per cent.

Supply and demand. – The persistent fall in share prices further dampened new equity issues so that there were only 5 new listings on Italy's main market and none on the Nuovo Mercato, compared with 13 and 4 respectively in 2001. The capital raised by listed and newly-listed companies declined from €6.2 billion to €3.9 billion and from €0.2 billion to €0.1 billion on the Nuovo Mercato (Table 56).

In 2001-2002 the average annual value of share issues in the G10 countries fell by about half compared with 1995-2000 to $200 billion and from 1.8 per cent of the stock-market capitalization to 0.9 per cent. The decline was sharpest in US share issues, which dropped from 59 per cent of total issues in 1995-2000 to 42 per cent. Around 500 companies were listed each year in the G10 countries in 2001-2002, compared with 1,200 in 1995-2000. The decline was largest in the mass media and telecommunications sectors.

At the end of March 2003, 265 companies were listed on the Italian Stock Exchange compared with 276 at the end of 2001. In the same period total market capitalization fell from €587 billion to €410 billion and from 48 to 33 per cent of GDP.

The many cases of mismanagement of listed companies in the industrial countries, illustrated by the collapse of major corporations such as Enron, and the consequent loss of investor confidence prompted a review of corporate governance rules and of the controls designed to avoid such events. At the beginning of 2003 the Italian Stock Exchange introduced new rules to regulate insider dealing, under which companies must make quarterly reports of all purchases and sales of more than €50,000 of their shares by a list of persons, including directors and their relatives. The companies must also give prompt notice of any operations exceeding €250,000 in value. Almost all the companies listed on the MIB30 decided to institute lower thresholds than those fixed by the Stock Exchange and to include stock options granted to senior managers among the operations subject to disclosure requirements.

Table 56

MAIN INDICATORS OF THE ITALIAN STOCK EXCHANGE (1)

(millions of euros unless otherwise indicated)

	1997	1998	1999	2000	2001	2002
Listed Italian companies (number at end of year)	209	219	247	276	276	275
of which: on the Nuovo Mercato	–	–	*6*	*39*	*44*	*44*
Total market capitalization (2)	309,896	481,065	721,128	812,443	587,467	453,513
of which: on the Nuovo Mercato	–	–	*6,981*	*22,166*	*12,489*	*6,438*
as a percentage of GDP	*30.2*	*44.8*	*65.1*	*69.7*	*48.3*	*36.0*
percentage breakdown:						
industry	*31*	*24*	*20*	*21*	*23*	*25*
insurance	*15*	*16*	*11*	*14*	*13*	*11*
banking	*19*	*27*	*23*	*25*	*23*	*22*
finance	*4*	*3*	*3*	*3*	*3*	*3*
services	*31*	*30*	*43*	*37*	*39*	*39*
Total	**100**	**100**	**100**	**100**	**100**	**100**
Gross share issues (3)	4,097	7,070	22,543	9,148	6,171	3,891
of which: on the Nuovo Mercato	–	–	*212*	*4,402*	*222*	*115*
Market capitalization of newly listed companies (4)	6,575	21,772	186,403	30,151	10,579	2,971
of which: foreign companies	*0*	*8,918*	*120,159*	*0*	*0*	*0*
of which: on the Nuovo Mercato	–	–	*1,345*	*22,108*	*458*	*0*
Dividends distributed	6,255	7,024	9,944	16,013	30,549	18,679
Earnings/price ratio (5)	4.6	3.9	3.4	4.5	6.0	5.9
Dividend/price ratio (5)	1.7	1.6	1.5	2.1	2.8	3.8
Turnover (6)						
stock exchange	*175,238*	*424,339*	*503,164*	*844,035*	*619,605*	*572,654*
futures on MIB30 index	*477,725*	*977,751*	*905,841*	*984,392*	*829,416*	*673,860*
options on MIB30 index	*125,099*	*267,247*	*264,181*	*323,166*	*246,555*	*176,636*
Annual change in prices (7)	58.2	41.0	22.3	5.4	–25.1	–23.7
Turnover ratio (8)	69	107	84	110	89	110

(1) Excludes the Mercato Ristretto. – (2) Italian companies; at end of period. – (3) Italian companies. The value of share issues is obtained by multiplying the number of shares issued by the issue price. – (4) Sum of the capitalization values of each company on the placement date. – (5) Source: Thomson Financial. End-of-period data. Percentages. Current earnings and dividends. – (6) Italian companies. – (7) Percentage change in the MIB index during the year. – (8) Italian companies. Turnover as a percentage of average market capitalization for the year.

In April of this year Consob approved some changes to the regulation of the Italian Stock Exchange. Under the new rules for companies seeking listing on the Nuovo Mercato, the minimum requirement for public placements of their shares is raised from 20 to 30 per cent and their minimum net worth from €1.5 million to €3 million. In addition, barring a few exceptions, firms less than three years old must have among their shareholders, since at least one year earlier, institutional investors with a minimum stake of 10 per cent; they are subject to lock-up (i.e. they are not allowed to sell their shares before a fixed period has elapsed). Moreover, companies seeking listing or already listed on the Nuovo Mercato must comply with certain corporate governance requirements relating to the composition of their board of directors, internal control committee and remuneration committee. The minimum capitalization required for companies to be listed on the main market was raised from €5 million to €20 million. Companies in the Star segment must comply with the new provisions of the Code of Conduct for companies listed on the Italian Stock Exchange, particularly as regards the operation of their internal controls committee.

Following an IPO the Italian Stock Exchange added 94 per cent of the capital of Montetitoli, the Italian company running the central securities system, to its existing 4.1 per cent.

The derivatives market. – In 2002 the average number of contracts traded daily on the Italian derivatives market rose by 1 per cent.

SUPERVISION OF BANKS AND OTHER INTERMEDIARIES

This section of the Report fulfils the Bank of Italy's obligation to publish an annual report on its supervision of banks and other intermediaries pursuant to Article 4 of Legislative Decree 385 of 1 September 1993; in particular, it sets out the criteria and methods followed in the Bank's supervisory activities and describes the actions taken in 2002.

In 2002 the slowdown in economic activity, the weakness of equity markets, the financial crises of some countries and important companies led regulatory authorities to intensify their examination in international fora of signs of fragility and to check on the resilience of financial systems. The Basel Committee continued its work on the revision of the Capital Accord. In Europe changes were made to the bodies and procedures involved in financial legislation with the aim of speeding up the process.

The Financial Stability Forum focused its work on measures to counter the causes of vulnerability in the functioning of markets. The competent authorities were encouraged to pursue the activity aimed at strengthening the rules on corporate governance, accounting and the disclosure of information to the market. The Forum also called for action to improve the transparency and control of the techniques for transferring credit risk.

In April 2003 the Basel Committee published the third consultation document for the new Accord on banks' capital; the new version is scheduled to come into force in 2006. The main changes compared with the earlier documents concern the reduction in the capital requirements for exposures to small and medium-sized enterprises, the introduction of measures to reduce the potential pro-cyclical effects of the new rules, and the simplification of the overall regulatory framework. The results of the quantitative impact study on the proposed new Accord have been released by the Committee and are basically consistent with the objective of obtaining, on average, levels of minimum capital similar to the present ones and providing incentives for banks to move progressively towards more accurate methods of measuring risk.

Within the European Union, in December 2002 the Ecofin Council approved the reform of regulation, supervision and financial stability that extends the Community structures and legislative procedures proposed by the Lamfalussy Report in 2001 to the banking and insurance industries. Already applied in the securities industry, the reform is intended to speed up the approval of Community legislation and ensure its uniform transposition into national legal systems. Further progress was also made in the implementation of the Commission's Action Plan, launched in 1999 to achieve the internal market for financial services in an organic manner; to date 34 of the 42 measures originally proposed have been approved.

In parallel with the Basel Committee, the European Commission is working on rules for the capital requirements applicable to banks and investment firms. It is intended that a proposal for a directive taking account of the special features of European intermediaries be published early in 2004.

As regards Italian legislation, in January 2003 Parliament approved a reform of company law intended to simplify the existing provisions, increase companies' freedom in drawing up their bylaws, enhance the entrepreneurial nature of firms and broaden the range of fund-raising mechanisms. In view of its general scope, the reform will also apply to banks and other intermediaries subject to supervision, except for mutual banks subject to special laws ("cooperative a mutualità prevalente").

In March 2003 the Interministerial Committee for Credit and Savings approved the Bank of Italy's proposal for an overhaul of the rules on the transparency of contractual terms and conditions, aimed at increasing the effectiveness of the protection of users of banking and financial services. The new rules cover the various aspects of savers' relations with intermediaries, such as the preliminary disclosure of conditions, the conclusion of contracts, and periodic and closing information.

In the asset management field provisions have been adopted to increase the operational flexibility of investment funds and strengthen intermediaries' organizational defences with respect to the risks they take on by supplying clients with products offering a guaranteed minimum rate of return and/or the repayment of the capital invested.

The reorganization of the financial system has proceeded at a particularly rapid pace in the banking industry. Some large groups were involved in consolidations, frequently accompanied by plans for the restructuring of the companies belonging to the group. The largest cooperative banks also engaged in merger activity. The expansion in the countries of Central and Eastern Europe with good growth prospects continued, while banks took steps to rationalize their presence in the leading financial centres.

As regards the asset management industry, last year saw an increase in the number of companies in operation, mainly as a result of the entry of some specialized in closed-end funds and others in hedge funds. Within the various groups there was a further concentration of the activity of asset management; the supply of investment funds was broadened and diversified in relation to the various types of clients.

In 2002 the banking system coped with the effects of the adverse cyclical conditions and the negative performance of the financial markets from a stronger position than in the past, thanks to the gains in efficiency and profitability achieved in the last few years.

Bank loans continued to outpace GDP, although the growth slowed compared with that of the three previous years. The quality of credit deteriorated, but only to a limited extent owing to the improvement in firms' financial positions and the refinement of the criteria used by banks in selecting borrowers.

Banks' exposures to the telecommunications industry declined; the growth in lending to the sectors most affected by international tensions slowed sharply. The total value of large exposures fell by 6 per cent; the exposure of Italian banks to countries at risk is one of the lowest by international standards.

The rate of return on bank capital fell from 9.1 to 6.4 per cent, which was nonetheless higher than the average of the 1990s. The capital adequacy ratio of the banking system as a whole rose from 10.4 to 11.2 per cent. For the leading groups the return on equity fell from 12.5 to 6 per cent; the solvency ratio rose by more than one percentage point to 10.6 per cent, partly as a consequence of supervisory action.

The weakness of the financial markets was reflected in the profitability of asset management companies and investment firms. The former saw net profits fall by 35 per cent, while overall the latter recorded a loss of €42 million, compared with a profit of €110 million in 2001.

The return on equity of financial companies rose, primarily owing to the reduction in their fund-raising costs and the growth in revenues from the supply of services complementary to financing.

The stability of the banking system is confirmed by off-site analysis, which shows relatively limited shifts in intermediaries' technical situations. The inspections carried out by the supervisory authority show that the cases of fragility are restricted exclusively to small banks; in 1999-2002 unfavourable assessments concerned intermediaries with 5 per cent of the banking system's total assets, compared with 8 per cent in the previous four-year period.

Banking supervision in 2002 focused primarily on building up the capital strength of the main banking groups, controlling the concentration of credit risks by sector of economic activity and individual borrower, and checking the comprehensiveness and effectiveness of banks' risk management and control systems.

As regards credit risks, the collection of data on banks' exposure to the telecommunications industry has been put on a systematic basis; the leading banking groups have been asked to submit periodic reports on the finance provided to their fifteen top counterparties; and the economic and prudential impact of the use of credit derivatives and securitizations has been analyzed. As regards financial risks, last year saw further activity aimed at the analysis and recognition of the internal models used by the leading intermediaries.

The fall in the profitability of asset management companies and investment firms was reflected in the deterioration in the related evaluations; in 2002, out of a total of 54 intermediaries deemed to be in an anomalous situation, 45 were investment firms accounting for 11 per cent of the sector's total revenues.

The supervision of investment firms and asset management companies focused on their ability to guarantee the regularity of their operations and remain profitable in periods of market turbulence, and on the need for some intermediaries belonging to groups that have been restructured in recent years to bring their organizational arrangements into line with the increased volume of assets under management. Some investment firms were told to draw up plans to strengthen their capital bases and to eliminate the organizational weaknesses found.

Financial companies were invited to improve their internal control systems and the management of risks connected with the quality and concentration of their loan portfolios.

THE REGULATORY FRAMEWORK

International cooperation and Community legislation

International cooperation. – Against a background of weak economic growth, uncertainty about developments in the financial markets and, more in general, serious international crises, international cooperation fora devoted particular attention to the effects of these factors on the stability of financial systems. Analyses of market trends were accompanied by studies in the field of regulation and cooperation aimed at improving the soundness of the systems.

Community legislation. – Implementation of the Financial Services Action Plan, launched by the Commission in 1999 for the systematic completion of the internal market for financial services, is progressing. Of the 42 measures originally contemplated, 34 have been approved. The Lisbon European Council of 2000 set the end of 2005 as the deadline for completing the Plan.

Directive 2002/87/EC on the supervision of financial conglomerates was approved. Its aim is to strengthen the overall effectiveness of the controls on the different financial undertakings within a conglomerate, which are already subject to sectoral supervision. The directive specifies the quantitative criteria serving to identify the conglomerate, the prudential rules for capital adequacy, risk concentration and intra-group transactions, and the procedures for coordination among the authorities that supervise the different components of the conglomerate.

The Commission drafted a proposal for the revision of Directive 93/22/EEC on investment services in the securities field. The proposal aims to establish uniform rules regarding markets and trading systems and to include new services and a greater number of financial instruments within the scope of the directive.

The reform of financial regulation, supervision and stability in Europe

Following the mandate received from the Ecofin Council in May 2002, the Economic and Financial Committee drew up a report proposing changes in the field of financial regulation, supervision and stability in the European Union, which the Ecofin Council subsequently approved on 3 December 2002.

The reform extends to the banking and insurance industries the decision-making structures and legislative procedures proposed by the Lamfalussy Report in 2001 and already applied in the securities sector. The approach comprises four different levels.

The first level concerns the drafting of primary legislation. As provided for by the EC Treaty, the Commission drafts the proposals for regulations and directives, whose scope is limited to laying down general principles.

The second level is entrusted with the preparation of secondary legislation. In this regard, more extensive use will be made of the comitology procedure based on Article 202 of the EC Treaty. According to this procedure, the Commission will draft secondary legislation with the assistance of committees of representatives of economic and finance ministries for, respectively, the banking, securities and insurance sectors. Another committee will handle the second-level activity for the implementation of the legislative measures regarding financial conglomerates contemplated by Directive 2002/87/EC.

At the third level, technical committees are to provide the Commission with advice in drafting the legislative and regulatory proposals regarding financial services. They will also serve to ensure coordination of national authorities' transposition of Community legislation into national law and of the performance of supervision.

Finally, the fourth level is devoted to checking the implementation of Community legislation. The powers of the Commission are strengthened, and it will monitor compliance with legislation on the part of member states and bring legal actions against those found to be non-compliant.

Provision has been made for the Economic and Financial Committee to contribute to the Ecofin Council's work on the analysis of financial stability by organizing ad hoc working sessions.

The reform of the capital adequacy rules

The third consultation document. – The Basel Committee released the third consultation document for the new Capital Accord at the end of April 2003. The principal changes compared with the earlier versions concern the reduction in the capital requirements for loans to small and medium-sized companies and for small loans, and the introduction of further measures to curb the potential pro-cyclical effects of the new rules. In addition, the overall structure of the Agreement has been considerably simplified.

Partly on the basis of the studies carried out by the Bank of Italy, loans to companies with up to €50 million of annual sales are subject to a lower requirement than those to larger companies, credit risk being equal. Reduced requirements are applied to corporate loans of less than €1 million.

The Committee has decided to ask banks to carry out stress tests on their levels of capital adequacy. The exercise will allow the supervisory authorities to check that intermediaries have sufficient capital buffers to absorb the effects of the business cycle, thereby avoiding credit supply restrictions.

Italian legislation

The reform of company law. – The reform of company law (Legislative Decree 6 of 17 January 2003, implementing Enabling Law 366 of 3 October 2001) marks an important step in the broader process of the revision of economic law.

The reform is general in scope and also applies to entities – such as banks, financial and securities intermediaries, and companies that operate regulated markets – governed by sectoral regulations. Mutual banks do not fall within its scope.

The fundamental options are in line with the evolution of company law in other industrial countries and with its projected development at EU level.

The rules for companies limited by shares are diversified according to the degree of their recourse to the equity capital market. In corporations that are not listed and whose shares are not widely held (so-called closed corporations), the rights of participation and withdrawal, control systems and transparency rules are calibrated to the situation of firms with a small number of shareholders and characterized, inter alia, by the absence of an active market for their shares. For so-called open companies, the rules are basically similar to those laid down for listed companies by the Consolidated Law on Financial Intermediation.

With regard to corporate governance, the role and the value of the management function are enhanced. To this end, there are stricter rules governing conflicts of interest, better definition of the tasks assigned to the board of directors and managing directors, and the choice – left to each company's bylaws – among three different models of management and control: the traditional Italian model, with a board of directors (or sole director) and a board of auditors; the one-tier system based on the Anglo-Saxon model, where an internal control committee is set up within the board of directors; and the two-tier system of German origin, where the company is run by a management board appointed by a supervisory board, which also supervises operations and approves the annual accounts.

The provisions governing the control bodies and the new rules on quorum in shareholders' meetings and on participatory rights attributed to shareholders are intended to strengthen the mechanisms for the control on management's activity.

The reform increases the options available to firms to raise capital, allowing them to issue financial instruments already widespread in the international markets. It permits a greater diversification of the rights attaching to shares and provides for new participation securities endowed with ownership and administrative rights established by company bylaws. The rules on dedicated assets enable firms to set up separate pools of assets or revenues and link creditors' claims to them. The scope for raising debt capital directly is broadened: listed companies may issue, without limit, bonds traded in regulated markets; for unlisted companies the reform extends the ordinary limit to two times capital and reserves and allows the issue to be unlimited if the securities are reserved to professional investors subject to prudential supervision, who in certain circumstances are liable for the solvency of the company if the securities are subsequently put into circulation.

Other measures implementing Law 366/2001 were Legislative Decree 61 of 11 April 2002, on penal and administrative offences regarding commercial companies and Legislative Decree 5 of 17 January 2003, which introduces procedural rules aimed at ensuring the rapid settlement of business disputes.

Implementation of Directives 2001/24/EC, 2002/47/EC, 2001/107/EC and 2001/108/EC. – Law 14 of 3 February 2003 (the Community Legislation Implementation Law for 2002) delegates authority to the Government to adopt legislative decrees implementing the Community directives on the reorganization and winding-up of credit institutions (Directive 2001/24/EC), financial collateral arrangements (Directive 2002/47/EC), and investment funds and open-end investment companies (Directives 2001/107/EC and 2001/108/EC).

The directive on the reorganization and winding-up of credit institutions, which will enter into force on 5 May 2004, regulates the crises of banks with branches in more than one member state. For its implementation, the Government is authorized to coordinate the provisions on crisis procedures of the 1993 Banking Law and the 1998 Consolidated Law on Financial Intermediation with those on the administrative liability of legal persons (Legislative Decree 231 of 8 June 2001).

The directive on financial collateral arrangements aims at ensuring a simple and effective regime for the provision and the certain and rapid realization of financial collateral.

Collective investment undertakings. – Following the implementation of the directives on investment funds and open-end investment companies, management companies will be allowed to operate subject to mutual recognition and the category of funds that may be freely marketed within the Union will be expanded to include many currently considered non-harmonized.

Secondary legislation

Transparency of contractual conditions. – On 4 March 2003 the Credit Committee, acting on a proposal from the Bank of Italy, adopted a resolution concerning transparency of contractual conditions that thoroughly revises the provisions governing the matter, introducing rules that reflect the objectives of protecting the users of banking and financial services and promoting competition. By strengthening the instruments of transparency, the new rules are consistent with the approach constantly followed by the Bank of Italy for the protection of bank customers.

The resolution lays down the basic principles and rules of the new provisions with regard to the different moments of the customer's relationship with the intermediary: prior disclosure of the conditions of contract, the conclusion of contracts, periodic statements and the final statement of the account. In view of the new channels of distribution for banking and financial products, specific provisions govern compliance with transparency requirements in the case of door-to-door selling and where distance communication techniques are used. The Bank of Italy is entrusted with issuing the implementing regulations.

Outsourcing. – Supervisory instructions were issued in July 2002 specifying the guidelines under which banks may outsource certain activities traditionally performed at branches to other banks of the group or to companies specialized in the use of distance communication techniques acting in the name and on behalf of the bank engaging them. Outsourcing is permitted provided the arrangements ensure compliance with the provisions concerning the performance of the individual transactions and adopt specific safeguards to preserve conditions of sound and prudent management.

Securitizations. – Rules were issued in February 2003 governing the treatment for capital adequacy purposes of asset securitizations with clauses that permit the operation to be terminated in advance via the redemption of the securities by the special-purpose vehicle and the repurchase of the assets by the originator upon the occurrence of certain conditions. In view of the fact that such clauses expose the originator to risks equivalent to those existing before the securitization, the rules establish a capital requirement equal to that applied to the securitized portfolio.

Guaranteed portfolio management. – Measures regulating guaranteed individual and collective investment portfolios – products requiring the manager to redeem the capital invested and/or pay a minimum return – were issued in January 2003. In particular, rules were adopted to strengthen intermediaries' organizational safeguards with respect to the risks taken on in supplying these products to customers.

Electronic money institutions. – On 4 March 2003 the Credit Committee, acting on a proposal from the Bank of Italy, adopted a resolution on electronic money institutions implementing Title V-bis of the 1993 Banking Law. The resolution, fashioned after the similar rules in force for banks, concerns shareholdings in electronic money institutions, supervisory regulation, and controls on the Italian branches of institutions authorized in other EU countries. The Bank of Italy will issue the related implementing provisions.

Capital adequacy of investment firms. – A measure issued in June 2002 made it possible for Italian investment firms to calculate their capital requirements against market risks using an internal model as an alternative to or in combination with the standardized method. Permission is subject to validation of the internal model by the Bank of Italy. The measure indicates the requisite features of the risk-measurement model, the method for calculating capital adequacy, and the conditions and procedures for validating the model.

Asset management companies and Italian collective investment undertakings. – Decree 47 of 31 January 2003, issued by the Minister for the Economy and Finance to implement Law 410 of 23 November 2001, amended the regulations governing real-estate investment funds. The decree also contains provisions regarding closed-end funds investing in securities and/or real estate, which are granted permission to raise funds through multiple issues of shares and to redeem shares early, and hedge funds, for which the minimum subscription is reduced from €1 million to €500,000 and the maximum number of participants increased from 100 to 200.

Financial intermediaries. – Rules were issued in October 2002 for the administrative and accounting organization and internal control systems of intermediaries entered in the special register under Article 107 of the 1993 Banking Law. The measure establishes a regulatory framework which, on the basis of the principles of good organization applying to all entities supervised by the Bank of Italy, gives intermediaries scope for flexibility in order to adjust their structure to their actual operations.

THE STRUCTURE OF THE FINANCIAL SYSTEM

At the end of 2002 Italy had 814 banks and 616 other supervised intermediaries (asset management companies, investment firms and financial companies; Table 57). These two categories of institutions administered assets, including those in custody or under management, worth respectively €1.65 trillion and e470 billion and provided financing of €1.3 trillion and €390 billion. Banks and other supervised intermediaries had respectively 343,900 and 21,600 employees.

Table 57

THE STRUCTURE OF THE ITALIAN FINANCIAL SYSTEM

	31 December 2001			31 December 2002		
	Interme-diaries	No. of branches		Interme-diaries	No. of branches	
		Italy	Abroad		Italy	Abroad
Banks	**830**	**29,270**	**91**	**814**	**29,926**	**88**
of which: limited company banks (1)	*252*	*21,081*	*81*	*253*	*22,924*	*81*
cooperative banks (banche popolari)	*44*	*5,036*	*10*	*40*	*3,704*	*7*
mutual banks (banche di credito cooperativo)	*474*	*3,044*	–	*461*	*3,192*	–
branches of foreign banks	*60*	*109*	–	*60*	*106*	–
Investment firms	**162**	–	–	**158**	–	–
Asset management companies and SICAVs	**132**	–	–	**142**	–	–
Financial companies entered in the register referred to in Art. 106 of the Banking Law	**1,376**	–	–	**1,459**	–	–
of which: entered in the special register referred to in Art. 107	*263*	–	–	*316*	–	–

(1) Includes central credit and refinancing institutions.

The number of banks decreased by 16 during the year. The number of asset management companies and other supervised intermediaries increased. The number of investment firms declined from 162 to 158.

There were 78 banking groups, encompassing 231 Italian banks, 98 asset management companies and investment firms and 226 Italian financial companies. They also included 87 foreign banks and 247 other foreign intermediaries. The groups' instrumental companies numbered 171, including 39 foreign companies.

Banks and banking groups

Consolidation and privatization. – The Italian banking system has undergone intensive restructuring in recent years, on a larger scale than in other EU countries.

The process of consolidation, after slackening in 2001, regained momentum last year with a number of major operations. Some mergers (such as those between Sanpaolo IMI and Cardine and between Banca di Roma and Bipop-Carire) served the aim of leading groups to create a nationwide distribution network and be able to offer a full range of products. These operations were accompanied by extensive rationalization to achieve more functional group configurations consistent with growth objectives.

Mergers have also been initiated among the larger cooperative banks. The merger between Banca Popolare di Novara and Banca Popolare di Verona was completed last year, and the merger of the Comindustria and Banca Popolare di Bergamo groups is now under way.

There were a total of 29 mergers and acquisitions, involving institutions holding 5 per cent of total system assets. The number of groups and solo banks fell from 680 to 661. Nevertheless, the market share of the top five groups increased only slightly, to 55 per cent of total assets. There were 16 intragroup mergers last year, involving 8.3 per cent of total assets. The number of banks in which a majority interest is held by a foundation fell from 27 to 25; they hold 10 per cent of total assets.

Access to the domestic market and presence abroad. – Twenty-three banks began operations in 2002 (34 in 2001); 7 were converted investment firms or financial companies and 4 were branches of foreign banks. Most of the new banks mainly provide investment services and personalized management of large investment portfolios.

At the end of the year 23 Italian groups were present abroad, down from 26 twelve months earlier owing to mergers. The number of branches abroad declined from 91 to 88 while the number of subsidiaries rose from 82 to 87. Subsidiaries and branches located in non-EU countries numbered 54 and 47 respectively. Foreign units' share of total consolidated assets fell from 16.5 to 12 per cent, owing in part to the appreciation of the euro in the course of the year against the other major currencies.

Strategies of foreign expansion have been modified in recent years. The foreign network has been progressively rationalized with the closing of some non-strategic branches, while expansion has continued in Central and Eastern Europe (especially Croatia and the non-Baltic EU accession countries), where banks controlled by Italian groups hold about 13 per cent of total assets. In Croatia, Bulgaria, Poland and Hungary the largest share of foreign-held assets is that of Italian banks. The presence in the Central and Eastern European markets brings a modest share of the groups' total business; on average, units in those countries account for 6 per cent of consolidated assets.

Foreign banks in Italy numbered 60, with 106 branches (3 fewer than at the end of 2001). There were 15 Italian subsidiaries of foreign banking groups, 10 of which belonged to EU groups.

Distribution. –The number of branches increased by 656 to 29,926. The proportion with 5 or fewer employees rose from 52.6 to 54 per cent. The number of financial salesmen used by banks rose by 35 per cent to over 37,000. The proportion of those who were employees fell from 23.2 to 14 per cent. Financial salesmen working for investment firms belonging to banking groups numbered 4,164.

Relations between banks and insurance companies. – At the end of 2002 Italian banks held equity investments in 74 Italian insurance companies and 34 insurance brokers, while insurance groups had holdings in 32 Italian banks, including controlling interests in 7 small banks.

Life insurance business continued to expand last year. A survey conducted by the Bank of Italy found that premiums on new life insurance policies collected by banks increased by about 27 per cent to a total of €33.3 billion, equivalent to a market share of 80 per cent.

Asset management companies

At the end of 2002 there were 139 registered asset management companies and 3 SICAVs; 22 new management companies were registered during the year and 12 cancelled; the SICAVs were unchanged (Table 58). In examining applications, the authorities mainly considered adequacy of resources and the investment needed to move into a market that is already heavily served and has been contracting for years.

Ownership is becoming more diversified. Since 1998 the number of registered asset management companies not controlled by banks has risen from 20 to 54; however, their share of investment fund assets remains limited (8.4 per cent, compared with 7 per cent in 1998).

The assets under management by the companies, including those entrusted to them by other intermediaries, amounted to €582 billion at the end of 2002, divided between investment funds (€379 billion) and individual portfolio management services (€203 billion). Open pension funds' assets are still very modest at €450 million.

Table 58

ASSET MANAGEMENT COMPANIES AND SICAVS

	31 December 2001		31 December 2002	
	Total	*of which: bank-controlled* (1)	Total	*of which: bank-controlled* (1)
Asset management companies (2)	**132**	**86**	**142**	**88**
of which, instituting and managing:				
harmonized open-end funds	*60*	*36*	*45*	*22*
harmonized and non-harmonized open-end funds	*21*	*16*	*28*	*22*
closed-end securities funds	*18*	*13*	*22*	*14*
closed-end real-estate funds	*7*	*5*	*8*	*6*
open-end and closed-end funds	*10*	*7*	*13*	*9*
hedge funds	*16*	*9*	*26*	*15*
Memorandum items:				
Companies with individual portfolio management services	*65*	*48*	*63*	*43*
Companies managing funds instituted by others	*16*	*10*	*15*	*10*
Companies instituting open pension funds	*19*	*15*	*15*	*12*
Foreign SICAVs and management companies (3)	**219**		**250**	
of which: SICAVs	*152*		*175*	

(1) Companies in which banks hold more than 50 per cent of the equity. – (2) The data include Italian SICAVs. – (3) Companies that market units to the general public in Italy pursuant to Legislative Decree 58/1998, Article 42.

Italian collective investment undertakings. – The number of Italian collective investment undertakings rose again last year to more than 1,500 (Table 59), owing to increases in the numbers of non-harmonized open-end funds, closed-end funds and hedge funds.

Open-end funds different from hedge funds held assets of €372.2 billion at the end of the year, a decrease of 10 per cent. The decline was due to net redemptions of €12.6 billion (€18.9 billion in 2001) and losses of €30.1 billion during the year.

There were 39 closed-end funds operational at the end of 2002 with assets of nearly €4.5 billion (€3.3 billion accounted for by real-estate funds), representing an increase of 28.5 per cent over the year.

Table 59

COLLECTIVE INVESTMENT UNDERTAKINGS

	31 December 2001	31 December 2002
Italian collective investment undertakings: total (1)	**1,485**	**1,543**
of which:		
Harmonized open-end funds and Sicavs	**1,234**	**1,201**
of which: equity	*624*	*609*
mixed	*88*	*86*
bond and money market	*499*	*479*
global	*23*	*27*
Non-harmonized open-end investment funds	**183**	**218**
of which: non-reserved funds of funds	*152*	*179*
funds of funds reserved to qualified investors	*8*	*8*
other non-reserved funds	*1*	*1*
other reserved funds	*22*	*30*
Closed-end investment funds	**47**	**61**
of which: non-reserved securities funds	*18*	*15*
securities funds reserved to qualified investors	*11*	*26*
non-reserved real-estate funds	*17*	*16*
real-estate funds reserved to qualified investors	*1*	*4*
Hedge funds	**21**	**63**
of which: funds of funds	*21*	*53*
Foreign funds and sub-funds marketed in Italy	**2,613**	**3,051**
of which: equity	*1,527*	*1,847*
mixed	*196*	*203*
bond and money market	*840*	*938*
global	*50*	*63*

(1) Sectors are considered individually.

Harmonized foreign collective investment undertakings. – The great majority of foreign funds are based in Luxembourg, a smaller number in Ireland. The assets held in Italy by these undertakings amounted to €122.7 billion at the end of the year. As a group the harmonized Italian and foreign undertakings managed by Italian intermediaries recorded net redemptions of €8.2 billion, compared with €2.3 billion in 2001.

Investment firms

The number of registered investment firms declined again, from 162 to 158 (Table 60). The difficulties of the securities industry have forced marginal firms out of the market. The main groups have continued rationalization to achieve more functional production, to focus their strategy and to cut costs. A total of 93 EU investment firms communicated their intention to provide services in Italy under Directive 93/22/EEC, including 8 that intended to establish a branch.

Table 60

ITALIAN INVESTMENT FIRMS

	31 December 2001	31 December 2002
Italian securities firms	**162**	**158**
of which: bank-controlled (1)	*66*	*64*
Memorandum items: authorizations issued for:		
Trading for own account	51	45
Trading for account of third parties	61	60
Underwriting	34	32
Placement without guarantee	109	112
Individual portfolio management	85	80
Reception of orders and mediation	92	89

(1) Companies in which banks hold more than 50 per cent of the equity.

Financial companies

At the end of the year the special register established by Article 107 of the 1993 Banking Law listed 316 financial companies, up from 263 (Table 61). Special purpose vehicles, which are entered in a special section of the register, numbered 133. Excluding the special purpose vehicles, the register diminished by 13 companies. The reduction was limited for factoring companies (from 40 to 37) and for consumer credit companies (from 18 to 16). It was more pronounced in the leasing sector, where sharpening competition spurred rationalization of strategies, firm size and business. At the end of the year there were 60 leasing companies, compared with 70 a year earlier and 74 in 2000.

Table 61

SPECIAL REGISTER OF FINANCIAL COMPANIES

	Number of companies				
	31 December 2001		Registra-tions	31 December 2002	
		of wich: bank controlled			*of wich:* bank controlled
Principal activity (1)					
Financing	156	88	10	142	75
of wich: *Leasing*	*70*	*52*	–	*60*	*43*
Factoring	*40*	*22*	*1*	*37*	*19*
Consumer credit	*18*	*11*	*2*	*16*	*9*
Other	*28*	*3*	*7*	*29*	*4*
Equity investment	18	11	2	18	11
Credit cards	12	3	2	12	3
Foreign exchange intermediation	3	–	–	3	–
Securitization under Law 130/99	74	18	67	141	31
of which: *Servicers*	*7*	–	*1*	*8*	*1*
Special purpose vehicles 130/99	*67*	*18*	*66*	*133*	*30*
Total	**263**	**121**	**81**	**316**	**120**

(1) The principal activity is determined by statistical reports and inquiries conducted during the year; companies may thus shift from one category to another.

RISKS, PROFITABILITY AND CAPITAL ADEQUACY OF INTERMEDIARIES

Banks

Last year banks in the main countries had to cope with the protraction of a period of slow economic growth, the negative performance of the financial markets, crisis in some countries of Latin America and the failure of some major international corporations.

The gains in efficiency and profitability achieved through re-organization in the last few years enabled the Italian banking system to face the adverse cyclical conditions from a stronger position than in the past.

Lending growth remained faster than that of GDP, although it was slower than in the previous three years, as the corporate merger and acquisition activity that had fueled the demand for credit from major industrial groups dwindled.

Loan quality deteriorated only very slightly, less than in comparable cyclical phases in the past. The improved financial condition of firms and stricter credit standards adopted by banks contributed to this result.

Banks' exposure to financial risks and to high-risk countries diminished. Italian banks' exposure to the latter was very low by international standards. Return on equity declined but remained better than the average for the last decade. Capital adequacy ratios improved, partly in response to the indications of the authorities but partly also thanks to banks' greater care in managing capital resources.

Lending. – Total bank lending, at current exchange rates and net of bad debts, increased by 5.8 per cent, two percentage points less than in 2001 (Table 62). Performing loans worth €12.5 billion were securitized, equal to 1.3 per cent of the stock outstanding at the start of the year, compared with 1.4 per cent in 2001.

Table 62

BANKS: LENDING AND RISK INDICATORS (1)

(end-of-period data; millions of euros and percentages)

	Loans outstanding (1)			Bad debts as a percentage of total loans	Adjusted new bad loans (3)	Amount of securitizations (4)	
	Performing loans	*of which:* doubtful	Bad debts (2)			Performing loans	Bad debts
1999	754,033	19,382	60,243	7.4	1.4	1,909	7,878
2000	861,205	19,185	51,940	5.7	1.0	6,751	8,390
2001	928,422	19,574	45,437	4.7	0.9	12,013	7,644
2002	982,419	20,465	46,309	4.5	1.0	12,461	2,420

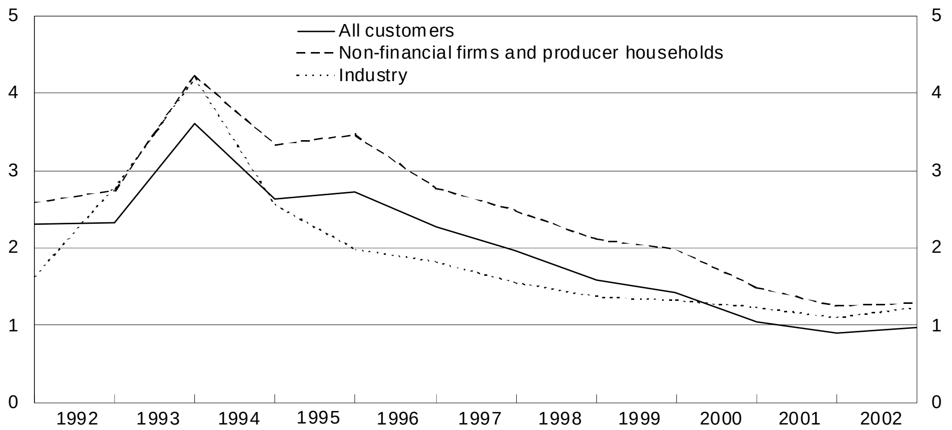
(1) Lending to resident customers of banks operating in Italy and Italian banks' branches abroad. – (2) Includes unpaid and protested bills. – (3) Adjusted new bad debts during the year as a percentage of performing loans at the end of the previous year; performing loans are net of adjusted bad debts. – (4) Annual flow.

Credit quality. – Loans newly classed as bad debts during the year amounted to €9 billion, compared with €7.7 billion in 2001; this represented a rise from 0.9 to 1 per cent in proportion to outstanding performing loans at the start of the year (Tables 62 and a30). During the cyclical downturn of the early 1990s, the new bad loan rate had been around 3 per cent (Figure 49). The stock of bad debts increased by 1.9 per cent last year after contracting by 12.5 per cent in 2001, but in relation to total lending it diminished further to 4.5 per cent, the lowest figure in the last ten years.

Figure 49

RATIO OF ADJUSTED NEW BAD DEBTS TO LENDING (1)

(percentages)



Sources: Central Credit Register and prudential reports.

(1) Ratio of annual flow of adjusted new bad debts to total performing loans at the end of the previous year; performing loans are net of bad debts.

Bad debts amounting to €2.4 billion were securitized. Including the annual flow of securitizations, the stock of bad debts increased by 7 per cent (2.2 per cent in 2001). Net of specific provisions, bad debts amounted to €21.5 billion or 16 per cent of consolidated supervisory capital, compared with 17.6 per cent in 2001.

Doubtful debts came to €20.5 billion at the end of the year, an increase of €900 million or 4.6 per cent. Most of the increase was accounted for by corporate lending and involved small exposures.

A statistical analysis of 133,000 firms, which accounted for 42 per cent of total credit to non-financial companies at the end of 2002, suggests there will be a slight increase in risk this year. Last December the weighted average probability of default within twelve months was 0.93 per cent, compared with 0.89 per cent a year earlier. This increase in lending risk nevertheless comes in a general situation of greater financial soundness than during the cyclical downturn of the early 1990s, when firms' probability of default was around 1.3 per cent.

Concentration risk. – There was a further decline in on balance lending to the telecommunications industry, which is particularly sensitive to cyclical developments and the performance of the financial markets. The amount outstanding contracted by 3.5 per cent to €17.8 billion, after falling by 10.7 per cent in 2001. This exposure was less than 2 per cent of total lending and equal to 13.2 per cent of consolidated supervisory capital.

Outstanding loans to industries that are particularly sensitive to international tensions – insurance, airlines and tourist services – amounted to €24.8 billion, or 2.5 per cent of total lending and 18.5 per cent of supervisory capital. The growth of this exposure slowed down sharply from 21.6 to 7.8 per cent.

Large exposures (those which, on a risk-weighted basis, exceed 10 per cent of a bank's supervisory capital) diminished by 6 per cent on a consolidated basis to €81 billion, or 6.5 per cent of total risk-weighted assets.

On the basis of consolidated data, in December Italian banks' equity interests in resident non-financial companies amounted to €6.9 billion, or 0.3 per cent of total assets and 5 per cent of supervisory capital. The leading groups accounted for 63 per cent of these holdings.

Country risk. – Italian banks' exposure to non-OECD countries was reduced by more than 20 per cent last year to €56 billion, including €38 billion in lending to developing countries and countries in Central and Eastern Europe. The contraction was due chiefly to the depreciation of the dollar and other currencies vis-à-vis the euro. In proportion to total assets, exposure to high-risk countries fell by nearly one point to 2.8 per cent.

Italian banks' share of on balance lending to non-OECD countries, according to consolidated reports to the BIS, fell from 2.9 to 2.8 per cent, putting the country in ninth place among lenders. Italy's role is greater with respect to Central and Eastern Europe (14.7 per cent) and Latin America (6.5 per cent). Italian banks account for 1.6 per cent of total exposure to offshore centres, the lowest figure among the G-7 countries.

Italian bank loans subject to value adjustments under the supervisory rules amounted to €11.5 billion in December. This represented a reduction of more than a third in twelve months, partly reflecting portfolio adjustment in terms of borrower countries. Required prudential value adjustments amounted to €1.8 billion or 1.3 per cent of supervisory capital, half of it relating to Latin America.

Profitability. – Banks' results on a consolidated basis worsened in 2002. Return on equity, which had fallen by about 4 percentage points in 2001, diminished by another 2.7 points to 6.4 per cent (Tables 63 and a31).

Table 63

RESULTS OF THE MAIN ITALIAN BANKING GROUPS AND OF THE BANKING SYSTEM (1)

(end-of-period amounts; millions of euros)

	Main banking groups		Banking system	
	2001	2002	2001	2002
Operating profit	16,373	14,655	26,866	24,944
Charges for loan losses	6,522	6,555	8,817	9,130
ROE	12.5	6.0	9.1	6.4
Allocations to supervisory capital	2,801	1,187	5,660	3,629
Capital increases (2)	675	0	4,428	864
Supervisory capital	66,787	72,474	129,229	134,519
Solvency ratio	9.3	10.6	10.4	11.2
Capital excesses	10,092	18,567	31,742	39,702
Capital shortfalls	–	–	550	176

(1) Consolidated reports for banking groups and individual reports for banks not belonging to groups. Excludes the Italian branches of foreign banks. – (2) Capital increases net of redemptions.

Interest income was €40.2 billion, an increase of 2.7 per cent that was due almost entirely to the growth in the volume of lending. The negative performance of the financial markets resulted in a further decline in non-interest income, which was reflected in a 2.9 per cent fall in gross income.

Operating expenses were stable at €38.8 billion, equal to 61 per cent of gross income. In 2001, the last year for which international data are available, this indicator was lower in Italy than the EU average. Staff costs also remained at the previous year's level, amounting to 38.8 per cent of gross income (compared with 37.5 per cent in 2001). Including incentives for early retirement, staff costs increased by 3.7 per cent.

Operating profit declined by 7.2 per cent, after a reduction of 1 per cent in 2001; the amount absorbed by loan losses increased to €9.1 billion, corresponding to or 36.6 per cent of operating profit. The volume of resources allocated to supervisory capital decreased by 36 per cent to €3.6 billion.

The leading groups were the most heavily affected by the performance of the economy and the financial markets. Profits fell from 12.5 to 6 per cent of equity.

Capital adequacy. – The supervisory capital of the Italian banking system, calculated on a consolidated basis, increased by 4 per cent in 2002 to €134.5 billion (Tables 63 and a32). Risk-weighted assets decreased by 2.2 per cent, mainly as a result of a reduction in foreign exposure and of securitizations. The solvency ratio rose from 10.4 to 11.2 per cent; for the main banking groups the increase was especially large (from 9.3 to 10.6 per cent). Capital in excess of minimum requirements increased from €31.7 billion to €39.7 billion. The number of banks with capital shortfalls remained unchanged at six, while the amount of the shortfalls diminished from €550 million to €180 million. At the end of 2002 capital charges against market risk on trading portfolios accounted for 5.4 per cent of supervisory capital, compared with 6.8 per cent a year earlier, largely due to generic risk on debt securities.

Asset management companies

Profitability. – Asset management companies made net profits of €350 million in 2002, a decrease of 35 per cent. There were 37 loss-making companies (34 in 2001), whose total losses amounted to €28 million. The drop in earnings, following that of 2001, was due both to a decline in revenues, mainly because of a decrease in assets under management, and to an increase in operating costs, one third of which consist of staff costs. Companies sought to overcome the cyclical difficulties by improving the quality of technology and staff. Operating costs rose by 15 per cent; personnel costs, whose incidence on the total held steady at 32 per cent, rose partly because of staff expansion (6 per cent) and partly because of higher unit labor costs (9 per cent).

Investment firms

Profitability. – The continuing weakness of the financial markets in 2002 had severe repercussions on Italian investment firms' earnings. Overall, the industry recorded losses of €42 million. In 2001 profits had fallen by 80 per cent but still totaled €110 million (Table 64). Of 142 operational firms, 72 made losses for a total of €209 million. The negative result was due above all to a steep decline in commission income from intermediation services for customers, which accounts for nearly half of net revenues.

Table 64

PROFIT AND LOSS ACCOUNTS OF INVESTMENT FIRMS (1)

	2001		2002	
	Millions of euros	Percentage share	Millions of euros	Percentage share
Revenue from trading on own account (2)	221	*15.9*	220	*24.5*
of which: interest and dividends	*205*	*14.8*	*281*	*31.3*
Revenue from trading for third parties (3)	733	*52.7*	434	*48.4*
Revenue from individual portfolio management	189	*13.6*	159	*17.7*
Revenue from door-to-door sales	165	*11.9*	41	*4.6*
Revenue from other business (4)	46	*3.3*	16	*1.8*
Revenue from securities administration (5)	36	*2.6*	27	*3.0*
Total revenue	**1,390**	*100*	**897**	*100*
Operating expenses (–)	1,186	*85.3*	795	*88.6*
Operating profit	**204**	*14.7*	**102**	*11.4*
Other revenues/expenses (6)	89	*6.4*	–48	*–5.4*
Profit before tax	**293**	*21.1*	**54**	*6.0*
Tax (–)	183	*13.2*	96	*10.7*
Net profit	**110**	*7.9*	**–42**	*–4.7*
Number of firms (7)	155		142	

(1) Profit-and-loss data from prudential reports. – (2) Including net interest income. – (3) Securities and foreign exchange trading, placement services and collection of orders. – (4) Revenue from accessory services (consulting, securities custody and administration, etc.). – (5) Net result of securities investment by firms not authorized to engage in trading on own account. – (6) Comprises allocations to provisions and non-recurring items. – (7) End-of-year data. Excluding non-operational firms. – (8) Average for the year.

Capital and risks. – At the end of the year the supervisory capital of investment firms stood at €1.5 billion; 95 per cent of it consisted of tier-one elements. Total capital requirements rose by 6.7 per cent to €655 million. This reflected an increment of 22 per cent in charges for market and credit risks, which absorb 75 per cent of the total. The requirement against "other" risks decreased by 23 per cent thanks to the reduction in fixed operating expenses registered in 2001. The investment firms' poor performance was reflected in their capital position. At the end of the year 15 firms had capital shortfalls, most of them because of losses for the year. In 12 cases supervisory capital was below the minimum for providing investment services. The authorities called on them to restore capital adequacy.

Financial companies

Credit risk. – At the end of the year the total lending of financial companies entered in the special register, excluding securitization vehicles, amounted to €105.3 billion, an increase of 5 per cent (7.2 per cent not counting securitizations during the year). The credit sectors registered slower growth of lending than in the last few years. Credit claims securitized by financial intermediaries under Law 130 of 30 April 1999, which were already substantial in 2001, were worth €8 billion last year. All the credits securitized were performing loans relating to leasing, which made up 80 per cent of the total, or consumer credit.

At the end of the year bad debts, gross of value adjustments, amounted to €1.9 billion, a reduction of 6.7 per cent. Their ratio to total lending fell from 2.1 to 1.8 per cent.

The concentration of lending portfolios remains high in relation to the permitted limits. Financial companies' lending in excess of the limit of 60 per cent of supervisory capital again increased. Nevertheless, as a consequence of requests by the supervisory authorities, there was a decline in the number of companies in violation.

Profitability. – Financial companies made net profits of €600 million in 2002, an increase of 43 per cent. Return on equity rose from 6 to 7 per cent. Net interest income increased by 7 per cent as a result of savings on the cost of funds. Owing to the limited expansion in lending and sharper competition, interest received fell by 6 per cent. Gross income improved by 16 per cent thanks to the growth in fee income and dividends.

Operating costs rose by 7 per cent as a result of higher distribution expenses and investment in capital goods. Staff costs, which account for 30 per cent of the total, rose by 1.4 per cent, as there was a 4 per cent expansion of staff.

Capital adequacy. – At the end of 2002 the financial companies' supervisory capital stood at €8.6 billion, up 9.5 per cent. Net of tangible and intangible fixed assets, free capital amounted to €2 billion, unchanged from the end of 2001. The ratio of leasing, factoring and consumer credit companies' capital to risk-weighted assets was 5.9 per cent, the same as a year earlier. For factoring companies alone, limited growth of lending resulted in a rise in the ratio from 6.8 to 7.5 per cent.

SUPERVISION OF BANKS AND OTHER INTERMEDIARIES

Banking supervision

Analytical methods and tools. – Increasingly, the methods used in supervision are differentiated according to banks' size and range of operations.

The prudential objectives for large and complex groups must take account of their systemic importance: the supervisory techniques employed must be adapted to the scale of operations, the organizational diversification and the complexity of risk management.

Capital adequacy is pursued by setting target values that are higher than the regulatory minimums; concentration risk is kept under control by monitoring larger exposures, broken down by sector of economic activity.

The checks on individual banks are performed by means of in-depth analyses of single aspects of their operations, with the main sectors of activity and categories of risk examined successively, but with a configuration that varies with the characteristics of the intermediary. The analysis is made with reference to the group as a whole, rather than the individual legal entities. Discussions with governing bodies are held at various hierarchical and operational levels. In measuring risk, increasing use is being made of quantitative information produced by banks' own internal models. Supervisory action is aimed primarily at ensuring that the risks groups assume are fully under control.

Preparing for the new Capital Accord. – The reform of the Accord is in the last stage as regards the definition of the rules, but the new methodologies envisaged for the management of credit and operational risks are already influencing the activity of supervisors and banks.

Larger banks have declared they intend to adopt internal rating systems for the measurement of credit risk; it is to be expected that they will also be used by some medium-sized banks.

As far as the larger groups are concerned, supervisory action with regard to credit operations is directed primarily at creating the conditions for the rapid application of the new methodologies. Most of the banks in question already use or are introducing rating systems that, even though they do not yet satisfy all the requirements of the new rules, are already tending to reduce the frequency of defaults for new loans granted . Progress is likely both in organizational terms and as regards the availability of data.

There are also projects aimed at improving the measurement of credit risk at smaller credit institutions, mostly mutual banks.

The evaluation of banks' situations. – The supervisory evaluations of banks were fairly stable. The progress made by some large groups with regard to their internal organization and operational efficiency made a decisive contribution to the reduction in the proportion of banks with an unsatisfactory overall score from 15 to 11 per cent, in terms of total assets, compared with 23 per cent at the end of 1997. The cyclical deterioration in profitability and exposure to risk was mainly reflected, instead, in the reduction in the proportion of banks with high scores, from 46 to 43 per cent.

Supervisory action. – Most of the supervisory action taken during the year was directed towards strengthening the capital bases of the leading banking groups, curbing the concentration of credit risk, and checking the configuration and effectiveness of banks' corporate governance and internal control systems.

Supervisory action involved 434 banks. Meetings between supervisors and bank managements totaled 469, of which 213 were arranged by the Bank of Italy's Head Office and 256 by its branch units. A total of 451 written reprimands were sent, 105 of them to banks with serious anomalies.

The fifteen leading banking groups received particular attention: following analysis of specific aspects, 118 meetings were held with management, of which 29 focused on the organizational structure and 22 on the quality of the loan portfolio and the reliability of the procedures for selecting and monitoring credit risk. A total of 16 meetings with top managers were devoted to the examination of strategies, business plans and restructuring operations under way; the Bank of Italy invited banks, in particular, to strengthen risk management and internal audit units and procedures.

Achievement of the targets for capital adequacy. – In 2001 the Bank of Italy had asked the 14 leading banking groups to submit plans for achieving capital adequacy targets higher than the regulatory minimums; the banks were invited to reach Tier 1 ratios and overall capital ratios of at least 6 and 10 per cent respectively.

Between 2000 and 2002 the Tier 1 ratio of the banks in question improved from 5.4 to 6.1 per cent and the overall ratio from 8.7 to 10.3 per cent. The number of banking groups that had achieved the target values rose from 4 to 7 for core capital and remained at 6 for overall capital.

The banks' adjustment plans were constantly monitored to see whether they needed to be reformulated so as to avoid any restrictions on credit at a time of slowing economic activity. For the most part the largest banking groups preferred to pursue policies aimed at containing their risk assets, while the medium-sized groups had recourse to capital increases. The reduction in risk-weighted assets was obtained mainly by cutting exposures to foreign borrowers and disposing of loans through securitizations.

Risk management and control. – For some time now the Bank of Italy has focused its attention on the evaluation of the methods used by banks for the management and control of risks, requesting changes where necessary. Within this framework, the Bank has intensified its contacts with the risk management and internal audit units of banking groups in order to keep abreast of developments regarding risk profiles.

The action taken in the field of credit risk was directed towards encouraging the use of lending and monitoring procedures based on internal rating systems, reducing concentration by economic sector and individual borrower, and verifying the effects of the use of credit derivatives and securitizations.

In order to improve the monitoring of major exposures, the Bank of Italy has asked the leading banking groups to report the exposures to their fifteen top-ranking borrowers on a quarterly basis. The first reports covered 96 borrowers with a total exposure to the reporting banks of €160 billion. The data with reference to December 2002 showed that the exposure to the first four groups of customers was about €74 billion (less than 7 per cent of the performing loans of the entire banking system).

Last year saw an overall reduction in Italian banks' business in credit derivatives; the bulk of the business is handled by a small number of institutions.

The need to meet the demand for credit while limiting the absorption of capital induced banks to make increasing use of securitizations.

The Bank of Italy assesses the degree to which risks are actually transferred from the originator to the market for each transaction. It also requires the management to provide an evaluation of the impact on the bank's profitability and capital adequacy.

As regards market risks, all the major banks are now applying for the validation of their internal models. The Bank pays special attention to the validation of a bank's first model in view of its subsequent application to the group's various financial portfolios and the need to verify its evolution over time in both methodological and organizational terms.

Lastly, as regards operational risks, especially legal risk and reputational risk, the Bank has carried out a survey of the ways in which financial services are offered to customers. Where shortcomings were found in the placement of financial products, banks' attention was drawn to the need to act diligently, fairly and transparently in the interest of the customer.

Contingency planning for business continuity. – In line with the guidelines laid down at international level following the events of 11 September 2001, the Bank of Italy has launched a series of initiatives aimed at verifying the ability of the Italian financial system to cope with disasters, to remedy situations judged to be unsatisfactory, and to improve the operational security of the leading financial intermediaries and of market and payment system infrastructure.

On the one hand the Bank of Italy has required intermediaries found to have shortcomings to make the necessary adjustments over a reasonable time horizon, on the other it has released a consultation document indicating the minimum requirements that all intermediaries should satisfy and the higher standards to be met by those of systemic significance.

Supervision of asset management companies and investment firms

Analysis of intermediaries' situations. – In a context marked by persistent weakness in securities markets, the average supervisory evaluations of intermediaries in 2002 show a deterioration compared with the previous year, primarily in connection with profitability, which declined at 49 per cent of the intermediaries, as against 31 per cent in 2001.

The number with unsatisfactory evaluations increased from 31 to 54 (45 investment firms and 9 asset management companies); the investment firms in question accounted for 11 per cent of these intermediaries' total business in terms of gross revenues, while the market share of the asset management companies with unsatisfactory evaluations was negligible (0.2 per cent of total assets under management). The larger intermediaries belonging to leading banking groups maintained sufficiently large volumes of business to remain profitable.

The analysis conducted by the Bank of Italy focused on the ability of intermediaries to ensure the regularity of operations and remain profitable in the present period of market turbulence and evaluated the effects on their technical situations of their strategic choices and the steps they have taken to cope with the fall in the volume of business.

Supervisory action. – In 2002 the Bank of Italy made 229 supervisory interventions, compared with 130 in 2001. There were 111 formal reprimands and 118 meetings with corporate officers. This action involved 150 intermediaries (85 investment firms and 65 asset management companies) and were carried out with the cooperation of the Bank's branches, which were entrusted with detailed investigations of specific aspects of intermediaries' organizations.

The reprimands mainly concerned investment firms and took the form of requests for action to strengthen capital bases and remedy organizational shortcomings.

Many asset management companies were called on to adopt mechanisms to ensure constant compliance with the mandatory investment limits by checking the impact of transactions on their portfolios. Errors in calculating the value of units came under close scrutiny. Asset management companies were made aware of the need to increase the reliability of procedures for valuing their portfolios, so as to limit the related reputation and capital adequacy risks.

The meetings with corporate officers were primarily concerned with organizational matters, plans for the aggregation and restructuring of companies belonging to groups, and changes in the ownership structure where this was deemed necessary to overcome difficulties.

Supervision of financial companies

Analysis of companies' situations. – In 2002 judgements on individual technical aspects and overall situations were extended to a broader range of financial intermediaries operating in fields other than credit. This led to greater uniformity in the evaluations assigned to the companies included in the special register.

A total of 30 financial companies had unsatisfactory evaluations; they accounted for 21 per cent of the sector's total balance sheet assets. Intermediate evaluations were given to 62 per cent of companies with 64 per cent of total assets; 29 companies had satisfactory evaluations.

Supervisory action. – In 2002 the Bank of Italy made 143 interventions involving 101 financial companies. In 98 cases the action consisted of meetings with corporate officers, sometimes at the Bank's branches. The meetings enabled supervisors to assess companies' operational procedures, internal controls and risk-management methods; for some companies operating in the field of merchant banking they made it possible to monitor their plans for changing strategies and repositioning themselves in the market.

There were 45 written reprimands, mainly concerning profitability and the quality and degree of concentration of loan portfolios.

Inspections

Developments in the banking industry. – The growing complexity of the main banking groups' organizations and operations and the number of smaller banks engaged in traditional lines of business have led to the institutionalization of a diversified approach to inspections. In particular, the checks carried out at less complex intermediaries have been based on the methods consolidated in the past, which provide for examination of all the various aspects of their production and organization. By contrast, inspections of the larger groups have focused either on single aspects of their business (network banks or product companies) or on sectors of activity engaged in directly by the parent company and/or by subsidiaries, in Italy or abroad. Thanks to this modular approach, between 1997 and 2002 at least two inspections of important organizational units and risk areas were performed at each of the ten largest banking groups.

On-site activity. – The inspections initiated in 2002 numbered 196 (compared with 195 in 2002); of which 135 were performed by Bank of Italy branches. The banks subjected to on-site examinations numbered 175 (compared with 178 in 2001) and their assets were equal to 15.7 per cent of the system total. There were 170 comprehensive inspections and 5 sectoral inspections, two of which were concerned respectively with the asset management business and the lending business of large banking groups.

The institutions with unsatisfactory evaluations were small and minor banks and mutual banks, with total assets amounting to less than 1 per cent of the system total.

Between 1999 and 2002 the Bank of Italy carried out inspections at 686 banks that accounted for 71 per cent of the total assets of the banking system, compared with 65 per cent in the previous four-year period. Comparison of the results of the comprehensive inspections in the two periods, covering respectively 39 and 41 per cent of total system assets, shows an improvement in evaluations, with the assets corresponding to unsatisfactory evaluations falling from 8 to 5 per cent of the system total.

Crisis and other special procedures

Special administration and compulsory administrative liquidation of banks. – Seven special administration procedures were initiated in 2002, involving six mutual banks and Cassa di Risparmio di Volterra and the compulsory administrative liquidation of a mutual bank that was already under special administration. Four special administration procedures were concluded and at the end of the year eight were under way, involving seven mutual banks and Cassa di Risparmio di Volterra. Eleven compulsory administrative liquidation procedures were concluded, mostly involving mutual banks. At the end of the year there were 21 such procedures under way, compared with 31 at the end of 2001.

The compulsory administrative liquidation of Sicilcassa saw the liquidators continue with the recovery of claims. Recourse to settlements made it possible to speed up recoveries compared with court proceedings. Attention was focused in particular on reaching settlements for large claims, whose management requires more time and resources. A complex set of agreements was drawn up for the final settlement of Sicilcassa's largest exposure to a debtor group. The action to give effect to the agreements is under way.

Other special procedures. – The collection company SGA continued to recover the impaired assets it had acquired from Banco di Napoli and Isveimer.

At the end of the year a total of €3,329 million had been recovered in respect of the claims acquired from Banco di Napoli, in addition to €176 million in buildings and securities; the net value of the remaining claims on customers was equal to €1,742 million. As a consequence of the claim recoveries and the payments by Banco di Napoli to cover SGA's losses, the latter's debt towards Banco di Napoli fell further, to €1,299 million at 31 December 2002. At the same date the outstanding claims on customers acquired from Isveimer amounted to €193 million.

SGA's accounts for the year show a loss of €283 million, which was made good by Banco di Napoli. As part of the action to rehabilitate the Banco di Napoli group provided for by Law 588/1996, the Bank of Italy has indemnified Banco di Napoli for the expense incurred in making good SGA's losses by means of special advances.

The liquidation of Isveimer, initiated in April 1996, has basically completed the realization of the company's assets and the discharge of its liabilities. During the year the wholly-owned subsidiary BN commercio e finanza S.p.A. (BNCF) was disposed of to Cassa di Risparmio di Ferrara following the spin-off of the impaired assets of BNCF and its subsidiary BN Finproget S.p.A.

The accounts of the liquidation at the end of the year essentially confirmed the estimate of a final loss of €917 million for the procedure, which had been entered in the earlier interim accounts and made good over time by Banco di Napoli, which the Bank of Italy has indemnified by means of special advances.

Special administration and compulsory administrative liquidation of investment firms. – The only special administration procedure under way at the end of the year was initiated in 2002 at the proposal of the Bank of Italy. It was concluded early in 2003 with the intermediary being placed in compulsory administrative liquidation. In addition, one investment firm was placed in compulsory administrative liquidation at the proposal of the Bank of Italy and the liquidation of a third firm was concluded with its deletion from the Company Register.

At the end of the year ten compulsory administrative liquidation procedures involving investment firms were under way for all but one of which the statement of liabilities has been drawn up; in seven cases partial allotments and restitutions have been made.

Transparency controls in banking and financial transactions

The Bank of Italy's branches made checks on the transparency of contractual conditions at 1,009 branches of 160 banks, compared with 698 branches of 154 banks in 2001.

The examinations found intermediaries were paying closer attention to complying with the legislation on transparency and making efforts to remedy the shortcomings found in 2001. Non-observance of both disclosure requirements and provisions concerning contracts was nonetheless still found.

Where widespread violations were found, banks were warned to observe the rules more scrupulously and to take steps to remove the causes of non-compliance. Where the irregularities were particularly serious, administrative sanction procedures were initiated. A total of 51 banks received warnings (82 in 2001) and 8 sanction procedures were initiated (7 in 2001). The supervisory action was aimed at the banks' head offices and in some cases at the heads of the branches where the irregularities had been uncovered.

The transparency controls carried out as part of ordinary on-site examinations found irregularities at 59 small banks, corresponding to 35 per cent of the sample. Sanction procedures were initiated for 17 banks.

Access to the securities markets

The checks made by the Bank of Italy pursuant to Article 129 of the 1993 Banking Law were aimed at verifying the compatibility of the characteristics of the securities offered with the objectives of market stability and efficiency, in line with the criteria laid down by the Credit Committee.

The advance notifications for about 1,300 issues and offerings of securities were examined. In 52 cases the operations notified did not take place because the securities had characteristics that were not consistent with the criteria laid down for the indexation of the rate of return or because they were not compatible with the orderly functioning of the financial market.

In the case of bank securities, the examination of the operations notified was supplemented by that of the information sheets that issuing banks are required to prepare under the current rules on the transparency of issue terms and conditions.

The post-issue reports that have to be submitted showed that domestic issues in 2002 amounted to €91.5 billion, an increase of 8.2 per cent on the previous year. Bank issues continued to predominate and amounted to €88.7 billion.

In a period marked by persistently weak share prices and low interest rates, there was a further increase in the funds raised by banks through the issue of financial instruments that combine guaranteed redemption of principal with yields linked to the performance of equity markets.

In 2002 notifications of securitizations under Law 130/1999 totaled 45. This was down on the previous year but the value of the asset-backed securities in issue rose by about 4 per cent to €33.7 billion, confirming Italy's position among the leaders in the European securitization market.

Sanctions

Last year the Bank of Italy submitted 94 proposals for sanctions in connection with violations of banking and financial rules and regulations, compared with 104 in 2001. The proposals concerned the governing bodies of 87 banks, 1 investment firm, 1 asset management company, 4 financial companies entered in the special register and 1 company engaged in unauthorized banking activity that illegitimately called itself a bank.

The Minister for the Economy and Finance issued 86 decrees imposing administrative sanctions, compared with 98 in 2001. The difference between the number of proposals and the number of decrees is due to the time needed to complete the procedures.

Cooperation with the judicial authorities and other governmental bodies. The prevention of financial crime

The Bank of Italy cooperated intensely with the judicial authorities last year, which saw a further increase in the number of requests for information and documentation from magistrates and investigative bodies, from 524 to 639, and in those for data on bank loans from the Central Credit Register, from 60 to 73. The number of criminal cases in which Bank employees gave evidence declined slightly, from 80 to 72.

The Bank submitted 45 reports to judicial authorities on suspected penal offences discovered in the course of on and off-site controls, compared with 33 in 2001. Seven inspection reports were turned over to the Bureau of Antimafia Investigation under special cooperation agreements.

In the course of 2002 the Bank received 93 requests for information in relation to parliamentary activity concerning matters falling within the competence of the Banking Supervision Department. This compared with 60 requests in 2001.

COMPETITION POLICY IN THE BANKING SECTOR

The progressive integration of European financial systems has spurred banks to increase the scale of their operations, above all through consolidation. Competition is now developing between banks that are more comparable in size and in their ability to compete.

In Italy the rise in competition in the banking industry reflects a combination of factors. The external opening-up of the financial system and the growth of efficient securities markets have contributed. The action of the Bank of Italy in defence of competition has played an especially important role. Commanding detailed information on markets and intermediaries, the Bank is in a position to scrutinize the conditions of competition in each product market and in the different geographical spheres in which banks operate.

All the indicators signal a constant rise in banking competition, a finding borne out, in particular, by the evolution of the market's structure, pricing and the distribution of market shares. The Herfindahl-Hirschman index of concentration for the provincial deposit market on a consolidated basis has declined by around 7 per cent from its peak of 1999, falling back to the levels recorded in the mid-1990s, when the process of consolidation had not yet spread to the largest banks. In regional lending markets, the index declined by 10 per cent between 1999 and 2002.

Interest rate developments also reveal heightened competition. The average short-term bank lending rate has come down by more than 8 percentage points since the start of the 1990s; at the end of 2002 it stood below 6 per cent, in line with the average in the euro area. Over the same period the average deposit rate decreased by 6 percentage points, the spread between short-term lending and deposit rates thus narrowing from 6 to 4 points.

The Bank of Italy safeguards competition using the instruments designed for monitoring and clearance of concentrations and the repression of agreements restricting competition. Since 1990 the Bank has conducted 46 investigations, a large number by international standards.

Concentrations. – A total of 32 concentrations involving banks were notified to the Bank of Italy last year under Law 287 of 10 October 1990. In three cases an enquiry was opened. In 13 cases it was found that the operations did not fall within the scope of the antitrust provisions, since they either involved companies belonging to the same group or intermediaries whose sales are below thresholds established by law. In 16 cases an examination of the effects of the operation – which looked at the market shares of the banks involved, their interest rates compared with the average in the markets affected and the indices of the concentration of supply – found no restrictions of competition in the relevant markets. The Authority's opinions under Article 20 of Law 287/1990 concurred with the findings of the three enquiries concluded by the Bank of Italy.

The merger of CARDINE Banca into SanPaolo-IMI. – The enquiry to determine whether the merger of CARDINE Banca into SanPaolo-IMI would create or reinforce a dominant position in the provincial bank deposit markets of Rovigo, Padua and Venice was concluded in May 2002. The operation was authorized on condition that the group leave the overall number of its branches unchanged for four years in the province of Rovigo and for two years in the provinces of Padua and Venice (Order 40 of 29 May 2002).

The acquisition by IntesaBCI of Cassa di Risparmio di Terni e Narni. – With regard to this operation, an investigation of the provincial deposit market in Terni was opened. The operation was authorized on the condition that the total number of branches of the group resulting from the consolidation remain unchanged in Terni province for three years (Order 43 of 6 August 2002).

The acquisition by Banca di Roma of BIPOP-CARIRE. – An investigation of this acquisition was opened with regard to thirteen provincial deposit markets, mostly in Sicily, and the asset management markets. No restrictions of competition in the provincial deposit markets were found.

The consolidation created the fourth-largest Italian provider of collective and individual asset management services. The enquiry found that these markets were distinguished by an appreciable degree of openness, a level of concentration that was not high, and significant mobility of market shares (Order 44 of 5 September 2002).

Agreements. – During the year special efforts were devoted to investigations of agreements regarding the payment system.

Investigation of bank payment cards. – The purpose of the investigation, which was opened in February 2001, was to ascertain whether

Servizi Bancari, Deutsche Bank, BNL, Findomestic Banca and Cariplo had formed an agreement on the conditions applied to customers, in particular in charging a uniform fee of 1,500 lire, equal to €0.77, on purchases of fuel by means of credit cards. The investigation was coordinated with the Antitrust Authority, which opened a similar investigation into non-bank issuers of credit cards. The facts brought to light during the procedure did not confirm a pattern of uniform conduct regarding the conditions applied to card-holders and the commissions payable by retailers to the banks for payments made with cards (Order 41 of 11 July 2002).

The ABI/Bancomat Convention investigation. – The enquiry concerned the renewal of authorization for the interbank agreements governing Bancomat, automated bank receipts and direct debits by way of derogation from the ban on agreements restricting competition. The agreements provide for the fixing of interbank terms for the provision of services and the preparation of a standardized contract for Bancomat services. The investigation ascertained that the conditions existed for granting a three-year derogation for the main fees connected with the services in question (Order 42 of 30 July 2002).

The ABI investigation: agreements on interbank terms regarding payment systems. – The enquiry into the interbank agreements on the conditions for collection and payment services consisting of bank cheques, bills, electronic payments, credit transfers and payment mandates, and interbank transfers was closed on 31 January 2003.

In the light of the enquiry and the decisions adopted by ABI while it was in course, the agreements on interbank fees were authorized for five years by way of derogation from the prohibition of agreements restricting competition. The interbank fees authorized were determined to be consistent with the related costs; where fees were found to be excessive with respect to costs, the authorization was conditional upon the fees being reduced (Order 46 of 31 January 2003).

The Pagobancomat order and compliance by the Bancomat Convention. – With Order 38 issued on 27 November 2001, the Bank of Italy had directed the Bancomat Convention to present, by 1 July 2002, a method for calculating the interbank fee for Pagobancomat services based on the criteria laid down by the order, to be applied in setting the fee for 2003. The order established that the fee must be consistent with the costs incurred by the issuing banks and, for greater compatibility with the nature of such costs, suggested replacing the fixed percentage fee with a fee comprising a fixed and a variable component.

The Bancomat Convention Board consequently voted to introduce a fee with a fixed component (€0.23) and a variable component (0.0897 per cent of the transaction amount) with effect from 1 January 2003. The fee is to remain in effect until the expiry of the five-year derogation granted with Order 23 of 8 October 1998.

The investigation into BCC Valdichiana/BCC di Montepulciano/ Federazione toscana delle banche di credito cooperative. – The investigation into Banca Valdichiana Credito Cooperativo Tosco-Umbro, Banca di Credito Cooperativo di Montepulciano and Federazione toscana delle banche di credito cooperativo (the Tuscan Federation of Mutual Banks) was concluded in November. Although the agreement between the two mutual banks constituted a restriction of competition, it was found that their market shares were too small to affect competition in the market significantly (Order 45 of 4 November 2002).

The investigations opened in 2002. – In the course of the investigations by the Bank of Italy and the Authority into payment cards, some cases regarding Servizi Interbancari spa were found to warrant further examination. The cases in question concern the setting by Servizi Interbancari of a fee schedule to which the banks refer in establishing the fees charged to retailers and card-holders, and the preparation of standard contractual agreements governing relationships with participating banks and with customers. Since the questions that emerged can affect competition among the banks subscribing to Servizi Interbancari, the Bank of Italy opened an investigation in July. Given the scope and importance of the matters to be examined, the time limit for concluding the procedure, initially set for 31 January 2003, was extended to 31 May.

MARKET SUPERVISION

The persistent weakness of economic activity in 2002 amplified the decline in equity prices that has been under way for about three years, while the yields on government securities fell back to the low levels they had touched in early 1999. These developments were accompanied by a decline in volume, as many market participants were reluctant to make investments in a climate of mounting uncertainty.

The serious accounting irregularities and the shortcomings in internal control systems that involved large listed companies, notably in the United Sates, engendered diffidence about companies' reported earnings. Investors' distaste for the financial markets increased. Political tensions reinforced the aversion to risk. However, the financing of positions in securities was facilitated by the expansionary monetary policy stance. Abundant use was again made of derivatives in order to manage the higher level of volatility.

The action of the supervisory authorities was aimed at countering the crisis of confidence on the one hand and increasing the soundness of market structures on the other.

The internationalization of the financial markets and post-trading structures is spurring the supervisory authorities to intensify their cooperation in carrying out the tasks assigned to them by their national legal systems, *inter alia* in order to avoid the duplication of supervisory costs. The authorities and market participants have accentuated their efforts to establish principles, common methods and standards that will promote competition, efficiency and security in the provision of trading and post-trading services.

The joint working group set up by the European System of Central Banks and the Committee of European Securities Regulators continued its labours in 2002. On the basis of the G10-IOSCO recommendations, the group is seeking to define common European standards of stability, efficiency, transparency and investor protection to guide supervisory authorities, central securities depositories, securities settlement systems, central counterparties and other institutions that provide similar services. The goals include accelerating the integration of the European markets and ensuring equal regulatory treatment to all entities – banks and non-banks alike – that operate in the post-trading sector at systemically important levels (the so-called functional approach).

The initiatives to increase the efficiency and stability of trading and settlement systems include the gradual extension of the activities of central counterparties to the cash markets; the authorities provide adequate stability safeguards for the prevention of systemic risk.

In Italy, the different components of the financial marketplace continued to develop innovative services, rationalized ownership structures and strengthened their position in the international context.

The Bank of Italy, in agreement with Consob, established the rules for guarantee schemes for transactions in financial instruments, regulating the possibility of introducing central counterparty service in the cash markets. The Bank followed the preparatory work for the new securities settlement system and launched initiatives to strengthen the ability of the Italian financial system to react effectively to emergencies.

The wholesale market in government securities

The cash market. – There was a slight contraction in the volume of trading in the MTS cash market, which was affected by the low levels of interest rates and the growing use of alternatives to cash trades (i.e. repos, futures and swaps) for the purpose managing interest-rate risk. The volatility of share prices benefited trading in both index-linked and short-term securities. The concentration of trading by financial instrument diminished further.

Daily turnover averaged €8.65 billion, 6 per cent less than in 2001. BTPs accounted for 60 per cent of the total (compared with 69 per cent in 2001), CCTs for 25 per cent (compared with 20 per cent), and BOTs and CTZs for 14 per cent (compared with 10 per cent).

There was a further, slight narrowing of the bid-asked spread, from 48 to 39 basis points. The changes introduced by MTS spa in the obligations to quote prices in order to maintain primary dealer status and the increasing use by market makers of specialized computer procedures for the automated quoting of the financial instruments assigned to them have a bearing on the improvement in the spread.

The number of market members declined from 175 to 153; as in the past few years, the withdrawal of smaller Italian dealers was only partly offset by the growth in the number of "remote-access" foreign intermediaries (from 30 to 36). The latter's market share remained unchanged at 38 per cent.

The number of primary dealers rose from 29 to 32 and they now account for 90 per cent of the market's total volume. The top five primary dealers handled 42 per cent of turnover (compared with 40 per cent in 2001), the top ten 62 per cent (compared with 60 per cent). Specialists in government securities contribute decisively to maintaining a highly efficient and liquid market.

In the periodic evaluation that the Bank performs on behalf of the Ministry for the Economy and Finance of contributions to the overall efficiency of the market, Italian primary dealers were again the most active in supplying liquidity, thanks above all to their greater capacity to quote even the least liquid securities with limited spreads. However, a significant improvement was found in the activity of foreign dealers, five of which figure among the top ten.

Central counterparty service on the MTS cash and repo segment, provided jointly by the Italian Cassa di compensazione e garanzia and the French Clearnet, has been available on an optional basis since December 2002. The service allows dealers to decide which central counterparty they wish to belong to. The choice is indifferent, for not only are the pricing structures, methods for calculating margins and capital requirements for membership the same for the two clearing houses, but the two guarantee systems are also linked: each central counterparty is a general clearing member of the other and allows dealers to trade with intermediaries belonging to one or the other. Six foreign intermediaries participating by remote access signed up with the central counterparty service at its inception. By the end of the first quarter of 2003 their number had increased to nine. At present, the volume of trades carried out by means of this procedure is small in relation to the total.

Total turnover on the grey market fell from €35 billion in 2001 to €31.8 billion last year. The ratio of turnover on the pre-issue market to the amount offered at auction averaged 13.5 per cent; it was higher for CCTs (32 per cent), three-year BTPs (26 per cent), five-year BTPs (23 per cent) and six-month BOTs (15 per cent). Prices were generally in line with or slightly lower than the issue prices; the difference averaged about 2 basis points, nearly all of it ascribable to fixed-rate securities.

The repo market. – Average daily turnover rose from €28 billion in 2001 to €43 billion in 2002, with peaks of more than €60 billion in July and October. Spot-next and tom-next were again the most liquid maturities, accounting, respectively, for 71 and 27 per cent of total trades. In June 2002 participation in the repo market became a criterion for maintaining MTS primary dealer status.

The increase in turnover was especially large in the general collateral segment (75 per cent), confirming the further growth of this instrument as a form of investment of liquidity for maturities other than overnight.

The differential between rates on the interbank deposit market and general collateral rates ranges from –0.7 basis points for tom-next to 5.1 basis points for the one-month maturity; the fact that the differential is close to nil for overnight funds shows that the costs associated with collateralization often outweigh the reduction in counterparty risk. The widening of the spread in the last quarter of both 2001 and 2002, in concomitance with rising uncertainty in the financial markets, shows the importance of repos as a financial instrument at times when unsecured transactions are perceived as excessively risky.

Turnover also rose in the special repo segment, though by less than in the general collateral segment. The use of the instrument to cover securities settlement obligations concentrates activity in the early hours of the day. The special repo rate effectively signaled moments of tension in the secondary market, many of them due to the disinclination of institutional investors to lend securities.

BondVision. – Average daily turnover rose from €220 million to €390 million in this market's second year of activity. BTPs accounted just over 45 per cent of the total (compared with 50 per cent in 2001), CCTs for 18 per cent (compared with 13 per cent) and securities of other euro-area countries for 25 per cent (compared with 20 per cent). The number of participants rose over the year from 40 to 99; institutional investors were responsible for all of this growth, since the number of market makers remained unchanged at 23. The number of remote-access intermediaries increased from 24 to 61. The top five primary dealers accounted for 68 per cent of total volume.

Other segments of the bond market

EuroMTS and other national MTSs. – Average daily turnover in government securities on EuroMTS contracted substantially, from €3.8 billion to €2.9 billion. The decline was partly attributable to the adoption of more stringent admission standards, which reduced the instruments listed to the actual benchmark securities of the euro-area countries.

Italian securities made up 28 per cent of the total, compared with 42 per cent in 2001, while Italian, German, French and Spanish securities as a group accounted for 64 per cent, down from 83 per cent. Large increases were recorded in turnover in the securities issued by other countries of the area (137 per cent for Greece, 91 per cent for Portugal, 46 per cent for Austria).

Volume rose on the national circuits that use the MTS platform. MTS/France, MTS/Belgium MTS/Germany and MTS/Spain benefited from the accession of major international intermediaries, the migration of some securities listed on the EuroMTS circuit and the appreciable increase in net issues of government securities in France and Germany.

Average daily turnover rose on MTS/France from €675 million to €1.02 billion and on MTS/Belgium from €850 million to €1.03 billion; on both MTS/Germany and MTS/Spain it increased to around €630 million.

The market in bonds other than government securities. – Average daily turnover on MTS/Corporate, the Italian regulated market, fell from €135 million to €97 million and concentrated almost entirely on the securities of international organizations. On EuroMTS, average daily turnover rose from €1.18 billion to €1.80 billion, around 70 per cent of it in financial instruments issued by international organizations and governmental agencies.

The over-the-counter market. – The volume of OTC trading in government securities, based on a significant sample of MTS primary dealers, declined by 9 per cent, which was in line with the contraction recorded on MTS itself. Although the regulated platform remained the principal channel of trading, its share of participants' total cash trades slipped from 63 to 60 per cent. Thirty per cent of the trading in repos on Italian securities takes place on the OTC market and 70 per cent on MTS; Italian dealers are more active on MTS, while foreign dealers transact most of their business over the counter.

The interbank deposit market

Daily turnover on e-MID averaged €17.6 billion in 2002, rising to €18.2 billion in the first three months of 2003. Daily turnover in overnight funds averaged €14 billion in 2002; its share of total turnover increased from 79 to 80 per cent in 2002, rising to 82 per cent in the first quarter of 2003.

Turnover in the large-deal segment grew by 38 per cent to a daily average of €4.85 billion and its share of the total volume of transactions in the four maturities traded on the segment rose from 24 to 29 per cent. Major foreign intermediaries participating by remote access were especially active in this segment, accounting for more than 50 per cent of total volume.

Daily turnover in the dollar segment averaged $600 million in 2002, rising further to more than $900 million in the first quarter of 2003. At the end of March 2003 the segment counted 58 active participants. Compared with funds in euros, activity in dollar funds was less heavily concentrated on the overnight maturity, which accounted for 58 per cent of the total; by contrast, trades in the tom-next maturity funds accounted for a larger share (35 per cent).

The overnight rate on e-MID displayed very limited variability, again proving to be a precise indicator of liquidity conditions throughout the euro area. The average differential between the e-MID overnight asked rate, calculated as a weighted daily average, and the EONIA has dwindled steadily in the past few years, reflecting the integration of the money market in the euro area. In the period under review the variability shown by the differential was statistically small, with significant increases corresponding to the closure of compulsory reserve maintenance periods and the end of calendar quarters. On the days when the ECB Governing Council was expected to make decisions regarding the level of official rates, the bid-asked spread widened slightly.

The consolidation of the banking sector, under way for years, led to a further reduction in the number of market participants, which fell from 187 to 163 in 2002 and then to 159 at the end of the first quarter of 2003. The combined market share of the ten most active participants rose from 29 to 32 per cent during the year.

The market accentuated its international dimension last year. The number of foreign intermediaries participating in e-MID by remote access nearly doubled, from 21 to 41, with a further increase to 49 in the first quarter of 2003; their combined market share rose from 13 per cent in 2001 to 22 per cent last year.

Interest rate derivatives

Average daily turnover in overnight indexed swaps on e-MIDER, the circuit operated by e-MID spa, fell from €1.5 billion in 2001 to just over €1 billion in 2002. The contraction was due in part to the low volatility of the overnight rate, which reduced the incentive to enter into derivative contracts designed to limit the risks deriving from sudden variations in very-short-term interest rates. Trading began to grow again in the first three months of 2003, rising to a daily average of more than €1.5 billion.

Central securities depositories

Against the background of the ongoing consolidation of post-trading systems, Monte Titoli became Europe’s third-largest central depository by value of securities held. At the end of 2002 the Euroclear group, including the Crest, held financial instruments with a market value of €10.6 trillion, 6.2 per cent less than a year earlier. The securities deposited with Clearstream Banking Luxembourg and Clearstream Banking Frankfurt, both controlled by the German market management company Deutsche Börse, were worth €6.9 trillion, 8 per cent less than a year earlier. At the same date the market value of the financial instruments held by Monte Titoli amounted to €1.93 trillion, a decrease of 4.1 per cent compared with the end of 2001.

At face value, the securities deposited with Monte Titoli amounted to €1.58 trillion, compared with €1.54 trillion at the end of 2001. Government securities made up 68 per cent of the total, broadly unchanged from the previous year. The financial instruments held by means of the ten links existing with foreign central depositories amounted to €11.8 billion, having increased by 4.3 per cent.

The total number of Monte Titoli participants rose from 1,867 to 1,916, that of issuers increasing from 1,214 to 1,346 and that of intermediaries decreasing from 653 to 570. The reduction in the latter mainly involved smaller intermediaries, in parallel with the trend in participation in payment and settlement systems. The number of participating banks decreased from 379 to 317, investment firms from 84 to 64, and stockbrokers from 29 to 13.

In January 2002 Monte Titoli took over the daily checking and correction services for off-market trades (RRG-LFM) and for transactions to be settled via the Express gross settlement system (RRG-REL). Monte Titoli also activated the securities lending service, which offers the possibility of finding the financial instruments needed in order to meet settlement obligations.

Settlement of transactions in securities

The Express gross settlement system. – The number of participants in Express rose from 107 to 125, comprising 104 banks and 20 investment firms (compared with 91 and 15, respectively, at the end of 2001). The average transactions settled per day increased in number from 383 to 402 but declined in value from €4.44 billion to €4.37 billion.

During the year the system maintained a high level of smoothness in its operations. Over-the-counter transactions accounted for 79 per cent of the total value handled, compared with 66 per cent in 2001. As in the past, peak activity occurred on the days when monetary policy operations were settled.

The concentration of transactions per participant remained high. The top five participants accounted for 76.5 per cent of all settlements by value and 75.8 per cent by number (compared with 73.3 and 77 per cent respectively in 2001). Express handles most of its transactions in the early part of the day, when the Bank of Italy's net securities settlement service is operating and Express queues lengthen. The profile of queues and queuing time shows that participants made better use of the system than in 2001.

The Express II settlement system. – Work is progressing for the launch of the new securities settlement system, operated by Monte Titoli and comprising a net and a gross component. The preparatory work involves intermediaries, their trade associations, the markets and the authorities. According to the present timetable, Express II should go live in October 2003, at which time the securities settlement service operated by the Bank of Italy will shut down.

Clearing and guarantee systems

Cassa di compensazione e garanzia members numbered 120 at the end of 2002 and comprised 34 general members, 33 individual members and 53 indirect members (compared with 33, 38 and 49, respectively, a year earlier). Italian banks decreased from 62 to 55, Italian investment firms increased from 33 to 36 and EU investment firms from 12 to 17, while the number of stockbrokers declined from 9 to 5. The number of remote-access members rose from 13 to 21.

Turnover on the Italian Derivatives Market (Idem) fell by 20 per cent compared with 2001 and at the end of the year open interest was 7.2 per cent smaller. The average daily amount of initial margins declined from €1.03 billion to €870 million.

In July the range of products in which the Cassa di compensazione e garanzia acts as interposed party was expanded with the addition of futures on individual stock options.

The Cassa took a prudent approach to the management of counterparty risk, calling on its participants to provide collateral more than sufficient to cover the daily volatility of the financial instruments guaranteed. In 2002 it never needed to request the deposit of intraday margins.

During the year the Cassa and Clearnet jointly established the methods to be used for calculating margins for the central counterparty service offered on MTS. On 23 May 2003 the Cassa, with its parent company Borsa Italiana spa, launched the central counterparty service on the cash share market.

At the end of the year the Contract Guarantee Fund and the Settlement Guarantee Fund amounted to €52.4 million and €36.9 million respectively, compared with €52.2 million and €43.3 million at the end of 2001. In 2002 the Contract Guarantee Fund intervened in the insolvency of two stockbrokers.

The regulatory framework

In Europe, further progress was made last year in implementing the Financial Services Action Plan, to achieve greater harmonization of the legislation governing the securities sector.

In May 2002 the European Commission began a public consultation on the guidelines to be adopted for the clearing and settlement of securities transactions. In November it submitted to the Council and the Parliament its proposal for amending the Investment Services Directive (93/22/EEC), which envisages trading taking place in three different spheres: regulated markets, multilateral trading facilities, and banks and investment firms. In this new environment it becomes crucial to ensure adequate transparency in price formation, whatever the venue, and to guarantee that prices are immediately accessible for investors.

In Italy the authorities adopted measures to complete the framework established by the Consolidated Law on Financial Intermediation and to adapt certain aspects to EU legislation and to the evolution of the financial markets.

In October the Bank of Italy, in agreement with Consob, issued a regulation on the clearing and guarantee of transactions in financial instruments pursuant to Articles 68, 69.2 and 70 of the Consolidated Law on Financial Intermediation. The measure introduces a single set of provisions for all guarantee systems and provides regulatory support for the introduction of the central counterparty service in the cash markets. It is based on criteria aimed at ensuring legal soundness, adequate risk monitoring, and non-discriminatory access. In a context of integration between markets, it governs the procedures for establishing international links between central counterparties.

As regards the finality of transfer orders, on 30 September the Bank, in agreement with Consob, issued rules under which each securities settlement system must establish the time at which orders are entered in the system, so as to make them binding and enforceable in respect of third parties even in the event of the opening of an insolvency procedure involving a participant. Under these rules two conditions must be satisfied for transfer orders to be considered entered in a system and thus final: the transaction must be non-revocable by the parties and it must be charged to the settlement agents. For central counterparty systems, finality commences at the time, immediately following the trade, when the clearinghouse takes over the contractual position to be settled.

The start of the central counterparty service on MTS required the drawing up of a memorandum of understanding between the Bank of Italy, Consob and the French authorities responsible for supervising Clearnet.

Supervision of market operating companies

Supervision of the companies that operate markets and market-support systems benefited from the rationalization of data flows achieved following the issue of supervisory instructions.

Meetings with operating companies' corporate officers again proved to be a useful means of exploring the various aspects of management, including organizational and IT-related matters, the quality of internal controls, and cooperation agreements with foreign parties. Specific attention was devoted to systems' continuity of operation, in order to evaluate their ability to recover from emergencies.

The Bank rendered opinions to the Ministry for the Economy and Finance regarding the operating rules of MTS and BondVision and the bylaws of the operating company. The issues addressed included the legislation applicable to contracts concluded in the market and access to trading by monetary authorities, central banks, public entities entrusted with public debt management and other national entities that perform similar functions. On this last matter the Ministry issued a decree, on which the Bank rendered the opinion within the scope of its authority. In addition, the Bank also provided opinions to Consob on questions regarding the rules of MTS/Corporate and the closure of the Italian Futures Market (MIF).

In December the Bank, in agreement with Consob, approved the operating rules of the central counterparty guarantee system introduced by the Cassa di compensazione e garanzia on MTS.

A large effort went into examining the numerous applications of non-resident intermediaries to participate in Italian markets (a total of around 90 for all the markets supervised). Where contemplated – in more than 50 cases – steps were taken for an exchange of information with the competent authorities of the home country.

PAYMENT SYSTEM OVERSIGHT AND SERVICES

In 2002 the central banks' commitment to enhancing the efficiency of payment systems reflected Europe's need to complete the single payment market and to prepare the accession of new countries to the EU. At world level, growing cooperation with the authorities responsible for maintaining financial stability continued to focus on reinforcing the reliability of payment systems.

At the Bank for International Settlements, the publication of the third report on retail payments marked the conclusion of a series of studies by the participating central banks designed to establish objectives and common lines of action for efficiency and security in a sector where both the market and other authorities play a crucial role.

The events of 11 September impressed upon the oversight authorities for intermediaries, markets and payment systems, the central banks and the payment system participants the need to cooperate in the development of rules and standards to cope with major shocks.

The Eurosystem adopted this approach. The Bank of Italy carried out a survey of the financial system's state of preparedness and ability to cope with emergencies; solutions based on the coordinated action of stakeholders were developed to minimize the systemic risks of an operational breakdown. The EU central banks stepped up cooperation with the oversight authorities and in March 2003 outlined a scheme of reference for more effective cooperation in crises involving cross-border intermediaries or payment circuits.

To raise efficiency levels in the TARGET trans-European settlement system the Eurosystem drew up a long-term strategy for its development, known as TARGET2. The plan is for further centralization of operations while maintaining banks' accounts with their respective national central banks. TARGET2 will consist of several platforms, only one of which is to be shared initially by a number of countries, offering a broader range of core services than at present at a single price that will ensure full cost recovery.

The operational and technological solutions of Italy's project for the New BI-REL gross settlement system anticipate the strengths of the EU-wide payment system. BI-REL will extend the services available to participants for more efficient liquidity management. In view of BI-REL's flexibility, security and high technology standards, the Bank of Italy proposed it as a basis for the single shared platform of TARGET2.

To encourage the European retail payment service market to overcome its remaining shortcomings, the Eurosystem strengthened its role as catalyst of change and sector coordinator. The European banks responded by setting up an organizational framework and charging it with the implementation of a broad plan for efficient execution of intra-EU payments (the Single Euro Payment Area, or SEPA, project), which embraces measures relating to individual instruments as well as the creation of an EU infrastructure for the exchange and clearing of low-value payments.

Following international and European guidelines Italy drafted the provisions for the enactment of Article 146 of the 1993 Banking Law, in which the purposes of oversight and the areas concerned are set out on a systematic basis.

In the sphere of retail payments, monitoring of conditions for the provision of services was stepped up. Actions were taken to improve confidence in the use of payment instruments – including the introduction of the interbank database on irregular cheques and payment cards – and, in the area of innovative payments, the assessment of new electronic payment schemes and of security questions relating to open networks.

The Bank of Italy increased and extended its action to improve the efficiency of the public administration payment system. Significant progress in this direction was made with the procedure for the payment of state salaries and pensions by credit transfer, the new methods for public administration collections and payments within the EMU, and the offer of special conditions for use of the electronic network by other public agencies.

As part of a move to upgrade the information on the state of the public accounts, the Ministry for the Economy asked the Bank of Italy to develop and manage, as part of the state treasury service, a computerized recording system for public agencies' collections and payments. The information will be coded using standard criteria in accordance with Article 28 of the 2003 Finance Law. The system gives the Ministry prompt and complete information on the cash flows of public agencies and the main components of local expenditures, which can serve the purpose of coordinating the public finances.

Oversight activities

Last year the oversight activity of central banks in the industrial countries focused on retail payment efficiency, public confidence in innovative payment services and instruments and measures to counter systemic operational risk within the financial industry. The objectives and procedures of national payment system oversight increasingly converge with those at European and global level.

Throughout the industrial world the interest of central bankers in retail payment systems and instruments has strengthened. This has taken the form of stepped-up efforts to work out wide-ranging policies to foster efficiency and reliability and demarcate the authorities' areas of interest, as has already been done for wholesale payment systems. The BIS has completed the reference framework. The Eurosystem has intensified work on common principles, guidelines and standards.

The action of the EU central banks to hasten the realization of the single payment market is consistent with the Commission's initiative to define common legal arrangements for euro payments in its paper "A Possible Legal Framework for the Single Payment Area". The central banks are also moving to foster and monitor adoption by the European banking industry of suitable solutions to the remaining shortcomings. The banks have responded with a major project for the creation of a Single Euro Payment Area (SEPA).

In Italy, oversight has been stepped up, with a strengthening of the guidance and control activity already under way and an extension of the monitoring of national systems and infrastructures. The Bank of Italy's oversight centred on structural matters and the setting of rules and guidelines for adaptation of the systems and structures to the European environment. Special action was taken to accelerate adoption of standards for straight-through processing, first of all the introduction of the International Bank Account Number (IBAN) and the Bank Identifier Code (BIC), and to enforce the Community rule of equal prices for cross-border and domestic payment services. There was intensified use of the instruments and procedures of dialogue. Regular meetings were held with the Italian Bankers' Association to identify problems, plan and if needed take joint action, and with the Interbank Company for Automation as the technology provider for the first infrastructure that meets the requirements for a pan-European automated clearing house (the EBA's STEP2 system). Important payment system participants were monitored, also on a decentralized basis, as part of the ongoing analysis of the prices charged for the main instruments. Coordination and information exchange within the Eurosystem and with the Commission continued. Work proceeded on the harmonization of methodology and standards for European statistics on retail payment instruments.

In keeping with the international tendency to formalize the oversight function, the regulatory framework for the exercise of the Bank of Italy's oversight responsibilities under Article 146 of the 1993 Banking Law was completed last year. The implementing provisions set the objectives, the areas of interest and the obligations of stakeholders and lay the basis for the definition of an organic body of instruments for the various agents involved in the operation of the payment system and in the issue and/or management of payment instruments and circuits. A related theme is strengthening the oversight authority's powers, already effected in part and bound for significant further development. The regulatory framework was improved by the simultaneous enactment of sectoral measures in areas of primary concern to the oversight function.

The increase in the number of transactions settled by cashless banking instruments continued in 2002, with growth of 7.1 per cent on an annual basis; the figure rises to 8 per cent if one considers the broader aggregate including some instruments provided by other intermediaries, such as Poste Italiane spa. The number of cashless transactions per inhabitant remains low by international standards: 54 in 2002, compared with an average of 131 in the euro area and 267 in the United States in 2000.

Trends in banking payment instrument use were not uniform. The fastest growth was recorded by those that have a technological edge over paper-based instruments. Bank cheques and bankers' drafts diminished sharply, by 8.9 per cent to 526 million during the year, while automated credit transfers increased by 11.6 per cent and direct debits by 11 per cent. As in recent years, POS debit card use increased sharply (24.6 per cent), thanks partly to the extension of the network, which now counts some 820,000 outlets (up 9.4 per cent over 2001 and 43.5 per cent over 2000). There were 25 million debit cards in being at the end of 2002, an increase of 7.1 per cent for the year. They accounted for 25.1 per cent of all cashless transactions, compared with 21.4 per cent in 2001. The number of ATM cash withdrawals rose by 6.7 per cent, with especially strong growth during the period of dual circulation of lira and euro.

The number of credit card transactions rose by 14 per cent to 358 million. As in previous years, the expansion of credit card use was spurred by the spread of co-branded cards issued by financial intermediaries and distributed by other institutions. The number of cards rose by 8.8 per cent to 22 million.

Various factors underlie the spread of cashless instruments. There has been an easing of the constraints and resistance, including cultural attitudes, that in past impeded the large-scale use of Italy's vast network of technological infrastructures and procedures for effecting transactions in bank money. The entry of new operators and the increased number of participants in payment card circuits has extended the range of payment means available.

In the second half of 2001 the Bank of Italy began a survey of procedures and fees for two of the most common payment instruments, namely cheques and credit transfers. The findings confirm the importance of local factors and the conduct of individual banks, which are reflected both in the ample variability of terms applied to customers and in the general long execution times and high cost of payments (Table 65). In view of the high level of standardization of interbank procedures and increasingly intrabank procedures as well, these conditions are hardly justified.

Table 65

HANDLING TIME FOR CHEQUES AND CREDIT TRANSFERS

(*number of working days*)

	Average			Minimum			Maximum		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Cheques									
Value	4.0	3.9	3.9	1.9	2.2	2.1	6.2	6.1	6.9
Availability of funds	6.7	6.6	6.8	5.4	5.5	5.6	8.7	7.9	7.9
Finality	10.0	9.4	9.6	8.4	8.1	8.4	11.6	10.0	11.0
Credit transfers									
Value date	2.0	2.1	2.3	1.3	1.9	2.1	4.0	4.5	4.0
Availability of funds	2.6	2.5	2.0	0.9	1.9	1.3	3.2	3.8	2.9

The charge for cross-border credit transfers in 2002 came to an average of e22 for outgoing and e16 for incoming payments, including operating commissions. As in the past, cross-border payments were much more variable and much more expensive than domestic credit transfers (which cost e2.00-e3.00). These differences reflect differentiated supply policies and the variety of procedures and practices for sending and receiving payment orders between euro-area countries. A drastic reduction is expected from the full application of the EU rule aligning cross-border to domestic charges and from some initiatives already under way as part of the SEPA project (STEP2, CREDEURO, and the convention on interbank fees).

In the first quarter of 2003 the survey questionnaire was extended to cover cross-border payments other than credit transfers, innovative Internet payments and money transfer activity.

Integration between the bank and postal payment circuits proceeded. With the conclusion of negotiations with ABI and the inclusion of Poste

Italiane spa in the main Bank of Italy clearing procedures, there was a significant rise in customer transactions between the two circuits and a broadening of the range of instruments supplied by the postal system, with increases of payment card issues, the ATM network, collection orders and credit transfers. Poste Italiane spa released an initial flow of data, for the most part comparable with those originating with the banks, describing its complex payment activities.

As regards innovative electronic payment instruments, oversight activity mainly aimed at reliability, security and transparency, with action to foster their spread and reduce the use of less efficient instruments. The relative importance of Internet payments remained limited. On-line payments by credit card, the most common electronic payment instruments, accounted for just 2.5 per cent of all card payments. Credit transfers ordered by customers on-line accounted for 3 per cent of all such transactions. Like other innovative products, on-line payments, especially credit transfers, continued to increase. A comparable increase was registered in the use of electronic substitutes for cash, i.e. e-purses and prepaid cards, whose ratio to the stock of money in circulation more than doubled.

There were over 270,000 prepaid cards in circulation at the end of the year, and those exclusively for Internet use now exceed 65,000. The average on-line transaction using prepaid cards remains smaller than e30, in keeping with their use for low-value payments. In 2002 card schemes subject to the Bank of Italy’s assessment consisted mainly in nationwide initiatives. At the end of March 2003 the prepaid payment instruments actually operational in Italy numbered 12, three times as many as the previous year. Another thirteen projects were under examination.

The impediments to the spread of on-line payment instruments have been analyzed in the broader context of the use of information and communications technology in banks and in the rest of the economy. A Bank of Italy survey of service companies in 2002 found that the main obstacles to e-commerce are posed by the characteristics of the goods and services offered and by doubts about technical security and the identity of counterparties. Similar conclusions were reached by surveys conducted last year by the OECD and Eurostat, which pinpointed security in on-line payments as a decisive factor for the expansion of the Internet business of smaller enterprises. The Bank of Italy’s most recent survey of ICT use found that 61 per cent of service firms and 63 per cent of manufacturing firms had effected on-line payments and collections in 2002.

The number of customers using e-banking is rising rapidly, both for effecting transactions and for checking account information. In the last two years the number of customers contacted via the web has increased enormously. In 2002, some 4 million used the Internet to make bank transactions. Demand-side developments are prompting banks and other payment service operators to offer on-line services, automating the entire payment cycle from customer order to execution to reporting.

The potential for the growth of on-line instruments depends on the confidence of markets, government and other final users. Oversight activity in 2002 accordingly focused on the prevention of illicit uses of these instruments, on defining security requirements for e-money, on monitoring card frauds and on promoting measures for the proper functioning of on-line transactions. The central bank's role in strengthening confidence in innovative payment circuits and instruments was recognized in 2002 by the decrees transposing EU directives on electronic payments, which assigned specific powers to the oversight function.

As part of action to contain systemic operational risk, a complex project to check the Italian financial industry's ability to cope with disasters was begun last year. The strategy is characterized by the involvement of payment system stakeholders from the outset, including the design phase. This reduces the cost of individual projects and improves the efficiency and security of the system as a whole.

Consistent with international and European action plans, the capacity of the Italian financial system and its various components to cope with a far-reaching crisis was studied. The survey covered payment system and market infrastructures and the main banking groups. The most important initiatives involved increasing service continuity, among other things through reciprocal back-up, organizational change to augment the availability of technical and administrative personnel, periodic tests involving the greatest possible number of participants, the definition of standing communication procedures between participants and the authorities, and the promotion of action to improve the reliability of public utilities.

The results of the survey and of the meetings with market players were set out in a preliminary report presented in February 2003 to the operators of the most important infrastructures and the main banking groups. The meeting laid out a mutually agreed agenda to enhance system security. A contact list of major institutions for crisis management in the financial sector will be drawn up and a working group of the main market players formed. The objective is close coordination and continuous exchange of information in contingency situations and the design of integrated, system-wide tests.

The monitoring of the ATM and POS circuits begun during the cash changeover to the euro was consolidated over the rest of the year, with the institution of a first procedure for monitoring the functioning of the ATM network and its individual components. These circuits are a problem area for payment system infrastructures and participants owing to the immediate impact that an operational failure has on users' ability to make payments at POS terminals or withdraw cash from ATMs. The implementation of the project, carried out by Cogeban, the Bancomat circuit operator, required close coordination with the many institutions that make up the circuit (service providers, terminal operators, participating banks).

Work continued on private payment systems that are of particular importance to the functioning of the overall Italian payment system. The work already under way together with the central credit institution for mutual banks was joined last year by action involving two other central bodies representing cooperative institutions. Oversight, conducted in close coordination with the Banking Supervision Department, is designed to make these systems more efficient and reliable. A new study carried out jointly with the Eurosystem further developed analysis of the operation of interbank correspondent accounts.

Direct provision of payment services

The flow of funds handled by the Bank of Italy's clearing and settlement systems last year amounted to nearly €37 trillion, or 29 times the Italian GDP. This was a decrease of almost 8 per cent compared with 2001. The BI-REL gross settlement system settled 87.6 per cent of all payments, over 45,000 transactions a day worth about €133 billion. Payments channeled through the BI-COMP retail clearing system accounted for 7.1 per cent and the multilateral cash balances generated by the LTD securities net settlement procedure for 5.3 per cent.

The value of the payments handled by BI-REL decreased by almost 5 per cent (Table 66). Transfers from foreign correspondents diminished by 27 per cent, the cash balances from securities settlement decreased by 13 per cent, and customer credit transfers also decreased. Payments for the e-MID interbank deposit market, by contrast, increased. The decrease in domestic payments was due mainly to banking concentrations, which are generally accompanied by an organizational and operational rationalization of banks' cash-flow management and larger intra-group flows. The same process affected the securities settlement procedure, with an increase in netting of debit and credit positions within groups and a consequent decrease in the balances settled in BI-REL. As in years past, the decline in interbank transfers from foreign correspondents stemmed from the reduction in the use of correspondent accounts to settle cross-border payments between euro-area countries.

Unlike 2001, last year saw a decrease in the value of cross-border payments as well (12 per cent), despite a rise in their number. The reduction in the size of payments, which was common to other EU countries, was due to the climate of uncertainty and to a general situation unfavourable to the activity of the financial markets. However, the reduction was more pronounced in Italy, essentially because of banking concentrations. Most of the decline can be attributed to banks involved in mergers or acquisitions.

Table 66

LARGE-VALUE GROSS AND NET SETTLEMENT SYSTEMS IN THE EU

(average daily flows in billions of euros)

	2001				2002				Total percentage change 2002/2001
	TARGET				TARGET				
	Domestic (1)	Cross-border outgoing	Cross-border in-coming	Total (1)	Domestic (1)	Cross-border outgoing	Cross-border in-coming	Total (1)	
Gross settlement (TARGET)									
Italy	67.4	39.2	39.3	145.9	64.1	34.5	34.4	133.0	–8.8
Germany (2)	140.0	131.0	130.9	401.9	360.1	129.3	129.4	618.8	54.0
France	270.0	75.2	75.3	420.5	287.4	68.9	68.9	425.2	1.1
Spain	189.0	19.6	19.5	228.1	231.0	17.8	17.8	266.6	16.9
Netherlands	37.0	46.7	46.7	130.4	37.6	45.0	45.0	127.6	–2.2
Other EMU	62.0	92.3	92.3	246.6	59.7	91.9	91.9	243.5	–1.3
Total EMU	**765.4**	**404.0**	**404.0**	**1.573.4**	**1.039.9**	**387.4**	**387.4**	**1.814.7**	**15.3**
Non-EMU countries	27.0	102.3	102.3	231.6	26.4	97.6	97.6	221.6	–4.3
Total EU	**792.4**	**506.3**	**506.3**	**1.805.0**	**1.066.3**	**485.0**	**485.0**	**2.036.3**	**12.8**
Net settlement									
Euro Access Frankfurt (EAF) (2)				162.2				–	–
Paris Net Settlement (PNS)				87.9				78.3	–10.9
Servicio Español de Pagos Interbancarios (SEPI)				1.4				1.2	–14.3
EBA Euro Clearing System (Euro1)				204.8				188.2	–8.1
Total other systems				**456.3**				**267.7**	**–41.3**

Sources: ECB and Bank of Italy.
(1) The comparison of figures for domestic payments is affected by specific features of the national gross settlement system architecture in some countries that allow transfers of liquidity between different accounts held by the same institution with no underlying transaction. Such payments are possible in Germany, France and Spain. The Eurosystem is working to improve the degree of statistical comparability between national real-time gross settlement systems of the figures on domestic flows. – (2) On 5 November 2001 Germany launched its new RTGS^{PLUS} system combining the functions of the predecessor RTGS system (ELS) and the hybrid system EAF.

The use of intraday liquidity in BI-REL, which averaged €2.9 billion a day, remained limited, coming to just 3 per cent of the value of the total settlement flow and 19.6 per cent of the value of securities pledged as collateral. The latter was reduced by 10 per cent compared with 2001, again as a result of concentrations and more efficient cash-flow management by banks.

The correspondent banking services provided by the Bank of Italy to countries outside the euro area increased. The number of transactions rose by 13 per cent, from 11,500 to 13,000, and their value by 3 per cent, from €224.5 billion to €231.3 billion.

The multicurrency Continuous Linked Settlement (CLS) system for foreign exchange transactions in seven currencies, including the euro, started operation in September. The CLS system works by the simultaneous transfer of credits in two different currencies.

TARGET further strengthened its leading position among large-value euro payment systems. It handled a daily average of over 250,000 transactions worth more than €1.55 trillion, accounting for 59 per cent of all funds transfers through the main EU systems and for 85 per cent by value (Table 66).

Developments in TARGET and New BI-REL. – In its first years TARGET has attained its objectives. However, participants have progressively felt the need for higher levels of service, in particular for more efficient and flexible liquidity management. In response to market requests, in the last two years the Eurosystem has undertaken a review of the long-term strategy, not least with a view to EU enlargement. The strategy for TARGET was devised by the ECB Governing Council in October 2002. The new TARGET2 system will not be operational before the second half of the decade.

At the domestic level, the Bank of Italy together with the banking industry has developed a project for upgrading BI-REL starting in June 2003. New BI-REL provides new services permitting more flexible management of payments in the course of the day. The system allows two forms of participation: direct, with a settlement account within the system, and indirect, settling one's transactions through a direct participant. The option obliges banks to make a strategic choice on its settlement system role, which must be consistent with its profile of operations, in that direct participation requires an investment that is justified only by large operating volumes.

The migration of banks to New BI-REL will be gradual. An optimization mechanism, designed to save on the use of intraday liquidity, will be introduced in January 2004. The system will have high security standards fully compliant with the new standards set at international level in the wake of 11 September 2001. Special attention has been given to measures to ensure business continuity in all possible contingencies. In consideration of the high quality of services, advanced technology, flexibility and security, the Bank of Italy has proposed New BI-REL to the ESCB as the basis for the single shared platform of TARGET2.

Securities: the LDT net settlement procedure. – The value of the securities handled by the securities settlement procedure came to €33 trillion in 2002, an increase of €3.9 trillion or 13.4 per cent. All of the increase was due to the growth in government securities repos on MTS. Turnover in shares amounted to €1.3 trillion, 5.8 per cent less than in 2001.

Securities: the Express gross settlement system. – In 2002 the average daily value of the settlements via BI-REL of the cash leg of OTC securities trades from the Express system was €3.4 billion, compared with €2.9 billion in 2001. The number of payments rose from 340 to 360 a day. The value of BI-REL credits and debits for settlement through Express of monetary policy repos came to €235 billion, down from €385 billion in 2001. The decrease reflected the reduction in monetary policy financing obtained by Italian banks at Eurosystem auctions.

The use of securities as collateral. – The volume of securities posted as collateral for Eurosystem monetary policy operations and intraday liquidity averaged €686 billion, compared with €689 billion in 2001. Foreign securities made up 27 per cent of the total. The cross-border use of collateral grew by 20 per cent; the increase came both through the Correspondent Central Banking Model (CCBM) and through bilateral links between national securities depositories.

There was a significant reduction in the collateral pledged by Italian banks both against monetary policy repos and against intraday liquidity. The decline vis-à-vis monetary policy operations reflected a trend that had emerged in 2001, while that vis-à-vis intraday credit stemmed, as noted, from more efficient cash-flow management by the banks mainly as the result of the consolidation process. In fact, the collateral reduction was more pronounced for banks affected by M&A operations.

In June 2002 the Bank of Italy made some changes in the operation of the CCBM. The measures increased the level of automation and thus shortened processing time at the Bank, which is now the shortest in Europe. At the same time, thanks to the Bank’s efforts to securitize market players in the course of bilateral meetings, the main depository banks made procedural and administrative changes to shorten their own processing time.

The interbank database on irregular cheques and payment cards. – The database was instituted pursuant to Law 205 of 25 June 1999 and Legislative Decree 507 of 30 December 1999, which modified the sanctions for writing bad or unauthorized bank or postal cheques. In addition to the names of violators (natural and legal persons), the database records the bank coordinates of cheques that are lost, stolen, not returned to the bank or post office when the account-holder's authorization to write cheques is revoked, or blocked for some other reason.

The database began operation as regards cheques in June 2002; in December the payment card sections also went operational.

At the end of the year the total amount of bank and postal cheques classed as "unpaid" due to irregularities was €636 million, with an average of €3,600 each. The great majority of irregular cheques were for less than €10,000; they were concentrated in the size classes between €250 and €10,000.

Government payment services. – Action to complete the projects for electronic systems under the Computerized Public Administration Payment System was intensified last year. At the start of 2003 the payment of public salaries and pensions by credit transfer under standing payment authorizations was initiated. When fully phased in, the system will make some 36 million payments a year. Both the spending orders and the documentary reports to the Ministry for the Economy and Finance and to the State Audit Office will be dematerialized, greatly simplifying procedures for the banking and postal system. The payments will be made electronically, via the Single Public Administration Network, the National Interbank Network and SWIFT, furthering integration of state treasury management with the other components of the payment system.

The Bank of Italy and the Ministry for the Economy and Finance defined new procedures for executing state payments abroad. Within the EMU such transactions will be effected directly by the Bank via TARGET; outside the euro area they will continue to be made by the Italian Foreign Exchange Office.

The Bank also continued to provide electronic payment services at special conditions to public bodies other than the central government. The prices for the services of the banks acting as tax collection agents were revised, and after a period of testing the convention for the payments collection service on behalf of the Advanced School for Economics and Finance was signed. The procedures for the decentralized management of liquidity for non-pension payments by INPS (e.g. maternity allowances and unemployment benefits) were subjected to testing. A convention governing this service is being drafted.

Work began last year towards the creation of an information system on public agencies' collections and payments, within the legal framework of Article 28 of the Finance Act for 2003. This database will record the revenues and expenditures of all central government departments and local governments, on a daily basis and in detail, with the help of ICT instruments. The system will make available to the Ministry for the Economy complete and up-to-date information on the state of the public accounts classified in uniform fashion throughout the national territory. The project is of strategic importance for monitoring compliance with the EU budget rules in the course of the year. It is also important to the coordination of national and local finances with a view to administrative and fiscal decentralization. The system will also give local governments the data needed to shape their budgetary policies and monitor economic management.

The system is scheduled to go into operation by the end of 2004. Its management has been assigned to the Bank of Italy as part of the state treasury service under a special supplementary agreement between the Ministry and the Bank dated 31 March 2003.

THE GOVERNOR'S CONCLUDING REMARKS

The opportunities and risks presented by globalization and the need to pay attention to local realities inform and shape the work of the Bank, which it performs in the service of Italy, a country still marked by economic dualism but ever more open to international relations.

We are strongly committed to playing our part in the formulation of Eurosystem policy and to its implementation at national level. Our collaboration within the Group of Ten and the wider international community is intensifying.

Supervisory activity is aimed at further strengthening the banking system and individual intermediaries, in conditions of stability and efficiency, as a response to the needs of firms and to protect savings.

The safeguarding of competition between banks at national level is supplemented by surveillance of transparency and competition in more than one hundred provincial marketplaces. Working in close cooperation with the central departments, the Bank's branches are also responsible for the direct supervision of intermediaries of predominantly local significance. Regional data form part of the documentation on the Italian economy and the basis of our analysis of its performance.

The research and studies by the Research Department on the economy and the financial system and the contributions from other departments are set out systematically in the Report; they are the foundation on which these Concluding Remarks are based.

We are closely monitoring the process of governmental decentralization. The importance of public expenditure and taxation at local level should increase, within a necessary framework of solidarity.

In agreement with the Ministry for the Economy and Finance, we have taken on the task of designing the information system for the operations of public bodies. The project, which is nearing completion, will make it possible to record all items of revenue and expenditure daily on the basis of uniform nationwide criteria. It will provide an up-to-date picture of the financial activities of central and local government, filling gaps in information that cause uncertainty in interpretation and decision-making.

The new interbank settlement system will shortly come into operation; it will give Italian banks further opportunities in terms of operations and information and can also be used by other European banking and financial systems.

Construction of three new buildings has begun at the Donato Menichella Centre. Plans to improve the accommodation of some departments of the Central Administration are being examined.

Constant attention is paid to staff training and skills, recruitment and promotion.

Important agreements relating to career paths and grades have been reached with the representatives of the Bank's staff; they accord even higher recognition to expertise and introduce greater flexibility in the use of personnel.

All the employees of the Bank, of every grade and level, work with dedication and professionalism in the service of the country. I wish to thank them on behalf of the Board of Directors, the Directorate and myself.

The world economy

In the advanced economies gross domestic product grew by 3.8 per cent in 2000 and by 0.9 per cent in 2001; the rate then recovered to 1.8 per cent in 2002. In the developing countries output growth was 5.7 per cent in 2000 and fell to 3.9 per cent in 2001 before accelerating to 4.6 per cent in 2002.

In the major industrial economies consumer price inflation is at an historical low; it amounted to 1.3 per cent in 2002, compared with 2.1 per cent in the previous year. The decline was largest in the United States and Germany; in Japan prices continued to fall.

In 2001 industrial activity had declined continuously in the United States and Europe and had fallen by 10 per cent in Japan; it had reached a low point virtually everywhere in the closing months of that year. There were widespread signs of recovery until the autumn of 2002, but the economy then slowed down once more in all the industrial countries.

Fear of terrorist attacks and the announcement of military action followed by the actual commencement of hostilities in Iraq in March of this year steadily depressed business and household expectations, share prices and investment.

In the United States, despite the fall in industrial production and employment, consumption had grown by 2.5 per cent in 2001, benefiting from cuts in personal income tax and the substantial reduction in interest rates. The rate of growth accelerated to 3.1 per cent in 2002. Public expenditure made a major contribution to domestic demand. Gross domestic product expanded by 2.4 per cent in 2002, compared with 0.3 per cent in the previous year.

In Japan household consumption had risen by 1.7 per cent in 2001, faster than the rate of growth of GDP; it increased again in 2002, by 1.4 per cent, although it stagnated in the fourth quarter.

In the euro area consumer demand had slackened in the second half of 2001; it remained hesitant throughout the first half of 2002 and picked up slightly in the second. Household spending was dampened by the perception among a large proportion of consumers – around 80 per cent – that the changeover to the euro had had a substantial impact on prices.

GDP growth in the euro area slowed from 1.4 per cent in 2001 to 0.8 per cent in 2002.

The uncertain outlook had repercussions on investment. In the advanced economies as a whole, fixed capital formation, which had increased by between 5 and 6 per cent a year from 1996 to 2000, declined by 1.6 per cent in 2001 and by 1.8 per cent in 2002.

The fall in investment was sharpest in Germany, where it amounted to 5.3 per cent in 2001 and 6.7 per cent in 2002, and in Japan, where the trend had already become uncertain by the middle of the last decade.

In the second half of the 1990s the rise in share prices and the low cost of capital had boosted investment in all the advanced economies. There had been an exceptionally large increase in corporate mergers and acquisitions.

The correction in the prices of high-technology stocks had begun in March 2000. As activity slowed at the end of 2000, the fall spread to all other sectors. It was aggravated by the discovery of serious irregularities in the management of some major corporations, notably in the United States.

To date, the US stock market index has lost 40 per cent of its value compared with the peak reached in 2000. In the euro area share prices have fallen by half. In Japan the index, which had already fallen by a quarter during 2000, has shed a further 35 per cent since the end of that year.

By the early months of 2003 share prices had moved back close to their equilibrium values. In all the main markets the price/earnings ratio has fallen well below the averages recorded in the second half of the 1990s.

Economic activity has been sustained by fiscal policy and public expenditure in the major countries. In the United States a budget surplus equal to 2.4 per cent of GDP in 2000 gave way to a deficit of 1.5 per cent in 2002. The deficit is expected to increase to 3.5 per cent of GDP in 2003, owing partly to the expansionary measures recently passed by Congress.

In Japan the budget deficit rose from 6.1 per cent of GDP in 2001 to 7.1 per cent in 2002.

In the euro area, even though governments are committed to contain the imbalances in their public finances in compliance with the Stability and Growth Pact, the budget deficit has risen from 1 per cent of GDP in 2000 to 2.2 per cent in 2002. The European Commission predicts that the deficit for the area as a whole will widen further in 2003, to 2.5 per cent.

Monetary policy has provided crucially important support to the economy.

In the United States flexibility in the use of factors of production allowed considerable scope for manoeuvre. In a little under two years the Federal Reserve reduced the federal funds rate from 6.5 to 1.25 per cent. In the euro area the rate on refinancing operations was cut from 4.75 to 2.5 per cent. In the United Kingdom official rates were lowered from 6 to 3.75 per cent, while in Japan they remained constantly close to zero.

Despite the weakness of credit demand, the money stock grew rapidly in all the major countries in response to the expansion in monetary base by their central banks.

The ratio of the money supply to GDP in the seven major industrial countries rose from 66 per cent in 1998 to 75 per cent at the end of 2002.

Adjusted for consumer price inflation, short-term interest rates decreased by 3 percentage points between 1998 and 2002, reaching almost zero at the end of last year; in the United States they are now negative. Real long-term yields on government bonds fell by more than one percentage point.

The amount of government bonds outstanding continued to rise. Real-estate values increased sharply.

The decline in the cost of borrowing offset the restrictive effect of the fall in share prices and prevented the fall from becoming too large. The abundant money supply and its effects on the other components of wealth sustained consumer and investment demand, avoiding a decline in world economic growth. It was in fact possible to prevent instability among credit intermediaries in the major countries and on the world market.

Exchange rates

The balance-of-payments disequilibrium of the United States has become more pronounced over the past five years. Part of the expansion in the domestic money supply has thus spilled over onto the international financial markets, making them more liquid.

The US current account deficit amounted to 410 billion dollars in 2000 and 503 billion in 2002, equal to 4.2 and 4.8 per cent of GDP respectively. The country's net debtor position rose from 16 to 23 per cent of GDP between 2000 and 2001 and increased again in 2002, to 27 per cent.

The weakness of external demand and the appreciation of the dollar acted as a brake on exports, which dropped sharply in 2001 and again in 2002. The containment of imports was insufficient.

As a result of the fall in share prices and, above all, the economic slowdown, net inflows of capital to the United States have declined substantially. Direct investment, which had amounted to 130 billion dollars in 2000, was nil in 2001 and gave way to disinvestment of 93 billion in 2002. Portfolio investment offset only part of this reversal in the sign of direct investment.

Growing fears about the growth prospects for the US economy and the widening of the deficit on the current account of the balance of payments prompted international investors to adjust their portfolios, moving out of the dollar-based market and into the euro area and Asia. The increase in the supply of dollar-denominated liquid assets caused the dollar to weaken.

Since March of last year the US currency has depreciated by 9 per cent in effective terms.

In Japan the current account surplus increased as a percentage of GDP in 2002. This was offset by direct and portfolio investment in other markets. The official reserves continued to grow as a result of large-scale intervention in the exchange market to restrain the appreciation of the yen; they rose to 490 billion dollars, compared with 400 billion at the end of 2001.

Japan's net creditor position increased to 38 per cent of GDP in 2002. The country's sound capital account situation explains the strength of its currency, notwithstanding extremely low interest rates, the difficulties of its economy and the large proportion of non-performing bank loans.

For some time the currencies of the emerging Asian countries, which have run large current account surpluses since 1998, have also come under upward pressure, which has been countered by purchasing dollars. These countries added 167 billion dollars to their foreign currency reserves in 2002; the increase since 1998 amounts to almost 450 billion. China's official reserves total about 300 billion dollars and those of Hong Kong, South Korea, Singapore and Taiwan together come to nearly 500 billion.

The euro area's balance of payments on current account had moved from a deficit of 61 billion dollars in 2000 to virtual balance in 2001 in connection with the slowdown in domestic demand. In 2002 demand weakened further, leading to a surplus of 60 billion dollars, equal to 0.9 per cent of GDP; another surplus is expected this year.

Between 1993 and the middle of 2001 the price competitiveness of the countries that now form the euro area had improved owing to the steady depreciation of their currencies by 15 per cent over the period as a whole. From the middle of 2001 onwards, exchange rate movements considerably reduced the area's international competitiveness. By April of this year the deterioration amounted to some 17 per cent; over the same period the competitiveness of the United States and Japan improved by 2 and 12 per cent respectively.

Firms and banks

In the Group of Ten countries the expansion in financial activity in 1999 and 2000 had led to a surge in corporate fund-raising in the bond and equity markets. The annual amount of capital increases by listed firms had risen to 2.6 per cent of GDP, compared with 1.7 per cent in 1997-98. Each year 1,300 companies had been admitted to the stock exchange.

In 2001 and 2002 new listings of non-financial companies became less frequent. The annual volume of funds raised in the form of equity capital was 64 per cent less than in the preceding two years. In 2002 bond issues fell by 60 per cent compared with 2001.

In the major markets as a group 10 per cent of all firms with low credit ratings defaulted on bonds in the first half of 2002, a figure just below the level reached in the recession of the early 1990s.

In the United States and Europe life assurance companies were affected by the prolonged decline in the stock markets and the increase in the credit risk on corporate bonds. Injections of capital were necessary in a number of cases. In the casualty and reassurance sectors, the massive claims arising from terrorist acts and natural disasters curtailed profits.

The banking systems of the major countries had no serious difficulty absorbing the effects of the adverse economic situation, the fall in share prices, the troubles in the corporate sector and the tensions in the financial markets of Asia and Latin America; their stability was not compromised. The strengthening of banks' capital bases in the second half of the 1990s was a contributory factor.

The growth of the markets, their increased liquidity and the innovations that had been introduced permitted better diversification of the sources of financing for borrowers and of the risks for creditors.

Cooperation has grown closer among the authorities responsible in the different countries for supervising the banking, insurance and financial sectors.

In 2002 banks' capital and reserves amounted to 9.2 per cent of assets in the United States, substantially higher than in the previous years. In Germany the figure was 4.6 per cent and in France 7.2 per cent; in the United Kingdom it was 5.1 per cent in 2001.

In Italy capital and reserves are equal to 7.2 per cent of total assets.

Banks' solvency ratios are generally higher than the minimum requirement in both Europe and the United States.

Between 1996 and 2001 the average annual value of bank mergers and acquisitions amounted to 1.4 per cent of GDP in the United States, 1.2 per cent in Italy and 1.1 per cent in the United Kingdom. This far-reaching reorganization made it possible to curb costs and expand the sources of income, in part by introducing innovative products.

In Japan and Germany the restructuring of the banking industry was more limited; the value of mergers and acquisitions amounted to around 0.4 per cent of GDP. Costs rose in relation to income.

In 2001 banks' staff costs were equal to 25 per cent of gross income in the United States, 28 per cent in the United Kingdom and around 37 per cent in Germany.

In Italy the ratio declined from 36 per cent in 1999 to 30 per cent in 2001; in 2002 it rose back to 33 per cent.

In the United States banks' return on equity rose to 14.5 per cent in 2002. Net loan losses were held in check by reducing lending to firms and increasing mortgage lending to households. Commercial banks have additional exposure via their ownership of securities issued or guaranteed by specialized federal agencies, which hold half of all mortgage loans; the interest rate risk is managed by means of complex transactions in derivative instruments.

In Japan the difficulties of the banking sector led to an overall contraction of 2.5 per cent in the volume of lending in 2002, after those of 1.8

per cent in 2001 and 2 per cent in 2000. The volume of credit decreased further in the first few months of this year. Bad loans have continued to be written off at a rate of between 2 and 3 per cent a year.

In Europe it was German banks that were worst affected by the stock market turbulence on account of their large equity holdings. Lending by German banks stagnated in 2002, and loans to firms contracted in absolute terms. A plan has been approved to mobilize a substantial amount of bank loans by means of securitization. The financing will come from the market.

The growth of derivatives has greatly increased the opportunities for hedging risk, thereby reducing its cost, and the ability of markets and intermediaries to withstand adverse events. It has contributed to the stability of financial systems.

The notional value of derivatives traded on over-the-counter markets reached 128 trillion dollars last June, 60 per cent more than in 1999. In recent years a market in derivatives for hedging credit risk has developed; its size in December 2002 can be estimated at 2 trillion in terms of notional value. According to a recent survey of 150 major international financial intermediaries, US institutions accounted for nearly two thirds of the transactions and intermediaries based in European countries, including Italy, for most of the rest.

Use of these instruments has made it possible to redistribute credit risk in the market. The exposure of large banks has decreased, while that of smaller banks has increased.

The splitting of risk may cause intermediaries to base their investment decisions exclusively on the ratings of outside agencies, without carefully assessing the risk they are assuming, thus possibly leading to an excessive expansion of credit to particular sectors or countries. Every bank must accurately evaluate the risk-return profile of each operation, even when participating in syndicated loans organized by other intermediaries.

The use of complex, non-standardized financial instruments can be a source of opacity in the financial statements of the major international banking groups, whose organizational structures are highly ramified.

There is broad agreement on the need for uniform standards across countries for the accounting treatment of derivative positions; efforts to extend the disclosure requirements are being stepped up.

The supervisory authorities of the European countries are widely critical of the application of valuation techniques based indiscriminately on methods such as mark-to-market or fair value as a means of valuing bank assets.

The extension of these methods to traditional banking products would increase the variability of financial reports. It would somehow fail to recognize the banker's true function based on the ability to evaluate creditworthiness accurately.

The new international accounting standards must produce methods for the valuation of financial instruments that can dispel all forms of opacity in financial statements. The European countries' decision to make the international accounting standards mandatory for listed firms must be matched by a concrete commitment on the part of the United States to move towards a common set of rules.

The development of the backward countries

Economic development policies must be accompanied by specific programmes to foster the social inclusion of the poorest strata of the world's population and their participation in the benefits of economic growth.

In the less-developed countries the institutions responsible for managing the economy must be strengthened. It is necessary to invest heavily in human capital.

In line with the commitments made at the conference in Monterrey, Mexico, in 2002, the volume and effectiveness of development assistance must be increased. The debt-reduction initiative is encountering difficulties that must be surmounted as soon as possible. Like the other industrial countries, Italy is pledged to contribute 0.33 per cent of its GDP.

In order to raise the level of welfare globally and in the poorest countries, it is crucial to achieve tangible results on the multilateral trade liberalization front, in accordance with the objectives established in Doha, Qatar, in November 2001.

The level of support granted to agriculture in the major industrial countries remains high. According to OECD estimates, in 2001 the European Union provided subsidies to farmers, agricultural price supports and export aid amounting to 106 billion dollars, or 1.4 per cent of the area's GDP. Farm subsidies totaled 95 billion dollars in the United States and 59 billion in Japan, equal respectively to 0.9 and 1.4 per cent of GDP.

The protection accorded to agriculture by the richest countries is particularly harmful to developing ones, which have a comparative advantage in this sector.

In the recent meetings in Washington the Development Committee issued a strong call for an acceptable compromise to be reached by the summer regarding primarily agriculture. In this way the ministerial meeting of the World Trade Organization to be held in Mexico in September will be able to close important chapters of the Doha agenda, such as the reduction of customs duties on industrial products and the further liberalization of trade and direct investment in services.

Progress on this front is necessary in order to give fresh impetus to international cooperation, to overcome the divisions and mistrust engendered by the conflict in Iraq and the continuation of terrorist attacks and tensions in various parts of the world, and to achieve a better balance between the industrial economies and the developing countries.

The Italian economy

The difficulties of the international business cycle had repercussions on the European and Italian economies, which are characterized by structural rigidities and slower growth of potential output than those of North America or the emerging countries.

In the euro area GDP growth slowed from 3.5 per cent in 2000 to 1.4 per cent in 2001 and 0.8 per cent in 2002.

In Italy the increase of 3.1 per cent in output in 2000 was followed by rises of 1.8 per cent in 2001 and 0.4 per cent in 2002.

In the second half of 2001 economic activity in Italy slowed down abruptly owing to a fall in exports and a slackening of domestic demand. Investment, consumption and exports all continued to decline in the first half of 2002; GDP stagnated.

In the second half of 2002 a recovery in investment, largely due to the impending expiry of tax incentives, was accompanied by an increase in exports. Consumption also began to grow again, albeit modestly.

However, the increase in all the components of demand was not sufficient to stimulate productive activity; the expansion of supply stemmed from a large rise in imports. GDP growth picked up slightly.

The sharp decline in industrial activity during 2001 was followed in 2002 by a tentative recovery that lasted until the summer.

Production fell again in the second half of the year and contracted further in the early months of 2003; in March the index of industrial production fell back to the low registered in late 2001.

Despite the cyclical slowdown, employment continued to expand, rising at an annual average rate of 1.4 per cent. In 2001 and especially in 2002 permanent employment benefited from the tax incentives introduced at the end of 2000, which were suspended last July because of their excessive cost to the exchequer. The growth in employment was one percentage point higher than that in GDP; the expansion in labour-intensive services contributed to the decline in productivity.

On the basis of harmonized data, consumer prices rose by 2.7 per cent in 2001 and by 2.6 per cent in 2002. Inflation accelerated from mid-year onwards, rising to 3 per cent in December. The twelve-month rise in the harmonized index was 2.9 per cent in May.

An inflation differential is re-emerging in relation to France and Germany, our main competitors in the domestic and international markets.

Per capita earnings in Italian industry rose by 3 per cent in 2001 and by 2.8 per cent in 2002. Labour productivity increased by 1.6 per cent in 2001 and declined by 0.4 per cent in 2002.

Over the past two years earnings in the manufacturing sector in Germany have risen at just over half the rate recorded in Italy, while productivity has improved twice as rapidly.

Unit labour costs in Italian industry rose by 4.3 per cent in the two years, compared with 1.3 per cent in France and Germany. The gap vis-à-vis these two countries was thus 3 percentage points.

While world trade in goods and services grew by 3 per cent over the past two years, German exports increased by 7.8 per cent and French exports by 3.2 per cent.

Italy's exports in 2002, measured in volume terms, were the same as in 2000.

Competitiveness

A look back over the years again highlights the weak growth of the Italian economy in the European and world context.

In the five years from 1998 to 2002 the GDP of the United States grew by an average of 3 per cent a year and that of Europe by 2.3 per cent. Italian output rose at an annual average rate of 1.8 per cent.

World trade in goods and services expanded by 28 per cent between 1997 and 2002. Italian exports increased by 16 per cent, while those of France and Germany rose by 31 and 38 per cent respectively.

The loss of competitiveness affects industrial value added and economic growth.

In the five years from 1997 to 2002 industrial production in Italy increased by 3 per cent. In France the growth was about 11 per cent, in Germany 12 per cent; in the euro area excluding Italy it was 14 per cent. The expansion of Italian firms' production abroad – in the emerging and developing countries – has been substantial, but no greater than that of the other large euro-area economies.

Italy's share of world exports had risen steadily from 2 per cent in the 1950s to 4.5 per cent in the 1980s.

Until the early 1970s the complete stability of the lira against the dollar and the other main currencies was accompanied by large gains in industrial productivity. During the 1950s and 1960s Italy's GDP increased at rates of between 5 and 6 per cent as the country gained export market shares.

In the subsequent decades, following the oil crises, labour incomes and prices rose sharply, productivity growth slackened and the annual rate of output growth slowed by half. Italy's share of world trade was defended by repeatedly devaluing the currency. Between 1971 and 1993 the nominal effective exchange rate of the lira against the leading currencies fell by about 70 per cent.

Competitiveness began to decline in the mid-1990s, bringing Italy's share of world trade back to the level of the mid-1960s; at constant prices it fell from 4.5 per cent in 1995 to 3.6 per cent in 2002.

The loss affected all markets. The composition of Italian exports makes them vulnerable to changes in prices, which are necessarily linked to production costs. Italian goods are poorly represented in technologically advanced sectors, whereas they are prominent in those where success depends on taste and workmanship.

Italy's share of world trade remains high in such industries as furniture, leather products and the working of non-metallic mineral products.

In machinery and mechanical equipment, Italy has a gradually declining share that now amounts to 9.6 per cent of world exports. In five years the country's share in motor vehicles and parts has fallen from 3.6 to about 3 per cent, and in electrical equipment and precision instruments from 2.1 to 1.8 per cent. Our exports of electronic and information technology products are very small.

The United States maintained a world market share of about 11 per cent by volume throughout the 1990s. France and Germany have gained market shares since the middle of the decade, benefiting from intensified specialization in high-technology sectors. Japan's share fell from 8.6 per cent in 1995 to 6.4 per cent in 2002; at current prices the loss was less marked, revealing an ability to sell at high prices owing to good product quality.

Chinese exports at current prices have expanded from 2.9 per cent of world trade in the mid-1990s to about 5 per cent, as the country has moved successfully into the production of medium-technology goods.

As in the rest of Europe, import penetration in the Italian market is growing. Domestic demand is being satisfied increasingly by goods produced in other countries.

Between 1990 and 1995 the net impact on production of the stimulus from exports and the restrictive effect of imports was positive, thanks to the recovery in competitiveness as a result of the devaluation of the lira in 1992. Between 1996 and 2002 the net effect turned negative; the rise in purchases of foreign products to meet a growing proportion of domestic demand for finished products and intermediate goods far outweighed the growth in exports.

Over these seven years the negative impact of foreign trade on GDP can be estimated at 2.9 percentage points. In the other euro-area economies increases in imports were more than matched by export growth.

Productivity

The unsatisfactory performance of the Italian economy has been due in large part to the slow increase in productivity.

In the United States between 1995 and 2000 the widespread application of information technology, increased investment, research, the wealth of human capital and flexibility in the utilization of labour fostered far-reaching organizational change and a shift towards the production of goods with a greater technological content. Hourly labour productivity in industry rose by 4.5 per cent a year.

In France productivity increased by 4.6 per cent a year and in Germany by 2.4 per cent.

In Italy hourly labour productivity in the manufacturing sector rose by 0.9 per cent a year between 1995 and 2000.

The loss in competitiveness has become more evident in recent years, but its origins lie further back in time.

In manufacturing, total factor productivity, which is a measure of technical and organizational advance, rose by only 1.3 per cent a year between 1980 and 1985, despite large-scale restructuring; in the economy as a whole there was virtually no increase at all.

From the mid-1980s to the mid-1990s total factor productivity in industry rose at an average annual rate of 1.5 per cent.

From 1995 to 2001 the growth of value added in manufacturing industry slowed down sharply. Investment increased, but not employment.

Total factor productivity stopped rising; over the period as a whole it declined by about one percentage point.

The increase in employment over these years was concentrated in the private service sector, where overall productivity increased slightly.

The contribution to output growth stemming from investment in information technology amounted to 0.2 per cent a year both in industry and in services.

Between 1995 and 2001 value added in the private sector increased by 13.1 per cent at constant prices. Of the overall gain, 5.8 percentage points can be attributed to labour, 5.2 points to capital and 2.1 points to the growth in total factor productivity.

The banking and financial sector accounted for one sixth of the productivity gain in the economy as a whole. Thanks to reorganization and investment in new technology, total factor productivity in the sector rose by almost 7 per cent during the period.

Transport and communications, agriculture, textiles and retailing also made significant contributions to the improvement in total factor productivity. In many branches of both industry and services the gain in productivity was practically nil; in others there was a decline.

Firms, research and economic growth

The paucity of the rise in productivity is attributable not least to the fragmentation of supply. Italian firms are small. The Census of October 2001 found that local production units in industry have an average of 6.3 workers, a very low figure compared with other European countries and the other major industrial economies.

This structure created abundant employment in past decades, and it is a reservoir of entrepreneurship. Unless it is complemented by large firms, however, it shows its limitations as regards productivity growth and the ability to compete in a world market where some new competitors benefit from minimum social protection and very low labour costs.

Studies by our Research Department of the economies of European countries reveal a close correlation between productivity growth and company size; in high-technology sectors size is decisive.

In Italy as elsewhere, firms are increasingly using information and communications technology, but they do not yet appear to have introduced production processes that have a significant impact on costs and productivity: the small scale and inherently simple model of production have not provided much scope for improving the organization of small businesses.

More efficient organization of the economy as a whole, through networking to replicate on a national level some of the characteristic advantages of local industrial districts, could generate significant productivity gains.

Italy's under-representation in technologically advanced sectors and its slowness to apply information technology to production processes and organization are ascribable partly to the limited amount of resources allocated to innovation and research, both by the public sector and by private firms. Total spending was 1.3 per cent of GDP in 1990 and fell to about 1 per cent in 1995.

In the United States expenditure on research rose from 2.4 per cent of GDP in 1994 to 2.8 per cent in 2001. In the other large industrial countries it ranges from 3 per cent in Japan to 1.9 per cent in the United Kingdom.

Public sector expenditure on research and development in Italy comes to about 0.5 per cent of GDP, a low figure by comparison with the other large industrial economies. According to the latest data, firms' investment in research and development is also about 0.5 per cent of GDP; it has declined since the early 1990s.

Firms in the United States and Japan invest more than 2 per cent of GDP in research, four times the Italian ratio. In Germany the figure is 1.8 per cent; in France and the United Kingdom it is between two and three times as high as in Italy.

The application of new technology to the coordination and control of production as part of an overhaul of processes to improve efficiency entails improving the skills of the work force, adopting new organizational models and redefining relationships with suppliers and distributors.

It requires adaptability on the part of workers, intelligence and high levels of skill.

The proportion of the population aged between 25 and 64 with post-secondary education is 36 per cent in the United States and around 30 per cent in Japan, the United Kingdom, Sweden, Finland and Belgium; in Italy it is 10 per cent, owing in part to a high university drop-out rate. Graduates in engineering and other scientific disciplines account for a smaller share of the total than in any other leading industrial country.

Investment in secondary and university education is indispensable if the technical and scientific training of the younger generation is to be improved with a view to reorganizing production processes in industry and especially in services to achieve greater flexibility and adaptability to changing demand.

A sound background in the humanities is needed to comprehend an economic and social environment in which intercultural relations are changing swiftly, owing in part to advancing globalization.

Investment in education rewards the individual with a rate of return close to double digits within a relatively short time span. The social return can be much greater than the individual yield alone.

The business start-up rate in Italy is comparable to that in other economies, but firms' subsequent expansion faces impediments both in Italy and in Europe.

The institutional, legal and fiscal obstacles to the growth of small companies must be eliminated. Services must be liberalized further. The labour legislation now being drafted moves towards easing the constraints on the utilization of the factors of production.

Employment regulations that are consistent with an industrial economy focusing on standardized mass-produced goods, and the related costs, are among the causes of the large number of self-employed workers and the abnormally high proportion of irregular employment.

The small size of production units, the proliferation of self-employment and the spread of the underground economy are also a response, albeit an unhealthy one, to the slow growth and poor competitiveness of the regular economy.

A new stage of development calls for reorganization of the structure of the economy and an increase in the size of firms.

Mergers and restructuring within the banking system have given a considerable boost to productivity in the sector. The long period of investment in information technology, the growing size of banks, the progressive replacement and training of staff, and greater employment flexibility are bearing fruit in terms of return on equity and the ability to serve households and firms.

Industry too needs to form stronger groups capable of product and process innovation and able to withstand growing competition in the domestic market and to move more confidently onto the world stage.

Corporate mergers and acquisitions call for careful market analysis and evaluation of productive synergy; they must be initiated by entrepreneurs.

More advanced forms of corporate organization and financial structure are needed. Universities can play an important role in cooperation between groups of firms for the purposes of introducing new technologies.

An innovative economic policy for research, education and technological progress together with industrial relations suited to the new environment of greater openness and competition can halt the slow but steady decline in competitiveness and improve productivity in industry and services.

We must strengthen existing production capacity and make it more economically viable and dynamic, in order to prevent backsliding and achieve a new stage of development.

The South

The economic disparity between the two main regions of Italy narrowed until the 1970s, thanks to large-scale investment in infrastructure and basic industry under the southern development programme, but it has widened again in recent decades.

The Centre and North are home to 85 per cent of Italy's industrial capacity. The local environment, the distance from the affluent regions of Europe and the lack of efficient transport networks make production in the South less competitive than in the rest of the country.

The consequences are lower employment rates, higher unemployment and a high proportion of underground economic activity and irregular work.

Since the mid-1990s the ratio of gross fixed capital formation to GDP has ranged between 18 and 20 per cent in the North. In the South it has averaged one percentage point more. The final domestic consumption of households and general government amounts to 97 per cent of output in the South and 74 per cent in the rest of the country.

Imports of goods and services to the South, which come predominantly from other parts of Italy, exceed exports by more than 50 billion euros. Only a very small part of this deficit, equivalent to 18 per cent of the area's output, is offset by net receipts from tourism.

Balance is achieved through the action of general government, in that public expenditure is roughly correlated to the number of inhabitants while tax revenues are more than proportional to income.

The South's balance of payments on current account is roughly in equilibrium. The region is not accumulating external debt.

Through their lending and fund-raising activities, banks channel a net flow of funds to the South, albeit a modest one. The branches of banks based in the Centre and North lend more in the South than they raise in the region, a tendency that has become more marked in recent years.

Capital transfers by northern companies investing in the South are substantial. Industrial firms with 50 or more employees made investments totaling 35.1 billion euros in 2001, including 6.3 billion in the South, but only 2.4 billion of this investment was by firms whose registered offices are located in the area.

According to the 1996 Census, more than 12 per cent of private sector employment in the South was in firms whose registered offices were outside the area.

Labour costs make the output of the South less competitive, owing to lower productivity because of external diseconomies. Government aid does not bridge the gap with the rest of the country.

At the beginning of 2003 the unemployment rate, which has declined in recent years, was 18.6 per cent in the South, compared with 4.2 per cent in the North-West, 3.7 per cent in the North-East and 6.9 per cent in the Centre. The employment rate of the working-age population was 43.2 per cent in the South, 58.4 per cent in the Centre and 63.7 per cent in the North.

In Europe the employment rate is over 64 per cent.

The number of irregular workers is extremely high in the South, accounting for as much as half of total employment in some branches of activity.

In the last few years substantial net emigration to the Centre and North has resumed.

The South’s medium-term growth potential is greater than that of the rest of Italy, owing precisely to its lower starting level, its demographic vitality and plentiful supply of young workers more open to learning the new techniques and skills required by a modern economy.

The contribution of tourism is modest in relation to total resources. Tourist receipts in 2001 came to 9.5 billion euros in the South, compared with 50.2 billion in the Centre and North. It is necessary to foster the industrial and high-technology activities that are already emerging in some areas.

Faster growth in the South will also benefit the economy of the North, with its rapidly ageing population and widening gap between the capacity for saving and the opportunities for investment.

Decentralization and fiscal federalism cannot afford to ignore the profound civil, social and economic ties that exist between the different parts of Italy.

They must aim at the development of the national economy as a whole.

Banking and the financial markets

During a cyclical slowdown overlaid by the destabilizing effects of the fall in share prices, large corporate failures and the difficulties of emerging countries, the Italian banking system is among those that have shown greatest resilience.

In the on-site inspections carried out at 342 banks in 2001 and 2002, the assessments were entirely positive in 139 cases. This is basically the same ratio as in the preceding two years, when 136 of 326 banks received a favourable assessment. The proportion of negative evaluations declined from 25 to 19 per cent; they concerned banks that accounted for 2 per cent of the system’s total assets.

The progress made since the mid-1990s is reflected in the positive judgement made by the financial markets. Setting the values of the start of 1995 at 100, the share index of Italian banks now stands at 245, some 15 points higher than the average for banks of the euro area and 44 higher than the Italian stock market index.

Over a period of ten years the portion of bank assets held by institutions in which more than half of the equity is owned by public bodies and banking foundations has fallen from 66 to 10 per cent. The greater focus on profitability and the need to attain an adequate volume of business to compete at international level have impelled the system towards consolidation, greater operating efficiency and the provision of new services.

Considerable productivity gains have been achieved. Between 1995 and 2002 the stock of IT capital per employee rose roughly fourfold; the number of staff decreased by 4.5 per cent.

The process of consolidation was particularly intense from 1995 to 2000. Following a pause in 2001, there have been another 36 mergers and acquisitions since the beginning of 2002.

Banks have expanded the supply of asset management services. The Italian investment fund industry has become the second largest in Europe in terms of assets under management.

The main banking groups have chosen to extend their presence in the countries of Central and Eastern Europe. Italian banks occupy significant positions in some of those that will join the European Union. Nevertheless, our banking system’s international activity remains small by comparison with that of banks from the other main euro-area countries.

Drawing on the knowledge of the markets gained in the course of supervision, we have taken steps to ensure that consolidation is accompanied by an increase in competition, even at local level.

The abolition of operating restrictions and geographical barriers has increased the opportunities for competition. Today there is one bank branch for every 1,900 inhabitants, compared with one for every 3,400 at the beginning of the 1990s. It has become easier to compare the conditions and products offered.

The spread between the return on loans and the cost of funds was 3.8 percentage points in 2002, compared with 6.1 points in 1995. The differential between the average and minimum lending rates has narrowed; the dispersion by geographical area has decreased.

Banks’ profitability and the supply of credit

In the mid-1990s banks’ return on equity was around 2 per cent for the system as a whole, with considerable variability from area to area; in 2000 it was 11.5 per cent. The increase, which was systemwide, was more pronounced for the large groups.

In the last two years profitability has been reduced by the economic slowdown, the need to provide against the risks connected with the exposure to Latin American countries and large international firms, and the contraction in income from asset management services.

Profits fell to 8.8 per cent of capital and reserves in 2001 and to 6.2 per cent in 2002. The reports for the first quarter of 2003 indicate an improvement with respect to the end of last year.

The return on equity of German banks declined from 5 to 3.7 per cent between 2000 and 2001; last year it fell further. In France the banking system's profitability was on the order of 9.5 per cent in 2000 and 2001; for the major banks, which account for two thirds of the system, it fell by around 2 percentage points in 2002. Bank profitability is higher in the United States and the United Kingdom, where GDP growth has been faster in recent years.

Credit risk has risen very slightly in Italy. In 2002 new bad debts amounted to 1 per cent of total lending; the ratio had reached 3.6 per cent in the wake of the 1993 recession and remained above 2 per cent until 1996.

The small scale of new bad debts primarily reflects the more balanced financial situation of corporate borrowers in both industry and services, where profitability remained high despite the weak economic situation; gross operating profit declined from 37.6 per cent of value added in 1995 to 36 per cent last year. The fall in interest rates caused interest charges to contract from 22 to 15 per cent of gross operating profit. Capital spending was low; the share financed internally remained high.

The large industrial groups, which in 2000 and 2001 had financed acquisitions by borrowing heavily from banks, subsequently disposed of non-strategic assets and reduced their debt. This helped banks comply with the limits on risk concentration. The Bank of Italy systematically monitors lending to large companies. Industrial groups with annual sales of at least 50 million euros account for 10 per cent of banks' total assets, a low proportion compared with other leading countries; in Germany the figure is around 30 per cent.

Statistical studies based on the financial statements and credit reports of 126,000 companies indicate that in the last four years banks have channeled an increasing share of their lending to firms with a low likelihood of default.

Among firms with annual sales of less than 5 million euros, lending to those with a probability of default below 0.5 per cent increased by an annual average of 11 per cent; lending to firms whose probability of default was higher than 1 per cent grew more slowly, by 5 per cent. A similar pattern is also found in lending to large firms.

Credit supply conditions remained relaxed.

Lending slowed down until last autumn. The annual rate of growth subsequently picked up, rising to 7.1 per cent in April. It is currently 3 points higher than that for the euro area. In France the increase in lending amounted to 4 per cent in 2002; in Germany it was virtually nil.

The expansion in lending was mostly at medium and long term, ensuring greater stability in the financing of firms. The undrawn margin on credit facilities remains large; it has increased for the manufacturing sector.

After the reductions in the euro-area reference rates, the average cost of short-term loans fell by 0.1 percentage points in December and by another 0.5 points in the first four months of this year. Today it stands at 5.2 per cent, the lowest figure for half a century. Bank interest rates are in line with the levels elsewhere in Europe.

Banks' capital resources, which represent the main guarantee of their ability to finance the economy on a stable basis, exceed the minimum requirement. Between the end of 2001 and the end of 2002 the solvency ratio rose from 10.4 to 11.2 per cent; for the main groups, it increased from 9.3 to 10.6 per cent.

The banking foundations have played an important role in the reorganization and privatization of the banking system. It is essential to ensure the continuity of the role they play as private non-profit institutions.

In the South, the contraction in the flow of new bad debts in relation to lending was also significant.

In the mid-1990s around 6 per cent of loans became irrecoverable every year in the southern regions, three times the figure for the rest of the country. Shortcomings in loan selection were common, particularly in the publicly owned banks.

The reorganization of banking in the South was achieved by privatizing the principal banks and with the entry into the area of better capitalized and managed intermediaries. The contribution of public resources was small and conditional on staff costs being brought into line with those in the rest of the banking system.

In the three years from 1999 to 2001 bank lending to southern firms grew by an average of 6.5 per cent a year, which was lower than in the Centre and North. In 2002 the growth in lending in the South amounted to 7 per cent, a higher rate than in the rest of the country. The flow of new bad debts declined to 1.6 per cent of lending, compared with 0.9 per cent in the Centre and North.

The differential between the interest rate on short-term corporate loans in the South and that in the Centre and North narrowed from 2.3 percentage points in 1996 to 1.6 points in 2002; it is less than one point when adjusted for the different sectoral and size composition of firms in the two parts of the country. The spread for medium and long-term loans is also very small, on the order of half a percentage point. The disparity with the rest of the country reflects the higher credit risk and is attributable to external diseconomies.

In recent years the interest rate on households' bank deposits in the South has gradually come into line with that in the Centre and North. The regional disparities in the remuneration of bank deposits have been eliminated.

The new Capital Accord

The Capital Accord currently in force dates back to 1988; it has been applied in more than 100 countries; it has made a major contribution to increasing the stability of banking systems and expanding their volume of business.

Since its adoption there has been considerable growth in banks' activity in international markets as well, new products have been introduced and new financial instruments have been created.

The opportunities for expanding business and profits have increased, but new risks have emerged.

The new Accord proposed by the Basel Committee on Banking Supervision establishes a closer link between capital requirements and level of risk in the light of the developments in banking over the last fifteen years. The reform is intended to encourage the application of more advanced methods of risk measurement and management, bolster the effect of market discipline on banks' policies and strengthen the action of supervisory authorities.

Empirical tests and consultation with a broad range of banks have made it possible to align the proposed new Accord with best management practice and to shape it in accordance with the operations of the various categories of credit institution. Banks are offered more ways to calculate their capital requirements; they can choose according to the configuration of their activities and the structure of their internal control systems.

The more advanced methods of calculating capital requirements will be used primarily by large banks that are active in international markets and by medium-sized banks specializing in innovative sectors.

Smaller banks, engaged in the traditional business of deposit-taking and lending, will be able to use a simplified method comparable to the present one.

At the end of April 2003 the Basel Committee released the third consultative paper with a view to launching the new Accord by the end of the year. Like the earlier versions, the paper is available for policy makers, market participants, trade associations and experts to comment on and make suggestions for amendments. These will be examined by the Committee in drawing up the final text. The new Accord is not expected to come into force before the end of 2006.

Compared with the initial draft, studies conducted by the Bank of Italy and the supervisory authorities of other countries have led to the introduction of specific methods for calculating capital requirements in relation to loans to smaller firms; their validity has been confirmed by simulations carried out by around 350 banks in more than 40 countries.

The new methods take account of the smaller exposure of the mass of small firms to the business cycle and the greater predictability of losses on portfolios of loans to smaller customers. The capital requirements for exposures to companies with sales revenues of up to 50 million euros are lower, for the same risk of default, than for exposures to larger firms. Loans of 1 million euros or less will receive even more favourable treatment. Under the new rules it will be possible for collective loan guarantees provided by consortia and cooperatives to be recognized for risk-mitigation purposes.

The new mechanism reduces the fluctuations in capital requirements with changes in cyclical conditions.

Analyses carried out by the supervisory authorities of several countries and tests performed by banks do not indicate any rationing effects or distortions in the allocation of credit as a consequence of the application of the new Accord.

By inducing a better use of capital resources, the new Accord ultimately aims to strengthen banks' stability further in order to protect the savings they manage.

It also aims to produce a more efficient allocation of credit to the economy.

Objective factors are taking on greater importance in the evaluation of creditworthiness. This is increasing the need for transparent financial reports giving a complete picture of firms' earnings and financial position.

Relationships between banks and firms must be based on mutual confidence and they must become more stable. This shift towards more advanced procedures and methods is necessary for both banks and firms. A better allocation of credit will help exploit the potential of the extensive network of small firms that is a feature of the Italian economy.

Savings and the financial market

After reaching a new low in 2000, household savings rose to 12.5 per cent of disposable income in 2002. A growing proportion was invested in medium and long-term bonds, largely government securities; house purchases increased.

Returns on financial investments fell short of savers' expectations in 2001 and 2002; after enjoying high interest rates for years, investors are finding it hard to realize that high yields necessarily imply high risks.

Some banks displayed shortcomings in the evaluation of risks, the recording of commitments in their accounts and their conduct towards customers.

In some cases it was necessary to initiate special procedures to safeguard the soundness of banks' operations.

In the four years from 1999 to 2002 the Bank of Italy undertook on-site inspections at 11 of the 100 or so asset management companies, most of which belong to Italian or foreign banking groups, and at 29 of the 170 Italian investment firms. Consob also carried out inspections.

Our checks at asset management companies found that on the whole their situation was satisfactory; in some cases organizational shortcomings came to light, leading the Bank to initiate sanction procedures. Some investment firms were found to have fragile ownership structures and serious organizational deficiencies; in some cases the Bank initiated sanction procedures and in others it imposed special administration or liquidation.

On-site inspections and the checks made at bank branches by the Bank's decentralized supervision units found some omissions in the information provided to customers; instances of non-compliance with the rules on transparency were also uncovered; in 2002 the Bank initiated sanction procedures against 25 banks.

Acting on a proposal from the Bank, the Interministerial Committee for Credit and Savings approved a comprehensive revision of the provisions implementing the primary legislation on transparency. New rules have been introduced with the aim of providing more effective investor protection; additional information has to be disclosed on the contractual terms and conditions, costs and risks associated with banking transactions, lending and fund-raising.

Banks and non-bank intermediaries must give investors accurate information and prudent advice on the investments best suited to their needs and consistent with their means. They must offer financial instruments that are easily comprehensible and without needless complexity. They must always ensure that products are comparable.

Ethics and professionalism are essential.

In the second half of the 1990s mistakes were made and excessive expectations were raised against the background of generalized optimism in the financial markets of the leading countries. Employees must undergo regular training based on the principle of customer service.

Customer confidence, which underpins financial institutions' stability and operations, must be strengthened.

Today there are 265 Italian companies listed on the stock exchange, down from 276 at the end of 2001. There are 715 listed companies in Germany, 737 in France and 2,405 in the United Kingdom. The listed Italian non-financial companies account for one sixth of the value added of such companies.

The small number of non-financial companies listed on the Italian stock exchange reflects the small size of our firms, but above all their low propensity to seek listing. The firms in the lowest quartile of listed companies by market value are eight times larger than their counterparts in Germany and five times larger than those in France.

According to research by Borsa Italiana, nearly 1,200 companies have the characteristics required for listing. More than half have been approached by merchant banks, commercial banks and management consultants with a view to admitting outside shareholders or floating on the stock market. So far the response has been unsatisfactory; listing increases the exposure to external scrutiny.

It is essential to proceed with reform of the rules and the removal of the constraints that hold back the activity and growth of firms.

The new company law is an important step in the process of overhauling the legislative framework.

This reform encourages entrepreneurship, increases directors' autonomy, better defines their responsibilities and improves the rules on conflicts of interest within firms and conglomerates. The difference between the legislation on companies with listed securities and that applying to other companies limited by shares has been reduced. The steps taken in this field must be completed by a reform of Italian bankruptcy law.

Labour market reform and a reduction in the tax burden must create conditions conducive to growth in the size of firms and the start of a new investment cycle, especially in high-tech sectors.

The challenge facing Italian firms is to achieve, mainly through consolidation, a scale of production that permits higher efficiency, more research, and innovations able to broaden the range and improve the quality of their products.

With their new size and organizational structures, banks, working closely with the capital market, must now contribute in a more determined fashion to the modernization of our economy, make their wealth of information available to firms, and assist them in planning mergers and acquisitions and finding more advanced forms of financing.

The efficient allocation of credit has a high social value, especially in today's difficult economic climate; it is essential in order to protect savings, support businessmen with a drive to innovate, and contribute to the growth of the economy by financing the best investment projects.

Last May, in the light of the improvement in economic performance after the events of 11 September, we had indicated that the GDP of the United States could be expected to increase by at least 4 per cent between the end of 2001 and the end of 2002.

The serious international tensions and subsequent developments curbed the recovery. Output grew by 2.9 per cent during 2002.

Growth in the euro area over the same period was only 1.2 per cent.

The cost of the dramatic international events, in terms of forgone growth, can be estimated at around one percentage point of GDP in the industrialized countries.

In the first few months of this year the economic situation was still dominated by the repercussions of war and terrorism.

In Japan prices are continuing to fall.

In the United States economic policy is geared strongly towards countering the slowdown in activity and combating unemployment. Inflation is being held in check by the reduction in costs associated with large productivity gains and the intensification of competition.

Gross domestic product increased at an annual rate of 1.9 per cent in the first quarter of 2003. Economic activity should accelerate in the second half of the year, boosted by low interest rates, a new programme of tax cuts and the depreciation of the dollar.

The growth forecasts for the fourth quarter in relation to the same period of the previous year range between 2.2 and 3 per cent. The increase in GDP for 2003 as a whole is likely to be between 2 and 2.5 per cent, still below potential growth.

A full recovery is widely expected to materialize in 2004.

Growth in the euro area was almost zero in the latter part of 2002 and the first quarter of 2003; it will be less than 1 per cent in the year as a whole.

The strong appreciation of the euro is affecting activity. The scope for budgetary measures is limited; in some countries the deficit is well above the 3 per cent limit.

The weakness of growth in continental Europe is attributable in large part to the rigidities that built up during the decades of rapid development after the Second World War, the ageing of the population and the associated heavy burden of pension and welfare spending.

In the major countries the launch of monetary union has not been followed by the structural reforms needed to bring about a better utilization of resources, first and foremost labour, and to compete in a profoundly changed economic and financial environment.

If the European objectives for growth and employment laid down in Lisbon in 2000 are to be achieved, the necessary measures must be taken in each country. Easing the tax burden presupposes a reduction in the ratio of public expenditure to GDP; state pensions have to be adjusted to take account of increased life expectancy; the development of supplementary private pensions will generate new resources to finance investment.

At a time when the economy is weak, the balance of payments in surplus and prices are stable, demand and growth can be stimulated by the resumption of a programme of major infrastructure works, on the basis of well-defined projects and timetables.

In the first quarter of this year Italy's gross domestic product remained at the same level as in the latter part of 2002.

Industrial production continued to fall in the three months to March; according to our preliminary estimates, it rose slightly over the following two months.

Exports should increase by 2 per cent in volume terms this year, thanks to the recovery in world demand; the loss of market share is continuing, owing partly to the appreciation of the euro.

Consumption should begin to grow again, albeit slowly. The availability of credit is conducive to investment in construction.

Imports are still outpacing exports; this will hold down production and the growth in national income.

It is difficult to see GDP growing by more than 1 per cent in 2003.

Companies' spending plans, influenced by expectations of weak demand, point to a contraction in investment, especially in manufacturing.

In 2002 public investment was 7 per cent higher than in the previous year. According to a survey by our branches, expenditure on public works is recovering from the slowdown observed in the first half of 2002; it should gain momentum during the current year.

Investment on construction in the fields of health, water supply, education, energy, transport and communications amounted to 3.3 per cent of GDP at the beginning of the 1990s; it fell to 2 per cent in 1995 before rising again to 2.5 per cent more recently.

Infrastructure deficiencies impinge upon growth in the North, but they are more severe in the South, where they are associated with far lower levels of productivity, employment and income.

Partly on account of the unfavourable economic climate, the performance of the public finances is not consistent with the repeatedly proclaimed objectives for consolidation and adjustment.

Net borrowing on an accruals basis ultimately worked out at 2.6 per cent of GDP in 2001. It fell to 2.3 per cent in 2002, with temporary measures responsible for an improvement of more than 1 percentage point.

The balance for 2003 is expected to be the same as last year in relation to GDP.

The primary surplus, that is to say the budget balance net of interest payments, which at the time of entry to Monetary Union we had committed ourselves to keeping at 5.5 per cent of GDP, fell to 4.6 per cent in 2000; it is expected to be 3.2 per cent in 2003.

In the current difficult phase of the cycle temporary measures make it possible to curb the deficit without cutting into permanent income, but there remains the problem of replacing them with structural measures.

The ratio of tax and social security contributions to GDP declined by half a percentage point between 2001 and 2002, from 42.1 to 41.6 per cent, thus sustaining domestic demand. The ratio of current primary expenditure to GDP rose by 0.4 points last year.

The gap between permanent revenue and permanent expenditure is widening; the gradual reduction in the tax burden that has been announced will have to be based on a reduction in expenditure.

There remains a large disparity between the cash deficit and net borrowing on an accruals basis.

Structural measures are essential to adjust the public finances once and for all, offer the certain prospect of an easing of the tax burden and improve business and household expectations. The incidence of unfunded pension liabilities must be contained, the retirement age raised and the ratio of primary current expenditure to GDP gradually reduced.

Market confidence is being eroded by international tensions and the resulting economic difficulties. In Italy, as elsewhere in Europe, clear economic policies centred on an improvement in the public finances and consistent with a new prolonged phase of economic growth are proving slow to emerge.

Action must be taken before uncertainty gives way to pessimism.

A medium-term plan must again be proposed along the lines put forward by the Government in the Economic and Financial Planning Document published in the summer of 2001.

Low inflation, a high propensity to save and extremely low interest rates are ideal conditions for an acceleration in both public and private investment.

The easing of the tax burden on firms, the low cost of capital and the knowledge which banks can contribute can help reduce the fragmentation of the economy and stem the slow but steady decline in productivity.

The efforts to improve secondary and university education must be combined with an increase in funding for basic and applied research and more efficient use of the funds available. It is essential that firms renew their efforts in research and development aimed at offering new products and introducing new production techniques.

Small firms are a vital part of our economy. Mergers and forms of cooperation that make widespread use of information and communications technology are the way to improve competitiveness.

The authorities must persevere with the measures aimed at raising the efficiency of the public administration, to serve the population and sustain economic activity.

The economic recovery in the United States should strengthen towards the end of the year. Conditions must be created for Italy to benefit fully from this, by removing the structural obstacles to growth.

Italy is on the point of assuming the Presidency of the European Union at a time of enlargement to admit new member countries. The new configuration will be strengthened if adequate arrangements are made for sharing sovereignty and the correct balance is struck between national and European interests; it must be inspired by the deep-rooted values that have united the peoples of Europe over the centuries.

We have the resources to grow. It is the duty of business, labour and politics to harness these resources in order to foster employment, assist the younger generation, promote economic and civil advancement and return to the path of growth.

ANNUAL ACCOUNTS

NOTES TO THE ACCOUNTS [1]

The Bank's results for the year 2002 were affected by the fall in interest rates on international markets and the depreciation of the US dollar and the yen against the euro, which became particularly pronounced in the last part of the year.

The year-end balance sheet total was equal to e147,338 million, down from e179,099 million at the end of 2001. On the assets side the reduction mainly reflects that in general government debt following the conversion under Law 289/2002 (the Finance Law for 2003) of the 1 per cent government bonds assigned to the Bank of Italy under Law 483/1993 into other government bonds at market conditions, the annulment of the credit balance on TARGET accounts at the end of 2001, the reduction in main refinancing operations, and the diminution in the value of securities and foreign exchange positions in relation to market movements. On the liabilities side the reduction was mainly due to the repayment of the cash deposits made by financial institutions as collateral for the euro banknotes and coins they received in the front-loading phase and the large reduction in the revaluation accounts, primarily as a consequence of the bond conversion and the diminution in the valuation gains recorded in earlier years in relation to the above-mentioned market movements.

Turning to the income statement, the net profit for the year amounted to e64 million, a decrease of e443 million compared with that of e507 million recorded in 2001 that was due to the movement in market variables. In particular, net interest income turned negative, writedowns of foreign currency positions were larger, and profits from trading in foreign currencies and securities were smaller. The bond conversion, the effects of which were included in the income statement together with the related withdrawals from provisions, had no effect on the net profit for the year.

1. Legal basis, methods of preparation and layout of the annual accounts

1.1 *Legal basis of the annual accounts.* – In drawing up its annual accounts, the Bank of Italy is subject to the provisions of special laws and,

(1) This abridged English version of the Bank's annual accounts does not contain all the information required by law in the Italian version. In addition, it does not include the external auditor's report issued by Reconta Ernst & Young.

although it is not bound by them, applies the rules laid down in the Civil Code, interpreted in the light of generally accepted accounting standards.

The main statutory provisions referred to above are:

- Article 8.1 of Legislative Decree 43/1998 (“Adaptation of Italian law to the provisions of the treaty establishing the European Community for matters concerning monetary policy and the European System of Central Banks”). The Decree states that “in drawing up its annual accounts, the Bank of Italy may adapt, *inter alia* by way of derogation from the provisions in force, the methods it uses in recognizing amounts and preparing its annual accounts to comply with the rules laid down by the ECB in accordance with Article 26.4 of the ESCB Statute and the recommendations issued by the ECB in this field. The annual accounts drawn up in accordance with this paragraph, with regard in particular to the methods used in their preparation, are also valid for tax purposes”.

  In a guideline approved by the Governing Council of the ECB on 1 December 1998 (ECB/1998/NP22), subsequently amended and then replaced by ECB/2000/18 with effect from 1 January 2003, the ECB laid down rules for items of central banks’ annual accounts with reference mainly to the institutional activities of the ESCB (system items) and non-binding recommendations for the other items of their annual accounts (non-system items). In addition, on 8 April 1999 the Governing Council of the ECB issued Recommendation ECB/1999/NP7 on the accounting treatment of the costs incurred in the production of banknotes.

  On the basis of the authority granted by Article 8 of Legislative Decree 43/1998, the Bank of Italy has applied in full the accounting rules and recommendations issued by the ECB, including those on the layout of the income statement in report form and that of the balance sheet. The latter is the same as that used for the monthly statement approved, pursuant to Article 8.2 of Legislative Decree 43/1998, by the Minister of the Treasury, the Budget and Economic Planning;

- Royal Decree 1067/1936 (the Bank’s Statute) as amended, which lays down special rules for the allocation of the net profit for the year, the creation of special reserves and provisions, and the allocation of the income arising from the investment of the reserves.

As regards the matters concerning the preparation of the accounts not covered by the foregoing rules, the following provisions apply:

- Legislative Decree 127/1991 (“Implementation of Directives 78/660/EEC on the annual accounts of certain types of companies and 83/349/EEC on consolidated accounts pursuant to Article 1.1 of Law 69/1990”);

- Legislative Decree 87/1992 ("Implementation of Directive 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 89/117/EEC on the obligations of branches established in a Member State of credit institutions and financial institutions having their head offices outside that Member State regarding the publication of annual accounting documents");
- the Income Tax Code approved by Presidential Decree 917/1986;
- Article 65 (transactions involving government bonds) of Law 289/2002.

1.2 *Accounting policies*. – The accounting policies applied in preparing the annual accounts for 2002 are described below. Where provided for by law, they were agreed with the Board of Auditors.

At the start of the Third Stage of EMU the opening book value of gold, of foreign currency assets/liabilities and of the securities used in monetary policy operations were adjusted to the market prices obtaining at that date, with the resulting capital gains assigned to so-called pre-system revaluation accounts.

GOLD

- *in valuing stocks and determining the results of trading, the "average-daily-net-cost" method is applied;*
- *the valuation is effected on the basis of the year-end price communicated by the ECB. Revaluation gains are included in the corresponding revaluation account; revaluation losses in excess of earlier revaluation gains are included in the income statement. Revaluation gains recorded through 1 January 1999 and still existing in special revaluation accounts at 30 December 2002, have been utilized in accordance with Article 65.1 of Law 289/2002;*
- *the cost of gold, for civil law and tax purposes, is equal to the amount stated in the accounts net of the pertinent revaluation account remaining.*

FOREIGN CURRENCY ASSETS/LIABILITIES

- *in valuing stocks and determining the results of trading, the "average-daily-net-cost" method is applied for each currency;*
- *the valuation is effected on the basis of the year-end exchange rates communicated by the ECB. Revaluation gains are included in the corresponding revaluation account; those deriving from the adjustment to market value and recorded through 1 January 1999 are included in the income statement on a pro rata basis in the event of redemptions or disposals. Revaluation losses in excess of earlier revaluation gains are included in the income statement, with the simultaneous entry under income of any amount withdrawn*

from the specific provision existing at the beginning of Stage Three of EMU, if it still exists;

- *the International Monetary Fund quota is translated on the basis of the euro/SDR exchange rate communicated by the IMF for the quota originally subscribed in lire and at the euro/SDR exchange rate communicated by the ECB for the quota in SDRs.*

SECURITIES

- *the cost (clean price) of bonds is adjusted by the amount of the amortization of the premium/discount (the difference between the book value and the redemption value, to be included in the income statement — on a pro rata basis using a method based on compound capitalization — in relation to the residual life of the security);*
- *purchases of bonds in connection with forward contracts are included, in accordance with the rules laid down in the Guideline, at the current market price recorded on the settlement day;*
- *the valuation of holdings for the purpose of determining the profit or loss on securities is effected, for each type of security, using the "average daily cost" method;*
- *holdings are stated as follows:*
  1) *for securities not held as fixed assets:*
     a) *listed shares and bonds: at the market price available at the end of the year; revaluation surpluses are included in the revaluation accounts; revaluation surpluses deriving from the adjustment to market value and recorded through 1 January 1999 are included in the income statement on a pro rata basis in the event of redemptions or disposals; revaluation deficits in excess of earlier revaluation surpluses are included in the income statement, with the simultaneous entry under income of any amount withdrawn from the specific provision existing at the beginning of Stage Three of EMU, if it still exists;*
     b) *unlisted bonds: at cost with account taken of any diminution in value corresponding to special situations related to the position of the issuer;*
     c) *unlisted shares and equity interests not represented by shares: at cost, reduced as appropriate where the losses incurred by the issuing company are such as to cause the security's value to fall below cost;*
  2) *for securities held as fixed assets (bonds and shares):*
     - *at cost, with account taken of special situations related to the position of the issuer that cause the security's value to fall below cost.*

PARTICIPATING INTERESTS

The Bank's participating interests in subsidiary and associated companies classified as fixed assets are stated at cost, with account taken of any losses that reduce the Bank's interest in the shareholders' equity below cost.

The UIC endowment fund and the participating interest in the ECB are stated at cost.

Dividends and profits are recognized on a cash basis. The profits the ECB distributes on account, corresponding to the Bank of Italy's share of the seigniorage income of the ECB, are stated on an accrual basis in the year to which the income in question refers.

The Bank's accounts are not consolidated with those of investee companies insofar as the Bank is not among the entities referred to in Article 25 of Legislative Decree 127/1991.

The annual accounts of the UIC are attached to those of the Bank pursuant to Article 4 of Legislative Decree 319/1998.

TANGIBLE FIXED ASSETS

Depreciation begins in the quarter subsequent to that of acquisition both for buildings and for plant and equipment.

Buildings

- *are stated at cost, including improvement expenditure, plus revaluations effected pursuant to specific laws. The depreciation of buildings used in the Bank's institutional activities and those that are "objectively instrumental" (included among the investments of the provision for staff severance pay and pensions in accordance with the definition of "instrumentality" contained in Article 40.2 of the Income Tax Code) is on a straight line basis using the annual allowance of 4 per cent established by the ECB.*

Plant and equipment

- *are stated at cost, including improvement expenditure. They are depreciated on a straight line basis using the allowances established by the ECB (plant, furniture and equipment, 10 per cent; computers and related hardware and basic software and motor vehicles, 25 per cent).*

For some tangible fixed assets acceleration is charged in addition to the ordinary depreciation envisaged by the ECB and set aside in the "reserve" referred to in Article 67.3 of the Income Tax Code as amended. The accelerated depreciation allowances are consistent with the provisions of Italian law and the rules laid down by the ECB.

INTANGIBLE FIXED ASSETS

Procedures, studies and designs under way and advances

- *included at purchase or production cost.*

Procedures, studies and designs completed

- *included at purchase or production cost and amortized on the basis of allowances deemed congruent with the assets' remaining useful lives.*

Deferred charges

- *software licences are stated at cost and amortized on a straight line basis over the life of the contract or, where no time limit is established or it is exceptionally long, over the estimated useful life of the software;*
- *costs incurred in constructing and enlarging communication networks and one-off contributions provided for in multi-year contracts are amortized on a straight line basis over the foreseeable life of the network in the first two cases and over the life of the contract in the third case;*
- *costs incurred in improving buildings owned by third parties and rented to the Bank are amortized on a straight line basis over the remaining life of the rental contract.*

Costs of less than 10,000 euros are not capitalized, except for those incurred for software licences.

STOCKS OF THE TECHNICAL DEPARTMENTS

The valuation of stocks, with reference exclusively to the EDP Department. The valuation is made using the LIFO method.

ACCRUALS AND DEFERRALS

Include accrued income and prepaid expenses and accrued expenses and deferred income.

BANKNOTES IN CIRCULATION

The ECB and the twelve participating NCBs, which together comprise the Eurosystem, have issued euro banknotes since 1 January 2002 (ECB Decision 2001/15 of 6 December 2001 on the issue of euro banknotes, in OJ L337 of 20 December 2001, pp. 52-54). The total value of euro banknotes in circulation is allocated on the last working day of each month on the basis of the criteria set out hereinafter.

The ECB has been allocated a share of 8 per cent of the total value of euro banknotes in circulation as from 2002, whereas the remaining 92 per cent has been allocated to NCBs according to their weightings in the capital key of the ECB. The share of banknotes allocated to each NCB is disclosed under the balance sheet liability item "Banknotes in circulation".

The difference between the value of the euro banknotes allocated to each NCB in accordance with the banknote allocation key and the value of the euro banknotes that it actually puts into circulation also gives rise to remunerated intra-Eurosystem balances (ECB Decision 2001/16 of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002, in OJ L337 of 20 December 2001, pp. 55-61).

From 2002 until 2007 the intra-system balances arising from the allocation of euro banknotes will be adjusted in order to avoid significant changes in NCBs' relative income positions as compared with previous years. The adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the period from July 1999 and June 2001 and the average value of banknotes that would have been allocated to them during that period under the ECB's capital key. The adjustments will be reduced in annual stages until the end of 2007, after which income on banknotes will be allocated fully in proportion to the NCBs' paid-up shares in the ECB's capital (ECB Decision 2001/16 of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002, in OJ L337 of 20 December 2001, pp. 55-61).

The interest income and expense on these balances is cleared through the accounts of the ECB and is disclosed under "Net interest income."

The Governing Council of the ECB has decided that the seigniorage income of the ECB arising from the 8 per cent share of euro banknotes allocated to the ECB shall be distributed separately to the NCBs in the form of an interim distribution of profit (ECB Decision 2002/9 of 21 November 2002 on the distribution of the income of the European Central Bank on euro banknotes in circulation to the national central banks of the participating Member States, in OJ L323 of 28 November 2002, pp. 49-50). It shall be so distributed in full unless the ECB's net profit for the year is less than its income earned on euro banknotes in circulation. For 2002, one interim distribution was made on the second working day of 2003. This is disclosed in the Profit and Loss account under "Income from equity shares and participating interest". From 2003 onwards, interim distributions will be made after the end of each quarter.

The item Banknotes in circulation includes the lira banknotes still in circulation at 31 December 2002.

INTRA-EUROSYSTEM ASSETS AND LIABILITIES

For each NCB the intra-Eurosystem balance arising from the allocation of euro banknotes within the Eurosystem is included as a net single asset or liability under "Net claim/liability related to the allocation of euro banknotes within the Eurosystem".

PROVISIONS FOR RISKS

These provisions take account, in compliance with the prudence principle, of the risks associated with the various sectors of the Bank's operations in compliance with the prudence principle and are based on an evaluation of their adequacy that covers the sum of all the provisions. The riskiness of the Bank's foreign exchange positions and securities portfolio is evaluated on a value-at-risk basis, with consideration also given to the size of the revaluation accounts.

The provision for general risks is also for risks in connection with the Bank's overall activity that cannot be determined individually or allocated objectively.

Transfers to and withdrawals from the provisions are decided by the Board of Directors.

TAX PROVISION

The provision for taxation is equal to the amount of taxes to be paid (including deferred tax liabilities), determined on the basis of a realistic estimate of the foreseeable liability under the tax rules in force and amounts possibly arising from disputes with the tax authorities.

SUNDRY STAFF-RELATED PROVISIONS

Transfers to the provision for severance pay and pensions are included in the annual accounts under Article 3 of the related Rules for an amount that comprises both the actuarial reserves corresponding to the situation of staff having entitlement and that of pensioners and the severance pay accrued at the end of the year.

The provision for staff costs includes the estimated amount of costs that had accrued (e.g. sundry bonuses, holidays not taken, contributions set aside for newly-hired staff) but not been paid at 31 December 2002.

The provision for grants to BI pensioners and their surviving dependents takes into account the revenues accruing under Article 24 of the Rules governing staff severance pay and pensions.

Transfers to the provision for severance pay of contract staff, who do not participate in pension funds, comprise the amounts determined pursuant to Law 297/1982.

OTHER ASSETS AND LIABILITIES ITEMS

These are stated at their nominal value; in particular:

– *for receivables, the nominal value coincides with the estimated realizable value;*
– *for deferred tax assets and liabilities, including the assets deriving from the application of Article 65.2 of Law 289/2002, the amount stated is determined on the basis of the presumable tax effect in future years.*

The items Other assets and Other liabilities include the investments and patrimony of the defined-contribution supplementary pension fund created for staff hired since 28 April 1993. The fund is invested in financial instruments, which are valued at year-end market prices. The resulting revaluation gains (losses) are treated as revenues (expenses) and, in the same way as for other operating revenues (expenses), added to (subtracted from) the fund's patrimony.

MEMORANDUM ACCOUNTS

Commitments to repurchase securities in connection with advances granted under Treasury Ministry Decree 27 September 1974 are valued at the forward price determined on the basis of market interest rates. Negative valuation differences are included in the balance sheet under the item other liabilities and included in the income statement.

Securities of third parties held on deposit are stated at their nominal value; shares are stated on a quantity basis.

Foreign currency amounts are translated at the year-end exchange rates communicated by the ECB.

1.3 *Changes to the layout of the balance sheet.* – The layout of the balance sheet adopted is in accordance with that recommended by the ECB, with additional detail for some subitems and the inclusion of the total amount of the memorandum accounts. The layout used reflects that of the monthly statement of accounts approved by the Minister for the Economy and Finance in a decree issued on 9 April 2003; with respect to the layout adopted for the year ended 31 December 2001, some minor changes have been made in compliance with the rules laid down by the Governing Council of the ECB on 5 December 2002 (Guideline ECB/2002/10). In particular:

– on the assets side the item Intra-Eurosystem claims has a new subitem – *9.3 Net claims related to the allocation of euro banknotes within the Eurosystem* – for the balance, if positive, of the compensatory amounts in respect of the circulation of euro banknotes;
– on the liabilities side the item Intra-Eurosystem liabilities has a new subitem – *9.2 Net liabilities related to the allocation of euro banknotes within the Eurosystem* – for the above balance, if negative.

It has not been necessary to reclassify the figures for 2001 since last year was the first time there was an amount to be stated in the new subitems.

2. *Comment on the accounts*

2.1 *Balance sheet.* – The year-end balance sheet total, excluding memorandum items, was equal to e147,338 million, compared with e179,099 million at the end of 2001 (Tables 1 and 2).

Table 1

BALANCE SHEET - ASSETS

(thousands of euros)

	Amounts at end-		Changes
	2002	2001	
1 Gold and gold receivables	**25,763,615**	**24,830,282**	**933,333**
2 Claims on non-euro-area residents denominated in foreign currency	**27,316,456**	**27,703,644**	**–387,188**
2.1 Receivables from the IMF	4,681,552	4,608,324	73,228
2.2 Securities (other than shares)	18,770,623	19,833,417	–1,062,794
2.3 Current accounts and deposits	3,687,102	3,258,153	428,949
2.4 Reverse operations	174,826	–	174,826
2.5 Other claims	2,353	3,750	–1,397
3 Claims on euro-area residents denominated in foreign currency	**5,298,229**	**5,462,237**	**–164,008**
3.1 Financial counterparties	5,298,229	5,462,237	–164,008
3.1.1 Securities (other than shares)	*2,125,504*	*143,936*	*1,981,568*
3.1.2 Reverse operations	–	–	–
3.1.3 Other claims	*3,172,725*	*5,318,301*	*–2,145,576*
3.2 General government	–	–	–
3.3 Other counterparties	–	–	–
4 Claims on non-euro-area residents	**–**	**–**	**–**
5 Lending to euro-area banks related to monetary policy operations	**6,933,008**	**9,719,070**	**–2,786,062**
5.1 Main refinancing operations	6,932,866	9,474,323	–2,541,457
5.2 Longer-term refinancing operations	–	244,747	–244,747
5.3 Fine-tuning reverse operations	–	–	–
5.4 Structural reverse operations	–	–	–
5.5 Marginal lending facility	–	–	–
5.6 Credits related to margin calls	142	–	142
6 Other claims on euro-area banks	**401**	**430**	**–29**
7 Securities issued by euro-area residents (other than shares)	**1,577,708**	**1,545,761**	**31,947**

Table 1 *cont.*

BALANCE SHEET - ASSETS

(thousands of euros)

		Amounts at end- 2002	2001	Changes
8	**General government debt**	**18,872,448**	**40,552,273**	**–21,679,825**
	Government securities deriving from the conversion of bonds issued under Law 483/1993 (1)	*17,727,042*	*39,356,989*	*–21,629,947*
	Items arising from the Bank's former management of stockpiling bills - securitized part	*1,111,714*	*1,161,592*	*–49,878*
	Items arising from the Bank's former management of stockpiling bills - unsecuritized part	*33,692*	*33,692*	–
9	**Intra-Eurosystem claims**	**8,192,250**	**18,903,338**	**–10,711,088**
9.1	Participating interest in the ECB	744,750	744,750	–
9.2	Claims deriving from the transfer of foreign reserves to the ECB	7,447,500	7,447,500	–
9.3	Net claims related to the allocation of euro banknotes within the Eurosystem	–	–	–
9.4	Other claims within the Eurosystem (net)	–	10,711,088	–10,711,088
10	**Items to be settled**	**7,161**	**828**	**6,333**
11	**Other assets**	**53,377,152**	**50,380,689**	**2,996,463**
11.1	Euro-area coins	25,744	7,613	18,131
11.2	UIC endowment fund	258,228	258,228	–
11.3	Investments of reserves and provisions (including shares)	28,291,710	28,969,311	–677,601
	Government securities	*23,132,701*	*22,339,989*	*792,712*
	Shares and participating interests	*4,933,521*	*6,169,908*	*–1,236,387*
	Other securities	225,488	*459,414*	*–233,926*
11.4	Intangible fixed assets	24,340	19,812	4,528
11.5	Deferred charges	9,684	9,081	603
11.6	Tangible fixed assets (net of depreciation)	2,732,847	2,772,917	–40,070
11.7	Accrued income and prepaid expenses	679,337	1,059,482	–380,145
11.8	Sundry	21,355,262	17,284,245	4,071,017
	Advances under Ministerial Decree of 1974	*12,287,868*	*15,401,649*	*–3,113,781*
	Other investments of severance pay and pension provisions	*55,002*	*46,572*	*8,430*
	Deferred tax assets	*7,090,587*	*30,441*	*7,060,146*
	Other items	*1,921,805*	*1,805,583*	*116,222*
	Total	**147,338,428**	**179,098,552**	**–31,760,124**

(1) Government securities at market rates (end-2002 amount) received in relation to the conversion pursuant to Law 289/2002 of the bonds issued under Law 483/1993 (end-2001 amount).

Table 2

BALANCE SHEET – LIABILITIES

(thousands of euros)

	Amounts at end- 2002	2001	Changes
1 Banknotes in circulation	**62,835,488**	**64,675,772**	**–1,840,284**
in euros	*60,657,830*	*–*	*60,657,830*
in lire	*2,177,658*	*64,675,772*	*–62,498,114*
2 Liabilities to euro-area banks related to monetary policy operations	**10,454,353**	**7,573,465**	**2,880,888**
2.1 Current accounts (covering the minimum reserve system)	10,452,311	7,569,710	2,882,601
2.2 Deposit facility	2,042	3,453	–1,411
2.3 Fixed-term deposits	–	–	–
2.4 Fine-tuning reverse operations	–	–	–
2.5 Deposits related to margin calls	–	302	–302
3 Other liabilities to euro-area banks	**–**	**18,708,179**	**–18,708,179**
4 Liabilities to other euro-area residents denominated in euros	**21,322,140**	**23,697,366**	**–2,375,226**
4.1 General government	21,316,379	23,463,305	–2,146,926
4.1.1 Treasury payments account	*20,617,850*	*21,287,086*	*–669,236*
4.1.2 Sinking fund for the redemption of government securities	*633,200*	*176,431*	*456,769*
4.1.3 Other liabilities	*65,329*	*1,999,788*	*–1,934,459*
4.2 Other counterparties	5,761	234,061	–228,300
5 Liabilities to non-euro-area residents denominated in euros	**53,952**	**38,333**	**15,619**
5.1 Liabilities to non-euro-area EU central banks	1	1	–
5.2 Other liabilities	53,951	38,332	15,619
6 Liabilities to euro-area residents denominated in foreign currency	**–**	**–**	**–**
7 Liabilities to non-euro-area residents denominated in foreign currency	**2,880,825**	**2,455,572**	**425,253**
7.1 Deposits and balances	12,439	14,766	–2,327
7.2 Other liabilities	2,868,386	2,440,806	427,580
8 Counterpart of SDRs allocated by the IMF	**910,521**	**1,000,576**	**–90,055**
9 Intra-Eurosystem liabilities	**7,866,469**	**–**	**7,866,469**
9.1 Promissory notes covering debt certificates issued by the ECB	–	–	–
9.2 Net liabilities related to the allocation of euro banknotes within the Eurosystem	5,731,537	–	5,731,537
9.3 Other liabilities within the Eurosystem (net)	2,134,932	–	2,134,932

Table 2 *cont.*

BALANCE SHEET – LIABILITIES

(thousands of euros)

		Amounts at end-		Changes
		2002	2001	
10	**Items to be settled**	**37,088**	**17,880**	**19,208**
11	**Other liabilities**	**1,747,879**	**1,921,622**	**–173,743**
11.1	Bank of Italy drafts	839,204	820,710	18,494
11.2	Cashier's department services	1,190	751	439
11.3	Accrued expenses and deferred income	12,699	83,951	–71,252
11.4	Sundry	894,786	1,016,210	–121,424
12	**Provisions**	**7,516,567**	**9,902,583**	**–2,386,016**
12.1	Provisions for specific risks:	1,966,367	4,423,194	–2,456,827
	for losses on foreign exchange	*1,537,605*	*2,157,764*	*–620,159*
	for losses on securities	–	*1,024,287*	*–1,024,287*
	for insurance cover	*309,874*	*309,874*	–
	for taxation	*118,888*	*931,269*	*–812,381*
12.2	Sundry staff-related provisions:	5,550,200	5,479,389	70,811
	for staff severance pay and pensions	*5,461,272*	*5,395,339*	*65,933*
	for grants to BI pensioners and their surviving dependents	*1,625*	*1,590*	*35*
	for severance pay of contract staff	*1,467*	*1,351*	*116*
	for staff costs	*85,836*	*81,109*	*4,727*
13	**Revaluation accounts**	**9,645,480**	**26,060,124**	**–16,414,644**
14	**Provision for general risks**	**8,789,382**	**9,798,072**	**–1,008,690**
15	**Capital and reserves**	**13,213,982**	**12,742,153**	**471,829**
15.1	Capital	156	155	1
15.2	Ordinary and extraordinary reserves	9,044,071	8,589,063	455,008
15.3	Other reserves	4,169,755	4,152,935	16,820
16	**Net profits for distribution**	**64,302**	**506,855**	**–442,553**
	Total	**147,338,428**	**179,098,552**	**–31,760,124**

Assets:

The item *Gold and gold receivables* rose by e933 million (from e24,830 million to e25,763 million) owing to the increase in the year-end market price communicated by the ECB (from e314,99 to e326.83 per ounce). In fact the quantity of gold remained unchanged at 79 million ounces or 2,452 tons.

Claims on non-euro-area residents denominated in foreign currency, valued at market prices and exchange rates, decreased by e387 million (from e27,704 million to e27,317 million).

Within this item:

- *receivables from the IMF* increased from e4,608 million to e4,682 million. They comprised:
  a) Italy's net position vis-à-vis the IMF, which rose from e3,646 million to e3,739 million;
  b) Italy's share of the loan to support debt-reduction initiatives for the poorest countries (PRGF), which rose from e625 million to e840 million;
  c) the Bank's SDRs, which fell from e337 million to e103 million, primarily in connection with their use to increase the participation in the PRGF.
- *securities (other than shares)* totaled e18,771 million (down from e19,834 million). Made up mostly of securities issued by the US and Japanese Treasuries and the BIS, the portfolio comprised e16,582 million of securities denominated in US dollars, e2,154 million of securities denominated in yen and e35 million of securities denominated in Swiss francs;
- *current accounts and deposits* rose from e3,258 million to e3,687 million; sight and overnight deposits from e751 million to 1,126 million and time deposits from e2,507 million to e2,561 million;
- *reverse operations* consisted of repos in US dollars and amounted to e175 million (zero at 31 December 2001);
- *other assets* consisted exclusively of foreign banknotes and fell from e4 million to e2 million.

Over the year the euro appreciated against both the US dollar (from 0.8813 to 1.0487 per euro) and the yen (from 115.33 to 124.39 per euro).

Claims on euro-area residents denominated in foreign currency, valued at market prices and exchange rates, decreased by e164 million (from e5,462 million to e5,298 million). In particular:

– *securities (other than shares)* rose from e144 million to e2,125 million, primarily as a consequence of net purchases during the year; they consisted almost entirely of securities issued by financial counterparties in France, Germany, the Netherlands and Belgium denominated in US dollars;
– *other assets* fell from e5,318 million to e3,173 million and consisted entirely of deposits with correspondent banks, mostly in the form of time deposits in US dollars, yen and Swiss francs.

Claims on non-euro-area residents, were equal to zero, as at the end of 2001.

Lending to euro-area banks related to monetary policy operations fell by e2,786 million (from e9,719 million to e6,933 million), primarily as a consequence of the reduction of e2,541 million (from e9,474 million to e6,933 million) in main refinancing operations, which also fell on an annual average basis (from e13,562 million to e7,913 million).

Longer-term refinancing operations fell to zero (from e245 million at the end of 2001); the annual average value of this item fell from e598 million to e44 million.

Fine-tuning reverse operations, for which, as in 2001, the year-end balance was zero, were used only three times during the year; the annual average value of this item rose from e34 million to e40 million.

No use was made of *structural reverse operations* during the year.

The *marginal lending facility* stood at zero at the end of the year, while *credits related to margin calls* amounted to less than one million euros (at the end of 2001 both items had been equal to zero). The annual average value of the first of these items was e6 million (compared with e47 million in 2001) and that of the second €0.2 million (€0.4 million in 2001).

The item *other claims on euro-area banks*, which comprises the correspondent accounts in connection with the activity of the Bank's representative offices abroad was small (€0.4 million; unchanged).

Securities issued by euro-area residents (other than shares), valued at market prices and consisting of government securities eligible for monetary policy purposes, remained basically unchanged, rising from €1,546 million to €1,578 million.

General government debt fell by €21,680 million (from €40,552 million to €18,872 million).

The reduction came as a consequence of:

– a decrease of €21,630 million following the bond conversion provided for in Article 65 of Law 289/2002. This transaction involved the restitution to the issuer of the 1 per cent securities issued under Law 483/1993 (stated in the balance sheet for the year ended 31 December 2001 at cost, equal to the face value, for an amount equal to €39,357 million and with maturities between 2014 and 2044) in exchange for securities paying market rates (with maturities between 2012 and 2031) for a total value of €17,520 million, thus giving rise to a negative conversion difference of €21,837 million. The item was increased by €207 million of bonds received in connection with the conversion as settlement of accrued interest.

Article 65 of Law 289/2002 made provision, subject to agreement between the Bank of Italy and the Ministry for the Economy and Finance, for the conversion of the 1 per cent bonds issued under Law 483/1993 to the Bank of Italy to replace the overdraft on the Treasury's current account with the Bank into other government bonds having the same market value.

The conversion, submitted to the ECB for its opinion pursuant to Article 105.4 of the EC Treaty, was deemed to comply with Community law. In particular, it was found to be in line with the fourth recital of EC Regulation No. 3603/1993, which recommended that Community "central banks which, after 1 January 1994, still hold claims against the public sector which are not negotiable or are subject to conditions which are not market conditions should be authorized subsequently to convert such claims into negotiable fixed-maturity securities under market conditions".

The transaction was settled on 30 December 2002. The loss of €21,837 that the Bank incurred led to:

a) the inclusion of €7,206 million of deferred tax assets in respect of the deductibility of the loss for tax purposes over twenty years. This amount was calculated prudentially on the basis of the 33 per cent corporate income tax rate contemplated by Law 80/2003 delegating the Government to reform the central government tax system;

b) the utilization, as provided for by Article 65.3 of Law 289/2002, of the gold revaluation accounts as ascertained at 1 January 1999, for a total of €13,060 million, of which €12,440 million withdrawn from the so-called pre-system revaluation account and €620 million from the provision for losses on foreign exchange created in the past with the revaluation of the gold reserves provided for in Decree Law 867/1976; consequently, the cost of gold is made equal, for tax purposes as well, to the value stated in the balance sheet net of the pertinent revaluation account remaining after the conversion;

c) the utilization of risk provisions for a total of €1,571 million, of which €1,024 million withdrawn from the provision for losses on securities and €547 million from the provision for general risks.

The inclusion in the balance sheet of the deferred tax assets deriving from the conversion is based on the reasonable expectation of the entire amount of the tax loss incurred being recovered in view of the twenty-year period allowed by Law 289/2002 and the Bank's income prospects.

Intra-Eurosystem claims decreased by €10,711 million (from €18,903 million to €8,192 million) and comprised:

- the Bank's *participating interest in the ECB* of €745 million and €7,447 million of *claims deriving from the transfer of reserves to the ECB* in the form of gold, foreign securities and foreign currencies at the beginning of Stage Three of EMU. The foregoing amounts were unchanged compared with 31 December 2001;
- *other intra-Eurosystem claims (net)*. This refers to the Bank's net position vis-à-vis the Eurosystem in connection with the TARGET system, which shows a zero value following the swing from a positive value of €10,711 million to a negative value of €2,135 million. The reduction of €10,711 million in this subitem is reflected in the value of the entire item.

From the end of December 2002 the above item also includes the subitem *Net claims related to the allocation of euro banknotes within the Eurosystem*. At the end of 2002 the balance of such claims was negative and is included in the corresponding newly-introduced subitem on the liabilities side.

Items to be settled rose by €6 million (from €1 million to €7 million).

Other assets rose from €50,381 million to €53,377 million. In particular:

- *euro-area coins*, which includes lira coins, rose from €8 million to €26 million, primarily because the face values of euro coins are higher than those of the lira coins they replaced;
- the *UIC endowment fund* remained unchanged at €258 million;
- *investments of reserves and provisions (including shares)* fell by €677 million (from €28,969 million to €28,292 million) as a consequence of the year-end net writedowns, which were partially offset by net purchases during the year. The annual average value of this item was €27,784 million, compared with €28,253 million in 2001;
- *intangible fixed assets* (net of amortization) increased from €20 million to €24 million primarily as a consequence of the larger amount of work in progress;
- *deferred charges* remained virtually unchanged (rising from €9 million to €10 million);
- *tangible fixed assets (net of depreciation)* amounted to €2,733 million. The decrease of €40 million compared with 31 December 2001 was due to €122 million of purchases and capitalized own work and €162 million of depreciation;
- *accrued income and prepaid expenses* decreased from €1,059 million to €679 million;
- *sundry* other assets rose from €17,284 million to €21,355 million. They included:

a) €12,288 million in respect of the advance granted under Treasury Ministry Decree 27.9.1974 to Banco di Napoli (subsequently merged into Sanpaolo IMI spa) pursuant to Law 588/1996 (€15,402 million at 31 December 2001);

b) €7,091 million of deferred tax assets (€30 million at the end of 2001), of which e1 million in respect of the regional tax on productive activities (Irap) and €7,090 million in respect of net corporate income tax (Irpeg), as the algebraic sum of the following:

– €7,206 million of deferred tax assets deriving from the deductibility for tax purposes of the loss incurred as a consequence of the bond conversion described above;

– €90 million of taxes for the year, theoretically payable in the absence of the above-mentioned conversion; consequently, the remaining deferred tax asset in connection with the carry forward of the tax loss for the year amounts to €7,116 million;

– €31 million of deferred tax assets deriving from other expense items; in particular the allocation of e21 million to the provision for staff costs and €9 million of prior-year depreciation at rates in excess of those allowed for tax purposes;

– €57 million of deferred tax liabilities in relation in particular to gains on disposals of fixed assets (€10 million) and accelerated depreciation under Article 67.3 of the Income Tax Code (€47 million);

c) €34 million, the balance-sheet total of the supplementary pension fund. Up by €5 million, this item is matched on the liabilities side by an equal amount entered under *other liabilities - sundry.*

Liabilities:

Banknotes in circulation amounted to €62,835 million and included €2,178 of lira banknotes not yet presented for conversion. The euro banknote component of this item is the Bank’s share of the total euro banknote in circulation (see the section on *Banknotes in circulation* under *Accounting policies*).

The value of the actual circulation expressed in euros, excluding the adjustments arising from the allocation of euro banknotes within Eurosystem, was €68,567 million, an increase of €3,891 million on the €64,676 million recorded at the end of 2001. By contrast, the annual average value of this item fell €69,331 million to €61,021 million.

Liabilities to euro-area banks related to monetary policy operations amounted to €10,454 million. The increase of €2,881 million on the €7,573 million recorded at the end of 2001 was almost entirely due to the increase in banks' *current accounts (covering the minimum reserve system)*, which rose from €7,570 million to €10,452 million (the annual average value rose from €12,771 million to €13,562 million). On the other hand, the *deposit facility* declined slightly (from €3 million to €2 million).

Fixed-term deposits and *fine-tuning reverse operations* were both equal to zero, as at the end of 2001.

Deposits related to margin calls fell from €0.3 million to zero.

Other liabilities to euro-area banks fell from €18,708 million to zero. At the end of 2001 they had comprised the cash deposits banks made as collateral for the euro notes and coins they received in the front-loading phase, which were repaid in three tranches in the early part of 2002, contemporaneously with the debiting of banks' accounts with the euro banknotes and coins they had acquired.

Liabilities to other euro-area residents decreased by €2,375 million (from €23,697 million to €21,322). The following changes occurred within the subitem *general government:*

- the *Treasury payments account* fell from €21,287 million to €20,618 million. By contrast, the average balance on the account rose from €20,918 million to €26,918 million;
- the *sinking fund for the redemption of government securities* rose from €176 million to €633 million. The annual average value of this item also fell (from €3,719 million to €231 million);
- *other liabilities* to general government fell from €2,000 million to €65 million, primarily owing to the repayment of the €1,964 of cash deposits made by Poste Italiane spa as collateral for the euro notes and coins it received in the front-loading phase.

The subitem liabilities to *other counterparties* fell from €234 million to €6 million almost exclusively in connection with the movement in the balance on the UIC's current account, which fell from €233 million to €5 million.

Liabilities to non-euro-area residents rose from €38 million to €54 million, primarily owing to the increase in *other liabilities*, which include the accounts held by central banks and international organizations.

Liabilities to euro-area residents denominated in foreign currency were equal to zero, as at 31 December 2001.

Liabilities to non-euro-area residents denominated in foreign currency, denominated exclusively in US dollars and valued at market prices, rose from €2,456 million to €2,881 million. In particular, *other liabilities* rose from €2,441 million to €2,868 million in connection with repo transactions. By contrast, the subitem *deposits and balances* decreased slightly, falling from €15 million to €13 million.

The *counterpart of SDRs allocated by the IMF* fell from €1,001 million to €911 million, primarily owing to the revaluation at the SDR exchange rate.

The item *intra-Eurosystem liabilities* rose from zero to €7,867 million and included:

- the new subitem *Net liabilities related to the allocation of euro banknotes within the Eurosystem*, which consists of the negative balance vis-à-vis the Eurosystem in relation to the allocation of euro banknotes in circulation, amounted to €5,732 million;
- *Other liabilities within the Eurosystem (net)* amounted to €2,135 million and shows the Bank's net debtor position vis-à-vis the Eurosystem in respect of the TARGET system; the net creditor position of €10,711 million at the end of 2001 was included under *Other claims within the Eurosystem (net)*.

Items to be settled rose from €18 million to €37 million.

Other liabilities declined by €174 million (from €1,922 million to €1,748 million). The subitem *sundry* fell by €121 million and *accrued expenses and deferred income* by €71 million, while *Bank of Italy drafts* rose by €18 million.

In particular, the subitem *sundry* other liabilities (€895 million) included:

- €385 million, the negative difference in respect of the forward repurchase position in securities connected with transactions under Treasury Ministry Decree 27.9.1974. At the end of 2001 the negative difference had amounted to €506 million;
- €34 million, the balance-sheet total of the defined-contribution supplementary pension fund for staff hired after 28 April 1993. This item is matched on the assets side by an equal amount entered under *other assets-sundry.*

Provisions decreased from €9,903 million to €7,517 million. In particular:

- *provisions for specific risks* decreased from €4,423 million to €1,966 million. The decrease was due to:

  a) the withdrawal of the entire amount of the provision for losses on securities (€1,024 million) and of the provision for losses on foreign exchange created under Decree Law 867/1976 (€620 million), to cover part of the loss deriving from the bond conversion described above under the item *General government debt*;

b) the reduction of €812 million in the tax provision, as a consequence of the payment of the Bank's taxes for 2001 (€783 million), the transfer of the corporate income tax (Irpeg) deferred liability (€51 million), which was deducted from the deferred tax assets, the allocation of €23 million for the regional tax on productive activities (Irap) for the year and deferred, and the withdrawal of €1 million for the derecognition of credit.

The provisions for exchange risk (€1,538 million) and for insurance cover (€310 million) remained unchanged.

- *sundry staff-related provisions* rose from €5,479 million to €5,550 million. In particular, the provisions for staff severance pay and pensions rose from €5,395 million to €5,461 million (the provision for pensions accounted for €6 million of the increase and that for severance pay the remaining €60 million). The provision for staff costs rose from €81 million to €86 million, owing to the increase in amounts accrued but not paid at the end of the year.

Taken together, the provision for grants to BI pensioners and their surviving dependents and that for the severance pay of contract staff remained at around €3 million.

The movements in provisions in 2002 are detailed in Table 3.

The *revaluation accounts* fell from €26,060 million to €9,645 million.

The *provision for general risks* fell from €9,798 million to €8,789 million following the withdrawal of €1,009 million, of which €547 million to cover part of the loss deriving from the bond conversion under Law 289/2002 and €462 million to cover writedowns of euro-denominated securities.

The item *capital and reserves* increased in total by €472 million (from €12,742 million to €13,214 million) as a result of:

- the increase in the *ordinary reserve* (from €4,373 million to €4,576 million) and that in the *extraordinary reserve* (from €4,216 million to €4,468 million), for a total of €455 million as a consequence of the allocation of the net profit for 2001 and the income earned on the reserves in 2002;
- of the increase of €17 million in *other reserves*, of which €16.7 million in relation to the reserve for accelerated depreciation under Article 67.3 of the income tax code, deriving – in line with the Bank's policy in

preceding years – from the accelerated depreciation of tangible fixed assets and €0.1 million in relation to the special reserve pursuant to Legislative Decree 124/1993 providing for the introduction of supplementary pension funds. The revaluation reserves and the provision for the renewal of tangible fixed assets remained unchanged at respectively €2,217 million and €1,805 million.

Table 3

PROVISIONS

(thousands of euros)

	Amounts at end-2001	Changes		Amounts at end-2002
		Transfers from	Transfers to	
Provisions for specific risks:	**4,423,194**	**2,479,866**	**23,039**	**1,966,367**
for losses on foreign exchange	2,157,764	620,159	–	1,537,605
exchange risk	*1,537,605*	–	–	*1,537,605*
under Decree Law 867/1976 .	*620,159*	*620,159*	–	–
for losses on securities	1,024,287	1,024,287	–	–
for insurance cover	309,874	–	–	309,874
for taxation	931,269	(1) 835,420	23,039	118,888
Sundry staff-related provisions:	**5,479,389**	**61,541**	**132,352**	**5,550,200**
for staff severance pay and pensions	5,395,339	(2) 45	65,978	5,461,272
for grants to BI pensioners and their surviving dependents . .	1,590	39	74	1,625
for severance pay of contract staff under Law 297/1982 . . .	1,351	111	227	1,467
for staff costs	81,109	61,346	66,073	85,836
Total . . .	**9,902,583**	**2,541,407**	**155,391**	**7,516,567**

(1) Includes the transfer to assets of the part of the provision in respect of deferred corporate income tax (Irpeg). – (2) Transfer to the supplementary pension fund.

The holders of the Bank’s capital are shown in Table 4 and the movements in the item *capital and reserves* in Table 5.

2.2 *Income statement*. – The net profit for the year amounted to €64 million (Table 6), down from €507 million in 2001 owing to the weak performance of most of the income items, in line with that of the market variables involved. The bond conversion under Law 289/2002, the effects of which were included in the income statement together with the related withdrawals from provisions, had no effect on the net profit for the year.

Among the items included under *net income from institutional operations*, *net interest income* fell by €687 million, from €626 million to a negative value of €61 million, since the fall in *interest income* was larger than that in *interest expense*.

Table 4

SHAREHOLDERS

	At 31 December 2002				At 31 December 2001			
	Number	Shares held (1)	%	Votes	Number	Shares held (1)	%	Votes
Shareholders with voting rights	71	299,934	100.0	692	79	299,934	100.0	735
Limited company banks	*64*	*253,434*	*84.5*	*571*	*71*	*253,434*	*84.5*	*610*
Social security institutions	*1*	*15,000*	*5.0*	*34*	*1*	*15,000*	*5.0*	*34*
Insurance companies	*6*	*31,500*	*10.5*	*87*	*7*	*31,500*	*10.5*	*91*
Shareholders without voting rights .	6	66	. .	–	6	66	. .	–
Total . . .	**77**	**300,000**	**100.0**	**692**	**85**	**300,000**	**100.0**	**735**

(1) With a par value of 0.52 euros each.

Table 5

MOVEMENTS IN CAPITAL AND RESERVES

(thousands of euros)

	Balance at end-2001	Increases	Decreases	Balance at end-2002
Share capital	155	(1) 1	–	156
Ordinary reserve	4,373,056	(2) 225,617	(3) 23,016	4,575,657
Extraordinary reserve	4,216,007	(2) 274,406	(3) 21,999	4,468,414
Revaluation surplus reserve (under Law 72/1983)	673,460	–	–	673,460
Revaluation surplus reserve (under Law 408/1990)	660,533	–	–	660,533
Revaluation surplus reserve (under Law 413/1991)	16,922	–	–	16,922
Revaluation surplus reserve (under Law 342/2000)	866,534	–	–	866,534
Reserve for accelerated depreciation (under Art. 67.3 of the income tax code)	130,348	16,709	–	147,057
Reserve (under Legislative Decree 124/1993)	94	111	–	205
Special provision for the renewal of tangible fixed assets	1,805,044	–	–	1,805,044
Total . . .	**12,742,153**	**516,844**	**45,015**	**13,213,982**

(1) Increase in capital (withdrawn from the extraordinary reserve) as a consequence of the rounding in connection with the conversion of the capital into euros. – (2) The movement was due to the allocation of the net profit for 2001 and the return earned in 2002 on the investment of the reserve. – (3) The movement was due to the dividend paid to shareholders in respect of the return earned in 2001 on the investment of the reserve (under Art. 56 of the Bank's Statute).

Total *interest income* decreased by €842 million (from €2,728 million to €1,886 million). In particular, interest income on positions denominated in foreign currency declined by €426 million (from €1,307 million to €881 million). The breakdown of the reduction was as follows:

Table 6

ANALYSIS OF THE INCOME STATEMENT

(euros)

	2002		2001		Changes	
A) NET INCOME FROM INSTITUTIONAL OPERATIONS:		**–6,373,433,456**		**2,708,194,302**		**–9,081,627,758**
Interest income		1,885,967,592		2,728,084,819		–842,117,227
securities and other assets denominated in foreign currency	*785,272,233*		*1,173,588,845*		*–388,316,612*	
IMF positions	*95,413,480*		*133,595,460*		*–38,181,980*	
refinancing operations	*267,009,309*		*644,826,429*		*–377,817,120*	
advances	*139,838,232*		*161,895,653*		*–22,057,421*	
claims on the State	*396,532,924*		*393,569,890*		*2,963,034*	
intra-Eurosystem balances	*328,042,511*		*373,819,840*		*–45,777,329*	
UIC current account	*45,807*		*133,863*		*–88,056*	
securities denominated in euros held for monetary policy purposes	*85,537,896*		*97,310,635*		*–11,772,739*	
bond premiums and discounts	*–211,725,634*		*–250,657,116*		*38,931,482*	
other	*834*		*1,320*		*–486*	
Interest expense		–1,946,502,469		–2,102,150,120		155,647,651
Treasury payments account	*–1,212,418,822*		*–1,146,667,464*		*–65,751,358*	
sinking fund for the redemption of government securities	*–8,169,406*		*–175,597,668*		*167,428,262*	
current account deposits of required reserves	*–448,259,584*		*–557,967,754*		*109,708,170*	
overnight deposits, term deposits and deposits related to margin calls	*–246,373*		*–390,213*		*143,840*	
UIC current account	*–1,214,138*		*–4,055,410*		*2,841,272*	
intra-Eurosystem balances	*–203,104,442*		*–93,240,937*		*–109,863,505*	
sundry interest denominated in foreign currency	*–38,539,392*		*–52,574,095*		*14,034,703*	
other	*–34,550,312*		*–71,656,579*		*37,106,267*	
Net interest income		**–60,534,877**		**625,934,699**		**–686,469,576**
Profits and losses on financial operations		–20,630,574,618		2,285,061,836		–22,915,636,454
profits/losses on securities trading	*–21,347,974,515*		*743,991,677*		*–22,091,966,192*	
profits/losses on foreign exchange trading	*288,003,004*		*1,163,224,582*		*–875,221,578*	
profits/losses on derivatives contracts denominated in foreign currency	*–*		*854*		*–854*	
profits/losses on forward transactions in securities under Ministerial Decree 1974	*429,396,893*		*377,844,723*		*51,552,170*	
Writedowns of financial assets and positions		–1,206,920,529		–545,207,137		–661,713,392
foreign securities	*–224,197*		*–38,666,695*		*38,442,498*	
foreign currencies	*–821,756,571*		*–5,604*		*–821,750,967*	
securities denominated in euros	*–21,787*		*–502,684*		*480,897*	
forward transactions in securities under Ministerial Decree 1974	*–384,917,974*		*–506,032,154*		*121,114,180*	
Transfers to/from provisions for losses on foreign exchange and securities		15,206,927,979		20,141,109		15,186,786,870
transfers from "pre-system" revaluations reserves	*12,553,792,201*		*20,141,109*		*12,533,651,092*	
transfers from the provision for general risks	*1,008,690,046*				*1,008,690,046*	
transfers from the provisions for losses on foreign exchange and securities	*1,644,445,732*				*1,644,445,732*	
Net result of financial operations, writedowns and risk provision transfers		**–6,630,567,168**		**1,759,995,808**		**–8,390,562,976**
Fee and commission income		20,335,870		21,606,242		–1,270,372
Fee and commission expense		–17,709,199		–24,589,170		6,879,971
Net income from fees and commissions		**2,626,671**		**–2,982,928**		**5,609,599**
Income from equity shares and participating interests		387,951,300		321,284,475		66,666,825
income from participating interest in ECB	*379,473,323*		*300,417,046*		*79,056,277*	
income from participating interest in UIC endowment fund	*8,477,977*		*20,867,429*		*–12,389,452*	
Net result of the pooling of monetary income		–72,909,382		3,962,248		–76,871,630
monetary income pooled	*1,770,306,284*		*6,178,721*		*1,764,127,563*	
monetary income conferred	*–1,843,215,666*		*–2,216,473*		*–1,840,999,193*	

Table 6 *cont.*

ANALYSIS OF THE INCOME STATEMENT

(euros)

	2002		2001		Changes	
B) OTHER INCOME:		**1,464,954,164**		**1,638,472,456**		**–173,518,292**
Income from the investment of reserves and provisions		1,294,023,772		1,433,588,255		–139,564,483
interest income	*1,048,954,347*		*1,406,159,961*		*–357,205,614*	
bond premiums and discounts	*–26,077,538*		*–159,861,911*		*133,784,373*	
dividends on equity shares and participating interests	*231,865,768*		*159,452,821*		*72,412,947*	
trading profits and gains on disposals	*39,281,195*		*27,837,384*		*11,443,811*	
Prior-year income		83,623,705		126,791,936		–43,168,231
Sundry		87,306,687		78,092,265		9,214,422
rental income from buildings	*18,506,330*		*17,405,922*		*1,100,408*	
interest on tax credits	*29,353,300*		*29,353,300*		*–*	
other interest income	*1,614,378*		*1,602,665*		*11,713*	
commissions paid by the Ministry of the Treasury	*275,884*		*239,744*		*36,140*	
procedures, studies and designs completed	*13,624,742*		*11,513,087*		*2,111,655*	
closing stocks	*574,007*		*440,030*		*133,977*	
other	*23,358,046*		*17,537,517*		*5,820,529*	
TOTAL NET INCOME (A+B)		**–4,908,479,292**		**4,346,666,758**		**–9,255,146,050**
C) OTHER EXPENSES:		**4,972,781,586**		**–3,839,811,347**		**8,812,592,933**
Staff costs		–1,051,489,954		–1,160,741,417		109,251,463
wages and salaries and related costs	*–667,337,117*		*–626,908,103*		*–40,429,014*	
emoluments paid to head and branch office collegial bodies (1)	*–2,862,972*		*–3,021,268*		*158,296*	
pensions and severance payments	*–237,290,842*		*–240,072,030*		*2,781,188*	
other	*11,645,273*	*–919,136,204*	*–11,244,494*	*–881,245,895*	*–400,779*	*–37,890,309*
transfers to:						
provision for staff severance pay and pensions	*–65,977,843*		*–217,924,849*		*151,947,006*	
provision for expenses accrued but not yet paid	*–66,073,128*		*–61,268,734*		*–4,804,394*	
other provisions	*–302,779*	*–132,353,750*	*–301,939*	*–279,495,522*	*–840*	*147,141,772*
Administrative costs		–371,153,211		–360,053,902		–11,099,309
Depreciation of tangible and intangible fixed assets		–186,350,136		–191,949,730		5,599,594
Other costs:						
losses on investments of reserves and provisions		–281,726,808		–144,147,828		–137,578,980
losses on trading and disposals	*–27,902,197*		*–1*		*–27,902,196*	
writedowns	*–253,824,611*		*–144,147,827*		*–109,676,784*	
other transfers to provisions		–16,820,747		–751,363,158		734,542,411
prior-year expense		–2,400,437		–1,232,074		–1,168,363
appropriation of investment income to reserves (2)		–297,281,479		–392,649,324		95,367,845
other taxes and duties		–16,190,519		–45,129,681		28,939,162
sundry		–3,805,123		–9,544,233		5,739,110
other interest expense	*–9,089*		*–1,450,846*		*1,441,757*	
opening stocks	*–440,030*		*–662,666*		*222,636*	
miscellaneous payables	*–3,356,004*		*–7,430,721*		*4,074,717*	
Taxes on income for the year and productive activities		7,200,000,000		–783,000,000		7,983,000,000
NET PROFIT FOR THE YEAR		**64,382,294**		**506,855,411**		**–442,553,117**

(1) Includes the remuneration of the Board of Directors (863,205 euros in 2002 and 1,424,707 euros in 2001 and the Board of Auditors (33,210 euros in 2002 and 32,337 euros in 2001). – (2) Pursuant to Article 55 of the Statute.

- €388 million in income from securities and other assets denominated in foreign currency. This reflected the fall in the average overall rate of return, while the annual average value of the portfolio remained basically unchanged (declining from €28,598 million to €27,364 million);
- €38 million in income from the position with the IMF, primarily owing to the reduction in the interest rate paid by the Fund.

Interest income earned on positions in euros fell by €455 million (from €1,672 million to €1,217 million), as a result of the decreases of:

- €378 million in income from refinancing operations (from €645 million to €267 million) that was mainly due to the decrease of €342 million in income from main refinancing operations as a consequence of the reduction in the annual average amount outstanding (from €13,562 million to €7,913 million) and the fall in the average rate of return (from 4,47 to 3,34 per cent);
- €46 million in income from intra-Eurosystem balances following the fall in interest income (from €278 million to €210 million) earned on the claims deriving from the transfer of foreign reserves to the ECB as a result of the lower average interest rate applied, which was partly offset by the increase (from €96 million to €111 million) in income from the Bank's TARGET balances. For the first time the item includes the interest earned (€7 million) on the balances related to the allocation of euro banknotes within the Eurosystem when these were positive.
- €22 million (from €162 million to €140 million) in the interest earned at the rate of 1 per cent on advances under Treasury Ministry Decree 27.9.1974;
- €12 million (from €97 million to €85 million) in the interest earned on securities held for monetary policy purposes, as a consequence of the downward trend of interest rates.

By contrast, there was a small increase in the interest income from claims on the State to €397 million. This included the interest earned at 1 per cent on the bonds held under Law 483/1993 (down from €394 million to €392 million) and that earned on the bonds deriving from the above-mentioned bond conversion (€5 million).

Premiums and discounts on securities denominated in euros and foreign currencies were negative in both years, but decreased from €251 million to €212 million, of which €179 million referred to securities denominated in US dollars (€216 million in 2001), €17 million to securities denominated in yen (€14 million in 2001) and €17 million to securities denominated in euros (€23 million in 2001), while net premiums amounting to €1 million were recorded on securities denominated in Swiss francs (€2 million in 2001).

Interest expense fell by €156 million (from €2,102 million to €1,946 million).

Overall, interest expense in respect of positions denominated in euros decreased by €142 million (from €2,050 million to €1,908 million). In particular:

- interest on the sinking fund for the redemption of government securities decreased by €168 million (from €176 million to €8 million) owing to the reduction in the average amount outstanding (from €3,719 million to €231 million) and the fall in the average rate of return (from 4.72 to 3.53 per cent);
- interest on current account deposits of required reserves decreased by €110 million (from €558 million to €448 million) owing to the fall in the average rate of return on required reserves (from 4.37 to 3.31 per cent). This was partly offset by the increase in the annual average amount of required reserves (from €12,771 million to €13,562 million);
- interest on the current account held by the UIC decreased by €3 million (from €4 million to €1 million);
- other interest decreased by €37 million (from €72 to €35 million) owing to the repayment in the early part of the year of the deposits of collateral for the euro notes and coins provided in the front-loading phase;
- interest on intra-Eurosystem balances increased by €110 million (from €93 million to €203 million) as a consequence of the inclusion of €107 million of interest payable, starting in 2002, on the balances related to the allocation of euro banknotes within the Eurosystem when these were negative. Interest payable in connection with the net position on the Bank's TARGET accounts edged up by €3 million (from €93 million to €96 million);
- interest on the Treasury payments account increased by €65 million (from €1,147 million to €1,212 million) owing to the increase in the annual average balance (from €20,918 million to €26,918 million), which was only offset in part by the decline in the average rate of return (from 5.48 to 4.50 per cent);
- interest on overnight deposits, fixed-term deposits and deposits related to margin calls decreased from €0.4 million to €0.2 million.

The interest paid on positions denominated in foreign currency fell from €52 million to €39 million, reflecting the decrease in payments in respect of allocations of SDRs (from €34 million to €21 million), while payments in respect of foreign accounts and repos denominated in foreign currencies declined by €1 million.

The *net result of financial operations, writedowns and risk provision transfers* showed a negative result of €6,631 million (as against a positive result of €1,760 million in 2001). The swing was the result of:

a) a loss of €21,348 million on trading in securities, as a consequence of the loss of €21,837 million deriving from the bond conversion under Law 289/2002, offset by a profit of €489 million (€744 million in 2001) on trading in securities denominated in foreign currencies;

b) a profit of €288 million on foreign exchange trading, earned almost exclusively on sales of US dollars and down by €875 million from the €1,163 million recorded in 2001 owing to the pattern of trading and the appreciation of the euro;

c) a profit of €429 million (€378 million in 2001) following the closure during the year of forward positions in connection with the advance granted under Treasury Ministry Decree 27.9.1974;

d) writedowns of financial assets and positions amounting to €1,207 million (up by €662 million on the €545 million recorded in 2001). The writedowns of net positions in US dollars and yen in relation to the appreciation of the euro accounted for most of the total (€822 million, compared with almost nothing in 2001). By contrast, there was a fall, from €506 million to €385 million, in the writedowns of the forward positions connected with the renewal of the above-mentioned advance on the basis of the foreseeable difference between the repurchase price and the future market price; the writedowns in connection with the prices of securities denominated in euros and foreign currencies were not material (€39 million in 2001);

e) provision transfers amounting to €15,207 million, as detailed below:

- €13,060 million of withdrawals from the gold revaluation accounts (of which €620 million from the 1976 adjustment of the gold reserves); €1,024 million from the provision for losses on securities; and €547 million from the provision for general risks to cover part of the loss deriving from the bond conversion described above;

- €462 million of withdrawals from the provision for general risks to cover writedowns of euro-denominated securities;

- €114 million (€20 million in 2001) of withdrawals from the pre-system revaluation accounts as a consequence of disposals and writedowns of securities and foreign currencies.

Net income from fees and commissions, swung from minus €3 million in 2001 to plus €3 million.

Income from equity shares and participating interests rose by €67 million (from €321 million to €388 million) and comprised:

– €268 million of dividends for the year 2001 on the Bank's interest in the capital of the ECB (down from €300 million);

– €111 million in respect of the Bank's share of the ECB's *seigniorage* income on euro banknotes (see the section on *Banknotes in circulation* under *Accounting policies*).

– €9 million of profits allocated to the Bank in respect of its interest in the UIC's endowment fund (down from €21 million in 2001).

The *net result of the pooling of monetary income* swung from plus €4 million to minus €73 million, the resultant of €1,843 million of monetary income pooled by the Bank and €1,770 million reallocated to the Bank.

In 2002 the amount of each NCB's monetary income was determined by multiplying the rate on main refinancing operations to an aggregate of its liabilities known as the liability base.

The liability base of each NCB consists of: banknotes in circulation (including both euro banknotes and non returned national banknotes); liabilities to credit institution related to monetary policy operations denominated in euros; net intra-Eurosystem liabilities resulting from TARGET transactions; and net intra-Eurosystem liabilities related to the allocation of euro banknotes within the Eurosystem.

Any interest paid on liabilities included within the liability base is to be deducted from the monetary income to be pooled.

The monetary income pooled by the Eurosystem is to be allocated among NCBs according to the subscribed capital key.

Other income decreased by €173 million (from €1,638 million to €1,465 million). In particular:

– *income from the investment of reserves and provisions* fell by €140 million (from €1,434 million to €1,294 million). In more detail, interest income and dividends from securities (including bond premiums and discounts) declined from €1,406 million to €1,255 million, while profits from trading of assets and disposals rose from €28 million to €39 million;

– *prior-year income* decreased by €43 million (from €127 to €84 million);

– *sundry* income amounted to €87 million, slightly up compared with 2001 (€78 million).

Staff costs fell by €110 million (from €1,161 million to €1,051 million) primarily as a result of the decrease in the transfers to the provision for severance pay and pensions from €218 million to €66 million. In accordance with ESCB accounting rules, this expense is included in staff costs together with the amount accrued but not yet paid to members of the staff at the end of the year (up from €61 million to €66 million).

Excluding the above-mentioned transfers to provisions and the emoluments paid to head and branch office collegial bodies, which remained unchanged at €3 million, staff costs — in respect of the Bank's employees and pensioners and including the severance pay disbursed for terminations – amounted to €916 million, an increase of €38 million on 2001. Wages and salaries and social security contributions increased by €41 million to €667 million, while pensions and severance pay decreased by €3 million to €237 million.

The breakdown of the Bank's staff by type of employment is shown in Table 7.

Table 7

THE BANK'S STAFF

	Average number of persons in service		Percentage composition	
	2002	2001	2002	2001
Managerial	1,991	1,956	23.5	23.0
Clerical	4,931	4,990	58.3	58.6
General services and security	974	992	11.5	11.6
Blue-collar	570	580	6.7	6.8
Total	**8,466**	**8,518**	**100.0**	**100.0**

Administrative costs rose by €11 million.

Depreciation of tangible and intangible fixed assets, which refers exclusively to ordinary depreciation, declined slightly (from €192 million to €186 million).

Other costs fell by €726 million (from €1,344 million to €618 million) and comprised:

- *losses on investments of reserves and provisions*, which rose from €144 million to €282 million as a result of the increase (from €144 million to €254 million) in writedowns of equity investments and the increase from an immaterial amount to €28 million in losses on disposals;
- *other transfers to provisions*, which fell from €751 million (including the transfer of €700 million to the provision for general risks) to €17 million and consisted almost entirely of accelerated depreciation (€51 million in 2001);
- *prior-year expense*, which rose from €1 million to €2 million;
- appropriation of investment income to reserves, which amounted to €297 million, down from €393 million in 2001;

– *other taxes and duties*, (i.e. excluding income tax for the year and the regional tax on productive activities) which fell from €45 million to €16 million owing to the abolition of the stamp duty on notes in circulation (€30 million in 2001) under Decree Law 209/2002, ratified by Law 265/2002;

– *sundry* other costs, which decreased by €6 million, primarily as a result of the absence of transfers provisions in connection with interest income accrued on securities and not received (€4 million in 2001).

Taxes for the year show a positive net result equal to €7,200 million (as against a negative amount equal to €783 million in 2001) that contributes in the same way as revenues to the result for the year, even though it is included under the expense item *Taxes on income for the year and productive activities* in accordance with the statutorily defined layout of the income statement. The amount derives for €7,116 from the accrual of the deferred tax asset in respect of corporate income tax (Irpeg) and for €112 million from the tax credit on dividends cashed, offset in part by the tax on productive activities (Irap) payable for the year (€23 million) and the residual net deferred tax liability (€5 million).

Excluding the bond conversion under Law 289/2002, which gave rise to the inclusion in the accounts of €7,206 million of deferred tax assets, taxes for the year amounted to €6 million, a substantial decrease of €783 million on 2001 as a consequence of the reduction in gross profit.

3. Proposals of the Board of Directors

Pursuant to Articles 54 and 57 of the Statute and after hearing the favourable opinion of the Board of Auditors, the Board of Directors proposes the following allocation of the net profit for 2002 of €64,302,294:

	euros
– 20 per cent to the ordinary reserve	12,860,459
– an amount equal to 6 per cent of the share capital to shareholders	9,360
– 20 per cent to the extraordinary reserve	12,860,459
– an additional amount equal to 4 per cent of the share capital to shareholders	6,240
– the remaining amount to the State	38,565,776
TOTAL	64,302,294

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 €42,945,000, equal to 0.50 per cent (0.55 per cent in 2001) of the total reserves at 31 December 2001.

If these proposals are approved, the total dividend will be equal to €42,960,600 corresponding to €143.202 per share.

THE GOVERNOR
Antonio Fazio

BALANCE SHEET
AND INCOME STATEMENT
for the year ended 31 December 2002

ASSETS		amounts in euros 2002	2001
1	**GOLD AND GOLD RECEIVABLES**	**25,763,615,140**	**24,830,282,205**
2	**CLAIMS ON NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**	**27,316,455,914**	**27,703,644,173**
2.1	Receivables from the IMF	4,681,552,173	4,608,324,572
2.2	Securities (other than shares)	18,770,622,928	19,833,416,871
2.3	Current accounts and deposits	3,687,101,568	3,258,152,788
2.4	Reverse operations	174,826,533	–
2.5	Other claims	2,352,712	3,749,942
3	**CLAIMS ON EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**	**5,298,228,670**	**5,462,237,036**
3.1	Financial counterparties	5,298,228,670	5,462,237,036
	3.1.1 Securities (other than shares)	*2,125,503,559*	*143,935,833*
	3.1.2 Reverse operations	–	–
	3.1.3 Other claims	*3,172,725,111*	*5,318,301,203*
3.2	General government	–	–
3.3	Other counterparties	–	–
4	**CLAIMS ON NON-EURO-AREA RESIDENTS**	**–**	**–**
4.1	Claims on non-euro-area EU central banks	–	–
4.2	Securities (other than shares)	–	–
4.3	Other claims	–	–
5	**LENDING TO EURO-AREA BANKS RELATED TO MONETARY POLICY OPERATIONS**	**6,933,007,746**	**9,719,069,910**
5.1	Main refinancing operations	6,932,865,946	9,474,322,699
5.2	Longer-term refinancing operations	–	244,747,211
5.3	Fine-tuning reverse operations	–	–
5.4	Structural reverse operations	–	–
5.5	Marginal lending facility	–	–
5.6	Credits related to margin calls	141,800	–
6	**OTHER CLAIMS ON EURO-AREA BANKS**	**400,710**	**430,026**
7	**SECURITIES ISSUED BY EURO-AREA RESIDENTS (other than shares)**	**1,577,708,552**	**1,545,760,828**
8	**GENERAL GOVERNMENT DEBT**	**18,872,447,779**	**40,552,272,808**
9	**INTRA-EUROSYSTEM CLAIMS**	**8,192,250,000**	**18,903,338,431**
9.1	Participating interest in the ECB	744,750,000	744,750,000
9.2	Claims deriving from the transfer of foreign reserves to the ECB	7,447,500,000	7,447,500,000
9.3	Net claims related to the allocation of euro banknotes within the Eurosystem	–	–
9.4	Other claims within the Eurosystem (net)	–	10,711,088,431
10	**ITEMS TO BE SETTLED**	**7,161,407**	**828,014**
11	**OTHER ASSETS**	**53,377,152,464**	**50,380,689,122**
11.1	Euro-area coins	25,744,271	7,613,069
11.2	UIC endowment fund	258,228,450	258,228,450
11.3	Investments of reserves and provisions (including shares)	28,291,710,474	28,969,310,742
11.4	Intangible fixed assets	24,339,495	19,811,500
11.5	Deferred charges	9,683,493	9,081,152
11.6	Tangible fixed assets (net of depreciation)	2,732,847,192	2,772,916,530
11.7	Accrued income and prepaid expenses	679,336,952	1,059,482,453
11.8	Sundry	21,355,262,137	17,284,245,226
	TOTAL	**147,338,428,382**	**179,098,552,553**
13	**MEMORANDUM ACCOUNTS**	**365,360,119,127**	**567,893,503,200**

Audited and found correct - 30 April 2003
THE AUDITORS: GIUSEPPE BRUNI, ENRICO NUZZO, ANGELO PROVASOLI, MASSIMO STIPO, GIANFRANCO ZANDA

SHEET

	LIABILITIES	amounts in euros	
		2002	2001
1	**BANKNOTES IN CIRCULATION**	**62,835,487,670**	**64,675,772,392**
2	**LIABILITIES TO EURO-AREA BANKS RELATED TO MONETARY POLICY OPERATIONS**	**10,454,353,301**	**7,573,465,398**
2.1	Current accounts (covering the minimum reserve system)	10,452,311,385	7,569,710,153
2.2	Deposit facility	2,041,916	3,452,663
2.3	Fixed-term deposits	–	–
2.4	Fine-tuning reverse operations	–	–
2.5	Deposits related to margin calls	–	302,582
3	**OTHER LIABILITIES TO EURO-AREA BANKS**	**–**	**18,708,178,607**
4	**LIABILITIES TO OTHER EURO-AREA RESIDENTS DENOMINATED IN EUROS**	**21,322,140,595**	**23,697,366,223**
4.1	General government	21,316,379,333	23,463,304,816
4.1.1	*Treasury payments account*	*20,617,850,101*	*21,287,086,365*
4.1.2	*Sinking fund for the redemption of government securities*	*633,200,291*	*176,430,644*
4.1.3	*Other liabilities*	*65,328,941*	*1,999,787,807*
4.2	Other counterparties	5,761,262	234,061,407
5	**LIABILITIES TO NON-EURO-AREA RESIDENTS DENOMINATED IN EUROS**	**53,952,167**	**38,332,907**
5.1	Liabilities to non-euro-area EU central banks	847	827
5.2	Other liabilities	53,951,320	38,332,080
6	**LIABILITIES TO EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**	**–**	**–**
6.1	Financial sector counterparties	–	–
6.2	General government	–	–
6.3	Other counterparties	–	–
7	**LIABILITIES TO NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY**	**2,880,824,617**	**2,455,571,547**
7.1	Deposits and balances	12,439,170	14,765,282
7.2	Other liabilities	2,868,385,447	2,440,806,265
8	**COUNTERPART OF SDRs ALLOCATED BY THE IMF**	**910,521,120**	**1,000,575,824**
9	**INTRA-EUROSYSTEM LIABILITIES**	**7,866,468,998**	**–**
9.1	Promissory notes covering debt certificates issued by the ECB	–	–
9.2	Net liabilities related to the allocation of euro banknotes within the Eurosystem	5,731,537,490	–
9.3	Other liabilities within the Eurosystem (net)	2,134,931,508	–
10	**ITEMS TO BE SETTLED**	**37,087,693**	**17,880,314**
11	**OTHER LIABILITIES**	**1,747,879,381**	**1,921,621,967**
11.1	Bank of Italy drafts	839,203,894	820,709,854
11.2	Cashier's department services	1,189,803	751,240
11.3	Accrued expenses and deferred income	12,699,227	83,951,332
11.4	Sundry	894,786,457	1,016,209,541
12	**PROVISIONS**	**7,516,566,695**	**9,902,583,255**
12.1	Provisions for specific risks	1,966,367,143	4,423,193,940
12.2	Sundry staff-related provisions	5,550,199,552	5,479,389,315
13	**REVALUATION ACCOUNTS**	**9,645,479,636**	**26,060,123,837**
14	**PROVISION FOR GENERAL RISKS**	**8,789,381,997**	**9,798,072,043**
15	**CAPITAL AND RESERVES**	**13,213,982,218**	**12,742,152,828**
15.1	Capital	156,000	154,937
15.2	Ordinary and extraordinary reserves	9,044,070,683	8,589,063,103
15.3	Other reserves	4,169,755,535	4,152,934,788
16	**NET PROFITS FOR DISTRIBUTION**	**64,302,294**	**506,855,411**
	TOTAL	**147,338,428,382**	**179,098,552,553**
18	**MEMORANDUM ACCOUNTS**	**365,360,119,127**	**567,893,503,200**

THE ACCOUNTANT GENERAL
ANTONIO PASQUALE SODA

THE GOVERNOR
ANTONIO FAZIO

INCOME STATEMENT

	amounts in euros 2002	amounts in euros 2001
a) Net income from institutional operations		
Interest income	*1,885,967,592*	*2,728,084,819*
Interest expense	*–1,946,502,469*	*–2,102,150,120*
Net interest income	**–60,534,877**	**625,934,699**
Profits and losses on financial operations	*–20,630,574,618*	*2,285,061,836*
Writedowns of financial assets and positions	*–1,206,920,529*	*–545,207,137*
Transfers to/from provisions for losses on foreign exchange and securities	*15,206,927,979*	*20,141,109*
Net result of financial operations, writedowns and risk provision transfers	**–6,630,567,168**	**1,759,995,808**
Fee and commission income	*20,335,870*	*21,606,242*
Fee and commission expense	*–17,709,199*	*–24,589,170*
Net income from fees and commissions	**2,626,671**	**–2,982,928**
Income from equity shares and participating interests	387,951,300	321,284,475
Net result of the pooling of monetary income	–72,909,382	3,962,248
b) Other income		
– *income from the investment of reserves and provisions*	1,294,023,772	1,433,588,255
– *prior-year income*	83,623,705	126,791,936
– *sundry*	87,306,687	78,092,265
Total net income (a+b)	**–4,908,479,292**	**4,346,666,758**
Staff costs	–1,051,489,954	–1,160,741,417
Administrative costs	–371,153,211	–360,053,902
Depreciation of tangible and intangible fixed assets	–186,350,136	–191,949,730
Banknote production services	–	–
Other costs:		
– *losses on investments of reserves and provisions*	–281,726,808	–144,147,828
– *other allocations to provisions*	–16,820,747	–751,363,158
– *prior-year expense*	–2,400,437	–1,232,074
– *appropriation of investment income to reserves* (1)	–297,281,479	–392,649,324
– *other taxes and duties*	–16,190,519	–45,129,681
– *sundry*	–3,805,123	–9,544,233
Taxes on income for the year and productive activities (2)	7,200,000,000	–783,000,000
Net profit for the year	**64,302,294**	**506,855,411**

(1) Pursuant to Article 55 of the Statute.– (2) Under the layout of the income statement adopted, this item includes amounts with a positive sign for 2002.

ALLOCATION OF THE NET PROFIT FOR THE YEAR	amounts in euros
TO THE ORDINARY RESERVE	**12,860,459**
TO THE EXTRAORDINARY RESERVE	**12,860,459**
TO SHAREHOLDERS: 6% OF THE CAPITAL	**9,360**
AN ADDITIONAL 4% OF THE CAPITAL	**6,240**
TO THE STATE	**38,565,776**
TOTAL	**64,302,294**

Audited and found correct
30 April 2003. **THE AUDITORS**

GIUSEPPE BRUNI
ENRICO NUZZO
ANGELO PROVASOLI
MASSIMO STIPO
GIANFRANCO ZANDA

THE ACCOUNTANT GENERAL

ANTONIO PASQUALE SODA

THE GOVERNOR

ANTONIO FAZIO

REPORT OF THE BOARD OF AUDITORS ON THE 109th FINANCIAL YEAR OF THE BANK OF ITALY AND THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2002

To the Shareholders

The accounts for the year ended 31 December 2002 submitted for your approval show the following results (in euros):

Assets	€	147,338,428,382
Liabilities	€	134,060,143,870
Capital and reserves	€	13,213,982,218
Net profit for the year (as shown in the vertical profit and loss account) .	€	64,302,294

The memorandum accounts, shown on both sides of the balance sheet for an amount of €365,360,119,127, refer to deposits of securities and sundry valuables and commitments and contingent liabilities (for purchases and sales of securities, foreign exchange and euros).

The accounts were kept properly in conformity with the standards and rules laid down by the law in force. The individual items of the accounts, which were also checked by the independent auditors, were compared with the accounting records and found to conform with them.

The methods used in preparing the annual accounts and valuing assets and liabilities have been updated compared with the previous year to take account of two decisions adopted by the ECB Governing Council (ECB Decision 2001/15 of 6 December 2001 on the issue of euro banknotes and ECB Decision 2001/16 of 6 December 2001 on the allocation of monetary income of the national central banks of participating Member States from the financial year 2002[1] and of Article 65 of Law 289/2002 (the Finance Law for 2002) concerning the conversion of the 1 per cent bonds issued under Law 483/1993 into other government bonds issued under market conditions.

The criteria for preparing the annual accounts and the valuation methods used, with whose adoption we agree, were found to conform with those approved by the Board of Directors and with the law in force. They are described in detail in the notes to the accounts and comply with the harmonized accounting rules laid down by the Governing Council of the

[1] The decisions are published in OJ L337 of 20 December 2001, pp. 52-61.

ECB and transposed for the purposes of the annual accounts by Article 8 of Legislative Decree 43/1998. The notes to the accounts contain all the other information required by current legislation.

We inform you that in drawing up the annual accounts it was not necessary to invoke the waiver provided for in the fourth paragraph of Article 2423 of the Civil Code.

Among other things, the annual accounts also reflect the conversion on 30 December 2002 of the 1 per cent bonds issued under Law 483/1993 into other government bonds issued under market conditions. The pertinent balance sheet and income statement items (including the negative conversion difference) are discussed in detail in the notes to the accounts.

In particular, the conversion gave rise to deferred tax assets, in connection with the deductibility for tax purposes of the loss incurred, included in the balance sheet for €7,116 million. The inclusion of this amount was based on a careful evaluation of the Bank's income-earning capacity in the years to come that suggested it was reasonable to expect the entire amount of the tax loss incurred would be utilized in the period allowed by Law 289/2002. The amount was calculated on the basis of the 33 per cent corporate income tax rate contemplated by Law 80/2003 delegating the Government to reform the central government tax system.

To cover the loss deriving from the conversion the Board of Directors resolved to utilize the gold revaluation accounts as ascertained at 1 January 1999, as provided for by Law 289/2002, for a total of €13,060 million (of which €12,440 million withdrawn from the so-called pre-system revaluation account and €620 million from the provision for losses on foreign exchange created in the past with part of the revaluation of the gold reserves provided for in Decree Law 867/1976) and provisions for specific and general risks for a total of €1,571 million.

The Board of Directors also resolved to withdraw €462 million from the provision for general risks to cover writedowns of securities denominated in euros.

Taking into account the above-mentioned withdrawals, we declare that the total amount of the Bank's general and specific risk provisions stand at a prudent level in our opinion. In particular, the provision for severance pay and pensions comprises both the actuarial reserves corresponding to the situation of staff having entitlement and that of pensioners and the severance pay accrued by all the members of the staff in service at the end of the year having entitlement.

Pursuant to Article 54 of the Statute, the Board of Directors proposes the following allocation of the net profit for 2002 of €64,302,294:

– 20 per cent to the ordinary reserve	€	12,860,459
– an amount equal to 6 per cent of the share capital to shareholders	€	9,360
– 20 per cent to the extraordinary reserve	€	12,860,459
– an additional amount equal to 4 per cent of the share capital to shareholders	€	6,240
– the remaining amount to the State	€	38,565,776
TOTAL	€	64,302,294

Pursuant to Article 56 of the Statute, the Board of Directors also proposes the distribution to shareholders – drawing on the income earned on the ordinary and extraordinary reserves – of an additional €42,945,000, equal to 0.50 per cent of such reserves at 31 December 2001 and within the limit laid down in the above-mentioned article.

During the year we attended the meetings of the Board of Directors and the Board Committee and made the tests and controls within the scope of our authority, in particular as regards the quantities of cash and valuables belonging to the Bank and third parties, verifying at all times compliance with the law and the Bank's Statute and General Regulations.

We monitored the activity of the Bank's peripheral units in close contact, in accordance with Articles 23 and 24 of the Bank's Statute, with the examiners at the main branches and the branches, whom we thank warmly.

We recommend that you approve the accounts for 2002 that have been submitted to you (the balance sheet, the income statement and the notes to the accounts) and the proposed allocation of the net profit for the year and distribution to shareholders of an additional amount pursuant to Article 56 of the Statute.

THE AUDITORS
GIUSEPPE BRUNI
ENRICO NUZZO
ANGELO PROVASOLI
MASSIMO STIPO
GIANFRANCO ZANDA

STATISTICAL APPENDIX

LIST OF TABLES

SOURCES AND USES OF INCOME IN FRANCE (1)
(at 1995 prices; billions of euros)

	Sources			Uses								
				Domestic demand								Exports of goods and services
	Gross domestic product	Imports of goods and services	Total	Gross fixed investment			National consumption		Change in stocks and valuables	Total		
				Construction	Other (2)	Total	Households (3)	General government				
1999	1,299.5	321.3	1,620.8	109.0	148.0	257.0	710.6	300.3	5.3	1,273.2		347.6
2000	1,348.8	368.2	1,717.0	116.8	160.1	276.9	729.1	308.7	12.8	1,325.7		391.3
2001	1,377.1	373.0	1,750.1	118.4	163.9	282.3	749.2	317.8	4.8	1,352.4		397.7
2002	1,393.7	375.2	1,768.9	117.2	160.7	277.9	758.1	331.0	–0.1	1,365.2		403.7
1999 – I	320.3	77.5	397.7	26.6	35.8	62.4	175.7	74.2	1.8	314.1		83.7
II	323.4	79.0	402.4	27.1	36.8	63.8	177.6	74.4	1.7	317.6		84.8
III	326.9	81.0	407.9	27.4	37.8	65.2	179.3	74.7	0.3	319.4		88.5
IV	331.2	84.3	415.5	27.8	38.6	66.4	180.8	75.5	2.3	325.0		90.5
2000 – I	335.3	87.8	423.1	28.7	39.7	68.4	182.3	76.0	2.7	329.4		93.7
II	337.8	91.2	429.0	29.2	40.4	69.6	183.1	76.7	2.3	331.7		97.3
III	339.6	94.5	434.0	29.2	40.7	69.9	183.8	77.0	3.6	334.3		99.7
IV	344.0	97.4	441.5	29.6	41.9	71.5	184.9	77.8	4.1	338.3		103.2
2001 – I	345.9	95.8	441.7	30.0	41.9	71.8	187.3	78.1	1.7	339.0		102.6
II	345.7	94.4	440.1	29.4	41.8	71.2	188.1	78.6	2.3	340.1		99.9
III	347.3	93.5	440.8	29.6	41.7	71.3	189.7	79.6	0.1	340.7		100.1
IV	346.3	92.2	438.5	29.5	41.5	70.9	189.9	80.1	–0.7	340.2		98.3
2002 – I	348.8	93.8	442.5	29.4	41.5	70.9	190.4	81.3	0.2	342.8		99.7
II	350.4	94.7	445.1	29.6	41.1	70.7	191.1	82.2	–0.6	343.3		101.8
III	351.6	95.3	446.9	29.3	40.9	70.2	192.0	82.9	–0.7	344.4		102.5
IV	351.3	94.7	446.0	29.0	40.4	69.3	192.6	83.5	–1.4	344.0		102.1

Source: National statistics.

(1) The quarterly data are adjusted for seasonal factors and the number of working days. – (2) Machinery, equipment, transport equipment and intangible assets. – (3) Consumption by resident households and non-profit institutions serving households.

Table a2

SOURCES AND USES OF INCOME IN GERMANY (1)
(at 1995 prices; billions of euros)

	Sources			Uses							
				Domestic demand							Exports of goods and services
	Gross domestic product	Imports of goods and services	Total	Gross fixed investment			National consumption		Change in stocks and valuables	Total	
				Construction	Other (2)	Total	Households (3)	General government			
1999	1,914.8	567.4	2,482.2	248.7	183.5	432.2	1,099.2	375.0	–6.6	1,899.8	582.5
2000	1,969.5	627.1	2,596.6	242.1	200.7	442.8	1,114.8	379.6	–2.7	1,934.5	662.1
2001	1,980.8	633.1	2,613.9	227.7	191.8	419.5	1,131.6	382.6	–15.2	1,918.6	695.4
2002	1,984.3	619.8	2,604.1	214.3	177.0	391.3	1,124.3	388.5	–13.9	1,890.3	713.8
1999 – I	474.2	136.5	610.7	61.2	44.6	105.7	274.4	93.8	–0.4	473.5	137.2
II	472.1	139.8	611.8	61.6	44.9	106.5	271.6	93.2	–2.3	469.0	142.8
III	479.0	143.3	622.2	62.7	46.2	108.9	274.2	93.8	–2.3	474.6	147.6
IV	484.5	144.6	629.1	62.0	46.4	108.4	276.6	94.2	–1.2	478.0	151.1
2000 – I	488.1	149.9	637.9	61.4	48.3	109.7	276.6	94.8	–1.0	480.1	157.9
II	493.3	153.6	646.9	61.0	49.7	110.7	280.4	94.5	–1.2	484.4	162.5
III	493.5	157.6	651.1	60.3	51.4	111.7	279.7	94.2	–1.3	484.3	166.9
IV	493.8	165.9	659.7	59.3	51.3	110.5	278.2	96.1	0.2	485.0	174.8
2001 – I	496.8	161.1	657.9	57.5	50.2	107.7	282.1	95.7	–2.3	483.2	174.8
II	496.7	160.4	657.1	57.3	48.7	106.0	284.4	95.5	–2.8	483.2	173.9
III	495.7	156.9	652.7	56.9	47.2	104.1	283.8	95.3	–6.2	477.1	175.6
IV	494.2	156.8	651.1	56.4	46.4	102.8	282.5	96.1	–4.1	477.2	173.8
2002 – I	495.7	151.2	646.9	56.0	44.8	100.8	280.6	96.7	–6.1	472.0	175.0
II	496.4	153.8	650.2	53.0	44.3	97.3	281.0	97.3	–2.4	473.2	177.0
III	498.0	157.1	655.0	53.1	44.1	97.1	282.0	97.5	–3.8	472.9	182.1
IV	497.8	160.0	657.8	53.3	44.7	98.0	282.2	97.1	–2.1	475.1	182.7

Source: National statistics.

(1) The quarterly data are adjusted for seasonal factors and the number of working days. – (2) Machinery, equipment, transport equipment and intangible assets. – (3) Consumption by resident households and non-profit institutions serving households.

Table a3

SOURCES AND USES OF INCOME IN SPAIN (1)
(at 1995 prices; billions of euros)

	Sources			Uses								
				Domestic demand								Exports of goods and services
				Gross fixed investment			National consumption		Change in stocks and valuables	Total		
	Gross domestic product	Imports of goods and services	Total	Construction	Other (2)	Total	Households (3)	General government				
1999	507.2	155.8	663.0	64.9	58.4	123.4	301.5	89.0	2.3	516.2	146.8
2000	528.4	172.2	700.7	68.9	61.4	130.4	313.5	93.4	1.9	539.1	161.5
2001	542.6	178.3	720.9	72.9	61.6	134.6	321.3	96.3	1.7	553.9	167.0
2002	553.5	182.2	735.7	76.2	60.3	136.5	327.4	100.0	2.4	566.3	169.4
1999 – I	124.1	36.9	161.1	15.8	14.2	30.0	74.4	21.9	–0.5	125.7	35.3
II	126.3	38.3	164.7	16.2	14.2	30.4	74.8	22.1	1.1	128.4	36.2
III	127.7	39.6	167.4	16.3	15.0	31.3	75.9	22.3	0.6	130.1	37.2
IV	129.0	40.9	169.9	16.6	15.1	31.7	76.4	22.7	1.1	131.9	38.0
2000 – I	130.5	41.3	171.8	16.9	15.0	31.8	77.8	23.0	1.2	133.8	38.0
II	132.0	42.3	174.3	17.1	15.3	32.4	78.5	23.3	0.1	134.3	40.0
III	132.5	44.2	176.8	17.3	15.8	33.1	78.3	23.4	0.9	135.7	41.1
IV	133.4	44.4	177.8	17.6	15.4	33.0	78.9	23.6	–0.2	135.4	42.4
2001 – I	134.5	44.7	179.2	18.0	15.5	33.5	79.5	23.8	0.7	137.4	41.8
II	135.1	44.9	180.0	18.2	15.5	33.7	80.2	24.0	0.3	138.2	41.8
III	136.4	44.1	180.6	18.3	15.6	34.0	80.5	24.2	0.1	138.8	41.8
IV	136.5	44.6	181.1	18.5	15.0	33.4	81.1	24.4	0.5	139.5	41.6
2002 – I	137.2	44.2	181.4	18.7	15.0	33.7	81.4	24.7	1.1	140.8	40.6
II	137.9	44.2	182.0	19.0	15.0	34.0	81.7	24.9	0.3	140.9	41.2
III	139.0	46.0	185.0	19.2	15.3	34.5	81.8	25.1	0.0	141.4	43.6
IV	139.4	47.8	187.3	19.3	14.9	34.3	82.6	25.4	1.0	143.2	44.0

Source: National statistics.

(1) The quarterly data are adjusted for seasonal factors and the number of working days. – (2) Machinery, equipment, transport equipment and intangible assets. – (3) Consumption by resident households and non-profit institutions serving households.

Table a4

ITALY: VALUE ADDED PER STANDARD LABOUR UNIT AND UNIT LABOUR COSTS, BY BRANCH

	1997	1998	1999	2000	2001	2002	1999	2000	2001	2002
	lire						euros			
	Value added at factor cost per standard labour unit (1) *(thousands of lire and euros at 1995 prices)*									
Agriculture, forestry and fishing	**38,540**	**40,557**	**45,314**	**44,890**	**44,288**	**44,151**	**23,403**	**23,184**	**22,873**	**22,802**
Industry excluding construction	**81,685**	**81,469**	**82,283**	**84,396**	**85,765**	**85,387**	**42,496**	**43,587**	**44,294**	**44,099**
of which: manufacturing	*75,820*	*75,524*	*75,751*	*78,030*	*79,117*	*78,118*	*39,122*	*40,299*	*40,861*	*40,344*
Construction	**57,571**	**58,472**	**57,904**	**57,803**	**57,413**	**56,801**	**29,905**	**29,853**	**29,651**	**29,335**
Services (2)	**68,664**	**69,332**	**69,540**	**71,333**	**71,565**	**71,169**	**35,914**	**36,840**	**36,960**	**36,756**
Wholesale and retail trade, repair of household goods etc.	68,567	69,393	68,289	70,768	70,313	69,592	35,269	36,549	36,314	35,941
Hotels and restaurants	49,422	49,970	50,616	50,680	50,518	49,897	26,141	26,174	26,090	25,770
Transport, storage and communication	92,880	93,860	95,288	99,390	102,465	102,172	49,212	51,331	52,919	52,767
Financial intermediation	172,688	177,754	173,080	190,561	187,959	187,746	89,388	98,417	97,072	96,963
Sundry business and household services (2) (3)	70,131	69,400	71,460	72,991	74,098	73,065	36,906	37,697	38,268	37,735
Public administration (4)	67,115	67,477	68,134	68,327	68,411	69,589	35,188	35,288	35,332	35,940
Education	53,037	52,954	52,435	52,105	51,443	51,487	27,080	26,910	26,568	26,591
Health and social work services	59,060	59,043	59,887	61,684	64,366	65,509	30,929	31,857	33,242	33,833
Other public, social and personal services	65,205	66,851	67,998	66,020	64,834	63,622	35,118	34,096	33,484	32,858
Private households with employed persons	18,552	18,523	18,525	18,497	18,498	18,530	9,568	9,553	9,553	9,570
Total (2)	**68,892**	**69,603**	**70,228**	**71,831**	**72,143**	**71,775**	**36,270**	**37,098**	**37,259**	**37,069**
	Unit labour costs (1) (5) *(current lire/euros per lire/euros at 1995 prices)*									
Agriculture, forestry and fishing	**0.680**	**0.637**	**0.575**	**0.577**	**0.591**	**0.610**	**0.575**	**0.577**	**0.591**	**0.610**
Industry excluding construction	**0.688**	**0.679**	**0.686**	**0.689**	**0.698**	**0.719**	**0.686**	**0.689**	**0.698**	**0.719**
of which: manufacturing	*0.723*	*0.715*	*0.729*	*0.730*	*0.741*	*0.771*	*0.729*	*0.730*	*0.741*	*0.771*
Construction	**0.758**	**0.739**	**0.767**	**0.789**	**0.807**	**0.833**	**0.767**	**0.789**	**0.807**	**0.833**
Services (2)	**0.802**	**0.780**	**0.799**	**0.804**	**0.828**	**0.852**	**0.799**	**0.804**	**0.828**	**0.852**
Wholesale and retail trade, repair of household goods etc.	0.665	0.654	0.686	0.683	0.711	0.737	0.686	0.683	0.711	0.737
Hotels and restaurants	0.843	0.852	0.890	0.911	0.950	0.993	0.890	0.911	0.950	0.993
Transport, storage and communication	0.639	0.626	0.620	0.606	0.596	0.601	0.620	0.606	0.596	0.601
Financial intermediation	0.598	0.557	0.574	0.532	0.548	0.565	0.574	0.532	0.548	0.565
Sundry business and household services (2) (3)	0.716	0.730	0.757	0.788	0.811	0.844	0.757	0.788	0.811	0.844
Public administration (4)	0.984	0.946	0.951	0.959	1.002	1.020	0.951	0.959	1.002	1.020
Education	1.112	1.101	1.155	1.215	1.275	1.303	1.155	1.215	1.275	1.303
Health and social work services	1.022	0.985	1.010	1.064	1.080	1.090	1.010	1.064	1.080	1.090
Other public, social and personal services	0.762	0.727	0.716	0.752	0.780	0.804	0.716	0.752	0.780	0.804
Private households with employed persons	1.092	1.102	1.123	1.159	1.177	1.221	1.123	1.159	1.177	1.221
Total (2)	**0.780**	**0.760**	**0.773**	**0.779**	**0.799**	**0.822**	**0.773**	**0.779**	**0.799**	**0.822**

Source: Istat, national accounts.

(1) Includes indirectly measured financial intermediation services. – (2) Excludes renting of buildings. – (3) Includes real estate services, renting services, computer and related services, research and other business services. – (4) Includes defence and compulsory social security services. – (5) Compensation of employees at current prices per standard labour unit divided by value added at factor cost at 1995 prices per standard labour unit.

SOURCES AND USES OF INCOME AND HOUSEHOLD CONSUMPTION IN ITALY

(at 1995 prices; billions of lire and, in brackets, millions of euros)

	SOURCES AND USES								
	Uses								TOTAL SOURCES/ USES
	Agriculture, forestry and fishing (1)	Industry (1)	Services (1) (2)	Financial intermediation services indirectly measured (–)	Other services (1) (3)	VAT and indirect taxes on imports	Gross domestic product	Imports of goods and services (*fob*) (4)	
1996	51,714	572,609	825,355	78,219	329,628	105,728	1,806,815	409,052	2,215,867
1997	52,328	583,509	846,680	81,446	332,703	109,652	1,843,426	450,418	2,293,844
1998	52,946	591,352	866,340	82,659	336,152	112,366	1,876,497	490,428	2,366,925
1999	56,250 *(29,051)*	596,143 *(307,882)*	881,280 *(455,143)*	82,901 *(42,815)*	342,103 *(176,681)*	114,842 *(59,311)*	1,907,716 *(985,253)*	517,660 *(267,349)*	2,425,376 *(1,252,602)*
2000	54,639 *(28,219)*	608,783 *(314,410)*	931,648 *(481,156)*	92,411 *(47,726)*	345,818 *(178,600)*	119,145 *(61,533)*	1,967,622 *(1,016,192)*	563,688 *(291,121)*	2,531,310 *(1,307,312)*
2001	54,264 *(28,025)*	617,161 *(318,737)*	954,503 *(492,960)*	97,518 *(50,364)*	353,012 *(182,316)*	121,744 *(62,876)*	2,003,166 *(1,034,549)*	569,176 *(293,955)*	2,572,342 *(1,328,504)*
2002	52,870 *(27,305)*	613,707 *(316,953)*	963,505 (497,609)	98,714 *(50,982)*	357,590 *(184,680)*	121,653 (62,829)	2,010,612 *(1,038,394)*	577,867 *(298,443)*	2,588,479 *(1,336,838)*
2000 – I	13,573 *(7,010)*	152,212 *(78,611)*	229,132 *(118,337)*	22,420 *(11,579)*	86,032 *(44,432)*	29,420 *(15,194)*	487,952 *(252,006)*	139,578 *(72,086)*	627,530 *(324,092)*
II	13,668 *(7,059)*	151,891 *(78,445)*	231,129 *(119,368)*	22,970 *(11,863)*	86,429 *(44,637)*	29,685 *(15,331)*	489,836 *(252,979)*	139,828 *(72,215)*	629,663 *(325,194)*
III	13,794 *(7,124)*	151,699 *(78,346)*	234,240 *(120,975)*	23,384 *(12,077)*	86,422 *(44,633)*	29,910 *(15,447)*	492,680 *(254,448)*	141,305 *(72,978)*	633,985 *(327,426)*
IV	13,602 *(7,025)*	152,981 *(79,008)*	237,143 *(122,474)*	23,638 *(12,208)*	86,935 *(44,898)*	30,130 *(15,561)*	497,155 *(256,759)*	142,976 *(73,841)*	640,133 *(330,601)*
2001 – I	13,736 *(7,094)*	155,709 *(80,417)*	237,443 *(122,629)*	24,546 *(12,677)*	87,881 *(45,387)*	30,450 *(15,726)*	500,671 *(258,575)*	145,395 *(75,090)*	646,066 *(333,665)*
II	13,339 *(6,889)*	153,986 *(79,527)*	238,955 *(123,410)*	24,354 *(12,578)*	88,408 *(45,659)*	30,490 *(15,747)*	500,824 *(258,654)*	145,344 *(75,064)*	646,168 *(333,718)*
III	13,529 *(6,987)*	153,848 *(79,456)*	239,031 *(123,449)*	23,967 *(12,378)*	88,358 *(45,633)*	30,370 *(15,685)*	501,167 *(258,831)*	139,526 *(72,059)*	640,692 *(330,890)*
IV	13,660 *(7,055)*	153,618 *(79,337)*	239,075 *(123,472)*	24,649 *(12,730)*	88,366 *(45,637)*	30,434 *(15,718)*	500,504 *(258,489)*	138,912 *(71,742)*	639,414 *(330,230)*
2002 – I	13,626 *(7,037)*	153,676 *(79,367)*	238,568 *(123,210)*	24,354 *(12,578)*	88,730 *(45,825)*	30,279 *(15,638)*	500,526 *(258,500)*	138,116 *(71,331)*	638,642 *(329,831)*
II	13,277 *(6,857)*	153,029 *(79,033)*	240,858 *(124,393)*	24,500 *(12,653)*	88,677 *(45,798)*	30,208 *(15,601)*	501,550 *(259,029)*	143,282 *(73,999)*	644,832 *(333,028)*
III	13,016 *(6,722)*	153,236 *(79,140)*	241,230 *(124,585)*	24,465 *(12,635)*	89,812 *(46,384)*	30,401 *(15,701)*	503,231 *(259,897)*	146,731 *(75,780)*	649,961 *(335,677)*
IV	12,952 *(6,689)*	153,767 *(79,414)*	242,849 *(125,421)*	25,396 *(13,116)*	90,372 *(46,673)*	30,763 *(15,888)*	505,306 *(260,969)*	149,740 *(77,334)*	655,046 *(338,303)*

Source: Istat, national accounts.

(1) Value added at market prices. – (2) Wholesale and retail trade, repair services, hotel and restaurant services, transport and communication services; monetary and financial institutions; real estate expenditure abroad. – (5) Expenditure of general government and non-profit institutions serving households. – (6) Includes non-residents' expenditure in Italy.

OF INCOME						HOUSEHOLD DOMESTIC CONSUMPTION				
Uses						By type of consumption			By type of good	
Investment in buildings and public works	Investment in machinery, equipment, transport equipment and intangible assets	Domestic consumption		Change in stocks and valuables	Exports of goods and services (*fob*) (6)	Non-durable goods	Durable goods	Services	Food products, beverages and tobacco products	Non-food products
		Domestic household expenditure	Public expenditure (5)							
154,535	185,187	1,054,736	330,406	4,815	486,188	489,087	107,815	476,208	203,001	870,109
151,520	195,294	1,088,836	331,441	9,477	517,276	499,321	125,520	483,464	206,126	902,179
151,225	209,364	1,123,606	332,516	15,175	535,039	512,935	131,837	497,089	207,223	934,638
155,106	223,672	1,152,566	337,274	21,217	535,541	520,036	138,624	510,380	207,904	961,136
(80,106)	*(115,517)*	*(595,251)*	*(174,188)*	*(10,958)*	*(276,584)*	*(268,576)*	*(71,593)*	*(263,589)*	*(107,373)*	*(496,385)*
164,289	241,567	1,184,165	342,904	–8	598,393	528,345	146,660	530,676	212,830	992,851
(84,848)	*(124,759)*	*(611,570)*	*(177,095)*	*(–4)*	*(309,044)*	*(272,867)*	*(75,744)*	*(274,071)*	*(109,918)*	*(512,765)*
169,620	246,963	1,196,501	354,861	–596	604,993	530,813	145,749	540,127	212,941	1,003,748
(87,601)	*(127,546)*	*(617,941)*	*(183,270)*	*(–308)*	*(312,453)*	*(274,142)*	*(75,273)*	*(278,952)*	*(109,975)*	*(518,393)*
170,179	248,554	1,201,696	361,045	7,907	599,099	529,423	141,631	543,888	213,737	1,001,205
(87,890)	*(128,367)*	*(620,624)*	*(186,464)*	*(4,084)*	*(309,409)*	*(273,424)*	*(73,146)*	*(280,895)*	*(110,386)*	*(517,079)*
40,667	59,122	293,438	85,182	995	148,123	131,297	36,030	131,165	53,048	245,444
(21,003)	*(30,534)*	*(151,548)*	*(43,993)*	*(514)*	*(76,499)*	*(67,809)*	*(18,608)*	*(67,741)*	*(27,397)*	*(126,761)*
41,026	60,410	295,332	85,304	1,899	145,691	131,939	36,359	132,162	53,180	247,281
(21,188)	*(31,199)*	*(152,526)*	*(44,056)*	*(981)*	*(75,243)*	*(68,141)*	*(18,778)*	*(68,256)*	*(27,465)*	*(127,710)*
41,390	61,242	296,759	85,812	–3,179	151,962	132,478	36,915	132,923	53,354	248,962
(21,376)	*(31,629)*	*(153,263)*	*(44,318)*	*(–1,642)*	*(78,482)*	*(68,419)*	*(19,065)*	*(68,649)*	*(27,555)*	*(128,578)*
41,206	60,795	298,637	86,604	275	152,615	132,631	37,355	134,427	53,249	251,163
(21,281)	*(31,398)*	*(154,233)*	*(44,727)*	*(142)*	*(78,819)*	*(68,498)*	*(19,292)*	*(69,426)*	*(27,501)*	*(129,715)*
42,122	61,705	299,229	87,763	–1,588	156,834	132,999	36,632	134,795	53,331	251,095
(21,754)	*(31,868)*	*(154,539)*	*(45,326)*	*(–820)*	*(80,998)*	*(68,688)*	*(18,919)*	*(69,616)*	*(27,543)*	*(129,680)*
42,623	61,920	299,769	88,449	707	152,700	133,299	36,446	135,320	53,499	251,566
(22,013)	*(31,979)*	*(154,818)*	*(45,680)*	*(365)*	*(78,863)*	*(68,843)*	*(18,823)*	*(69,887)*	*(27,630)*	*(129,923)*
42,455	61,932	298,650	88,983	796	147,877	132,524	35,866	135,353	53,104	250,637
(21,926)	*(31,985)*	*(154,240)*	*(45,956)*	*(411)*	*(76,372)*	*(68,443)*	*(18,523)*	*(69,904)*	*(27,426)*	*(129,443)*
42,420	61,409	298,854	89,665	–511	147,581	131,992	36,805	134,660	53,005	250,451
(21,908)	*(31,715)*	*(154,345)*	*(46,308)*	*(–264)*	*(76,219)*	*(68,168)*	*(19,008)*	*(69,546)*	*(27,375)*	*(129,347)*
42,151	60,158	298,056	90,203	6,221	141,851	131,401	35,275	135,504	52,820	249,361
(21,769)	*(31,069)*	*(153,933)*	*(46,586)*	*(3,213)*	*(73,260)*	*(67,863)*	*(18,218)*	*(69,982)*	*(27,279)*	*(128,784)*
42,406	60,417	298,650	90,406	3,739	149,213	132,137	34,994	134,780	53,544	248,369
(21,901)	*(31,203)*	*(154,240)*	*(46,691)*	*(1,931)*	*(77,062)*	*(68,243)*	*(18,073)*	*(69,608)*	*(27,653)*	*(128,272)*
42,685	63,028	300,951	90,494	–1,297	154,100	132,536	34,973	136,420	53,464	250,464
(22,045)	*(32,551)*	*(155,428)*	*(46,736)*	*(–670)*	*(79,586)*	*(68,449)*	*(18,062)*	*(70,455)*	*(27,612)*	*(129,354)*
42,939	64,948	304,039	89,942	–759	153,935	133,349	33,388	137,185	53,912	253,010
(22,176)	*(33,543)*	*(157,023)*	*(46,451)*	*(–392)*	*(79,501)*	*(68,869)*	*(18,793)*	*(70,850)*	*(27,843)*	*(130,669)*

services and business activities. – (3) Public administration and defence services; compulsory social security services; other community, social and personal service activities. – (4) Includes residents'

Table a6

ITALY: INDUSTRIAL PRODUCTION BY MAIN INDUSTRIAL GROUPINGS

(indices, 2000=100; raw annual data; quarterly data adjusted for seasonal factors and the number of working days)

	Consumer goods			Investment goods	Intermediate goods	Energy	Manufacturing	AGGREGATE INDEX
	Durable	Non-durable	Total					
1993	70.2	89.4	85.1	78.5	86.1	83.4	83.9	83.7
1994	77.3	92.7	89.4	82.3	91.2	86.2	88.5	88.1
1995	84.2	94.8	92.7	92.6	94.7	89.0	93.5	92.8
1996	83.9	94.2	92.1	94.3	91.4	89.6	92.4	92.0
1997	85.0	97.2	94.7	96.8	95.0	93.0	95.4	95.1
1998	89.6	98.8	96.9	96.9	97.2	95.6	97.0	96.8
1999	93.5	100.0	98.7	97.3	95.1	97.3	96.9	97.0
2000	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
2001	99.0	100.8	100.4	99.0	98.2	99.6	99.1	99.2
2002	96.0	99.0	98.4	97.7	95.5	103.8	97.0	97.8
1996 – I	84.2	93.5	91.4	96.1	93.2	92.9	93.4	93.2
II	83.0	92.3	90.6	93.9	90.9	86.5	91.7	91.0
III	84.0	93.3	91.6	92.8	90.3	87.7	91.5	91.1
IV	82.1	94.8	92.1	90.9	88.8	89.8	90.5	90.5
1997 – I	82.8	95.0	92.6	92.7	89.7	90.9	91.9	91.7
II	85.3	96.6	94.4	97.1	95.2	92.9	95.0	94.7
III	84.8	98.5	95.8	97.5	96.3	93.3	96.4	96.1
IV	85.7	97.7	95.2	98.9	98.4	95.1	97.5	97.2
1998 – I	87.1	96.4	94.5	97.3	98.5	94.6	96.8	96.5
II	89.5	98.4	96.7	97.2	98.2	94.4	97.3	96.9
III	89.9	98.7	96.9	96.8	95.8	95.6	96.4	96.4
IV	88.3	98.4	96.3	92.8	93.9	97.0	94.8	95.2
1999 – I	88.4	98.4	96.3	95.4	92.8	97.7	94.5	94.9
II	90.4	97.5	96.1	95.2	93.5	94.9	94.6	94.6
III	94.4	101.0	99.5	96.2	94.3	97.6	96.5	96.7
IV	97.1	99.3	99.0	97.9	96.9	98.0	97.9	98.0
2000 – I	98.2	97.2	97.3	98.6	98.2	99.7	98.0	98.2
II	100.4	99.9	100.0	100.4	99.7	100.4	100.0	99.9
III	99.7	100.4	100.0	100.4	99.9	100.7	100.0	100.1
IV	101.7	102.6	102.6	100.7	102.1	99.2	102.0	101.7
2001 – I	102.5	103.5	103.4	101.8	100.5	97.4	101.7	101.2
II	99.1	100.4	100.2	99.0	98.9	98.3	99.5	99.6
III	96.3	100.0	99.0	97.6	97.6	99.4	98.2	98.3
IV	95.8	97.6	97.3	95.7	94.5	102.9	95.9	96.7
2002 – I	96.1	99.1	98.6	96.5	94.8	103.3	96.5	97.3
II	95.0	98.9	98.2	96.7	94.9	104.2	96.4	97.5
III	95.6	98.2	97.5	97.7	96.1	105.5	97.0	98.0
IV	94.6	98.0	97.5	97.8	95.1	102.3	96.9	97.5

Source: Based on Istat data.

ITALY: CAPACITY UTILIZATION RATES, BY MAIN INDUSTRIAL GROUPINGS
(data adjusted for seasonal factors and the number of working days; percentages)

	Consumer goods			Investment goods	Intermediate goods	Energy	Manufacturing	AGGREGATE INDEX
	Durable	Non-durable	Total					
1993	80.3	96.3	93.0	80.2	92.2	94.9	89.3	89.0
1994	86.9	98.8	96.6	84.5	97.0	96.2	93.8	93.4
1995	92.7	99.4	98.9	95.1	99.7	97.2	98.5	97.9
1996	89.9	96.7	95.8	95.2	94.5	95.3	95.5	95.3
1997	89.3	98.7	97.2	97.6	97.4	97.4	98.0	98.0
1998	91.6	98.3	97.2	96.3	98.3	97.9	97.8	98.2
1999	93.6	97.9	97.1	95.7	95.9	97.6	95.9	96.8
2000	99.1	97.5	97.7	98.8	99.9	98.6	98.5	99.3
2001	96.6	97.0	96.7	96.8	98.6	96.3	96.8	97.7
2002	93.8	95.2	94.7	95.5	96.3	98.8	94.7	96.4
1996 – I	91.6	97.4	96.5	98.3	97.5	100.0	97.6	97.5
II	89.8	95.7	95.1	95.8	94.8	92.6	95.6	95.0
III	90.4	96.3	95.7	94.4	93.9	93.5	95.1	94.9
IV	87.8	97.4	95.9	92.3	92.0	95.2	93.8	93.9
1997 – I	88.1	97.3	96.0	94.0	92.7	95.9	95.0	95.0
II	90.2	98.5	97.4	98.3	98.1	97.5	98.0	97.9
III	89.2	100.0	98.4	98.5	98.9	97.4	99.1	99.1
IV	89.7	98.8	97.3	99.7	100.0	98.8	100.0	100.0
1998 – I	90.7	97.2	96.2	97.9	100.0	97.8	98.9	98.9
II	92.7	98.8	98.0	97.6	100.0	97.1	99.0	99.1
III	92.6	98.8	97.8	97.0	97.6	97.8	97.7	98.2
IV	90.5	98.2	96.8	92.8	95.6	98.7	95.8	96.7
1999 – I	90.1	97.8	96.4	95.3	94.4	99.0	95.0	96.1
II	91.7	96.6	95.8	94.9	95.0	95.7	94.8	95.5
III	95.2	99.6	98.7	95.6	95.8	97.9	96.3	97.3
IV	97.4	97.7	97.8	97.1	98.4	97.9	97.4	98.3
2000 – I	98.1	95.2	95.7	97.7	99.6	99.1	97.1	98.2
II	99.7	97.5	97.9	99.2	100.0	99.3	98.7	99.6
III	98.6	97.7	97.5	99.0	100.0	99.1	98.4	99.5
IV	100.0	99.4	99.6	99.1	100.0	97.2	100.0	100.0
2001 – I	100.0	100.0	100.0	100.0	100.0	95.0	99.7	100.0
II	97.5	97.0	96.9	97.2	100.0	95.4	97.5	98.4
III	94.7	96.7	95.7	95.9	98.7	96.0	96.2	97.1
IV	94.2	94.3	94.1	94.0	95.6	98.9	94.0	95.5
2002 – I	94.5	95.8	95.3	94.8	95.9	98.9	94.5	96.1
II	93.4	95.6	94.9	95.1	96.0	99.3	94.5	96.3
III	94.0	94.8	94.2	96.0	97.2	100.0	95.1	96.8
IV	93.1	94.7	94.3	96.1	96.2	97.0	94.9	96.3

Source: Based on Istat data.

Table a8

ITALIAN CONSUMER PRICE INDICES
(percentage changes on corresponding period)

	CPI (1) – Goods and services with unregulated prices – Non-food and non-energy products	CPI (1) – Goods and services with unregulated prices – Non-food and non-energy products – *of which: net of cars*	CPI (1) – Goods and services with unregulated prices – Services	CPI (1) – Goods and services with unregulated prices – Food products – Processed	CPI (1) – Goods and services with unregulated prices – Food products – Un-processed	CPI (1) – Goods and services with unregulated prices – Food products – Total	CPI (1) – Goods and services with unregulated prices – Energy products	CPI (1) – Goods and services with unregulated prices – Total	CPI (1) – Goods and services with regulated prices (4) – Energy products	CPI (1) – Goods and services with regulated prices (4) – Non-energy products (5)	CPI (1) – Goods and services with regulated prices (4) – Total	CPI (1) – Rents	CPI (1) – Overall index (6)	CPI (1) – Total net of food and energy products and those with regulated prices	WEH (2) – Overall index (6)
Weights (3)	*31.9*	*28.2*	*30.3*	*9.8*	*6.9*	*16.7*	*3.1*	*82.0*	*2.9*	*12.0*	*14.9*	*3.1*	*100.0*	*62.2*	*100.0*
1998	1.9	1.8	2.6	0.8	1.6	1.2	–2.7	1.8	. .	3.1	2.3	5.2	2.0	2.2	1.7
1999	1.2	1.2	2.6	0.8	1.1	0.9	4.2	1.8	–2.6	1.9	0.8	3.3	1.7	1.9	1.6
2000	1.5	1.4	2.8	1.2	2.0	1.6	13.2	2.5	9.8	1.2	3.0	2.5	2.5	2.1	2.6
2001	2.0	2.0	3.2	2.4	6.4	4.0	–2.0	2.7	5.8	3.1	3.7	2.3	2.7	2.6	2.7
2002	2.2	2.1	3.9	2.4	5.3	3.6	–1.9	2.9	–3.4	1.3	0.3	2.3	2.5	3.0	2.4
2000 – July ...	1.5	1.4	2.8	1.3	2.5	1.8	13.9	2.6	12.2	0.9	3.2	2.5	2.6	2.1	2.7
Aug. ...	1.6	1.4	2.8	1.3	2.8	1.9	12.1	2.5	12.1	1.1	3.3	2.5	2.6	2.1	2.7
Sept. ..	1.5	1.4	2.7	1.3	3.2	2.1	14.0	2.6	11.1	1.0	3.1	2.5	2.6	2.1	2.6
Oct. ...	1.5	1.5	2.7	1.4	3.4	2.2	13.3	2.6	10.3	1.1	3.0	2.4	2.6	2.1	2.6
Nov. ...	1.7	1.7	2.5	1.4	3.6	2.3	14.6	2.7	11.0	1.3	3.4	2.4	2.7	2.1	2.7
Dec. ...	1.8	1.8	2.6	1.5	4.5	2.7	9.9	2.6	11.0	1.3	3.3	2.4	2.7	2.2	2.7
2001 – Jan. ...	1.9	1.8	2.8	1.7	4.9	3.0	5.6	2.6	13.1	3.1	5.2	2.4	3.0	2.3	3.1
Feb. ...	2.0	2.0	2.8	1.8	5.8	3.5	3.4	2.6	13.3	3.1	5.3	2.4	3.0	2.3	3.0
Mar. ...	2.0	2.0	2.8	1.9	5.8	3.5	0.2	2.5	11.6	3.2	5.0	2.4	2.8	2.4	2.8
Apr. ...	2.1	2.1	3.2	2.2	5.5	3.6	2.2	2.8	11.8	3.6	5.4	2.2	3.1	2.6	3.1
May ...	2.1	2.0	3.2	2.3	6.1	3.9	3.6	2.9	6.1	3.5	4.0	2.2	3.0	2.6	3.0
June ..	2.0	2.0	3.2	2.4	7.0	4.3	1.8	2.9	6.0	3.4	4.0	2.2	3.0	2.5	2.9
July ...	2.0	2.0	3.4	2.5	7.6	4.6	–1.7	2.9	3.0	3.1	3.1	2.2	2.9	2.6	2.7
Aug. ...	2.0	2.0	3.4	2.6	7.4	4.6	–3.2	2.8	2.9	2.9	2.9	2.2	2.8	2.7	2.7
Sept. ..	2.1	2.2	3.4	2.7	6.9	4.4	–6.4	2.7	1.0	2.9	2.5	2.2	2.6	2.8	2.6
Oct. ...	2.1	2.2	3.5	2.7	6.9	4.4	–7.9	2.6	1.5	2.9	2.6	2.2	2.5	2.7	2.6
Nov. ...	1.9	2.0	3.5	2.8	6.7	4.4	–9.9	2.4	0.4	2.9	2.3	2.2	2.4	2.7	2.3
Dec. ...	1.9	2.1	3.7	2.8	6.3	4.2	–9.8	2.5	0.5	2.5	2.0	2.2	2.4	2.8	2.3
2002 – Jan. ...	2.0	2.1	3.7	2.8	7.7	4.8	–6.5	2.8	–4.0	1.8	0.6	2.1	2.4	2.8	2.3
Feb. ...	2.2	2.0	3.8	2.6	6.5	4.2	–5.4	2.9	–4.3	1.6	0.4	2.1	2.3	3.0	2.3
Mar. ...	2.2	2.1	3.8	2.6	6.2	4.1	–4.5	2.9	–5.4	1.8	0.3	2.1	2.5	3.0	2.4
Apr. ...	2.1	2.0	3.7	2.4	6.8	4.2	–1.6	2.9	–6.4	1.3	–0.4	2.4	2.3	2.8	2.4
May. ...	2.1	2.0	3.8	2.4	6.1	3.9	–3.5	2.8	–4.3	0.5	–0.5	2.4	2.3	2.9	2.3
June ..	2.1	2.0	3.9	2.4	4.5	3.3	–5.1	2.6	–4.3	0.8	–0.2	2.4	2.2	2.9	2.3
July ...	2.2	2.1	4.0	2.3	3.7	2.9	–3.4	2.7	–1.9	0.9	0.4	2.1	2.2	3.0	2.3
Aug. ...	2.2	2.1	4.2	2.3	3.8	2.9	–1.4	2.9	–1.8	1.2	0.6	2.1	2.4	3.1	2.5
Sept. ..	2.3	2.2	4.1	2.3	4.4	3.2	–0.5	3.0	–1.5	1.3	0.8	2.1	2.6	3.1	2.6
Oct. ...	2.2	2.1	4.0	2.3	4.6	3.2	2.3	3.1	–1.4	1.3	0.8	2.5	2.7	3.1	2.6
Nov. ...	2.3	2.2	4.2	2.2	4.8	3.3	3.5	3.2	–2.8	1.2	0.4	2.5	2.8	3.2	2.7
Dec. ...	2.2	2.1	4.0	2.2	4.8	3.3	4.3	3.2	–2.9	1.9	0.9	2.5	2.8	3.1	2.7
2003 – Jan. ...	2.2	2.1	3.8	2.1	3.1	2.5	7.2	3.0	1.5	1.3	1.3	2.7	2.8	3.0	2.7
Feb. ...	2.0	2.0	3.6	2.2	2.6	2.4	8.4	2.9	2.0	0.5	0.8	2.7	2.6	2.8	2.5
Mar. ...	2.0	2.1	3.7	2.3	2.8	2.5	9.5	3.0	3.2	0.5	1.0	2.7	2.7	2.8	2.6
Apr. ...	2.1	2.1	3.7	2.3	2.1	2.2	3.2	2.7	6.0	1.7	2.5	2.8	2.7	2.8	2.5

Source: Based on Istat data.

(1) Consumer price index (entire resident population); 1995=100. – (2) Consumer price index for worker and employee households, excluding tobacco products; 1995=100. – (3) As 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 January 2003. – (4) The sub-indices are based on the 208-product classification. – (5) Includes medicines, for which 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. – (6) Percentage changes published by Istat and calculated on indices rounded to the first decimal place.

Table a9

ITALY: HARMONIZED INDEX OF CONSUMER PRICES (1)

(percentage changes on corresponding period) (2)

	Non-food and non-energy products	Services	Total net of food and energy products	Food products			Energy products	Total net of unprocessed food and energy products	Overall index
				Processed	Unprocessed				
Weights	*36.2*	*37.9*	*74.2*	*11.1*	*8.3*	*19.4*	*6.3*	*85.4*	*100.0*
1997	1.7	3.3	2.4	1.2	–0.7	0.3	1.9	2.3	1.9
1998	2.1	2.8	2.4	1.4	1.6	1.5	–1.4	2.3	2.0
1999	1.4	2.5	1.9	0.9	1.1	1.0	1.1	1.8	1.7
2000	1.7	2.3	2.0	1.3	1.8	1.5	11.6	1.9	2.6
2001	1.8	2.9	2.4	2.5	5.8	3.9	1.6	2.4	2.7
2002	2.4	3.4	2.9	2.2	4.9	3.4	–2.6	2.8	2.6
2000 – Jan.	1.5	2.4	1.9	1.3	–0.1	0.7	9.6	1.8	2.2
Feb.	1.5	2.6	2.0	1.3	0.2	0.8	10.0	1.9	2.4
Mar.	1.5	2.6	2.0	1.3	0.3	0.9	12.7	1.9	2.6
Apr.	1.6	2.3	2.0	1.3	0.9	1.1	9.8	1.9	2.4
May	1.7	2.3	2.0	1.4	1.3	1.3	11.2	1.9	2.5
June	1.8	2.4	2.1	1.5	1.7	1.5	13.1	2.0	2.7
July	1.7	2.3	2.0	1.1	2.2	1.6	13.1	1.9	2.6
Aug.	1.7	2.4	2.1	1.2	2.5	1.7	12.1	1.9	2.6
Sept.	1.8	2.1	2.0	1.2	2.9	1.9	12.6	1.9	2.6
Oct.	1.8	2.2	2.0	1.3	3.0	2.0	11.9	1.9	2.7
Nov.	2.0	2.2	2.1	1.4	3.1	2.1	13.0	2.0	2.9
Dec.	2.0	2.3	2.2	1.3	3.9	2.4	10.4	2.1	2.8
2001 – Jan.	1.8	2.5	2.2	1.5	4.3	2.7	9.2	2.1	2.7
Feb.	1.8	2.4	2.1	1.6	5.2	3.1	8.0	2.0	2.7
Mar.	1.9	2.5	2.2	1.6	5.1	3.1	5.4	2.1	2.6
Apr.	2.0	3.0	2.5	2.5	4.9	3.5	6.7	2.5	3.0
May	1.9	3.0	2.5	2.6	5.5	3.8	4.8	2.5	2.9
June	1.8	2.9	2.4	2.7	6.2	4.2	3.7	2.4	2.9
July	1.8	3.1	2.5	2.8	6.8	4.5	0.5	2.5	2.8
Aug.	1.8	3.1	2.5	2.9	6.7	4.5	–0.3	2.5	2.8
Sept.	1.9	3.2	2.6	2.9	6.3	4.4	–3.0	2.6	2.6
Oct.	1.8	3.2	2.5	2.9	6.3	4.3	–3.5	2.6	2.5
Nov.	1.7	3.2	2.5	2.9	6.2	4.3	–5.1	2.5	2.3
Dec.	1.7	3.4	2.5	3.0	5.8	4.2	–5.0	2.6	2.3
2002 – Jan.	1.6	3.3	2.5	2.9	7.1	4.7	–5.3	2.5	2.3
Feb.	2.7	3.3	3.0	2.8	5.9	4.1	–4.9	2.9	2.7
Mar.	2.5	3.3	2.9	2.7	5.6	4.0	–4.9	2.9	2.5
Apr.	2.5	3.1	2.8	1.8	6.2	3.7	–4.0	2.7	2.5
May.	2.3	3.3	2.8	1.8	5.7	3.4	–3.9	2.7	2.4
June	2.3	3.4	2.8	2.0	4.3	3.0	–4.7	2.7	2.2
July	2.2	3.4	2.8	2.0	3.6	2.7	–2.7	2.7	2.4
Aug.	2.3	3.6	2.9	2.2	3.6	2.8	–1.6	2.8	2.6
Sept.	2.7	3.6	3.1	2.2	4.1	3.0	–1.0	3.0	2.8
Oct.	2.4	3.5	3.0	2.2	4.3	3.1	0.5	2.9	2.8
Nov.	2.6	3.6	3.1	2.1	4.4	3.1	0.4	3.0	2.9
Dec.	2.7	3.5	3.1	2.3	4.3	3.1	0.7	3.0	3.0
2003 – Jan.	1.8	3.5	2.7	2.3	2.8	2.5	4.4	2.7	2.9
Feb.	1.1	3.4	2.4	2.3	2.5	2.4	5.3	2.4	2.6
Mar.	2.0	3.5	2.8	2.5	2.6	2.5	6.4	2.8	2.9
Apr.	2.0	3.4	2.8	3.9	2.0	3.0	4.5	2.9	3.0

Source: Eurostat.

(1) Chain indices, 1996=100 up to December 2001; 2001=100 from January 2002. 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 January 2003. – (2) From January 2002, calculated with reference to the indices compiled using the new treatment of price reductions introduced in that month by Istat in accordance with Commission Regulation (EC) no. 2602/2000.

Table a10

EURO AREA: HARMONIZED INDEX OF CONSUMER PRICES (1)
(percentage changes on corresponding period) (2)

	Non-food and non-energy products	Services	Total net of food and energy products	Food products			Energy products	Total net of unprocessed food and energy products	Overall index
				Processed	Unprocessed				
Weights	*31.6*	*40.9*	*72.5*	*11.7*	*7.6*	*19.3*	*8.2*	*84.2*	*100.0*
1999	0.8	1.5	1.1	0.9	. .	0.6	2.4	1.1	1.1
2000	0.5	1.5	1.1	1.2	1.8	1.4	13.1	1.1	2.1
2001	0.9	2.4	1.9	2.8	7.0	4.5	2.2	1.9	2.4
2002	1.5	3.1	2.5	3.1	3.1	3.1	–0.6	2.5	2.2
2000 – Jan.	0.5	1.6	1.1	1.1	–0.5	0.4	12.1	1.1	1.8
Feb.	0.4	1.5	1.0	1.1	0	0.7	13.4	1.0	1.9
May	0.5	1.3	0.9	1.0	–0.5	0.4	15.2	0.9	1.9
Apr.	0.4	1.6	1.1	1.0	0.3	0.7	10.2	1.0	1.7
May	0.4	1.3	0.9	1.1	0.6	0.9	12.0	0.9	1.7
June	0.5	1.4	1.0	1.1	1.6	1.3	14.3	1.0	2.1
July	0.2	1.6	1.0	1.1	2.7	1.7	13.3	1.0	2.1
Aug.	0.3	1.5	1.0	1.2	3.3	2.0	11.7	1.0	2.1
Sept.	0.5	1.3	1.0	1.3	3.3	2.1	15.2	1.0	2.4
Oct.	0.6	1.4	1.0	1.3	3.2	2.1	14.1	1.1	2.3
Nov.	0.6	1.3	1.0	1.4	3.5	2.2	14.7	1.0	2.4
Dec.	0.7	2.4	1.6	1.5	4.0	2.4	10.8	1.6	2.6
2001 – Jan.	0.2	2.2	1.3	1.6	4.6	2.8	7.3	1.3	2.1
Feb.	–0.3	2.2	1.1	1.9	4.6	3.0	7.7	1.2	2.0
May	0.6	2.0	1.4	2.1	6.6	3.9	4.9	1.5	2.2
Apr.	1.1	2.2	1.7	2.5	7.1	4.3	7.2	1.8	2.7
May	1.2	2.4	1.9	2.7	8.9	5.1	7.9	2.0	3.1
June	1.2	2.4	1.9	2.9	8.8	5.3	5.0	2.0	2.8
July	0.8	2.3	1.7	3.2	8.5	5.3	2.3	1.9	2.4
Aug.	0.6	2.5	1.6	3.3	7.6	5.0	1.5	1.9	2.3
Sept.	1.1	2.7	2.0	3.5	7.5	5.0	–1.8	2.2	2.3
Oct.	1.4	2.8	2.2	3.5	7.5	5.0	–3.0	2.4	2.3
Nov.	1.5	3.0	2.3	3.4	6.1	4.5	–5.3	2.5	2.1
Dec.	1.6	2.5	2.1	3.5	6.2	4.5	–4.8	2.3	2.0
2002 – Jan.	1.6	2.7	2.2	3.8	8.4	5.6	–2.0	2.5	2.5
Feb.	1.8	2.8	2.4	3.4	7.1	4.9	–3.0	2.5	2.4
May	1.7	3.2	2.6	3.3	5.6	4.2	–1.5	2.7	2.5
Apr.	1.7	2.9	2.4	3.3	4.2	3.6	–0.5	2.5	2.3
May	1.6	3.3	2.5	3.2	2.1	2.7	–2.8	2.6	2.0
June	1.5	3.2	2.5	3.1	1.2	2.3	–3.6	2.6	1.9
July	1.3	3.2	2.4	3.0	1.0	2.2	–1.6	2.5	2.0
Aug.	1.3	3.3	2.4	3.0	1.4	2.3	–0.3	2.5	2.1
Sept.	1.3	3.2	2.4	2.8	1.7	2.4	–0.2	2.4	2.1
Oct.	1.2	3.1	2.3	2.7	1.7	2.3	2.6	2.3	2.3
Nov.	1.3	3.1	2.3	2.6	2.0	2.4	2.4	2.3	2.3
Dec.	1.2	3.0	2.2	2.7	1.3	2.2	3.8	2.3	2.3
2003 – Jan.	0.6	2.8	1.9	2.9	–0.6	1.5	6.0	2.0	2.1
Feb.	0.7	2.7	1.9	3.3	0.3	2.1	7.7	2.1	2.4
May	0.8	2.6	1.8	3.3	0.8	2.3	7.5	2.0	2.4
Apr.	0.8	2.9	2.0	3.4	1.0	2.4	2.2	2.2	2.1

Source: Eurostat.
(1) Weighted average of the indices of the euro-area countries. The weights shown in the table are those for January 2003. – (2) From January 2002, calculated with reference to the indices compiled using the new treatment of price reductions introduced in that month by Istat in accordance with Commission Regulation (EC) no. 2602/2000.

Table a11

ITALY: INDEX OF THE PRODUCER PRICES OF MANUFACTURES SOLD IN THE DOMESTIC MARKET (1)
(percentage changes on corresponding period)

	Consumer goods (2)		Investment goods	Intermediate goods		Overall index net of food and energy products	Overall index
	Non-food products	Food products		Non-energy products	Energy products		
Weights	*20.5*	*14.5*	*9.5*	*41.0*	*14.5*	*71.0*	*100.0*
1999	1.3	–0.1	1.0	–1.1	–1.0	–0.1	–0.3
2000	2.0	1.3	1.1	4.6	24.2	3.3	6.0
2001	2.2	2.8	1.2	1.3	2.7	1.6	1.9
2002	2.5	1.0	1.0	0.4	4.0	1.1	0.2
2000 – Jan.	1.3	0.4	0.9	2.6	17.2	2.0	3.8
Feb.	1.5	0.4	1.1	3.2	20.5	2.4	4.6
Mar.	1.5	0.8	1.1	3.8	24.4	2.7	5.5
Apr.	1.6	1.5	1.0	4.6	21.1	3.2	5.4
May	2.0	2.0	1.1	5.2	25.3	3.6	6.4
June	2.1	1.8	1.2	5.5	27.5	3.8	6.9
July	2.3	1.1	1.2	5.5	26.6	3.9	6.7
Aug.	2.4	1.0	1.1	5.3	24.7	3.8	6.5
Sept.	2.2	1.4	1.2	5.3	26.2	3.8	6.7
Oct.	2.1	1.3	1.1	4.9	27.5	3.5	6.8
Nov.	2.2	1.4	1.2	4.8	26.3	3.5	6.7
Dec.	2.4	2.2	1.2	4.6	22.6	3.4	6.2
2001 – Jan.	2.4	2.1	1.2	3.9	18.4	3.1	5.4
Feb.	2.5	2.9	1.3	3.5	15.8	2.9	5.0
Mar.	2.6	2.4	1.2	3.2	11.9	2.8	4.2
Apr.	2.5	3.0	1.4	2.5	14.0	2.3	4.3
May	2.4	2.5	1.3	1.8	8.3	1.9	2.9
June	2.4	2.9	1.2	1.3	4.8	1.6	2.4
July	2.3	3.0	1.2	1.0	0.1	1.4	1.3
Aug.	2.1	3.1	1.2	0.7	–0.3	1.1	1.2
Sept.	2.1	3.1	1.2	0.3	–4.1	0.9	0.4
Oct.	2.1	3.1	1.3	–0.2	–8.0	0.7	–0.6
Nov.	1.8	3.0	1.1	–0.7	–10.7	0.3	–1.3
Dec.	1.8	2.2	1.2	–0.9	–10.1	0.2	–1.3
2002 – Jan.	2.8	1.9	1.1	–1.4	–8.6	0.3	–1.2
Feb.	2.8	0.9	1.0	–1.0	–8.2	0.5	–1.1
Mar.	2.8	0.9	1.2	–0.8	–7.3	0.6	–0.8
Apr.	2.3	0.1	1.2	–0.5	–7.1	0.6	–0.8
May	2.1	0.4	1.1	. .	–6.2	0.8	–0.5
June	2.6	0.2	1.0	0.3	–6.8	1.1	–0.5
July	2.3	0.6	1.0	0.7	–3.2	1.2	0.4
Aug.	2.6	0.7	1.0	0.9	–2.4	1.3	0.6
Sept.	2.5	1.0	1.0	1.1	–1.5	1.4	0.9
Oct.	2.6	1.5	1.1	1.5	1.2	1.7	1.6
Nov.	2.4	2.0	1.1	1.8	0.6	1.8	1.6
Dec.	2.5	2.1	0.9	1.9	2.8	1.8	2.0
2003 – Jan.	1.7	2.2	0.7	2.3	5.7	1.7	2.5
Feb.	1.5	2.3	0.6	2.6	7.2	1.8	2.8
Mar.	1.5	2.0	0.6	2.5	8.1	1.7	2.8

Source: Istat.
(1) Classification of goods by main industrial groupings, 2000=100; Istat data. – (2) The item does not include energy products or motor vehicles; the latter are included under investment goods.

Table a12

MAJOR EURO-AREA COUNTRIES: INDEX OF THE PRODUCER PRICES OF MANUFACTURES SOLD IN THE DOMESTIC MARKET

(percentage changes on corresponding period)

	GERMANY					FRANCE				
	Consumer goods net of food products (2)	Intermediate goods		Overall index net of food and energy products	Overall index	Consumer goods net of food products (3)	Intermediate goods		Overall index net of food and energy products	Overall index
		Non-energy products	Energy products				Non-energy products	Energy products		
Weights (1)	*(15.2)*	*(31.2)*	*(18.1)*	*(69.7)*	*(100.0)*	*(15.7)*	*(28.5)*	*(16.3)*	*(65.0)*	*(100.0)*
2000	0.8	3.6	9.9	2.1	3.3	0.6	4.6	25.4	1.1	5.5
2001	1.6	0.7	9.0	1.3	3.0	1.4	2.0	–3.1	1.8	1.3
2002	1.5	–0.5	–3.3	0.3	–0.4	0.4	–0.3	–2.1	0.3	–0.3
2001 – Oct.	2.1	–1.0	–0.5	0.4	0.6	1.4	0.2	–13.8	1.8	–1.4
Nov.	1.8	–1.1	–2.3	0.3	0.1	1.0	–0.1	–16.9	1.7	–2.3
Dec.	1.7	–1.3	–1.1	0.1	0.1	1.0	–0.4	–13.0	1.3	–1.5
2002 – Jan.	2.5	–1.6	–2.2	0.1	–0.1	0.4	–1.0	–8.1	0.5	–1.0
Feb.	2.3	–1.8	–2.6	0.1	–0.3	0.1	–1.2	–7.9	0.1	–1.4
Mar.	1.8	–1.6	–1.4	0.1	–0.2	. .	–1.0	–3.9	. .	–0.9
Apr.	1.7	–1.1	–4.3	0.1	–0.8	0.1	–0.9	–2.3	. .	–0.7
May	1.6	–1.1	–5.0	0.2	–0.9	–0.2	–0.6	–5.9	0.3	–1.2
June	1.2	–0.7	–5.9	0.2	–1.1	. .	–0.5	–7.1	0.5	–1.4
July	1.3	–0.1	–5.4	0.3	–1.0	1.0	0.1	–3.2	0.6	–0.4
Aug.	1.4	. .	–5.6	0.3	–1.0	0.8	0.2	–1.2	0.6	. .
Sept.	1.1	0.1	–5.7	0.5	–0.9	0.8	0.1	–0.2	0.5	0.3
Oct.	0.8	0.4	–0.9	0.7	0.3	0.5	0.2	3.4	0.2	0.8
Nov.	0.9	0.4	–0.5	0.7	0.4	0.5	0.1	4.6	0.2	1.1
Dec.	1.0	0.6	1.0	0.9	0.9	0.6	0.3	8.9	. .	1.7
2003 – Jan.	0.5	1.1	4.9	1.0	1.6	0.7	0.6	10.5	. .	2.1
Feb.	0.5	1.4	6.2	1.0	1.9	1.0	0.8	14.0	–0.1	2.8
Mar.	0.7	1.4	5.6	0.9	1.7	1.0	0.9	11.4	0.2	2.5

	SPAIN					EURO (3)				
Weights (1)	*(17.3)*	*(31.6)*	*(18.0)*	*(67.2)*	*(100.0)*	*(15.9)*	*(31.7)*	*(16.8)*	*(66.8)*	*(100.0)*
2000	1.7	6.8	22.7	3.3	5.4	1.4	5.0	19.0	3.1	5.5
2001	3.2	1.4	–2.0	2.3	1.7	1.9	1.2	2.7	1.6	2.2
2002	2.0	0.2	–1.3	0.8	0.7	2.1	–0.2	–2.2	0.4	. .
2001 – Sept.	3.0	–0.3	–7.0	2.2	0.7	1.8	–0.3	–2.0	0.8	0.7
Oct.	2.9	–1.1	–11.4	2.1	–0.4	1.6	–0.9	–6.9	0.5	–0.5
Nov.	2.6	–1.5	–13.3	1.9	–0.9	2.0	–1.3	–9.0	0.4	–1.1
Dec.	2.7	–2.0	–11.8	1.4	–0.9	2.0	–1.4	–6.8	0.2	–0.8
2002 – Jan.	2.4	–1.1	–4.5	0.4	0.0	2.4	–1.6	–4.8	–0.1	–0.7
Feb.	1.9	–1.3	–4.3	0.3	–0.2	2.2	–1.6	–5.0	–0.1	–0.9
Mar.	1.8	–1.1	–3.4	0.3	–0.1	2.0	–1.3	–3.2	. .	–0.6
Apr.	2.0	–0.4	–1.9	0.6	0.5	2.0	–0.9	–3.4	0.1	–0.5
May	1.8	–0.3	–2.9	0.9	0.5	1.8	–0.8	–4.6	0.2	–0.7
June	1.6	0.2	–5.1	1.2	0.2	1.9	–0.4	–5.4	0.3	–0.8
July	1.7	0.6	–4.1	1.2	0.4	2.1	0.1	–3.3	0.6	–0.2
Aug.	2.2	0.9	–1.7	1.1	0.7	2.2	0.3	–2.4	0.6	. .
Sept.	2.2	0.8	–0.3	1.1	1.0	2.2	0.5	–1.8	0.7	0.2
Oct.	2.1	1.1	3.8	1.0	1.7	2.1	0.8	2.1	0.9	1.1
Nov.	2.3	1.4	4.1	1.0	1.7	1.8	1.1	2.3	0.9	1.2
Dec.	2.2	1.9	6.2	1.0	2.0	2.0	1.1	4.2	1.1	1.6
2003 – Jan.	2.5	1.2	7.4	1.4	2.5	1.6	1.4	6.9	1.3	2.2
Feb.	2.8	1.5	8.9	1.5	2.9	1.6	1.7	8.8	1.3	2.7
Mar.	2.9	1.5	9.5	1.6	3.0	1.6	1.7	7.7	1.4	2.4

Source: Based on Eurostat data.
(1) 1995=100 for Germany, France and euro area; 2000=100 for Spain. – (2) The item does not include energy products. – (3) GDP-weighted average for the 12 euro-area countries.

ITALY: BALANCE OF PAYMENTS
(balances in billions of lire and millions of euros)

	1998	1999		2000		2001		2002	
	lire		euros	lire	euros	lire	euros	lire	euros
Current account	**39,585**	**14,894**	**7,692**	**–12,209**	**–6,305**	**–1,432**	**–740**	**–14,169**	**–7,318**
Goods	63,091	42,683	22,044	20,075	10,368	33,701	17,405	33,492	17,297
Credits	426,181	428,853	221,484	505,184	260,906	529,756	273,596	519,577	268,339
Debits	363,089	386,170	199,440	485,109	250,538	496,055	256,191	486,085	251,042
Services	8,493	2,178	1,125	2,260	1,167	34	18	–7,082	–3,657
Credits	111,145	107,089	55,307	119,041	61,479	125,110	64,614	123,051	63,550
Debits	102,652	104,911	54,182	116,781	60,312	125,076	64,596	130,132	67,208
Income	–19,109	–20,122	–10,392	–25,363	–13,099	–22,529	–11,635	–29,811	–15,396
Credits	77,138	84,195	43,483	81,118	41,894	83,474	43,111	88,645	45,781
Debits	96,247	104,317	53,875	106,481	54,993	106,004	54,746	118,457	61,178
Transfers	–12,891	–9,846	–5,085	–9,181	–4,742	–12,638	–6,527	–10,768	–5,561
EU institutions	*–11,502*	*–9,070*	*–4,685*	*–9,497*	*–4,905*	*–10,909*	*–5,634*	*–10,956*	*–5,658*
Capital account	**4,355**	**5,400**	**2,789**	**6,187**	**3,195**	**1,812**	**936**	**1,622**	**838**
Intangible assets	–234	–6	–3	–139	–72	–604	–312	–399	–206
Transfers	4,589	5,406	2,792	6,326	3,267	2,416	1,248	2,021	1,044
EU institutions	*5,320*	*6,198*	*3,201*	*7,018*	*3,624*	*3,385*	*1,748*	*3,148*	*1,626*
Financial account	**2,482**	**–17,169**	**–8,867**	**8,301**	**4,287**	**–6,378**	**–3,294**	**16,532**	**8,538**
Direct investment	–20,486	345	178	2,225	1,149	–14,284	–7,377	–5,303	–2,739
Abroad	–27,917	–12,216	–6,309	–25,884	–13,368	–46,461	–23,995	–35,228	–18,194
In Italy	7,431	12,561	6,487	28,109	14,517	32,177	16,618	29,925	15,455
Portfolio investment	13,699	–45,763	–23,635	–50,837	–26,255	–14,793	–7,640	31,188	16,107
Assets	–167,129	–235,243	–121,493	–167,178	–86,340	–77,586	–40,070	–32,855	–16,968
Liabilities	180,828	189,480	97,858	116,341	60,085	62,793	32,430	64,042	33,075
Financial derivatives	–1,475	3,419	1,766	4,843	2,501	–924	–477	–5,247	–2,710
Other investment	–26,231	11,085	5,725	57,991	29,950	22,685	11,716	1,919	991
Assets	–58,501	–60,936	–31,471	1,911	987	5,822	3,007	12,115	6,257
Liabilities	32,270	72,022	37,196	56,080	28,963	16,863	8,709	–10,169	–5,266
Change in official reserves	36,975	13,746	7,099	–5,921	–3,058	937	484	–6,024	–3,111
Errors and omissions	**–46,422**	**–3,125**	**–1,614**	**–2,279**	**–1,177**	**5,999**	**3,098**	**–3,985**	**–2,058**

ITALY'S EXTERNAL POSITION

(billions of lire and millions of euros)

	1997	1998	1999		2000		2001		2002	
	lire			euros	lire	euros	lire	euros	lire	euros
ASSETS	**1,424,609**	**1,657,289**	**2,124,205**	**1,097,059**	**2,363,354**	**1,220,570**	**2,369,298**	**1,223,640**	**2,231,407**	**1,152,426**
Non-bank sectors	**939,566**	**1,194,543**	**1,645,623**	**849,893**	**1,850,140**	**955,517**	**1,855,458**	**958,264**	**1,658,438**	**856,512**
Direct investment	232,839	277,466	330,831	170,860	346,492	178,948	371,047	191,630	329,466	170,155
Real estate	9,840	10,350	11,823	6,106	12,938	6,682	14,503	7,490	14,733	7,609
Other	222,999	267,116	319,008	164,754	333,554	172,266	356,545	184,140	314,733	162,546
Portfolio investment	453,631	639,747	985,322	508,876	1,157,636	597,869	1,140,293	588,912	1,024,672	529,199
Other investment	248,744	273,974	326,807	168,782	341,357	176,296	337,583	174,347	288,481	148,988
Financial derivatives	4,352	3,356	2,663	1,375	4,655	2,404	6,535	3,375	15,819	8,170
Banks	**349,235**	**372,095**	**357,730**	**184,752**	**393,876**	**203,420**	**365,210**	**188,615**	**444,362**	**229,494**
Direct investment	12,650	15,064	19,667	10,157	28,639	14,791	29,634	15,305	29,637	15,306
Portfolio investment	27,115	51,439	67,669	34,948	70,283	36,298	70,787	36,558	45,622	39,055
Other investment	308,620	303,323	267,368	138,084	292,257	150,938	261,844	135,231	334,519	172,764
Financial derivatives	850	2,269	3,026	1,563	2,697	1,393	2,946	1,521	4,584	2,368
Central bank	**135,808**	**90,651**	**120,852**	**62,414**	**119,338**	**61,633**	**148,630**	**76,761**	**128,607**	**66,420**
Direct investment	..	7	8	4	8	4	10	5	10	5
Portfolio investment	..	525	1,118	577	1,384	715	1,766	912	5,176	2,673
Other investment	190	1,480	32,400	16,733	20,424	10,548	45,322	23,407	20,722	10,702
Financial derivatives	135,618	88,639	87,326	45,100	97,522	50,366	101,532	52,437	102,700	53,040
Gold	*37,578*	*39,814*	*44,099*	*22,775*	*44,724*	*23,098*	*47,888*	*24,732*	*49,886*	*25,764*
LIABILITIES	**1,424,751**	**1,688,606**	**2,021,337**	**1,043,934**	**2,266,250**	**1,170,420**	**2,309,803**	**1,192,914**	**2,368,067**	**1,223,004**
Non-bank sectors	**1,003,695**	**1,243,937**	**1,498,361**	**773,839**	**1,651,573**	**852,966**	**1,697,849**	**876,866**	**1,763,073**	**910,551**
Direct investment	149,454	178,662	208,209	107,531	234,225	120,967	235,646	121,701	231,783	119,706
Real estate	3,541	3,807	4,419	2,282	5,733	2,961	6,291	3,249	6,905	3,566
Other	145,913	174,855	203,790	105,249	228,492	118,006	229,355	118,452	224,878	116,140
Portfolio investment	677,971	894,674	1,048,115	541,306	1,161,168	599,693	1,202,584	621,083	1,272,021	656,944
Government securities	*515,914*	*675,718*	*822,750*	*424,915*	*910,722*	*470,349*	*939,525*	*485,224*	*997,843*	*515,343*
BOTs	*32,255*	*85,590*	*125,605*	*64,870*	*118,827*	*61,369*	*108,042*	*55,799*	*120,895*	*62,437*
BTPs	*283,139*	*317,309*	*406,655*	*210,020*	*499,546*	*257,994*	*549,320*	*283,700*	*632,006*	*326,404*
Other	*109,234*	*176,879*	*185,042*	*95,566*	*160,224*	*82,749*	*126,502*	*65,333*	*84,600*	*43,692*
Republic of Italy	*91,286*	*95,940*	*105,448*	*54,459*	*132,125*	*68,237*	*155,661*	*80,392*	*160,343*	*82,810*
Other investment	173,387	168,042	238,843	123,352	252,505	130,408	252,666	130,491	248,561	128,371
Financial derivatives	2,883	2,559	3,194	1,650	3,675	1,898	6,953	3,591	10,708	5,530
Banks	**420,748**	**444,576**	**480,667**	**248,244**	**579,789**	**299,436**	**607,127**	**313,555**	**583,873**	**301,545**
Direct investment	900	1,231	1,297	670	1,015	524	1,654	854	1,744	901
Portfolio investment	3,362	3,201	10,518	5,432	25,431	13,134	30,018	15,503	28,594	14,767
Other investment	415,553	437,614	465,795	240,563	551,523	284,838	572,472	295,657	547,774	282,902
Financial derivatives	933	2,529	3,057	1,579	1,820	940	2,984	1,541	5,761	2,975
Central bank	**308**	**93**	**42,309**	**21,851**	**34,888**	**18,018**	**4,827**	**2,493**	**21,121**	**10,908**
Direct investment	....	....	....	....	....	....	....	....	....	....
Portfolio investment	....	....	....	....	....	....	....	....	....	....
Other investment	308	93	42,309	21,851	34,888	18,018	4,827	2,493	21,121	10,908
OVERALL NET POSITION	**–142**	**–31,317**	**102,868**	**53,125**	**97,104**	**50,150**	**59,494**	**30,726**	**–136,658**	**–70,578**

Table a15

CONSOLIDATED ACCOUNTS OF GENERAL GOVERNMENT (1)
(billions of lire and millions of euros)

	1996	1997	1998	1999		2000		2001		2002	
	lire				euros	lire	euros	lire	euros	lire	euros
Revenue											
Direct taxes	290,923	318,582	299,065	322,263	166,435	330,225	170,547	353,762	182,703	343,345	177,323
Indirect taxes	224,852	247,286	318,311	324,325	167,500	339,178	175,171	341,736	176,492	355,511	183,606
Actual social security contributions	278,359	296,935	258,978	265,892	137,322	279,208	144,199	290,299	149,927	301,078	155,494
Imputed social security contributions	7,807	7,696	7,670	7,375	3,809	7,520	3,884	7,704	3,979	7,381	3,812
Income from capital	11,728	12,252	10,440	13,777	7,115	10,876	5,617	11,858	6,124	12,361	6,384
Other	49,145	51,994	56,587	56,568	29,215	57,840	29,872	62,778	32,422	63,872	32,987
Total current revenue	**862,814**	**934,745**	**951,051**	**990,201**	**511,396**	**1,024,848**	**529,290**	**1,068,138**	**551,647**	**1,083,548**	**559,606**
Capital account revenue	8,259	19,595	14,274	10,812	5,584	9,894	5,110	6,587	3,402	10,868	5,613
Total revenue	**871,073**	**954,340**	**965,325**	**1,001,013**	**516,980**	**1,034,743**	**534,400**	**1,074,725**	**555,049**	**1,094,417**	**565,219**
as a percentage of GDP	*45.8*	*48.0*	*46.5*	*46.7*		*45.8*		*45.5*		*44.9*	
Expenditure											
Compensation of employees	218,559	230,627	221,606	228,393	117,955	239,091	123,480	253,589	130,968	260,608	134,593
Intermediate consumption	90,920	93,860	99,298	105,622	54,549	112,718	58,214	121,133	62,560	121,530	62,765
Social assistance benefits in kind (market purchases)	37,988	40,816	43,078	45,715	23,610	53,271	27,512	60,603	31,299	63,496	32,793
Social assistance benefits in cash	320,665	344,212	352,196	367,872	189,990	378,463	195,460	391,547	202,217	417,001	215,363
Subsidies to firms	28,251	24,286	27,921	26,490	13,681	26,920	13,903	28,024	14,473	24,198	12,497
Interest payments	218,701	186,086	166,541	144,713	74,738	145,865	75,333	151,054	78,013	137,981	71,261
Other	18,750	18,729	33,101	33,873	17,494	35,532	18,351	38,576	19,923	42,826	22,118
Total current expenditure	**933,834**	**938,616**	**943,741**	**952,678**	**492,017**	**991,860**	**512,253**	**1,044,527**	**539,453**	**1,067,640**	**551,390**
Gross investment (2)	42,111	44,255	49,421	51,840	26,773	53,842	27,807	58,427	30,175	44,854	23,165
Investment grants	23,040	17,419	22,077	25,747	13,297	25,737	13,292	30,374	15,687	34,818	17,982
Other (3)	7,135	7,729	8,558	7,780	4,018	–22,089	–11,408	3,801	1,963	3,371	1,741
Total capital account expenditure (2) (3)	**72,286**	**69,403**	**80,056**	**85,366**	**44,088**	**57,490**	**29,691**	**92,602**	**47,825**	**83,043**	**42,888**
Total expenditure (2) (3)	**1,006,120**	**1,008,019**	**1,023,797**	**1,038,044**	**536,105**	**1,049,350**	**541,944**	**1,137,129**	**587,278**	**1,150,683**	**594,278**
as a percentage of GDP	*52.9*	*50.7*	*49.3*	*48.4*		*46.5*		*48.1*		*47.2*	
Deficit on current account	**71,020**	**3,871**	**–7,310**	**–37,523**	**–19,379**	**–32,988**	**–17,037**	**–23,611**	**–12,194**	**–15,908**	**–8,216**
Net borrowing (4)	**135,047**	**53,679**	**58,472**	**37,031**	**19,125**	**14,607**	**7,544**	**62,404**	**32,229**	**56,266**	**29,059**
as a percentage of GDP	*7.1*	*2.7*	*2.8*	*1.7*		*0.6*		*2.6*		*2.3*	

Source: Based on Istat data.
(1) Rounding and euro/lira conversions may cause discrepancies. – (2) This item includes (with a negative sign) the proceeds of disposals of public buildings. – (3) The figures for 2000 include the proceeds of the sale of UMTS licences with a negative sign (1.2 per cent of GDP). – (4) The figures for 2000 include the proceeds of the sale of UMTS licences.

FINANCING OF THE GENERAL GOVERNMENT BORROWING REQUIREMENT (1)
(billions of lire and millions of euros)

	1996	1997	1998	1999		2000		2001		2002	
	lire				euros	lire	euros	lire	euros	lire	euros
Medium and long-term securities	**140,673**	**107,135**	**82,919**	**44,550**	**23,008**	**67,784**	**35,007**	**46,231**	**23,876**	**60,359**	**31,173**
of which:											
floating rate	*31,404*	*9,058*	*–39,142*	*–52,157*	*–26,937*	*–14,680*	*–7,582*	*–19,296*	*–9,966*	*–26,741*	*–13,811*
issued abroad	*14,245*	*6,556*	*1,668*	*–5,327*	*–2,751*	*31,181*	*16,104*	*19,938*	*10,297*	*17,396*	*8,984*
Short-term securities	**–27,174**	**–81,771**	**–35,371**	**–34,235**	**–17,681**	**–34,278**	**–17,703**	**22,256**	**11,494**	**–114**	**–59**
of which:											
issued abroad	–	–	–	*713*	*368*	*–458*	*–237*	*390*	*202*	*–644*	*–333*
Post Office deposits	**12,798**	**11,641**	**6,400**	**17,418**	**8,996**	**9,023**	**4,660**	**21,143**	**10,919**	**14,110**	**7,287**
of which:											
Post Office savings certificates	*12,733*	*7,183*	*5,020*	*6,790*	*3,507*	*4,599*	*2,375*	*8,000*	*4,132*	*7,480*	*3,863*
savings books	*1,606*	*5,519*	*7,483*	*10,706*	*5,529*	*4,424*	*2,285*	*13,143*	*6,788*	*6,630*	*3,424*
current accounts	*–1,541*	*–1,062*	*–6,104*	*–78*	*–40*	–	–	–	–	–	–
Lending by banks	**–795**	**3,769**	**–17,655**	**2,143**	**1,107**	**–12,246**	**–6,324**	**–7,245**	**–3,742**	**–5,354**	**–2,765**
of which:											
resident banks	*–2,044*	*2,991*	*–3,874*	*3,828*	*1,977*	*–5,420*	*–2,799*	*–4,728*	*–2,442*	*–3,496*	*–1,806*
non-resident banks	*1,248*	*778*	*–13,782*	*–1,684*	*–870*	*–6,825*	*–3,525*	*–2,517*	*–1,300*	*–1,858*	*–960*
Other debt	**100**	**90**	**490**	**8,374**	**4,325**	**–185**	**–96**	**9,118**	**4,709**	**–853**	**–440**
of which:											
towards Bank of Italy	*–51*	*–47*	*133*	*–720*	*–372*	*–2,718*	*–1,403*	*–101*	*–52*	*76*	*39*
Claims on Bank of Italy	**17,725**	**–2,538**	**15,829**	**–13,276**	**–6,856**	**18,581**	**9,596**	**–7,737**	**–3,996**	**4,296**	**2,219**
TOTAL BORROWING REQUIREMENT	**143,327**	**38,326**	**52,612**	**24,975**	**12,899**	**48,679**	**25,141**	**83,767**	**43,262**	**72,445**	**37,415**
as a percentage of GDP	*7.5*	*1.9*	*2.5*	*1.2*		*2.2*		*3.5*		*3.0*	
Settlements of past debts (2)	**13,502**	**–409**	**4,770**	**12,118**	**6,259**	**8,909**	**4,601**	**19,925**	**10,291**	**11,481**	**5,929**
Privatization receipts (2)	**–6,226**	**–21,179**	**–15,277**	**–43,839**	**–22,641**	**–29,915**	**–15,450**	**–8,383**	**–4,329**	**–3,933**	**–2,031**
Borrowing requirement net of settlements of past debts and privatization receipts	**136,052**	**59,914**	**63,120**	**56,696**	**29,281**	**69,685**	**35,989**	**72,224**	**37,301**	**64,897**	**33,516**
Memorandum items:											
debts of other entities serviced by the government	*690*	*–6,500*	*–10,997*	*–2,213*	*–1,143*	*–4,949*	*–2,556*	*–7,953*	*–4,107*	*–3,759*	*–1,941*
change in bank deposits	*3,532*	*–1,388*	*3,295*	*5,752*	*2,971*	*1,428*	*737*	*–81*	*–42*	*3,554*	*1,836*
Central government borrowing requirement	**143,888**	**31,759**	**50,904**	**13,262**	**6,849**	**36,621**	**18,913**	**80,330**	**41,487**	**61,250**	**31,633**
of which:											
securities	*112,994*	*23,585*	*45,863*	*5,891*	*3,042*	*28,429*	*14,682*	*64,919*	*33,528*	*49,328*	*25,476*
bank lending	*228*	*–1,075*	*–17,726*	*–5,146*	*–2,658*	*–19,227*	*–9,930*	*–7,113*	*–3,674*	*–5,631*	*–2,908*
other	*30,666*	*9,250*	*22,767*	*12,517*	*6,465*	*27,419*	*14,161*	*22,524*	*11,633*	*17,553*	*9,066*
Local authority borrowing requirement	**–532**	**6,577**	**1,880**	**11,843**	**6,116**	**12,057**	**6,227**	**3,359**	**1,735**	**11,263**	**5,817**
of which:											
securities	*505*	*1,779*	*1,685*	*4,424*	*2,285*	*5,077*	*2,622*	*3,568*	*1,843*	*10,918*	*5,638*
bank lending	*–994*	*4,854*	*242*	*7,419*	*3,832*	*6,980*	*3,605*	*–209*	*–108*	*345*	*178*
other	*–43*	*–56*	*–47*	–	–	–	–	–	–	–	–
Social security institution borrowing requirement	**–29**	**–10**	**–171**	**–129**	**–67**	**1**	**1**	**77**	**40**	**–68**	**–35**

(1) Rounding and euro/lira conversions may cause discrepancies. – (2) The figures refer to the central government.

GENERAL GOVERNMENT DEBT: BREAKDOWN BY HOLDING SECTOR (1)

(face value in billions of lire and millions of euros)

	1996	1997	1998	1999		2000		2001		2002	
	lire				euros	lire	euros	lire	euros	lire	euros
Medium and long-term securities	**1,626,823**	**1,746,749**	**1,820,830**	**1,875,300**	**968,512**	**1,946,124**	**1,005,089**	**1,988,512**	**1,026,981**	**1,994,327**	**1,029,984**
held by:											
Bank of Italy	*166,478*	*137,709*	*120,169*	*112,113*	*57,902*	*120,669*	*62,320*	*124,470*	*64,283*	*79,231*	*40,920*
banks	*282,667*	*265,120*	*243,980*	*275,236*	*142,147*	*233,580*	*120,634*	*208,033*	*107,440*	*158,511*	*81,864*
other residents	*799,245*	*877,622*	*902,432*	*795,332*	*410,755*	*817,449*	*422,177*	*828,302*	*427,782*	*917,937*	*474,075*
non-residents	*378,432*	*466,298*	*554,249*	*692,619*	*357,708*	*774,426*	*399,957*	*827,708*	*427,475*	*838,648*	*433,125*
Short-term securities	**383,297**	**301,526**	**266,157**	**231,921**	**119,777**	**197,643**	**102,074**	**219,902**	**113,570**	**219,784**	**113,509**
held by:											
Bank of Italy	*1,698*	*14,331*	*230*	–	–	*150*	*78*	–	–	*349*	*180*
banks	*56,256*	*33,519*	*46,552*	*34,309*	*17,719*	*15,574*	*8,043*	*23,669*	*12,224*	*31,683*	*16,363*
other residents	*300,653*	*220,819*	*132,953*	*70,430*	*36,374*	*55,507*	*28,667*	*86,964*	*44,913*	*65,762*	*33,963*
non-residents	*24,690*	*32,858*	*86,423*	*127,182*	*65,684*	*126,412*	*65,286*	*109,269*	*56,433*	*121,991*	*63,003*
Post Office deposits	**164,557**	**176,198**	**182,598**	**200,016**	**103,300**	**209,040**	**107,960**	**230,183**	**118,879**	**244,293**	**126,167**
Lending by banks	**151,570**	**156,183**	**139,026**	**141,620**	**73,140**	**129,569**	**66,917**	**122,916**	**63,481**	**117,449**	**60,658**
of which:											
resident banks	*118,387*	*121,378*	*117,504*	*121,332*	*62,663*	*115,912*	*59,863*	*111,184*	*57,422*	*107,688*	*55,616*
non-resident banks	*33,183*	*34,805*	*21,522*	*20,287*	*10,478*	*13,658*	*7,054*	*11,732*	*6,059*	*9,761*	*5,041*
Other liabilities towards Bank of Italy	**2,842**	**2,794**	**2,927**	**2,901**	**1,498**	**184**	**95**	**82**	**42**	**158**	**82**
Other domestic debt	**3,995**	**4,133**	**4,490**	**13,584**	**7,016**	**16,117**	**8,323**	**25,336**	**13,085**	**24,179**	**12,488**
General government debt (2)	**2,333,084**	**2,387,583**	**2,416,029**	**2,465,342**	**1,273,243**	**2,498,676**	**1,290,459**	**2,586,931**	**1,336,038**	**2,600,191**	**1,342,887**
as a percentage of GDP	*122.6*	*120.2*	*116.3*	*114.9*		*110.6*		*109.5*		*106.7*	
held by:											
Bank of Italy	*171,018*	*154,834*	*123,326*	*115,015*	*59,400*	*121,003*	*62,493*	*124,552*	*64,326*	*79,738*	*41,181*
banks	*457,311*	*420,017*	*408,036*	*430,877*	*222,530*	*365,066*	*188,541*	*342,886*	*177,086*	*297,882*	*153,843*
other residents	*1,268,450*	*1,278,771*	*1,222,472*	*1,079,362*	*557,444*	*1,098,113*	*567,128*	*1,170,784*	*604,660*	*1,252,171*	*646,693*
non-residents	*436,305*	*533,961*	*662,194*	*840,088*	*433,869*	*914,495*	*472,297*	*948,709*	*489,967*	*970,400*	*501,170*
Memorandum item:											
debt issued abroad	126,752	143,064	130,454	137,015	70,763	163,556	84,470	182,417	94,211	190,415	98,341

(1) Rounding and euro/lira conversions may cause discrepancies. – (2) In accordance with the criteria laid down in Council Regulation (EC) No. 3605/93.

Table a18

GENERAL GOVERNMENT DEBT:
BREAKDOWN BY INSTRUMENT AND SUBSECTOR (1)
(face value in billions of lire and millions of euros)

	1995	1996	1997	1998	1999	
	lire					euros
Medium and long-term securities	**1,487,329**	**1,626,823**	**1,746,749**	**1,820,830**	**1,875,300**	**968,512**
of which: in foreign currencies	130,910	126,468	132,693	126,509	74,864	38,664
in non-euro-area currencies	55,129	61,761	66,546	65,817	74,864	38,664
floating rate	517,514	548,144	557,411	517,895	465,433	240,376
issued abroad	85,028	93,569	108,259	108,931	116,015	59,917
Short-term securities	**410,471**	**383,297**	**301,526**	**266,157**	**231,921**	**119,777**
of which: in foreign currencies	–	–	–	–	–	–
in non-euro-area currencies	–	–	–	–	–	–
issued abroad	–	–	–	–	713	368
Post Office deposits	**151,759**	**164,557**	**176,198**	**182,598**	**200,016**	**103,300**
of which: Post Office savings certificates	97,771	110,504	117,687	122,707	129,498	66,880
memorandum item: redemption value	*152,083*	*172,844*	*187,004*	*203,098*	*218,963*	*113,085*
savings books	45,204	46,811	52,330	59,813	70,519	36,420
current accounts	8,784	7,243	6,181	78	–	–
Lending by banks	**154,876**	**151,570**	**156,183**	**139,026**	**141,620**	**73,140**
of which: in foreign currencies	30,009	25,568	25,226	12,588	4,401	2,273
in non-euro-area currencies	6,615	5,389	5,290	4,611	4,401	2,273
resident banks	120,431	118,387	121,378	117,504	121,332	62,663
non-resident banks	34,445	33,183	34,805	21,522	20,287	10,478
Other liabilities	**6,737**	**6,837**	**6,927**	**7,418**	**16,485**	**8,514**
of which: towards the Bank of Italy	2,893	2,842	2,794	2,927	2,901	1,498
GENERAL GOVERNMENT DEBT (2)	**2,211,172**	**2,333,084**	**2,387,583**	**2,416,029**	**2,465,342**	**1,273,243**
as a percentage of GDP	*123.7*	*122.6*	*120.2*	*116.3*	*114.9*	
Central government debt	**2,167,057**	**2,289,512**	**2,337,400**	**2,364,201**	**2,401,328**	**1,240,182**
of which: securities	1,897,800	2,009,583	2,045,915	2,083,005	2,098,344	1,083,704
bank lending	111,136	108,867	108,636	91,408	86,710	44,782
other	158,121	171,062	182,850	189,788	216,274	111,696
Local authority debt	**43,513**	**43,000**	**49,620**	**51,437**	**63,752**	**32,925**
of which: securities	–	537	2,360	3,981	8,877	4,584
bank lending	43,139	42,130	46,985	47,227	54,648	28,223
other	374	332	275	228	228	118
Social security institution debt	**602**	**573**	**563**	**391**	**262**	**135**
Treasury assets held with the Bank of Italy	**74,184**	**56,459**	**58,997**	**43,168**	**56,443**	**29,151**
DEBT NET OF TREASURY ASSETS HELD WITH THE BANK OF ITALY	**2,136,988**	**2,276,625**	**2,328,586**	**2,372,861**	**2,408,899**	**1,244,093**
of which: debt in foreign currencies	160,919	152,035	157,919	139,097	79,266	40,937
debt in non-euro-area currencies	61,744	67,149	71,836	70,427	79,266	40,937
debt of other entities serviced by the government	44,827	44,557	38,488	27,402	25,461	13,149
Debt of other public sector bodies (3)	**2,526**	**2,017**	**2,202**	**2,002**	**2,163**	**1,117**
Public sector debt net of Treasury assets held with the Bank of Italy	**2,139,514**	**2,278,642**	**2,330,788**	**2,374,863**	**2,411,062**	**1,245,210**
Memorandum items:						
Non consolidated central government debt	2,189,442	2,312,476	2,359,060	2,385,176	2,421,166	1,250,428
Bank deposits	30,083	33,615	32,227	35,522	41,274	21,316

(1) Rounding and euro/lira conversions may cause discrepancies. – (2) In accordance with the criteria laid down in Council Regulation (EC) No. 3605/93. – (3) Excluding debts serviced

2000 lire	2000 euros	2001 lire	2001 euros	2002 lire	2002 euros	
1,946,124	**1,005,089**	**1,988,512**	**1,026,981**	**1,994,327**	**1,029,984**	**Medium and long-term securities**
85,697	44,259	72,044	37,208	75,884	39,191	*of which:* in foreign currencies
85,697	44,259	72,044	37,208	75,884	39,191	. . . . in non-euro-area currencies
450,534	232,681	430,822	222,501	407,113	210,256	. . . . floating rate
149,644	77,284	170,037	87,817	180,654	93,300	. . . . issued abroad
197,643	**102,074**	**219,902**	**113,570**	**219,784**	**113,509**	**Short-term securities**
–	–	–	–	–	–	*of which:* in foreign currencies
–	–	–	–	–	–	. . . . in non-euro-area currencies
255	132	648	335	–	–	. . . . issued abroad
209,040	**107,960**	**230,183**	**118,879**	**244,293**	**126,167**	**Post Office deposits**
134,096	69,255	142,097	73,387	149,577	77,250	*of which:* Post Office savings certificates
232,562	*120,108*	*251,027*	*129,644*	*267,916*	*138,367*	. . . . *memorandum item:* redemption value
74,943	38,705	88,086	45,493	94,716	48,917	. . . . savings books
–	–	–	–	–	–	. . . . current accounts
129,569	**66,917**	**122,916**	**63,481**	**117,449**	**60,658**	**Lending by banks**
3,661	1,891	2,727	1,408	2,060	1,064	*of which:* in foreign currencies
3,661	1,891	2,727	1,408	2,060	1,064	. . . . in non-euro-area currencies
115,912	59,863	111,184	57,422	107,688	55,616	. . . . resident banks
13,658	7,054	11,732	6,059	9,761	5,041	. . . . non-resident banks
16,300	**8,418**	**25,418**	**13,127**	**24,338**	**12,569**	**Other liabilities**
184	95	82	42	158	82	*of which:* towards the Bank of Italy
2,498,676	**1,290,459**	**2,586,931**	**1,336,038**	**2,600,191**	**1,342,887**	**GENERAL GOVERNMENT DEBT** (2)
110.6		*109.5*		*106.7*		*as a percentage of GDP*
2,422,609	**1,251,173**	**2,507,359**	**1,294,943**	**2,510,078**	**1,296,347**	**Central government debt**
2,129,819	1,099,960	2,190,844	1,131,477	2,186,050	1,129,000	*of which:* securities
67,678	34,953	61,142	31,577	55,398	28,611	. . . . bank lending
225,112	116,261	255,373	131,889	268,630	138,736	. . . . other
75,804	**39,150**	**79,231**	**40,919**	**89,841**	**46,399**	**Local authority debt**
13,948	7,204	17,570	9,074	28,062	14,493	*of which:* securities
61,628	31,828	61,433	31,728	61,779	31,906	. . . . bank lending
228	118	228	118	–	–	. . . . other
264	**136**	**341**	**176**	**273**	**141**	**Social security institution debt**
37,863	**19,554**	**45,599**	**23,550**	**41,304**	**21,332**	**Treasury assets held with the Bank of Italy**
2,460,814	**1,270,904**	**2,541,332**	**1,312,488**	**2,558,888**	**1,321,555**	**DEBT NET OF TREASURY ASSETS HELD WITH THE BANK OF ITALY**
89,358	46,149	74,772	38,616	77,945	40,255	*of which:* debt in foreign currencies
89,358	46,149	74,772	38,616	77,945	40,255	. . . . debt in non-euro-area currencies
21,206	10,952	13,407	6,924	9,439	4,875	. . . . debt of other entities serviced by the government
1,972	**1,018**	**1,530**	**790**	**1,364**	**704**	**Debt of other public sector bodies** (3)
2,462,786	**1,271,923**	**2,542,862**	**1,313,279**	**2,560,252**	**1,322,260**	**Public sector debt net of Treasury assets held with the Bank of Italy**
						Memorandum items:
2,442,454	1,261,422	2,525,825	1,304,480	2,527,931	1,305,568	. . . . Non consolidated central government debt
42,701	22,053	42,621	22,012	46,175	23,847	. . . . Bank deposits

by the government.

FORMATION OF THE GENERAL GOVERNMENT BORROWING REQUIREMENT (1)
(on a cash basis; billions of lire and millions of euros)

	1999		2000		2001		2002	
	lire	euros	lire	euros	lire	euros	lire	euros
State budget receipts	684,688	353,612	679,372	350,866	681,581	352,007	683,503	353,000
State budget payments	761,725	393,398	750,901	387,808	825,618	426,396	789,489	407,737
State budget balance (deficit: –)	–77,036	–39,786	–71,529	–36,942	–144,037	–74,389	–105,987	–54,738
Other Treasury operations	63,774	32,937	34,908	18,029	63,707	32,902	44,736	23,104
Central government borrowing requirement	–13,262	–6,849	–36,621	–18,913	–80,330	–41,487	–61,250	–31,633
Local government borrowing requirement after consolidation	–11,843	–6,116	–12,057	–6,227	–3,359	–1,735	–11,263	–5,817
Borrowing requirement of social security institutions after consolidation	129	67	–1	–1	–77	–40	68	35
General government borrowing requirement	**–24,975**	**–12,899**	**–48,679**	**–25,141**	**–83,767**	**–43,262**	**–72,445**	**–37,415**
as a percentage of GDP	*–1.2*		*–2.2*		*–3.5*		*–3.0*	
Settlements of past debts	–12,118	–6,259	–8,909	–4,601	–19,925	–10,291	–11,481	–5,929
Privatization receipts	43,839	22,641	29,915	15,450	8,383	4,329	3,933	2,031
General government borrowing requirement net of settlements of past debts and privatization receipts	**–56,696**	**–29,281**	**–69,685**	**–35,989**	**–72,224**	**–37,301**	**–64,897**	**–33,516**
Direct taxes								
Personal income tax	222,014	114,661	220,676	113,970	234,155	120,931	232,558	120,106
Corporate income tax	57,622	29,759	55,420	28,622	62,969	32,521	56,965	29,420
Local income tax	709	366	320	165	378	195	279	144
Withholding tax on interest income and capital gains	22,335	11,535	35,678	18,426	29,381	15,174	24,380	12,591
Direct tax condonation schemes	90	46	20	10	15	8	19	10
Other	10,544	5,446	7,288	3,764	16,906	8,731	14,797	7,642
Total adjusted direct taxes (2)	**313,314**	**161,813**	**319,402**	**164,957**	**343,804**	**177,560**	**328,997**	**169,913**
Indirect taxes								
VAT	146,721	75,775	172,371	89,022	177,198	91,515	182,921	94,471
Other business taxes	31,878	16,464	29,125	15,042	28,113	14,519	31,908	16,479
Excise taxes on mineral oils	39,199	20,245	37,962	19,606	38,902	20,091	39,998	20,657
Other excise taxes	12,973	6,700	13,411	6,926	11,317	5,845	10,266	5,302
Taxes on tobacco products	12,389	6,398	14,245	7,357	14,144	7,305	14,880	7,685
Lotto and lotteries	22,657	11,701	17,207	8,887	14,952	7,722	14,797	7,642
Indirect tax condonation schemes	46	24	18	9	10	5	6	3
Other	1,310	677	1,297	670	1,224	632	1,231	636
Total adjusted indirect taxes (2)	**267,173**	**137,983**	**285,636**	**147,519**	**285,859**	**147,634**	**296,007**	**152,875**
Accounting items	21,729	11,222	6,054	3,127	10,754	5,554	6,519	3,367
Total budget receipts	**602,216**	**311,019**	**611,092**	**315,603**	**640,417**	**330,748**	**631,524**	**326,155**

Sources: Based on data contained in *Relazione generale sulla situazione economica del Paese, Rendiconto generale dell'amministrazione dello Stato,* and *Relazione trimestrale di Cassa.*
(1) Rounding and euro/lira conversions may cause discrepancies. – (2) Data are adjusted to exclude accounting settlements with the Sicily and Sardinia regions and those that did not correspond to actual changes in revenue.

EURO-AREA BANKING SYSTEM'S LIQUIDITY POSITION: ITALIAN CONTRIBUTION
(maintenance period average amounts in millions of euros)

Maintenance period ending in:	Liquidity-providing factors					
			Monetary policy operations			
	Net assets in gold and foreign currency	Net claims on the Eurosystem	Main refinancing operations	Longer-term refinancing operations	Marginal lending facility	Other liquidity-providing operations
2000 – Dec.	53,528	466	22,129	4	28	2
2001 – Dec.	51,193	7,937	10,087	270	14	1,056
2002 – Jan.	50,738	8,614	9,137	245	. .	353
Feb.	51,284	8,846	9,709	128	5	. .
Mar.	51,310	3,561	7,005	62	. .	. .
Apr.	53,559	808	8,961	59	. .	. .
May	53,729	–7,081	10,613	5	. .	. .
June	53,052	–6,366	7,275	3	. .	. .
July	49,211	4,829	6,880	. .	. .	1
Aug.	48,180	3,926	6,961	14	64	. .
Sept.	50,652	–1,278	7,572	14	. .	. .
Oct.	51,434	–6,756	6,936	28	. .	. .
Nov.	51,672	–8,152	6,922	18	. .	. .
Dec.	51,533	7,493	7,315	15	. .	128
2003 – Jan.	50,693	3,609	7,407	. .	1	. .
Feb.	53,743	7,227	6,646	7	5	. .
Mar.	54,858	14,291	6,944	8	. .	. .

Maintenance period ending in:	Liquidity-absorbing factors					Credit institutions' current accounts with the central bank (c)	Italian contribution to base money (a+b+c)
	Monetary policy operations						
	Other liquidity-absorbing operations	Deposit facility (a)	Currency in circulation (b)	Central government deposits	Other factors (net)		
2000 – Dec.	. .	8	73,223	26,051	–35,807	12,680	85,911
2001 – Dec.	. .	24	67,269	19,350	–29,198	13,113	80,405
2002 – Jan.	. .	30	80,101	17,420	–41,523	13,059	93,191
Feb.	. .	5	70,452	30,004	–44,436	13,947	84,404
Mar.	. .	15	57,225	32,316	–41,232	13,614	70,853
Apr.	. .	7	56,071	33,659	–39,971	13,622	69,700
May	. .	7	56,897	26,160	–39,463	13,664	70,569
June	. .	12	58,350	22,408	–40,558	13,752	72,114
July	. .	6	60,070	32,971	–45,795	13,670	73,746
Aug.	. .	9	61,949	30,377	–46,848	13,657	75,615
Sept.	. .	18	62,392	27,803	–46,672	13,419	75,829
Oct.	. .	4	63,223	22,375	–47,126	13,167	76,394
Nov.	. .	3	64,153	20,012	–47,069	13,361	77,517
Dec.	. .	11	68,420	31,866	–47,272	13,458	81,889
2003 – Jan.	. .	10	68,335	25,071	–45,256	13,550	81,896
Feb.	. .	3	64,911	32,706	–44,271	14,277	79,191
Mar.	. .	10	66,438	40,674	–44,751	13,729	80,178

Table a21

ITALIAN COMPONENTS OF THE MONETARY AGGREGATES OF THE EURO AREA: RESIDENTS OF THE AREA (1)

(end-of-period amounts in millions of euros)

	Currency in circulation (2)	Overnight deposits	Total	Deposits with agreed maturity up to 2 years	Deposits redeemable at notice up to 3 months	Total
2000	69,680	412,275	481,955	57,611	125,783	665,349
2001	57,506	450,832	508,338	52,623	135,123	696,084
2002 – Jan. . . .	53,189	432,785	485,974	56,117	141,801	683,892
Feb. . . .	43,082	438,361	481,443	56,221	143,102	680,766
Mar. . . .	46,994	439,998	486,992	56,689	142,506	686,187
Apr. . . .	47,581	446,301	493,882	57,723	143,035	694,640
May . . .	50,002	450,332	500,334	55,920	143,096	699,350
June . . .	52,482	454,026	506,508	56,475	143,181	706,164
July . . .	53,924	447,546	501,470	55,280	143,678	700,428
Aug. . . .	54,836	437,842	492,678	55,383	144,821	692,882
Sept. . .	55,448	449,462	504,910	54,198	144,576	703,684
Oct. . . .	57,210	451,851	509,061	54,327	145,014	708,402
Nov. . . .	58,265	453,651	511,916	52,874	144,966	709,756
Dec. . . .	61,543	493,380	554,923	50,669	147,747	753,339
2003 – Jan. . . .	58,081	467,302	525,383	51,100	152,005	728,488
Feb. . . .	59,411	470,601	530,011	52,900	153,207	736,118
Mar. . . .	60,318	480,011	540,330	51,719	153,474	745,522

(1) Liabilities of MFIs and the Post Office to the “money-holding sector”, except for the items specified in footnotes (2) and (3), for the whole euro area. – (2) Bank of Italy banknotes and Treasury by the MFIs of the rest of the area or that held by general government, it is not possible to determine exactly the amount held by the “money-holding sector”.

Table a21

Repurchase agreements	Money-market fund share/units (3)	Debt securities up to 2 years and money-market paper (3)	Total monetary liabilities	Contribution to the monetary aggregates of the euro area (excluding currency held by the public)			
				M1	M2	M3	
68,303	10,039	11,137	754,828	412,275	595,669	685,148	 2000
76,213	26,103	10,118	808,518	450,832	638,578	751,012	 2001
77,548	27,822	10,087	799,349	432,785	630,703	746,160	. . . . Jan. – 2002
82,222	29,110	9,991	802,089	438,361	637,684	759,007	. . . . Feb.
88,435	30,684	9,983	815,289	439,998	639,193	768,295	. . . . Mar.
85,319	32,189	9,743	821,891	446,301	647,059	774,310	. . . . Apr.
89,779	33,712	10,180	833,021	450,332	649,348	783,019	. . . . May
87,257	35,082	10,600	839,103	454,026	653,682	786,621	. . . . June
90,955	36,039	10,694	838,116	447,546	646,504	784,192	. . . . July
91,405	38,083	10,826	833,196	437,842	638,046	778,360	. . . . Aug.
87,139	39,008	11,213	841,044	449,462	648,236	785,596	. . . . Sept.
89,080	40,161	10,111	847,754	451,851	651,192	790,544	. . . . Oct.
88,709	41,147	9,659	849,271	453,651	651,491	791,006	. . . . Nov.
89,310	41,690	9,814	849,153	493,380	691,796	832,610	. . . . Dec.
82,714	87,257	9,883	908,342	467,302	670,407	850,261	. . . . Jan. – 2003
81,997	90,180	9,512	917,808	470,601	676,707	858,397	. . . . Feb.
78,516	94,195	9,895	928,127	480,011	685,204	867,808	. . . . Mar.

coins. – (3) Calculated by subtracting from the total of such liabilities of Italian MFIs the amount held by Italian MFIs themselves. Since the returns to the ECB do not contain the amounts held

Table a22

ITALIAN COUNTERPARTS OF MONEY OF THE EURO AREA: RESIDENTS OF THE AREA

(end-of-period amounts in millions of euros)

	Total monetary liabilities	OTHER LIABILITIES OF MFIs								
		Deposits of central government	Medium and long-term liabilities to the money-holding sector					Liabilities to non-residents of the euro area	Finance	
			Deposits with agreed maturity over 2 years	Deposits redeemable at notice over 3 months	Debt securities over 2 years' agreed maturity (1)	Capital and reserves (1)	Total		Loans	
2000	754,828	26,368	11,492	. .	246,821	122,581	380,894	158,559	60,747	
2001	808,518	30,968	6,407	. .	280,877	131,139	418,423	174,324	58,161	
2002 – Jan. ...	799,349	45,421	4,155	. .	283,367	135,376	422,898	167,239	58,027	
Feb. ...	802,089	49,349	4,106	. .	285,468	136,977	426,551	162,862	58,073	
Mar. ...	815,289	52,693	4,034	. .	288,467	136,435	428,936	165,078	58,557	
Apr. ...	821,891	49,008	3,981	. .	290,004	135,621	429,606	161,715	57,086	
May ...	833,021	38,005	4,061	. .	293,788	136,722	434,571	155,057	56,491	
June ...	839,103	49,849	3,855	. .	298,227	136,135	438,217	148,479	57,173	
July ...	838,116	50,176	4,058	. .	299,738	135,406	439,202	145,320	54,781	
Aug. ...	833,196	45,670	4,204	. .	301,246	136,032	441,482	140,642	54,224	
Sept. ..	841,044	39,321	4,081	. .	302,387	137,288	443,756	142,948	55,314	
Oct. ...	847,754	38,711	4,037	. .	304,044	138,156	446,237	147,933	54,494	
Nov. ...	849,271	44,030	4,006	. .	304,241	138,284	446,531	149,867	55,677	
Dec. ...	894,153	28,433	4,067	. .	306,916	118,673	429,656	149,678	56,507	
2003 – Jan. ...	908,342	50,128	3,930	. .	305,662	120,996	430,617	149,273	56,809	
Feb. ...	917,808	53,903	3,905	. .	301,737	128,298	433,970	152,852	57,574	
Mar. ...	928,127	51,425	3,839	. .	305,748	127,221	436,840	154,545	56,173	

(1) Calculated by subtracting from the total of such liabilities of Italian MFIs the amount held by Italian MFIs themselves. Since the returns to the ECB do not contain the amounts held by the

ASSETS OF MFIs										
Claims on residents of Italy and the rest of the euro area								Claims on non-residents of the euro area	Other counterparts	
to general government		Finance to other residents				Total				
Bonds	Total	Loans	Bonds	Holdings of shares/other equity	Total					
213,837	274,584	878,020	13,527	42,926	934,473	1,209,057	116,031	–4,439	 2000
218,843	277,004	936,346	20,083	47,355	1,003,784	1,280,788	108,437	43,008	 2001
223,915	281,942	935,466	19,355	47,731	1,002,552	1,284,494	104,264	46,149	.... Jan.– 2002
225,509	283,582	935,244	19,506	47,398	1,002,148	1,285,730	106,629	48,492	.... Feb.
232,971	291,528	939,623	20,091	50,235	1,009,949	1,301,477	111,053	49,466	.... Mar.
230,771	287,857	941,365	20,471	56,058	1,017,894	1,305,751	110,824	45,645	.... Apr.
233,551	290,042	949,494	20,149	56,956	1,026,599	1,316,641	108,914	35,149	.... May
228,918	286,091	957,869	19,656	60,898	1,038,423	1,324,514	102,183	48,951	.... June
223,895	278,676	962,724	19,577	52,258	1,034,559	1,313,235	106,609	52,970	.... July
223,051	277,275	953,511	19,253	52,586	1,025,350	1,302,625	101,189	57,176	.... Aug.
228,627	283,941	955,928	19,740	50,335	1,026,003	1,309,944	103,024	54,101	.... Sept.
228,690	283,184	960,685	19,755	52,385	1,032,825	1,316,009	115,249	49,377	.... Oct.
224,203	279,880	963,063	19,479	58,107	1,040,649	1,320,529	111,802	57,368	.... Nov.
195,237	251,744	993,460	21,522	54,397	1,069,379	1,321,123	112,695	68,102	.... Dec.
220,187	276,996	1,006,377	24,870	53,887	1,085,134	1,362,130	113,176	63,054	.... Jan.– 2003
224,740	282,314	1,006,599	25,977	53,636	1,086,211	1,368,525	119,098	70,909	.... Feb.
225,667	281,840	1,004,402	26,493	55,919	1,086,813	1,368,653	119,896	82,389	.... Mar.

MFIs of the rest of the area or that held by general government, it is not possible to determine exactly the amount held by the “money-holding sector”.

Table a23

BANKS AND MONEY MARKET FUNDS RESIDENT IN ITALY: SUMMARY BALANCE SHEET DATA (1)
(end-of-period stocks; millions of euros) **Assets**

	Cash	Loans							Holdings of securities other than		
		Residents of Italy			Residents of other euro-area countries			Rest of the world	Residents of Italy		
		MFIs	General government	Other sectors	MFIs	General government	Other sectors		MFIs	General government	Other sectors
1999 – Dec. .	6,150	154,756	63,160	761,321	57,705	45	12,756	67,629	37,806	176,844	5,399
2000 – ” . .	7,013	187,708	60,549	862,250	58,760	111	15,770	69,308	43,388	146,097	7,936
2001 – ” . .	8,687	205,076	58,003	922,575	49,945	124	13,771	65,094	42,488	149,149	13,509
2002 – Jan. . .	20,214	182,749	57,869	922,274	52,519	124	13,192	60,914	41,780	156,823	12,520
Feb. . .	14,794	181,531	57,915	921,851	53,232	124	13,393	63,670	43,305	158,086	12,347
Mar. . .	9,705	195,219	58,399	925,028	56,219	124	14,595	67,652	44,717	164,851	12,443
Apr. . .	9,214	200,850	56,929	927,103	63,098	123	14,262	66,729	45,418	162,379	12,694
May . .	8,141	213,522	56,344	935,849	62,247	113	13,645	65,141	46,001	164,999	12,162
June .	7,386	198,060	57,029	944,310	65,683	110	13,559	62,324	47,646	160,476	12,181
July . .	7,834	224,352	54,634	948,654	64,517	113	14,070	66,138	45,084	154,146	12,329
Aug. . .	7,282	229,632	54,080	940,650	64,309	110	12,861	60,409	45,447	151,310	12,089
Sept. .	7,421	226,512	55,165	943,326	71,627	115	12,602	60,278	46,654	154,690	12,292
Oct. . .	7,084	237,307	54,344	948,231	71,992	116	12,454	70,945	46,959	154,637	12,284
Nov. . .	6,989	252,786	55,528	950,676	74,464	115	12,387	67,864	47,456	151,392	12,123
Dec. . .	9,566	285,834	56,363	979,584	72,827	110	13,876	71,406	48,040	145,094	13,127
2003 – Jan. . .	6,799	295,597	56,664	990,856	76,355	111	15,521	66,621	49,045	162,335	15,305
Feb. . .	6,523	293,488	57,429	993,118	84,182	110	13,480	70,935	48,841	165,200	16,133
Mar. . .	6,974	293,386	56,029	991,116	80,087	110	13,286	71,208	49,018	167,061	16,870

(1) ESCB harmonized statistics. Rounding may cause discrepancies in totals.

Table a23

Assets

shares, at market value				Shares and other equity					Fixed assets	Remaining assets	Total assets	
Residents of other euro-area countries			Rest of the world	Residents of Italy		Residents of other euro-area countries		Rest of the world				
MFIs	General government	Other sectors		MFIs	Other sectors	MFIs	Other sectors					
4,339	3,080	4,870	17,888	39,051	21,512	5,078	5,193	4,601	44,719	147,969	1,641,869	. . Dec. – 1999
3,705	4,581	5,355	15,392	40,803	26,636	5,947	8,239	7,318	46,283	158,053	1,781,201	. . . . " – 2000
4,039	4,671	6,279	13,286	42,957	30,513	6,481	10,393	6,454	48,397	176,266	1,878,155	. . . . " – 2001
4,763	4,258	6,540	12,592	43,071	30,957	6,470	10,386	7,196	47,723	188,960	1,883,897	. . Jan. – 2002
4,776	4,365	6,864	12,591	42,798	30,843	6,206	10,305	7,038	47,771	170,548	1,864,354	. . Feb.
4,493	4,612	7,353	12,776	43,406	33,329	6,097	10,522	7,548	47,392	169,554	1,896,032	. . Mar.
4,577	4,551	7,487	12,619	44,548	39,288	6,214	10,633	9,021	47,230	165,584	1,910,551	. . Apr.
4,753	4,440	7,698	12,592	42,766	40,564	6,164	10,486	9,784	47,232	160,164	1,924,807	. . May
5,034	3,808	7,186	12,104	39,913	43,919	6,075	11,420	7,506	46,800	167,368	1,919,896	. . June
5,249	4,738	7,183	11,830	47,185	35,981	6,164	11,013	8,087	46,899	170,132	1,946,332	. . July
5,474	6,209	7,098	12,048	47,251	35,406	6,146	11,839	8,174	47,599	159,802	1,925,226	. . Aug.
5,346	8,012	7,390	11,902	46,769	34,580	6,331	11,020	7,940	48,008	161,999	1,939,977	. . Sept.
4,757	7,984	7,409	12,015	47,156	35,660	6,343	11,545	8,738	48,757	156,458	1,963,177	. . Oct.
4,802	6,661	7,290	12,035	46,516	40,867	6,350	11,615	8,816	48,887	172,427	1,998,046	. . Nov.
4,456	5,692	8,333	11,354	42,179	38,105	6,692	11,073	6,818	49,992	185,600	2,066,123	. . Dec.
5,767	13,812	9,503	13,563	42,061	38,221	6,636	10,624	7,673	49,568	194,286	2,127,479	. . Jan. – 2003
6,317	15,606	9,784	14,164	42,831	38,932	6,637	9,865	8,179	49,161	194,591	2,146,132	. . Feb.
6,545	14,870	9,563	14,240	43,677	42,093	6,489	9,452	8,526	47,342	203,588	2,152,301	. . Mar.

BANKS AND MONEY MARKET FUNDS RESIDENT IN ITALY: SUMMARY BALANCE SHEET DATA (1)
(end-of-period stocks; millions of euros) **Liabilities**

	Deposits					
	Residents of Italy			Residents of other euro-area countries		
	MFIs	Central government	Other general government – other sectors	MFIs	Central government	Other general government – other sectors
1999 – Dec. . .	181,345	7,922	575,519	98,653	38	6,133
2000 – ” . .	206,307	6,964	598,170	107,605	34	7,032
2001 – ” . .	192,934	7,214	636,656	109,572	291	5,525
2002 – Jan. . .	181,823	7,456	619,412	118,392	925	8,978
Feb. . .	180,686	6,935	629,600	109,548	103	9,463
Mar. . .	196,211	7,156	636,801	113,440	162	9,873
Apr. . .	204,908	6,953	639,421	111,725	59	11,725
May . .	214,662	6,953	646,726	116,572	87	11,074
June .	199,792	7,335	647,141	118,039	11	12,701
July . .	222,491	6,896	646,495	114,695	9	9,827
Aug. . .	230,182	7,083	637,360	113,903	733	10,418
Sept. .	225,096	7,325	644,071	113,342	9	9,925
Oct. . .	239,599	6,777	647,404	113,168	14	11,105
Nov. . .	255,832	6,788	648,580	114,837	30	9,836
Dec. . .	285,275	7,109	689,068	111,654	8	9,279
2003 – Jan. . .	291,827	7,357	653,855	122,012	808	11,690
Feb. . .	288,870	7,098	656,853	131,135	8	13,437
Mar. . .	280,356	8,163	662,488	125,676	8	12,822

(1) ESCB harmonized statistics. Rounding may cause discrepancies in totals.

Table a23 *cont.*

Liabilities

Rest of the world	Money market fund shares/units	Debt securities issued	Capital and reserves	Remaining liabilities	Total liabilities	
135,738	13,065	271,553	118,265	233,637	1,641,869	. Dec. – 1999
157,710	10,075	302,481	123,930	260,894	1,781,201	. . . . ” – 2000
171,121	26,164	334,672	133,633	260,372	1,878,155	. . . . ” – 2001
165,597	27,891	336,453	136,123	280,848	1,883,897	. . . Jan. – 2002
161,776	29,174	340,214	136,181	260,674	1,864,354	. . . Feb.
163,338	30,752	344,768	136,712	256,820	1,896,032	. . . Mar.
160,028	32,247	347,324	138,216	257,945	1,910,551	. . . Apr.
153,328	33,769	352,296	138,183	251,157	1,924,808	. . . May
146,856	35,140	358,666	138,909	255,306	1,919,896	. . . June
143,365	36,080	357,821	145,747	262,905	1,946,332	. . . July
139,601	38,126	359,830	145,719	242,269	1,925,226	. . . Aug.
141,453	39,200	362,980	146,216	250,360	1,939,977	. . . Sept.
145,017	40,376	364,077	147,720	247,920	1,963,177	. . . Oct.
147,219	41,387	364,817	147,019	261,700	1,998,046	. . . Nov.
146,026	41,966	367,969	146,172	261,601	2,066,129	. . . Dec.
147,039	88,060	367,584	148,099	289,148	2,127,478	. . . Jan. – 2003
150,747	91,214	368,648	147,453	290,667	2,146,132	. . . Feb.
152,240	95,145	373,336	149,219	292,850	2,152,302	. . . Mar.

PROFIT AND LOSS ACCOUNTS OF RESIDENT ITALIAN BANKS BY CATEGORY OF BANK (1)
(millions of euros)

	Interest receivable					Interest payable					Balance of derivative hedging contracts	Net interest income (a)
	Deposits with BI-UIC & Treasury	Loans	Securities	Interbank accounts	Claims on non-residents	Deposits	BI-UIC financing	Interbank accounts	Bonds and subordi-nated liabilities	Liabilities to non-residents		
						Limited company banks (2)						
1999	430	37,909	6,612	3,314	5,234	8,066	295	3,585	10,910	6,852	1,119	24,909
2000	594	43,160	6,442	5,746	6,794	9,813	535	5,807	12,009	9,256	540	25,857
2001	674	48,680	6,008	7,156	5,344	10,571	436	7,055	12,866	9,121	–607	27,207
2002 (3) ...	613	47,077	5,547	6,499	4,143	8,809	183	6,303	12,016	5,904	–1,042	29,621
						Cooperative banks *(banche popolari)*						
1999	55	5,513	982	494	451	1,266	11	412	1,013	494	2	4,300
2000	95	7,613	1,214	601	553	1,829	46	623	1,411	798	–64	5,304
2001	114	9,002	1,206	729	769	2,221	49	736	1,805	989	–183	5,836
2002 (3) ...	94	6,944	927	616	529	1,457	18	651	1,566	461	–90	4,867
						Mutual banks *(banche di credito cooperativo)*						
1999	43	2,479	1,000	138	36	784	. .	43	467	2	6	2,405
2000	48	2,982	932	154	45	894	. .	64	523	2	4	2,682
2001	51	3,469	928	227	41	1,082	. .	52	714	3	. .	2,865
2002 (3) ...	45	3,502	848	223	36	937	. .	31	778	3	25	2,930
						Branches of foreign banks						
1999	21	775	904	316	929	146	60	664	. .	1,562	–233	280
2000	81	1,136	1,049	541	1,056	234	345	797	. .	1,981	26	531
2001	133	1,807	999	577	862	325	44	1,082	2	2,177	–246	502
2002 (3) ...	121	1,988	467	468	594	402	60	530	. .	1,713	–139	794
						Total banks						
1999	549	46,675	9,498	4,262	6,649	10,262	365	4,705	12,390	8,910	893	31,894
2000	818	54,890	9,637	7,042	8,448	12,770	926	7,291	13,944	12,037	506	34,373
2001	972	62,958	9,141	8,689	7,015	14,198	529	8,925	15,387	12,290	–1,036	36,411
2002 (3) ...	874	59,511	7,789	7,806	5,302	11,605	261	7,515	14,360	8,082	–1,247	38,212

(1) Rounding may cause discrepancies in totals. – (2) Includes central credit institutions. – (3) Provisional.

Table a24

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	Capital and reserves	Number of banking staff (average)
						Limited company banks (2)							
21,424	2,146	9,661	46,333	27,569	16,331	18,765	5,344	6,118	5,333	8,088	1,298,296	89,298	266,854
25,667	1,852	11,502	51,524	28,229	16,069	23,295	4,412	4,901	7,178	11,705	1,402,215	98,220	260,800
27,592	2,134	9,985	54,799	29,333	16,073	25,466	10,476	5,572	6,079	8,912	1,467,458	101,233	261,702
24,470	1,201	9,613	54,092	31,791	17,487	22,301	9,566	6,391	4,871	7,864	1,586,426	110,323	268,715
						Cooperative banks *(banche popolari)*							
3,074	386	1,671	7,374	4,596	2,677	2,777	1,008	739	780	989	186,734	14,909	47,384
4,015	421	2,141	9,319	5,385	3,062	3,934	1,568	1,046	1002	1,365	223,569	17,217	52,865
4,102	300	1,844	9,938	5,713	3,188	4,225	1,768	1,057	1,026	1,431	249,669	18,714	53,857
3,374	136	1,543	8,241	5,021	2,726	3,219	1,131	706	834	1,254	232,884	18,071	44,366
						Mutual banks *(banche di credito cooperativo)*							
828	198	327	3,233	2,234	1,175	999	342	200	148	509	74,655	8,726	21,721
843	75	429	3,525	2,307	1,218	1,218	337	235	166	715	78,753	9,306	22,343
802	84	347	3,667	2,443	1,279	1,224	433	229	150	641	86,388	9,931	23,147
802	52	346	3,733	2,585	1,363	1,148	355	269	164	629	96,254	10,478	23,622
						Branches of foreign banks							
753	230	311	1,032	706	319	327	–233	56	222	337	72,539	802	2,826
903	209	456	1,434	841	352	593	71	99	240	282	80,938	914	3,047
663	–75	558	1,165	958	426	207	–204	128	162	249	86,209	1,117	3,572
532	11	322	1,326	931	435	394	117	140	150	127	82,883	1,273	3,839
						Total banks							
26,078	2,960	11,970	57,973	35,105	20,503	22,867	6,462	7,113	6,483	9,923	1,632,225	113,735	338,785
31,429	2,558	14,528	65,802	36,762	20,702	29,041	6,388	6,281	8,585	14,067	1,785,475	125,657	339,054
33,158	2,443	12,734	69,570	38,447	20,966	31,123	12,473	6,985	7,416	11,233	1,889,724	130,994	342,279
29,178	1,400	11,825	67,390	40,329	22,011	27,062	11,169	7,506	6,019	9,874	1,998,447	140,146	340,541

Table a25

ITALIAN FINANCIAL MARKET: GROSS AND NET ISSUES OF SECURITIES

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

	Bonds and public sector							
	Public sector							
	Government securities							
	BOTs	CTZs	CCTs (1)	BTPs (1)	CTEs	Republic of Italy issues	Other (2)	Total
				Gross issues				
1998 lire	425,768	97,778	42,501	261,441	–	17,949	39	845,476
1999 lire	373,493	95,069	39,823	275,239	–	19,731	–	803,355
euros . .	*192,893*	*49,099*	*20,567*	*142,149*	–	*10,190*	–	*414,898*
2000 lire	318,807	64,511	38,474	206,672	–	38,039	2,260	668,761
euros . .	*164,650*	*33,317*	*19,870*	*106,737*	–	*19,646*	*1,167*	*345,386*
2001 lire	365,330	68,792	54,855	232,215	–	43,622	105	764,918
euros . .	*188,677*	*35,528*	*28,330*	*119,929*	–	*22,529*	*54*	*395,047*
2002 lire	404,218	63,037	86,232	258,775	–	31,242	–	843,503
euros . .	*208,761*	*32,556*	*44,535*	*133,646*	–	*16,135*	–	*435,633*
				Redemptions				
1998 lire	461,250	84,576	84,973	119,921	12,448	12,391	25,680	801,240
1999 lire	408,599	107,300	92,850	127,323	18,879	27,499	8,192	790,643
euros . .	*211,024*	*55,416*	*47,953*	*65,757*	*9,750*	*14,202*	*4,231*	*408,333*
2000 lire	352,788	103,399	53,912	112,141	3,377	13,403	–	639,019
euros . .	*182,200*	*53,401*	*27,843*	*57,916*	*1,744*	*6,922*	–	*330,026*
2001 lire	342,642	95,588	74,270	161,798	2,904	27,179	–	704,380
euros . .	*176,960*	*49,367*	*38,357*	*83,562*	*1,500*	*14,037*	–	*363,782*
2002 lire	404,353	42,482	110,908	181,616	–	22,081	76,206	837,644
euros . .	*208,831*	*21,940*	*57,279*	*93,797*	–	*11,404*	*39,357*	*432,607*
				Issue discounts				
1998 lire	–	6,605	–374	–7,823	–	130	–	–1,462
1999 lire	–	4,864	–304	1,057	–	–39	–	5,578
euros . .	–	*2,512*	*–157*	*546*	–	*–20*	–	*2,881*
2000 lire	–	4,606	–219	2,314	–	29	–	6,730
euros . .	–	*2,379*	*–113*	*1,195*	–	*15*	–	*3,476*
2001 lire	–	5,106	–416	–3,174	–	43	–	1,559
euros . .	–	*2,637*	*–215*	*–1,639*	–	*22*	–	*805*
2002 lire	–	4,419	–879	–4,870	–	68	–42,282	–43,544
euros . .	–	*2,282*	*–454*	*–2,515*	–	*35*	*–21,837*	*–22,489*
				Net issues (6)				
1998 lire	–35,482	6,598	–42,096	149,343	–12,448	2,472	–25,643	42,743
1999 lire	–35,107	–17,097	–52,723	146,858	–18,879	–7,600	–8,192	7,261
euros . .	*–18,131*	*–8,830*	*–27,229*	*75,846*	*–9,750*	*–3,925*	*–4,231*	*3,750*
2000 lire	–33,982	–43,492	–15,219	92,217	–3,377	26,728	2,260	25,135
euros . .	*–17,550*	*–22,462*	*–7,860*	*47,626*	*–1,744*	*13,804*	*1,167*	*12,981*
2001 lire	22,687	–31,902	–18,999	73,590	–2,904	17,522	105	60,098
euros . .	*11,717*	*–16,476*	*–9,812*	*38,006*	*–1,500*	*9,049*	*54*	*31,038*
2002 lire	–135	16,138	–23,797	82,028	–	8,497	–33,923	48,808
euros . .	*–70*	*8,335*	*–12,290*	*42,364*	–	*4,388*	*–17,520*	*25,207*
				Coupons (7)				
1998 lire	11,740	10,374	37,111	72,734	2,689	5,209	2,924	142,780
1999 lire	7,269	10,188	22,010	72,358	1,755	5,685	1,592	120,857
euros . .	*3,754*	*5,262*	*11,367*	*37,370*	*906*	*2,936*	*822*	*62,417*
2000 lire	9,399	6,377	19,702	72,668	456	6,554	–	115,156
euros . .	*4,854*	*3,293*	*10,175*	*37,530*	*236*	*3,385*	–	*59,473*
2001 lire	9,327	6,023	25,030	74,397	184	7,952	–	122,914
euros . .	*4,817*	*3,111*	*12,927*	*38,423*	*95*	*4,107*	–	*63,480*
2002 lire	8,241	3,690	18,438	73,189	–	8,990	–	112,548
euros . .	*4,256*	*1,906*	*9,522*	*37,799*	–	*4,643*	–	*58,126*

(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. – 2002. – (3) The total for the public sector differs from the sum of the individual components by the amount of the bonds issued by Crediop on behalf of the Treasury. – (4) The values refer accounting lags. – (7) The figures refer only to fixed rate securities, except for CCTs.

securities									
			Firms and international institutions				Total bonds and public sector securities	Listed shares (5)	
Autonomous government agencies and State Railways	Local governments	Total (3)	Banks	Private firms	International institutions (4)	Total			
				Gross issues					
–	1,095	846,572	135,981	1,115	28,208	165,303	1,011,875	13,648	. . . . . lire 1998
–	4,761	808,116	157,707	25,745	46,608	230,060	1,038,176	43,649	. . . . . lire 1999
–	*2,459*	*417,357*	*81,449*	*13,296*	*24,071*	*118,816*	*536,173*	*22,543*	. . . . . *euros*
–	5,712	674,473	168,291	39,763	6,416	214,469	888,943	17,714	. . . . . lire 2000
–	*2,950*	*348,336*	*86,915*	*20,536*	*3,314*	*110,764*	*459,101*	*9,148*	. . . . . *euros*
–	4,648	769,565	185,450	102,624	9,681	297,758	1,067,322	11,948	. . . . . lire 2001
–	*2,401*	*397,447*	*95,777*	*53,001*	*5,000*	*153,779*	*551,226*	*6,171*	. . . . . *euros*
–	9,615	853,119	178,807	85,961	10	264,777	1,117,894	7,534	. . . . . lire 2002
–	*4,966*	*440,599*	*92,346*	*44,395*	*5*	*136,746*	*577,344*	*3,891*	. . . . . *euros*
				Redemptions					
5,000	72	806,311	77,652	1,374	500	79,526	885,838	–	. . . . . lire 1998
1,000	306	791,962	117,973	9,011	1,150	128,133	920,096	–	. . . . . lire 1999
516	*158*	*409,014*	*60,928*	*4,654*	*594*	*66,175*	*475,190*	–	. . . . . *euros*
2,250	542	641,812	108,407	8,985	500	117,892	759,703	–	. . . . . lire 2000
1,162	*280*	*331,468*	*55,987*	*4,641*	*258*	*60,886*	*392,354*	–	. . . . . *euros*
3,750	638	708,770	123,120	10,167	700	133,986	842,754	–	. . . . . lire 2001
1,937	*330*	*366,049*	*63,586*	*5,251*	*362*	*69,198*	*435,246*	–	. . . . . *euros*
2,000	809	840,453	114,335	16,024	2,040	132,400	972,854	–	. . . . . lire 2002
1,033	*418*	*434,058*	*59,049*	*8,276*	*1,054*	*68,379*	*502,437*	–	. . . . . *euros*
				Issue discounts					
–	. .	–1,462	601	. .	826	1,427	–34	–	. . . . . lire 1998
–	. .	5,578	618	566	190	1,374	6,953	–	. . . . . lire 1999
–	. .	*2,881*	*319*	*293*	*98*	*710*	*3,591*	–	. . . . . *euros*
–	4	6,734	665	1,302	34	1,999	8,733	–	. . . . . lire 2000
–	*2*	*3,478*	*343*	*672*	*18*	*1,032*	*4,510*	–	. . . . . *euros*
–	. .	1,559	691	1,348	78	2,118	3,676	–	. . . . . lire 2001
–	. .	*805*	*357*	*696*	*40*	*1,094*	*1,899*	–	. . . . . *euros*
–	–8	–43,552	689	167	. .	856	–42,696	–	. . . . . lire 2002
–	*–4*	*–22,493*	*356*	*86*	. .	*442*	*–22,051*	–	. . . . . *euros*
				Net issues (6)					
–5,000	1,023	38,766	57,728	–259	26,881	84,350	123,116	13,648	. . . . . lire 1998
–1,000	4,454	10,704	39,118	16,167	45,268	100,552	111,256	43,649	. . . . . lire 1999
–516	*2,301*	*5,528*	*20,203*	*8,350*	*23,379*	*51,931*	*57,459*	*22,543*	. . . . . *euros*
–2,250	5,167	28,051	59,222	29,476	5,882	94,579	122,630	17,714	. . . . . lire 2000
–1,162	*2,669*	*14,487*	*30,585*	*15,223*	*3,038*	*48,846*	*63,333*	*9,148*	. . . . . *euros*
–3,750	4,010	60,359	61,640	91,109	8,904	161,651	222,011	11,948	. . . . . lire 2001
–1,937	*2,071*	*31,173*	*31,834*	*47,054*	*4,598*	*83,486*	*114,659*	*6,171*	. . . . . *euros*
–2,000	8,813	55,619	63,783	69,770	–2,031	131,521	187,142	7,534	. . . . . lire 2002
–1,033	*4,552*	*28,725*	*32,941*	*36,033*	*–1,049*	*67,925*	*96,651*	*3,891*	. . . . . *euros*
				Coupons (7)					
521	116	143,422	26,844	. . . .	296	27,140	170,562	13,061	. . . . . lire 1998
376	244	121,480	22,528	. . . .	1,102	23,630	145,110	19,254	. . . . . lire 1999
194	*126*	*62,741*	*11,635*	. . . .	*569*	*12,204*	*74,945*	*9,944*	. . . . . *euros*
372	482	116,010	24,175	. . . .	3,648	27,823	143,832	31,005	. . . . . lire 2000
192	*249*	*59,914*	*12,485*	. . . .	*1,884*	*14,369*	*74,283*	*16,013*	. . . . . *euros*
279	844	124,037	25,702	. . . .	3,987	29,689	153,726	30,549	. . . . . lire 2001
144	*436*	*64,060*	*13,274*	. . . .	*2,059*	*15,333*	*79,393*	*15,777*	. . . . . *euros*
161	1,170	113,878	23,593	. . . .	4,415	28,008	141,886	35,933	. . . . . lire 2002
83	*604*	*58,813*	*12,185*	. . . .	*2,280*	*14,465*	*73,278*	*18,558*	. . . . . *euros*

(2) Includes the 76,206 billion lire of securities issued in November 1994 to consolidate the Treasury's overdraft on its current account with the Bank of Italy and redeemed earlier in December
to the securities issued by international institutions listed on Borsa Italiana's MOT market and on the MTS market. – (5) Issues for cash. – (6) The net issues of Republic of Italy loans include

Table a26

INTEREST RATES ON SECURITIES
(average values before tax)

	CCTs	CTEs	CTOs	BTPs	CTZs
1993	11.77	7.81	11.12	11.32	–
1994	9.97	7.64	10.53	10.68	–
1995	11.60	8.82	11.64	11.94	11.40
1996	9.01	6.33	8.77	9.06	8.49
1997	6.81	5.42	7.17	6.76	6.45
1998	4.89	4.87	7.01	4.92	4.58
1999	3.13	4.35	–	4.71	3.21
2000	4.58	5.94	–	5.59	4.70
2001	4.34	6.02	–	5.17	4.04
2002	3.37	–	–	4.95	3.49
2001 – Jan.	4.95	5.82	–	5.27	4.49
Feb.	4.82	6.38	–	5.27	4.51
Mar.	4.88	6.07	–	5.21	4.39
Apr.	4.56	5.21	–	5.29	4.38
May	4.81	5.69	–	5.43	4.45
June	4.62	6.95	–	5.37	4.27
July	4.42	–	–	5.36	4.28
Aug.	4.43	–	–	5.19	4.06
Sept.	4.24	–	–	5.14	3.72
Oct.	3.58	–	–	4.89	3.36
Nov.	3.48	–	–	4.72	3.22
Dec.	3.35	–	–	4.91	3.36
2002 – Jan.	3.30	–	–	5.01	3.54
Feb.	3.48	–	–	5.12	3.67
Mar.	3.47	–	–	5.30	3.90
Apr.	3.58	–	–	5.32	3.94
May	3.58	–	–	5.31	4.01
June	3.67	–	–	5.17	3.89
July	3.53	–	–	5.01	3.65
Aug.	3.37	–	–	4.77	3.38
Sept.	3.31	–	–	4.58	3.15
Oct.	3.16	–	–	4.65	3.04
Nov.	3.10	–	–	4.62	2.95
Dec.	2.92	–	–	4.48	2.74
2003 – Jan.	2.77	–	–	4.35	2.59
Feb.	2.63	–	–	4.18	2.40
Mar.	2.41	–	–	4.21	2.34
Apr.	2.44	–	–	4.30	2.39

Table a26 *cont.*

INTEREST RATES ON SECURITIES
(average values before tax)

	Straight bonds			
	Banks	Enterprises	International institutions	Total (1)
1993	11.28	10.90	10.02	11.09
1994	10.14	10.55	9.83	10.15
1995	11.58	11.35	11.00	11.45
1996	9.20	9.08	9.46	9.09
1997	7.41	7.07	7.17	7.14
1998	5.45	5.71	5.87	5.55
1999	4.80	5.49	6.32	5.19
2000	5.80	6.61	7.83	6.27
2001	5.13	6.12	–	5.31
2002	4.90	–	–	4.79
2001 – Jan.	5.37	6.56	–	5.62
Feb.	5.30	6.48	–	5.54
Mar.	5.28	6.38	–	5.49
Apr.	5.21	6.36	–	5.44
May	5.35	6.36	–	5.54
June	5.31	6.25	–	5.47
July	5.27	6.22	–	5.44
Aug.	5.11	6.08	–	5.28
Sept.	5.04	5.90	–	5.17
Oct.	4.84	5.68	–	4.95
Nov.	4.66	5.56	–	4.79
Dec.	4.90	5.65	–	5.00
2002 – Jan.	4.92	–	–	5.01
Feb.	5.06	–	–	5.10
Mar.	5.18	–	–	5.23
Apr.	5.20	–	–	5.21
May	5.24	–	–	5.21
June	5.17	–	–	5.10
July	4.99	–	–	4.88
Aug.	4.82	–	–	4.72
Sept.	4.61	–	–	4.43
Oct.	4.60	–	–	4.30
Nov.	4.57	–	–	4.24
Dec.	4.42	–	–	4.09
2003 – Jan.	4.13	–	–	3.89
Feb.	3.88	–	–	3.69
Mar.	3.95	–	–	3.94
Apr.	4.00	–	–	4.00

(1) Until September 1995 includes the bonds issued by autonomous government agencies and public enterprises.

Table a27

ITALY'S FINANCIAL ASSETS AND LIABILITIES IN 2002 (1)

(stocks in millions of euros)

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	**–**	**–**	**25,866**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Currency and transferable deposits, with	**112,601**	**–**	**149,801**	**778,126**	**17,218**	**–**	**23,294**	**–**	**11,969**	**–**
MFIs	111,869	–	128,093	778,126	17,218	–	17,112	–	8,777	–
central government	..	–	1,108	–	–	–	–	–	–	–
rest of the world	732	–	20,599	–	..	–	6,182	–	3,192	–
Other deposits, with	**8,903**	**–**	**225,957**	**464,810**	**22,038**	**–**	**9,676**	**–**	**2,891**	**–**
MFIs	7,868	–	176,578	464,810	22,038	–	9,676	–	2,808	–
central government	1,035	–	–	–	–	–	–	–	–	–
rest of the world	..	–	49,380	–	..	–	..	–	82	–
Short-term securities, issued by	**2,028**	**3,875**	**37,823**	**7**	**9,614**	**72**	**34**	**–**	**1,544**	**–**
general government	129	–	27,584	–	6,783	–	34	–	378	–
other residents	3	3,875	3,539	7	135	72	–	–	–	–
rest of the world	1,896	–	6,700	–	2,696	–	–	–	1,166	–
Bonds, issued by	**51,175**	**40,068**	**249,440**	**370,231**	**256,812**	**88,030**	**6,588**	**–**	**218,114**	**4,015**
MFIs	9,684	–	44,127	370,231	10,201	–	675	–	25,119	–
central government: CCTs	6,973	–	63,581	–	31,203	–	845	–	25,632	–
central government: other	7,732	–	94,110	–	67,171	–	2,224	–	129,114	–
local government	1,786	–	3,487	–	1,812	–	899	–	961	–
other residents	5,549	40,068	7,612	–	14,299	88,030	1,944	–	6,873	4,015
rest of the world	19,452	–	36,524	–	132,127	–	–	–	30,415	–
Derivatives	**5,580**	**6,650**	**65,572**	**62,911**	**1,097**	**1,021**	**–**	**–**	**2,790**	**1,995**
Short-term loans, of	**47,500**	**389,993**	**580,463**	**70,653**	**67,038**	**157,400**	**–**	**4,139**	**–**	**472**
non-financial corporations	47,500	–	–	–	–	–	–	–	–	–
MFIs	–	287,891	580,463	13,389	–	119,174	–	4,139	–	472
other financial corporations	–	28,868	–	1,048	67,038	–	–	–	–	..
general government	–	–	–	–	–	–	–	–	–	–
rest of the world	–	73,234	–	56,215	–	38,226	–	–	–	–
Medium and long-term loans, of	**–**	**330,180**	**587,743**	**73,472**	**84,973**	**32,547**	**20**	**1,884**	**1,349**	**6,598**
non-financial corporations	–	–	–	–	–	–	–	–	–	–
MFIs	–	252,953	587,743	14,766	–	29,157	–	419	–	3,180
other financial corporations	–	47,783	–	731	84,973	–	20	–	1,349	64
general government	–	23,448	–	3,024	–	–	–	1,465	–	1,573
rest of the world	–	5,996	–	54,950	–	3,390	–	–	–	1,782
Shares and other equity, issued by	**804,557**	**1,108,405**	**104,007**	**239,603**	**222,763**	**46,632**	**..**	**4,526**	**52,802**	**81,241**
residents	693,225	1,108,405	84,148	239,603	72,044	46,632	..	4,526	30,094	81,241
of which: listed shares	186,690	306,287	30,396	102,113	36,408	1,060	–	–	15,798	48,532
rest of the world	111,332	–	19,859	–	150,718	–	–	–	22,708	–
Mutual fund shares, issued by	**13,756**	**–**	**8,233**	**41,966**	**23,088**	**318,591**	**387**	**–**	**39,039**	**–**
residents	4,302	–	4,806	41,966	–	318,591	387	–	36,692	–
rest of the world	9,454	–	3,427	–	23,088	–	–	–	2,347	–
Insurance technical reserves	**17,830**	**85,135**	**1,013**	**17,709**	**–**	**–**	**–**	**–**	**–**	**301,999**
net equity of households	–	85,135	–	17,709	–	–	–	–	–	244,771
prepayments and other claims	17,830	–	1,013	–	–	–	–	–	–	57,228
Other accounts receivable/payable	**318,372**	**276,834**	**597**	**179**	**1,117**	**..**	**–**	**–**	**40**	**905**
Trade credits	293,006	264,515	–	–	–	–	–	–	–	–
Other	25,366	12,318	597	179	1,117	..	–	–	40	905
Total	**1,382,303**	**2,241,139**	**2,036,516**	**2,119,666**	**705,758**	**644,293**	**39,999**	**10,549**	**330,538**	**397,225**

(1) Provisional. Rounding may cause discrepancies in totals.

General government						Households and non-profit institutions serving households		Rest of the world		Total		Institutional sectors
Central government		Local government		Social security funds								
Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Financial instruments
–	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**25,866**	**25,866**	**25,866**	**Monetary gold and SDRs**
18,857	**16,148**	**23,791**	**–**	**15,617**	**–**	**443,087**	**–**	**20,070**	**42,030**	**836,304**	**836,304**	**Currency and transferable deposits**, with
18,413	–	10,359	–	14,994	–	431,221	–	20,070	–	778,126	778,126	MFIs
–	16,148	12,911	–	..	–	2,129	–	–	–	16,148	16,148	central government
443	–	521	–	622	–	9,737	–	–	42,030	42,030	42,030	rest of the world
895	**188,320**	**1,543**	**–**	**1,076**	**–**	**288,975**	**–**	**141,198**	**50,022**	**703,151**	**703,151**	**Other deposits**, with
892	–	1,429	–	1,075	–	101,248	–	141,198	–	464,810	464,810	MFIs
–	188,320	–	–	–	–	187,284	–	–	–	188,320	188,320	central government
3	–	113	–	1	–	443	–	–	50,022	50,022	50,022	rest of the world
50	**112,718**	**16**	**..**	**152**	**–**	**14,333**	**–**	**63,660**	**12,582**	**129,255**	**129,255**	**Short-term securities**, issued by
50	112,718	16	..	152	–	13,931	–	63,660	–	112,718	112,718	general government
–	–	–	–	–	–	277	–	–	–	3,954	3,954	other residents
–	–	–	–	–	–	124	–	–	12,582	12,582	12,582	rest of the world
6,523	**1,109,223**	**3,915**	**14,850**	**7,992**	**–**	**602,346**	**–**	**537,626**	**314,115**	**1,940,531**	**1,940,531**	**Bonds**, issued by
204	–	609	–	1,072	–	275,343	–	3,197	–	370,231	370,231	MFIs
2,155	219,905	158	–	1,674	–	65,759	–	21,925	–	219,905	219,905	central government: CCTs
3,903	889,318	262	–	2,879	–	136,645	–	445,279	–	889,318	889,318	central government: other
50	–	808	14,850	..	–	1,784	–	3,263	–	14,850	14,850	local government
212	–	236	–	586	–	30,839	–	63,962	–	132,113	132,113	other residents
–	–	1,842	–	1,780	–	91,976	–	–	314,115	314,115	314,115	rest of the world
–	**6,283**	**–**	**–**	**–**	**–**	**–**	**–**	**40,119**	**36,299**	**115,158**	**115,158**	**Derivatives**
11,166	**2,329**	**–**	**4,966**	**–**	**1,050**	**–**	**54,944**	**167,675**	**187,896**	**873,842**	**873,842**	**Short-term loans**, of
–	–	–	–	–	–	–	–	–	47,500	47,500	47,500	non-financial corporations
–	2,329	–	4,904	–	124	–	54,237	–	93,803	580,463	580,463	MFIs
–	–	–	62	–	–	–	706	–	36,353	67,038	67,038	other financial corporations
11,166	–	–	–	–	926	–	–	–	10,240	11,166	11,166	general government
–	–	–	–	–	–	–	–	167,675	–	167,675	167,675	rest of the world
130,100	**35,967**	**–**	**113,547**	**–**	**5,700**	**–**	**249,390**	**75,286**	**30,187**	**879,472**	**879,472**	**Medium and long-term loans**, of
–	–	–	–	–	–	–	–	–	–	–	–	non-financial corporations
–	22,444	–	25,860	–	17	–	228,016	–	10,931	587,743	587,743	MFIs
–	5,497	–	587	–	5,683	–	21,351	–	4,647	86,342	86,342	other financial corporations
130,100	..	–	85,958	–	–	–	22	–	14,609	130,100	130,100	general government
–	8,026	–	1,142	–	–	–	–	75,286	–	75,286	75,286	rest of the world
88,394	**–**	**5,133**	**103**	**759**	**–**	**419,108**	**–**	**164,027**	**381,040**	**1,861,549**	**1,861,549**	**Shares and other equity**, issued by
80,475	–	4,343	103	342	–	351,810	–	164,027	–	1,480,509	1,480,509	residents
40,742	–	1,955	–	147	–	85,980	–	59,877	–	457,992	457,992	*of which: listed shares*
7,919	–	790	–	417	–	67,298	–	–	381,040	381,040	381,040	rest of the world
86	**–**	**5,810**	**–**	**988**	**–**	**333,812**	**–**	**4,111**	**68,754**	**429,311**	**429,311**	**Mutual fund shares**, issued by
44	–	41	–	831	–	309,342	–	4,111	–	360,557	360,557	residents
42	–	5,769	–	156	–	24,469	–	–	68,754	68,754	68,754	rest of the world
128	**–**	**1,002**	**–**	**28**	**–**	**401,911**	**25,781**	**8,712**	**–**	**430,624**	**430,624**	**Insurance technical reserves**
–	–	–	–	–	–	373,396	25,781	–	–	373,396	373,396	net equity of households
128	–	1,002	–	28	–	28,515	–	8,712	–	57,228	57,228	prepayments and other claims
44,484	**18,901**	**26,090**	**22,040**	**22,556**	**3,580**	**15,094**	**72,853**	**36,144**	**69,202**	**464,494**	**464,494**	**Other accounts receivable/payable**
–	–	–	–	–	–	4,567	–	36,144	69,202	333,718	333,718	Trade credits
44,484	18,901	26,090	22,040	22,556	3,580	10,527	72,853	–	–	130,776	130,776	Other
300,682	**1,489,888**	**67,299**	**155,507**	**49,167**	**10,329**	**2,518,667**	**402,967**	**1,258,628**	**1,217,994**	**8,689,557**	**8,689,557**	**Total**

Table a28

ITALY'S FINANCIAL ASSETS AND LIABILITIES IN 2002 (1)

(flows in millions of euros)

Institutional sectors / Financial instruments	Non-financial corporations		Financial corporations: Monetary financial institutions		Financial corporations: Other financial intermediaries		Financial corporations: Financial auxiliaries		Financial corporations: Insurance corporations and pension funds	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Monetary gold and SDRs	**–**	**–**	**–214**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Currency and transferable deposits, with	**2,732**	**–**	**53,862**	**87,225**	**–2,088**	**–**	**–556**	**–**	**817**	**–**
MFIs	6,471	–	53,346	87,225	–2,088	–	2,750	–	1,150	–
central government	–166	–	417	–	–	–	–	–	–	–
rest of the world	–3,573	–	98	–	..	–	–3,306	–	–333	–
Other deposits, with	**–166**	**–**	**48,977**	**43,727**	**6,158**	**–**	**4,532**	**–**	**1,348**	**–**
MFIs	–218	–	45,310	43,727	6,158	–	4,532	–	1,329	–
central government	51	–	–	–	–	–	–	–	–	–
rest of the world	..	–	3,667	–	..	–	..	–	20	–
Short-term securities, issued by	**–571**	**703**	**8,697**	**2**	**–405**	**21**	**–226**	**–**	**227**	**–**
general government	–578	–	6,171	–	1,498	–	–226	–	–263	–
other residents	..	703	762	2	40	21	–	–	–	–
rest of the world	7	–	1,764	–	–1,943	–	–	–	490	–
Bonds, issued by	**–4,536**	**9,308**	**–14,267**	**32,613**	**–6,735**	**26,117**	**–4,547**	**–**	**39,073**	**62**
MFIs	–489	–	6,077	32,613	–259	–	–2,616	–	4,251	–
central government: CCTs	582	–	–11,349	–	2,903	–	–1,882	–	4,047	–
central government: other	313	–	–9,774	–	–15,251	–	–2,324	–	22,596	–
local government	831	–	1,133	–	852	–	413	–	426	–
other residents	–6,454	9,308	–1,965	–	5,331	26,117	1,862	–	3,623	62
rest of the world	681	–	1,612	–	–310	–	–	–	4,131	–
Derivatives	**–**	**–3,613**	**–3,212**	**–**	**–**	**–2,068**	**–**	**–**	**–**	**–41**
Short-term loans, of	**4,316**	**–7,870**	**8,701**	**–15,157**	**5,949**	**9,671**	**–**	**1,910**	**–**	**–307**
non-financial corporations	4,316	–	–	–	–	–	–	–	–	–
MFIs	–	–2,164	8,701	–9,867	–	3,100	–	1,910	–	–307
other financial corporations	–	1,903	–	69	5,949	–	–	–	–	..
general government	–	–	–	–	–	–	–	–	–	–
rest of the world	–	–7,609	–	–5,359	–	6,571	–	–	–	–
Medium and long-term loans, of	**–**	**40,443**	**67,752**	**15,885**	**5,512**	**4,588**	**–9**	**–1,913**	**41**	**946**
non-financial corporations	–	–	–	–	–	–	–	–	–	–
MFIs	–	32,555	67,752	6,813	–	2,890	–	21	–	213
other financial corporations	–	6,671	–	113	5,512	–	–9	–	41	10
general government	–	2,929	–	558	–	–	–	–1,934	–	379
rest of the world	–	–1,713	–	8,401	–	1,699	–	–	–	345
Shares and other equity, issued by	**42,391**	**34,951**	**6,533**	**9,017**	**–4,753**	**1,452**	**185**	**66**	**3,753**	**..**
residents	32,592	34,951	5,253	9,017	–2,135	1,452	185	66	2,492	..
of which: listed shares	....	....	....	....	....	....	–	–	....	....
rest of the world	9,798	–	1,280	–	–2,618	–	–	–	1,262	–
Mutual fund shares, issued by	**15**	**–**	**994**	**–1,179**	**4,656**	**335**	**–1**	**–**	**824**	**–**
residents	–10	–	–11	–1,179	–	335	–1	–	–79	–
rest of the world	25	–	1,005	–	4,656	–	–	–	902	–
Insurance technical reserves	**1,281**	**5,412**	**73**	**–236**	**–**	**–**	**–**	**–**	**–**	**31,441**
net equity of households	–	5,412	–	–236	–	–	–	–	–	27,442
prepayments and other claims	1,281	–	73	–	–	–	–	–	–	3,999
Other accounts receivable/payable	**36,379**	**35,281**	**–37**	**70**	**1,117**	**..**	**–**	**–**	**10**	**125**
Trade credits	38,992	36,729	–	–	–	–	–	–	–	–
Other	–2,613	–1,448	–37	70	1,117	..	–	–	10	125
Total	**81,841**	**114,616**	**177,858**	**171,968**	**9,412**	**40,117**	**–621**	**63**	**46,094**	**32,226**

(1) Provisional. Rounding may cause discrepancies in totals.

General government						Households and non-profit institutions serving households		Rest of the world		Total		Institutional sectors
Central government		Local government		Social security funds								
Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Financial instruments
–	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–214**	**–214**	**–214**	**Monetary gold and SDRs**
–10,179	**1,160**	**1,601**	**–**	**6,715**	**–**	**11,040**	**–**	**–4,733**	**–29,174**	**59,211**	**59,211**	**Currency and transferable deposits**, with
–8,843	–	1,693	–	6,742	–	30,737	–	–4,733	–	87,225	87,225	MFIs
–	1,160	..	–	..	–	909	–	–	–	1,160	1,160	central government
–1,336	–	–92	–	–27	–	–20,606	–	–	–29,174	–29,174	–29,174	rest of the world
4	**12,460**	**–278**	**–**	**406**	**–**	**11,784**	**–**	**–12,680**	**3,899**	**60,085**	**60,085**	**Other deposits**, with
4	–	–278	–	406	–	–835	–	–12,680	–	43,727	43,727	MFIs
–	12,460	–	–	–	–	12,408	–	–	–	12,460	12,460	central government
..	–	..	–	..	–	211	–	–	3,899	3,899	3,899	rest of the world
–53	**162**	**–7**	**..**	**–90**	**–**	**–18,464**	**–**	**11,366**	**–414**	**475**	**475**	**Short-term securities**, issued by
–53	162	–7	..	–90	–	–17,657	–	11,366	–	162	162	general government
–	–	–	–	–	–	–75	–	–	–	727	727	other residents
–	–	–	–	–	–	–733	–	–	–414	–414	–414	rest of the world
–1,252	**23,956**	**1,890**	**5,553**	**–83**	**–**	**61,902**	**–**	**38,288**	**12,125**	**109,735**	**109,735**	**Bonds**, issued by
–1,155	–	–6	–	–167	–	26,742	–	235	–	32,613	32,613	MFIs
2,006	–13,977	–127	–	–720	–	14,437	–	–23,873	–	–13,977	–13,977	central government: CCTs
–2,104	37,933	–67	–	83	–	5,409	–	39,053	–	37,933	37,933	central government: other
..	–	60	5,553	..	–	767	–	1,073	–	5,553	5,553	local government
2	–	1,986	–	394	–	8,907	–	21,802	–	35,487	35,487	other residents
–	–	43	–	327	–	5,640	–	–	12,125	12,125	12,125	rest of the world
–	**..**	**–**	**–**	**–**	**–**	**–**	**–**	**–2,511**	**–**	**–5,723**	**–5,723**	**Derivatives**
..	**547**	**–**	**718**	**–**	**28**	**–**	**–304**	**–6,397**	**23,334**	**12,570**	**12,570**	**Short-term loans**, of
–	–	–	–	–	–	–	–	–	4,316	4,316	4,316	non-financial corporations
–	547	–	714	–	28	–	–351	–	15,091	8,701	8,701	MFIs
–	–	–	4	–	–	–	47	–	3,926	5,949	5,949	other financial corporations
..	–	–	–	–	..	–	–	–	..	..	..	general government
–	–	–	–	–	–	–	–	–6,397	–	–6,397	–6,397	rest of the world
10,489	**–2,669**	**–**	**7,863**	**–**	**–2,467**	**–**	**27,396**	**8,269**	**1,981**	**92,053**	**92,053**	**Medium and long-term loans**, of
–	–	–	–	–	–	–	–	–	–	–	–	non-financial corporations
–	–2,339	–	–666	–	–63	–	26,490	–	1,837	67,752	67,752	MFIs
–	263	–	–198	–	–2,405	–	902	–	187	5,544	5,544	other financial corporations
10,489	..	–	8,596	–	–	–	4	–	–44	10,489	10,489	general government
–	–593	–	130	–	–	–	–	8,269	–	8,269	8,269	rest of the world
1,565	**–**	**269**	**7**	**51**	**–**	**6,076**	**–**	**5,318**	**15,896**	**61,389**	**61,389**	**Shares and other equity**, issued by
1,251	–	275	7	–89	–	350	–	5,318	–	45,493	45,493	residents
....	–	....	–	....	–	....	–	....	–	....	....	*of which: listed shares*
314	–	–6	–	139	–	5,726	–	–	15,896	15,896	15,896	rest of the world
–24	**–**	**8**	**–**	**84**	**–**	**–2,558**	**–**	**–5**	**4,836**	**3,992**	**3,992**	**Mutual fund shares**, issued by
..	–	..	–	–2	–	–736	–	–5	–	–844	–844	residents
–24	–	8	–	86	–	–1,823	–	–	4,836	4,836	4,836	rest of the world
9	**–**	**72**	**–**	**2**	**–**	**36,418**	**1,863**	**626**	**–**	**38,481**	**38,481**	**Insurance technical reserves**
–	–	–	–	–	–	34,482	1,863	–	–	34,482	34,482	net equity of households
9	–	72	–	2	–	1,936	–	626	–	3,999	3,999	prepayments and other claims
272	**–4,461**	**1,867**	**854**	**–1,272**	**548**	**746**	**3,781**	**5,687**	**8,570**	**44,769**	**44,769**	**Other accounts receivable/payable**
–	–	–	–	–	–	621	–	5,687	8,570	45,300	45,300	Trade credits
272	–4,461	1,867	854	–1,272	548	125	3,781	–	–	–531	–531	Other
831	**31,155**	**5,423**	**14,996**	**5,813**	**–1,892**	**106,944**	**32,735**	**43,228**	**40,839**	**476,822**	**476,822**	**Total**

BANK INTEREST RATES (1)

	Deposits (2)						Loans (2)		New medium & long-term loans to enterprises (6)	New medium & long-term loans to consumer households (6)	ABI prime rate (7)
	Average: current accounts	Overall average	Maximum (3)	Certificates of deposit: Overall average	Certificates of deposit: Maturities up to 6 months	Certificates of deposit: Maturities from 18 to 24 months (4)	Short-term average	Lowest short-term (5)			
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
1999	1.18	1.61	2.73	4.23	2.32	2.62	5.58	2.94	4.46	5.66	5.86
2000	1.65	1.84	3.87	3.81	2.95	3.48	6.26	3.92	5.44	6.26	7.29
2001	1.87	1.96	4.33	3.62	3.26	3.52	6.53	4.41	5.47	6.67	7.75
2002	1.37	1.43	3.31	2.88	2.50	2.92	5.78	3.47	4.74	5.83	7.31
2001 – Jan.	2.08	2.19	4.68	3.89	3.50	3.77	6.84	4.72	5.95	6.92	8.00
Feb.	2.05	2.16	4.60	3.86	3.50	3.69	6.80	4.75	6.12	6.99	8.00
Mar.	2.08	2.18	4.63	3.82	3.52	3.70	6.76	4.72	5.74	6.94	8.00
Apr.	2.08	2.17	4.61	3.77	3.55	3.74	6.72	4.69	5.90	6.88	8.00
May	2.03	2.11	4.56	3.70	3.48	3.69	6.69	4.69	5.84	6.91	7.88
June	1.97	2.04	4.49	3.62	3.43	3.67	6.61	4.62	5.46	6.75	7.88
July	1.96	2.03	4.44	3.58	3.40	3.66	6.59	4.55	5.45	6.63	7.88
Aug.	1.93	2.00	4.41	3.56	3.35	3.61	6.54	4.51	5.52	6.89	7.88
Sept.	1.81	1.89	4.24	3.53	3.24	3.54	6.48	4.35	5.15	6.62	7.50
Oct.	1.60	1.69	3.97	3.47	2.94	3.22	6.29	3.99	4.94	6.39	7.50
Nov.	1.50	1.59	3.77	3.37	2.73	3.06	6.10	3.78	4.77	6.25	7.25
Dec.	1.38	1.47	3.53	3.27	2.55	2.92	5.91	3.59	4.74	5.87	7.25
2002 – Jan.	1.37	1.45	3.43	3.15	2.55	2.87	5.84	3.51	4.59	6.00	7.25
Feb.	1.36	1.44	3.36	3.05	2.54	2.92	5.81	3.47	4.81	5.98	7.25
Mar.	1.36	1.44	3.34	2.98	2.54	2.97	5.77	3.47	4.75	5.91	7.25
Apr.	1.39	1.45	3.32	2.92	2.53	2.99	5.76	3.48	4.73	5.94	7.25
May	1.40	1.46	3.32	2.88	2.55	3.07	5.76	3.50	4.80	5.92	7.25
June	1.42	1.47	3.33	2.86	2.55	3.13	5.79	3.53	4.79	5.87	7.25
July	1.43	1.48	3.34	2.85	2.55	3.14	5.81	3.51	4.89	5.75	7.38
Aug.	1.40	1.45	3.33	2.83	2.53	3.02	5.79	3.50	4.93	6.08	7.38
Sept.	1.38	1.44	3.31	2.81	2.49	2.86	5.76	3.50	4.81	5.79	7.38
Oct.	1.34	1.39	3.26	2.79	2.47	2.75	5.79	3.47	4.67	5.71	7.38
Nov.	1.35	1.39	3.25	2.75	2.43	2.69	5.77	3.45	4.67	5.66	7.38
Dec.	1.25	1.30	3.13	2.72	2.32	2.59	5.66	3.28	4.42	5.36	7.38
2003 – Jan.	1.15	1.20	2.96	2.66	2.15	2.40	5.54	3.15	4.40	5.50	7.38
Feb.	1.12	1.18	2.87	2.58	2.09	2.27	5.47	3.03	4.30	5.47	7.38
Mar.	1.05	1.11	2.76	2.49	1.96	2.07	5.31	2.89	4.23	5.33	7.38
Apr.	0.98	1.03	2.62	2.40	1.84	1.96	5.17	2.74	4.11	5.25	7.38

(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. – (3) Rate applied to the last decile of freely available deposits in lire (and from January 1999 onwards, also in other euro-area currencies) on current and savings accounts ranked according to the interest rate. – (4) Average issue rate of fixed-rate CDs in lire (and from January 1999 onwards, also in other euro-area currencies) with an original maturity of between 18 and 24 months. – (5) Rate applied to the first decile of short-term loans in lire (and from January 1999 onwards, also in other euro-area currencies) to enterprises ranked according to the interest rate. – (6) The rates are reported only for the last 10-day period of each month. – (7) The monthly data are end-of-period data.

Table a30

CREDIT RISK INDICATORS (1)

(end-of-period data; amounts in millions of euros and percentages)

	Loans (1)	As a ratio to loans (1)				Adjusted bad debts / Accounting bad debts
		Non-performing loans		Adjusted bad debts	New bad debts (2)	
			of which: bad debts			
			Banking system			
2000	913,092	7.8	5.7	6.2	1.0	108.5
2001	973,859	6.7	4.7	5.0	0.9	107.6
2002	1,028,728	6.5	4.5	4.8	1.0	106.6
			Limited company banks *(società per azioni)*			
2000	782,522	8.1	6.0	6.6	1.1	108.7
2001	829,274	6.8	4.9	5.3	0.9	107.6
2002	862,943	6.6	4.7	5.0	1.0	106.5
			Cooperative banks *(banche popolari)*			
2000	87,337	4.9	3.2	3.5	0.8	107.4
2001	96,249	4.9	3.0	3.3	0.8	107.9
2002	108,901	5.5	3.6	3.9	0.9	106.6
			Mutual banks *(banche di credito cooperativo)*			
2000	43,234	8.3	4.4	4.6	0.9	104.9
2001	48,335	8.0	4.2	4.4	0.9	106.0
2002	56,884	6.8	3.2	3.5	0.9	107.6
			Major, large and medium-sized banks			
2000	686,876	7.3	5.3	5.7	1.1	108.7
2001	716,004	6.0	4.0	4.3	0.9	107.8
2002	734,139	6.2	4.2	4.5	1.0	106.3
			Other banks			
2000	226,215	9.3	7.0	7.5	1.0	108.1
2001	257,855	8.5	6.4	6.9	0.9	107.3
2002	294,589	7.3	5.2	5.6	0.9	107.1
			Banks based in the Centre or North			
2000	864,091	7.1	5.1	5.6	1.0	109.8
2001	924,139	6.1	4.1	4.5	0.9	108.7
2002	980,172	6.1	4.2	4.5	1.0	107.3
			Banks based in the South			
2000	49,001	20.1	16.4	16.6	1.7	101.6
2001	49,720	17.9	15.0	15.3	1.4	101.9
2002	48,556	13.8	11.2	11.3	1.1	100.9

(1) Gross of bad debts and unpaid and protested bills. – (2) Percentage ratio of loans newly classed as bad debts to performing loans in the previous year, net of adjusted bad debts.

Table a31

CONSOLIDATED INCOME STATEMENT:
CONTRIBUTION OF OPERATIONS TO SUPERVISORY CAPITAL (1)
(millions of euros)

	Banking system				
	Classification by size			Classification by geographical area	
	Main banking groups	Rest of the system		Centre and North	South
			Net interest income		
2000	20,994	14,769	35,763	34,418	1,345
2001	22,358	16,822	39,180	38,159	1,021
2002	22,613	17,628	40,241	39,214	1,027
			Non-interest income		
2000	18,338	9,848	28,186	27,757	429
2001	16,826	9,654	26,480	26,137	343
2002	14,194	9,323	23,517	23,190	327
			Gross income		
2000	39,332	24,617	63,949	62,175	1,774
2001	39,184	26,476	65,660	64,296	1,364
2002	36,807	26,951	63,758	62,404	1,354
			Operating expenses		
2000	22,233	14,568	36,801	35,629	1,172
2001	22,811	15,983	38,794	37,885	909
2002	22,152	16,662	38,814	37,862	952
			Operating profit		
2000	17,099	10,049	27,148	26,546	602
2001	16,373	10,493	26,866	26,411	455
2002	14,655	10,289	24,944	24,542	402
			Non-recurring items (net) and allocations to provisions		
2000	553	500	1,053	1,013	40
2001	1,914	1,351	3,265	3,233	32
2002	2,541	1,272	3,813	3,782	31
			Loan losses		
2000	4,643	2,175	6,818	6,553	265
2001	6,522	2,295	8,817	8,664	153
2002	6,555	2,575	9,130	9,024	106
			Taxes		
2000	4,857	2,921	7,778	7,648	130
2001	3,074	2,799	5,873	5,774	99
2002	2,352	2,585	4,937	4,839	98
			Dividends		
2000	3,104	1,374	4,478	4,448	30
2001	2,063	990	3,053	3,030	23
2002	2,020	1,274	3,294	3,269	25
			Allocations to supervisory capital		
2000	3,943	2,948	6,891	6,775	116
2001	2,801	2,859	5,660	5,538	122
2002	1,187	2,442	3,629	3,499	130
			ROE *(percentages)*		
2000	17.1	9.7	12.9	13.4	3.2
2001	12.5	6.4	9.1	9.2	4.3
2002	6.0	6.8	6.4	6.5	4.5

(1) Consolidated data for banking groups and data on a solo basis for banks not belonging to a group.

SUPERVISORY CAPITAL AND SOLVENCY RATIO (1) (2)

(end-of-period data; amounts in millions of euros)

	Primary capital	Supplementary capital		Supervisory capital	Solvency ratio (percentages)	Excess capital	Capital shortfalls	
			of which: subordinated liabilities (3)				Number of banks	Amount
				Banking system				
2000	91,419	33,021	27,900	118,607	10.1	25,480	3	9
2001	97,445	39,181	34,286	129,229	10.4	31,742	6	550
2002	98,923	40,315	36,131	134,519	11.2	39,702	6	176
				Main banking groups				
2000	42,184	22,025	19,491	61,051	8.7	4,826	–	–
2001	46,164	25,689	24,136	66,787	9.3	10,092	–	–
2002	48,655	26,614	24,871	72,474	10.6	18,567	–	–
				Banks and banking groups based in the Centre or North				
2000	87,808	32,629	27,653	114,705	10.0	23,432	1	8
2001	94,471	38,908	34,104	125,996	10.3	29,950	3	536
2002	95,898	40,048	35,967	131,229	11.1	37,866	5	175
				Banks and banking groups based in the South				
2000	3,611	392	247	3,901	16.8	2,047	2	1
2001	2,974	273	183	3,233	17.8	1,792	3	14
2002	3,025	268	164	3,290	18.1	1,836	1	2

(1) Consolidated data for banking groups and data on a solo basis for banks not belonging to a group. – (2) Excludes the Italian branches of foreign banks. – (3) Includes innovative and hybrid capital instruments.

LIST OF ABBREVIATIONS

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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

CTE – *Certificati del Tesoro in ECU*
Treasury certificates in ecus

CTO – *Certificati del Tesoro con opzione*
Treasury option certificates

CTZ – *Certificati del Tesoro* zero-coupon
Zero-coupon Treasury certificates

IACP – *Indice armonizzato dei prezzi al consumo*
Harmonized index of consumer prices

ICI – *Imposta comunale sugli immobili*
Municipal real estate tax

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 2002

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

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Vincenzo CATAPANO	– Legal research (general counsel)
Carlo TRESOLDI	– Payment system and treasury operations
Giancarlo MORCALDO	– Economic research
Mario MELONI	– Organization and logistics
Angelo DE MATTIA	– Governor's secretariat
Anna Maria GIANNONI	– Note issue
Antonio Pasquale SODA	– Accounting and control (accountant general)