BANCA D'ITALIA

ORDINARY GENERAL MEETING OF SHAREHOLDERS

HELD IN ROME ON 31 MAY 2004

ABRIDGED REPORT FOR THE YEAR 2003

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THE INTERNATIONAL ECONOMY

Developments during the year

World economic activity gathered pace from the middle of 2003 as international political tensions eased, and monetary and fiscal policies remained highly expansionary. The acceleration of the US economy and the continuation of the exceptional growth in China fostered a strong recovery in international trade in the second half of the year. Although the revival of activity gradually spread to all areas of the globe, its strength differed between countries and areas. External imbalances grew more pronounced, with the US balance-of-payments deficit on current account widening even further. As a result, the dollar came under additional downward pressure. The depreciation of the US currency was contained by action on the part of authorities in numerous countries to counter the appreciation of their own currencies and accumulate dollar reserves. However, the euro, the pound and the Swiss franc appreciated significantly against the dollar. Despite the accommodating stance of monetary policies and the recovery in economic activity, inflation tended to decline from its already low level, prompting concern about deflation in some countries.

The financial markets began to recover in the spring, stimulated by abundant liquidity and the improvement in the growth prospects of the world economy. Share prices staged a strong recovery on all markets; in the United States and Japan they were boosted by a significant increase in profits. Risk premiums on corporate bonds and those of the emerging countries fell to particularly low levels.

World output grew by an average of 3.9 per cent in 2003 (compared with 3 per cent the previous year), in line with the potential rate estimated by the IMF. Growth in world trade increased from 3.1 to 4.5 per cent. As in 2002, trade growth mainly benefited the Asian countries, whose exports expanded by about 12 per cent. By contrast, euro-area exports stagnated, in response to the appreciation of the euro. Trade growth was weak in the first half but strengthened in the third and above all the fourth quarter; indicators point to a further acceleration in 2004.

In the first few months of 2003 oil prices were affected by the uncertainty over the Iraq crisis. Subsequently, they were influenced mainly by the world economic recovery. The weakness of the dollar helped to keep prices high. Over the year, oil prices averaged close to $30 a barrel, an increase of about 16 per cent with respect to 2002. In 2004 the strengthening of world economic activity, the decision by the OPEC countries to cut oil production and mounting tensions in the Middle East pushed prices up to $39 a barrel at the end of the second ten days of May. Metal prices, which are mainly quoted in dollars, also increased significantly. Demand from China was one factor in the rise. As a ratio to the international prices of manufactures, the increases are similar in magnitude to those seen in previous recoveries.

In 2003 the GDP of the emerging economies expanded by more than 6 per cent, compared with 4.6 per cent in 2002, although there were significant differences among regions. Growth was strong in China, India and the former Soviet Union. In Africa it increased from 3.5 to 4.1 per cent and per capita GDP gained about 2 per cent. After stagnating in 2002 output in Latin America began to expand again, increasing by 1.7 per cent. Most of the rise is attributable to the recovery in Argentina, although this only partially offset the sharp drop in activity in the previous four years. In Brazil, economic activity slackened in the first part of the year owing to the highly restrictive stance of economic policy; the recovery in world trade and the improvement in financial conditions fostered a revival of growth in the final months of the year. In the ten countries of Central and Eastern Europe and the Mediterranean that joined the European Union on 1 May 2004, the stimulus of domestic demand produced GDP growth of 3.6 per cent, compared with 2.4 per cent in 2002.

The United States

In 2003 GDP growth quickened from 2.2 to 3.1 per cent, nearly a percentage point more than the forecasts made a year ago. Activity accelerated in the second half of the year, buoyed by the stimulus of economic policy. In June fears of a further decline in inflation, which had already fallen to very low levels, prompted the Federal Reserve to lower the federal funds target rate to 1 per cent, the lowest level since the Second World War. Real short-term interest rates were negative by about 1 percentage point last year.

Budgetary policy also imparted a strong impulse to demand: in fiscal 2003 the federal government budget deficit expanded by 2 percentage points to 3.5 per cent of GDP; the deterioration came on top of that registered between 2000 and 2002, which amounted to nearly 4 points of GDP. The main factor in the widening of the deficit was the tax cuts approved in 2001 and 2003. Their effect was compounded by higher defence and homeland security spending since September 2001. Some of the measures already approved will have an impact in 2004 as well; recent Administration forecasts put the deficit at 4.5 per cent of GDP for this fiscal year.

US firms have exploited the efficiency gains and flexibility of production permitted by new information and communication technologies to achieve especially rapid productivity growth in the last two years. The gains have made it possible to meet rising demand while reducing the use of labour. Between 1996 and 2003, the average annual increase in labour productivity was 3 per cent, double the 1.5 per cent rate registered over the previous two decades. In the coming years the potential growth rate of the US economy could rise above its current estimated level of 3.5 per cent.

The substantial increases in productivity, together with moderate wage growth and gradually strengthening demand, fostered a recovery in the profitability of non-financial corporations, which had been considerably eroded in 2000 and 2001. The growth in profits and favourable financial conditions created scope for an upturn in investment, especially in high-tech capital equipment. However, the drastic industrial and financial restructuring of firms had an adverse impact on the labour market. Employment, which began to decline in early 2001, continued to fall until August of 2003. Signs of improvement emerged in the following month, but only since the start of 2004 has the rate of job creation returned to the level seen in previous recoveries. Despite the softness of labour market conditions, consumption continued to expand rapidly, sustained by the tax cuts enacted in May 2003, the rise in household wealth and the increased spending capacity generated by mortgage refinancing.

The divergence between the growth in domestic demand in the US and in the other main industrial countries and in some emerging economies more than offset the positive balance-of-payments impact of the increased competitiveness of US products. The deficit on current account widened to nearly 5 per cent of GDP, the largest since the end of the Second World War. The external imbalance had already deteriorated by nearly three percentage points between 1997 and 2000 in the wake of the exceptional growth in investment in information and communication technology. During that period, the large inflows of private capital, especially for portfolio investment, easily exceeded the amount needed to finance the current account deficit. Such inflows have diminished in the last two years; at the same time there has been an increase in purchases of US Treasury bonds by foreign authorities, especially by China and other Asian countries, which accumulated reserves to counter the appreciation of their currencies against the dollar.

Partly as a result of these strategies, the dollar depreciated in effective terms by only 10 per cent with respect to its level in February 2002. At the conclusion of their meeting at Boca Raton on 7 February 2004 the G7 Finance Ministers and Central Bank Governors called for greater flexibility of currencies that had not yet appreciated against the dollar in order to facilitate the gradual adjustment of external imbalances around the world. The statement, whose substance has been reaffirmed at recent Washington meetings, helped stabilize the exchange rate between the dollar and the euro; in fact the dollar actually strengthened slightly in subsequent weeks.

Asia

In Japan the expansion that began in 2002 under the impulse of the recovery in exports to other Asian countries continued last year at a pace even faster than had been expected. In 2003 GDP grew by 2.5 per cent, compared with a contraction of 0.3 per cent the previous year. Economic activity was driven not only by exports, which expanded at twice the rate of world trade, but also by private investment. The recovery in capital formation after a decade of stagnation was fostered by stronger foreign demand and an increase in corporate profitability, especially at large manufacturing firms, which thanks to restructuring begun in the late 1990s significantly reduced the large debt burden from the level reached in the early part of the decade. The climate of confidence among firms operating in sectors less exposed to international competition has also improved recently, confirming that the recovery in activity is spreading to the entire economy. The improvement in economic conditions has facilitated efforts to strengthen banks' balance sheets; profits were higher than expected and bad debts decreased significantly. Nevertheless, the divide between the sounder large banks and their regional counterparts, whose financial condition remained fragile, widened further.

Despite the gradual strengthening of economic activity, the decline in prices continued in 2003, albeit at a slower pace. The Bank of Japan accentuated its strategy of providing abundant liquidity and keeping nominal short-term interest rates close to zero. The quantity target adopted in March 2001, based on the balance of financial institutions' current accounts with the central bank, was raised repeatedly during the year. Large-scale intervention in the foreign exchange market to stem the appreciation of the yen helped to maintain expansionary monetary conditions, keeping long-term rates very low. Fiscal policy also remained expansive. According to the OECD, in 2003 the cyclically adjusted budget deficit increased by half a percentage point to 7.5 per cent of GDP. The ratio of gross debt to GDP exceeded 150 per cent, the highest in any industrial country.

After a temporary slowdown in connection with the SARS epidemic, the emerging Asian countries returned to rapid growth in the second half of the year, thanks in part to surging domestic demand. China's output, which accounts for more than 45 per cent of regional GDP and 13 per cent of world GDP, grew by 9.1 per cent, reflecting the exceptional expansion of investment. Chinese imports again provided essential support to growth in the other Asian economies.

The outlook

IMF projections released in April indicate growth rates in 2004 of 4.6 per cent for world GDP and 6.8 per cent for world trade, higher than the averages for the 1990s. These forecasts must be judged as conservative, on the whole. At its meeting at the end of March 2004, the Financial Stability Forum emphasized that the progress made in restoring corporate financial health in most countries was an important factor in the recovery.

Although growth has strengthened in all areas of the world, the pace of the recovery will differ. The United States and China are expected to continue to drive the global economy. In the main industrial countries GDP is forecast to grow by 3.5 per cent, compared with 2.2 per cent in 2003. In the United States output is expected to expand by 4.6 per cent, the highest rate since 1984, under the ongoing impulse of expansionary economic policies. In Japan growth is projected to pick up to 3.4 per cent thanks to the continuing contribution of exports. In the euro area, output is expected to increase by a modest 1.7 per cent, still below potential. Economic activity in the emerging economies as a group is expected to accelerate, while divergences in growth rates between areas should narrow. In Asia, which accounts for a quarter of world output, economic activity is set to expand by about 7 per cent thanks mainly to China (8.5 per cent) and India (6.8 per cent). In the countries of Central and Eastern Europe and the Mediterranean that have just joined the European Union, growth is forecast to rise to 4 per cent; in Russia it is expected to ease slightly, to 6 per cent. In Latin America growth should strengthen considerably, rising to nearly 4 per cent, primarily reflecting an acceleration in Brazil and Mexico. Output in sub-Saharan Africa is also expected to expand rapidly (4.2 per cent), implying per capita GDP growth of about 2 per cent in the region.

Performance in the first few months of the year substantiates these forecasts. In the first quarter GDP grew at an annualized rate of 4.4 per cent in the United States, which although slightly below expectations confirms the robustness of the American recovery. The main stimulus came from consumption, sustained by the increase in employment. Although decelerating, investment in advanced capital equipment continued to expand rapidly. The recent upward pressure on prices signals a rapid exhaustion of unused capacity and suggests that the current level of real interest rates could soon be incompatible with the continuation of non-inflationary growth. Additional inflationary pressures could emerge if oil prices remain high; they are currently 30 per cent above those assumed in the reference scenario (an average of $30 a barrel in 2004).

In a statement issued in early May the Federal Reserve intimated that it might adjust its monetary policy stance relatively soon. Partly in relation to the sharp increase in employment registered in April, which exceeded analysts' expectations, the markets now discount an initial rate increase at the next meeting of the Federal Open Market Committee, set for the end of June. Anticipating a reversal of monetary policy, long-term yields have risen by about 100 basis points in recent weeks, albeit from a low level. The increase should not pose a serious threat to the recovery. The debt of US consumers is mainly long-term and fixed-rate, while firms can count on strong profitability to meet any increase in financing costs.

Preliminary estimates for the euro area show annualized GDP growth of 2.3 per cent in the first quarter of 2004. This was surprisingly fast, especially in view of the weak performance of industrial production. In Japan, output grew by 6.1 per cent on an annual basis; in the light of this very strong performance, the IMF raised its growth forecast for 2004 to about 4 per cent. In China, GDP grew at an exceptionally rapid rate (9.7 per cent on the corresponding period of 2003), prompting the authorities to take action to slow investment growth, which threatens to cause the economy to overheat and to create excess capacity in some sectors.

RECENT DEVELOPMENTS AND ECONOMIC POLICIES

Economic developments in the United States, Japan and the United Kingdom

The United States. – Economic activity, which had been recovering since November 2001, surged in the second half of 2003, benefiting from the continuation of expansionary monetary and fiscal policies. GDP growth picked up from an annualized rate of 2.1 per cent in the first half of the year to 5.9 per cent in the second as a consequence of accelerating consumption and private investment and a recovery in exports (Table 1). Labour productivity continued to increase very rapidly in 2003; the rise in the non-farm private sector was 4.4 per cent. The improvement helped to restore high profitability and keep inflation relatively subdued.

Household consumption expanded rapidly (3.1 per cent, slightly less than in 2002), sustained by the gain of 2.7 per cent in real disposable income, of which about 40 per cent stemmed from tax cuts and increased government transfers. In the first half of the year consumption was also supported by higher household borrowing in connection with substantial mortgage renegotiations prompted by the further decline in long-term interest rates. Consumer spending was subsequently buoyed by the improvement in households' finances thanks to the recovery in share prices and the continued rise in real estate prices. Good borrowing terms caused household debt to increase from 102 to 108 per cent of disposable income; the rise in housing demand fueled residential investment, which increased by 7.5 per cent in 2003 as a whole.

Capital formation by business increased by 3 per cent after having contracted by a total of 11.3 per cent in the previous two years. Investment was driven by spending on information and communication technology, which expanded by 13.8 per cent. During the prolonged expansion in the 1990s, such investment had grown by an annual average of about 18 per cent. It is likely that the recovery in demand also reflects the replacement of the capital formed by the end of the last decade in view of the rapid obsolescence of these technologies compared with more traditional forms of investment. Other investment continued to contract, although the decline in investment in plant was much smaller than in 2002.

The upturn in capital formation was mainly driven by the recovery in profits. The profits of non-financial corporations as defined by the national accounts rose by 34 per cent in 2003, continuing the positive performance begun in 2002 after two years of substantial decline. The rise in self-financing, in the presence of the still moderate increase in investment and the recovery in share prices, enabled firms to reduce their financial leverage. The latter, measured as the ratio of debt to the sum of debt and equity at market prices, fell from 39.5 per cent in mid-2002 to 32.8 per cent at the end of last year.

Table 1

GROSS DOMESTIC PRODUCT AND COMPONENTS OF DEMAND IN THE LEADING INDUSTRIAL COUNTRIES

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

	2002	2003	2003				2004
			Q1	Q2	Q3	Q4	Q1
United States							
GDP	2.2	3.1	2.0	3.1	8.2	4.1	4.4
Household consumption (1)	3.4	3.1	2.5	3.3	6.9	3.2	3.9
General government expenditure (2)	3.8	3.3	–0.4	7.4	1.8	–0.1	2.9
Gross fixed private investment	–3.7	4.4	1.1	6.1	15.8	9.9	5.1
Change in stocks (3)	0.4	..	–0.7	–0.2	–0.1	0.7	0.8
Net exports (3)	–0.7	–0.4	0.8	–1.3	0.8	–0.3	–0.4
Japan							
GDP	–0.3	2.5	0.2	3.8	2.7	7.3	6.1
Household consumption (1)	0.9	0.8	–0.4	0.8	2.5	4.3	4.0
General government expenditure	2.4	1.0	1.1	–0.7	2.5	1.5	1.5
Gross fixed private investment	–6.2	3.1	3.0	8.2	–3.0	17.0	2.7
Change in stocks (3)	–0.3	0.3	–0.6	0.2	0.9	–1.0	2.0
Net exports (3)	0.7	0.7	0.1	1.2	0.7	1.5	1.0
Euro area							
GDP	0.9	0.5	..	–0.3	1.7	1.5	....
Household consumption (1)	0.5	1.0	1.7	–0.3	0.5	0.5	....
General government expenditure	3.0	2.0	1.8	2.3	2.8	1.6	....
Gross fixed private investment	–2.8	–0.8	–2.9	–1.1	0.2	2.3	....
Change in stocks (3) (4)	0.1	0.3	1.0	0.1	–0.8	1.9	....
Net exports (3)	0.5	–0.7	–1.8	–0.5	1.6	–1.4	....
United Kingdom							
GDP	1.6	2.2	1.1	2.4	3.4	3.7	....
Household consumption (1)	3.4	2.5	0.1	3.0	3.6	3.5	....
General government expenditure	2.5	1.8	3.9	0.5	0.7	7.8	....
Gross fixed private investment	1.8	2.9	–7.7	5.5	8.0	10.0	....
Change in stocks (3) (4)	–0.2	..	–0.6	–2.0	1.0	0.1	....
Net exports (3)	–1.3	–0.3	2.4	1.4	–1.5	–1.9	....

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 rise in profitability in a highly competitive environment is attributable to the rapid growth in labour productivity over the last two years; in the non-farm business sector productivity improved by 5 per cent in 2002 and 4.4 per cent in 2003. With wage growth moderate, unit labour costs fell by 2.5 and 1 per cent respectively.

One element of weakness within the overall strengthening of economic activity was the continuing decline in non-farm payroll employment, with a loss of 307,000 jobs in the first eight months of 2003, in contrast to the pattern recorded in previous cyclical recoveries. The slowness of labour market conditions to improve can be ascribed to the restructuring carried out by firms in 2001, which generated large productivity gains. Following a gradual recovery between September and December 2003, with payrolls expanding by 246,000, employment growth accelerated in the first four months of this year to produce another 867,000 jobs. The increase since last September reflects the stabilization of employment in manufacturing and an expansion in the service sector.

After peaking at 6.3 per cent in June, the unemployment rate fell to 5.7 per cent in December, where it settled in the first four months of 2004. Part of the fall reflected a decline in the labour market participation rate from 66.5 to 65.9 per cent.

In the first part of 2003, against a background of moderate growth in economic activity and considerable spare capacity, inflation fell to an especially low level. In April and May prices decreased, raising fears of deflation. The subsequent acceleration in activity and the rise in the price of oil quickly dispelled that risk. Instead, upward pressure on prices had already emerged at the start of 2004, and it was strengthening in April and May. In 2003 the 12-month rate of consumer price inflation excluding food and energy products fell from 1.9 per cent in January to 1.1 per cent in December; over the same period the rise in the general price index eased from 2.6 to 1.9 per cent, despite higher energy prices. Since the start of this year, core inflation has turned upwards, reaching 1.8 per cent in April. The rate of decline in the prices of manufactures diminished, reflecting the progressive pass-through of higher energy costs.

In the first quarter of 2004 economic activity continued to expand rapidly (4.4 per cent on an annualized basis) under the impulse of consumption. The recovery in investment continued, although at a slower pace than in the second half of 2003. The rise in consumption was sustained by an acceleration in wages and salaries. Capital accumulation continued to be driven almost entirely by investment in information and communication technology. Boosted by defence spending, public expenditure made a significant contribution to growth.

Based on the provisional results for the first quarter, if growth were to stall in the next three quarters GDP for the year would be 3.1 per cent higher than in 2003. Similarly, labour productivity in the non-farm business sector, which increased rapidly in 2003 and posted a further annualized rise of 3.5 per cent in the first quarter of 2004, would be up by 2.8 per cent year-on-year even if it were to remain unchanged for the next three quarters.

Japan. – Economic activity in Japan, which has been recovering since the second half of 2002 under the impulse of exports, strengthened in 2003, sustained by the expansion in investment. Output increased by a surprising 2.5 per cent, the fastest rate since 1996. All of the components of demand made a positive contribution to growth. The largest came from investment and the external sector, at 0.8 and 0.7 percentage points respectively; private consumption contributed 0.5 points.

Export growth, which accelerated from 8 to 10.1 per cent in 2003, was fueled by demand in other Asian countries, especially China. The largest increases came in information and communication technology (12.9 per cent) and other capital goods (17.1 per cent).

Corporate investment, which had stagnated in the 1990s, began to rise in the second quarter of 2002 after two years of contraction. In 2003 private non-residential investment increased by 9.3 per cent, while residential investment was virtually unchanged; public investment declined. Overall, fixed capital formation increased by 3.1 per cent.

The recovery in private investment was stimulated by the improvement in corporate profitability, which was partly attributable to the restructuring of production carried out in the late 1990s. Between 1997 and 2003 there was a decrease more than 2 million payroll jobs; the use of more flexible employment contracts spread; personnel costs decreased by 6 per cent. Profits at non-financial corporations, which had fallen in the two previous years, increased by an average of 12 per cent in 2003.

Firms' financial situation also improved. During the 1990s they reduced their recourse to new liabilities, partly in connection with the sharp slowdown in investment. Since 1998 they have had a positive net financial position, which has helped reduce the large debt burdens accumulated in the second half of the 1980s.

Despite a worsening decline in working households' real disposable income (down 2.2 per cent, after a 1.3 per cent decrease in 2002), private consumption continued to increase, albeit slowly (0.8 per cent in 2003). Consumption has increased more than disposable income, significantly reducing the household saving rate since the end of the 1980s. One of the highest among the industrial countries in that decade, the rate is now just over 6 per cent, lower than in Germany, France and Italy.

The strengthening of consumption in the second half of 2003 reflected the improvement in household confidence and the stabilization of employment, which declined by just 0.2 per cent for the year, compared with a contraction of 1.3 per cent in 2002. Owing to the concomitant reduction in the labour force the unemployment rate averaged 5.3 per cent, similar to the level in 2002.

In 2003 the decline in consumer prices gradually slowed from 0.9 to 0.3 per cent and that in producer prices from from 2.1 to 0.8 per cent.

In the first quarter of 2004 economic activity continued to expand at a rapid annual rate of 6.1 per cent, led by all the main components of demand. The Tankan survey conducted in March found that large and medium-sized manufacturing firms expect to increase investment significantly (by 7.8 and 9.3 per cent respectively) in the new fiscal year, which began in April.

United Kingdom. – In the United Kingdom economic activity gathered pace over the course of 2003, accelerating from year-on-year growth of 1.6 per cent in 2002 to 2.2 per cent. Domestic demand was buoyed by private consumption, which expanded at an annualized rate of 3.4 per cent in the second half of the year, and the continuation of growth in residential investment (10.1 per cent). Household spending on durables and housing was financed not only by an increase in disposable income but also by a sharp rise in debt.

Employment rose by about 1 per cent in 2003, mainly attributable to the increase in self-employment. The unemployment rate fell below 5 per cent in the final months of the year, its lowest level since 1975, but wage growth remained subdued.

Consumer price inflation excluding mortgage interest, which until last December was the monetary policy target variable, fell from 3 per cent in February 2003 to 2 per cent in April 2004.

Economic policies in the United States, Japan and the United Kingdom

Monetary policies. – In the United States, amidst uncertainty about the strength of the recovery, at the end of May 2003 the Federal Reserve modified its assessment of risks, assigning greater weight to a further decline in inflation from its already low level. On 25 June the Fed lowered its target for the federal funds rate by 0.25 points to 1 per cent. Since the final months of 2003, as with the pick-up in economic activity, the Fed has significantly attenuated the emphasis on the risk of deflation in its statements, making a restrictive turn in the monetary policy stance seem more and more likely. At the start of May 2004 the Federal Open Market Committee judged the upside and downside risks to price stability to be equal and intimated that the tightening of monetary conditions would be gradual.

At the end of March 2004 the yield curve implied by futures contracts indicated that investors expected an initial increase of 0.25 points in the target rate in the last quarter of the year. The rise in payroll employment in the first few months of 2004, announced at the beginning of April, prompted the markets to revise their expectations concerning the timing of a monetary restriction, fostering a rapid increase in yields on long-term corporate and government bonds and in mortgage interest rates. The yield curve implicit in futures contracts shifted progressively upwards, signaling that investors were now discounting an increase of 0.25 points in the target rate in June.

In Japan the continuing decline in consumer prices, albeit at a more moderate pace, prompted the Bank of Japan to intensify measures to expand liquidity in order to bring inflation back above zero and keep it there. The target for financial institutions' current account balance with the central bank was raised repeatedly from ¥15-20 trillion at the end of 2002 to ¥30-35 trillion in January 2004. The overnight rate remained close to zero.

Monetary base continued to expand rapidly in 2003 (13.5 per cent). A contributory factor was the central bank's incomplete sterilization of the substantial purchases of dollars that it carried out in order to counter the appreciation of the yen. However, the growth of the broad monetary aggregate (M2 + CDs) remained slow; the 12-month rate of change of 1.5 per cent registered in 2003 did not change significantly in the first few months of 2004. Credit to the private sector, even including written-off uncollectible claims, continued to decline, falling by 1.9 per cent in 2003.

The results of banks for the half-year from April to September, released in February 2004, were better than expected. Profits rose significantly thanks to an exceptional refund of local taxes and the good performance of the stock market. Bad loans decreased sharply; net of loan loss provisions, they totaled ¥31.6 trillion at the end of September, equal to 7.3 per cent of total lending and 1 percentage point less than a year earlier. The decline was greatest at the larger banks.

In the United Kingdom the slowdown in domestic demand in the first half of 2003 in a context of considerable uncertainty led the Bank of England to reduce its reference rate in two steps, by a total of 0.5 points, to 3.5 per cent. Monetary policy subsequently became less accommodating with a view to dampening inflation, which although in decline remained above the target level during the year, and to containing the additional risks associated with the rise in household debt. The reference rate was increased in November 2003 and in February and May 2004, to 4.25 per cent.

Fiscal policies. – In the United States the federal budget deficit in the fiscal year ending in September 2003 rose to $375 billion, equal to 3.5 per cent of GDP. The general government deficit increased to $501 billion, or 4.6 per cent of GDP. The increase of about $220 billion in the federal deficit stemmed from a decline of $71 billion in revenues, mainly attributable to personal income tax cuts approved by Congress in May 2003, and an increase of $147 billion in expenditure, over half of it associated with higher discretionary spending, largely to finance military operations in Iraq.

Developments in US public finances in 2003 continued the trend under way since the start of the decade. Between 2000 and 2003 government revenues declined from 20.9 to 16.5 per cent of GDP, while discretionary spending rose from 6.3 to 7.6 per cent. The result was a deterioration of about 6 percentage points in the budget balance, which swung from a surplus of 2.4 per cent of GDP to a deficit of 3.5 per cent. At the same time federal debt held by the public, which at the end of fiscal 2001 amounted to 33.1 per cent of GDP, the lowest level since 1983, gradually increased to 36.1 per cent at the end of fiscal 2003.

In March 2004 the Congressional Budget Office estimated that the federal deficit would rise to 4.2 per cent of GDP in fiscal 2004 as the full effects of the tax cuts and increased defence spending approved in 2003 unfold. The reduction in taxes on dividends and capital gains will have a sizeable impact.

The budget proposals for 2005-2014 presented by the Administration in February this year envisage a reduction in discretionary expenditure and the extension of the tax cuts approved between 2001 and 2003 beyond their current expiry date. The Congressional Budget Office calculates that the plan would reduce but not eliminate the deficit.

In Japan fiscal policy remained expansionary in 2003. The OECD estimates that despite faster-than-expected growth the budget deficit, including the social security balance, remained at about 8 per cent of GDP, the same as in 2002; on a cyclically adjusted basis it increased by 0.5 percentage points. At the end of 2003 gross public debt amounted to about 155 per cent of GDP, compared with 147 per cent in 2002, very high by comparison with debt levels in the industrial countries over the last 30 years.

For the fiscal year starting in April 2004 the budget law keeps overall expenditure virtually unchanged in nominal terms. The reduction, for the second year in a row, in spending on education and public investment will be offset by an increase in pension outlays, a trend that has been under way for some years in response to the ageing of the population.

In the United Kingdom too fiscal policy remained strongly expansionary. In the fiscal year ending in March 2004, the public sector deficit increased from 2.2 to 3 per cent of GDP, partly owing to an increase in current expenditure. Other factors included higher spending on public infrastructure, which has increased from 0.5 to 1.4 per cent of GDP over the last three years. Net public debt increased from 30.8 to 32.7 per cent of GDP between March 2003 and March 2004.

Developments and economic policies in the new EU member states

Economic activity in the ten countries that joined the European Union on 1 May this year strengthened on average, with growth accelerating from 2.4 per cent in 2002 to 3.6 per cent last year. The positive growth differential vis-à-vis the other EU members widened sharply. The gains were greatest in the Baltic countries, the Slovak Republic and Poland, whose living standards, gauged by per capita income, are more than 50 per cent lower than the Community average.

In 2003 the main stimulus to growth in nearly all of these countries continued to be imparted by private consumption, which expanded by more than 4 per cent in connection with rising real wages and increasing household debt. The acceleration in economic activity with respect to 2002 was mainly due to the gradual recovery in investment, which expanded by 1.9 per cent after contracting for two years. The pronounced pick-up in merchandise exports (from 6.5 to 11.7 per cent), especially in Poland and the Slovak Republic, was accompanied by an overall acceleration in imports, which expanded by 9.3 per cent. As a result, net foreign demand made a negative contribution to growth in most of these countries.

Although demand in the euro area has been virtually stagnant in the last three years, merchandise exports by the new EU members grew by an annual average of 9 per cent. These countries' gain in market shares in the euro area is attributable to the rapid improvement in the competitiveness of their economic systems thanks in part to substantial foreign direct investment since the mid-1990s.

While nearly all the new members have made significant macroeconomic progress in the last three years, their public finances remain a problem. In addition, with the robust expansion of domestic demand in recent years, they have continued to run external current account deficits (3.7 per cent of GDP in 2003 for the group as a whole).

Developments and economic policies in other emerging countries

In 2003 the emerging Asian economies once again posted strong growth despite the adverse impact of the SARS epidemic in the spring. Activity was driven by exports, especially of information technology goods, and in a number of countries by domestic demand as well. For the area as a whole (which includes the recently industrialized economies of South Korea, Hong Kong, Singapore and Taiwan) growth accelerated from 6.2 to 7.2 per cent.

In China the growth rate rose from 8 to 9.1 per cent, the highest since 1997. The expansion was fueled by a massive rise in investment (27 per cent at current prices), especially in the automobile sector, steel and construction. Trade also increased at an exceptionally rapid rate: growth in exports, which came to 35 per cent in value terms, was outpaced by the still faster expansion in imports (40 per cent). The inflow of foreign direct investment remained substantial, at about $50 billion, as in 2002. Growth accelerated even further in the first quarter of 2004, to 9.7 per cent on the year-earlier period, and investment jumped by 43 per cent in value. The sharp expansion in imports (42 per cent), together with the slight slowdown in exports (to growth of 34 per cent) caused a pronounced deterioration in the trade deficit with respect to the same quarter of 2003.

Bank credit, which expanded by 21 per cent, provided a strong boost to capital formation in 2003. A contributory factor was the abundance of liquidity, despite the authorities' efforts to sterilize the monetary base created by the build-up of official reserves. In order to absorb liquidity, the authorities tightened the monetary policy stance and took measures to improve the balance sheets of the major banks.

In India the opening of the economy to international merchandise trade and foreign direct investment continued. The strong growth in services, especially those linked to information and communication technology, and the rapid increase in agricultural output, which is the main source of income for about two thirds of the population, fostered GDP growth of 7.2 for the year as a whole, up from 4.6 per cent in 2002. Despite average output growth of 6.1 per cent over the last decade, per capita GDP calculated on a purchasing power parity basis remains comparatively low, at just over half the level of the other developing countries in the region.

Thanks in part to the increase in domestic demand, output accelerated in most of the other developing countries in the area, with growth rates ranging from 4.2 per cent in Indonesia to 6.7 per cent in Thailand. In the newly industrialized economies of Hong Kong, Singapore, South Korea and Taiwan growth diminished in 2003 despite the expansion of exports, owing to the slowdown in domestic demand.

In Latin America economic activity strengthened almost everywhere in 2003 after two years of stagnation, benefiting above all in the second half of the year from the recovery in world trade and the improvement in the terms of trade generated by the rise in the prices of raw materials, of which the area's countries are major producers. Regional GDP, which had been unchanged in 2002, expanded by 1.7 per cent last year, with growth unevenly distributed among the various countries.

THE INTERNATIONAL FOREIGN EXCHANGE AND FINANCIAL MARKETS

The weakening of the dollar that had begun in early 2002 intensified in 2003. At first this was partly a reflection of the uncertainty surrounding the timing and strength of the recovery in the United States, to some extent attributable to international political tensions, while later it was mainly connected with growing concern about the size of America's net external debt, which rose to more than 25 per cent of GDP. The depreciation was sizable against the euro and, from September onwards, also against the yen, considerably less pronounced against the currencies of other Asian countries, whose authorities countered the appreciation of their currencies with massive purchases of dollars in the foreign exchange market. In Latin America, the rise in foreign exchange reserves was mainly due to the need to build them back to the levels where they had been before the currency crises. In the first few months of this year the dollar ceased to fall against the euro, recouping considerable ground. The turnaround appears to be partly the consequence of the progressive strengthening of economic activity in the United States, set against its persistent weakness in the euro area. By contrast, the yen continued to strengthen up to the end of March.

The already strongly expansionary stance of monetary policies in the three major areas was further relaxed, fostering a large increase in global liquidity. The monetary aggregates, and narrow money in particular, grew rapidly, as did bank deposits held by non-resident households and firms. In the major economies, real short-term interest rates have been negative from the start of 2003; real long-term rates remained low until April of this year.

The abundance of liquidity and the expectations that it would persist for some time favoured portfolio reallocation by investors, who shifted funds into higher-yielding instruments, thereby helping to keep the yields on the government securities of the industrial countries at historically low levels. The reduction in risk premiums involved all financial assets and borrowers of varying quality and belonging to different geographical areas. The current and expected improvement in corporate profitability helped to boost corporate bond prices and, from the spring of last year, as international political tensions subsided, share prices as well. The prices of bonds issued by emerging countries rose as the underlying conditions of their economies improved. The reduction in mortgage lending rates buoyed house prices.

The rise in asset prices contributed in varying degree to strengthen the financial position of households, firms and financial intermediaries in the industrial countries and sovereign issuers in the emerging countries.

This upward movement of asset prices has halted since the start of this year, partly as a consequence of growing expectations of an imminent inversion of US short-term interest rates. Credit spreads have widened since January, more moderately for corporate bonds, more markedly for emerging countries' securities. The rally in equities was interrupted in February and government bond yields have increased since the middle of March.

Foreign exchange and financial markets in the industrial countries

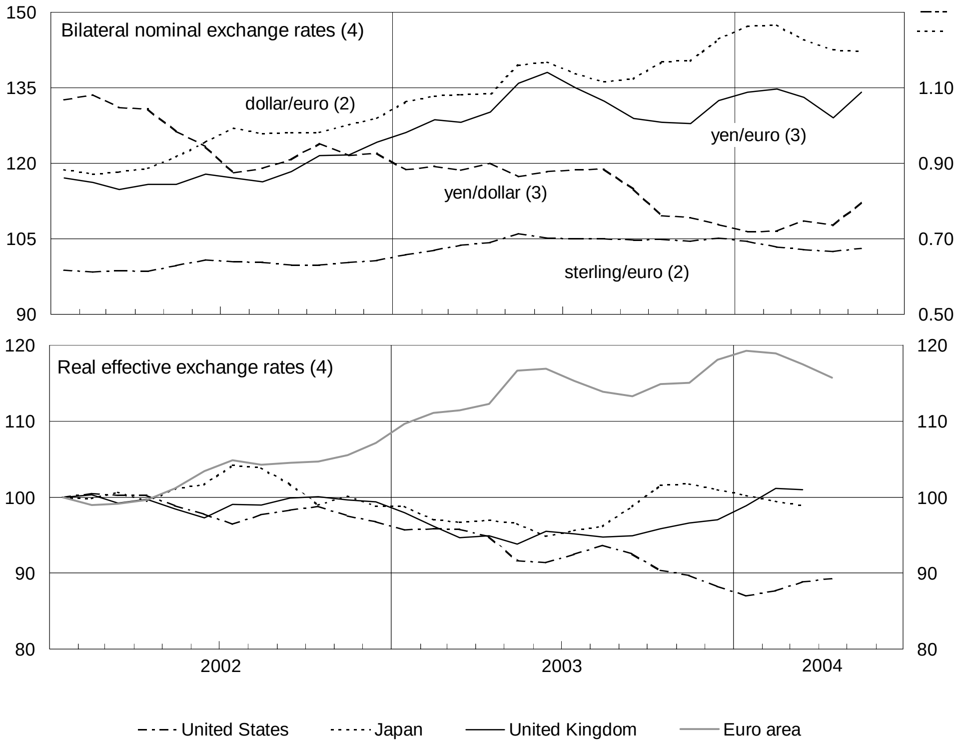
During the first half of 2003 the US dollar depreciated by 8 per cent against the euro and by between 14 and 20 per cent against the Canadian dollar, the Australian dollar and the currencies of the major Latin American countries, while it remained virtually unchanged against sterling, the yen and the currencies of the emerging Asian countries (Figure 1). The latter and Japan resisted the upward pressure on their currencies with massive intervention in foreign exchange markets; in particular, China, Hong Kong and Malaysia, among the main trading partners of the United States, kept their exchange rates pegged to the dollar.

After strengthening temporarily during the summer, between September and January 2004 the dollar weakened again, this time against the yen as well. It slid further after the finance ministers and central bank governors of the G-7 countries issued a communiqué recommending greater exchange rate flexibility in order to foster adjustment of the principal areas' external account imbalances. The dollar's fall during this period was considerable, ranging between 9 and 13 per cent, not only against the euro but also vis-à-vis sterling and the yen. By contrast, its value remained virtually unchanged against the currencies of the emerging countries of Asia and Latin America, whose authorities stepped up their purchases of dollars.

In the first two months of 2004 the dollar stabilized against the euro; on 12 January and 17 February it touched its minimum values, close to \$1.29 per euro. In the G-7 summit held in Florida on 7 February, the authorities called for greater flexibility of the exchange rates of the currencies that had not yet strengthened significantly against the dollar, and expressed concern for the excessive variability of exchange rates. In their Washington summit in April they reiterated these positions.

Figure 1

BILATERAL NOMINAL EXCHANGE RATES
OF THE MAIN CURRENCIES AND INDICATORS OF COMPETITIVENESS
(monthly averages)



Sources: Bank of Italy, ECB and Federal Reserve.

(1) Units of the first currency per units of the second; the data for May 2004 refer to the first 19 days of the month. – (2) Right-hand scale. – (3) Left-hand scale. – (4) Indices, January 2002=100, based on producer prices of manufactures for the euro area, Japan and the United Kingdom and consumer prices for the United States. A rise indicates a loss of competitiveness.

In the second half of February the dollar turned upwards against the euro, gaining 7 per cent from then to mid-May. By contrast, the downward pressure vis-à-vis the yen continued until the end of March and was countered by interventions by the Japanese authorities, whose dollar purchases from the beginning of January to the middle of March amounted to around 80 per cent of those made in 2003 as a whole. The dollar remained practically unchanged against the currencies of the emerging countries of Asia. In nominal effective terms it has appreciated by 4 per cent since January, after depreciating by 8.8 per cent in 2003.

A strong upswing began on all the main international stock markets in March 2003 and lasted until February of this year. From March 2003 and to mid-May 2004, the Dow Jones Industrial Average index gained around

32 per cent and the technology-heavy Nasdaq 100 index almost 50 per cent. Share prices benefited not only from abundant liquidity, but also, in the first half of the year, from the lessening of international tensions and, afterwards, from the improvement in the current and prospective earnings of listed companies as the cyclical upturn gathered strength, especially in the United States and Japan.

The rise in share prices was accompanied by an increase in initial public offerings and a decline in price volatility. In the United States the number of newly-listed companies rose from 9 in the first half of 2003 to 78 in the second; in the first four months of 2004 it was equal to 51. Both actual volatility and that implied by stock index options, which had been very high until the eve of the war in Iraq, decreased rapidly and have been very low since the end of 2003.

Ten-year US Treasury bond yields, which in 2002 had fallen sharply to the historically low level of 4 per cent, remained at that level on average in 2003, but with pronounced fluctuations in the middle part of the year. Massive purchases by non-residents helped to contain the yields on long-term paper; from the start of 2002 to the fourth quarter of 2003, the share of Treasury securities held by non-residents rose by more than 7 percentage points to 44.6 per cent, of which more than half was held by foreign authorities.

This year long-term yields dipped temporarily to 3.7 per cent in the first half of March, in connection with disappointing employment growth. Subsequently, they turned upwards at the first signs of a pick-up in employment and inflation. In mid-May they stood at 4.8 per cent.

In 2003 long-term yields in the United States remained low in real terms as well. Although they rose slightly in the course of the year, in April 2004 interest rates deflated with long-term inflation expectations surveyed by Consensus Forecasts stood at 2 per cent, well below the US economy's potential growth rate.

Notwithstanding the serious accounting irregularities that came to light in 2002 in the case of Enron and other high-capitalization companies and the consequent blow to confidence in the corporate governance system, investors' propensity to purchase corporate bonds was rapidly restored, thanks not least to the prompt tightening of some provisions of company law. The reduction in the risk premiums for corporate bonds that began in 2002 grew much more marked in 2003, in response not only to abundant liquidity but also to the improvement in corporate balance sheets. Compared with the peaks reached in 2002, the yield differential between bonds issued by firms rated BAA and government securities narrowed by almost 3 percentage points and in mid-May 2004 was equal to 0.8 points; for high-yield firms the differential narrowed by 7 points, to about 3 points. Over the same period the cost of finance for the two classes of firms decreased by 2 and 6 percentage points to 5.6 and 8.3 per cent respectively.

In Japan, where economic activity continued to expand in 2003 at an unexpectedly rapid rate, the stock market turned bullish last May, with the Nikkei 225 index gaining 44 per cent since then. The rise was even larger for bank shares, which more than doubled over the same time span following the improvement in their earnings and balance sheets. The faster expansion of liquidity and the monetary authorities' commitment to pursue this policy until the inflation rate is consistently positive helped to keep the yields on government securities at very low levels. In the second half of 2003 a reallocation of investors' portfolios led to a rise in government bond yields; ten-year yields, which in the first six months of the year had averaged 0.7 per cent, stabilized at around 1.3 per cent in September before moving slowly upwards to stand at 1.5 per cent in mid-May 2004.

International derivatives markets experienced a surge in 2003. The acute political tensions in the early months of the year and, subsequently, the high degree of uncertainty about the stance of US monetary policy, which caused bond prices to fluctuate sharply, generated substantial demand for hedges with derivative instruments. There were large increases in volumes of interest rate options and futures on three-month Euromarket deposits in dollars and euros and on US and German government securities. The notional value of exchange-traded options and futures, nearly all of them based on interest rates, rose by 71 and 33 per cent respectively; the amount outstanding grew to $23 trillion for options and $13.7 trillion for futures. Growth had been similarly rapid in 2001, at the start of the monetary expansion by the Federal Reserve, and at the end of the same year, following the terrorist attacks in the United States. In that year the notional value of exchange-traded derivatives grew by 67 per cent.

As in 2002, investors again made ample 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. According to estimates by the International Swaps and Derivatives Association, in 2003 the amount of credit default swaps outstanding rose by 64 per cent to nearly $3.6 trillion.

Foreign exchange and financial markets in the emerging countries

The currencies of the three largest new members of the European Union – Poland, the Czech Republic and Hungary – came under different degrees of downward pressure partly in connection with their exchange rate regimes. In the Czech Republic, which achieved a higher degree of economic convergence, conditions remained broadly stable. From the beginning of 2003 to April 2004, the koruna depreciated by 4 per cent against the euro; the short-term interest rate differential with the euro has been virtually nil since the second half of 2002. In Poland the zloty continued to weaken, depreciating by 16 per cent from the beginning of 2003 to April 2004 owing in part to fears engendered by the deterioration of the public finances; the short-term interest rate differential with the euro remained stable at around 3 percentage points. In Hungary, whose currency is pegged to the euro with a fluctuation band, the authorities resolutely countered the heavy speculative pressure that developed after a limited downward adjustment of the forint's central rate was announced in June; in the weeks that followed the central bank raised reference interest rates by 3 percentage points to 9.5 per cent. In November, in the face of renewed downward pressure on the currency, the authorities raised interest rates by another 3 points to 12.5 per cent. In the first few months of this year the speculative pressure abated and the forint stabilized. Reference rates were lowered by 100 basis points. Overall, from the beginning of 2003 to April 2004 the forint depreciated by 6 per cent.

In Asia, the yield differential between dollar-denominated government securities and the corresponding US securities widened to as much as 4.5 percentage points in the early part of the year as the international political situation deteriorated. The spread began to narrow in the middle of March, decreasing to 3.1 points by October before widening slightly to the current 3.8 per cent. The economic upswing benefited Asian share markets, which registered strong gains: from the beginning of 2003 to mid-May 2004, these ranged from 22 per cent in Malaysia to 70 per cent in Thailand. The exchange rates of the currencies under a "managed float" changed very little. Hong Kong, Malaysia and China continued their policy of pegging to the dollar; in China the authorities are weighing the possibility of making the exchange rate regime more flexible, partly with a view to better control of domestic liquidity.

In Brazil, thanks to rigorous macroeconomic and structural policies, the yield differential between dollar-denominated government bonds and the corresponding US Treasury securities narrowed further in 2003, continuing a trend that began in the autumn of the previous year. From the start of 2003, when the new government took office, the differential contracted by more than 10 percentage points to the historically low level of 4.1 percentage points at the turn of this year. It subsequently widened, partly in response to the possibility of a less accommodating US monetary policy. In mid-May it was equal to 7 points. The exchange rate of the

Brazilian real against the dollar gained around 20 per cent in the first four months of last year and stabilized thereafter at around 2.9 per dollar. In December the IMF extended the time limits for repaying the loan it had granted Brazil in September 2002 and increased the amount.

In Turkey, uncertainty connected with the war in Iraq caused the yield differential of dollar-denominated government securities to widen by 6 percentage points in the early months of 2003. From April 2003 onwards the differential gradually narrowed, thanks in part to the improvement in economic conditions and the financial support granted by the IMF and the United States, and notwithstanding the grave terrorist attacks in November. After reaching a minimum of 2.3 points in April of this year, the differential began widening again. In mid-May it stood at 5 points. The Turkish lira appreciated by 25 per cent against the dollar from the beginning of 2003 to the middle of March 2004; since then it has lost 15 per cent.

In 2003 the IMF slowed down the pace of its lending to member countries and strengthened its preventive action based on surveillance. On the crisis resolution front, after shelving the idea of normative intervention to be implemented through an international treaty (the Sovereign Debt Restructuring Mechanism, SDRM), the international official community turned towards more market-oriented solutions. In this context, efforts continued to promote contractual forms that facilitate group representation of private creditors and prevent legal actions being brought by minorities of creditors in the debt restructuring process. In addition, discussions began on the development of a “code of conduct” for creditors and borrowers in sovereign debt restructuring negotiations, to be implemented on a voluntary basis.

INTERNATIONAL TRADE AND THE BALANCE OF PAYMENTS

Trade and the prices of raw materials

The growth in world trade under way since 2002 quickened in the second half of last year, fueled mainly by the acceleration in economic activity in the United States and Asia. Trade in goods and services at constant prices, after stagnating in 2001 and rising by 3.1 per cent in 2002, increased by 4.5 per cent, below the average annual rate of expansion over the past decade (6.5 per cent).

For goods alone, the annual growth in the volume of trade picked up from 3.1 to 5.2 per cent last year, driven by the upturn in the world investment cycle. This impetus was accompanied by growing demand, especially from the emerging countries of Asia, for energy sources and industrial raw materials. As the supply of these products is relatively rigid in the short term, their prices rose, particularly in the second half of the year.

The countries of Asia, Japan included, again registered a much larger increase in exports than the other leading countries and regions. Given the high degree of trade integration within the region, this rapid growth reflected the pick-up in economic activity, especially in China and Japan. Some impetus derived from the strengthening of the international cycle in the high-tech goods sectors, where the countries of the region are major exporters. Exports of the Asian countries also continued to be favoured by strong price competitiveness, which they preserved by pegging their currencies to the dollar.

The export upturn also involved the United States in 2003, thanks to the cumulative gains in competitiveness over the past two years, as well as the developing countries of the other regions, which as net exporters of raw materials also benefited from an improvement in the terms of trade.

For the third consecutive year the exports of the euro-area countries slowed down, owing mainly to the performance of sales outside the area, which suffered from the appreciation of the euro. The exports of the countries of Central and Eastern Europe, by contrast, increased strongly, reflecting the advancing integration of their economies with those of the EU members.

The advanced countries' imports of goods and services at constant prices grew by 3.5 per cent in 2003, compared with 2.3 per cent in 2002. Against the weak increase in the euro area (1.7 per cent, after a contraction of 0.1 per cent in 2002), US and Japanese imports rose by 4 and 4.9 per cent respectively compared with 3.3 and 2 per cent in 2002, propelled by faster growth in domestic demand. The acceleration of imports in the newly industrialized economies of Asia to growth of 8.9 per cent reflected the high level of activity in the export-oriented manufacturing sectors.

The United States suffered a deterioration of 1.7 per cent in the terms of trade for goods and services in 2003, owing to the depreciation of the dollar and the rise in raw material prices. The euro-area countries' terms of trade for goods and services improved by 0.8 per cent despite higher energy prices, thanks to the appreciation of the currency. The oil-exporting developing countries and exporters of other raw materials saw their terms of trade improve for the second consecutive year. In Latin America the gain was 3.5 per cent, in Africa 1.6 per cent and in the Middle East 0.8 per cent. The developing countries of Asia, whose currencies are still pegged to the dollar and which are net importers of raw materials and exporters of manufactures, experienced a deterioration of 1.6 per cent.

The fifth ministerial meeting of the World Trade Organization in Cancun in November ended without an agreement. The planned accord would have sanctioned the progress in the trade liberalization talks begun at Doha in 2001. The meeting's failure therefore dimmed the prospects for a rapid conclusion of the talks, which had originally been expected for the end of 2004. The Washington meetings of the economic ministers of the leading industrial countries this April also underscored the importance of breaking the deadlock and emphasized the agreement's potential contribution to long-run world trade and economic growth.

The acceleration of economic activity and the weakening of the dollar accentuated the rise in raw material prices that began in 2002. The indexes of the dollar prices of oil and non-energy raw materials rose respectively by 15.8 and 7.1 per cent on average for the year, compared with 2.5 and 0.5 per cent in 2002. The increase for non-energy materials was due above all to higher world metal prices (a rise of 11.9 per cent in 2003, compared with a fall of 12.5 per cent over the previous two years), which are more cyclically sensitive.

In order to avoid a worsening of their terms of trade, the raw-material-producing countries generally sought to offset the depreciation of the dollar over the past two years with increases in the dollar prices of their commodities. Strengthening world demand in the past year drove the dollar prices of metals sharply upwards. Overall, they rose by 47.8 per cent between April 2003 and April 2004. Expressed in SDRs in order to correct for the depreciation of the dollar, the rise in the index of metal prices was no sharper than those recorded in comparable cyclical upswings in world industrial activity in the past.

Oil prices neared an average of $29 a barrel for 2003 (as an average of the three main grades), $4 more than in 2002. Prices surged further early in 2004, reaching $34 a barrel in March. A factor in the rise was OPEC's decision to lower its output target as of 1 April. On 20 May the average price for the three main grades was $38.50 a barrel. Futures contracts for WTI grade oil traded on NYMEX on that date indicated that prices should come gradually down from their current level of $41 to below $38 by the start of 2005. The rise in prices over the past three quarters has been due in part to persistent supply strains in connection with the crisis in the Middle East.

Balance-of-payments developments

International payments disequilibria worsened in 2003, continuing the previous year's tendencies (Table 2). The US current account deficit widened from $481 billion to $542 billion or from 4.6 to 4.9 per cent of GDP, due to persistently faster growth in domestic demand in the United States than in the other leading economies.

As the US deficit increased, the current account surplus of the Asian economies as a group rose from $251 billion to $268 billion, thanks to highly favourable developments in trade volumes; the surplus of the oil-exporting countries also expanded, reflecting their improved terms of trade. By contrast, the euro area's surplus contracted by nearly half, despite the slowdown in economic activity.

Among the emerging areas with structural external account disequilibria, the countries of Central and Eastern Europe saw an increase in their deficit from 3.3 to 3.9 per cent of GDP. Latin America as a whole, by contrast, had its external account in balance for the first time in more than forty years.

The international competitiveness of US products (the change in the real effective exchange rate as gauged by producer prices) improved by an average of 4.3 per cent in 2003 as the dollar depreciated. The overall gain of 7 per cent between 2001 and 2003 is still modest, however, compared with the loss of 19.3 per cent registered between 1996 and 2001. The euro area's competitiveness slid by 10.9 per cent last year, mainly because of the sharp appreciation of the euro, bringing the cumulative deterioration since 2000 to 18.4 per cent. Japan's competitiveness improved again, although less than in 2002, reflecting favourable relative price developments. The effective exchange rate of the yen was substantially unchanged.

Table 2

CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS OF THE MAIN COUNTRIES

	Billions of dollars				As a percentage of GDP			
	2000	2001	2002	2003	2000	2001	2002	2003
Advanced countries								
United States	–411.5	–393.7	–480.9	–541.8	–4.2	–3.9	–4.6	–4.9
Japan	119.6	87.8	112.8	136.4	2.5	2.1	2.8	3.2
Euro area	–62.3	–15.1	53.0	30.8	–1.0	–0.2	0.8	0.4
Newly industrialized Asian economies (NIEs) (1)	41.4	52.0	63.6	86.5	3.8	5.1	5.9	7.6
of which: South Korea	*12.2*	*8.0*	*5.4*	*12.3*	*2.4*	*1.7*	*1.0*	*2.0*
Developing and emerging countries								
Latin America	–47.0	–54.5	–15.8	3.8	–2.4	–2.9	–0.9	0.2
of which: Argentina	*–9.0*	*–3.9*	*9.6*	*7.9*	*–3.2*	*–1.5*	*10.4*	*6.1*
Brazil	*–24.2*	*–23.2*	*–7.7*	*4.1*	*–4.0*	*–4.6*	*–1.7*	*0.8*
Mexico	*–18.2*	*–18.2*	*–14.1*	*–9.2*	*–3.1*	*–2.9*	*–2.2*	*–1.5*
Venezuela	*12.1*	*2.1*	*7.4*	*9.6*	*10.0*	*1.6*	*7.9*	*11.3*
Asia	45.4	38.1	68.1	61.8	2.1	1.7	2.8	2.3
of which: ASEAN-4 (2)	*32.1*	*21.7*	*26.2*	*29.1*	*7.3*	*5.2*	*5.6*	*5.5*
China	*20.5*	*17.4*	*35.4*	*29.6*	*1.9*	*1.5*	*2.8*	*2.1*
India	*–5.1*	*–0.8*	*4.8*	*3.0*	*–1.1*	*–0.2*	*1.0*	*0.5*
Middle East	69.6	38.1	29.0	51.7	11.0	5.9	4.6	7.3
Central and Eastern Europe (3)	–31.7	–14.8	–22.2	–31.7	–5.2	–2.5	–3.3	–3.9
Russia	46.8	33.9	29.5	35.9	18.0	11.1	8.5	8.3
Memorandum items:								
Oil-exporting emerging and developing countries	**99.6**	**48.7**	**34.1**	**62.7**	**13.4**	**6.4**	**4.7**	**7.6**
Japan, NIEs and Asian developing countries	**206.5**	**209.6**	**251.4**	**267.8**	**2.6**	**2.8**	**3.4**	**3.3**

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.

Net capital flows to emerging countries and emigrants' remittances

Net private capital inflows to emerging countries increased markedly, from $47 billion in 2002 to $131 billion last year, the highest level since 1997 (Table 3). On the other hand, net official financing, after falling to practically nil in 2002, turned negative by $7 billion. The increase in private financing was prompted not only by the exceptionally low interest rates in the industrial countries but also by the general strengthening of activity in the emerging economies, especially those in Asia, buoyed by the recovery in exports.

International bank lending grew for the first time since 1996. The return of bank capital to the emerging economies, especially those of Asia, was based in part on the improvement in the quality of those countries' debt over the past five years. This positive development reflected strengthening external accounts, the decreasing proportion of short-term foreign debt and the build-up of foreign exchange reserves.

The net inflow on account of "other investment", which includes bank lending, came to $99 billion in 2003, compared with $6 billion in 2002; over the previous five years, this item had produced substantial net outflows. The net "other investment" inflows to the emerging countries of Asia rose from $29 billion to $93 billion, driven by strongly expanding demand for credit, especially in South Korea and China.

Net direct investment inflows, still the main source of external finance for the emerging economies, diminished for the second consecutive year, from $139 billion to $119 billion. They were again affected by the decline in international merger and acquisition activity that began in 2001. A significant share ($47 billion) went to China.

There were overall net portfolio investment outflows of $88 billion, despite an improvement in the bond segment.

Net private capital inflows to Latin America remained modest at $12 billion ($9 billion in 2002). An improvement in the portfolio segment, which benefited from the resumption of bond issues, was countered by a decrease in net direct investment inflows from $40 billion to $30 billion, reflecting the completion of the privatization programmes begun in the 1990s.

Net private capital inflows to the countries of Central and Eastern Europe remained unchanged at $44 billion, with a further gradual shift from direct investment to different forms, notably "other investment". In the countries of the former Soviet Union net private capital inflows were positive, albeit only slightly, for the first time since 1998, owing in part to a let-up in residents' capital flight.

Given the significant increase in net capital inflows and the broad improvement in current accounts, emerging countries recorded an increase of $364 billion in official exchange reserves in 2003, after the gain of $196 billion in 2002. Again, the bulk involved the Asian countries, which accumulated $245 billion ($158 billion in 2002).

Table 3

NET CAPITAL FLOWS TO EMERGING COUNTRIES (1)

(billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003
	All emerging countries							
Net private flows	217.8	177.6	77.4	86.6	42.2	20.6	47.0	131.2
Direct investment	*116.0*	*144.0*	*153.0*	*171.2*	*175.0*	*189.1*	*139.3*	*119.3*
Portfolio investment	*85.0*	*62.8*	*38.4*	*66.0*	*6.1*	*–95.7*	*–98.6*	*–87.5*
Other investment	*16.8*	*–29.2*	*–114.0*	*–150.6*	*–139.0*	*–72.8*	*6.3*	*99.3*
Net official flows	–5.1	48.3	47.3	6.4	–14.5	25.8	3.3	–7.2
	Asia (2)							
Net private flows	118.6	34.0	–50.6	2.7	–4.2	10.1	24.8	84.3
Direct investment	*53.4*	*56.5*	*56.1*	*66.4*	*67.4*	*60.5*	*53.1*	*49.3*
Portfolio investment	*32.0*	*6.3*	*8.4*	*56.6*	*20.1*	*–54.4*	*–57.6*	*–58.4*
Other investment	*33.1*	*–28.8*	*–115.0*	*–120.2*	*–91.7*	*4.0*	*29.3*	*93.4*
Net official flows	–13.2	25.2	17.5	1.8	4.0	–2.0	–1.9	–8.6
	Latin America							
Net private flows	70.4	91.9	78.6	53.2	51.9	26.9	8.5	11.8
Direct investment	*39.6*	*56.9*	*61.5*	*65.5*	*66.4*	*68.9*	*39.6*	*30.0*
Portfolio investment	*47.9*	*29.2*	*27.2*	*4.4*	*2.9*	*–7.2*	*–13.7*	*2.9*
Other investment	*–17.1*	*5.8*	*–10.1*	*–16.6*	*–17.4*	*–34.7*	*–17.4*	*–21.1*
Net official flows	–7.2	7.3	9.5	–3.4	–9.9	26.3	14.6	18.2
	Africa							
Net private flows	9.1	4.0	9.1	11.8	1.1	6.5	7.2	9.5
Direct investment	*3.6*	*7.9*	*6.9*	*9.8*	*8.2*	*23.9*	*12.3*	*14.3*
Portfolio investment	*2.8*	*7.0*	*3.7*	*8.3*	*–2.2*	*–8.8*	*–0.7*	*1.8*
Other investment	*2.7*	*–10.9*	*–1.6*	*–6.3*	*–4.9*	*–8.5*	*–4.4*	*–6.6*
Net official flows	–3.0	3.3	4.7	3.5	3.1	1.9	4.2	4.1
	Middle East							
Net private flows	2.0	9.6	8.4	–7.9	–24.9	–16.3	–27.6	–22.9
Direct investment	*4.1*	*5.2*	*5.1*	*3.9*	*7.7*	*8.1*	*6.9*	*8.9*
Portfolio investment	*1.0*	*–2.7*	*–6.2*	*–4.5*	*–12.3*	*–15.8*	*–19.0*	*–24.3*
Other investment	*–3.1*	*7.2*	*9.5*	*–7.3*	*–20.4*	*–8.6*	*–15.4*	*–7.4*
Net official flows	7.4	6.7	5.2	6.6	–11.0	–3.2	–5.4	–11.0
	Central and Eastern Europe (3)							
Net private flows	25.6	21.8	27.3	34.5	33.4	–1.1	43.8	43.5
Direct investment	*10.4*	*11.6*	*18.0*	*21.3*	*22.9*	*22.7*	*23.1*	*13.2*
Portfolio investment	*1.3*	*5.4*	*–2.4*	*4.3*	*3.6*	*–0.2*	*0.7*	*3.9*
Other investment	*13.9*	*4.8*	*11.8*	*8.8*	*6.9*	*–23.6*	*20.0*	*26.4*
Net official flows	. .	–2.8	1.1	–2.0	2.7	6.5	–7.2	–5.7
	Countries of the former Soviet Union (4)							
Net private flows	–7.9	16.3	4.5	–7.6	–15.1	–5.6	–9.7	4.8
Direct investment	*4.9*	*5.9*	*5.3*	*4.3*	*2.4*	*5.0*	*4.2*	*3.6*
Portfolio investment	*–0.1*	*17.6*	*7.7*	*–3.0*	*–6.0*	*–9.2*	*–8.2*	*–13.3*
Other investment	*–12.7*	*–7.2*	*–8.5*	*–8.9*	*–11.5*	*–1.3*	*–5.7*	*14.6*
Net official flows	10.9	8.5	9.4	0.1	–3.4	–3.7	–1.1	–4.2
Memorandum item:								
Change in reserves (5)								
All emerging countries	–91.2	–104.1	–34.6	–92.7	–116.9	–113.5	–196.0	–363.9
of which: Asia	*–46.1*	*–35.9*	*–52.6*	*–87.1*	*–60.8*	*–90.7*	*–157.8*	*–245.3*

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) Including the newly industrialized economies (Hong, Kong, Singapore, South Korea and Taiwan). – (3) Including Malta and Turkey. – (4) Including Mongolia. – (5) A minus sign indicates an increase in reserves.

With the sharp contraction of private lending to the emerging and developing countries following the Asian crisis of 1997-1998, for many of these countries emigrants' remittances became an important source of external financing. Estimated at $88 billion in 2002 and $93 billion last year, remittances are second only to foreign direct investment as a source of foreign financial receipts. In absolute terms, remittances are most substantial in such important countries as India, Mexico and the Philippines. For 20 countries, remittances are equal to 7 per cent of GDP or more. Remittances are more equally distributed among the receiving countries than are overall capital flows. The countries producing the largest flows of immigrants' remittances are the United States, Saudi Arabia, Germany, Belgium and Switzerland.

The Mediterranean countries: trade and financial relations with Europe and Italy

In view of the relative lack of knowledge concerning the economies of the Mediterranean and the region's banking and financial systems, the commencement of the Euro-Mediterranean Partnership in Barcelona in 1995 with its plan for a free trade area between the EU and Mediterranean countries by 2010, the scale of migration to the northern shore of the Mediterranean, and the region's proximity to Europe and especially to Italy, the Bank of Italy undertook a project to gather information on the economic conditions of the countries of the region as a basis for closer interaction and cooperation with their central banks.

The economies of the Mediterranean region differ significantly in stages of development, structure, resources, management models, demography, and social and political conditions.

The total gross product of the region amounted to about €600 billion in 2002, equal to 6 per cent of the European Union's GDP. Two thirds of this output was accounted for by just three countries: Turkey, Israel and Egypt. Per capita GDP (at purchasing power parities) ranges from just €400 a year in the West Bank and the Gaza Strip to over €17,000 in Cyprus. The EU average is €24,000.

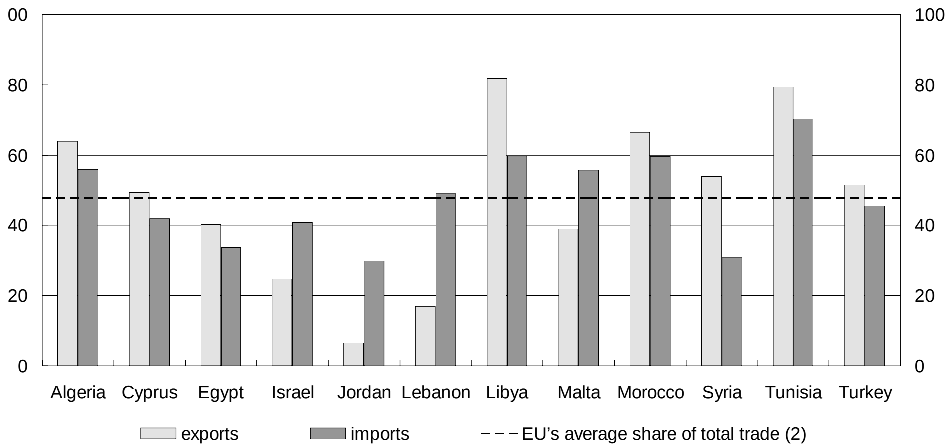
The Mediterranean economies are linked to the advanced countries by intensive trade relations. The EU is their principal export market and leading supplier of imports, accounting for about 50 per cent of their total foreign trade. For the nations of the Maghreb the share is between 60 and 70 per cent, while the bulk of the trade of Egypt, Jordan and Israel is with the United States or the countries of the Persian Gulf (Figure 2).

For Europe, by contrast, the Mediterranean has a lesser incidence. It is most important for Italy, accounting for 6 per cent of the country's foreign trade, compared with between 3 and 4 per cent for France and Germany. And finally, the Mediterranean economies are relatively isolated from one another: intraregional trade in goods and services and financial flows are not especially significant.

Figure 2

THE PARTNERSHIP COUNTRIES' TRADE WITH THE EU

(percentage of total foreign trade) (1)



Source: IMF.
(1) In 2002. – (2) Exports plus imports.

The Euro-Mediterranean Partnership has transformed relations between the European Union and the countries of the region. The Mediterranean countries are no longer seen as individual trading partners or recipients of development assistance but as a single area in which economic transformation and a major financial effort can trigger a process of accelerated development, exploiting potential synergy between the gains of each country and those of the rest of the area. The economic renewal envisaged by the Partnership has been seriously retarded by a series of factors – the inadequate commitment of the EU, unfavourable political developments in the Middle East, Mediterranean governments' lack of real willingness and ability to engage in the radical economic and social transformation that the project entailed. In the light of the initial results, which on the whole have not come up to expectations, review and revision of the project have become essential.

Nor does the Partnership appear to have produced the hoped-for advance in economic integration. Since 1995 the Mediterranean countries' trade with the EU has expanded by 32 per cent, but the EU's share of their overall trade has declined. The drive towards a joint effort has lost momentum. Unless the impetus of the Partnership is renewed, there is a danger that only a few countries will manage to find the path to rapid development. The Mediterranean area could become locked into a state of perennial backwardness with respect to the transformation and globalization of the world economy. Given the population growth and increasing unemployment that characterize the area, this could generate acute political and social conflict, from whose effects Europe could hardly be insulated.

An important occasion for discussion of these issues and of the top economic policy priorities was provided by the first joint Euro-Mediterranean Seminar between the Eurosystem and the central banks of the Mediterranean. The gathering, organized by the Bank of Italy and the European Central Bank, was held in Naples in January 2004. The participating nations were those of the southern and eastern Mediterranean: Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Libya (which has observer status within the Partnership), Malta, Morocco, the Palestinian National Authority, Syria, Tunisia and Turkey.

The Seminar conducted wide-ranging discussions of the Mediterranean region's economic and financial ties to the European Union, exchange rate regimes, and the region's banking and financial systems. The participants resolved that the Seminar should serve to initiate structured, permanent cooperation on matters of common interest between the Bank of Italy, the European Central Bank, the rest of the Eurosystem and the Mediterranean central banks.

The connective tissues of the financial relations between the northern and southern shores of the Mediterranean consist above all in three crucial elements: foreign direct investment, emigrants' remittances and official development assistance.

Foreign direct investment in the Mediterranean countries by the EU member states is modest. Just 0.7 per cent of total EU direct investment goes to the Mediterranean, compared with 2 per cent to the new EU member states and 5 per cent to Latin America. From the standpoint of the recipients, too, the flow is modest. Direct investment from the EU averages around 4 per cent of the Mediterranean countries' GDP.

Emigrants' remittances form a significant part of the inflow of funds to the countries of the Mediterranean. For immigrants to Italy, the Mediterranean is a major destination of remittances. According to estimates that also take account of transfers via specialized non-bank agencies, Morocco receives 10 per cent of total remittances from Italy, second only to Romania; Tunisia takes 1 per cent and Egypt 0.5 per cent.

Official development assistance to the Mediterranean countries is significant. The EU's MEDA programme commitments amount to more than €5 billion for the period 2000-06, up from €3 billion between 1995 and 1999. The funds tend to go mostly to some Maghreb countries (Morocco and Tunisia) and to Egypt. Between 1992 and 2003 the European Investment Bank made loans totaling €13 billion. In 2002 the EIB created a special facility, the Euro-Mediterranean Investment and Partnership Fund, to sustain private sector growth by financing investment projects and making loans to small and medium-sized enterprises channeled through local banks.

The exchange rate regimes of the Mediterranean countries display a great variety of types, ranging from pegs to one currency to free floats. Most have an "intermediate" system under which the national currency is pegged to a single currency or a basket of currencies but with some flexibility, varying in degree. A broad transition is under way from administered exchange rate regimes to systems in which the rate is determined freely by market forces. At the same time, with the opening of the economies to external capital flows, there is a tendency towards greater exchange rate flexibility. For most of the region's countries the volatility of the euro/dollar exchange rate is a real problem. The difference between the currency composition of their foreign debt and that of their export earnings, as well as between their banking systems' external assets and liabilities, poses a difficult challenge to authorities in deciding on the optimal exchange rate regime.

The region's financial systems, finally, are bank-centred, with a very limited role for other financial institutions. For the most part stock exchanges are only modestly developed.

Major banking and financial reforms have been undertaken in the last few years. Monetary policy instruments and procedures have been made more market-oriented. Central banks' independence from government has been strengthened. Interest rates, which had been subject to administrative constraints, have been liberalized almost everywhere. Policies of financial repression have been abandoned and the presence of the public sector reduced. Prudential regulation of banks has moved towards the introduction of international standards.

Notwithstanding these recent advances, however, in many cases the development of the financial system has encountered severe limitations in the inefficiency of the judicial system, the unreliability of the overall legislative framework and the poor quality of corporate disclosure and of the rules of corporate governance.

INCOME, PRICES AND THE BALANCE OF PAYMENTS

Economic activity in the euro area

Euro-area GDP grew by just 0.4 per cent in 2003, less than half the previous year's already modest expansion (Table 4). The slowdown in economic activity in the second half of 2002 was followed by stagnation in the early months of 2003, marked by tensions surrounding the start of the war in Iraq. From the summer onwards, as the US recovery gained momentum and the international climate improved, GDP began growing again, albeit at an extremely slow pace. During the year the contribution of domestic demand to output growth was partly offset by negative net exports. The appreciation of the effective exchange rate of the euro acted as a brake on the area's exports, which were stagnant for the year as a whole, while imports increased by nearly 2 per cent.

Economic policy provided only partial support for growth. The adoption of expansionary fiscal policies was hampered by the persistence of imbalances in the public finances. Monetary conditions were further relaxed, thus bringing real short-term interest rates close to nil.

Economic activity in all three of the area's main countries was generally sluggish during the year as a whole. There was very slow growth in France and Italy and a contraction in Germany (Table 4), the first since 1993. The growth rate in the other countries remained higher than the area's average; in Spain it rose to 2.4 per cent.

After stalling in 2002 private consumption in the euro area turned upwards, albeit by only 1 per cent. It rose in the first quarter and then remained stationary throughout the rest of the year owing to the weak growth of disposable income and the uncertainties of households, which were reflected in the confidence index. Among the major countries, in Germany consumption contracted again, although less sharply than in 2002 (by 0.1 compared with 1 per cent), while in Italy, France and above all Spain it increased, partly due to the improvement in disposable income.

Gross fixed investment declined for the third consecutive year, falling by 1 per cent owing to the excess of capacity. Capital formation was negative in all three main euro-area countries, although signs of recovery appeared in France and Germany during the year, suggesting that the trend might reverse in 2004.

Table 4

GDP, IMPORTS AND MAIN COMPONENTS OF DEMAND IN THE MAJOR EURO-AREA COUNTRIES

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

	2001	2002	2003	2003			
	Year	Year	Year	Q1	Q2	Q3	Q4
				GDP			
Germany	0.8	0.2	–0.1	–0.2	–0.2	0.2	0.2
France	2.1	1.2	0.5	0.2	–0.3	0.6	0.6
Italy	1.8	0.4	0.3	–0.2	–0.1	0.4	..
Spain	2.8	2.0	2.4	0.5	0.7	0.6	0.7
Euro area	1.6	0.9	0.4	..	–0.1	0.4	0.3
				Imports			
Germany	0.9	–1.7	2.6	1.5	–2.3	0.2	2.7
France	1.3	2.9	–0.1	–0.6	–0.1	0.2	2.5
Italy	0.5	–0.2	–0.6	–4.8	0.1	5.2	–3.2
Spain	4.0	1.8	6.7	–2.8	2.1	1.2	2.2
Euro area	1.7	–0.1	1.8	–0.4	–0.5	1.1	1.6
				Exports			
Germany	5.6	3.4	1.2	–0.5	–2.6	3.8	0.3
France	1.6	1.9	–2.5	–2.2	–1.4	0.9	1.5
Italy	1.6	–3.4	–3.9	–5.3	–0.1	5.7	–3.8
Spain	3.6	..	4.0	–1.7	4.0	–1.0	0.6
Euro area	3.4	1.5	0.1	–1.3	–0.8	2.2	0.2
				Household consumption (1)			
Germany	1.4	–1.0	–0.1	0.4	–0.4	–0.3	–0.4
France	2.7	1.5	1.5	0.7	–0.2	0.6	0.5
Italy	0.8	0.5	1.3	0.2	0.1	0.4	–0.4
Spain	2.8	2.6	3.0	0.6	1.1	0.2	1.1
Euro area	1.7	0.1	1.0	0.5	..	0.1	..
				Gross fixed investment			
Germany	–4.2	–6.7	–2.9	–1.5	–0.8	–0.5	1.7
France	1.9	–2.0	–0.2	0.3	0.5	..	0.8
Italy	1.9	1.2	–2.1	–4.9	–1.0	–0.9	–1.2
Spain	3.3	1.0	3.0	0.4	–0.2	1.7	0.6
Euro area	–0.3	–2.8	–1.0	–0.8	–0.3	–0.2	0.6
				National demand			
Germany	–0.8	–1.6	0.3	0.5	..	–1.1	1.0
France	2.0	1.5	1.2	0.6	0.1	0.4	0.9
Italy	1.4	1.3	1.2	–0.1	..	0.3	0.2
Spain	3.0	2.6	3.3	0.1	0.2	1.4	1.2
Euro area	1.0	0.3	1.1	0.4	..	–0.1	0.8
				Net exports (2)			
Germany	1.6	1.7	–0.4	–0.7	–0.2	1.3	–0.7
France	0.1	–0.2	–0.7	–0.5	–0.4	0.2	–0.3
Italy	0.3	–1.0	–0.9	–0.2	–0.1	0.2	–0.2
Spain	–1.0	–0.6	–0.2	0.4	0.5	–0.7	–0.6
Euro area	0.7	0.6	–0.6	–0.4	–0.1	0.5	–0.5

Sources: Based on national statistics and Eurostat data.

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

Like output, employment also stagnated in 2003, remaining close to the levels of the previous year. The unemployment rate rose by a further 0.4 percentage points to 8.8 per cent.

Inflation, measured by the harmonized consumer price index, was equal to 2.1 per cent, 0.2 percentage points less than in 2002. Core inflation declined from 2.5 to 2 per cent as a result of the appreciation of the euro and continuing weakness of demand, which more than offset the effect of the rise in oil prices on the energy components of the index. The rate of increase of consumer prices diverged among the main euro-area countries, accelerating from 2.6 to 2.8 per cent in Italy and from 1.9 to 2.2 per cent in France and falling from 1.3 to 1 per cent in Germany. Apart from specific factors, such as the increase in indirect taxes in Italy and France, these developments can be ascribed to the rate of increase in unit labour costs, which in Italy continued to be higher than the average for the euro area.

A decade of weak growth in the euro area

The economic stagnation of the euro area over the past three years (Figure 3) cannot be traced to cyclical factors alone. Growth began to slow in the 1990s: between 1993 and 2003 it averaged 2 per cent annually, 0.4 percentage points less than in the previous ten years. In the United States average GDP growth was unchanged between the two periods at 3.3 per cent a year. Per capita output in the euro area has fallen in recent years to about 70 per cent that of the US, compared with 75 per cent in the mid-1980s.

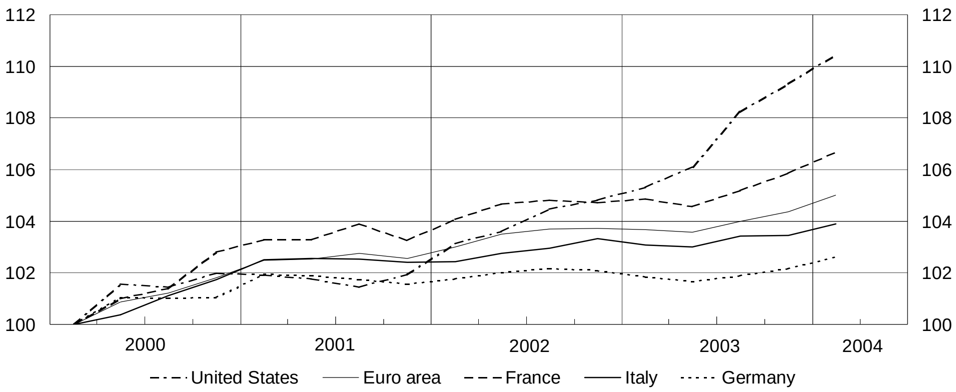
Increasing international competition and the ascent of new countries in world trade have heightened the need to reorganize Europe’s industrial systems and improve their efficiency. The process has made slow headway in most euro-area countries, helping to widen the gap with the more dynamic economies.

The gap between Europe and the United States in the use of information and communication technology (ICT) and spending on research and development is considerable. As early as the beginning of the 1980s American firms were investing around 3 per cent of GDP in ICT; European companies only attained that level twenty years later, by which time the US had passed the 5 per cent mark. According to OECD estimates, between the first and second half of the 1990s the average annual gain in total factor productivity – i.e. the part of average labour productivity not attributable to an increase in either the quantity or quality of inputs – rose sharply in the US, from 0.9 to 1.3 per cent. By contrast, in the main euro-area countries it fell to less than 1 per cent. In Italy the slowdown involved all sectors of the economy except banking and finance, transport and telecommunications, where ICT use is most intensive. In Italy, the trend in total factor productivity is probably linked not only to ICT investment but also to international competitiveness.

Figure 3

GROSS DOMESTIC PRODUCT

(at constant prices; indices, first quarter 2000=100)



Sources: Based on national statistics and Eurostat data.

Between 1993 and 2003 output per employee grew more slowly in Europe than in the United States. In Europe, as the proportion of people in work increased the growth rate of labour productivity slackened considerably compared with previous years. In the US output per employee accelerated while the participation rate rose.

Economic activity in Italy

In 2003 economic activity continued to expand slowly (Table 5). The slight decrease in GDP in the first half of the year gave way to an increase in the third quarter in conjunction with the world recovery. Unlike the other main euro-area countries, Italy recorded a halt in growth in the last quarter as household spending and, above all, exports declined.

Manufacturing activity followed a similar pattern. The seasonally and calendar adjusted index of industrial production turned upwards in the summer then remained flat in the closing months of 2003 (Figure 4). On average for the year it fell by 0.8 per cent. In March 2004 the index was down almost 6 per cent below the cyclical peak of the end of 2000, compared with a fall of 3 per cent in Germany and 1 per cent in France.

Table 5

ITALY: RESOURCES AND USES OF INCOME

	As a percentage of GDP in 2003	2002			2003		
		Percentage changes		Contribution to the growth in GDP at constant prices	Percentage changes		Contribution to the growth in GDP at constant prices
		Constant prices	Deflators		Constant prices	Deflators	
Resources							
GDP	–	0.4	3.1	–	0.3	2.9	–
Imports of goods *fob* and services (1)	27.4	–0.2	0.1	–0.1	–0.6	–0.8	–0.2
of which: goods	*20.9*	*–1.1*	*–0.2*	*–0.2*	*–1.3*	..	*–0.3*
Uses							
National demand	99.9	1.3	2.6	1.3	1.2	2.4	1.2
Consumption of resident households	60.3	0.5	3.1	0.3	1.3	2.5	0.8
Consumption of general government and non-profit institutions serving households	18.4	1.9	2.2	0.3	2.2	3.7	0.4
Gross fixed capital formation	20.3	1.2	2.4	0.2	–2.1	1.9	–0.4
machinery, equipment and transport equipment	*10.6*	*–0.3*	*1.4*	..	*–5.3*	*0.6*	*–0.6*
construction	*8.8*	*3.3*	*3.7*	*0.3*	*1.8*	*3.3*	*0.2*
intangible assets	*0.9*	*0.3*	*1.5*	..	*0.6*	*0.6*	..
Change in stocks and valuables (2)	0.8	–	–	0.5	–	–	0.5
Exports of goods *fob* and services (3)	27.5	–3.4	1.8	–1.0	–3.9	1.0	–1.1
of which: goods	*21.9*	*–2.9*	*1.4*	*–0.7*	*–4.3*	*0.7*	*–1.0*
Net exports	0.1	–	–	–0.9	–	–	–0.9

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

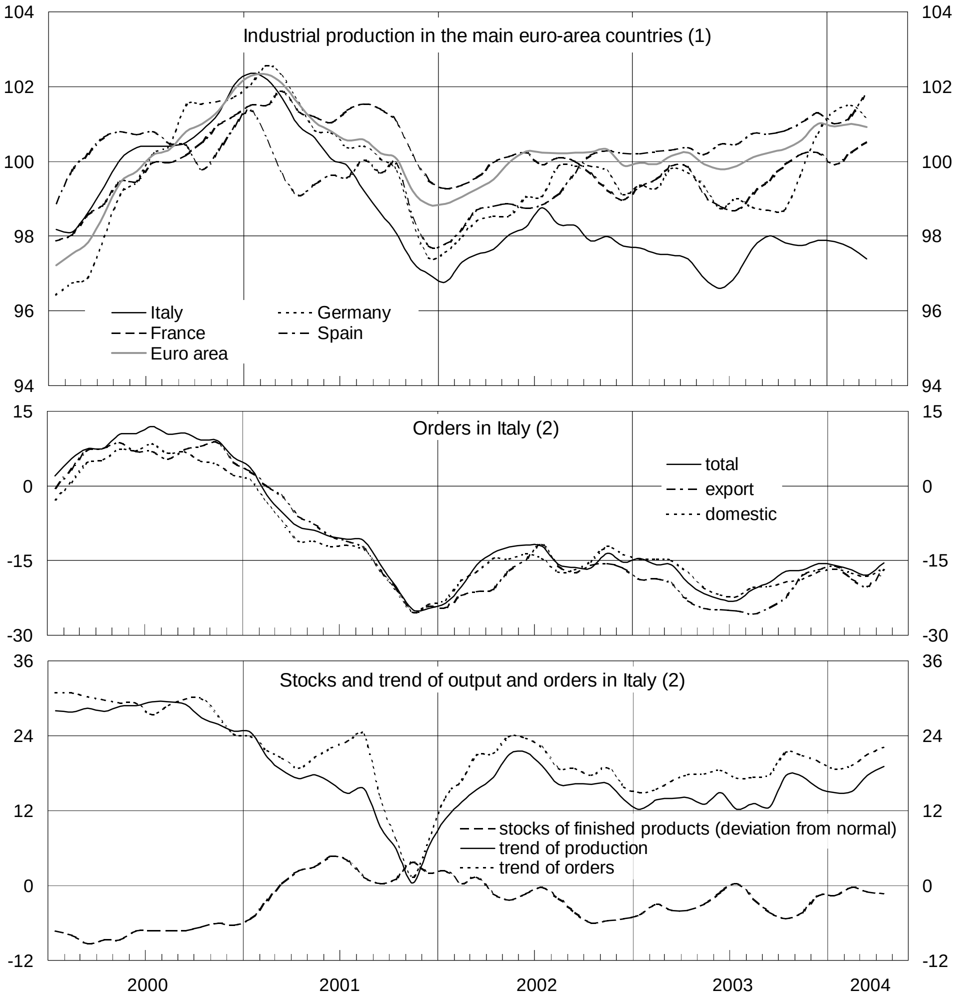
On the demand side, the contribution of the domestic components to GDP growth more than compensated for the 0.9 percentage points subtracted by net exports. A small decline in imports was accompanied by a larger one in exports in real terms (3.9 per cent; Table 5), mainly in the sectors in which Italian firms specialize, such as clothing and furnishings. As a consequence, Italy's share of world trade in goods at constant prices fell to 3 per cent, 1.5 points lower than in 1995. The slackness of demand in the main outlet markets and the loss of price competitiveness, amounting to around 9 per cent in the past three years, compounded the difficulties stemming from Italy's model of product specialization.

The sharp drop in exports nearly halved the trade surplus from €14 billion in 2002 to €8.8 billion in 2003. The large deterioration in the current account deficit, which reached €18.4 billion, equal to 1.4 per cent of GDP, was partly due to a widening of the deficit on income and transfer payments, while the deficit on services remained unchanged.

Figure 4

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, 2000=100; seasonally adjusted data. – (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.

In 2003 gross fixed investment decreased in real terms for the first time since 1993, falling by 2.1 per cent. Against a background of persistent uncertainty about the economic outlook, the contraction was entirely accounted for by the 5.3 per cent fall in investment in machinery, equipment and transport equipment (Table 5), and can be ascribed to the weakness of domestic demand and decline in export demand, which outweighed the positive effects of the reduction in the cost of money. Capacity utilization in industry fell to its lowest level since 1997, particularly in the sectors with the largest proportion of exporting companies. On the other hand, investment in construction continued to increase, albeit more slowly than in 2002, recording growth of 1.8 per cent. Activity in the residential building sector was boosted by the low cost of mortgages and availability of tax incentives.

Consumption by resident households rose by 1.3 per cent, compared with 0.5 per cent in 2002. After a substantial increase in the last quarter of 2002, particularly for durable goods, household spending began to tail off, finally declining in the last three months of the year. Consumption followed the same negative pattern as the confidence index, which fell sharply in the second half of the year, owing to events involving some large industrial groups.

The gradual loss of confidence over the last three years may have reflected households' fears of a gradual impoverishment rather than an actual worsening of their economic situation, which has not shown up either in income distribution and poverty statistics, little changed since the mid-1990s, or in wealth, which has increased. It is likely that such fears were also bred by uncertainties about the completion of pension reforms, which thus fostered an increase in the propensity to save, up by 0.5 percentage points in 2003 and by 1.5 points since 2000.

The prolonged stagnation of economic activity did not stop employment growth, but only slowed it. Istat's labour force survey found that the average number of persons in work rose by 1 per cent in 2003 (against 1.5 per cent in 2002), with the bulk of the increase coming from permanent jobs. However, the growth in the number of employees with fixed-term contracts began to grow again during the year, partly because of fewer incentives for permanent employment. Labour productivity diminished further by 0.3 percentage points.

In 2003 Italy's inflation differential with the rest of the euro area, measured by the harmonized index of consumer prices, was 0.9 percentage points, compared with 0.4 points in 2002. A contributory factor was the substantial rise in unit labour costs in industry excluding construction (about 2.5 percentage points higher than the average for the other major countries), mainly owing to the fall in productivity. Average annual inflation rose by 0.2 percentage points to 2.8 per cent in 2003 and was fueled by a faster increase in prices of regulated items. Net of these items and the most volatile components, inflation fell from 3 to 2.7 per cent, with a slowdown in the prices of both goods and services.

In contrast with the rest of the euro area, in Italy households continued to perceive a very high rate of consumer price inflation in 2003. It is plausible that consumers' opinions were influenced above all by higher than average rises in the prices of the most frequently purchased items. Moreover, in all likelihood they assessed price increases and decreases differently.

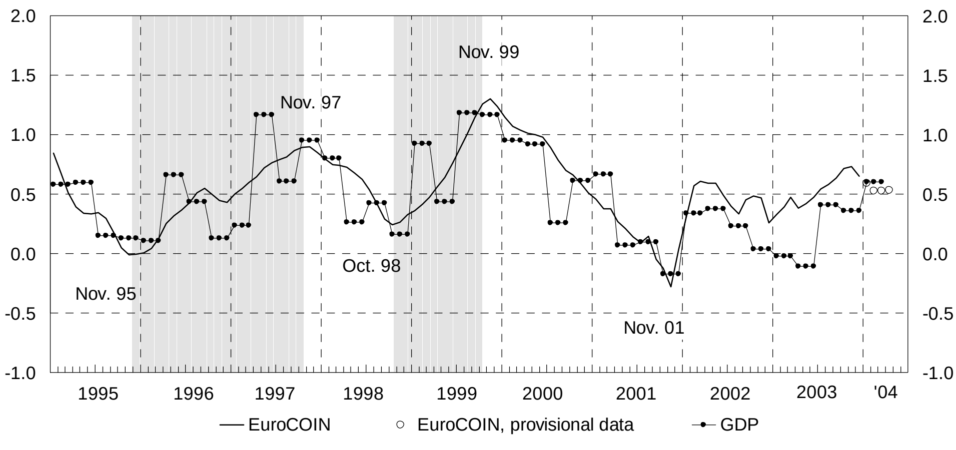
Recent developments

The recovery of economic activity in the euro area that began in the second half of 2003 gained strength in the first quarter of this year. According to preliminary estimates by Eurostat, GDP was 0.6 per cent higher than in the fourth quarter of last year. The signs coming from the EuroCOIN coincident indicator remain uncertain (Figure 5). In the early months of 2004 the index of industrial production remained at the end-2003 level (Figure 4), probably showing the effects of the appreciation of the euro.

Figure 5

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

(three-month percentage changes)



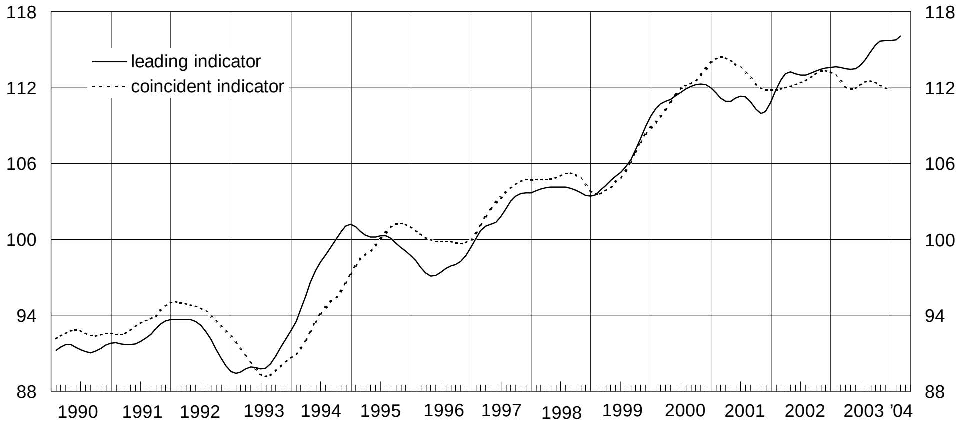
Source: Center of Economic Policy Research.
(1) The shaded areas denote cyclical upturns.

The consensus forecast is that euro-area inflation will come down further in 2004, falling to below 2 per cent in the second half of the year. In 2005 it is expected to be 1.6 per cent.

Figure 6

INDICATORS OF THE ITALIAN BUSINESS CYCLE

(indices, 1995=100)



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

Italy's business cycle follows the same pattern of macroeconomic developments as that described for the euro area, but with wider fluctuations. After stagnating in the last quarter of 2003, GDP expanded by 0.4 per cent quarter on quarter; the growth was concentrated in the service and agricultural sectors. The leading indicator of the Italian business cycle does not yet show a steady rise (Figure 6).

DEMAND

The euro area

Household consumption

In 2003 household spending in the euro area returned to growth, albeit by a modest 1 per cent, after stagnating in 2002 (Table 4). The rise came entirely in the first quarter. The increase involved all the main countries except Germany, which registered a slight contraction, performing significantly worse than the rest of the area for the fourth consecutive year. By contrast, in France, Italy and Spain growth strengthened.

Table 6

ITALIAN HOUSEHOLD CONSUMPTION

(at 1995 prices; percentage changes)

	% share in 2003	2000	2001	2002	2003
Non-durable goods	43.4	1.6	0.1	..	0.5
food and beverages	*16.0*	*2.1*	*0.2*	*0.8*	*0.8*
clothing and footwear	*9.0*	*2.5*	*–0.2*	*–0.8*	*–2.0*
Durable goods	11.9	5.8	–0.7	–1.8	1.8
furniture and repairs	*3.8*	*2.8*	*–1.4*	*–4.8*	*2.4*
electrical household appliances and repairs	*1.5*	*1.1*	*0.7*	*4.2*	*9.6*
television receiving sets, photographic, computer and hi-fi equipment	*1.4*	*14.6*	*6.4*	*2.7*	*1.2*
transport equipment	*3.8*	*2.8*	*–3.2*	*0.2*	*–2.9*
Services	44.8	4.0	1.6	0.6	1.3
hotel and restaurant	*9.2*	*8.6*	*2.5*	*–0.8*	*–0.5*
communication	*4.3*	*18.4*	*4.6*	*3.2*	*5.3*
recreational and cultural	*2.6*	*5.9*	*–0.7*	*0.3*	*–0.5*
healthcare	*3.1*	*0.6*	*–1.0*	*1.9*	*2.8*
Total domestic consumption	100.0	3.1	0.7	0.1	1.0
Residents' consumption abroad	(1)	–3.2	–5.6	7.1	3.5
Non-residents' consumption in Italy	(1)	8.5	–5.5	–5.3	–4.1
Total national consumption	–	2.7	0.8	0.5	1.3
Memorandum item:					
Deflator of national consumption	–	2.9	2.8	3.1	2.5

Source: Istat, national accounts.

(1) Residents' consumption abroad and non-residents' consumption in Italy amounted in 2003 to 2.6 and 3.6 per cent, respectively, of total domestic consumption.

Household confidence deteriorated in all the main countries from the middle of 2002 to the middle of 2003. While the recovery got under way in the area as a whole in the summer, a climate of prudence prevailed in France and particularly Italy, where confidence fluctuated around a downward trend. More promising signs began to spread to the other main countries in March of this year.

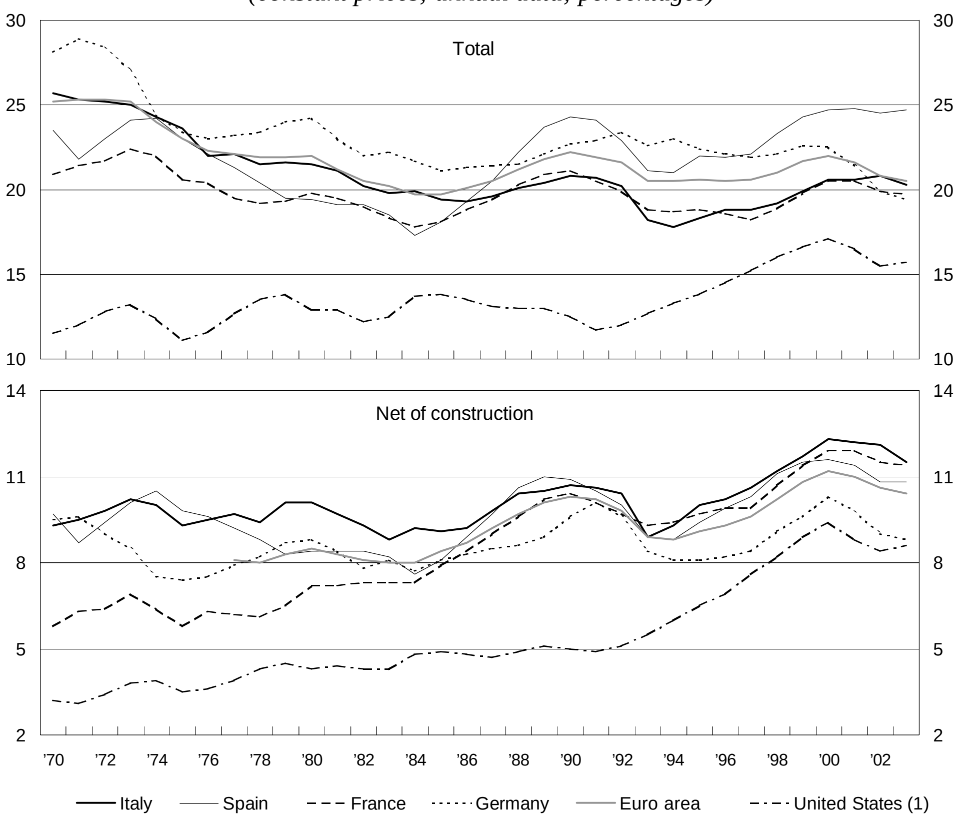
Investment

In 2003 investment in the euro area decreased further by 1 per cent, registering an overall contraction of 4.1 per cent since 2000. After rising to 22 per cent of GDP in that year, it dropped by almost 2 percentage points to a level close to that of the mid-1990s (Figure 7). Although borrowing conditions remained favourable, investment plans were discouraged by substantial spare capacity and enduring uncertainty about the timing and extent of the recovery.

Figure 7

RATIO OF GROSS FIXED INVESMENT 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 contraction in gross fixed investment was sharpest in Germany, less marked in Italy and even more moderate in France (Table 4). Capital formation continued only in Spain, expanding by 3 per cent after the previous year's sharp decline in all sectors but construction.

Exports and imports

In 2003 exports of goods and services by the euro area as a whole – which include intra-area trade – were virtually stationary after two years of slowing growth. National performances differed widely. French and Italian exports fell while those of Germany and Spain increased (Table 4). According to the foreign trade indices, total exports of goods to countries outside the euro area rose by 0.5 per cent at constant prices, compared with 3 per cent in 2002. Despite the appreciation of the euro, exports picked up during the year in response to the recovery in world trade. In Italy, however, there was a new downturn in exports in the fourth quarter.

After stalling in 2002, euro-area imports of goods and services – including intra-area imports – increased by 1.8 per cent. According to the foreign trade indices, a larger increase was registered in imports of goods from countries outside the euro area, which went up by 2.8 per cent under the stimulus of a modest upturn in domestic demand and appreciation of the euro (Table 4). Net external demand subtracted 0.6 percentage points from output growth, the first negative contribution in four years.

The Italian economy

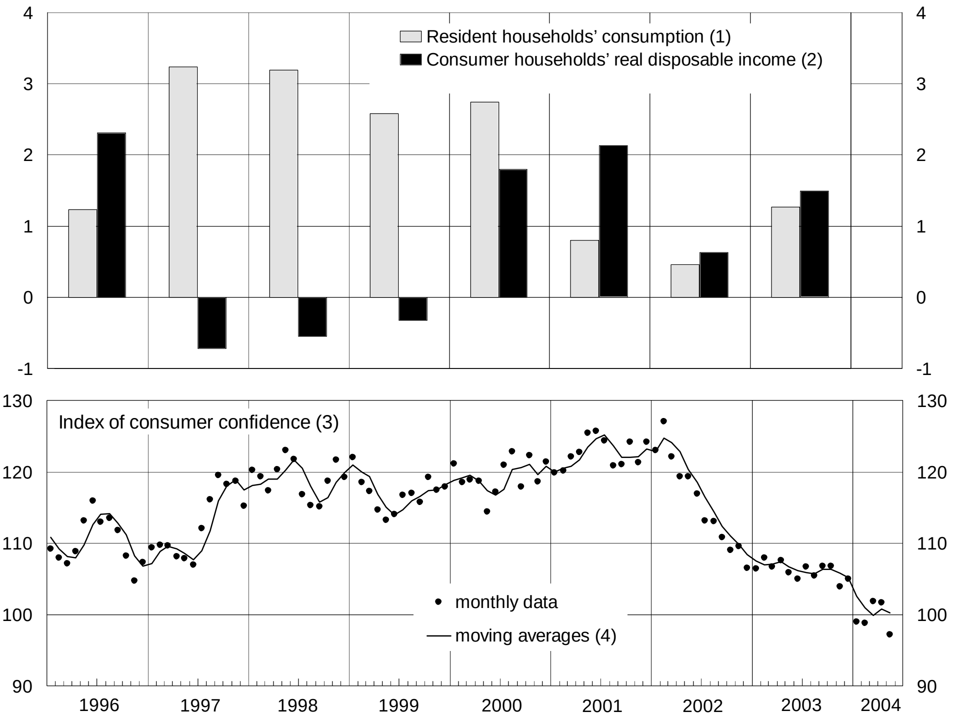
Household consumption

Household spending in Italy increased on average by 1.3 per cent at constant prices in 2003, a slight improvement on the modest growth of the previous two years. Spending on services, mainly for health and home, continued to rise. Regarding durable goods, spending on transport equipment fell by nearly 3 per cent in the year as a whole, after the sharp increase in the second half of 2002 when incentives to scrap old vehicles were in place. Demand for other durable goods, principally household appliances and furniture, rose by 4.1 per cent in connection with the prolonged upswing in residential construction.

Despite the improvement in spending capacity, households' demand was affected by lingering pessimism over the general economic outlook and the labour market. The ISAE survey found that respondents' opinions of their own financial situation also deteriorated sharply in 2003. This led to a progressive decline in the confidence index that continued into this year, reaching a new low point in May (Figure 8).

Figure 8

CONSUMPTION, REAL INCOME AND CONSUMER CONFIDENCE IN ITALY



Source: Based on Istat and ISAE data.

(1) At 1995 prices; percentage change on previous year. – (2) Percentage change on 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.

In 2003 the gross disposable income of Italian consumer households grew by 4 per cent at current prices and by 1.5 per cent at constant prices, faster than in 2002 (Table 7). Adjusted for the smaller drop in the purchasing power of net financial assets due to the decline in expected inflation during the year, the increase at constant prices was 2.1 per cent.

The effect of general government measures was broadly neutral, with the 4.9 per cent increase in the provision of social benefits offset by a rise of 5.8 per cent in social security contributions and virtually no change in current taxation of income and capital, which declined from 14.4 to 13.9 per cent of disposable income.

Table 7

GROSS DISPOSABLE INCOME AND PROPENSITY TO SAVE IN ITALY

(at current prices, except as indicated)

	2000	2001	2002	2003
	percentage changes			
Earnings net of social contributions charged to workers	5.2	5.7	4.3	3.5
Income from salaried employment per standard labour unit	*3.0*	*3.3*	*2.4*	*3.8*
Total social contributions (1)	*0.2*	*0.3*	*0.1*	*–0.7*
Standard employee labour units	*1.9*	*2.1*	*1.8*	*0.5*
Income from self-employment net of social contributions (2)	3.4	5.4	2.2	3.0
Income from self-employment per standard labour unit	*2.5*	*4.3*	*2.8*	*3.0*
Total social contributions (1)	*–0.5*	*0.5*	*–0.6*	*–0.2*
Standard self-employed labour units	*1.4*	*0.5*	*..*	*0.2*
Net property income (3)	7.7	2.5	–0.2	2.0
Social benefits and other net transfers	2.8	3.3	6.3	5.1
net social benefits	*3.0*	*3.8*	*6.0*	*4.9*
Current taxes on income and wealth (–)	4.8	1.4	1.1	0.2
Households' gross disposable income (4)	**4.8**	**4.9**	**3.7**	**4.0**
at 1995 prices (5)	1.8	2.1	0.6	1.5
at 1995 prices, adjusted for expected inflation (6)	1.8	1.7	0.6	2.1
at 1995 prices, adjusted for past inflation (7)	1.6	2.6	–0.3	2.5
Private sector gross disposable income	**5.2**	**4.3**	**3.4**	**3.3**
at 1995 prices (5)	2.2	1.5	0.3	0.7
at 1995 prices, adjusted for expected inflation (6)	2.4	1.3	0.2	1.2
at 1995 prices, adjusted for past inflation (7)	2.3	2.0	–0.4	1.5
	percentage			
Households' average propensity to save (4) (8)	**11.2**	**12.4**	**12.5**	**12.7**
calculated on income adjusted for expected inflation	8.7	9.5	9.6	10.4
calculated on income adjusted for past inflation	8.0	9.6	8.9	10.0
Private sector average propensity to save (8)	**23.5**	**24.0**	**23.9**	**23.5**
calculated on income adjusted for expected inflation	24.0	24.6	24.6	24.0
calculated on income adjusted for past inflation	24.1	24.6	24.7	24.1

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

(1) Contribution of social contributions to the change in net income, in percentage points; 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 of saving (gross of depreciation and amortization and net of the change in pension fund reserves) to the gross disposable income of the sector.

Italian households' propensity to save increased from 12.5 to 12.7 per cent. If income is adjusted for expected inflation, it increased by almost 1 percentage point to 10.4 per cent.

With the protraction of discussions on the reform of the pension system, in recent years Italian households have probably become more unsure about what benefits they can expect when they retire. According to recent estimates, pension wealth, which is a measure of the present value of expected flows of benefits, fell to about 3 times disposable income in 2002, less than half of what the ratio was ten years before. A recent econometric analysis by the Bank's Economic Research Department indicates that this has had a negative impact on consumer spending plans. Households have presumably compensated for the smaller contribution of pensions by stepping up other investments, particularly in real estate in recent years. Between 1992 and 2002 non-pension wealth, net of the substantial increase in real-estate values, rose from 6 to around 8 times disposable income.

Possibly, in order to support this investment, households' propensity to save began to decline less sharply before turning back upwards in 2001. Including services for durable goods and adjusting for the loss of purchasing power of financial assets, the saving rate rose by almost 2 percentage points in the three years.

The growth in gross disposable income of the private sector as a whole – that is, households and enterprises – was virtually stable at the previous year's rate of around 3 per cent at current prices. In view of the fall in the retained earnings of firms, the private sector saving rate decreased from 23.9 to 23.5 per cent. The overall national saving rate fell more sharply, from 19.9 to 18.7 per cent, reflecting the contraction of 0.3 per cent in general government saving, compared with an increase of 0.8 per cent in 2002 (Table 8).

Table 8

GROSS SAVING AND INVESTMENT IN ITALY

(as a percentage of gross national disposable income)

	Average 1981-1990	Average 1991-2000	Average 1994-2003	2000	2001	2002	2003
General government saving	–6.4	–3.3	–0.9	1.5	1.0	0.8	–0.3
Private sector saving	28.8	24.1	21.7	18.8	19.2	19.2	18.9
consumer households	*22.4*	*14.0*	*11.1*	*7.7*	*8.5*	*8.7*	*8.9*
Gross national saving	22.4	20.7	20.8	20.3	20.2	19.9	18.7
Gross investment	23.3	19.9	19.7	20.5	19.9	20.2	19.9
Memorandum item:							
Balance of current account transactions with the rest of the world	–0.9	0.8	1.1	–0.2	0.3	–0.3	–1.2

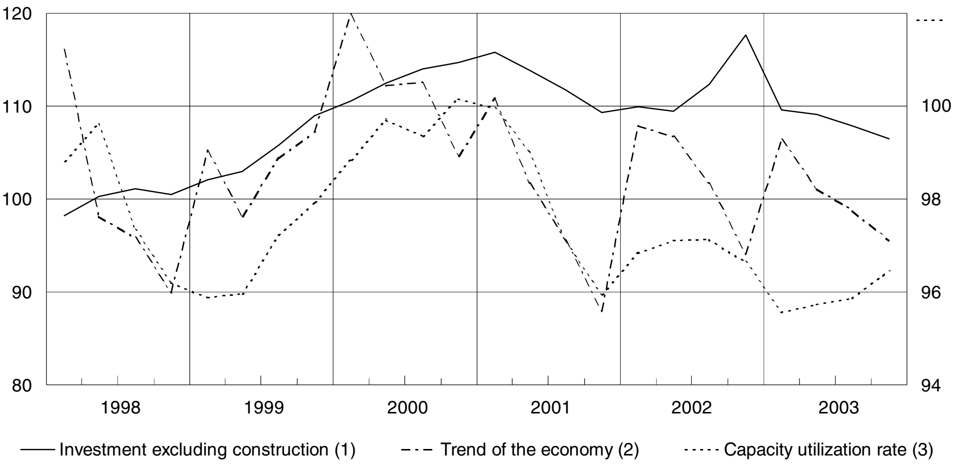
Sources: Based on Istat and Bank of Italy data.

Investment

Gross fixed investment declined by 2.1 per cent in 2003 reflecting a sharp drop in spending on machinery and equipment and transport equipment

Figure 9

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



Sources: Based on Istat and ISAE data.

(1) At constant prices. Indices, 1998=100. – (2) Average of seasonally adjusted differences between the percentage of positive replies ("increasing") and negative replies ("decreasing") to ISAE business opinion surveys regarding the 3-4 month trend of output; indices, 1998=100. – (3) Average of Bank of Italy's indicators (Wharton) and ISAE indicators for industrial sectors; indices, 1989=100. Right-hand scale.

(Table 9). Apart from a brief upturn in the second half of 2002 in connection with the impending expiry of tax incentives, capital formation has diminished steadily the second quarter of 2001 onwards, the longest decline in the past thirty years. As a consequence, 0.6 percentage points were subtracted from output growth last year. By contrast investment in construction continued to increase although the growth of 1.8 per cent was only about half the average annual rate of increase recorded between 1999 and 2002.

Table 9

FIXED INVESTMENT IN ITALY

(at 1995 prices; percentage changes and percentages)

	% composition in 2003	Percentage change			As a percentage of GDP		
		2001	2002	2003	2001	2002	2003
Construction	43.5	3.0	3.3	1.8	8.5	8.7	8.8
residential	*23.9*	*1.4*	*4.4*	*2.3*	*4.6*	*4.8*	*4.9*
other	*19.6*	*4.8*	*1.9*	*1.3*	*3.9*	*3.9*	*4.0*
Machinery and equipment	40.5	–0.4	–0.3	–4.0	8.7	8.6	8.2
Transport equipment	11.4	5.8	–0.3	–9.8	2.6	2.6	2.3
Intangible assets	4.5	2.9	0.3	0.6	0.9	0.9	0.9
Total gross fixed investment	**100**	**1.9**	**1.2**	**–2.1**	**20.6**	**20.8**	**20.3**
Total excluding residential buildings	–	2.0	0.2	–3.4	16.1	16.0	15.5
Total excluding construction	–	1.1	–0.3	–4.9	12.2	12.1	11.5
Total net fixed investment (1)	**–**	**–0.5**	**–2.4**	**–12.0**	**6.8**	**6.7**	**5.8**

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

Despite the low cost of money, capital formation was discouraged by the later than expected recovery of demand and by the deterioration in firms' profits and financial situation after prolonged improvement. In addition there continued to be an excess of spare capacity, particularly in sectors exporting a large share of their output.

Investment in residential building continued to expand steadily (Table 9), both for new homes and for renovation and extraordinary maintenance work, which was encouraged by a further extension of the tax credits introduced in 1998. Demand in the property market remained robust, benefiting from still favourable conditions for mortgage loans, which rose by a further 16.1 per cent last year. Real-estate prices continued to climb, as they had been doing since 2000 (Table 10).

Investment in non-residential construction slipped from growth of 1.9 to 1.3 per cent, as civil engineering work stagnated after expanding by 8.3 per cent in 2002. These projects account for about one third of the entire construction sector and comprise part of public works activity as well as private infrastructure investments, where the slowdown was most marked.

Table 10

REAL HOUSE PRICES IN THE MAIN ITALIAN CITIES (1)

(percentage changes, except as indicated)

	% of total (2)	2000	2001	2002	2003	Relative nominal prices (3)
Rome	4.74	1.5	4.7	12.5	19.0	1.62
Milan	2.51	1.4	12.3	9.4	17.6	1.74
Turin	1.71	1.6	–0.4	7.7	8.7	0.88
Naples	1.37	–3.9	0.6	12.0	19.6	1.28
Genoa	1.21	–7.0	9.7	18.3	6.0	1.02
Palermo	1.04	2.9	–0.2	9.5	–7.7	0.64
Bologna	0.77	1.6	14.5	6.6	13.5	1.22
Florence	0.69	11.4	21.4	23.4	22.9	1.38
Venice	0.50	–4.9	5.4	11.8	7.6	1.36
Bari	0.49	–0.7	4.3	3.8	11.8	0.83
Trieste	0.45	–3.2	–2.0	14.1	3.5	0.75
Cagliari	0.28	4.8	4.2	–1.4	13.3	0.72
Perugia	0.23	–7.0	3.1	6.4	2.4	0.68
Ancona	0.17	–5.8	–1.9	19.8	1.4	0.83
Trento	0.17	1.3	0.3	9.4	3.1	0.81
Catanzaro	0.13	–0.7	12.2	9.4	–3.6	0.51
L'Aquila	0.11	–3.9	–3.5	6.9	10.4	0.60
Potenza	0.09	–1.1	–4.4	5.6	2.4	0.56
Campobasso	0.07	6.5	–0.4	7.7	–2.3	0.55
Aosta	0.06	0.3	0.2	7.9	–6.0	0.79
Italy	**100**	**1.3**	**5.0**	**8.8**	**10.4**	**1.0**

Sources: Based on data from *Il Consulente Immobiliare*, Istat, and Bank of Italy, *Indagine sui bilanci delle famiglie italiane*.

(1) Prices per square metre in euros obtained by deflating current prices with consumer prices in each city. – (2) Share of total housing units in Italy in 2003. – (3) Average nominal prices in each of the cities as a ratio to the national average in 2003, which was €2,747 per square metre.

Exports and imports

Exports. – In 2003 exports of goods and services contracted by a further 3.9 per cent in volume (Table 11), marking the first time since the 1950s that Italy's exports have declined for two years running. The poor performance, the worst of all the main continental European countries, contrasts with the gradual recovery of Italy's main outlet markets, which grew on a par with those of France and faster that those of Germany and Spain (Table 12). Italian exports were affected by larger losses of price competitiveness. Between end-2001 and end-2003 the loss amounted to almost 8 per cent measured on the basis of the producer prices of manufactures and around 16 per cent on the basis of unit labour costs, some 10 points more than for Germany and France (Figure 10). In both those countries the loss of competitiveness was due almost entirely to the nominal appreciation of the euro, whereas in Italy this was compounded by a much more unfavourable trend in unit labour costs, largely due to the widening gap in productivity, which declined in Italy over the two years.

Table 11

ITALY'S EXPORTS AND IMPORTS OF GOODS AND SERVICES

(percentage changes on previous year, except as indicated)

	2001			2002			2003		
	Goods	Services	Total	Goods	Services	Total	Goods	Services	Total
Exports (1)									
At current prices	4.8	5.0	4.8	–1.6	–2.1	–1.7	–3.6	–0.3	–2.9
At 1995 prices	1.5	1.8	1.6	–2.9	–5.3	–3.4	–4.3	–2.2	–3.9
Deflators	3.2	3.1	3.2	1.4	3.3	1.8	0.7	1.9	1.0
Imports (2)									
At current prices	2.4	5.5	3.1	–1.2	3.4	–0.1	–1.3	–1.7	–1.4
At 1995 prices	..	2.2	0.5	–1.1	2.6	–0.2	–1.3	1.6	–0.6
Deflators	2.4	3.2	2.6	-0.2	0.8	0.1	..	–3.2	–0.8
Exports/imports									
At current prices, % ratio	108.6	94.5	105.3	108.2	89.4	103.7	105.7	90.7	102.1
At 1995 prices, % ratio	110.2	96.3	107.1	108.2	88.9	103.7	104.9	85.7	100.3
Terms of trade; indices, 1995=100	98.5	98.1	98.4	100.1	100.6	100.0	100.8	105.9	101.8
Contribution of net exports to real GDP growth (3)	0.4	..	0.3	–0.5	–0.5	–0.9	–0.7	–0.2	–0.9

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

As in the previous three years, Italian exports to the other EU member states fell more than those to the rest of the world (Table 13). The decline in exports to the euro area was even sharper, particularly to Italy's two main outlets, the French and German markets. Among the non-EU countries, the sharpest contraction involved exports to the United States and China (Table 13), even though both countries' imports expanded.

Table 12

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

(at constant prices; percentage changes)

	1999	2000	2001	2002	2003
Germany					
Imports of goods and services	8.4	10.5	0.9	–1.7	2.6
Exports of goods and services	5.5	13.7	5.6	3.4	1.2
Outlet markets (1)	7.6	11.2	0.8	2.0	2.0
Indicators of competitiveness (2)					
overall	–3.7	–6.9	3.2	1.7	6.3
export	–4.3	–7.8	3.4	2.3	7.3
import	–3.0	–5.8	3.0	1.0	4.9
France					
Imports of goods and services	6.2	14.6	1.3	2.9	–0.1
Exports of goods and services	4.3	12.6	1.6	1.9	–2.5
Outlet markets (1)	8.1	10.4	1.0	0.9	2.5
Indicators of competitiveness (2)					
overall	–2.4	–4.8	0.7	1.7	4.3
export	–3.2	–5.8	1.1	2.3	5.4
import	–1.5	–3.8	0.3	1.0	3.0
Italy					
Imports of goods and services	5.6	7.1	0.5	–0.2	–0.6
Exports of goods and services	0.1	9.7	1.6	–3.4	–3.9
Outlet markets (1)	8.2	11.5	0.9	1.3	2.5
Indicators of competitiveness (2)					
overall	–2.8	–3.1	1.6	2.2	5.1
export	–3.6	–4.3	1.9	2.9	6.4
import	–1.7	–1.4	1.2	1.3	3.4
Spain					
Imports of goods and services	12.6	10.6	4.0	1.8	6.7
Exports of goods and services	7.7	10.0	3.6	..	4.0
Outlet markets (1)	7.4	11.0	0.9	1.2	1.5
Indicators of competitiveness (2)					
overall	–1.1	–2.6	1.1	2.1	3.7
export	–1.7	–3.5	1.2	2.6	4.8
import	–0.5	–1.7	0.9	1.6	2.8

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.

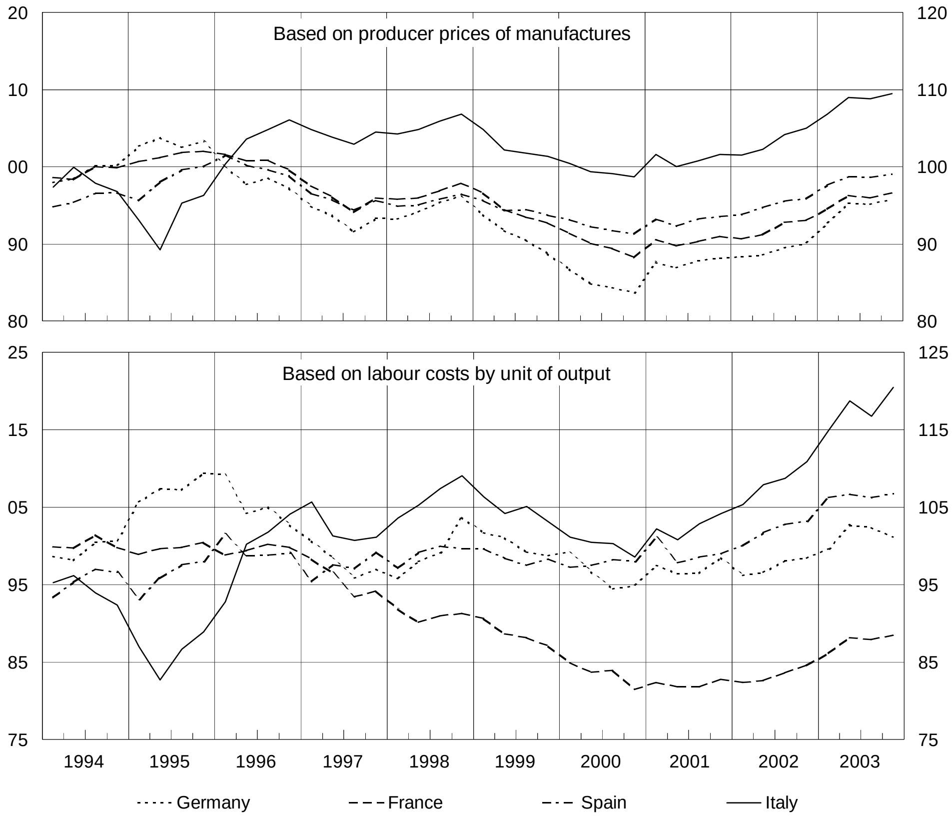
To offset some of the euro’s appreciation against the dollar, which averaged 19.6 per cent in 2003, Italian exporters kept their US prices down. As a result average unit values, which act as a proxy, decreased by 5.2 per cent from the previous year. The other euro-area countries maintained their share of the US market, while China’s continued to increase and was second only to that of Canada in 2003.

In 2003 the exports of goods at constant prices by Italy’s main sectors of specialization decreased; exports of leather and footwear were down by 10.9 per cent, textiles and clothing by 9.1 per cent, non-metallic minerals by 7.5 per cent, electrical engineering by 6.6 per cent and mechanical engineering by 4.8 per cent. Only exports of chemical products held up.

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 exchange rates; an increase indicates a loss of competitiveness.

Imports. – In 2003 imports of goods and services fell by 0.6 per cent at constant prices, after a smaller contraction in 2002. Given the decline in exports, in the two years net foreign demand subtracted 0.9 percentage points from the annual growth in output, more than twice the 0.4 percentage point average registered in the previous five years.

Table13

ITALIAN EXPORTS AND IMPORTS *CIF-FOB*
BY MAIN COUNTRIES AND AREAS:
VALUES AND INDICES OF AVERAGE UNIT VALUES (AUV) AND VOLUMES
(percentage composition and percentage changes on previous year; indices, 2000=100)

	Exsprts						Imports					
	2002			2003			2002			2003		
	% comp. of value in 2001	% change in AUV	% change in volumes	% comp. of value in 2002	% change in AUV	% change in volumes	% comp. of value in 2001	% change in AUV	% change in volumes	% comp. of value in 2002	% change in AUV	% change in volumes
EU-15 countries	**54.2**	**1.5**	**–3.7**	**53.9**	**1.3**	**–5.7**	**57.0**	**0.7**	**–0.8**	**57.6**	**1.4**	**–3.7**
France	*12.3*	*2.2*	*–3.8*	*12.3*	*2.4*	*–6.5*	*11.2*	*1.9*	*–1.0*	*11.4*	*2.2*	*–5.7*
Germany................	*14.7*	*1.0*	*–8.1*	*13.8*	*2.2*	*–6.3*	*17.8*	*0.2*	*–1.0*	*17.9*	*–0.2*	*–1.7*
United Kingdom	*6.8*	*1.7*	*0.1*	*7.0*	*–3.2*	*–1.7*	*5.1*	*0.8*	*–1.7*	*5.1*	*1.2*	*–10.2*
Spain	*6.2*	*3.6*	*–1.2*	*6.4*	*1.6*	*2.4*	*4.2*	*–1.7*	*10.4*	*4.6*	*4.3*	*–2.7*
Non-EU-15 countries	**45.8**	**1.3**	**–2.0**	**46.1**	**0.4**	**–3.7**	**43.0**	**–2.3**	**..**	**42.4**	**–1.9**	**1.9**
New EU countries (1)	*5.3*	*2.6*	*–2.3*	*5.4*	*2.6*	*4.4*	*3.3*	*0.4*	*3.2*	*3.4*	*–1.3*	*5.0*
China.....................	*1.2*	*1.0*	*22.1*	*1.5*	*2.8*	*–7.7*	*2.8*	*–7.8*	*20.7*	*3.2*	*–10.9*	*28.7*
Japan.....................	*1.7*	*–1.6*	*–2.1*	*1.7*	*–0.4*	*–4.0*	*2.4*	*0.6*	*–15.8*	*2.0*	*–0.5*	*–0.6*
DAE (2)	*3.6*	*3.1*	*–8.6*	*3.5*	*–2.1*	*–6.1*	*2.4*	*–0.1*	*–4.8*	*2.3*	*–2.3*	*8.2*
Russia	*1.3*	*8.5*	*–1.1*	*1.4*	*3.2*	*–1.6*	*3.2*	*–6.6*	*–0.8*	*3.0*	*1.5*	*2.5*
United States...........	*9.6*	*–0.3*	*–1.5*	*9.6*	*–5.2*	*–9.9*	*4.9*	*2.1*	*–4.5*	*4.8*	*–4.7*	*–14.3*
Total ...	**100.0**	**1.4**	**–2.8**	**100.0**	**0.8**	**–4.7**	**100.0**	**–0.5**	**–0.6**	**100.0**	**..**	**–1.3**

Source: Based on Istat data.

(1) Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic and Slovenia. – (3) Dynamic Asian economies: Hong Kong, Malaysia, Singapore, South Korea, Taiwan and Thailand.

Imports from the EU-15 declined by 3.7 per cent, spread among all the main countries, while those from non-EU countries turned upwards by 1.9 per cent with the appreciation of the euro. The largest contribution to import growth came from purchases from China, which rose by 28.7 per cent.

DOMESTIC SUPPLY

Economic sectors

In Italy value added at current prices was virtually unchanged in 2003, growing by just 0.1 per cent. The increase of 0.6 per cent in services was largely counterbalanced by a contraction of 0.4 per cent in the industrial sector, whose share of total value added decreased again (Table 14).

Table 14

VALUE ADDED AT FACTOR COST IN ITALY

	2002		2003		Percentage changes			
	Current prices (millions of euros)	Share of value added (%)	Current prices (millions of euros	Share of value added (%))	Volumes		Deflators	
					2002	2003	2002	2003
Industry	**306,902**	**26.9**	**313,226**	**26.6**	**0.2**	**–0.4**	**1.2**	**2.4**
Industry excluding contruction	**250,142**	**21.9**	**253,420**	**21.5**	**–0.3**	**–1.0**	**0.8**	**2.3**
Extractive industries	4,977	0.4	4,949	0.4	3.9	–0.1	–3.4	–0.5
Manufacturing	220,665	19.4	221,642	18.8	–1.2	–1.4	2.0	1.9
Production and distribution of electricity, gas, steam and water	24,500	2.1	26,829	2.3	7.2	2.5	–9.1	6.8
Construction	**56,760**	**5.0**	**59,806**	**5.1**	**2.5**	**2.5**	**3.2**	**2.8**
Services	**801,675**	**70.3**	**834,670**	**70.7**	**0.9**	**0.6**	**3.3**	**3.5**
Wholesale and retail trade, repairs	146,620	12.9	150,424	12.7	–0.8	0.2	2.8	2.3
Hotels and restaurants	41,411	3.6	43,336	3.7	–1.1	–0.7	4.9	5.4
Transport, storage and communication services	85,297	7.4	87,547	7.4	1.5	0.0	0.8	2.7
Financial intermediation services (1)	65,019	5.7	65,087	5.5	–2.9	–0.2	2.8	0.3
Services to businesses and households (2)	240,264	21.1	253,118	21.5	3.5	1.7	4.0	3.6
Public administration (3)	62,056	5.4	65,754	5.6	–0.2	0.3	6.3	5.7
Education	56,608	5.0	61,361	5.2	0.8	1.0	1.1	7.3
Health and other social services	54,227	4.8	55,284	4.7	3.8	0.7	0.0	1.2
Other community, social and personal services	41,051	3.6	43,039	3.6	–0.1	0.1	5.9	4.7
Private households with employed persons	9,122	0.8	9,720	0.8	1.7	2.1	3.2	4.4
Agriculture (4)	**31,670**	**2.8**	**32,067**	**2.7**	**–3.8**	**–5.6**	**3.3**	**7.3**
Value added at factor cost (5)	**1,140,247**	**100.0**	**1,179,963**	**100.0**	**0.6**	**0.1**	**2.7**	**3.3**

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.

In the service sector, which accounts for more than 70 per cent of national value added, the largest increases in production came in domestic services provided to households and services provided to businesses and households. Wholesale and retail trade showed a small rise, while the value added of hotels and restaurants and financial intermediation services continued to fall, although by less than in 2002.

Value added in agriculture, forestry and fishing contracted sharply, continuing a trend under way since 2000; the sector's share of total value added fell to 2.7 per cent.

In 2003 Italy's gross energy requirement increased by 2.9 per cent. However, domestic energy production fell again (by 2.3 per cent with respect to the previous year), causing Italy's import dependency to rise from 83.9 to 84.8 per cent. The "energy bill" (total expenditure on primary energy imports) was trimmed to 2 per cent of GDP as a result of the appreciation of the euro against the dollar.

Company demographics. – According to the Chamber of Commerce register of companies, entries of non-farm companies outnumbered exits by about 94,000 in 2003. Over the year the number of registered firms rose by 2 per cent, an historically large increase if compared with the change in GDP. The positive balance was the result of about 354,000 entries and 260,000 exits, generating "turbulence" – the ratio of the sum of entries and exits to the number of registered firms – of 12.5 per cent, less than the 13.7 per cent recorded in 2002.

Net business creation was positive in all parts of the country. The largest gains came in real estate and construction, which continued to benefit from favourable market conditions. They accounted for more than 38 per cent of the increase in the number of registered firms in 2003. The number of firms in wholesale and retail trade also rose, by about 14,000.

The evolution of the Italian business system

Istat recently published the final data of the eighth Census of Industry and Services, which refers to 22 October 2001. Changes in survey methods complicate direct comparison with previous censuses.

Compared with the 1991 census, for the total economy the average number of workers per firm decreased by 11 per cent, from 4.4 to 3.9 (Table 15), confirming the tendency towards fragmentation of production under way since the 1970s. The decline in average firm size is attributable to the higher proportion of those with a single worker (i.e. businesses with no employees, a category referring mainly to persons in the professions, consultants and other self-employed workers), the number of which increased substantially, partly as a result of the new survey methodology. Excluding this class, the average firm had 7.9 workers, up slightly from 7.6 in 1991.

Table 15

FIRMS AND AVERAGE FIRM SIZE IN ITALY

Size classes (number of workers)	1991		1996		2001 (1)	
	Firms	Average size (workers per firm)	Firms	Average size (workers per firm)	Firms	Average size (workers per firm)
1	1,569,954	1.0	1,956,368	1.0	2,376,017	1.0
2 – 49	1,678,364	4.8	1,545,782	4.8	1,649,938	4.9
50 – 99	11,648	68.3	10,903	69.0	13,564	68.4
100 – 249	6,005	149.5	5,730	149.7	6,868	150.1
250 – 499	1,695	340.0	1,572	342.1	1,925	342.9
>500	1,184	2,167.0	1,061	2,101.3	1,338	1,875.3
Total ...	**3,268,850**	**4.4**	**3,521,416**	**3.9**	**4,049,650**	**3.9**
Sector						
Extractive	3,617	12.8	4,239	9.1	3,837	9.4
Manufacturing	552,334	9.5	551,241	8.9	542,876	9.0
Energy	1,273	135.4	1,985	82.1	1,983	64.7
Construction	332,995	4.0	440,824	3.1	515,777	3.0
Wholesale and retail trade .	1,280,044	2.5	1,227,679	2.4	1,230,731	2.6
Hotels and restaurants	217,628	3.3	211,573	3.4	244,540	3.5
Transport and communication services	124,768	9.1	156,148	7.0	157,390	7.6
Financial intermediation services	49,897	11.5	63,003	8.9	81,870	7.2
Real estate (2)	375,729	3.1	667,996	2.3	846,518	2.6
Education	12,091	5.2	–	–	14,409	3.4
Health (3)	118,911	2.4	–	–	180,450	2.1
Other services	199,563	2.4	196,728	2.2	229,269	2.5
Total ...	**3,268,850**	**4.4**	**3,521,416**	**3.9**	**4,049,650**	**3.9**

Source: Based on Istat's 1991, 1996 and 2001 censuses.
(1) Excluding agriculture and public and non-profit institutions. – (2) Includes rental, information technology and research services. – (3) Includes social services.

The average workforce of firms with between 20 and 249 workers increased marginally (from 46.2 to 48). By contrast, that of large firms (with more than 500 workers) decreased by about 13 per cent to 1,875.3; the number of firms in this size class rose appreciably.

The 2001 census revealed a further decline from 36.1 to 31.3 per cent in the manufacturing sector's share of total employment, with the loss of 368,000 workers. Employment in traditional Italian export industries (textiles, clothing and footwear) continued the contraction that began in 1981. The service sector added 1,367,000 workers between 1991 and 2001 and its share of employment rose from 52.9 to 57.8 per cent. Employment in wholesale and retail trade decreased overall, as the gain in the second half of the 1990s was not sufficient to offset the pronounced loss recorded between 1991 and 1996. By contrast, the number of active firms and the share of employment in construction rose sharply, especially in the last five years of the survey period. All segments of the service sector saw average firm size decline, with the exception of wholesale and retail trade and hotels, where most of the rise in average size occurred in the second half of the 1990s.

The growth in employment in the mechanical engineering industry during the decade (11 per cent, equal to 60,000 workers) may reflect the shift by some firms, especially those established in industrial districts, from the manufacture of traditional final goods to the production of the machinery needed to make those products. The increase in the share of employment in the metal-working and metal products sector, mainly attributable to the increase in subcontracting and the manufacture of semi-finished goods, could reflect the outsourcing of activities upstream in the chain of production.

Medium-sized firms appear to be one of the strengths of Italian industry. A recent survey conducted by Mediobanca and Unioncamere of Italy's medium-sized industrial firms (defined as corporations with between 50 and 499 employees, turnover of between €13 million and €260 million and independent ownership) found about 3,700 such firms. As a group, they employed 482,000, or 10 per cent of Italy's manufacturing workforce, in 1999 and showed operating profits between 1996 and 2000. About nine tenths of these firms had between 50 and 249 employees. Most of them were specialized in typical Italian export sectors and had a relatively sound financial position. Between 1998 and 2000, the survey shows, these efficient firms tended to grow in size. In particular, the sample includes many formerly small firms that became medium-sized and medium-sized ones that have developed into large enterprises. By contrast, there were few cases of small firms jumping directly to the largest category of firms. Medium-sized enterprises do not appear to have had much difficulty in raising funds and maintained a level of liquidity equal to that of large groups. Their external financing largely came from banks, and their average cost of debt, consisting mainly of short-term liabilities, was equivalent to that of large firms.

The ownership structure of Italian firms

The results achieved by firms are closely linked to the characteristics of their owners, to the relationships between all owners and controlling shareholders and to the ways in which control is exercised and transferred. Corporate governance mechanisms differ in the degree of protection they offer investors and can have an impact on the ability of firms to raise the financial resources they need in order to grow to optimal size.

A number of insights into the characteristics of corporate governance in Italy are offered by the Bank of Italy's survey of industrial firms, which in 2003 involved a sample of more than 1,800 predominantly unlisted companies with more than 50 employees. The results show that there has been little change in the structure of control since the Bank's first survey of corporate ownership a decade ago. In the 2003 sample the largest shareholder held an average of 66.2 per cent of the capital, in line with the figure in 1993; the median firm had about three shareholders. Concentration of ownership remains high, although for unlisted firms it is not unlike the situation in France, one of the few countries for which comparable data are available.

As in 1993, just over half of the sample firms were controlled by individuals and about a third by non-financial companies, holding companies or other firms, an indication of the important role of groups. The percentage of firms controlled by banks or other financial companies was negligible, while the proportion controlled by foreign firms increased from 7.8 to 14.6 per cent. As expected, public ownership declined (Table 16).

Table 16

DISTRIBUTION OF FIRMS IN BANK OF ITALY SAMPLE BY TYPE OF CONTROLLING SHAREHOLDER
(percentage shares) (1)

	1992	2003
Individual	50.9	53.3
Foreign firm	7.8	13.7
Public enterprise or entity	6.9	1.2
Holding or subholding company	20.8	23.2
Private non-financial company	13.6	7.7
Financial intermediaries, insurance companies and other financial companies	0.0	0.9
Total	**100.0**	**100.0**

Source: Banca d'Italia, *Indagine sulle imprese industriali*.
(1) Values adjusted to take account of the different representation of size classes in the sample.

The Consob-Bank of Italy database of listed groups, established in 1992 and recently updated with figures for 1998 and 2001, shows a decrease in the concentration of ownership of listed companies between 1993 and 1998, partly attributable to the privatization of major state-controlled enterprises through public offerings. The average stake held by the largest shareholder declined from 49.6 to 31.7 per cent between 1993 and 1998 before rising to 37.8 per cent in 2001. A comparison with available figures for listed companies in other countries in 1996 shows that the concentration of ownership of Italian firms is broadly similar to that in other continental European countries, while ownership in the United Kingdom and the United States is much more diffuse. The State's shareholding of Italian listed companies has declined markedly, while the share held by small investors and that held by foreign investors have increased. Since 1993 the share held by banks has fallen sharply, to the benefit of that held by bank foundations; the proportion held by financial companies remains modest.

Legal institutions can have a significant impact on firms' ability to raise funds.

For companies with a narrow shareholder base, sufficient flexibility in governance mechanisms can mean easier access to larger and more diversified sources of financing. The reform of Italian company law, which came into force on 1 January 2004, is a step in this direction.

In order to facilitate access to the equity capital market, corporate governance rules must also be framed so as to reduce the private benefits of control and thereby lower the cost of capital. Especially important are mechanisms for electing control bodies that make them representative of minority shareholders (or of qualified groups of investors, including bondholders) without, however, giving them undue influence in corporate decision-making. A reform of bankruptcy procedures could affect the ex ante valuation of business risk and further reduce the cost of capital; encouraging firms to disclose a state of crisis early on could foster the rapid reallocation of inefficiently employed resources.

Privatizations and the problems of the electricity sector

In 2003 the privatization of publicly-owned companies proceeded slowly. In July, the state's holding in Ente Tabacchi Italiani (a tobacco products company) was sold en bloc in a public tender. The bid by British American Tobacco was significantly higher than the others, generating proceeds of €2.32 billion for the Ministry for the Economy, equal to twelve times ETI's forecast 2003 gross operating profit.

In October, the sale of a second tranche of Enel stock was completed with the disposal of about 400,000 ordinary shares for €2.17 billion. The Treasury's remaining stake decreased to 61 per cent.

The electricity sector. – On 28 September 2003 a breakdown in the Swiss electricity transmission grid triggered a blackout of the entire Italian electricity network that lasted for many hours, revealing the vulnerability of the system.

In electric power, as in the energy sector as a whole, Italy has a high degree of import dependency compared with other industrial countries, but it also uses less power as a proportion of GDP.

The electricity intensity of GDP in Italy is still about a fifth less than the OECD average but is rising, whereas the overall energy intensity of GDP has fallen by more than a third in the last 30 years (Table 17). Long-term forecasts indicate that the rate of growth of electricity consumption in Italy will slow somewhat but will continue to be high for at least a decade. By contrast, electricity intensity is declining in the other advanced countries.

Table 17

ELECTRICITY INTENSITY OF GDP IN SELECTED ADVANCED COUNTRIES
(ratio of kWh consumed to GDP in 1995 dollars)

	1973	1979	1999	2000	2001	Average annual rate of change	
						1990-95	1996-2001
France	0.19	0.22	0.27	0.26	0.26	1.47	–1.10
Germany	0.25	0.27	0.21	0.21	0.22	–2.40	–0.40
Italy	0.22	0.23	0.26	0.26	0.26	0.80	0.93
United Kingdom ...	0.38	0.37	0.30	0.30	0.30	–0.60	–1.30
Spain	0.21	0.26	0.31	0.32	0.33	0.93	2.45
United States	0.49	0.50	0.45	0.45	0.43	0.07	–2.30
Japan	0.18	0.18	0.19	0.19	0.18	1.46	0.02
OECD total	**0.33**	**0.34**	**0.34**	**0.34**	**0.33**	**0.36**	**–0.80**

Source: International Energy Agency, Energy Policies of IEA Countries, 2003 Review, Paris.

Between 1990 and 2002 power generation expanded by 27 per cent in Italy, while consumption rose by 32 per cent. Net imports increased and now cover 16 per cent of the national requirement.

Italy stands out for its lack of any nuclear power generation capacity and its position as the world's largest net importer of electric power.

The inadequacy of interconnections between European domestic power grids increases the risk of blackouts for countries such as Italy that rely on electricity imports for a substantial portion of their needs.

The lower cost of imported energy has encouraged imports. For technical reasons associated with the infrastructure for cross-border connections and the type of contracts used, imported power is an inflexible resource, increasing the rigidity of the national system.

In the second half of the 1990s it was decided to eliminate Enel's electricity monopoly and to separate the various stages of power provision – generation, transmission, dispatching and distribution – in order to prevent a dominant vertically integrated producer from blocking access to new entrants.

In 1999 an independent system operator (ISO) was created to run the national transmission network. Nearly all of the grid remained in the hands of Enel, which exercised its ownership rights through its Enel Terna SpA subsidiary. Enel transferred the assets and personnel necessary to operate the network to the ISO.

In recent years the supply of electricity in Italy has struggled to keep up with mounting demand.

At the start of the summer of 2003 the Italian system reached its alert threshold; there was the risk that available power would not be sufficient to meet demand peaks. In view of the small operational reserves available, the ISO was forced to carry out scheduled rolling power cuts during the summer, a sign of the structural problems culminating in the collapse at the end of September, due, in particular, to the fragility of the network.

The governance mechanisms for the network have created problems of coordination between the ISO and Enel (respectively the operator and owner of the grid) and provide few incentives for investment in maintenance and upgrading of the network. The Electricity and Gas Authority and the Antitrust Authority have expressed doubts about the decision to leave ownership of the high-voltage transmission network in the hands of Enel, which could base its investment decisions on different criteria from those desired by its competitors.

Educational levels and the return on education in Italy

Numerous empirical studies have shown that an increase in the level of education increases the likelihood of finding employment and is associated with higher earnings. Differences in the stock of human capital are strongly correlated with differences in productivity between countries and regions, both directly and through their impact on the adoption of technological innovations.

In Italy the average level of educational attainment is lower than in the other main industrial countries, due especially to the small percentage of university graduates.

According to the OECD, in 2001 more than 55 per cent of the Italian population between the ages of 25 and 64 had only a lower-secondary school diploma, compared with an average of 34 per cent in the industrial countries. The share of the working age population with a university diploma, degree or doctorate (10 per cent) was less than half the OECD average.

Appropriate incentives can influence individual decisions to increase one's educational level. A recent study conducted by the Bank of Italy's Economic Research Department estimated that the average private return on a 1-year increase in the average level of schooling in Italy in 2000 was equal to 7.1 per cent. The returns associated with an additional year of high-school or university education were close to 8 per cent. The average return on education is therefore much higher than that on alternative investments, such as securities or physical capital. In the southern regions, given the greater impact of education on the probability of finding employment, the estimated returns were higher than the national average. From the point of view of the individual, continuing one's education is an attractive investment opportunity, especially in the poorest parts of the country.

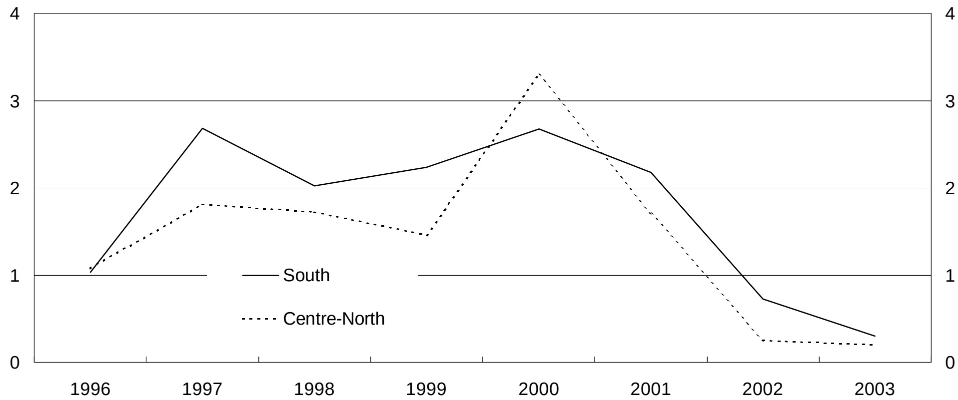
Human capital formation is also profitable for the community. The benefits in terms of higher future labour productivity are estimated at about 7 per cent (7.8 per cent in the South). The findings show that about 30 per cent of the differential in regional productivity can be explained by differences in the level of human capital.

Regional economic developments and regional policy

Svimez (the Association for Industrial Development in Southern Italy) estimates that output in the South increased by 0.3 per cent in 2003, compared with 0.7 per cent the previous year; in the Centre and North economic activity remained sluggish, with GDP increasing by just 0.2 per cent, compared with 0.3 per cent in 2002. Growth in final consumption, which accelerated with respect to 2002, was slightly faster in the Centre and North (1.3 per cent, compared with 1.2 per cent in the South and reflected the recovery in both household and general government spending. Gross fixed investment decreased with respect to the previous year; the decline was smaller in the South (0.8 per cent) than in the rest of the country (2.5 per cent).

Figure 11

RATE OF GDP GROWTH IN THE SOUTH AND THE CENTRE-NORTH
(1995 prices)



Source: Istat, *Conti economici territoriali* for1996-2002, Svimez estimates for 2003.

The average rate of GDP growth at constant prices between 1995 and 2003 was higher in the South than in the rest of the country (Figure 11). The Ministry for the Economy estimates that the difference in GDP growth reflects the higher rate of increase in gross fixed investment and the smaller decline in exports in the South.

Table 18

EXPORTS BY GEOGRAPHICAL AREA
(percentage shares and annual rates of change at current prices)

	Percentage shares 2003	2000	2001	2002	2003
North-West	41.6	15.9	5.7	–3.5	–2.0
North-East	31.2	14.9	5.5	0.8	–5.5
Centre	16.1	21.2	2.3	0.6	–6.5
South	10.7	27.7	3.6	–3.0	–3.8
Italy	**100.0** (1)	**17.8**	**4.9**	**–1.4**	**–4.0**

Source: Istat, *Le esportazioni delle regioni italiane*.
(1) Includes the share of exports (0.3 per cent) not attributed to any region.

The value of exports of goods decreased in all parts of the country. The decline was largest in the Centre and North East and least pronounced in the North West. The rise recorded in the island regions, due to increased sales of refined petroleum products, helped attenuate the decline in the South as a whole (3.8 per cent; Table 18).

Theoretical models and empirical studies suggest the existence of a correlation between the composition of foreign trade and growth opportunities. In particular, they indicate that a high degree of specialization in low-tech sectors tends to be associated with a reduction in an area's development.

THE LABOUR MARKET

The euro area

The continuing weakness of economic activity caused a further slowdown in employment growth in the euro area. According to partially estimated national accounts data, the number of persons employed increased by just 0.2 per cent on average for 2003, compared with gains of 0.5 per cent in 2002 and 1.3 per cent in 2001 (Figure 12). Again the overall slowdown was largely the reflection of the significant fall in labour demand in Germany (down by 1.1 per cent, after a decline of 0.6 per cent in 2002), but employment also fell in Portugal, Finland, Belgium and the Netherlands. France registered a modest increment of 0.2 per cent, while larger gains were recorded in Italy (1 per cent) and especially Ireland, Greece and Spain (1.9 per cent). The unemployment rate rose in all countries except Italy, Finland, Greece and Spain.

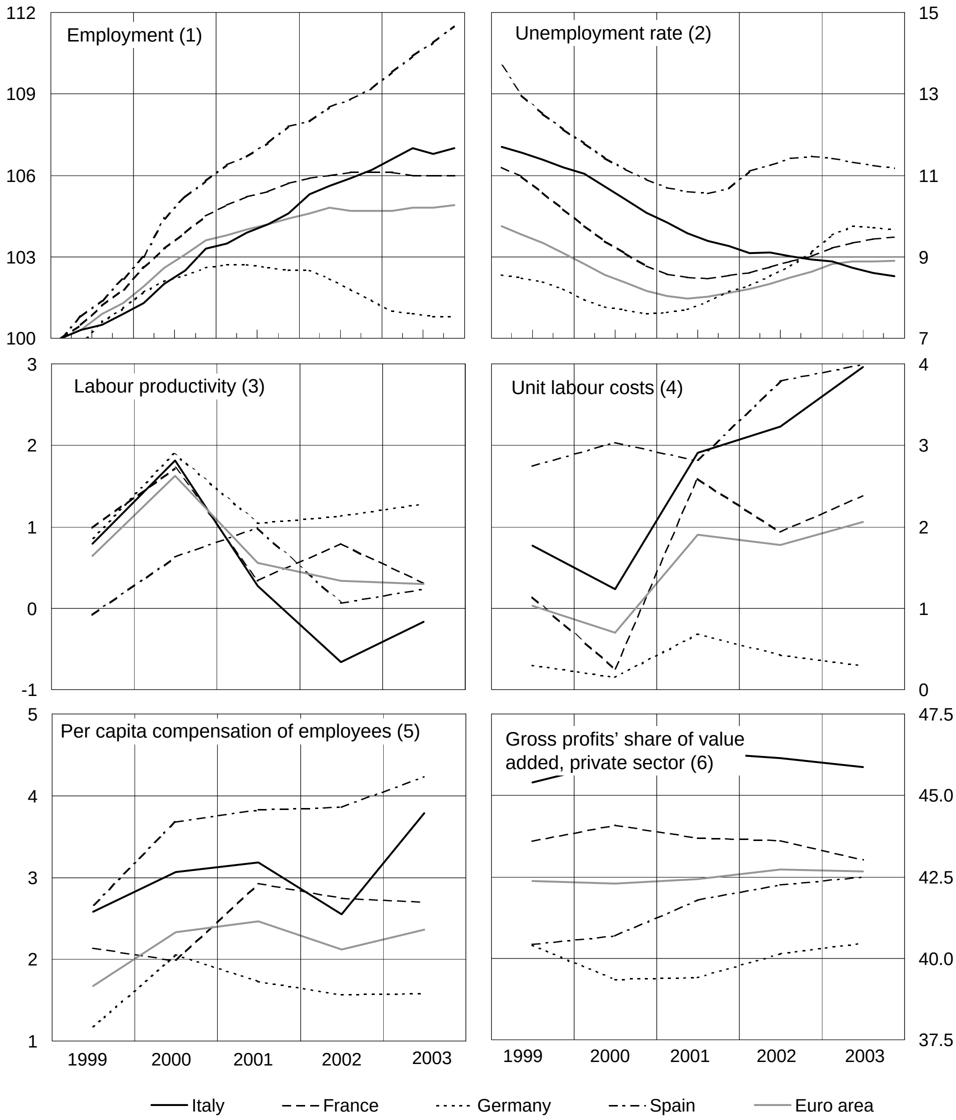
Between 2001 and 2003 labour productivity – real value added per worker at base prices – rose by 0.3 per cent per year for the area as a whole. Productivity performance varied widely among the main economies. Productivity declined by 0.4 per cent per year in Italy, rose at close to the average rate in France and Spain (0.3 and 0.2 per cent per year respectively) and improved much more sharply in Germany (1.3 per cent per year). The differences were reflected in unit labour costs, which rose by 4.2 per cent per year in Italy, 4 per cent in Spain, 2.4 per cent in France and 0.3 per cent in Germany.

In the last few years Germany and Italy have had modest economic growth in common but diverged in labour utilization. German firms have gradually consolidated their presence in foreign markets, shed labour and increased productivity, benefiting from more slowly rising labour costs than in the other countries in the area, thanks in part to lower inflation. In Italy, by contrast, employment growth has continued to be quite rapid despite the weak cyclical phase. Contributing factors have been the slowness of growth in real wages and greater flexibility in the use of manpower. Labour productivity has been adversely affected; the main factor in the productivity decline, however, continues to be the lack of technological and organizational improvements, signaled by the fall in total factor productivity (TFP). For the entire economy TFP, net of the improvement in labour quality, is estimated to have diminished by 1.1 per cent both in 2002 and in 2003, marking the first time since the start of the 1980s that it has fallen for two consecutive years (Figure 13). In industry excluding construction, TFP, adjusted for number of man-hours and capacity utilization, fell by 1.2 per cent per year. Only once in the six years beginning with 1998 did it improve (in 2001, and then only slightly); the cumulative fall over the period came to 3 per cent.

Figure 12

THE LABOUR MARKET IN THE EURO AREA

(seasonally adjusted data)



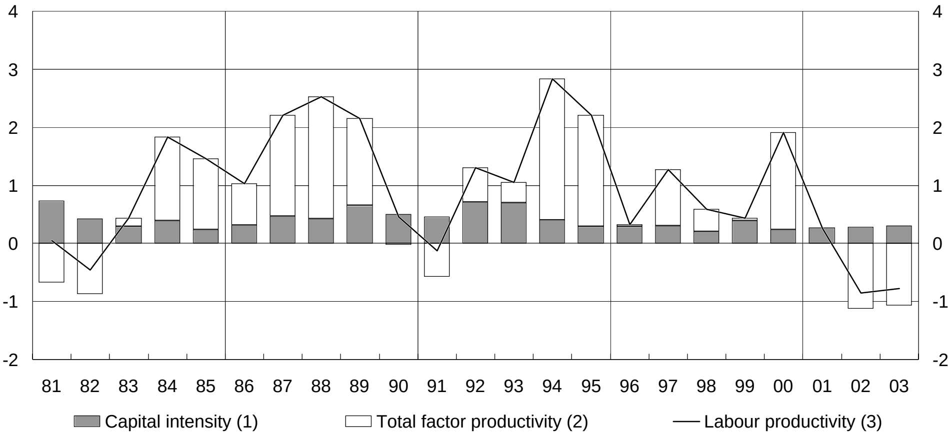
Sources: Based on Istat and Eurostat, national accounts and labour force surveys.

(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 compensation of employees 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 the average compensation of employees) divided by total value added.

Figure 13

LABOUR PRODUCTIVITY IN ITALY

(annual percentage changes, except as indicated)



Source: Based on Istat, national accounts; for 2002 and 2003, partly estimated.

(1) Contribution of the change in the capital stock per standard labour unit to the change in labour productivity, in percentage points. – (2) Difference between the rate of growth in value added at factor costs (at 1995 prices) and the rates of growth of the capital stock and labour input (net of quality improvement), weighted by their respective shares in the distribution of value added. – (3) Change in value added at factor costs (at 1995 prices) per standard labour unit.

Employment and unemployment in Italy

According to Istat's labour force survey – which does not count some categories of employed persons that are included in the national accounts, such as workers living in institutions, conscripts and non-resident aliens – the increase in the average number of persons employed in 2003 was 1 per cent, compared with 1.5 per cent in 2002 and 2.1 per cent in 2001. The gain amounted to 225,000 jobs, two thirds of them permanent payroll positions (177,000, including 29,000 part-time jobs). The number of fixed-term workers rose by 20,000 and that of self-employed workers by 28,000 (Table 19).

Between 1995 and 2000, 46 per cent of the overall increase in employment came from fixed-term positions, 42 per cent from permanent jobs, and 12 per cent from self-employment. In the three years from 2001 to 2003, 89 per cent of the increase was accounted for by permanent jobs, 5 per cent by fixed-term positions and 6 per cent by self-employment (Figure 14).

The use of more stable forms of employment in recent years stems from several factors. Between 2000 and 2002, historically severe labour shortages in many parts of the country may have improved workers' chances of obtaining permanent jobs. A second factor was the reduction in labour force exits by workers in their fifties, mostly holding open-ended positions, owing in part to the raising of the retirement age under the pension reforms of the 1990s. Finally, a significant stimulus came from the tax credit for permanent hiring under Law 388 of 23 December 2000 until it was suspended in July 2002 because of its cost, which was much higher than had been expected.

Table 19

STRUCTURE OF EMPLOYMENT IN ITALY

	2003 (1)		Change 2003/2002 (1)		Change January 2004/January 2003	
	Thousands of persons	Percentage share	Thousands of persons	Percentage share	Thousands of persons	Percentage share
Self-employed	6,008	27.2	28	0.5	28	0.5
full-time	*5,605*	*25.4*	*51*	*0.9*	*21*	*0.4*
part-time	*403*	*1.8*	*–23*	*–5.2*	*7*	*1.8*
Employees	16,046	72.8	197	1.2	138	0.9
permanent	14,464	65.6	177	1.2	118	0.8
full-time	*13,449*	*61.0*	*148*	*1.1*	*78*	*0.6*
part-time	*1,015*	*4.6*	*29*	*2.9*	*40*	*4.0*
fixed-term and temporary	1,582	7.2	20	1.3	20	1.4
full-time	*1,119*	*5.1*	*16*	*–44.1*	*40*	*4.0*
part-time	*463*	*2.1*	*4*	*0.9*	*–20*	*–4.6*
Total	**22,054**	**100.0**	**225**	**1.0**	**166**	**0.8**

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

In the 1990s the presence of immigrant workers increased very substantially. It is estimated that between 1991 and 2000 the share of regular and irregular foreign workers rose from 2.3 to 4.8 per cent of the work force. Ignoring complementarity or substitution effects between Italian and foreign workers, this means that as a result of immigration the total number of persons employed increased by 0.4 per cent over the period, despite a 2.2 per cent fall in the number of Italians in work.

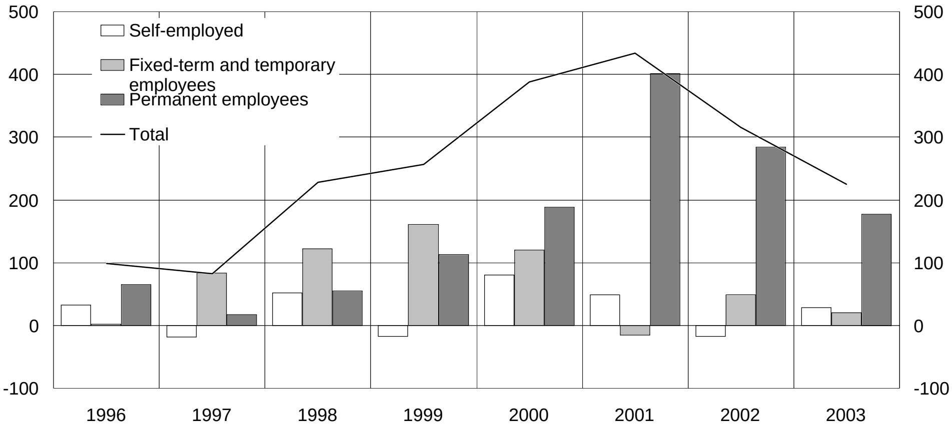
According to the Ministry of the Interior the positions of 635,000 immigrant workers were regularized under Law 189 of 30 July 2002, or 90 per cent of the 705,000 applications received (92 per cent counting residence permits granted but not actually collected by the persons involved). According to the Caritas volunteer organization, 88 per cent of the 259,000 applications presented in the regularization of 1995 were granted and 86 per cent of the 251,000 presented in 1998.

In 2000, the last year for which figures are available, unregistered foreign workers numbered 600,000 and accounted for 17 per cent of total off-the-books employment as estimated in the national accounts. Chiefly as a result of the latest regularization, underground employment fell to 14.2 per cent of total employment in 2002, compared with an average of 15 per cent from 1997 to 2001.

Figure 14

EMPLOYMENT GROWTH IN ITALY

(on a yearly basis; thousands of positions created)



Source: Istat, labour force surveys.

The average unemployment rate in 2003 was 8.7 per cent, down from 9 per cent in 2002. It fell in all parts of the country: from 4 to 3.8 per cent in the North, from 6.6 to 6.5 per cent in the Centre and from 18.3 to 17.7 per cent in the South. The male unemployment rate declined from 7 to 6.8 per cent and the female rate from 12.2 to 11.6 per cent.

The fact that older workers are remaining in the work force longer was reflected in an increase in the employment rate of persons aged 55-64 from 28.9 per cent in 2002 to 30.3 per cent in 2003. The employment rate for all persons of working age (15-64) rose from 55.4 to 56 per cent (from 68.8 to 69.3 per cent for men and from 42 to 42.7 per cent for women). Although it has risen by about 5 percentage points in ten years, Italy's employment rate for the working-age population remains one of the lowest in the European Union.

Labour input and sectoral developments in Italy

In 2003 labour input, measured in standard labour units for the national accounts, increased by 0.4 per cent year on year, or by 104,000 units (Table 20), compared with the rise of 1.2 per cent or 278,000 in the number of persons employed. The discrepancy, which was the greatest since 1991, depended largely on the 28.2 per cent jump in the number of hours of Wage Supplementation authorized, which was equivalent to some 30,000 full-time jobs.

Table 20

SECTORAL DISTRIBUTION OF LABOUR INPUT IN ITALY
(standard labour units; percentage shares of total and percentage changes)

	Total employment				Payroll employment			
	Share		Change		Share		Change	
	1993	2003	2003/1993	2003/2002	1993	2003	2003/1993	2003/2002
Agriculture, forestry and fishing	**7.8**	**5.2**	**–28.1**	**–3.7**	**4.2**	**3.0**	**–22.9**	**–6.1**
Industry excluding construction	**22.8**	**21.6**	**0.8**	**–0.3**	**26.8**	**25.3**	**2.4**	**–0.4**
manufacturing	*21.8*	*20.9*	*1.9*	*–0.2*	*25.4*	*24.3*	*3.8*	*–0.2*
Construction	**7.0**	**7.2**	**9.0**	**2.9**	**6.2**	**6.0**	**6.1**	**4.0**
Services	**62.4**	**66.0**	**12.7**	**0.8**	**62.9**	**65.8**	**13.4**	**0.9**
Wholesale and retail trade, repair of personal and household goods	15.6	15.3	4.5	1.3	10.2	11.6	23.3	2.4
Hotels and restaurants	4.8	5.4	21.4	0.9	3.8	4.2	19.1	–0.6
Transport, storage and communications	6.1	6.2	7.5	0.9	6.7	6.6	7.4	1.1
Financial intermediation	2.8	2.7	2.3	2.1	3.5	3.3	2.3	1.6
Services to businesses and households (1)	7.6	11.1	54.5	2.4	6.2	8.7	50.4	3.6
Public administration (2)	6.5	5.5	–9.1	–3.1	9.3	7.8	–9.1	–3.1
Education	7.0	6.7	1.4	..	9.4	8.6	–0.5	0.1
Health	5.4	5.5	8.0	–0.9	6.2	6.2	7.7	–0.3
Other community, social and personal services	3.7	4.4	26.5	1.3	3.3	4.1	35.8	1.7
Private households with employed persons	2.9	3.3	19.8	2.1	4.2	4.7	19.8	2.1
Total	**100.0**	**100.0**	**6.5**	**0.4**	**100.0**	**100.0**	**8.5**	**0.5**

Source: Istat, national accounts.
(1) Real-estate, renting, computer and research services and other professional and business services. – (2) Includes defence services and compulsory social security services.

Labour input contracted in agriculture and fishing and in industry excluding construction. The Bank of Italy's survey of industrial firms with 20 or more workers found a decrease of 1.4 per cent in the number of persons employed in 2003 (Table 21). The contraction involved all parts of the country and firms of all sizes and was accompanied by a decrease in the number of hours worked per capita. Immigrants accounted for 2.9 per cent of the total work force of the firms surveyed.

In construction, labour input rose strongly for the fifth consecutive year to its highest level since 1975. In the service sector it expanded by 123,000 standard labour units, the 1.5 per cent increase in the private sector more than offsetting a contraction of 0.4 per cent in the public sector. As in the previous five years, labour input increased in wholesale and retail trade, in hotel services and in transport and communication; it recovered in financial intermediation services following the decline registered in 2002, principally because of the growth in auxiliary activities. The rate of growth of employment in private services to businesses and households slowed from 7.3 to 2.4 per cent.

Table 21

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

(percentages)

	2002	2003								
		Total	Size class (number of workers)				Geographical area (1)			
			20-49	50-199	200-499	500+	North-West	North-East	Centre	South and Islands
	Payroll employment									
Average employment (2)	–1.2	–1.4	–1.3	–1.2	–1.0	–2.1	–1.7	–1.3	–1.5	–0.9
Employment at end of year (2)	–0.9	–1.8	–1.9	–1.3	–1.2	–2.5	–1.9	–1.7	–2.0	–1.4
Proportion of fixed-term workers at end of year	6.5	5.9	6.5	5.9	5.6	5.5	4.8	6.4	6.5	7.7
Percentage of immigrants	....	2.9	3.8	3.2	2.8	1.5	....	....	....	....
	Turnover (3)									
Turnover (4)	31.5	29.1	34.4	30.4	26.9	23.6	23.6	32.5	30.0	37.3
Hirings	15.3	13.6	16.2	14.6	12.8	10.6	10.9	15.4	*14.0*	17.9
permanent	*6.4*	*5.7*	*6.9*	*6.0*	*5.1*	*4.7*	*4.9*	*6.9*	*5.2*	*6.3*
at fixed term	*8.9*	*7.9*	*9.3*	*8.6*	*7.7*	*5.9*	*6.0*	*8.5*	*8.8*	*11.6*
Separations	16.2	15.5	18.2	15.8	14.1	13.0	12.7	17.1	*16.0*	19.4
for expiry of fixed-term contract	*9.0*	*8.2*	*9.2*	*8.9*	*8.2*	*6.3*	*6.1*	*8.8*	*9.0*	*12.1*
for other reasons	*7.2*	*7.3*	*9.0*	*6.9*	*5.9*	*6.7*	*6.6*	*8.3*	*7.0*	*7.3*
	Actual working hours									
Hours worked per employee (2)	–0.8	–0.7	0.1	–0.5	–0.8	–1.6	–0.8	–0.5	–0.5	–0.7
Overtime (5)	4.1	4.0	3.6	4.1	4.1	4.4	4.2	4.1	3.7	3.8
Temporary employment (5) (6)	1.7	2.0	....	1.8	2.4	2.0	2.1	2.2	1.5	1.6
Wage Supplementation (5) (6)	1.3	1.5	....	1.4	1.6	1.7	1.7	0.9	1.6	2.2

Source: *Indagine sulle imprese industriali.*

(1) Actual location of employees. – (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 workers.

The Bank of Italy's survey of non-financial private service firms with 20 or more workers found an average increase in staff of 1.5 per cent in 2003 (Table 22). Immigrant workers made up 3.8 per cent of the total staff, and 6.2 per cent in firms with 200 to 499 workers.

Table 22

EMPLOYMENT AND WORKING HOURS IN ITALIAN NON-FINANCIAL PRIVATE SERVICE FIRMS WITH AT LEAST 20 WORKERS

(percentages)

	2002	2003								
		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									
Average employment (2)	2.0	1.5	0.2	2.0	2.3	1.8	2.0	2.8	0.4	–0.1
Employment at end of year (2)	2.0	1.8	1.4	1.6	1.6	2.3	2.5	2.7	1.2	–0.7
Proportion of fixed-term workers at end of year	9.5	9.2	9.5	11.1	10.3	7.1	8.3	11.1	8.1	9.8
Percentage of immigrants	….	3.8	2.4	4.7	6.2	2.9	….	….	….	….
	Turnover (3)									
Turnover (4)	55.0	55.9	63.5	56.8	66.3	45.6	46.4	70.6	55.9	57.4
Hirings	28.5	28.9	32.4	29.2	34.0	23.9	24.4	36.7	28.5	28.3
permanent	*12.8*	*11.6*	*9.9*	*12.7*	*15.3*	*10.5*	*12.2*	*13.2*	*10.5*	*9.2*
at fixed term	*15.7*	*17.3*	*22.5*	*16.5*	*18.7*	*13.4*	*12.2*	*23.5*	*18.0*	*19.1*
Separations	26.5	27.0	31.1	27.6	32.3	21.7	22.0	33.9	27.4	29.1
for expiry of fixed-term contract	*15.0*	*17.6*	*22.4*	*16.8*	*17.8*	*14.9*	*13.1*	23.4	18.6	18.9
for other reasons	*11.5*	*9.4*	*8.7*	*10.8*	*14.5*	*6.8*	*8.9*	*10.5*	*8.8*	*10.2*
	Actual working hours									
Hours worked per employee (2)	0.5	–0.4	–1.0	–0.1	0.3	–0.3	–0.5	–1.1	0.4	0.1
Overtime (5)	5.6	5.3	4.2	5.3	5.5	6.0	5.5	5.0	5.4	4.8
Temporary employment (5) (6)	0.9	0.8	….	0.4	0.6	1.4	0.8	1.1	0.4	0.5

Source: *Indagine sulle imprese industriali*.

(1) Actual location of employees. – (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 workers.

Wages and the cost of labour in Italy

Actual earnings per standard employee labour unit, as measured in the national accounts, increased year on year by 3.2 per cent, compared with 2.6 per cent in 2002 (Table 23); in real terms the yearly gain was 0.6 per cent (0.2 per cent in 2002). As in the three previous years, the rise

Table 23

LABOUR COSTS AND PRODUCTIVITY IN ITALY

(annual percentage changes)

Anni	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	1.0	3.4	2.6	1.5	64.2	0.4	..
2001	–0.2	–0.5	0.3	3.4	3.1	2.8	62.5	–0.7	0.3
2002	–0.3	0.5	–0.8	2.5	2.2	3.1	63.7	–1.4	–1.1
2003	–1.0	–0.3	–0.6	2.8	3.0	3.7	64.8	–1.3	–1.2
					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 .	–1.3	–0.6	–0.6	4.5	4.5	5.2	70.1	–0.5	–
Average 1996-2000 .	1.3	0.8	0.5	3.4	2.3	1.8	70.4	–0.2	–
2001	3.1	4.7	–1.5	2.2	2.1	3.7	71.7	–2.1	–
2002	2.5	2.6	–0.1	1.8	2.4	2.5	71.2	–1.0	–
2003	2.5	2.9	–0.4	2.3	3.2	3.6	71.8	–1.0	–
					Private 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	0.8	–
2001	3.5	2.4	1.0	3.4	3.1	2.1	64.2	0.6	–
2002	1.0	2.1	–1.1	2.2	2.2	3.4	64.7	–1.4	–
2003	0.5	1.5	–1.0	2.2	2.7	3.7	65.2	–1.1	–
					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	–
2001	2.1	1.5	0.5	3.2	2.9	2.4	65.2	..	–
2002	0.5	1.4	–0.9	2.3	2.2	3.2	65.9	–1.3	–
2003	–0.1	0.7	–0.8	2.6	3.0	3.8	66.6	–1.1	–
					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	1.3	3.5	2.8	1.5	70.9	0.9	0.6
2001	2.1	1.6	0.4	3.5	3.2	2.8	69.4	0.1	..
2002	0.6	1.3	–0.6	2.6	2.5	3.2	69.9	–1.0	–1.1
2003	0.1	0.4	–0.4	3.2	3.8	4.2	70.6	–0.8	–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) The difference between the rate of growth in value added at factor costs and the rates of growth in labour input and the capital stock, weighted according to their respective shares in the distribution of value added. Adjusted productivity is calculated taking account of the improvement in the quality of labour input (proxied by workers' educational attainment) and, for industry only, also of the change in the number of hours worked and capacity utilization. For 2002 and 2003, 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.

was more pronounced in the public than in the private sector (5 and 2.6 per cent respectively). Over the four years 2000-2003, public employees' earnings increased by an average of 4.3 per cent per year, against 2.7 per cent for private-sector employees. Actual per capita earnings rose by 2.2 per cent last year in the private service sector, 2.3 per cent in construction and 2.8 per cent in industry excluding construction; contractual per capita earnings in the three sectors increased by 2.3, 2.6 and 2.5 per cent respectively.

In the second half of 2003 and early 2004 industry-wide contracts were signed for food processing, insurance, tourism, municipal transit, tanneries, the national health service, chemicals, printing and publishing, textiles and clothing, footwear and construction. The agreements confirmed the trend of two-year wage increases in line with expected inflation rather than with the Government's official target inflation rates, as well as the substantive recouping of the gap between actual and target inflation over the previous two-year contract period.

Labour costs per standard labour unit – gross earnings plus employer social contributions – rose by 3.8 per cent in 2003, or 0.6 percentage points more than per capita earnings. As there was no change in contribution rates, the faster rise in labour costs was due in part to the increase in the contribution burden as a result of the regularization of immigrant workers.

The distribution of earnings and household income in Italy

According to the Bank of Italy's biennial survey of Italian households' income and wealth, average real net monthly payroll earnings rose by 1 per cent per year from 2000 to 2002 (Table 24). The increase was sharper for women than for men (1.9 as against 0.8 per cent) and greater in the South than in the Centre and North (1.5 against 1 per cent). For full-time employees only, the geographical difference vanishes but the gender difference is accentuated (2.2 per cent for women, 0.8 per cent for men).

Continuing the upward trend that began in 1995, in 2001 and 2002 households' real equivalent disposable income rose by 1.5 per cent per year, gaining 2.1 per cent per year in the Centre and North and declining 0.5 per cent annually in the South (Table 25). Over the four years from 1999 to 2002 it increased in both parts of the country, at annual rates of 1.1 and 0.8 per cent respectively.

Between 2000 and 2002 the overall indices of income inequality and of poverty remained unchanged. However, there was a change in income distribution to the benefit of self-employed workers and managers as against production and clerical workers and pensioners. Real equivalent disposable income (which includes all income, not just labour compensation and pensions) rose by 8.9 per cent per year for the households of public and private-sector managers and by 2.4 per cent for those of self-employed workers, compared with 0.9 per cent for those of clerical workers, 0.6 per cent for those of production workers and 0.3 per cent for those of pensioners.

Table 24

REAL MONTHLY TAKE-HOME PAY IN ITALY, 2000-2002 (1)

(in euros at 2002 prices, except as indicated)

	Total		Men		Women		Centre-North		South	
	2000	2002	2000	2002	2000	2002	2000	2002	2000	2002
	All employees									
Average compensation ...	1,202	1,227	1,311	1,331	1,040	1,079	1,249	1,273	1,080	1,112
Gini index (2)	0.240	0.251	0.235	0.238	0.230	0.259	0.227	0.249	0.268	0.254
Interdecile ratio (3)	3.1	2.9	2.7	2.8	2.8	3.2	2.7	2.9	3.6	3.3
Low-income workers (4)	16.9	17.8	11.2	10.6	25.4	28.0	13.3	14.9	26.5	24.9
	Full-time employees									
Average compensation ...	1,263	1,293	1,337	1,358	1,134	1,185	1,305	1,337	1,152	1,181
Gini index (2)	0.217	0.228	0.225	0.227	0.190	0.223	0.208	0.227	0.237	0.224
Interdecile ratio (3)	2.4	2.6	2.5	2.5	2.3	2.5	2.3	2.5	3.1	2.7
Low-income workers (4)	10.6	11.3	9.0	8.0	13.4	16.9	7.4	8.6	19.3	18.4

Source: *Indagine sui bilanci delle famiglie italiane, Archivio storico* (Version 3.0 January 2004).

1) Main jobs (i.e. excluding second jobs). Compensation is deflated by the cost-of-living index. – (2) The Gini index of concentration ranges from 0 (perfect equality) to 1 (maximum inequality). – (3) Ratio of the compensation of the 9th to the 1st decile. – (4) Percentage shares. According to the OECD definition, low-wage workers are those earning less than two-thirds of the median for full-time workers.

These developments reinforced medium-term trends in household incomes that, while leaving the overall incidence of poverty unchanged, have affected its composition. Between 1995 and 2002 the population share of persons in low-income households – those with equivalent disposable income of less than half the median – rose from 16.9 to 21.4 per cent among blue-collar households and declined from 15.5 to 11.9 per cent among self-employed households. There was an increase for clerical-worker households as well, albeit from a much lower level. The incidence of poverty diminished slightly among pensioner households and remained negligible among those headed by managers.

Table 25

HOUSEHOLDS' REAL EQUIVALENT DISPOSABLE INCOME IN ITALY 1993-2002 (1)
(at 2002 prices, in lire and euros; percentage)

	1993	1995	1998	2000	2002	2000	2002
	Thousands of lire					Euros	
Average equivalent income	28,483	27,921	29,666	30,061	30,953	15,525	15,986
Centre-North	*32,946*	*32,427*	*34,965*	*35,054*	*36,535*	*18,104*	*18,869*
South	*20,633*	*20,038*	*20,356*	*21,252*	*21,022*	*10,976*	*10,857*
Gini index (2)	0.336	0.337	0.348	0.335	0.333	–	–
Centre-North	*0.300*	*0.299*	*0.314*	*0.293*	*0.296*	–	–
South	*0.350*	*0.356*	*0.350*	*0.357*	*0.330*	–	–
Interdecile ratio (3)	4.7	4.7	4.8	4.6	4.5	–	–
Low-income households (4)	12.4	12.5	13.0	12.4	12.3	–	–
Centre-North	*6.4*	*5.2*	*5.9*	*4.4*	*4.6*	–	–
South	*25.1*	*27.1*	*27.4*	*28.4*	*27.7*	–	–
Persons in low-income households (4)	14.1	14.1	14.4	14.1	14.1	–	–
Centre-North	*5.5*	*4.8*	*5.3*	*4.4*	*4.7*	–	–
South	*29.3*	*30.4*	*30.4*	*31.2*	*30.9*	–	–

Source: *Indagine sui bilanci delle famiglie italiane, Archivio storico* (Version 3.0 January 2004).

(1) Total household income (including imputed rental income on home-owners' dwellings), net of income and social security taxes, deflated by the national accounts domestic consumption deflator and made comparable using a modified OECD scale of equivalence (which assigns a weight of 1 to the first adult member of the household, 0.5 to every other member aged 13 and above, and 0.3 to those aged under 13). The figures in the table are weighted by the number of household members so determined, except the share of low-income households, which is calculated on the number of households. (2) The Gini index of concentration ranges from 0 (perfect equality) to 1 (maximum inequality). – (3) Ratio of the equivalent disposable income of the 9th to the 1st decile. – (4) Percentage shares. "Low income" is defined as less than 50 per cent of the median equivalent disposable household income.

PRICES AND COSTS

The increasing weakness of domestic demand and the appreciation of the euro moderated inflation in the euro area in 2003. The prices of imported goods and services continued to fall, despite the rise in the dollar prices of raw materials. Against this background, euro-area firms tended to compress their unit profit margins.

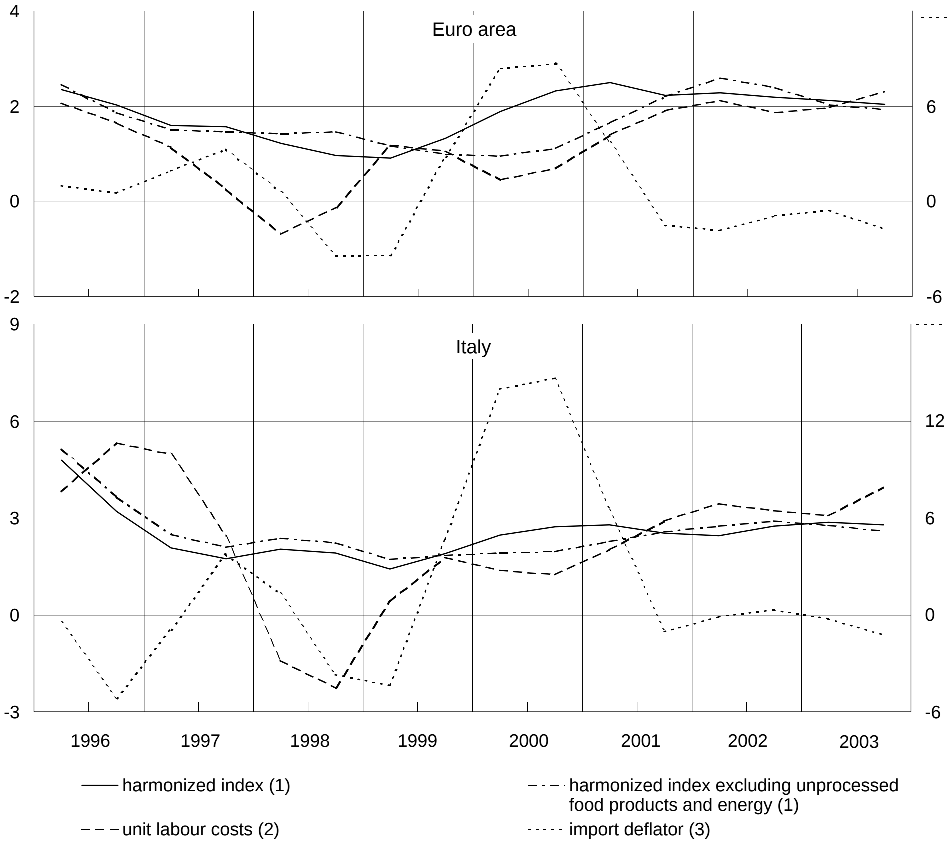
In the euro area, harmonized consumer price inflation declined from an average of 2.3 per cent in 2002 to 2.1 per cent last year. Core inflation, measured by the change in the index net of energy and unprocessed food products, diminished more markedly, from 2.5 to 2 per cent. Domestically-generated inflation, estimated on the basis of the changes in the GDP deflator, decreased from 2.5 to 2.1 per cent. Unit labour costs rose slightly faster than in 2002, by just over 2 per cent (Figure 15). The jump in the price of oil and other raw materials and the increase in the prices of tobacco products in several countries curbed the fall in consumer price inflation. In this context and in the light of the improved outlook for the growth of world trade, deflationary risks did not emerge. Inflation expectations remained around 2 per cent.

In Italy, the pick-up in inflation from 2.6 to 2.8 per cent was due to the rise in the prices of raw materials, above all oil, offset only in part by the slight reduction in core inflation from 2.8 to 2.7 per cent. The new widening of the inflation differential between Italy and the rest of the euro area, which reached 0.9 percentage points both including and excluding the more volatile items, is attributable to the higher differential in the growth in unit labour costs across the whole economy, which in the two years 2002-03 on average was about 1.5 percentage points greater than in the previous three years. This deterioration in the relative performance of domestic costs was due mainly to labour productivity developments in Italy.

The price tensions that arose in 2002 in connection with the cash changeover to the euro, generally moderate though more pronounced in some services, died away in 2003. Nevertheless, the distinct worsening in perceptions of inflation that household opinion surveys registered in concomitance with the introduction of the euro has been reversed only in part for the euro area as a whole. In Italy the perceived rate of inflation remained high.

Figure 15

INFLATION INDICATORS IN THE EURO AREA AND ITALY
(half-yearly data; percentage changes)



Source: Based on Eurostat data.

(1) Harmonized index of consumer prices. For Italy, the percentage changes for 2001 are calculated with reference to the harmonized indices that exclude price reductions for special offers. Left-hand scale. – (2) For the entire economy. The changes are calculated from the moving average of the two quarters ending in the reference period. For the euro area, the changes are calculated on the basis of the figures 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. – The twelve-month rate of increase in the euro-area harmonized index of consumer prices, which had averaged 2.3 per cent in the first quarter of 2003, subsequently fell to 2 per cent, as did that in core inflation (Table a10).

The twelve-month rate of increase in the prices of the most volatile components, which in the first quarter of 2003 had risen to an average of 3.6 per cent, compared with 2.3 per cent at the end of 2002, came down to 1.5 per cent in the spring before rising again to 2.7 per cent in the second half of the year.

Core inflation held at 2 per cent from the second quarter onwards. The twelve-month increase in the prices of processed food rose to 3.8 per cent in the fourth quarter. By contrast, the prices of services gradually slowed down, with the ebbing of the transitory tensions that had affected some services following the introduction of the euro; in Italy this deceleration came later, beginning in the second half of 2003. The rate of increase in the prices of non-food and non-energy products also eased significantly during the year to an average of 0.8 per cent in the euro area (1.9 per cent in Italy, 0.6 per cent in France, minus 0.4 per cent in Germany; Table 26).

Table 26

HARMONIZED INDICES OF CONSUMER PRICES IN THE EURO AREA
(percentage changes on year-earlier period)

	Italy			Germany			France			Euro area		
	2002	2003	2004 Q1	2002	2003	2004 Q1	2002	2003	2004 Q1	2002	2003	2004 Q1
General index	2.6	2.8	2.3	1.3	1.0	1.0	1.9	2.2	2.0	2.3	2.1	1.7
Core inflation (1)	2.8	2.7	2.3	1.5	0.9	1.4	2.2	2.2	2.6	2.5	2.0	2.0
Processed food	2.2	3.4	4.3	2.5	2.4	1.6	3.3	4.7	7.1	3.1	3.3	3.5
Non-food and non-energy products	2.4	1.9	1.5	0.4	–0.4	0.7	0.9	0.6	0.5	1.5	0.8	0.7
Services	3.4	3.2	2.4	2.1	1.4	1.9	2.8	2.6	2.8	3.1	2.5	2.6
Unprocessed food	4.9	3.9	5.0	–0.1	–1.1	0.1	2.9	2.0	1.0	3.1	2.1	2.2
Energy products	–2.6	3.2	–0.9	0.3	4.0	–1.6	–1.5	2.3	–2.6	–0.6	3.0	–1.5

Source: Based on Eurostat data.
(1) General index excluding unprocessed food and energy products.

Producer and export prices. – Euro-area producer prices rose by 1.6 per cent year on year; in 2002 they had decreased by 0.1 per cent (Table a12). Producer price inflation was fueled by the upturn in the prices of intermediate energy and non-energy goods, which rose by 4.1 and 0.8 per cent respectively, whereas in 2002 they had fallen by 2 and 0.3 per cent. Non-energy intermediate goods gradually incorporated the rise in international commodity prices in the second half of 2003, particularly those of metals, which reflected the continuing upswing in international demand in the second half of the year.

Faced with the euro’s large appreciation in nominal effective terms (11.4 per cent on average for the year), euro-area firms trimmed their export prices of goods and services by 0.5 per cent with respect to the previous year according to national accounts data.

Costs. – The implicit deflator of imports of goods and services in the euro area fell by 1.2 per cent for the year, more or less as in 2002. This development was connected to the strengthening of the nominal effective exchange rate of the euro, which moderated the pricing policies of foreign exporters and countered the impact of the rise in the dollar prices of commodities. On the basis of IMF indicators, non-energy commodity prices increased by 7.1 per cent; the dollar prices of oil rose even more steeply (by over 15 per cent for Brent grade), in response to the crisis in the Middle East.

For the four largest euro-area countries, unit labour costs in the whole economy rose by an average of 2.1 per cent in 2003, compared with 1.8 per cent in 2002 (Table 27). The increase was due above all to slightly faster growth in labour costs per employee; labour productivity continued to stagnate.

Table 27

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

(percentage changes on previous year)

	Labour costs per employee (1)		Labour productivity						Unit labour costs	
					Value added (2)		Employment (1)			
	2002	2003	2002	2003	2002	2003	2003	2003	2002	2003
	Industry excluding construction (3)									
Germany	1.6	2.6	2.2	3.2	–0.1	0.4	–2.2	–2.7	–0.5	–0.6
France	2.5	2.8	1.9	2.3	0.3	0.1	–1.6	–2.2	0.6	0.5
Italy	2.2	3.0	–0.8	–0.6	–0.3	–1.0	0.5	–0.3	3.1	3.7
Spain	3.6	3.9	0.7	2.4	0.6	1.3	–0.1	–1.1	2.9	1.5
Euro 4 (4)	1.9	2.6	1.1	1.8	0.0	0.1	–1.1	–1.6	0.8	0.8
	Services (5)									
Germany	1.7	1.4	0.7	0.7	1.1	0.5	0.5	–0.2	1.0	0.6
France	3.1	2.6	0.6	0.4	1.8	1.1	1.2	0.7	2.5	2.2
Italy	2.7	4.0	–0.6	–0.2	1.0	0.6	1.6	0.8	3.3	4.2
private	*2.2*	*2.7*	*–1.1*	*–1.0*	*1.0*	*0.5*	*2.1*	*1.5*	*3.4*	*3.7*
public	*3.3*	*5.5*	*0.3*	*1.0*	*1.2*	*0.6*	*0.9*	*–0.4*	*3.0*	*4.4*
Spain	3.8	4.4	–0.8	–0.5	1.6	2.2	2.4	2.8	4.6	4.9
Euro 4 (4)	2.3	2.4	0.0	0.0	1.3	0.8	1.4	0.8	2.3	2.4
	Total economy									
Germany	1.5	1.6	1.1	1.3	0.4	0.2	–0.6	–1.1	0.5	0.3
France	2.7	2.7	0.8	0.3	1.5	0.5	0.7	0.2	1.9	2.4
Italy	2.5	3.8	–0.6	–0.4	0.6	0.1	1.3	0.4	3.2	4.2
Spain	3.9	4.2	0.1	0.2	1.6	2.1	1.5	1.8	3.8	4.0
Euro 4 (4)	2.1	2.4	0.3	0.3	0.9	0.5	0.6	0.2	1.8	2.1

Source: Based on Eurostat data.

(1) For Italy and Spain, based on standard labour units. – (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 sum of the figures for France, Germany, Italy and Spain. – (5) For Italy, private services exclude the renting of property.

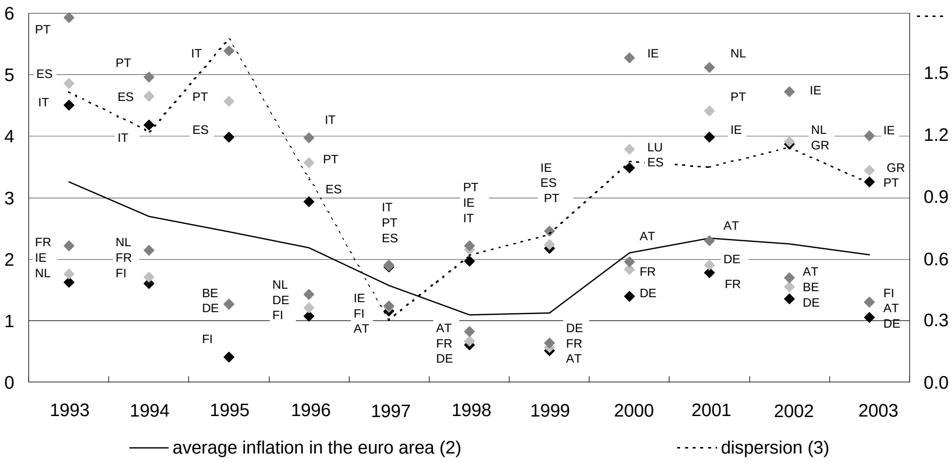
The first few months of 2004. – Euro-area consumer price inflation fell below 2 per cent in January, although it regained that level in April. The main factors in the decline were the decrease in the twelve-month rate of growth in the prices of unprocessed foods to an average of 2.2 per cent in the first quarter of this year, from one of 3.6 per cent in the fourth quarter of 2003, and the decrease of 1.5 per cent in the prices of energy products, compared with an increase of 1.6 per cent in the previous quarter. By contrast, core inflation picked up during the first quarter from 1.9 per cent in January to 2.1 per cent in March, boosted by the surge from 3.4 to 4.1 per cent for processed food, which was due entirely to price hikes for tobacco products in several countries of the area.

The inflation rate dispersion and price levels. – For 2003 as a whole the dispersion of inflation rates among the euro-area countries, measured by the average unweighted standard deviation, was equal to 1 percentage point. This marked a modest contraction following the series of slight increases that began in 1998 (Figure 16).

Figure 16

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

(percentage changes on previous year and percentage points) (1)



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.

Between 1998 and 2003 consumer price inflation was systematically below the euro-area average in Germany, France, Belgium, Finland and Luxembourg and above it in the other countries. Italy was among the latter despite experiencing very weak economic growth, surpassing only

Germany's during the period. Breaking down the variation of the deflator of final demand, whose movement was in line with that of the consumer price index, into the components of import demand, incomes, productivity and profit margins, one finds that between 1998 and 2003 the inflation differentials among the countries of the area were paralleled by the accumulation of a similar gap in unit labour costs. On the other hand, the disparities for the imported component and for profit margins were much smaller.

Available data suggest that the dispersion of inflation rates among the countries of the area has been accompanied by only limited convergence of price levels since the introduction of the euro, in contrast with considerable convergence in the period from 1995 and 1999. This was the finding of the survey coordinated by Eurostat on purchasing power parities, the only official source for comparing the price levels in the EU countries.

Inflation expectations. — The Consensus Forecast panel surveyed in May 2004 predicted that euro-area inflation would average 1.8 per cent this year and decline to 1.6 per cent in 2005. Italian inflation was expected to continue to run about half a percentage point higher, at 2.2 and 2.1 per cent respectively. However, these forecasts assume that the recent tensions in the international oil markets will subside.

Over longer time horizons, professional forecasters' inflation expectations for the euro area are in line with the medium-term target indicated in May by the Eurosystem. In April they were predicting a rate of approximately 1.9 per cent from 2006 forward; financial markets expect the rate to be a little higher.

Prices and costs in Italy

Prices. – In 2003 year-on-year consumer price inflation in Italy rose by 0.2 points to 2.8 per cent on the basis of the harmonized index and 2.7 per cent according to the general consumer price index. The twelve-month increase in the latter hovered between 2.7 and 2.8 per cent in the first quarter before easing to 2.5 per cent in the final part of the year (Figure 17).

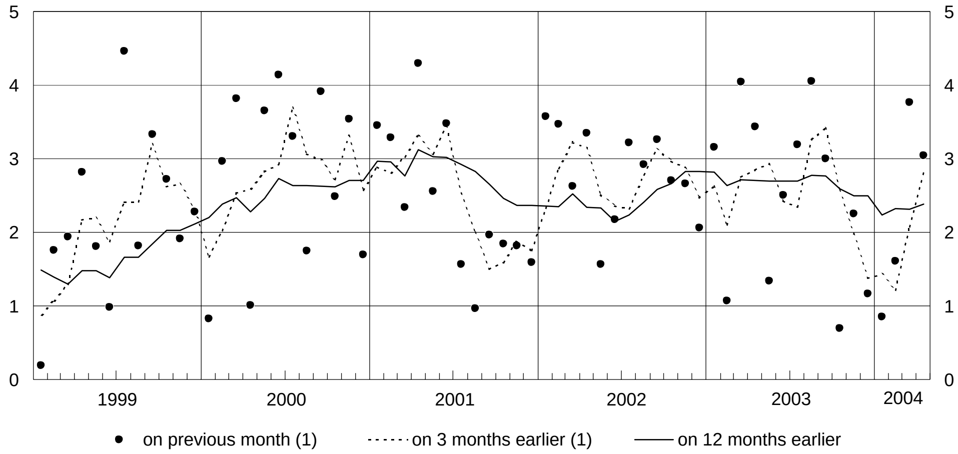
The prices of goods and services subject to price controls, net of house rentals, accelerated sharply to an annual increase of 2.1 per cent, compared with 0.3 per cent in 2002, boosted by the energy component, where prices rose by 4.1 per cent last year after falling by 3.4 per cent in 2002 (Table a8).

Excluding these items and the more volatile components of the index (food and energy products), average annual consumer price inflation came down from 3 to 2.7 per cent in 2003. Contributory factors were the moderate deceleration in the prices of non-food and non-energy products, from 2.2 to 1.9 per cent, and the let-up in those of services, from 3.9 to 3.5 per cent. However, in 2003 the latter component of the index was again pushed up by specific items in particular, such as catering services (restaurants, pizzerias and cafés), repair and maintenance services and financial services.

Figure 17

ITALY: GENERAL CONSUMER PRICE INDEX

(percentage changes)



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

Consumer price inflation continued to diminish in the first few months of this year. The twelve-month increase in the general index leveled off at 2.3 per cent through April. The decline at the beginning of the year is attributable to the unregulated components; in particular, the prices of energy products steepened their fall and were 2.4 per cent lower in the first quarter of 2004 than in the corresponding period of 2003.

The regulated component of consumer prices, which in 2003 had risen less than the overall index, recorded a brusque acceleration to 2.9 per cent twelve-month growth in March, mainly as a consequence of the large increases in the prices of tobacco products.

Producer prices of industrial goods rose by an average of 1.6 per cent in 2003 after remaining almost stationary in 2002 (Table a11). The increase was due to the surge in the energy component, which rose by 2.5 per cent after declining by 4 per cent in 2002.

In 2003 the average unit values of Italian exports of manufactures increased by 0.8 per cent year on year. The prices of those going to the EU countries rose by 1.3 per cent, in line with the increases applied by domestic producers in those markets. In non-EU markets Italian firms raised their selling prices by a much smaller margin (0.4 per cent) to compensate for at least part of the impact of the euro's large appreciation on their market shares.

Costs and margins. – In 2003 average profit margins contracted for the second consecutive year in the main sectors. On the basis of input-output prices calculated by Istat in the context of the national accounts, unit variable costs in manufacturing rose by 2.3 per cent, compared with 2 per cent in 2002, while output prices increased by 1.4 per cent (Table 28). While the costs of imported inputs in industry remained broadly stable, those of labour inputs grew by about 4 per cent year on year.

Table 28

UNIT VARIABLE COSTS AND OUTPUT PRICES IN ITALY (1)
(percentage changes on previous year)

	Manufacturing			Services excluding general government		
	% weights in 1995	2002	2003	% weights in 1995	2002	2003
Unit variable costs	100.0	2.0	2.3	100.0	2.6	3.1
Labour inputs	35.9	4.0	4.1	73.6	2.6	3.7
Other inputs	64.1	0.9	1.2	26.4	2.5	1.8
Domestic	38.3	1.7	2.2	19.9	2.8	3.3
Imported	25.8	0.1	0.1	6.5	1.9	-2.4
Output prices	100.0	1.3	1.4	100.0	2.2	2.7
On the domestic market	58.3	1.1	2.2	91.3	2.1	2.7
On the export markets	41.7	1.6	0.4	8.7	3.5	1.9

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

The contraction in profit margins was smaller in the service sector. Unit variable costs in private services rose by 3.1 per cent, compared with 2.6 per cent in 2002, reflecting the high incidence of labour inputs, whose year-on-year growth jumped from 2.6 to 3.7 per cent; the 2.7 per cent increase in output prices partly compensated for this.

Italy's inflation differential. – The difference between the rise in the harmonized consumer price index in Italy and that in the euro area, which had narrowed to less than half a percentage point in 2001 and 2002, widened to 0.9 points last year. Italy's inflation differential vis-à-vis the rest of the area increased for both the more volatile items and the core components, from 0.4 points to 1.2 and 0.9 points respectively.

Among the core components, the year-on-year increase in the prices of non-food and non-energy goods was 1.4 percentage points higher in Italy than in the rest of the area. This differential reflected the markedly faster growth in Italy of unit labour costs in industry excluding construction, which over the two years 2002-03 outstripped the average for the three other major euro-area countries by more than 3 percentage points, owing largely to the unfavourable developments in productivity. On average for the year, in the service sector prices rose by 0.8 percentage points more in Italy than in the area as a whole, up from 0.3 points in 2002, while the differential for domestic costs widened to around 2 points.

Pricing policies in Italy. – As part of a Eurosystem research project called the Inflation Persistence Network, the Bank's Economic Research Department conducted several empirical studies that shed light on the pricing policies of Italian firms.

The first draws on the results of a qualitative survey carried out at the beginning of 2003 on a sample of over 300 private industrial and service companies with more than 50 employees. The survey questionnaire focused on firms' procedures for setting and revising prices.

The majority of Italian firms determine their selling prices by applying a fixed or variable mark-up to production costs. Competitive pressure exerts a heavy influence on pricing strategies, particularly in industrial firms. The lesser importance of this factor in the service sector appears to be connected with the importance of local markets for the firms of the sector and the application, especially in retailing, of selling prices that are often set directly by producers. Firms' selling prices are also influenced by the specific characteristics of buyers; in particular, some pricing policies are graduated according to the category of customer and the quantities sold.

In 2001 and 2002 firms adjusted their selling prices on an average of once a year, comparable to the frequency found by similar studies for other countries. In general, the intensity of price adjustments in response to demand or cost shocks depends partly on such factors as the competitiveness of the market and the costs customers sustain to find the best opportunities on the market (so-called search costs).

In Italy, the main specific factors hindering more frequent price adjustment are the existence of explicit contracts with buyers, the reluctance of individual firms to reprice for fear of provoking reaction from competitors, and the perceived temporary nature of the shocks. On the other hand, with the exception of firms in the retail sector, menu costs are not considered an especially important impediment to more frequent price adjustments.

The reaction of firms' prices to shocks is asymmetrical. Positive changes in costs have a greater impact than negative ones; increases in demand give rise to larger price changes than decreases in demand.

The second study, based on a subset of elementary price observations made on a monthly basis by Istat for the purpose of calculating the national index of consumer prices, focuses only on the frequency with which these prices are changed. The study analyzed some 750,000 elementary price observations referring to 50 widely used products included in the national consumer price index basket (excluding a priori items whose price is regulated) in the months from January 1996 to December 2003. For this subset, prices remain unchanged for an average of about nine months, only slightly shorter than the interval indicated by firms in the qualitative survey. However, the results for the main components of the basket differ widely: at one extreme there are the prices of energy and unprocessed food products, which tend to change every month; at the other, those of services and non-food and non-energy products, which remain unchanged for more than a year. The frequency of repricing also differs according to distributive channel; in particular, it is higher in large-scale distribution.

Households' inflation perceptions

During 2003 consumers' inflation perceptions, measured by qualitative household surveys coordinated by the European Commission, gradually receded from the peaks recorded at end-2002 in the euro area a whole. However, in Italy they remained high, as in 2002, and have only begun to diminish since the start of 2004. The surge in perceived inflation coincided with the introduction of the euro, although the national statistical institutes and central banks estimated that the currency changeover's impact on prices was generally modest.

The gap between the inflation rate measured by Istat and perceived inflation can be traced to multiple causes. In the first place, during and following the cash changeover a larger proportion of prices were marked up or down. As producers had to modify their price lists in any case in order to redenominate them in euros, they may have decided to telescope their ordinary price adjustments. If consumers' perceptions reflect the effective impact of each price change on their total spending asymmetrically, being more heavily influenced by price increases than decreases, even of equal amount, then even if average inflation remains unchanged there will be an increase in perceived inflation. The impact of this factor is magnified by the sharp, higher-than-average rises recorded in the last two years for the most frequently purchased items (food products, tobacco products, fuel and some services, notably transport, postal, banking, and catering services). It is likely that the impact of these items on households' inflation perceptions is much stronger than their actual importance in the consumer price index basket, which is based on the structure of average consumption of the whole population over the entire observation period. That structure is influenced heavily by less frequently purchased products with higher unit costs, such as durable goods.

Secondly, statistical analyses indicate that the feedback between individuals' perceptions and media attention to the issue may have played a more important role than in the past. Following the introduction of the euro, and in particular from the summer of 2002 onwards, the mass media in Italy gave exceptional coverage to price developments, despite the broad stability of inflation measured by Istat. In particular, in the last two years one finds instances of coincidence between abrupt swings in households' opinions of the behaviour of prices and the number of articles on the inflation controversy appearing in a sample of newspapers. This contrasts with what was observed in previous phases of deteriorating inflation perceptions (1995-96 and 1999-2000), when an equally significant upturn in the consumer price index did not elicit comparably intense coverage.

THE BALANCE OF PAYMENTS AND THE NET INTERNATIONAL INVESTMENT POSITION

Italy's current account deficit increased, rising from €10 billion (0.8 per cent of GDP) in 2002 to €18.4 billion (1.4 per cent of GDP) in 2003 (Table 29). The increase was chiefly due to the fall in the trade surplus from €14 billion to €8.8 billion. Other contributory factors were the rise in the deficit on income from €15.4 billion to €17 billion and in that on current transfers from €5.6 billion to €7.1 billion. The deficit on services remained unchanged at €3 billion.

Table 29

ITALY'S BALANCE OF PAYMENTS (1)
(balance in billions of euros)

	2001	2002	2003
Current account	**–0.7**	**–10.0**	**–18.4**
Goods	17.4	14.0	8.8
Exports	*273.6*	*267.6*	*259.1*
Imports	*256.2*	*253.5*	*250.3*
Services	..	–3.0	–3.0
Income	–11.6	–15.4	–17.0
Transfers	–6.5	–5.6	–7.1
EU institutions	*–5.6*	*–5.7*	*–6.3*
Capital account	**0.9**	**–0.1**	**2.5**
Intangible assets	–0.3	–0.2	–0.1
Transfers	1.2	0.1	2.5
EU institutions	*1.7*	*1.6*	*3.6*
Financial account	**–3.3**	**8.5**	**16.8**
Direct investment	–7.4	–2.7	6.5
Portfolio investment	–7.6	16.1	3.4
Financial derivatives	–0.5	–2.7	–4.8
Other investment	11.7	1.0	13.1
Banks (1)	*27.6*	*–41.7*	*39.4*
Change in official reserves	0.5	–3.1	–1.4
Errors and omissions	**3.1**	**1.5**	**–0.9**

(1) MFIs, excluding the Bank of Italy.

The capital account swung from near balance in 2002 to a surplus of €2.5 billion.

The financial account saw net inflows increase from €8.5 billion (0.7 per cent of GDP) to €16.8 billion (1.3 per cent of GDP); the errors and omissions item was a small net outflow of €0.9 billion.

The largest contribution to the improvement in the financial account came from "other investment", with the surplus rising from €1 billion to €13.1 billion. The net inflow of direct investment, portfolio investment and derivatives decreased from €10.7 billion to €5.1 billion and from 0.8 to 0.4 per cent of GDP.

Italy made a marginal contribution to the decline in the current account surplus of the euro area, as its surplus vis-à-vis countries outside the area contracted from €6.1 billion to €5.5 billion. Its trade surplus with these countries also declined slightly (from €23.6 billion to €20.5 billion) and the deficit on transfers increased. The deficit on income narrowed from €5.9 billion to €1.4 billion, while that on services widened from €4.3 billion to €5.2 billion. Turning to Italy's financial flows other than reserves vis-à-vis countries outside the euro area, net inflows rose from €20.1 billion in 2002 to a substantial €85.1 billion; the net inflow of direct investment, portfolio investment and derivatives more than doubled, rising from €23.9 billion to €57.9 billion.

At the end of 2003 Italy had a net external debtor position of €75.1 billion, or 5.8 per cent of GDP; at the end of 2002 the position had been negative by €67.4 billion, or 5.4 per cent of GDP.

Trade

Italy's trade surplus fell from €14 billion (1.1 per cent of GDP) in 2002 to €8.8 billion (0.7 per cent of GDP). Trade decreased in value terms for the second successive year: exports declined by 3.2 per cent and imports by 1.3 per cent. The decline in exports was due to the contraction in volumes (by 4.7 per cent according to foreign trade data), which was attenuated by an increase of 0.8 per cent in average unit values. The decline in imports was entirely attributable to lower volumes, as average unit values were unchanged overall. The terms of trade therefore improved for the third successive year, although the gain of 0.9 per cent was smaller than that registered in 2002.

Turning to trade with the euro-area countries, the contraction in volume of 6.2 per cent was larger than that for all trade, as was the increase of 2 per cent in average unit values. For trade with countries outside the euro area average unit values declined, especially vis-à-vis the United States, probably in relation to pricing policies aimed at mitigating the effects of the depreciation of the dollar against the euro. Imports displayed a similar pattern, with the largest decline in volumes (2.9 per cent) and increase in prices (1.2 per cent) found for trade with euro-area countries. Imports from non-EU markets increased in volume while prices fell, especially those of goods other than raw materials coming from the dollar area (including China). The rise in raw material prices tended to offset the benefits of the appreciation of the euro against the dollar.

The contraction in exports and imports with euro-area countries by respectively 3.3 and 1.4 per cent caused Italy's trade deficit with the area to rise from €9.5 billion to €11.7 billion. As in 2002, trade with Germany, the Netherlands, Ireland, Belgium and Luxembourg accounted for the bulk of the deficit.

Although the trade surplus with countries outside the euro area remained large at €20.5 billion (1.6 per cent of GDP), it contracted by more than €3 billion. This was entirely due to trade with non-EU countries other than the accession countries. The surplus with the other EU countries rose from €5 billion to €5.3 billion and that with the accession countries from €6 billion to €6.6 billion.

Italy's trade surplus with the United States fell from €13.5 billion to €12.3 billion (from 1.1 to 0.9 per cent of GDP) as a result of a sharp contraction in both exports and imports. The trade surplus vis-à-vis the newly industrialized Asian countries declined from €3.3 billion to €2.4 billion owing to a significant decrease in exports and a rise in imports. The deficit with China increased from €4.3 billion to €5.2 billion, or 0.4 per cent of GDP.

Services, income and transfers

Services. – The deficit on services remained unchanged at €3 billion, or 0.2 per cent of GDP.

Total credits declined slightly, from €63.8 billion to €62.9 billion. Two of the three largest sectors recorded decreases, as travel receipts fell by 2.1 per cent and transport receipts by 10 per cent. Total debits declined from €66.8 billion to €66 billion, reflecting falls in many items (government services, insurance, construction, information and computer services, and personal services); debits on the travel account increased by €0.4 billion.

The deficit on services reflected that on transactions with countries outside the euro area, which increased from €4.3 billion in 2002 to €5.2 billion; it has been curbed by the surplus vis-à-vis euro-area countries, which rose from €1.3 billion to €2.8 billion.

The only two sectors to show a surplus were travel, the most significant item, and financial services. The surplus on the former declined for the third successive year from the 10-year high recorded in 2000 in conjunction with the Jubilee celebrations. The appreciation of the euro against the currencies of some of the countries with which Italy has its largest flows of tourism reduced holiday-related travel. The weakness of economic activity in Italy and the euro area depressed business travel.

The surplus on travel fell from €10.4 billion to €9.4 billion, the net result of a decrease of 2.1 per cent in receipts and an increase of 2.4 per cent in spending. The number of visitors and their per capita expenditure declined slightly, by respectively 0.9 and 0.6 per cent. By contrast, the number of Italian travellers abroad increased by 3 per cent, while their per capita spending eased by 0.6 per cent. The surplus vis-à-vis euro-area countries increased from €8 billion to €8.5 billion, in line with the results of the previous three years. The surplus with respect to countries outside the area fell from €2.4 billion to €0.9 billion; in 2000 it had been equal to €4.3 billion and in 2001 to €4.1 billion.

The deficit on transport increased as a result of a rise in debits and a fall in credits. The deficits increased on two of the three items that contribute most to the overall negative result: that on air passenger transport rose from €1.6 billion to €1.7 billion and that on maritime goods transport from €1.3 billion to €1.8 billion. The deficit in respect of other goods transport services, which mainly comprises road transport, remained stable.

Income. – The deficit on the income account continued to mount in 2003, rising from €15.4 billion to €17 billion. The deterioration mainly involved investment income, but the deficit on labour income also increased from €0.9 to €1.1 billion as receipts fell more sharply than outlays. The deficit on investment income grew by €1.4 billion, from €14.5 billion to €15.9 billion, reflecting the increases of respectively €0.9 billion and €0.3 billion in the deficits on income from portfolio investment and “other investment”; the small surplus on income from direct investment decreased, from €0.2 billion to €0.1 billion.

The increase in the deficit on the income account was entirely due to the deficit with the euro-area countries, which rose from €9.5 billion to €15.5 billion, while that with the rest of the world fell from €5.9 billion to €1.5 billion. Developments in investment income, especially that of a portfolio nature, were the main factor in the changes in the balances with the euro-area countries and the rest of the world.

Current account transfers. – Italy’s deficit on current account transfers increased from €5.6 billion to €7.1 billion. The deterioration was entirely attributable to the increase in the deficit on public transfers, which reflected the rise in the deficit towards EU institutions caused by the increase in transfers other than customs duty and VAT, and the decrease of €3.6 billion in the credits of non-residents for taxes and duties. By contrast, private-sector transfers made a positive contribution, with an improvement in the balance on “other transfers” (which include casualty insurance premiums and claims, taxes and duties paid by residents and transfers for pensions and social security contributions); the deficit on emigrants’ remittances increased from €0.5 billion to €0.9 billion.

The capital account

The capital account improved from balance in 2002 to a surplus of €2.5 billion. The gain was nearly all attributable to public transfers, which swung from a small deficit of €0.1 billion in 2002 to a surplus of €2.3 billion. A contributory factor was the increase of €2 billion in the surplus vis-à-vis EU institutions in relation to larger transfers from the Regional Development Fund.

The financial account

Direct investment. – Direct investment gave rise to net inflows of €6.5 billion (0.5 per cent of GDP), compared with net outflows of €2.7 billion in 2002. As in 2002, the swing was mainly due to the fall in Italian investment abroad, which decreased by more than half from €18.2 billion to €8 billion; foreign investment in Italy amounted to €14.5 billion, compared with €15.5 billion in 2002.

The decrease in Italian foreign investment was primarily attributable to net disinvestment in the transport and communications sectors and in the mechanical engineering (machinery and transport equipment) sector.

The balances with the euro-area and non-euro-area countries both showed net direct investment inflows in 2003, compared with net outward flows the previous year. The main contribution to the overall swing concerned the euro-area countries, with a net inflow of €5.7 billion, compared with a net outflow of €2.5 billion in 2002; vis-à-vis the non-euro-area countries there was a net inflow of €0.8 billion, compared with broad balance in 2002.

Portfolio investment and derivatives. – Net outflows of portfolio investment and derivatives amounted to €1.5 billion in 2003, compared with net inflows of €13.4 billion in 2002. For portfolio investment alone, net inflows fell from €16.1 billion to €3.4 billion and from 1.3 to 0.3 per cent of GDP, reflecting the sharp increase in Italian outward investment (from €17 billion to €51.1 billion), which exceeded the rise in foreign investment in Italy (from €33.1 billion to €54.4 billion). Italians increased their net purchases of shares from €6 billion to €13.8 billion and of bonds from €10.9 billion to €37.3 billion. Foreigners continued to run down their holdings of Italian equities, although to a lesser extent than in 2002 as net outflows decreased from €7.2 billion to €2.2 billion. Their net investment in securities other than shares increased by €16.4 billion, with the rise again being driven by investment in bonds. The balance of investment in equities shows net outflows of €16 billion, that in non-equity securities net inflows of €19.4 billion. While net foreign investment in the bonds of Italian non-bank issuers contracted sharply (from €18.1 billion to €0.9 billion) in response to a number of corporate crises and more generally to the small volume of net issues, net investment in Italian government securities rose from €24.2 billion to €61.9 billion and consisted almost entirely of BTPs and BOTs.

The geographical breakdown of portfolio investment flows shows that the decrease in overall net inflows was the result of the increase in net outflows towards the euro area from €8.7 billion to €57.4 billion that was only partly offset by the increase in net inflows from the rest of the world from €24.8 billion to €60.8 billion. The expansion in net outflows of portfolio investment to the euro area involved all categories of securities; the rise in net inflows from the rest of the world involved securities other than equities.

“Other investment”. – Net inflows of “other investment” rose from €1 billion in 2002 to €13.1 billion, as net inflows of liabilities (€32.9 billion) exceeded net outflows of assets (€19.9 billion). The overall balance of bank transactions swung from a net outflow of €41.7 billion to a net inflow of €39.4 billion. The change primarily reflected developments in bank loans and deposits: repatriations of assets amounted to €3.8 billion (compared with outflows of €33.4 billion in 2002) and inflows of liabilities totaled €39.2 billion (as against repayments of €6.5 billion the previous year). The loans and deposits of private-sector non-bank residents swung from a net inflow of €36.7 billion to a net outflow of €22.1 billion, the result of net outflows of assets of €18.1 billion (compared with net inflows of €29.2 billion in 2002) and net outflows of liabilities amounting to €4 billion (compared with net inflows of €7.5 billion the previous year).

The official reserves. – Italy’s official reserves stood at €50.1 billion at the end of 2003, compared with €53 billion a year earlier. Flows during the year increased the reserves by €1.4 billion, exchange rate and value adjustments reduced them by €4.4 billion. The value of foreign currency assets declined, while that of gold stocks increased from €25.8 billion to €26 billion.

Italy's net international investment position

Italy had a net debtor position of €75.1 billion at the end of 2003 (5.8 per cent of GDP), compared with one of €67.4 billion at the end of 2002 (5.4 per cent of GDP). The financial account made a negative contribution of €16.8 billion, while value and exchange rate adjustments were positive by slightly more than €9 billion (Table 30). Exchange rate losses totaled

Table 30

ITALY'S NET INTERNATIONAL INVESTMENT POSITION

(millions of euros)

	Stocks at end-2002 (1) (a)	January-December 2003					Stocks at end-2003 (1) (a)+(d)
		Flows (2) (b)	Value adjustments			Change in stocks (d)=(b)+(c)	
			(c)	Exchange rate (3)	Other		
	Resident non-banks						
Assets	**851,961**	**69,143**	**–17,568**	**–41,013**	**23,445**	**51,575**	**903,536**
Direct investment	170,155	6,902	–2,290	–6,295	4,005	4,612	174,767
Portfolio investment	526,659	40,274	–12,556	–31,937	19,381	27,717	554,376
equities	*225,656*	*13,567*	*9,538*	*–6,032*	*15,570*	*23,105*	*248,761*
Other investment	146,977	18,987	–2,719	–2,781	62	16,268	163,245
Derivatives	8,170	2,980	– 2	..	– 2	2,978	11,148
Liabilities	**908,665**	**70,077**	**–6,148**	**–8,172**	**2,024**	**63,929**	**972,594**
Direct investment	119,706	14,707	2,109	–74	2,183	16,816	136,522
Portfolio investment	656,944	56,899	–6,678	–6,475	– 204	50,221	707,165
equities	*28,135*	*–6,107*	*2,588*	*–10*	*2,598*	*–3,519*	*24,616*
Other investment	126,485	–3,532	–1,584	–1,623	39	–5,116	121,369
Derivatives	5,530	2,003	5	..	5	2,008	7,538
Net position	**–56,704**	**–934**	**–11,419**	**–32,841**	**21,422**	**–12,353**	**–69,057**
	Resident banks						
Assets	229,491	17,219	13,840	–5,590	19,430	31,059	260,550
Liabilities	301,544	38,293	–11,485	–10,466	–1,018	26,808	328,352
Net position	**–72,053**	**–21,074**	**25,325**	**4,877**	**20,448**	**4,251**	**–67,802**
	Central bank						
Assets	66,420	2,821	–5,075	–5,197	122	–2,254	64,166
Liabilities	5,108	–2,412	–252	–252	..	–2,664	2,444
Net position	**61,312**	**5233**	**–4823**	**–4,945**	**122**	**410**	**61,722**
OVERALL NET INTERNATIONAL INVESTMENT POSITION	**–67.445**	**–16,775**	**9,083**	**–32,909**	**41,992**	**–7,692**	**–75,137**

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

about €33 billion, while other adjustments (mainly in relation to prices) showed a gain of about €42 billion. Exchange rate adjustments reduced the value of the assets of non-bank residents, especially portfolio investments; however, they helped to lower the value of banks' external liabilities by €10.5 billion. The decrease in the net creditor position on direct investment from 5.1 to 4 per cent of GDP was partly offset by a reduction in the net debtor position on portfolio investment from 8.2 to 8.1 per cent of GDP and on other investment from 6.7 to 5.9 per cent.

THE PUBLIC FINANCES

General government net borrowing in the euro area grew for the third successive year. In relation to GDP it rose from 2.3 to 2.7 per cent; according to the programmes governments had submitted, it should have fallen by 0.4 percentage points. The primary surplus contracted by 0.6 percentage points of GDP, reflecting the persistence of unfavourable economic conditions. The deterioration was checked by the greater recourse made by some governments to one-off measures. The ratio of debt to GDP rose by 1.2 percentage points to 70.5 per cent.

Four countries (France, Germany, Greece and the Netherlands) recorded deficits in excess of 3 per cent of GDP. France and Germany had also exceeded this threshold in 2002.

In the first part of 2003 the Excessive Deficit Procedure was launched against France and Germany. On 25 November 2003 the EU Council decided to hold the Excessive Deficit Procedure in abeyance for both countries; continuing with the procedure, as proposed by the European Commission, would have been a further step towards the imposition of sanctions. The Council nonetheless recommended that the two countries should achieve substantial reductions in their cyclically adjusted deficits in 2004-05 and set 2005 as the time limit for bringing their deficits below the 3 per cent threshold.

The Governing Council of the European Central Bank stated that the failure to go along with the rules and procedures of the Stability and Growth Pact risked undermining the credibility of the institutional framework and the confidence in sound public finances of member states across the euro area.

In view of the prolongation of unfavourable economic conditions, the objectives set by the euro-area countries for 2004 and the following years were made less ambitious. According to the forecasts of the European Commission, in many countries the new objectives for 2004 will not be achieved; France, Germany, Greece, Italy, the Netherlands and Portugal are expected to record deficits in excess of 3 per cent of GDP.

In April 2004 the Commission recommended that the Council should issue an early warning to Italy. It also launched the Excessive Deficit Procedure against the Netherlands and Greece. In the latter country, as in Portugal in 2002, there has been an abrupt worsening of the public finances. The Council will decide on the positions of the individual countries in the coming months.

In Italy general government net borrowing amounted to 2.4 per cent of GDP, compared with 2.3 per cent in 2002. Interest payments declined from 5.8 to 5.3 per cent. The primary surplus fell from 3.5 to 2.9 per cent; about half the deterioration can be attributed to the poor performance of the economy. The fall in the primary surplus was curbed by an increase in one-off measures, which rose from 1.5 per cent of GDP in 2002 to around 2 per cent in 2003. As a consequence of the various tax regularization schemes, taxes and social security contributions rose by 0.9 percentage points of GDP. Primary current expenditure increased by one percentage point.

In the last few years the reduction in interest payments has offset the gradual decline in the primary surplus: between 1997 and 2003 both aggregates contracted by around 4 percentage points of GDP. In the same period taxes and social security contributions decreased by 1.7 points; when receipts from one-off measures are excluded, the decrease was sharper. The adjustment of the public finances and the process of reducing the fiscal burden have been checked by the performance of primary current expenditure, which rose over the same period by around 1.5 points.

The overall general government borrowing requirement fell to 2.8 per cent of GDP from 3.4 per cent in 2002. When privatization receipts, which were substantial in 2003, are excluded, the borrowing requirement rose from 3.5 to 4.1 per cent. The gap with respect to net borrowing was equal to 1.6 percentage points of GDP, in line with the average of the four preceding years. The borrowing requirement was curbed by one-off measures amounting to around 2 per cent of GDP.

General government debt increased by €21.1 billion, which was €15.2 billion less than the total borrowing requirement. The difference stemmed from the withdrawal of assets held with the Bank of Italy (€8 billion), the effects of the issue of securities above par (€3.9 billion) and those of the appreciation of the euro (€3.9 billion). The ratio of debt to GDP declined from 107.9 to 106.2 per cent.

The objective for net borrowing in 2004 was set at 1.8 per cent of GDP in the Economic and Financial Planning Document of July 2003. In December a budgetary adjustment on the order of 0.8 per cent of GDP was approved. In May 2004 the Quarterly Report on the Borrowing Requirement estimated net borrowing for the year at 2.9 per cent of GDP, with the primary surplus falling to 2.2 per cent. The real growth in GDP was forecast to be 1.2 per cent. If the performance of the public finances in the coming months should prove less satisfactory than expected, the Government has indicated that it will adopt additional corrective measures.

In the meeting of the EU Council on 11 May Italy undertook to take steps to keep the deficit below the 3 per cent threshold. The Council resolved to postpone the decision whether to issue an early warning to Italy until July, when it will be in a position to evaluate the measures announced by the Government.

The Quarterly Report on the Borrowing Requirement foresees a significant deterioration in the financial balances: the public sector borrowing requirement, net of settlements of past debts and privatization receipts, is seen as rising from 3.5 to 4.9 per cent of GDP; excluding only privatization receipts, the expected increase is from 4.2 to 5.3 per cent. The Report indicates a further widening of the gap between the borrowing requirement and net borrowing; the maximum transparency is necessary with regard to the underlying factors. The contribution of one-off corrective measures remains high at around 1 per cent of GDP.

The performance of the public finances in the early months of the year is consistent with the new estimates for the financial balances for the year as a whole: in the first quarter the general government net borrowing requirement amounted to €33.3 billion, which was about €11.2 billion more than in the first quarter of 2002.

According to official estimates, which assume privatizations amounting to €21 billion, the public debt should decline by 0.3 percentage points of GDP in 2004 (from 106.2 to 105.9 per cent). In a medium-term perspective, the reduction of the debt burden requires a significant increase in the primary surplus and a substantial decrease in the borrowing requirement. In order to achieve a lasting improvement in the public finances and a further fall in the ratio of taxes and social security contributions to GDP, structural reforms of the main current expenditure items are needed, capable of significantly reducing their incidence in relation to GDP.

BUDGETARY POLICY IN 2003

The euro area

General government net borrowing rose for the third successive year, to stand at 2.7 per cent of GDP, compared with 2.3 per cent in 2002; most of the countries in the euro area contributed to the deterioration (Table 31). On the basis of the stability programme updates submitted in late 2002 and early 2003, the euro-area deficit should have declined by 0.4 percentage points of GDP. Against a background of persistently unfavourable economic conditions, which proved worse than envisaged in the stability programmes, budget outcomes were influenced above all by the working of built-in stabilizers. In some countries the expansion in the deficit was kept in check by increased recourse to one-off corrective measures.

Table 31

GENERAL GOVERNMENT NET BORROWING AND DEBT IN THE EURO-AREA COUNTRIES

(as a percentage of GDP)

	Net borrowing (1)				Debt			
	2000	2001	2002	2003	2000	2001	2002	2003
Germany	1.2	2.8	3.5	3.9	60.2	59.4	60.8	64.2
France	1.4	1.6	3.3	4.1	57.2	56.8	58.9	63.3
Italy	1.8	2.6	2.3	2.4	111.2	110.6	107.9	106.2
Spain	1.0	0.4	0.0	–0.3	61.2	57.5	54.6	50.8
Netherlands	–1.5	0.0	1.9	3.2	55.9	52.9	52.6	54.8
Belgium	–0.2	–0.4	–0.1	–0.2	109.1	108.1	105.8	100.5
Austria	1.9	–0.2	0.2	1.1	67.0	67.1	66.6	64.9
Greece	2.0	1.9	1.4	3.2	106.2	106.9	104.7	103.0
Finland	–7.1	–5.2	–4.3	–2.3	44.6	43.9	42.6	45.3
Ireland	–4.4	–1.1	0.4	–0.2	38.4	36.1	32.3	32.4
Portugal	3.2	4.4	2.7	2.8	53.3	55.6	57.9	59.9
Luxembourg	–6.3	–6.3	–2.7	0.1	5.5	5.5	5.7	4.9
Euro area (2)	0.9	1.7	2.3	2.7	70.4	69.4	69.3	70.5

Sources: European Commission and Eurostat.
(1) The data 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.

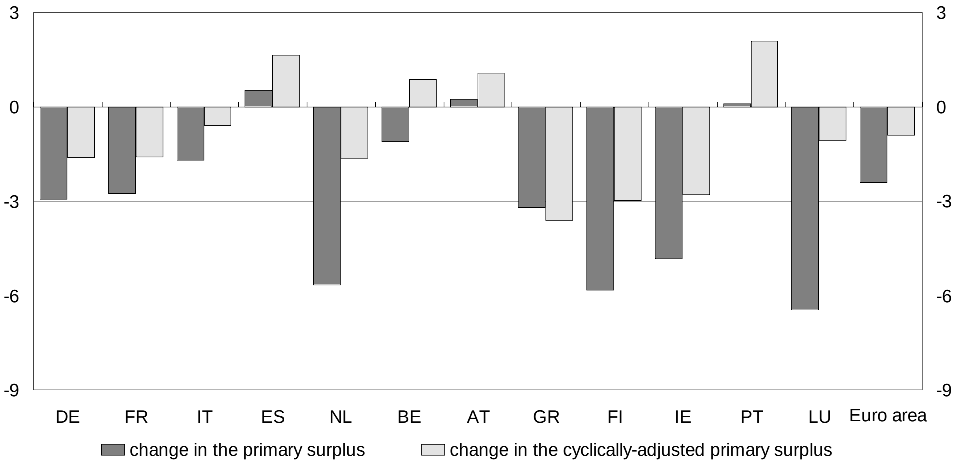
The primary surplus of the euro area continued on the downward trend that had begun in 2001, falling to 0.8 per cent of GDP, compared with 1.4

per cent in 2002 and 3.2 per cent in 2000 (Figure 18). Interest payments diminished further, declining from 3.7 to 3.5 per cent of GDP.

Figure 18

CHANGE IN THE PRIMARY SURPLUS IN THE PERIOD 2001-03 IN THE EURO-AREA COUNTRIES (1)

(percentage points of GDP)



Source: European Commission.

(1) The changes are calculated taking the figures for 2000 as the initial values.

Net borrowing was particularly high in relation to GDP in France (4.1 per cent), Germany (3.9 per cent), Greece (3.2 per cent), the Netherlands (3.2 per cent) and Portugal (2.8 per cent). The deficits of France and Germany exceeded the 3 per cent threshold for the second successive year. Among the countries that have not adopted the euro, the United Kingdom recorded a deficit equal to 3.2 per cent of GDP, up from 1.6 per cent in 2002.

The European Commission's estimate of the ratio of the cyclically-adjusted deficit to GDP improved from 2.4 to 2.1 per cent. Among the countries whose budgetary positions in 2002 were not close to balance or in surplus, Ireland, the Netherlands and Portugal fulfilled the undertaking entered into in October 2002 within the Eurogroup to improve their cyclically-adjusted balances on current account by at least 0.5 percentage points of GDP. The cyclically-adjusted primary surplus of the euro area rose from 1.2 to 1.4 per cent of GDP; excluding the effects of the main one-off measures, the ratio remained basically unchanged.

In 2003 one-off measures are estimated to have curbed the euro-area deficit by about half a percentage point of GDP (against approximately one third of a point in 2002). The measures in question mainly concerned Belgium, Italy and Portugal.

The euro-area debt ratio rose for the first time since 1996, reaching 70.5 per cent of GDP, compared with 69.3 per cent in 2002. The deterioration was especially marked in France, where the ratio rose from 58.9 to 63.3 per cent, and Germany, where it rose from 60.8 to 64.2 per cent. Among the countries whose debt exceeds their GDP, Belgium achieved a reduction of 5.3 percentage points and Italy and Greece of 1.7 points.

In view of the 2002 budget figures, in January 2003 the EU Council initiated the excessive deficit procedure against Germany and in June 2003 against France. At the same time it recommended that these countries adopt measures within four months that would bring their deficits below the 3 per cent threshold in 2004.

In October and November respectively the European Commission found that France and Germany had not taken steps that would enable them to comply fully with the Council's indications. It recommended calling on the two countries to achieve a larger-than-planned deficit reduction in 2004 and proposed extending by one year, to 2005, the time limit within which they should eliminate their excessive deficits.

On 25 November the EU Council decided not to adopt the Commission's recommendations and to hold the excessive deficit procedure in abeyance for the two countries. Continuing with the procedure would have been a further step towards the imposition of sanctions. In the Conclusions directed to each of the two countries the Council nonetheless recommended that in the two years 2004-05 they should achieve significant reductions in their cyclically-adjusted net borrowing (at least 1.4 and 1.1 percentage points of GDP for France and Germany respectively) and extended the deadline for the reduction of their deficits below the 3 per cent threshold to 2005.

In November the Governing Council of the European Central Bank expressed regret with regard to the EU Council's decisions. It observed that the failure to go along with the rules and procedures foreseen in the Stability and Growth Pact risked undermining the credibility of the institutional framework and confidence in sound public finances of member states across the euro area.

At the beginning of this year the Commission appealed to the European Court of Justice for a ruling on the conformity with the Maastricht Treaty of the decisions taken by the EU Council on 25 November.

Italy

Budgetary policy. − The Economic and Financial Planning Document of July 2002 set an objective of 0.8 per cent of GDP for general government net borrowing in 2003 and of 5.1 per cent for the primary surplus (Table 32). In addition, it envisaged a reduction of 0.4 percentage points in the ratio of taxes and social security contributions to GDP, to 41.9 per cent, and a reduction of 4 percentage points in the debt ratio, to 104.5 per cent. It was assumed that the economy would grow by 2.9 per cent.

Table 32

PUBLIC FINANCE OBJECTIVES, ESTIMATES AND OUTTURNS FOR THE YEAR 2003

(billions of euros)

	State sector borrowing requirement (1)	General government				*Memorandum items*	
		Net borrowing	Primary surplus	Interest payments	Debt	Real GDP growth rate (%)	Nominal GDP
Objectives							
EFPD (July 2002)	. . . .	10.8	67.6	78.4	. . . .	2.9	1,325.3
as a percentage of GDP	. . . .	*0.8*	*5.1*	*5.9*	*104.5*		
EFPD update (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*	*105.0*		
Stability programme update (November 2002)	. . . .	. . . .	. . . .	. . . .	. . . .	2.3	1,305.0
as a percentage of GDP	. . . .	*1.5*	*4.5*	*6.0*	*105.0*		
Estimates released during the year							
QRBR and FPR (April 2003)	42.0	30.1	41.3	71.4	. . . .	1.1	1,307.1
as a percentage of GDP	*3.2*	*2.3*	*3.2*	*5.5*	*105.9*		
EFPD (July 2003)	43.0	30.4	38.9	69.3	. . . .	0.8	1,303.7
as a percentage of GDP	*3.3*	*2.3*	*3.0*	*5.3*	*105.6*		
FPR and EFPD update (September 2003)	45.0	32.9	36.4	69.3	. . . .	0.5	1,300.2
as a percentage of GDP	*3.5*	*2.5*	*2.8*	*5.3*	*106.0*		
Stability programme update (November 2003)	. . . .	. . . .	. . . .	. . . .	. . . .	0.5	1,300.0
as a percentage of GDP	. . . .	*2.5*	*2.8*	*5.3*	*106.0*		
Outturns	42.7	31.8	37.5	69.3	1,381.4	0.3	1,300.9
as a percentage of GDP	*3.3*	*2.4*	*2.9*	*5.3*	*106.2*		

(1) Net of settlements of past debts and privatization receipts.

The objectives were revised in the September update of the Economic and Financial Planning Document: the figure for net borrowing was raised to 1.5 per cent of GDP, that for the primary surplus lowered to 4.5 per cent and that for the debt raised to 105 per cent. In particular, account was taken of the upward revision of the estimate for the budget deficit in 2002 (from 1.1 to 2.1 per cent of GDP) and of the reduction in forecast economic growth to 2.3 per cent. The update of the stability programme in November 2002 confirmed this planning scenario.

In order to achieve the objectives for 2003, the Government submitted a bill to Parliament containing measures to reduce the deficit on a current programmes basis by an estimated one per cent of GDP. The changes introduced by Parliament left the size of the correction basically unchanged (see the box “The implementing provisions of the budget for 2003”, *Economic Bulletin* No. 36, March 2003). The bulk of the adjustment consisted of tax regularization schemes, which were expected to generate €8 billion of receipts. In addition, the budget estimates on a current programmes basis discounted a sizable contribution to the reduction in the deficit from the sale of publicly-owned real estate.

In the early months of 2003 the borrowing requirement was higher than expected. At the beginning of March Istat published a figure of 2.3 per cent of GDP for net borrowing in 2002, which was higher than the Government’s estimate of 2.1 per cent in the previous autumn. In April, in the Quarterly Report on the Borrowing Requirement, the Government raised the estimate of net borrowing to 2.3 per cent of GDP and reduced that of the primary surplus to 3.2 per cent. The estimate of economic growth was lowered to 1.1 per cent.

In July the Economic and Financial Planning Document for the years 2004-07 reduced the estimate of the primary surplus for 2003 to 3 per cent of GDP following the downward adjustment of the estimate of economic growth to 0.8 per cent; the target for net borrowing was left unchanged in the light of a more favourable estimate of interest payments.

In September the Forecasting and Planning Report raised the estimate of net borrowing to 2.5 per cent of GDP and lowered that of the primary surplus to 2.8 per cent. In arriving at these figures, account was taken of the results on an accrual basis of the tax regularization schemes, which were much better than expected, and of the decision to defer a large part of the planned sales of real estate to 2004. The estimate of economic growth was reduced to 0.5 per cent.

In December the Government introduced a requirement for banks acting as tax-collection agents to make an advance payment that can be offset the following year. In 2003 this led to a temporary improvement in the deficit of €2.7 billion or 0.2 per cent of GDP.

The results. − In 2003 the general government deficit amounted to 2.4 per cent of GDP, a slight increase on the 2.3 per cent recorded in 2002.

Interest payments declined from 5.8 to 5.3 per cent of GDP (Tables 33 and a15; Figure 19).

Table 33

MAIN INDICATORS OF THE GENERAL GOVERNMENT FINANCES (1)
(as a percentage of GDP)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Revenue	47.3	45.1	45.6	45.8	48.0	46.5	46.7	45.8	45.7	45.3	46.3
Expenditure (2) (3)	57.6	54.3	53.2	52.9	50.7	49.3	48.4	47.6	48.3	47.6	48.8
of which: interest	*13.0*	*11.4*	*11.5*	*11.5*	*9.4*	*8.0*	*6.7*	*6.5*	*6.5*	*5.8*	*5.3*
Primary surplus (3)	2.8	2.1	3.9	4.4	6.7	5.2	5.0	4.6	3.9	3.5	2.9
Net borrowing (3)	10.3	9.3	7.6	7.1	2.7	2.8	1.7	1.8	2.6	2.3	2.4
Total borrowing requirement	11.0	9.8	7.2	7.5	1.8	2.6	1.3	2.2	4.0	3.4	2.8
Borrowing requirement net of privatization receipts	11.0	10.1	7.7	7.8	2.9	3.3	3.3	3.5	4.3	3.5	4.1
Borrowing requirement net of settlements of past debts and privatization receipts ..	10.3	9.6	7.5	7.1	2.9	3.1	2.8	3.1	3.6	3.1	3.4
Debt	118.7	124.8	124.3	123.1	120.5	116.7	115.5	111.2	110.6	107.9	106.2

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 continued on the downward trend that began in 1998, falling from 3.5 to 2.9 per cent of GDP, close to the level in 1993. The deterioration reflected the increase of 1 percentage point of GDP in primary current expenditure (owing to the increase of 5.8 per cent in the numerator and the limited growth of the denominator) and the fall in receipts from the sale of publicly-owned real estate (from 0.9 to 0.2 per cent of GDP), which are included under investment with a negative sign. On the other hand the primary surplus benefited from the increase of 1 percentage point in the ratio of taxes to GDP in connection with the revenues from tax regularization schemes.

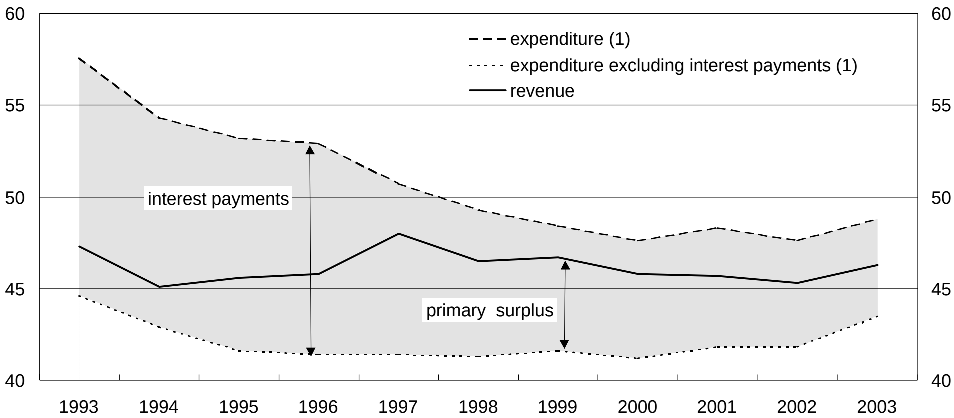
In 2003 the weak performance of the economy is estimated to have accounted for 0.3 percentage points of the worsening of the ratio of the primary surplus to GDP. In the last two years it is estimated to have accounted for 0.7 points out of the total deterioration of 1 point.

The 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 *Abridged Report for the Year 2000*). Ignoring composition effects, which in 2002 and 2003 mainly reflected the relatively favourable performance, compared with GDP, of payroll employment and per capita earnings, the negative impact of economic conditions on the primary surplus amounted to 1 percentage point. This is in line with the European Commission's recent estimate of 1.1 per cent, obtained using a methodology that does not take account of changes in the composition of GDP.

Figure 19

GENERAL GOVERNMENT REVENUE AND EXPENDITURE

(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.

One-off measures reduced net borrowing by about 2 percentage points of GDP in 2003, compared with 1.5 points in 2002 and 0.5 points in 2001. These estimates refer to the main budgetary measures; they do not include the temporary expense arising from investment incentives, which is difficult to assess.

The most important one-off measures that affected net borrowing in 2003 were: tax regularization schemes (1.5 per cent of GDP), sales of public buildings (0.2 per cent), the advance payment required from banks acting as tax-collection agents (0.2 per cent), the special taxes in lieu of income tax introduced in the Finance Law for 2002 (0.1 per cent), the payments of the substitute tax on the revaluation of corporate assets that was introduced in 2000 and extended several times, most recently in the budget for 2004 (0.1 per cent).

In 2002 the most important one-off measures had been: sales of public buildings (0.9 per cent of GDP), interest rate swaps (0.2 per cent), the above-mentioned substitute tax on the revaluation of corporate assets (0.1 per cent), the capital repatriation scheme (0.1 per cent), and the additional payment made at the end of the year by banks acting as tax-collection agents (0.1 per cent). Net borrowing in 2001 had been reduced mainly by sales of public buildings (0.2 per cent of GDP) and receipts of the tax on the revaluation of corporate assets (0.4 per cent).

Primary current expenditure rose from 38.4 per cent of GDP in 2002 to 39.4 per cent, the highest level in the last ten years. The increase was primarily due to the sharp rise in intermediate consumption (which had been curbed in the last part of 2002), staff costs (influenced by contract renewals) and social benefits. Excluding the proceeds of sales of real estate, which are included under investment with a negative sign, capital expenditure remained unchanged in relation to GDP and investment expenditure increased by 6.9 per cent, rising from 2.8 to 2.9 per cent of GDP and thus prolonging the upward trend under way since 1995.

In 2003 disposals of real estate generated €2.7 billion, almost entirely by way of direct sales, €1 billion of which involved buildings included in the securitization carried out in 2001 but not counted in calculating the borrowing requirement for that year. In 2001 and 2002 such disposals amounted to respectively €2 billion and €11 billion. The former amount derived exclusively from direct sales, while the latter came from a €6.6 billion securitization and €4.4 billion of direct sales, of which just over half was in respect of buildings included in the 2001 securitization. In July 2002 Eurostat established the criteria on the basis of which securitizations are to be classified as sales or as loans (see the chapter on Budgetary Policy in 2002 in the *Abridged Report for the Year 2002*).

Revenue rose from 45.3 per cent of GDP in 2002 to 46.3 per cent as a consequence of the large increase of 1.4 percentage points in capital taxes, which was offset only in part by the decrease of 0.4 percentage points in current revenues. The former included the amounts that accrued in 2003 in respect of the tax regularization schemes introduced in the Finance Law for 2003 (€19.3 billion) and the new time limits set for the capital repatriation scheme (€0.6 billion). Current revenues were particularly affected by the fall of 0.6 percentage points in the ratio of direct taxes to GDP in response to a series of factors that included the entry into force of the first step of the income tax reform, the weak phase of the economic cycle and the effects of the investment tax incentives introduced in earlier years.

The revenue generated by the tax regularization schemes introduced by the Finance Law for 2003 amounted to about €13 billion. Since taxpayers can settle these liabilities in instalments, the revenue accruing in 2003 includes the estimate of €6.3 billion for the payments that will be made this year and in the following years.

Financial balances and the public debt. − When the figures for Italy's public finances were communicated to the European Commission on 1 March 2004, those for the general government borrowing requirement and debt were substantially revised.

The revisions were made in the light of new data on the amount of postal current accounts held by the private sector and, to a lesser extent, the results of checks on the procedures used to determine the value of the government securities held by social security institutions belonging to the general government sector (see the box "Changes to the statistics on the general government borrowing requirement and debt" in *Economic Bulletin* No. 38, March 2004).

The impact of the changes is significant from 1999 onwards. Including the effects of ordinary statistical revisions, the borrowing requirement was revised upwards by €1.6 billion in 1999, €0.7 billion in 2000, €5.2 billion in 2001 and €5 billion in 2002; the debt for those years was increased by €6.3 billion, €7 billion, €12.2 billion and €17.8 billion respectively. The revisions of the estimates of the borrowing requirement did not affect those of net borrowing.

The general government total borrowing requirement fell from €42.4 billion in 2002 to €36.4 billion and from 3.4 to 2.8 per cent of GDP (Tables 33, 34, and a19). The reduction reflects the increase in privatization receipts from €1.9 billion to €16.8 billion, which was mainly due to the transactions connected with the transformation of Cassa Depositi e Prestiti into a limited company (€12 billion). Settlements of past debts rose from €5.3 billion to €8.5 billion, which was slightly above the average of the previous four years.

As regards the financing of the borrowing requirement, net issues of medium and long-term securities fell from €31.8 billion in 2002 to €23.4 billion, while for short-term securities there was a swing from net redemptions of €0.4 billion to net issues of €6.1 billion. The average residual maturity of medium and long-term government securities nonetheless lengthened from 5.5 to 6 years. Bank loans amounting to €5.2 billion were repaid (€2.4 billion in 2002). The assets held by the Treasury with the Bank of Italy were reduced by €8 billion (€2.2 billion in 2002). The funds raised by way of postal current accounts held by the private sector declined slightly from €4.2 billion to €3.8 billion.

Excluding privatization receipts and settlements of past debts, the borrowing requirement rose from 3.1 to 3.4 per cent of GDP. Temporary measures are estimated to have reduced the net borrowing requirement by about two percentage points of GDP, as in 2002.

Table 34

GENERAL GOVERNMENT BALANCES AND DEBT
(millions of euros)

	2000	2001	2002	2003
Net borrowing (1)	21,359	32,262	28,403	31,832
Total borrowing requirement	25,726	48,364	42,409	36,360
Borrowing requirement net of settlements of past debts and privatization receipts (2)	36,575	43,383	39,010	44,667
Debt	1,297,100	1,347,805	1,360,253	1,381,394
Memorandum items:				
Settlements of past debts (2)	4,601	9,310	5,328	8,537
Privatization receipts (–) (2)	–15,450	–4,329	–1,929	–16,844

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.

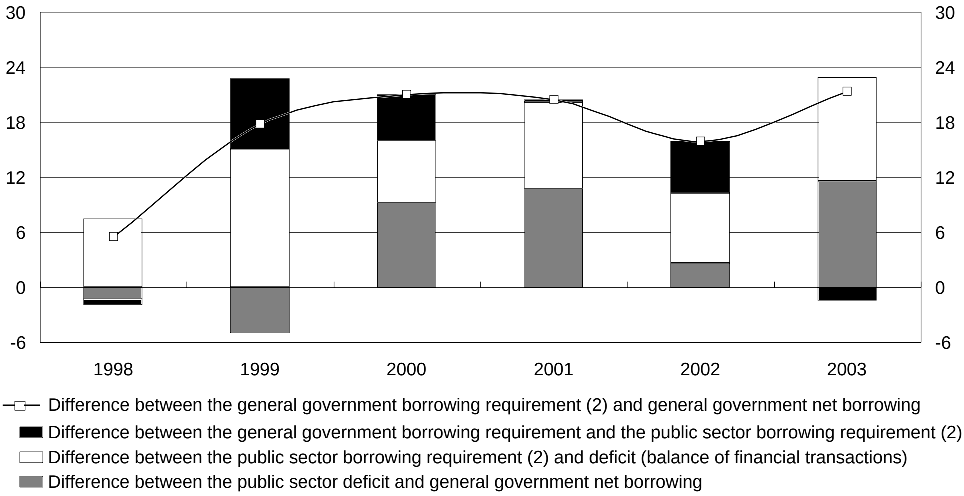
The temporary measures that affected the borrowing requirement but not net borrowing include the securitizations of social security contributions due to the National Social Security Institute (INPS) and claims of the State Sector Employees' Social Security Institute (INPDAP), which generated revenue equal to 0.2 and 0.3 percentage points of GDP respectively. Conversely, the borrowing requirement was unaffected by the revenue expected from the instalments of tax regularization schemes not yet paid, which reduced net borrowing by 0.5 per cent of GDP.

The gap between the net borrowing requirement and net borrowing amounted to 1 per cent of GDP, which was in line with the values recorded in the period from 1999 to 2002. Excluding only privatization receipts, the borrowing requirement exceeded net borrowing by 1.6 percentage points of GDP, which was equal to the average of the previous four years.

The difference between the general government borrowing requirement excluding only privatization receipts (calculated by the Bank of Italy on the financing side on a cash basis) and general government net borrowing (calculated by Istat on the formation side on an accrual basis) was equal to 0.5 per cent of GDP between 1994 and 1998 and close to 1.6 per cent of GDP in the five following years (Figure 20). It can be divided into three components: a) the balance of transactions in financial assets, which affects the borrowing requirement but not net borrowing (this balance is calculated by the Ministry for the Economy and Finance with reference to the public sector, an aggregate that corresponds closely to general government); b) the difference between the deficit of the public sector (calculated by the Ministry by subtracting the balance of transactions in financial assets from the borrowing requirement) and the general government borrowing requirement (this difference is mostly due to the different accounting principles applied: cash basis for the deficit, accrual basis for net borrowing); and c) the gap between the general government borrowing requirement (calculated by the Bank of Italy on the financing side) and the public sector borrowing requirement (calculated by the Ministry on the formation side), which primarily reflects statistical discrepancies deriving from the different sources used (for additional methodological details, see the chapter on "Budgetary policy in 2002" in the *Abridged Report for the Year 2002*).

Figure 20

GAP BETWEEN THE BORROWING REQUIREMENT AND NET BORROWING (1)
(billions of euros)



Sources: For the public sector borrowing requirement, balance of financial transactions and deficit, Ministry for the Economy and Finance, *Relazione trimestrale* di cassa, various years; for the general government borrowing requirement, Bank of Italy; for net borrowing, Istat.
(1) The data on the borrowing requirement and net borrowing in 2000 exclude the proceeds of the sale of UMTS licences. – (2) Borrowing requirement net of privatization receipts.

On average for the period 1999-2003 about half the total gap was due to the balance of transactions in financial assets (more than 0.8 percentage points of GDP), which was always negative and particularly large in 1999 (€15.1 billion) and 2003 (€11.3 billion); nearly one third (0.5 points) was due to the difference between the deficit on a cash basis and net borrowing on an accrual basis, which was positive from 2000 onwards and particularly large in 2001 (€10.7 billion) and 2003 (€11.6 billion); the remaining part (0.3 points) reflects the difference between the general government and public sector borrowing requirements, which was significant in 1999 and, to a lesser extent, in 2000 and 2002. The Commission set up at the Presidency of the Council of Ministers to verify the consistency of the public finance statistics prepared by Istat, the Ministry for the Economy and Finance and the Bank of Italy has not yet concluded its work.

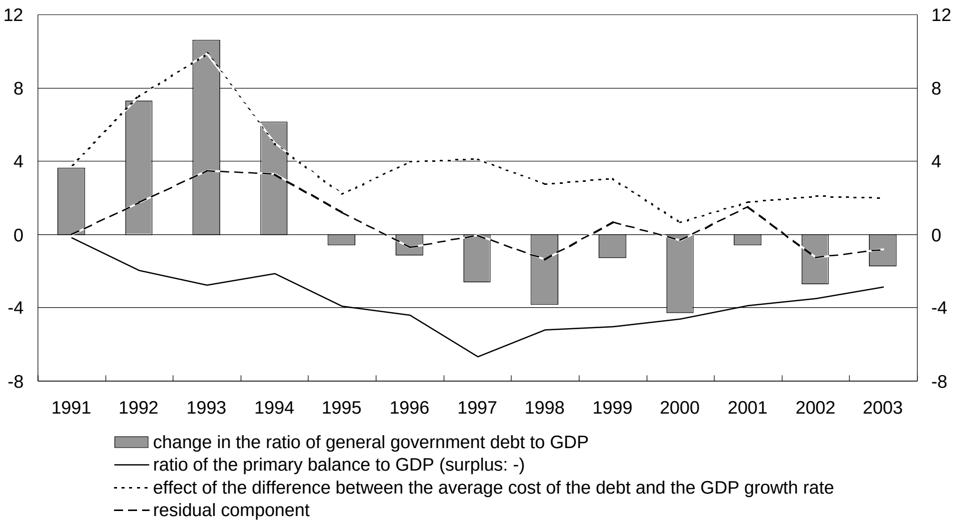
General government debt increased by €21.1 billion (Tables 34, a16 and a17). The upward impulse imparted by the net borrowing requirement and settlements of past debts, totaling €53.2 billion, was partially offset by privation receipts amounting to €16.8 billion, the withdrawal of €8 billion of Treasury assets held with the Bank of Italy, the issue of securities above par (which increased the debt in nominal terms by €3.9 billion less than the amount of funds raised) and the appreciation of the euro (which reduced the value of liabilities denominated in other currencies by €3.3 billion).

The ratio of general government debt to GDP declined by 1.7 percentage points to 106.2 per cent (Table 33 and Figure 21). About two thirds of the reduction due to the primary surplus was offset by the increase attributable to the difference between the average cost of the debt and the nominal GDP growth rate. This difference narrowed slightly since the fall in the average cost of the debt from 5.4 to 5.1 per cent was larger than the slowdown in GDP growth, which slipped from 3.4 to 3.2 per cent. The residual component − the algebraic sum of the difference between the change in the debt and the total borrowing requirement (–1.2 percentage points of GDP) and the difference between the total borrowing requirement and net borrowing (more than 0.3 points) − lowered the ratio by 0.8 points.

Figure 21

COMPOSITION OF THE CHANGE IN THE RATIO OF THE PUBLIC DEBT TO GDP (1)

(percentage points)



(1) The change in the debt-to-GDP ratio (d) can be decomposed into three components on the basis of the following identity: n$d_t = pr_t + (r_t - g_t)\,[d_{t-l}\,/(1+g_t] + re_t$, where *pr* is the ratio of the primary balance to GDP, $(r_t - g_t)\,[d_{t-l}\,/(1+g_t)$ is the effect of the difference between the average cost of the debt (r, defined as the ratio of interest payments for the year to the debt at the end of the previous year) and the rate of increase in nominal GDP (g), and *re* is the ratio to GDP of the difference between net borrowing and the change in the debt. The primary balance for 2000 excludes the proceeds of the sale of UMTS licences (26,750 billion lire, qual to 1.2 per cent of GDP); the part of the proceeds received in that year (23,040 billion lire, equal to 1 per cent of GDP) is included in the residual component.

The transformation of Cassa Depositi e Prestiti into a limited company. − On 12 December 2003 Cassa Depositi e Prestiti became a limited company and is no longer included in general government but among non-bank financial intermediaries.

The Cassa finances general government and public-law bodies by drawing on postal savings and by issuing securities and engaging in other financial transactions that are eligible for a state guarantee. It also finances infrastructure works for the supply of public services by issuing securities and engaging in other financial transactions that are not eligible for a state guarantee.

Before the Cassa's transformation, its main assets consisted of around €180 billion of deposits with the Treasury and more than €70 billion of loans to general government bodies; its liabilities consisted primarily of funds raised by the Post Office, which amounted to more than €230 billion, valuing postal savings certificates at their redemption value. The transformation involved the transfer to the State of part of the Cassa's assets and liabilities. The new company's initial assets included €47.5 billion of loans to general government bodies and €30.5 billion of deposits with the Treasury; its liabilities consisted primarily of the part of postal savings that was not transferred to the Ministry for the Economy and Finance (€80 billion, comprising savings books and savings certificates).

The transformation of the Cassa, the transfer of part of its assets and liabilities to the State and its reclassification outside the general government sector modified the composition of the latter's debt significantly; the impact on the level of the debt and the borrowing requirement was limited (a reduction of €0.6 billion; see the box "The transformation of Cassa Depositi e Prestiti into a limited company: the impact on the public debt", *Economic Bulletin* No. 38, March 2004). However, large reductions in the borrowing requirement and the debt followed from the transfer of €11 billion of share holdings from the Treasury to Cassa Depositi e Prestiti, which was matched by a corresponding reduction in the Cassa's deposits with the Treasury, and the sale by the Treasury of 30 per cent of Cassa Depositi e Prestiti S.p.A. to banking foundations (€1 billion).

In the absence of the transactions accompanying the transformation, at the end of 2003 the public debt would have included €154.1 billion of the Cassa's liabilities, primarily in relation to funds raised by the Post Office, which amounted to €152.9 billion, valuing postal savings certificates at their issue value. Instead, it included the liabilities assigned to the State (€75.5 billion, consisting almost entirely of funds raised by the Post Office) and the part of the assets assigned to the Cassa in the form of claims on general government (€78 billion, comprising both deposits and loans).

REVENUE AND EXPENDITURE IN ITALY

General government revenue

General government revenue on an accrual basis grew by 5.5 per cent in 2003 to €602.8 billion; in relation to GDP it rose from 45.3 to 46.3 per cent (Tables 35 and a15).

Table 35

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

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Direct taxes	16.0	14.9	14.7	15.3	16.0	14.4	15.0	14.6	15.0	14.2	13.6
Indirect taxes	12.0	11.8	12.1	11.8	12.4	15.3	15.1	15.0	14.5	14.7	14.5
Current tax revenue	**28.0**	**26.7**	**26.8**	**27.1**	**28.5**	**29.7**	**30.1**	**29.6**	**29.5**	**28.9**	**28.1**
Actual social security contributions	13.5	13.2	13.0	14.6	14.9	12.5	12.4	12.4	12.3	12.5	12.9
Imputed social security contributions	1.8	1.9	1.7	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Current fiscal revenue ...	**43.3**	**41.7**	**41.6**	**42.2**	**43.8**	**42.5**	**42.9**	**42.3**	**42.1**	**41.7**	**41.3**
Capital taxes	0.7	0.1	0.6	0.3	0.7	0.4	0.1	0.1	0.1	0.2	1.6
Tax revenue and social security contributions	**44.0**	**41.8**	**42.2**	**42.5**	**44.5**	**42.9**	**43.0**	**42.4**	**42.2**	**41.9**	**42.8**
Other current revenue	3.1	2.9	3.1	3.2	3.2	3.2	3.3	3.0	3.3	3.2	3.2
Other capital revenue	0.2	0.3	0.3	0.1	0.3	0.3	0.4	0.3	0.2	0.2	0.3
Total revenue	**47.3**	**45.1**	**45.6**	**45.8**	**48.0**	**46.5**	**46.7**	**45.8**	**45.7**	**45.3**	**46.3**

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

Current revenue grew by 2.2 per cent but declined in relation to GDP by 0.4 percentage points to 44.5 per cent. The decrease of 0.6 points in direct taxes and 0.2 points in indirect taxes was only partly offset by the increase of 0.4 points in social security contributions.

Direct taxes contracted by 0.9 per cent, reflecting not only the poor performance of the economy but also the entry into force of the first part of the personal income tax reform and the effects of the investment incentives introduced in earlier years.

Indirect taxes grew by 1.8 per cent. Excluding the advance payment that banks acting as tax-collection agents were required to make in December, they were basically unchanged. The payment was set equal to 1 per cent of the total taxes collected in the previous year and can be used to offset liabilities the following year; in 2003 it amounted to €2.7 billion. The smallness of the growth in indirect taxes was presumably due in part to an increase in the tax refunds that accrued during the year, for which data are not yet available.

While gross earnings grew by 3.8 per cent, social security contributions increased by 6.2 per cent, rising from 12.5 to 12.9 per cent of GDP.

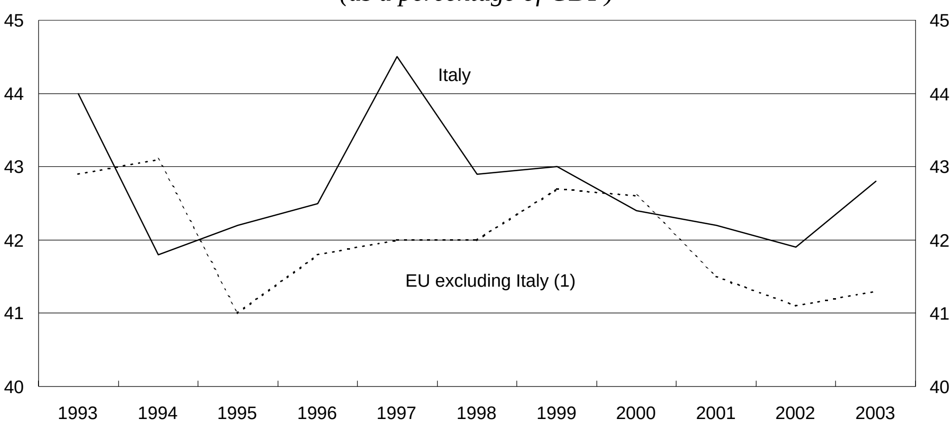
Capital revenue rose from 0.4 to 1.9 per cent of GDP as a consequence of the tax regularization schemes introduced in the Finance Law for 2003 (which generated €19.3 billion, including the instalments to be paid in subsequent years), the extension of the scheme for the repatriation and regularization of assets held abroad (€0.6 billion) and the increase in the investment grants received from the European Union (€1.9 billion).

The ratio of taxes and social security contributions to GDP turned up, rising from 41.9 to 42.8 per cent (Figure 22). One-off measures are estimated to have increased revenue by about 2 percentage points of GDP, compared with 0.6 points in 2002. Excluding the effects of these measures, the ratio declined by 0.5 points.

Figure 22

TAX REVENUE AND SOCIAL SECURITY CONTRIBUTIONS

(as a percentage of GDP)



Sources: Based on Istat and European Commission data.

(1) GDP-weighted average of the 15 countries belonging to the EU in 2003. There is a break in the series between 1994 and 1995 owing to the switch to ESA95.

The main taxes. – The following analysis of individual taxes is based on receipts allocated to the State budget on a cash basis.

State budget *direct taxes* grew on a cash basis by €7.1 billion or 4.2 per cent, which was basically in line with the figure on an accrual basis (3.8 per cent). Excluding the revenue from tax regularization schemes recorded in the State budget, which amounted to €7.8 billion or 0.6 per cent of GDP, direct taxes contracted by 0.4 per cent; on the basis of assessments, they decreased by 0.7 per cent.

Personal income tax receipts grew by €3.9 billion or 3.3 per cent. Withholding tax on employee incomes and the like increased by €2.9 billion or 3.3 per cent, which was less than the growth in gross earnings (3.8 per cent) and pensions (4.7 per cent). The increase was curbed by the effects of the entry into force of the first part of the personal income tax reform, officially estimated at €4.2 billion for this item (see the box "The first step of the reform of personal income tax", *Economic Bulletin*, No. 36, 2003). Self-assessed personal income tax grew by €0.6 billion or 3.1 per cent. The balance paid decreased by €0.2 billion or 3.7 per cent, reflecting the poor performance of the economy and the effects of the investment incentives introduced in earlier years. Payments on account rose by €0.8 billion or 5.4 per cent, partly because the effects of the investment incentives came to an end.

Corporate income tax receipts decreased by €0.7 billion or 2.4 per cent, reflecting the decline in the balance paid for 2002 caused by the poor performance of the economy and the investment incentives introduced in earlier years. Payments on account for 2003, which were unaffected by the investment incentives, rose by €0.3 billion or 1.2 per cent after their amount was raised from 98.5 to 99 per cent. The reduction in the corporate income tax rate from 35 to 34 per cent acted in the opposite direction.

Receipts of withholding tax on interest income and capital gains fell by €2.1 billion or 16.8 per cent, reflecting the decline in interest rates. Another factor contributing to the result was the fall in receipts of the tax on capital gains from the sale of businesses. The tax on managed assets again produced virtually no revenue.

State budget *indirect taxes* on a cash basis grew by €8 billion or 5.2 per cent, which was less than the figure of 6 per cent recorded on an assessment basis. Excluding the receipts generated directly by tax regularization schemes, which amounted to €3.1 billion or 0.2 per cent of GDP, the growth in indirect tax revenue falls to 3.2 per cent and to 4 per cent on an assessment basis.

A contribution to the increase in indirect tax revenue came from the advance payment of €2.7 billion made in December by banks acting as tax-collection agents. The fall of €2 billion or 22.8 per cent in lotto and lottery receipts was more than offset by the rise of €3.5 billion or 3.7 per cent in VAT, of €0.4 billion or 1.8 per cent in excise duties on mineral oils, of €0.9 billion or 31.5 per cent in excise duties on methane, and of €0.4 billion or 44.4 per cent in government licences.

General government expenditure

General government expenditure amounted to €634.6 billion, an increase of 5.8 per cent on 2002; in relation to GDP it rose from 47.6 to 48.8 per cent (Tables 36 and a15). Excluding the proceeds of sales of public-sector real estate (€11 billion in 2002 and €2.7 billion in 2003), which are deducted from investment in the accounts, overall expenditure grew by 4.3 per cent, rising from 48.5 to 49 per cent of GDP. Interest payments decreased from 5.8 to 5.3 per cent of GDP. Primary current expenditure increased further, from 38.4 to 39.4 per cent of GDP (Figure23), while capital expenditure, excluding the proceeds of sales of real estate, remained unchanged at 4.3 per cent.

Table 36

GENERAL GOVERNMENT EXPENDITURE (1)
(*as a percentage of GDP*)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Compensation of employees	12.3	11.9	11.2	11.5	11.6	10.7	10.6	10.6	10.8	10.8	11.0
Intermediate consumption	5.2	5.2	4.8	4.8	4.7	4.8	4.9	5.0	5.1	5.0	5.3
Market purchases of social benefits in kind	2.4	2.2	2.0	2.0	2.1	2.1	2.1	2.4	2.6	2.6	2.6
Social benefits in cash	17.0	17.3	16.7	16.9	17.3	17.0	17.1	16.8	16.6	17.0	17.2
Interest	13.0	11.4	11.5	11.5	9.4	8.0	6.7	6.5	6.5	5.8	5.3
Other current expenditure	3.3	2.7	2.3	2.5	2.2	2.9	2.8	2.8	2.8	2.9	3.2
Total current expenditure	**53.3**	**50.6**	**48.5**	**49.1**	**47.2**	**45.4**	**44.4**	**43.9**	**44.4**	**44.2**	**44.7**
Gross fixed investment (2)	2.6	2.3	2.1	2.2	2.2	2.4	2.4	2.4	2.5	1.9	2.6
Other capital expenditure (3)	1.7	1.5	2.5	1.6	1.3	1.5	1.6	1.3	1.4	1.6	1.4
Total capital expenditure (2) (3) .	**4.3**	**3.7**	**4.6**	**3.8**	**3.5**	**3.9**	**4.0**	**3.7**	**3.9**	**3.4**	**4.1**
Total expenditure (2) (3) .	**57.6**	**54.3**	**53.2**	**52.9**	**50.7**	**49.3**	**48.4**	**47.6**	**48.3**	**47.6**	**48.8**
expenditure excluding interest payments (2)(3)	*44.6*	*42.9*	*41.6*	*41.4*	*41.4*	*41.3*	*41.6*	*41.2*	*41.8*	*41.8*	*43.5*

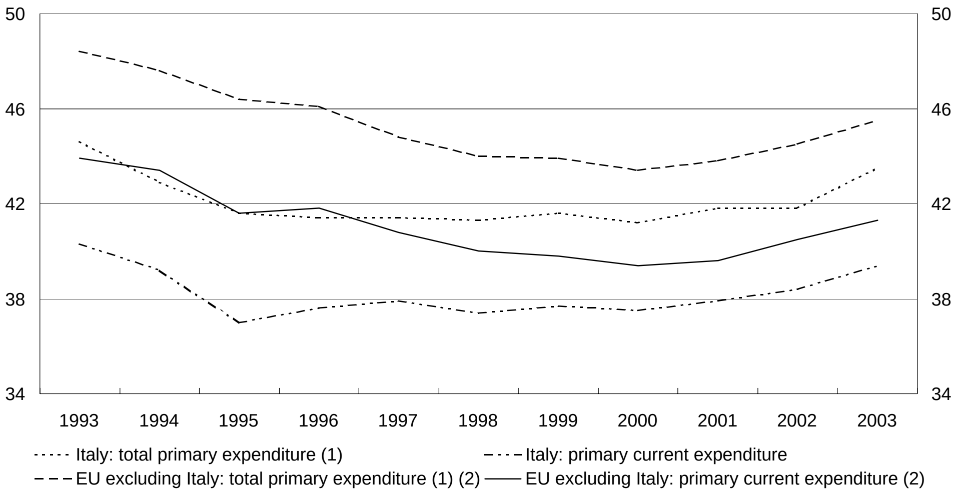
Source: Based on Istat data.

(1) Rounding may cause discrepancies. See also Table a15 in the Statistical Appendix. – (2) The proceeds of sales of public assets are recorded as a deduction from this item. – (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 deduction from the item “Other capital expenditure”.

Figure 23

TOTAL AND CURRENT PRIMARY EXPENDITURE

(*as a percentage of GDP*)



Sources: Based on Istat and European Commission data.

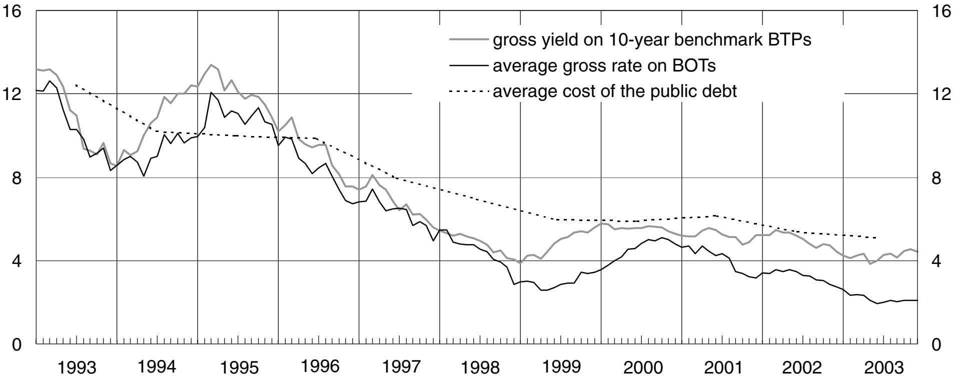
(1) The proceeds of sales of public assets are recorded as a deduction from this item; it does not include the proceeds of sales of UMTS licences, which are also entered as a deduction from expenditure in the national accounts. – (2) GDP-weighted average of the 15 countries belonging to the EU in 2003. There is a break in the series between 1994 and 1995 owing to the switch to ESA95.

Interest payments. – The ratio of this item to GDP decreased significantly for the second successive year, falling by 0.7 percentage points in 2002 and 0.5 points in 2003. The average cost of the debt (the ratio between interest payments and the initial stock of liabilities), which had remained substantially stable at 6 per cent in the three years from 1999 to 2001, fell to 5.4 per cent in 2002 and 5.1 per cent in 2003, reflecting the decline in interest rates and the redemption of relatively high-yielding securities (Figure 24). In addition, swap operations contributed €1.9 billion to the reduction in interest payments in 2002 and €0.6 billion in 2003.

Figure 24

GROSS YIELD ON 10-YEAR BTPs, AVERAGE GROSS RATE ON BOTs AND AVERAGE COST OF THE PUBLIC DEBT

(percentages)



The average gross rate on the three maturities of Treasury bills decreased from 5.1 to 1.9 per cent between October 2000 and June 2003 and then rose slightly to 2.1 per cent at the end of last year. The gross yield on ten-year Treasury bonds, which stood at 5.7 per cent in September 2000, came down to 3.7 per cent in June 2003 and then rose to 4.4 per cent at the end of last year. In 2001 and 2002 ten-year Treasury bonds with coupons of around 12 per cent matured for a total face value of €30.2 billion. In 2003 an additional €24.8 billion of Treasury bonds with coupons of between 8.5 and 12 per cent matured.

The spread between long-term and short-term interest rates has widened steadily since 2000, both in Italy and in the euro area as a whole. In Italy the spread between the gross yield of ten-year Treasury bonds and the average gross rate on the three maturities of Treasury bills widened from an annual average of 1.1 percentage points in 2000 to one of 2.1 points in 2003.

The widening of the spread has been accompanied by an increase in the share of short-term securities, which rose from 9.2 per cent of total securities in 2000 to 10.2 per cent in 2003 in Italy and from 11.5 to 13.1 per cent in the euro area. On the other hand, the share of short-term and variable-rate securities declined in Italy, from 30.4 per cent in 2000 to 27 per cent in 2003, continuing the downward trend that first emerged more than ten years ago.

At the beginning of the 1990s an increase of one percentage point in issue rates would have been almost entirely passed through to the average cost of the debt in about four years. Given the present structure of the debt it is estimated that an equivalent increase would cause the average cost to rise by 0.2 percentage points in the first year, 0.25 points in the second year, and approximately 0.1 points in the third and fourth years.

Social benefits in cash. – The ratio of these disbursements to GDP rose by 0.2 percentage points to 17.2 per cent. The increase of 4.8 per cent (5.8 per cent in 2002) reflected the rise in expenditure on pensions and annuities, which increased by 4.7 per cent (6.2 per cent in 2002). In relation to GDP the latter rose from 15.4 to 15.7 per cent.

Expenditure on unemployment benefits and wage supplementation rose for the second successive year, with an increase of 10.5 per cent in 2002 and 4.3 per cent in 2003; the latter reflected the larger number of hours of wage supplementation authorized in industry. Expenditure on family allowances grew by 0.9 per cent. Outlays on public employees’ severance pay rose by 10.3 per cent after falling significantly in 2001 and 2002.

Compensation of employees. – Staff costs increased by 5.3 per cent and from 10.8 to 11 per cent of GDP. Gross earnings increased by 4.4 per cent. Excluding military conscripts, employment remained virtually unchanged; the increase of about 4.4 per cent in per capita earnings was largely due to the renewal of labour agreements for the two years 2002-03 for about one third of public employees and the consequent disbursement of substantial amounts of back pay. General government social security contributions grew by 7.3 per cent.

Other current expenditure. – This item rose by 0.5 percentage points to 11.1 per cent of GDP. Intermediate consumption recorded a particularly large increase of 8.8 per cent (1.7 per cent in 2002) and rose from 5 to 5.3 per cent of GDP. The increase in this type of expenditure was substantial in all the sub-sectors of general government, especially central government, where it expanded by 16.3 per cent after contracting by 6.4 per cent in 2002. The increase in 2003 was fueled by the expenditure postponed from 2002 following the Government's imposition of spending restrictions in the last part of that year.

Social benefits in kind rose by 0.5 per cent, compared with 5.7 per cent in 2002; the increase was curbed by the large reduction in expenditure on pharmaceuticals, which accounts for about one third of the total. Other current expenditure increased by 13.4 per cent and rose from 2.9 to 3.2 per cent of GDP. It includes transfers to the EU in connection with the fourth resource, which rose from €7.2 billion to €8.8 billion, and transfers to firms.

Capital expenditure. – Excluding the proceeds from the disposal of public real estate by means of securitizations (€8.9 billion in 2002 and €1.2 in 2003) and ordinary sales (€2.1 billion in 2002 and €1.5 in 2003), investment expenditure increased by 6.9 per cent, compared with 8.1 per cent in 2002; in relation to GDP it rose from 2.8 to 2.9 per cent.

Investment grants contracted by 2.9 per cent, after expanding by 13.6 per cent in 2002 in connection with the incentives for investment in disadvantaged areas and employment that were granted in the form of tax credits in the budget for 2001. After rising to 1.4 per cent of GDP in 2002, they dropped back to 1.3 per cent, their level in 2001.

Local government

The net borrowing of local government amounted to 0.2 per cent of GDP. Continuing the upward trend under way since the middle of the 1990s, expenditure rose to 15 per cent of GDP; on the other side revenue rose to 14.8 per cent of GDP.

Total revenue rose by 7.4 per cent to €192.3 billion. The proportion of revenue other than public transfers increased further both in relation to GDP, from 8.2 to 8.7 per cent, and in relation to total general government revenue, from 18 to 18.8 per cent.

The increase of €6.4 billion or 3.9 per cent in current revenue was mainly due to that in tax revenue: the growth in receipts of regional and municipal personal income surtaxes helped to boost direct tax revenue by €2.8 billion or 11.8 per cent, and that in receipts of IRAP helped push up indirect tax receipts by €2.1 billion or 3.6 per cent. Current transfers remained basically unchanged; since 1998 they have been a smaller percentage of GDP than tax revenue.

As regards the scope for local authorities to change local tax rates, the Finance Law for 2003 suspended the effects of the measures adopted by regions after 29 September 2002 raising their personal income surtax and IRAP rates; the suspension also applied to similar measures adopted by municipalities introducing personal income surtaxes or raising their rates. The Finance Law for 2004 extended the suspension to December of this year.

Capital revenue rose by €6.9 billion or 44.8 per cent. The increase of €3.5 billion in revenue from other general government bodies, including both investment grants and other transfers, benefited from transfers to the health sector. The increase of €2 billion in capital taxes is attributable to the receipts of tax regularization schemes and that of €1.4 billion in other investment grants referred to amounts received from European Funds.

Local government expenditure rose by 4.5 per cent to €195.5 billion. As a percentage of general government expenditure it declined from 31.2 to 30.8 per cent.

Current expenditure increased by €6.2 billion or 4 per cent. Intermediate consumption rose by €2.8 billion or 6.3 per cent and staff costs by €1.3 billion or 2.2 per cent, while social benefits in kind, concentrated mainly in the health sector, remained basically unchanged.

Health expenditure grew by 2.5 per cent in 2003, compared with 4.1 per cent in 2002. As a percentage of GDP it remained unchanged at 6.3 per cent. Purchases of goods and services rose by 7.7 per cent and staff costs by 0.9 per cent, partly as a result of the failure to renew the sector's labour agreements. Outlays in connection with general medical care rose by 5 per cent. Spending on pharmaceuticals, which had increased significantly in 2000 and 2001, rose by 1.9 per cent in 2002 and fell by 6.2 per cent in 2003. The fall was due in part to the measures adopted in previous years by the Government and the regions, which included price curbs, the reintroduction of prescription charges, the reclassification of some drugs in the formulary, and the direct distribution of drugs, since the related outlays are included in the accounts under purchases of goods and services.

Capital spending rose by €2.2 billion or 6.5 per cent, influenced by the increase of €1.6 billion or 6.7 per cent in fixed investment and €0.6 billion or 6.8 per cent in investment grants.

The implementing provisions of the Domestic Stability Pact were further amended for provinces and municipalities: the objectives for 2003 were established with reference to their financial balances rather than their expenditure. For regions, instead, the constraints on disbursements remained in force.

In 2003 local government debt to creditors other than general government increased from €45.3 billion to €70.4 billion. In relation to GDP it rose from 3.6 to 5.4 per cent (Table a18). One and a half percentage points of the increase was due to the inclusion of loans from the Cassa Depositi e Prestiti following its transformation into a limited company. Of the remainder of the increase the growth in the liabilities of regions contributed 0.2 points and that in the liabilities of provinces and municipalities 0.1 points.

Excluding loans from Cassa Depositi e Prestiti S.p.A., local government debt increased significantly in the South and Islands, from 3.1 to 4 per cent of the area's GDP, and slightly in the Centre, from 6.2 to 6.4 per cent; it remained unchanged in the North at 2.9 per cent.

The share of debt represented by securities continued to grow in 2003, rising from 29.6 to 38.2 per cent of the total net of loans from Cassa Depositi e Prestiti S.p.A. The increase was partly due to the increase in securitizations compared with the previous year. Again excluding loans from Cassa Depositi e Prestiti S.p.A., the share of debt contracted abroad rose from 25.7 to 28.6 per cent, prolonging the trend that began in the second half of the 1990s. The rise reflected both the increase of 20.5 per cent in loans disbursed by non-resident intermediaries and that of 24 per cent in bonds issued abroad.

The securitizations carried out in the last few years have also involved local authorities. In some cases the transaction involved claims on local authorities of private-sector entities and other public-sector bodies. The most important transactions involved: the Lazio region in 2001 and 2003 with regard to sales of hospital buildings and claims of firms on Local Health Units and hospitals for rents; the Sicily region in 2002 and 2003 with regard to claims of firms, Local Health Units and hospitals on the region; a wide range of local authorities in 2003 with regard to INPDAP claims on them. Securitizations totaled €0.5 billion in 2001, €0.3 billion in 2002 and €2.7 billion in 2003. Most of the €2.4 billion of transactions carried out in 2003 caused an increase in the financial liabilities included in the public debt statistics.

In December 2003 the Ministry for the Economy and Finance laid down rules on the use of some types of financial instruments by local authorities; at the same time it introduced new disclosure requirements for bond issues, securitizations, private-sector loans and derivatives.

THE OUTLOOK

Budgetary policy in the euro area

In their latest stability programme updates most countries announced less ambitious objectives for 2004 and the following years. The revisions reflect a less favourable scenario for economic growth and the fact that the results for the public finances in 2003 had fallen short of expectations.

According to the new programmes, the area's general government net borrowing in 2004 will amount to 2.3 per cent of GDP, as against 2.7 per cent in 2003 (Table 37). The projections show that a budgetary position close to balance or in surplus will not be achieved within the forecasting horizon, which for most countries is 2007. In the previous updates this objective was to have been achieved in 2006. The area's ratio of debt to GDP should come down gradually from 70.2 per cent in 2003 to 67.2 in 2007.

Table 37

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

	2003	2004	2005	2006
Net borrowing				
National stability programme objectives	2.7	2.3	1.8	1.2
Outturn and forecasts:				
European Commission	2.7	2.7	2.6	–
IMF	2.8	2.8	2.4	–
OECD	2.7	2.8	2.7	–
Debt				
National stability programme objectives	70.2	70.1	69.4	68.3
Outturn and forecasts:				
European Commission	70.5	71.0	71.0	–
IMF	70.4	70.6	70.3	–

Sources: Based on data published by the European Commission (*Spring Forecasts*, April 2004), the IMF (*World Economic Outlook*, April 2004), the OECD (*Economic Outlook*, May 2004) and the updates to national stability programmes submitted in late 2003 and early 2004.

European Commission forecasts released in April indicate that in 2004 general government net borrowing will remain unchanged at 2.7 per cent of GDP. According to the Commission a reduction in interest payments of 0.1 percentage points will be offset by a contraction in the primary surplus, since the expected fall in primary expenditure will be outweighed by that in revenue (0.5 points). On a cyclically adjusted basis the primary surplus is expected to remain unchanged at 1.4 per cent of GDP.

The Commission's current programmes projections for 2005 indicate that area-wide net borrowing will amount to 2.6 per cent of GDP.

The ratio of debt to GDP is expected to rise from 70.5 per cent of GDP in 2003 to 71 per cent in 2004 and to remain unchanged in 2005.

Many countries will not achieve the new objectives set in their stability programme updates; according to the Commission's estimates, in the absence of additional adjustment measures, the budget deficit will amount to 3.7 per cent of GDP in France, 3.6 per cent in Germany, 3.5 per cent in the Netherlands and Portugal, and 3.2 per cent in Greece and Italy. Among the non-euro-area countries, the United Kingdom is expected to have a deficit equal to 2.8 per cent of GDP.

The net borrowing of both France and Germany is expected to exceed the 3 per cent threshold for the third successive year. The excessive deficit procedure was launched against these two countries in 2003, but is currently in abeyance for both.

The European Commission recently launched the excessive deficit procedure against the Netherlands and Greece, which exceeded the 3 per cent threshold for the first time in 2003. The EU Council will decide on the Commission's rulings in the coming months.

As regards Portugal, the EU Council abrogated the excessive deficit procedure launched with reference to the budget outturn for 2001; the decision took account of the fact that Portugal's net borrowing was below the 3 per cent threshold in both 2002 and 2003, in line with the Council Recommendation of November 2002. In this respect it is worth noting that in its April forecast the Commission indicated a deficit of 3.5 per cent of GDP in 2004. It stressed, however, that the forecast did not take account of the measures announced by the Portuguese Government to keep the deficit below the 3 per cent threshold.

According to the Commission, Italy's deficit in 2004 will amount to 3.2 per cent of GDP, exceeding the 3 per cent threshold for the first time since the start of stage three of Economic and Monetary Union. The Commission accordingly recommended that the EU Council should send Italy an early warning. The Council will decide on the Commission's recommendation in the coming months.

The Commission also examined the public finances of the United Kingdom in view of the deficit of 3.2 per cent of GDP in 2003. It expects British net borrowing to be less than 3 per cent of GDP in both 2004 and 2005. The overshoot recorded in 2003 is thus likely to have been not only small but also temporary. The Commission accordingly ruled that the United Kingdom was not in an excessive deficit situation.

Budgetary policy in Italy

The outlook for 2004. – The current programmes projections of the July 2003 Economic and Financial Planning Document were for a deficit of 3.1 per cent of GDP and a primary surplus of 1.9 per cent, with output expected to grow by 1.8 per cent (Table 38). The net state sector borrowing requirement was seen as amounting to 4.7 per cent of GDP. The Document set a target for general government net borrowing of 1.8 per cent of GDP and for the primary surplus of 3.1 per cent. A budgetary adjustment of the order of €16 billion (about 1.2 per cent of GDP) was envisaged, of which more than €10 billion would come from one-off measures. The growth in output was expected to rise to 2 per cent as a consequence of the policies adopted.

Table 38

OBJECTIVES AND ESTIMATES FOR THE PUBLIC FINANCES IN 2004
(billions of euros and percentages)

	State sector borrowing requirement (1)	General government				*Memorandum items:*	
		Net borrow-ing	Primary surplus	Interest pay-ments	Debt	Real GDP growth rate	Nominal GDP
Estimates on a current programmes basis							
Planning Document (July 2003)	63.0	41.7	25.7	67.3	. . . .	1.8	1,351.6
as a percentage of GDP	*4.7*	*3.1*	*1.9*	*5.0*			
Objectives							
Planning Document (July 2003)	. . . .	. . . .	. . . .	. . . .	. . . .	2.0	1,354.1
as a percentage of GDP		*1.8*	*3.1*	*4.9*	*104.2*		
Planning Document update and Forecasting and Planning Report (September 2003)	49.5	30.3	38.7	69.0	. . . .	1.9	1,352.5
as a percentage of GDP	*3.7*	*2.2*	*2.9*	*5.1*	*105.0*		
Stability programme update (November 2003)	. . . .	. . . .	. . . .	. . . .	. . . .	1.9	1,352.0
as a percentage of GDP		*2.2*	*2.9*	*5.1*	*105.0*		
Current estimates							
Quarterly Report on the Borrowing Requirement and Forecasting and Planning Report update (May 2004)	62.0	39.7	29.5	69.2	. . . .	1.2	1,351.5
as a percentage of GDP	*4.6*	*2.9*	*2.2*	*5.1*	*105.9*		

(1) Net of settlements of past debts and privatization receipts.

The Document indicated a reduction in cyclically-adjusted net borrowing of 0.5 percentage points of GDP, in line with the commitments entered into within the Eurogroup in October 2002. It also indicated a progressive reduction in the use of one-off measures and their complete replacement with structural measures by the end of 2006.

In September the Forecasting and Planning Report for 2004 and the Planning Document update basically confirmed the assessment of the prospects for growth in 2004. The estimate of net borrowing on a current programmes basis was kept unchanged. The target for net borrowing was nonetheless revised upwards from 1.8 to 2.2 per cent of GDP in connection with the reduction in the size of the budgetary adjustment from 1.2 to 0.8 percentage points. The objective for the primary surplus was made less demanding (2.9 per cent of GDP instead of 3.1 per cent). The planned reduction in the debt ratio was revised downwards from 1.4 percentage points of GDP, as indicated in the original Planning Document, to 1 point.

The forecast for interest payments was revised upwards from 4.9 to 5.1 per cent of GDP. There was an improvement in the primary surplus for 2004 on a current programmes basis, despite a reduction from 3 to 2.8 per cent of GDP in the primary surplus forecast for 2003. The new estimates took account of the positive effects of the inclusion in the balance for 2003 of the instalments of regularization schemes to be paid in 2004 and of the negative effects of the delay in carrying out a large part of the planned real-estate sales in 2003.

The update of the stability programme published in November confirmed the scenario of the Forecasting and Planning Report. The objectives for the public finances and the macroeconomic forecasts were left unchanged.

The budget the Government submitted to Parliament in September amounted to €11 billion. In addition to the measures aimed at reducing the deficit by €16 billion announced in the Planning Document, measures were included to support growth amounting to €5 billion. The amendments introduced by Parliament increased the budgetary adjustment to €12 billion.

On the basis of official estimates the budget approved by Parliament at the end of 2003 includes measures to reduce net borrowing by €18.1 billion and expansionary measures amounting to €6.1 billion. An increase of €13.8 billion in net revenue and of €1.8 billion in expenditure are expected. Nearly all the additional revenue (€16.2 billion) will come from one-off measures, with regularization schemes expected to generate €5 billion and real-estate sales €5.5 billion. The expenditure savings of €1.9 billion, about half of which in relation to the transformation of Cassa Depositi e Prestiti into a limited company, will be more than offset by increases amounting to €3.7 billion, primarily in connection with staff costs, workfare programmes and the extension of support for road hauliers.

As in earlier years, a large part of the adjustment is entrusted to one-off measures. Including the residual effects of such measures adopted in the past, their incidence can be estimated at about 1 percentage point of GDP, compared with 2 points in 2003 and 1.5 points in 2002.

To a considerable extent the receipts from the one-off measures rely on the voluntary participation of the interested parties. The use of corrective measures of this kind may reduce the negative impact on economic agents' spending decisions. However, if it is accompanied by a postponement of the necessary structural measures, it risks contributing to a worsening of expectations regarding the consolidation of the public finances. Repeated recourse to tax regularization schemes may also adversely affect compliance with the rules.

The May 2004 Quarterly Report on the Borrowing Requirement and Forecasting and Planning Report update raised the estimate of general government net borrowing for the year to 2.9 per cent of GDP, partly as a consequence of the downward revision of expected growth, from 1.9 to 1.2 per cent. The primary surplus is now expected to fall to 2.2 per cent of GDP, continuing the downward trend under way since 1998 (Figure 25). The new figure for the reduction in the debt ratio is 0.3 percentage points, taking it to 105.9 per cent of GDP. This result depends on the achievement of about €21 billion of privatization receipts.

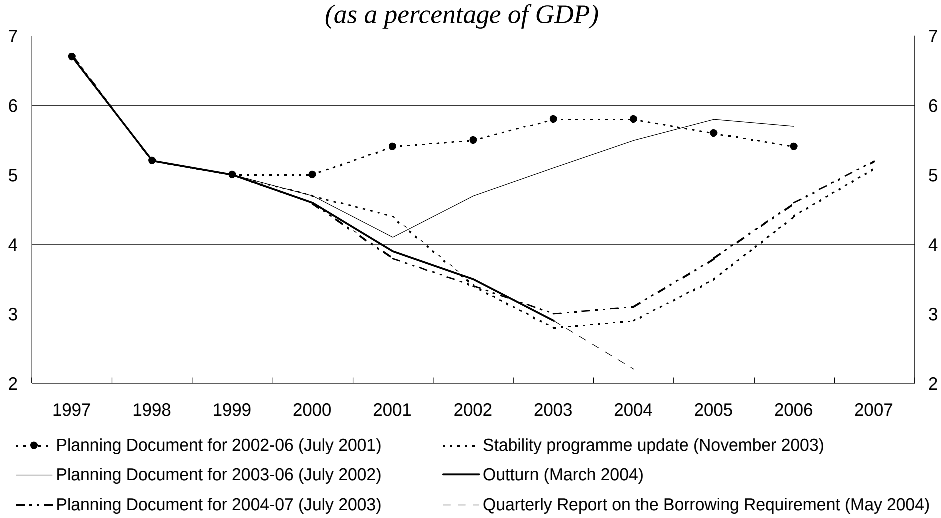
In the new forecasting framework both total revenue and total expenditure are expected to fall in relation to GDP between 2003 and 2004. The former by 1.2 percentage points, from 46.3 to 45.1 per cent, as a consequence of the reduction of 1.5 percentage points of GDP in taxes and social security contributions, from 42.8 to 41.3 per cent, and the latter by 0.8 points, from 48.8 to 48 per cent, of which 0.2 points coming from interest payments and 0.6 points from primary expenditure. Given basically no change in primary current expenditure, capital expenditure is seen as falling from 4.1 to 3.4 per cent of GDP. Of the total, it is expected that 0.5 points will come from an increase from 0.2 to 0.7 per cent of GDP in receipts of real-estate sales (accounted for as a reduction in this item of expenditure) and 0.2 points from the exclusion of the National Road Agency, ANAS, from general government.

The Quarterly Report forecasts substantial growth in the state sector borrowing requirement in 2004. Net of settlements of past debts and privatization receipts, it is expected to rise from €42.7 billion to €62 billion, or from 3.3 to 4.6 per cent of GDP, owing in part to a substantial increase in current transfers to regions and social security institutions. The public sector net borrowing requirement is seen as rising from 3.5 to 4.9 per cent of GDP. If settlements of past debts are included, the balance would rise from 4.2 to 5.3 per cent.

Figure 25

PRIMARY BUDGET SURPLUS: OBJECTIVES AND OUTTURNS

(as a percentage of GDP)



The gap between the public sector borrowing requirement and general government net borrowing would thus widen considerably.

With reference to the borrowing requirement net of asset disposals, the gap is expected to rise from €22.9 billion to €31.3 billion and from 1.8 to 2.3 per cent of GDP. The part due to the balance of financial transactions is expected to remain basically unchanged (€11.7 billion, as against €11.3 billion), while the remaining part, which primarily reflects the difference between the data on a cash and an accrual basis, is expected to rise from €11.6 billion to €19.7 billion, the highest level of the last few years, and from 0.9 to 1.5 per cent of GDP.

The estimate of net borrowing indicated in the May Quarterly Report on the Borrowing Requirement (2.9 per cent of GDP) assumes rigorous control of current expenditure, strict compliance with the Domestic Stability Pact by local authorities, the exclusion of the National Road Agency (ANAS) from the general government sector (with a consequent reduction in the deficit of 0.2 percentage points of GDP), full effectiveness of the measures introduced in the budget (0.8 points of GDP, of which about half from sales of real estate) and the completion of the other sales planned for this year (another 0.3 points of GDP).

On the basis of receipts in the first part of the year, the extension for 2004 introduced in the budget of the main tax regularization schemes in the 2003 budget has produced more revenue than expected. On the other hand, the revenue from the building offences regularization scheme is at risk following the objections raised before the Constitutional Court. The operating results of ANAS may not satisfy the criteria for its classification outside the public sector. There may be difficulties in implementing the plans for the disposal of assets. Lastly, provinces and municipalities may be hard put to comply with the Domestic Stability Pact in view of the substantial increase in their staff costs that contract renewals are expected to bring.

The Quarterly Report stresses that the development of the public finances will be carefully monitored and makes it clear that the Government will take steps to ensure compliance with the Maastricht Treaty parameters if the results fall short of what is expected.

In April the European Commission estimated that net borrowing in 2004 would amount to 3.2 per cent of GDP; it accordingly recommended that the EU Council should send Italy an early warning with a request that it adopt additional corrective measures.

The Commission drew attention to the substantial difference between the deficit forecast for 2004 and the objectives indicated in the last two updates of the Stability Programme (2.2 per cent of GDP in the most recent document and 0.6 per cent in the previous one) and pointed to the primarily structural nature of the divergences. It also noted that these had occurred despite the adoption of sizable one-off measures. According to the Commission, further progress in reducing the ratio of the debt to GDP appeared doubtful. Lastly, it stressed the persistence of a large gap between the borrowing requirement and net borrowing.

On 11 May the EU Council examined the Commission's Recommendation. Italy undertook to adopt measures to keep the deficit below the 3 per cent threshold and the Council agreed to postpone its decision on whether to send an early warning until July, when it would be able to examine the measures announced by the Italian Government.

In the first four months of this year the state sector borrowing requirement net of settlements of past debts and privatization receipts amounted to €38.1 billion, some €5 billion more than in the corresponding period in 2003. In the first three months the net general government borrowing requirement amounted to €33.3 billion, some €11.2 billion more than in the first quarter of 2003. These results appear basically in line with the estimates of the borrowing requirement contained in the Quarterly Report on the Borrowing Requirement published in May.

The outlook for the medium term. – The Economic and Financial Planning Document of July 2003 envisaged a rapid reduction in the deficit in the years after 2004. General government net borrowing was set to come down progressively from the target of 1.8 per cent of GDP set for 2004 and turn into a small surplus in 2007. The primary surplus, for which the target set for this year was 3.1 per cent of GDP, was set to rise to above 5 per cent at the end of the planning period.

The update of the Planning Document published in September 2003 maintained the objective of arriving close to balance in 2007 by slightly accelerating the improvement in the results between 2005 and 2007. For 2005 itself, the objective for net borrowing was reset at 1.5 per cent of GDP, as against the earlier figure of 1.2 per cent. In November the update of the Stability Programme confirmed this planning framework.

In the Planning Document published in July 2003 the gap between net borrowing on a current programmes basis and that planned, attributable only in part to the differences between the macroeconomic scenarios adopted, widened progressively from 1.3 percentage points of GDP in 2004 to 2 points in 2005 and 2.3 and 2.5 points in the two following years. The adjustments implicit in this scenario were nonetheless larger, owing in part to the need to finance the cost of foreseeable staff contract renewals and new investment plans, excluded from the calculation of the current programmes balance, which is based strictly on the legislation in force. Other measures would also have been necessary to finance the reduction in the tax burden planned by the Government and progressively replace the effects of the one-off measures adopted in earlier years. Compared with the Planning Document, the November update of the Stability Programme indicated an improvement in net borrowing on a current programmes basis of 0.2 percentage points of GDP in each of the years 2005-07. When account is also taken of the changes made to the objectives for these years, the gap between the balances on a current programmes basis and the planned results narrowed to 1.5 points of GDP in 2005, 1.9 points in 2006 and 2.2 points in 2007.

The new estimate of net borrowing in 2004 contained in the May Quarterly Report on the Borrowing Requirement should lead to a revision of the medium-term outlook for the public finances on a current programmes basis. A planning framework incorporating the results of this revision will be presented together with the next Economic and Financial Planning Document.

The Senate recently approved the enabling bill concerning social security. It aims mainly to give an impulse to forms of supplementary retirement provision and to make the requirements for retirement more rigorous from 2008 onwards.

In recent years the deterioration in economic conditions and the gradual contraction in the primary surplus have slowed the reduction in the ratio of general government debt to GDP. This has occurred despite the continuation of the downward trend of the average cost of the debt and the implementation of large financial transactions that have reduced the debt without affecting net borrowing.

The securitizations of credits carried out in the three years 2001-03 reduced general government debt by €12.5 billion. The same period also saw privatization receipts amounting to €23 billion, of which about €12 billion in connection with the transformation of Cassa Depositi e Prestiti into a limited company. In 2002 a bond conversion was carried out involving government securities held by the Bank of Italy that reduced the debt by nearly €24 billion.

A high level of debt restricts the scope for counter-cyclical use of the budget and makes the latter more vulnerable to interest rate shocks; it imposes constraints on resources by requiring their allocation to interest payments and makes it more difficult to deal with the pressures that demographic developments exert on the budget.

Achieving a budgetary position close to balance, in 2007 according to the Government's plans, is a necessary condition for speeding up the reduction of the debt in relation to GDP. In conformity with the plans drawn up by the Government, this will depend on curbing primary current expenditure. This will make it possible to avoid having to limit investment or increase the tax burden. As regards the latter, the additional resources needed to proceed with the reduction referred to in official documents will have to be found. One-off adjustment measures will have to be progressively replaced by others producing permanent effects. To ensure that improvements achieved in terms of net borrowing lead to progress in the reduction of the debt in relation to GDP, it will also be necessary to reduce the borrowing requirement significantly.

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

Against a backdrop of protracted cyclical sluggishness, severe international political tensions, easing inflationary pressures and an appreciation of the euro, the Governing Council of the European Central Bank lowered its minimum rate on main refinancing operations twice in 2003, by 0.25 points in March and by 0.50 points in June, bringing it to 2 per cent. Monetary conditions remained expansionary overall. In December, real short-term yields in the euro area were practically nil and long-term rates, as measured by ten-year inflation-indexed bonds, were below 2 per cent.

In the first half of the year the money and financial markets in the euro area and in Italy were affected by the uncertainty over the timing of the economic upturn. Expectations of a reduction in official interest rates were reflected in the negative slope of the yield curve at the short end. Beginning in the summer the signs of a world economic recovery became steadily stronger; the yield curve shifted upwards and took on a positive slope, indicating expectations of an increase in yields. Towards the end of the year the appreciation of the euro and renewed uncertainty concerning the economic recovery in the area induced market expectations that short-term interest rates would remain unchanged longer than had been forecast during the summer.

Long-term euro yields registered analogous, broad fluctuations while remaining extremely low by historical standards. Ten-year rates based on interest rate swaps recorded an all-time low of 3.6 per cent in June. In the second half of the year they gradually regained their January levels.

The appreciation of the euro that had begun in 2002 continued last year, with an acceleration in the fourth quarter. For the year as a whole the gain came to 11.3 per cent on an overall trade-weighted basis and 20.4 per cent against the dollar. The weakening of the dollar was due in part to the heightening of international tensions and the growing concern over the sustainability and methods of adjustment of the US current account and budget deficits.

The euro depreciated against the dollar in the first few months of 2004, mainly in response to highly encouraging reports on economic activity and the labour market in the US and the persistent uncertainty over prospects in the euro area. In this context long-term interest rates rose significantly in the US and more modestly in the euro area. The dollar-euro differential on ten-year yields, measured on the basis of interest rate swaps, widened by 0.6 percentage points between January and mid-May.

Euro-area M3 decelerated gradually over the year, but growth remained rapid at 7 per cent. The slowdown in the growth of the money stock reflected the steady but very slow diminution in investors' liquidity preference as stock markets recovered and financial market volatility diminished.

Uncertainty over the prospects for economic recovery and low nominal yields influenced Italian households' investment decisions. Financial saving was reduced, while overall saving increased, reflecting the high propensity to invest in housing. Households' financial investment was directed chiefly to low-risk assets (money market funds and life insurance policies). Household debt continued to increase, largely in the form of home mortgages.

Affected by the slackness of economic activity, the profits of Italian firms declined as a share of value added; self-financing decreased. Financial leverage increased but still remained relatively modest. The ratio of firms' debt to GDP also increased, but remained lower than in the other major euro-area countries. Profitability and indebtedness nonetheless display very significant dispersion around the mean.

Overall, bank credit conditions remained expansionary during the year. The growth of bank lending (6.7 per cent) outpaced both nominal GDP and lending in the euro area as a whole. Nominal lending rates are as low as they have ever been in the last fifty years. In the first two months of 2004, owing in part to the perception that firms' riskiness had increased, banks showed somewhat greater prudence in lending, which was reflected in a slowdown in credit growth.

The growth in bank credit last year involved mainly households and the most dynamic sectors, such as those connected with the real estate market. Firms' demand for credit was fueled by the reduction in self-financing and the low level of interest rates. As in 2002, the fastest-growing components of bank credit were lending in the South (7.9 per cent as against 6 per cent in the Centre and North) and to small firms. Smaller banks contributed more than the average to the credit expansion.

The quality of credit was affected only slightly by the protracted sluggishness of the economy. Loans equal to 1.2 per cent of the total value outstanding at the start of the year were classed as bad debts; about 0.2 percentage points consisted of loans to firms involved in the collapse of the Parmalat group. Despite the increase in loan loss provisions, banks' profitability turned upward, thanks to an increase in gross income.

The yields on corporate bonds in the euro area fell further from their already very low level at the beginning of the year. The differential with respect to government securities halved to 0.6 percentage points. Many issuers took advantage of the favourable market conditions to raise funds for future loan repayments or to lengthen the average duration of their debt. In contrast with the area-wide trend, Italian firms' net bond issues contracted.

The sharp decline in credit risk premia in the international bond market can be ascribed in part to the decrease in the number of defaults, thanks to the improving tone of the world economy. Another factor was the very strong investor demand for high-yield financial assets, favoured by the exceptionally expansionary stance of monetary policies worldwide and abundant liquidity.

In the last year and a half two major Italian industrial groups have collapsed. These defaults have not had repercussions on the terms for all Italian issuers in the bond market, but they have induced a more selective attitude on the part of subscribers. After the Parmalat default in December 2003 the terms for the bonds of high-rated issuers remained unchanged, while those for riskier issuers worsened.

After declining for three years, the Italian stock market index gained 15 per cent in 2003, close to the euro-area average of 18 per cent. The improvement mainly reflected the strengthening of the world economic recovery and the reduction in the risk premium on shares demanded by international investors. Current share prices are not far from levels consistent with the long-term growth expectations for the main euro-area economies and the still low level of interest rates.

The good performance of the stock market was not accompanied, however, by any appreciable increase in listings. Only five companies were listed in Italy in 2003 and thirty-two in the euro area as a whole.

MONETARY POLICY

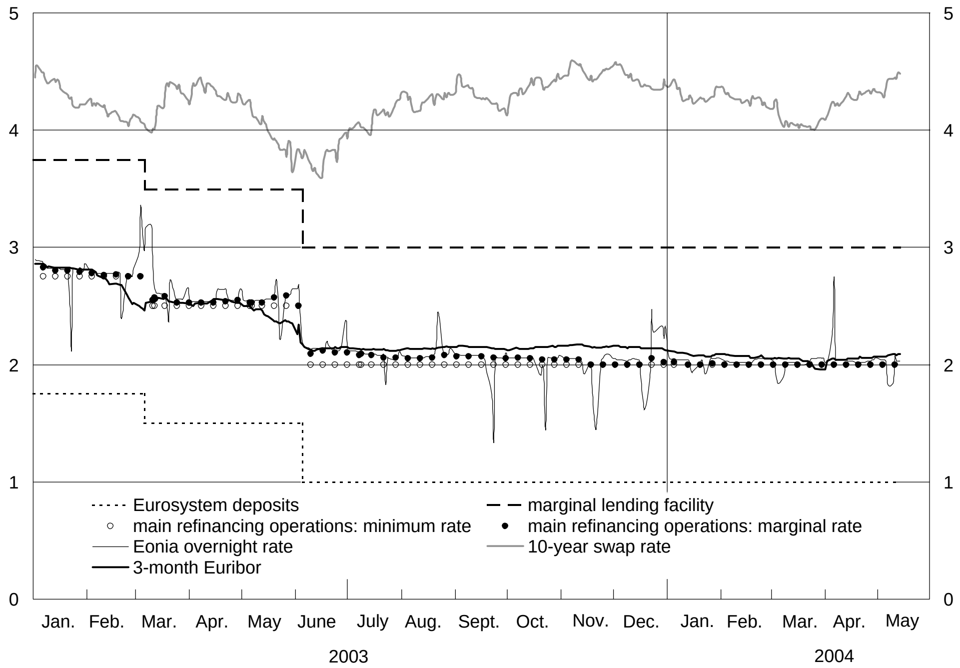
Interest rates and the exchange rate

Short-term interest rates. – In 2003 the euro-area economies were marked by uncertainty as to the timing and strength of the cyclical recovery. Inflationary pressures abated in the first quarter owing to the continued weakness of the economy and the appreciation of the euro in the preceding months. International tensions connected with the war in Iraq led to higher financial market volatility and greater uncertainty about the resumption of growth. On 6 March the Governing Council of the European Central Bank reduced the minimum bid rate on its main refinancing operations by 0.25 percentage points, to 2.5 per cent (Figure 26). In the second quarter, against a background of macroeconomic weakness and strengthening of the euro, expectations developed that inflation would be below 2 per cent in the medium term. On 5 June the Governing Council reduced the minimum bid rate by another 0.5 percentage points, to 2 per cent.

Figure 26

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

(daily data; percentages)



Sources: ECB, Reuters, Telerate.

In the first half of 2003 the Governing Council carried out an evaluation of the ECB's monetary policy strategy since the start of the third stage of EMU. It reaffirmed the definition of price stability announced in October 1998, but clarified that it would pursue that aim by maintaining inflation rates "below, but close to, 2 per cent over the medium term". In order to improve the transparency of communication with the market, changes were made in the manner of presenting decisions and it was decided to abolish the annual review of the reference value for the growth of M3.

From the summer onwards, with the steady improvement in the international economic situation and the recovery of share markets, the economic outlook gradually brightened in the euro area. Inflation returned briefly over 2 per cent, mainly in connection with the rise in oil and food prices. However, the gradual appreciation of the euro and the moderation of wage claims ensured that inflation expectations remained below the 2 per cent mark for 2004.

The international economic situation continued to improve in the first part of 2004. The growth in euro-area GDP quickened and between January and March inflation fell below 2 per cent as the rates of increase in food and energy prices slackened.

Expectations regarding short-term euro yields fluctuated widely during 2003, reflecting economic developments. In the first half of the year the yield curve shifted downwards as the prospects of a recovery faded. After official rates were cut in June, the curve continued to have a negative slope at the short end in the summer, signalling expectations that monetary conditions would ease further before the end of the year (Figure 27). In the last quarter, once the prospects of a recovery had improved, the curve took on a positive slope even for the shortest maturities and shifted upwards. At the end of the year it reflected expectations that official rates would be raised by June 2004.

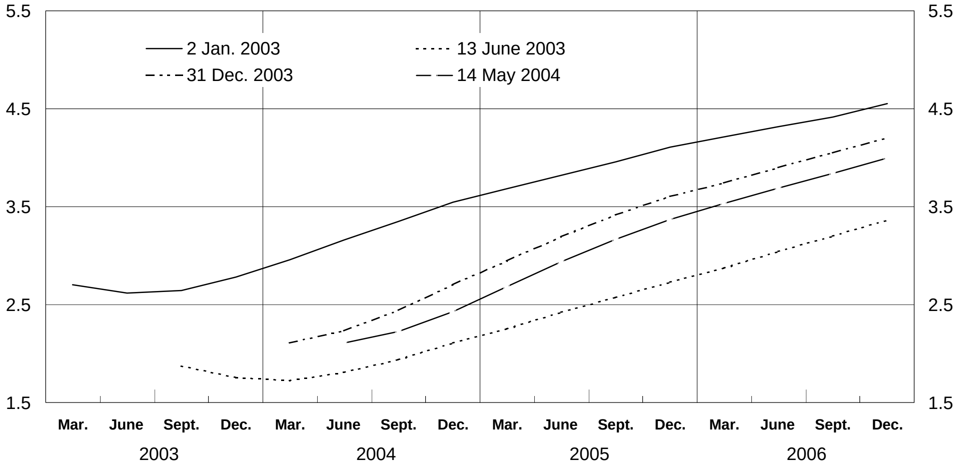
In the early months of this year the uncertain economic outlook and the moderate rise in prices prompted market expectations that the increase in official rates would come later than had previously been thought. In mid-May the curve indicated that the rates would be raised by at least 0.25 percentage points by December.

Real rates of return have been at extremely low levels. In the first three months of 2003 the real short-term interest rate in the euro area, deflated using inflation expectations from surveys, gradually declined from 1 to 0.3 per cent. It rose briefly towards the end of the year before falling back to 0.2 per cent in the first quarter of 2004. In Italy, where inflation expectations were higher than in the euro area, the real interest rate averaged –0.1 per cent in 2003, about half a percentage point below that of the area as a whole.

Figure 27

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

(percentages)



Source: Reuters.

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

Long-term yields. – Long-term euro rates fluctuated widely during 2003 (Figure 26). In the first six months rates of return on ten-year interest-rate swaps fell to 3.6 per cent, the lowest level ever recorded for long-term interest rates in Italy. In the second half of the year the improvement in the world economy and the shift in portfolio composition from bonds to shares fostered a gradual return to the level at the beginning of the year.

In the euro area real long-term interest rates declined in the first part of the year. In June they reached exceptionally low levels, as little as 1.8 per cent for French ten-year bonds indexed to euro-area consumer prices, before inching up in the second part of the year to reach 2 per cent in December. They slipped again briefly but then picked up and stood at 1.9 per cent in mid-May 2004.

The exchange rate. – The euro continued to strengthen in 2003; over the year as a whole it gained 11.3 per cent in nominal effective terms, 20.4 per cent against the US dollar, 8.3 per cent against sterling and 8.6 per cent against the yen.

In the first half of the year the strengthening of the euro against the dollar was mainly the result of fears triggered by the widening of the US current account and federal budget deficits. From November onwards the euro began to appreciate rapidly vis-à-vis the main international currencies, notably the dollar.

By contrast, between the beginning of January and the middle of May 2004 the effective exchange rate of the euro fell by 3.5 per cent, reflecting losses of 6.6 per cent against the dollar and 4.4 per cent against sterling and a depreciation vis-à-vis the currencies of the main Asian trading partners. The weakening of the euro with respect to the main international currencies was influenced by the widening gap between output growth in those countries and the euro area.

The money supply and credit

The euro area. – In 2003 euro-area M3 continued to grow at a rapid pace. The expansion accelerated until the summer and then slowed. The twelve-month growth rate averaged 7.5 per cent in the last quarter of the year. The slowdown in the growth of the money supply continued in the early months of 2004 and in March the twelve-month rate stood at 6.3 per cent.

The moderate increases in real GDP and prices acted as a brake on M3, while the exceptionally low yields on alternative assets, both short and long term, had the opposite effect. However, demand for M3 during the year cannot be ascribed entirely to these factors. The large expansion that took place in previous years and in the first half of 2003 was due to the marked preference of investors for short-term assets during a period of high financial market volatility and international tensions. The improvement in share market conditions that began in the spring, borne out by the reduction in volatility and rise in prices, prompted investors to reduce their portfolios of monetary assets in the second half of the year.

The rate of increase in lending to euro-area residents by monetary financial institutions rose steadily from the summer onwards to 5.5 per cent in December 2003, compared with 4.8 per cent a year earlier. The acceleration occurred principally in lending to non-financial corporations and to households. In the first three months of 2004 there was no change in the rate of increase in bank lending.

Italy. – Excluding currency in circulation, the growth of Italy’s contribution to euro-area M3, which had been slowing since the second quarter of 2002, fell to 4.8 per cent in December 2003. This downward trend reflected the decline in repurchase agreements and money market fund units, which the upturn in overnight deposits and deposits redeemable at notice up to three-months only offset in part. In the first three months of 2004 the growth in Italy’s contribution to M3 fell further.

The rate of increase in total credit to the private sector in Italy remained stationary and was equal to 8.6 per cent in December 2003. This result reflected the upturn in domestic bond issues and the offsetting downturn in borrowing abroad. The growth in bank loans, which was generally stable in 2003, diminished in the first part of this year.

Monetary policy operations in the euro area

The average daily volumes of liquidity provided by the Eurosystem via main refinancing operations rose from €132 billion in 2002 to €197.5 billion in 2003, in response to increased borrowing requirements. An average of 74.4 per cent of demand was met, compared with 59.3 per cent in 2002.

The average number of participants at auctions was smaller than in the previous year, falling from 307 to 267 in the area as a whole and from 18 to 14 in Italy. This partly reflected the narrowing of the differential between the EONIA rate and the allotment rate from 2.3 basis points in 2002 to 0.7 basis points in 2003. The differential was virtually nil on average for the year, but it widened sharply on specific occasions, such as when expectations of a reduction in minimum bid rates caused a shortage of demand for funds at auction.

The Italian counterparties received on average 4 per cent of the total financing allotted at auction, compared with 6.1 per cent in 2002. Demand at auction by Italian banks has been declining steadily since June 2000 when variable rate auctions were introduced and it became relatively more advantageous to raise funds on the market. Another contributory factory has been the growing integration of the euro-area money market.

On 23 January 2003 the Governing Council of the European Central Bank decided to review the operational arrangements for the conduct of monetary policy. The changes, which took effect in March 2004, concern the calendar of compulsory reserve maintenance periods and the duration of the main refinancing operations. The aim of the changes is to prevent fluctuations in liquidity creation and market interest rates from undermining the role of the minimum rate on main refinancing operations as an indicator of the stance of monetary policy.

THE HOUSEHOLD AND CORPORATE SECTORS

The financial surplus of the household sector in Italy decreased in 2003 from €87 billion to €73 billion and from 6.9 to 5.6 per cent of GDP (Table 39), lower than the average for the period between 1995 and 2001. In view of developments in the sector's overall saving, which rose to more than €110 billion, the decline can be attributed to households' high propensity to acquire real assets, especially housing.

Table 39

ITALY: FINANCIAL BALANCES (1)
(millions of euros and percentages)

	2000	2001	2002	2003
Households	78,165	101,075	86,740	72,518
of which: external balance	*32,210*	*22,005*	*–9,980*	*2,000*
Non-financial corporations	–59,717	–31,833	–42,988	–32,046
of which: external balance	*9,819*	*7,532*	*5,077*	*23,214*
General government	–7,700	–35,108	–30,145	–36,753
of which: external balance	*–49,306*	*–10,331*	*–25,104*	*–64,143*
Monetary financial institutions	–2,894	–8,874	11,225	38,274
of which: external balance	*–27,885*	*–23,468*	*40,023*	*–20,174*
Other financial intermediaries (2)	3,559	–17,497	–34,878	–37,865
of which: external balance	*38,637*	*–2,732*	*–29,181*	*25,172*
Insurance companies (3)	–11,515	–9,578	–3,309	–24,934
of which: external balance	*–3,577*	*5,179*	*5,809*	*13,125*
Rest of the world account	102	1,816	13,355	20,805
	As a percentage of GDP			
Households	6.7	8.3	6.9	5.6
Non-financial corporations	–5.1	–2.6	–3.4	–2.5
General government	–0.7	–2.9	–2.4	–2.8
Financial institutions (4)	–0.9	–3.0	–2.1	–1.9
Rest of the world account	0.0	0.1	1.1	1.6
	As a percentage of GDP, adjusted for inflation (5)			
Households	4.4	6.0	4.7	3.6
Non-financial corporations	–4.3	–1.7	–2.5	–1.6
General government	1.7	–0.7	–0.4	–1.2

(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.

Households channeled their financial investment in Italy and abroad into investment fund units, life insurance policies and medium and long-term private-sector bonds, reduced the flow of bank deposits and made net disposals of shares and government securities. Compared with the second half of the 1990s, when equity prices were high, Italian households' financial portfolios are more heavily oriented towards low-risk assets. At the end of 2003 gross household wealth, equal to the sum of real and financial assets, was an estimated €8.2 trillion, while wealth net of debt came to €7.7 trillion. Net wealth has increased by more than 5 per cent a year since 1994, primarily as a consequence of rising asset values in addition to new savings.

Non-financial firms' operating profits decreased in relation to value added. The decline was reflected in lower overall profits, despite the fall in interest charges. Self-financing remained unchanged as a proportion of investment, which diminished. Firms' financial debt increased from 60 to 62 per cent of GDP. Leverage (the ratio of debt to the sum of debt and equity) rose from 42.2 to 44.1 per cent; the ratio is lower than the average for the 1990s but the degree of dispersion among firms remains high.

At the end of 2003 Italy's total stock of financial assets amounted to €9.1 trillion, or 7 times GDP.

The financial accounts of households

The financial surplus of the household sector (comprising consumer households, sole proprietorships with up to five workers and private social institutions) fell to €73 billion (Table 40). Net of the loss of purchasing power due to the impact of inflation on the stock of net household financial assets (2 per cent of GDP, compared with 2.2 per cent in 2002), it was equal to 3.6 per cent of GDP, compared with 4.7 per cent in 2002 (Table 39).

Net investment in bonds issued by Italian firms and non-bank financial corporations amounted to €20.8 billion, compared with €7.2 billion in 2002.

The share of medium and long-term bonds, equities, investment fund units and private pension fund assets in the total flow of financial assets was equal to 47 per cent in 2003, comparable to that in 2002 (40 per cent) but below the average over the four previous years (88 per cent).

After making large net disposals of foreign assets in 2002 in connection with the capital repatriation scheme, in 2003 Italian households began to invest in foreign assets again, with net purchases of €2 billion. Household

Table 40

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

	End-of-period stocks			Flows	
	December 2003	Percentage composition		2002	2003
		December 2002	December 2003		
ASSETS					
Cash and sight deposits	481,330	16.0	16.5	35,677	35,245
of which: bank deposits	*424,006*	*14.3*	*14.6*	*37,021*	*25,780*
Other deposits	298,417	10.3	10.2	11,568	5,187
bank	*89,738*	*3.6*	*3.1*	*–840*	*–10,502*
post office	*208,679*	*6.7*	*7.2*	*12,408*	*15,688*
Short-term securities	6,516	1.1	0.2	3,387	–26,236
Medium and long-term securities	541,884	18.1	18.6	42,532	29,033
of which: government	*190,081*	*7.2*	*6.5*	*8,053*	*–12,391*
corporate	*53,540*	*1.0*	*1.8*	*7,209*	*20,763*
bank	*298,263*	*9.8*	*10.2*	*27,269*	*20,662*
Investment fund units	325,835	11.1	11.2	–736	16,311
Shares and other equity	567,491	20.9	19.5	–3,032	–878
External assets	203,814	7.1	7.0	–9,980	2,000
of which: deposits	*7,950*	*0.5*	*0.3*	*–18,476*	*–6,479*
short-term securities	*348*	*0.0*	*0.0*	*–675*	*–90*
medium and long-term securities	*91,295*	*3.3*	*3.1*	*5,203*	*5,148*
shares and other equity	*73,353*	*2.4*	*2.5*	*5,655*	*–71*
investment fund units	*30,868*	*0.9*	*1.1*	*–1,688*	*3,493*
Insurance and pension fund reserves (2)	467,177	14.8	16.1	42,632	54,723
of which: life insurance reserves	*269,989*	*8.1*	*9.3*	*31,918*	*43,544*
Other financial assets (3)	19,146	0.6	0.7	2,725	1,754
Total assets	**2,911,610**	**100.0**	**100.0**	**124,773**	**117,139**
LIABILITIES					
Short-term debt (4)	53,584	13.6	11.9	–152	–1,204
of which: bank	*52,513*	*13.4*	*11.7*	*–400*	*–1,368*
Medium and long-term debt (5)	283,255	62.0	63.2	29,462	33,352
of which: bank	*257,549*	*56.2*	*57.4*	*26,331*	*31,248*
Other financial liabilities (6)	111,593	24.4	24.9	8,722	12,474
Total liabilities	**448,432**	**100.0**	**100.0**	**38,032**	**44,622**
BALANCE	**2,463,178**			**86,741**	**72,517**

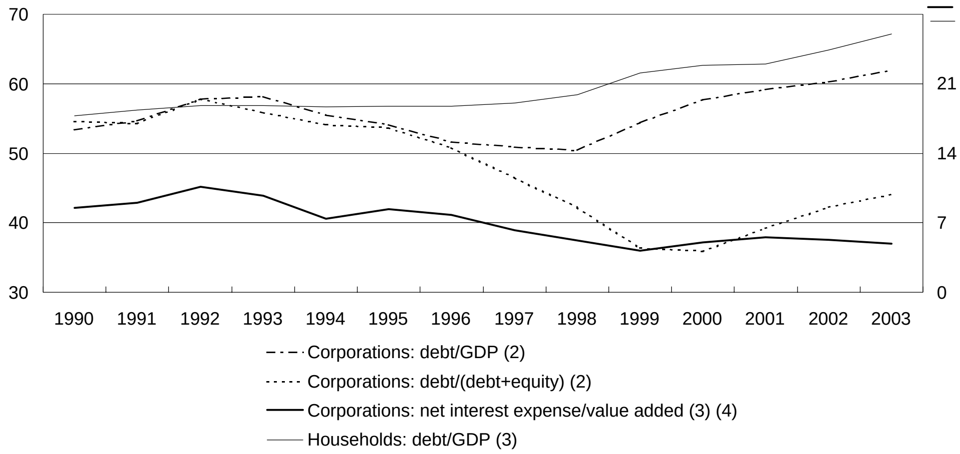
(1) Consumer households, non-profit institutions serving households, and sole proprietorships with up to 5 workers. Rounding may cause discrepancies in totals. – (2) Includes insurance reserves of both the life and casualty sectors, pension funds and severance pay entitlements. – (3) Trade credit and 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 pension provisions and other minor items.

debt rose further by €32 billion, largely in the form of mortgage loans. Households' financial debt remains low as a proportion of GDP at 26 per cent, compared with 24 per cent in 2002 (Figure 28).

Figure 28

THE FINANCIAL DEBT OF ITALIAN HOUSEHOLDS AND NON-FINANCIAL ENTERPRISES (1)

(annual data; percentages)



Source: For GDP and value added, Istat.

(1) From 1995 the data refer to the new definitions of instruments and sectors of economic activity introduced by ESA95. – (2) Left-hand scale. Equity is stated at market value. – (3) Right-hand scale. – (4) Net interest expense is estimated. Value added for 2003 is estimated on the basis of national accounts data.

The characteristics of Italian households' assets and liabilities

Debt. – The Bank of Italy's survey of household income and wealth indicates that a fifth of households were indebted to banks or financial corporations in 2002, a share that has remained virtually unchanged over the last decade (Table 41). By contrast, the proportion of households indebted to friends or relatives has declined over time. The purchase or renovation of property remains the primary purpose for taking on debt. In the last ten years the proportion of households that contract debt to finance the purchase of transport equipment has risen. Most borrowing is done by wealthier households: the average income of indebted households is one fourth higher than that of non-indebted households. Among indebted households, the median ratio of debt to total wealth was equal to 10 per cent, slightly higher than in previous years.

The amount and composition of wealth in Italy. – In the last decade the amount and composition of household wealth has varied in connection with changes in the prices of financial and real assets, and with the shift in the composition of portfolios towards riskier instruments. These trends have not significantly reduced the differences between the various parts of Italy.

Table 41

ITALIAN HOUSEHOLDS' DEBT STATUS BY OWNERSHIP OF ASSETS AND INCOME DISTRIBUTION (1)

(percentages)

	1991-95 average		1998-2002 average		2002	
	Indebted	Non-indebted	Indebted	Non-indebted	Indebted	Non-indebted
Households owning: (2)						
Bank or postal deposits	91.7	83.9	93.5	83.3	94.8	83.3
Government securities	20.7	24.8	7.8	11.8	6.0	10.3
Investment funds	4.1	3.6	13.1	10.3	14.1	10.5
Bonds	2.3	2.1	5.1	5.8	4.8	6.3
Shares	5.3	4.2	11.8	8.7	11.9	9.5
Own home	71.0	63.2	70.5	68.0	73.0	68.5
Composition of assets: (3)						
Financial assets	15.9	24.8	21.0	24.4	19.9	22.9
Real assets	84.1	75.2	79.0	75.6	80.1	77.1
Income (2) (4)						
First quintile (5)	10.5	22.4	9.4	22.7	9.0	22.8
Fifth quintile (6)	32.1	17.0	30.0	17.5	28.7	17.8
Memorandum items:						
Percentage of households indebted to banks or financial corporations: (2)	19.3		18.8		19.2	
purpose of debt: (7)						
purchase or renovation of property	*61.7*		*50.2*		*53.0*	
purchase of transport equipment	*30.0*		*44.5*		*44.1*	
purchase of non-durable goods and services	*4.9*		*3.4*		*2.1*	
Percentage of households indebted to friends or relatives	3.4		1.8		1.1	

Source: Based on the Bank of Italy's survey of household income and wealth (various years).

(1) Simple average of the sample values extrapolated to the population. – (2) Frequences expressed as percentages. – (3) Percentage shares of total assets. – (4) Disposable income net of financial investment income. – (5) Up to €13,000 in 2002; up to €12,900 and €13,100 in 1991-95 and 1998-2002 respectively. – (6) More than €38,500 in 2002. More than €37,100 and €38,700 in 1991-95 and 1998-2002 respectively. – (7) As a percentage of all indebted households.

Estimates based on financial and real accounts show that in 2001 the net per capita wealth of households in the North (€143,000) was more than twice as high as that in the South (€68,000) and 20 per cent higher than in the Centre (€120,000). In southern Italy, the share of wealth invested in real assets was more than 9 percentage points greater than in the North.

Bank and post office deposits. – The survey of Italian household income and wealth showed that in 2002 14 per cent of households did not have deposits in current or savings accounts held with a bank or the Post Office; the proportion has remained broadly stable in the last 10 years. Households without bank or post office deposits are poorer on average in terms of both wealth and income.

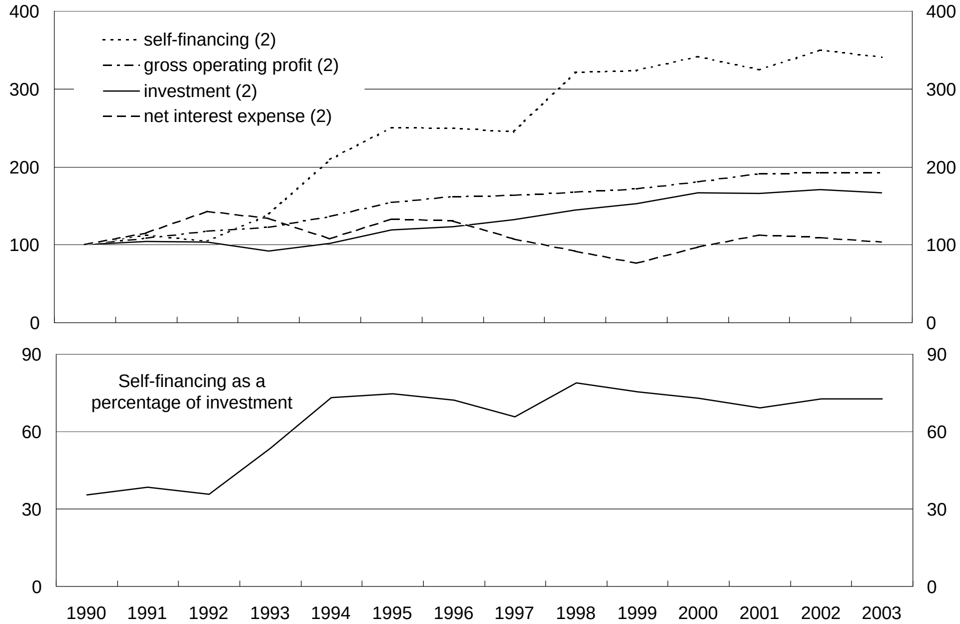
The financing of firms and their liquidity

Profitability and cash flow. – The weakness of economic activity was reflected in the operating profit of firms: in 2003 gross operating profit fell from 36 to 35 per cent of value added, lower than in the second half of the 1990s. The fall in interest rates led to a reduction in interest expense (Figure 29), from 5.2 to 4.9 per cent of value added, a very low level historically.

Figure 29

THE EXTERNAL FUNDING REQUIREMENT OF ITALIAN NON-FINANCIAL FIRMS (1)

(annual data)



Source: Based on Istat data.

(1) Estimate based on national accounts data for the sector "non-financial corporations", 1990-2002. The data for 2003 are estimated on the basis of the national accounts for the year. Investment includes stocks. – (2) Indices, 1990=100. Net interest expense is estimated.

Owing to the decline in operating profitability, self-financing fell from 15.2 to 14.5 per cent of value added in 2003. Against a background of lower capital expenditure, the proportion of investment covered by internally generated funds remained stable at 73 per cent. The corporate sector's borrowing requirement amounted to €32 billion (Table 42).

Debt. – The increase in Italian firms' gross financial liabilities in 2003 was less than in 2002 (€68 billion, compared with €110 billion). The component consisting of medium and long-term bank loans expanded considerably, while net issues of longer-term bonds were smaller than in

Table 42

FINANCIAL ASSETS AND LIABILITIES OF ITALIAN FIRMS (1)

(millions of euros and percentage composition)

	End-of-period stocks			Flows	
	December 2003	Percentage composition		2002	2003
		December 2002	December 2003		
ASSETS					
Cash and sight deposits	119,903	10.4	10.7	6,474	8,554
Other deposits	10,067	0.8	0.9	–166	1,213
of which: bank	*8,897*	*0.7*	*0.8*	*–218*	*1,078*
Short-term securities	69	0.0	0.0	–805	–879
Medium and long-term securities	27,375	2.8	2.4	–947	–5,753
of which: government	*10,250*	*1.4*	*0.9*	*–1,083*	*–6,788*
corporate	*6,377*	*0.5*	*0.6*	*553*	*268*
Shares and other equity	388,114	33.3	34.6	18,651	26,101
Investment fund units	4,532	0.4	0.4	–10	227
Trade credit receivable	238,659	24.1	21.3	42,630	–19,439
Other financial assets (2)	45,381	4.5	4.0	–1,032	–1,639
External assets	288,603	23.7	25.7	1,841	27,750
of which: deposits	*21,373*	*1.8*	*1.9*	*2,231*	*1,616*
trade credit receivable	*68,852*	*5.5*	*6.1*	*–5*	*9,683*
securities	*18,903*	*1.7*	*1.7*	*–2,877*	*2,113*
shares and other equity	*129,961*	*10.4*	*11.6*	*9,810*	*8,595*
Total assets	**1,122,703**	**100.0**	**100.0**	**66,635**	**36,135**
LIABILITIES					
Domestic liabilities	**1,951,951**	**88.6**	**88.0**	**112,857**	**63,644**
short-term debt (3)	313,929	14.5	14.2	–1,725	–3,217
of which: bank	*283,574*	*13.1*	*12.8*	*–1,943*	*–3,086*
Medium and long-term debt (4)	366,204	14.6	16.5	40,606	47,254
of which: bank	*295,133*	*11.5*	*13.3*	*32,473*	*44,906*
Securities	33,544	0.9	1.5	10,047	12,333
of which: medium and long-term	*27,824*	*0.8*	*1.3*	*9,344*	*10,489*
Shares and other equity	887,981	41.8	40.0	14,476	23,859
Trade credit payable	243,530	12.0	11.0	43,500	–19,835
Other financial liabilities (5)	106,763	4.8	4.8	5,953	3,250
External liabilities	**265,249**	**11.4**	**12.0**	**–3,236**	**4,536**
of which: trade credit payable	*36,350*	*1.3*	*1.6*	*–631*	*8,421*
financial debt	*92,158*	*4.5*	*4.2*	*–6,773*	*–6,440*
of which: medium and long-term securities	*13,751*	*0.9*	*0.6*	*–362*	*–4,921*
shares and other equity	*133,459*	*5.4*	*6.0*	*6,531*	*4,510*
Total liabilities	**2,217,200**	**100.0**	**100.0**	**109,621**	**68,180**
BALANCE	**–1,094,497**			**–42,986**	**–32,045**

(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 pension provisions and other minor items.

2002. The growth in the share of medium and long-term debt (from 47.8 to 51.1 per cent) is partly attributable to the restructuring of the maturity of liabilities by several major industrial groups.

With firms' financial debt increasing faster than equity capital, their leverage, measured by the ratio of debt to the sum of debt and equity, increased from 42.2 to 44.1 per cent in 2003 (Figure 28). The ratio is still less than the average in the first half of the 1990s, when it was close to 55 per cent; it is similar to that in the rest of the euro area.

Equity capital and venture capital. – Firms' raised €23.9 billion of equity capital in the domestic market and €4.5 billion abroad, compared with €14.5 billion and €6.5 billion respectively in 2002. According to the Italian Private Equity and Venture Capital Association, investment by venture capital firms increased from €2.6 billion to €3 billion. Venture capital fund-raising remained virtually unchanged with respect to 2002 at about €2 billion.

Trade credit payable. – Domestic and foreign trade credit payable declined by €11.4 billion; at the end of 2003 it accounted for 13 per cent of firms' total financial liabilities.

The financial position of Italian firms

Medium-term trends in debt and profits. – Following the decline in the 1990s, in 2001 and 2002 borrowing by Italian firms began to rise again; profits contracted, after the satisfactory results reported in the second half of the last decade.

According to the available data on the approximately 40,000 non-financial firms surveyed by the Company Accounts Data Service, leverage, which had declined steadily between 1992 and 2000 (from 60 to 50 per cent), subsequently rose slightly through 2002 (Table 43).

In the second half of the 1990s, the reduction in debt and the sharp decline in interest rates were reflected in a pronounced fall in net interest expense relative to gross operating profit. Despite recent developments, leverage, the ratio of financial debt to sales revenues and that of net interest expense to gross operating profit remain at historically low levels.

Table 43

PROFITABILITY AND DEBT OF ITALIAN FIRMS (1)

(weighted averages; percentages)

	Total sample					Bottom quartile (2)				
	1990	1995	2000	2001	2002	1990	1995	2000	2001	2002
	Gross operating profit/total assets									
Centre and North	9.9	11.1	8.5	8.9	8.2	1.2	–0.6	–2.5	–2.0	–2.4
South	7.1	7.8	6.8	6.1	5.7	–0.8	–1.1	–3.3	–3.5	–2.5
1–499 workers	9.6	10.3	8.1	8.1	7.8	0.5	–1.5	–2.6	–2.3	–2.3
>= 500 workers	9.8	11.9	9.4	9.8	8.6	1.5	0.6	–3.2	–2.1	–2.6
Total firms	**9.6**	**10.8**	**8.3**	**8.6**	**8.0**	**1.0**	**–0.7**	**–2.6**	**–2.2**	**–2.4**
	Net interest expense/gross operating profit (3)									
Centre and North	23.6	16.3	2.1	3.2	1.5	102.4	84.3	61.7	67.4	59.8
South	33.3	25.7	12.4	12.4	9.5	102.0	99.2	66.8	65.1	58.7
1–499 workers	29.9	20.9	9.6	10.1	8.3	101.0	84.4	61.1	64.5	59.6
>= 500 workers	18.4	10.9	–5.5	–3.3	–5.2	108.3	88.2	65.7	84.5	58.8
Total firms	**24.4**	**17.0**	**2.8**	**3.8**	**2.0**	**102.3**	**86.5**	**62.4**	**67.1**	**59.6**
	Return on equity (4)									
Centre and North	6.4	8.1	7.3	5.0	3.3	–15.2	–17.5	–17.7	–24.0	–24.3
South	2.3	4.7	4.4	–1.3	2.7	–16.4	–13.2	–16.4	–26.8	–12.6
1–499 workers	6.6	8.1	6.6	6.2	5.9	–16.0	–18.7	–19.9	–21.6	–19.4
>= 500 workers	5.3	7.6	7.7	3.0	0.7	–15.0	–14.0	–18.4	–29.0	–25.2
Total firms	**6.0**	**7.8**	**7.1**	**4.5**	**3.2**	**–15.4**	**–16.8**	**–17.6**	**–24.4**	**–22.7**
	Financial debt/sales revenues									
Centre and North	32.4	28.8	28.3	29.3	30.7	87.1	73.0	79.9	83.7	86.3
South	37.5	34.2	28.3	30.1	29.5	83.5	91.7	82.5	83.2	87.4
1–499 workers	28.3	26.0	28.1	28.5	28.0	78.5	70.8	79.6	81.7	82.1
>= 500 workers	39.1	34.8	29.4	30.6	35.2	93.3	75.7	78.5	84.5	90.5
Total firms	**32.8**	**29.3**	**28.3**	**29.3**	**30.6**	**86.7**	**74.6**	**80.1**	**83.7**	**86.4**
	Leverage (5)									
Centre and North	57.5	55.4	50.1	50.3	50.5	87.7	92.4	91.6	91.8	90.6
South	57.4	56.1	50.4	51.6	50.8	88.6	96.2	90.9	89.2	89.0
1–499 workers	58.8	58.2	56.7	56.6	54.7	87.8	91.4	91.4	91.4	89.9
>= 500 workers	56.2	51.7	41.6	43.5	45.9	87.6	96.2	90.6	91.6	91.0
Total firms	**57.5**	**55.4**	**50.2**	**50.4**	**50.5**	**87.9**	**92.9**	**91.5**	**91.6**	**90.5**

Source: Based on Company Accounts Data Service data.

(1) Book value. The figures for total firms also include data for which information on geographical area or size class is not available. – (2) The quartile is identified with reference to the entire sample; the bottom quartile refers, depending on the case, to firms with the lowest profits, the highest net interest expense in relation to gross operating profit, the lowest return on equity, the highest ratio of financial debt to sales revenues or the highest leverage. – (3) Firms with nil or negative gross operating profit were excluded from the calculation. – (4) Profit for the year/equity. Profit is stated gross of accelerated depreciation and other adjustments and revaluations. – (5) Financial debt/(financial debt + equity).

Debt and profits by size class of firms. – The increase in debt and the decline in profits in 2001 and 2002 were pronounced for firms with at least 500 workers. The leverage of this class increased from 42 to 46 per cent over the two years; their return on equity decreased from 7.7 per cent in 2000 to 0.7 per cent in 2002. However, the leverage of these firms remained lower than that of smaller firms (46 as against 55 per cent in 2002).

The dispersion of financial situations. – Profitability and debt indicators measured on a broad sample of firms show a wide diversity of financial situations (Table 43).

For the 25 per cent of firms in the Company Accounts Data Service sample with the worst ratio of gross operating profit to total assets in 2002, average value added was not sufficient to cover labour costs. These firms' share of value added increased between 2001 and 2002 to 11 per cent of the total for the sample; their share of sales revenues rose to more than 20 per cent.

Firms in the lowest quartile in terms of return on equity had average losses of more than 22 per cent of equity in 2002 (24 per cent in 2001), a deterioration with respect to the early 1990s.

Between 2001 and 2002 the average leverage of the 25 per cent of firms with the most debt declined by 1 percentage point to 90 per cent, a high level but lower than that recorded in 1992 and 1993. The share of large firms among the most heavily indebted firms increased, especially in the Centre and North.

The quartile of firms with the highest ratio of net interest expense to gross operating profit saw the burden of interest charges diminish, on average, from 67.1 to 59.6 per cent between 2001 and 2002; in 1990 it was higher than 100 per cent.

BANKS AND OTHER CREDIT INTERMEDIARIES

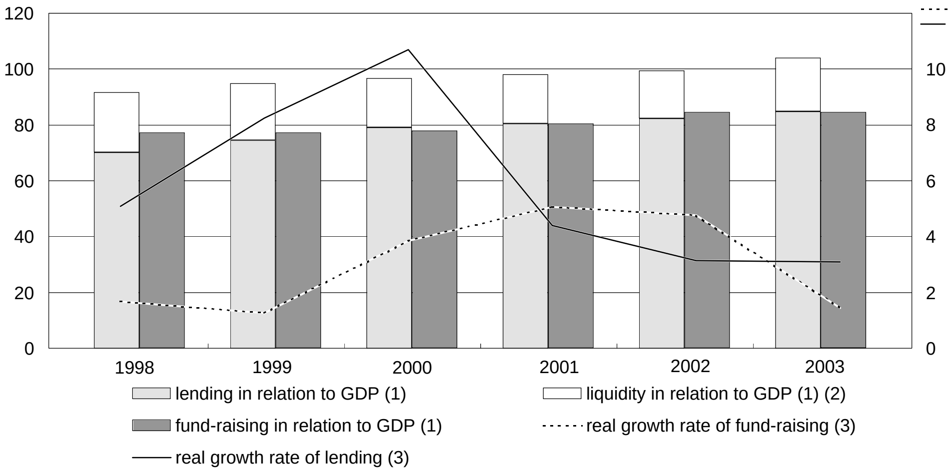
Against a background of uncertainty regarding the prospects of a recovery, Italian banks continued to expand their lending activity. Thanks to the policy of reducing costs and capital strengthening followed in previous years, they were able to withstand the collapse of several large corporations.

Lending growth in 2003 exceeded both the average for the euro area and the nominal growth in GDP; the ratio of outstanding loans to GDP rose by over 2 percentage points to 84.7 per cent (Figure 30).

Figure 30

BANKING INTERMEDIATION IN ITALY

(*year-end data; percentages)*



Sources: Based on supervisory reports and Istat data.

(1) Left-hand scale. The figure for GDP refers to the whole year. – (2) Cash and securities. – (3) On previous year; right-hand scale. Year-end stocks deflated using the GDP deflator.

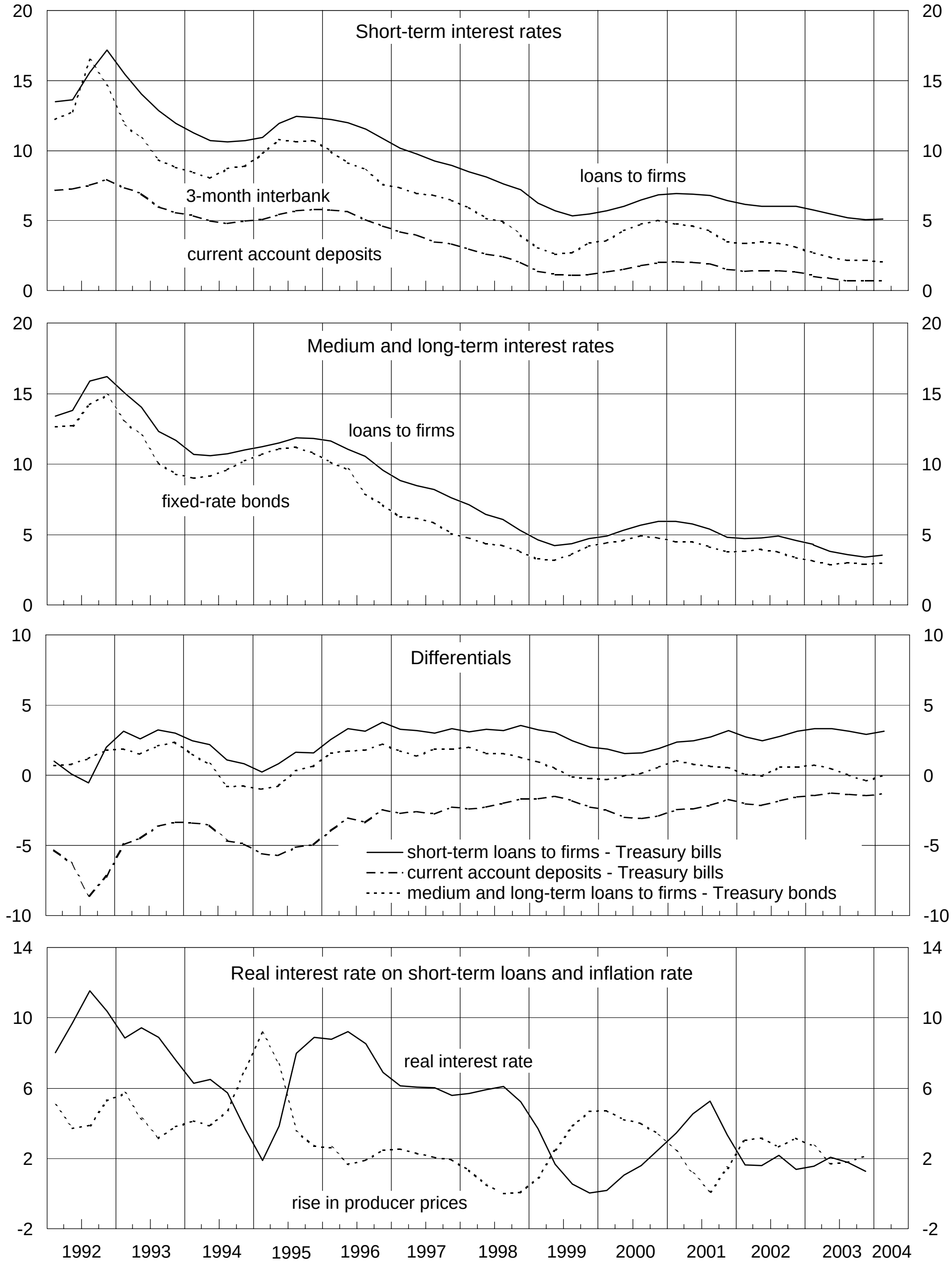
Lending to non-financial firms, particularly in the service and construction sectors, accelerated. There were no indications of a tightening of credit: undrawn current account facilities remained ample and bank interest rates were lower than at any other time in the past fifty years (Figure 31).

In the first quarter of 2004 the growth in lending to firms, especially large corporations, slackened, possibly because banks exercised greater prudence following the collapse of the Parmalat group in December 2003.

Figure 31

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

(quarterly data; percentages and percentage points)



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

Lending to households, and especially loans for house purchases, continued to expand at a rapid pace, but by international standards household credit remained low in relation to GDP.

The quality of banks' assets deteriorated slightly as a result of the prolonged economic stagnation and financial crises affecting several large industrial groups, but far less than in comparable cyclical phases in the past. Excluding the effects of writing off loans granted to companies involved in the Parmalat group crisis, the ratio of bad debts to total lending was unchanged in the Centre and North but increased slightly in the South.

Domestic fund-raising grew at a moderate pace, reflecting the performance of deposits. Bond issues again expanded sharply, buoyed by larger placements on the Euromarket. The gap between the growth in lending and in domestic fund-raising was offset by stepping up net foreign borrowing. The ratio of liquid assets to loans decreased further, to the lowest level of the past thirty years.

Profitability turned upwards, thanks to an increase in gross income. Total staff costs accelerated owing to the rise in costs per employee and in extraordinary charges for early severance incentives. Despite the large increase in net value adjustments to loans, the annual return on equity rose from 6.2 to 7.2 per cent.

Lending

In 2003 bank lending increased by 6.7 per cent in Italy and 5.1 per cent in the euro area (Figure 32). In both cases the growth was concentrated in the medium and long-term component, partly owing to the marked rise in loans for real-estate operations. In Italy loans with more than eighteen months maturity grew by 13.3 per cent (Table 44), while short-term loans fell by 1.5 per cent.

Lending to firms. – Excluding bad debts and repos, credit to firms rose by 6.3 per cent, compared with 4.2 per cent in 2002. Demand was fueled above all by low interest rates, but also by the reduction in internal fund-raising.

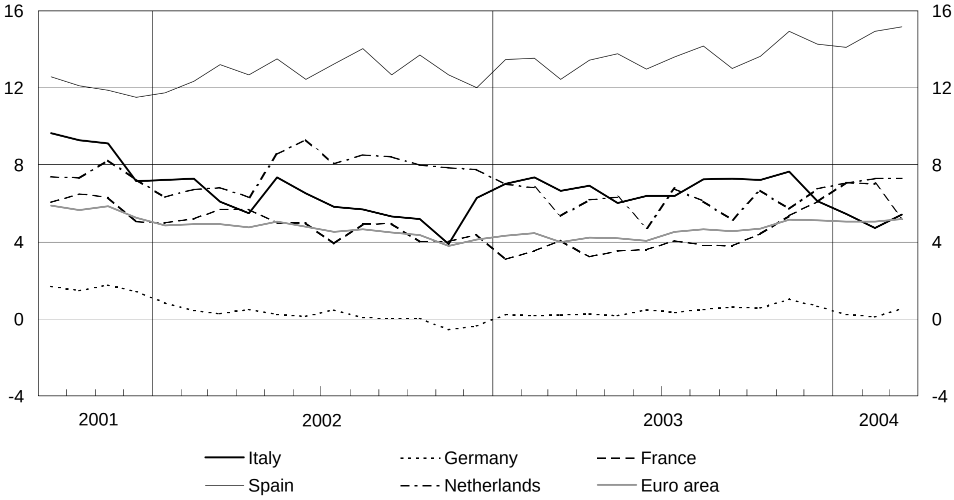
In Italy about three quarters of the growth in lending to non-financial firms was concentrated in the service sector, notably companies connected with the property market, and one fifth in the construction sector, for the most part residential building firms.

After stagnating in 2002, lending to manufacturing firms, mainly in the minerals and metals and paper and publishing industries, rose by just 1.5 per cent. By contrast, less credit was granted to manufacturers of transport equipment and precision machinery and tools, whose capacity utilization rate was much lower than in the previous year.

Figure 32

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 financial institutions (MFIs) of the euro area, excluding the Eurosystem, to non-MFI resident customers.

Lending to small businesses (sole proprietorships and partnerships with fewer than 20 workers) grew faster than credit to other non-financial companies, rising by 7.6 per cent as against 6.1 per cent.

The share of loans with more than eighteen months maturity increased to 58 per cent of total lending to small businesses and 48 per cent to large enterprises, rising by 3 percentage points in both segments.

Against a background of persistently weak economic activity, the shift in the composition of lending towards longer maturities mainly affected the less financially sound companies. It enabled them to stabilize their sources of finance and reduce interest payments.

In total 71 per cent of medium and long-term loans are backed by guarantees, including 57 per cent by real collateral, compared with 39 per cent of short-term loans (6 per cent with real collateral). Overall, the proportion of business loans backed by collateral or personal guarantees rose from 52 to 54 per cent.

In the South of Italy the growth in lending to non-financial firms slowed but was still substantial at 6.3 per cent. In the Centre and North it was equal to 6.6 per cent, exceeding the previous year’s expansion in all sectors of production. The rate of growth slowed in the first quarter of 2004, particularly in the Centre and North, and by the end of March the growth rate of 5.9 per cent in lending to firms in the South was 1.5 points higher than in the rest of Italy.

Table 44

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)					
				2003				2004	
	Dec. 2002	Dec. 2003	Mar. 2004	Q1	Q2	Q3	Q4	Q1	December 2003
Assets									
Securities	–15.6	4.2	4.1	7.1	8.9	7.8	–6.3	7.0	170,353
government securities	*–19.8*	*–3.9*	*–3.7*	*2.1*	*6.4*	*14.7*	*–31.7*	*3.3*	*99,610*
Loans	6.3	6.7	5.8	7.6	7.2	7.2	5.4	4.0	1,100,054
of which: (3)									
short-term (a)	*0.4*	*–1.5*	*–4.4*	*0.8*	*0.3*	*–3.3*	*–3.5*	*–9.9*	*457,354*
medium and long-term (b)	*11.7*	*13.3*	*13.8*	*12.6*	*11.9*	*17.1*	*11.7*	*14.7*	*581,810*
(a)+(b)	*6.1*	*6.3*	*5.4*	*6.9*	*6.4*	*7.4*	*4.7*	*3.5*	*1,039,164*
repos	*–7.3*	*–1.1*	*–21.6*	*120.9*	*7.0*	*–58.1*	*–3.3*	*–12.9*	*6,217*
bad debts (4)	*1.9*	*10.7*	*11.2*	*6.2*	*8.3*	*5.8*	*23.2*	*8.5*	*51,243*
Memorandum item:									
net bad debts	*–0.4*	*9.3*	*1.8*	*–10.0*	*4.7*	*1.1*	*48.3*	*–31.2*	*23,140*
External assets	19.8	0.4	1.8	3.9	–2.4	–6.2	6.9	9.7	212,979
Liabilities									
Domestic funding (5)	8.0	4.4	5.6	3.9	6.3	3.8	3.9	8.2	1,099,652
Deposits	6.7	2.2	3.1	2.7	5.3	3.8	–2.9	6.1	700,514
of which: (6)									
current accounts	*7.2*	*5.9*	*7.8*	*9.1*	*10.5*	*7.3*	*–1.1*	*14.4*	*515,703*
fixed-term	*–8.6*	*–10.2*	*–7.8*	*–18.4*	*1.0*	*–9.0*	*–13.4*	*–9.2*	*44,042*
repayable at notice	*5.4*	*5.1*	*5.6*	*10.9*	*3.9*	*5.4*	*1.0*	*12.9*	*64,853*
repos	*17.2*	*–15.7*	*–19.9*	*–24.8*	*–20.4*	*–9.4*	*–10.7*	*–36.0*	*68,184*
Bonds (5)	10.3	8.6	10.0	6.1	8.1	3.6	17.0	11.8	399,137
External liabilities	–3.2	11.1	6.0	45.8	2.7	–2.1	3.7	21.1	286,445

(1) The figures for March 2004 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 of claims. – (5) Including bonds held by non-residents. – (6) Excluding those of central government.

Lending to firms by smaller banks continued to grow much faster than that by other intermediaries. In 2003 “small” and “minor” banks together accounted for about three quarters of the overall increase, and their share of total outstanding loans rose by almost 3 points to 32 per cent. The acquisition of market shares by smaller banks was a phenomenon common to all the geographical areas and the main sectors of economic activity, continuing a trend under way since the mid-1990s.

In 2003 leasing credit granted by banks fell by 0.3 per cent, after rising by 15.4 per cent the year before (Table 45), while the growth in credit granted by finance companies slowed from 11.7 to 2.8 per cent, mainly in connection with securitizations. The volume of claims assigned to banks through factoring expanded by 19.8 per cent while that assigned to finance companies contracted by 2.2 per cent.

Table 45

LEASING, FACTORING AND CONSUMER CREDIT IN ITALY

(end-of-period data; millions of euros and percentages)

	Percentage changes on previous year			Outstanding 2003 (1)	Percentage of total
	2001	2002	2003 (1)		
			Leasing		
Total credit	15.8	12.5	2.2	61,693	100.0
Finance companies	18.6	11.7	2.8	48,975	79.4
Banks	5.3	15.4	–0.3	12,718	20.6
			Factoring		
Total credit	14.2	2.5	–0.1	39,434	100.0
Finance companies	12.9	3.7	–2.2	34,725	88.1
Banks	32.1	–8.9	19.8	4,709	11.9
			Consumer credit		
Total credit	6.6	9.3	12.2	51,298	100.0
of which: credit cards	*18.2*	*32.4*	*15.7*	*7,081*	*13.8*
Finance companies	6.5	10.0	15.9	20,692	40.3
of which: credit cards	*14.7*	*26.7*	*10.4*	*4,477*	*8.7*
for purchases of motor vehicles	*3.7*	*5.2*	*8.8*	*10,868*	*21.2*
Banks	6.7	8.8	9.9	30,606	59.7
of which: credit cards	*26.9*	*45.4*	*26.2*	*2,604*	*5.1*
Memorandum item: Other loans to consumer households excluding those for house purchases	12.0	–3.5	–0.1	51,457	

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

Lending to households. – Lending to producer and consumer households continued to expand faster than the euro-area average, rising by 10.3 per cent, compared with 9.3 per cent in 2002. Nonetheless, in Italy the volume of household credit remains small by comparison with other countries.

At the end of 2003 bank credit to households amounted to 23.3 per cent of GDP in Italy, compared with 66.6 per cent in Germany, 36.9 per cent in France, 54.9 per cent in Spain and 46.8 per cent in the euro area as a whole. Loans for house purchases and consumer credit are of relatively little account in Italy, totaling respectively 11.8 and 2.5 per cent of GDP, compared with 31.4 per cent and 6.4 per cent in the euro area.

Bank credit to consumer households alone grew by 11.1 per cent, compared with 10.8 per cent in 2002. Lending for house purchases continued to expand rapidly, by a further 16.1 per cent after the 19.7 per cent increase registered in 2002. New mortgages were granted to the value of €42.9 billion (€35.4 billion in 2002), most of which were indexed or re-negotiable within a year. The present low rate of interest on these loans allows borrowers to limit the size of their initial repayment instalments, provided they accept the risk of subsequent rises.

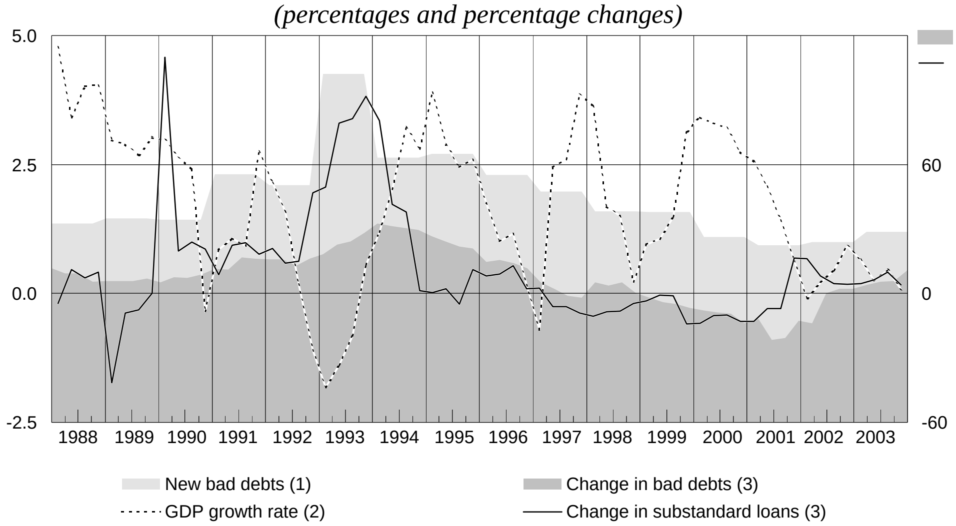
Consumer credit granted by banks rose by 9.9 per cent, compared with 8.8 per cent in 2002. The acceleration was sharper for credit granted by finance companies, for which growth rose from 10 to 15.9 per cent, despite massive securitizations.

Bad debts. – New bad debts (under the broad definition of adjusted bad debts) amounted to 1.2 per cent of lending in 2003, compared with 1 per cent the year before (Figure 33), of which 0.2 percentage points were due to loans to companies involved in the Parmalat crisis. Excluding that component, the ratio remained virtually unchanged in the Centre and North at 0.9 per cent, and increased from 1.6 to 1.7 per cent in the South.

Figure 33

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 write-offs and sales; right-hand scale.

The banks' exposure to customers in temporary difficulty (so-called substandard loans) fell to 2 per cent of performing loans, from 2.1 per cent in 2002. The growth in these non-performing loans slowed from 4.6 per cent to 3.8 per cent (3.2 per cent in the Centre and North, 6 per cent in the South).

Lending conditions and interest rates

Lending conditions. – Credit conditions remained expansionary in 2003. The dispersion of short-term interest rates among categories of borrowers did not increase appreciably; the spread between the average and the minimum short-term lending rate, which tends to widen when supply is tight, held steady at around 2.4 percentage points.

Undrawn margins on overdraft facilities were again substantial for all categories of customers. The ratio of credit drawn to that granted on overdraft facilities dipped from 42.7 per cent in 2002 to 42 per cent. The value of excess drawings fell from 13.1 to 10.8 per cent of the overdraft facilities accorded, and the number of firms breaching their overdraft ceilings also diminished.

Information supplied by the seven Italian banking groups taking part in the Eurosystem quarterly survey of bank lending in the euro area indicates virtually no change in the credit standards applied to the approval of loans and credit lines to firms in 2003 as a whole. However, a few intermediaries reported that towards the end of the year they did become more prudent with larger companies and higher-risk customers. This tendency continued in the first quarter of 2004. In the case of households the survey reported fairly stable credit standards, with signs of an easing of terms in the fourth quarter.

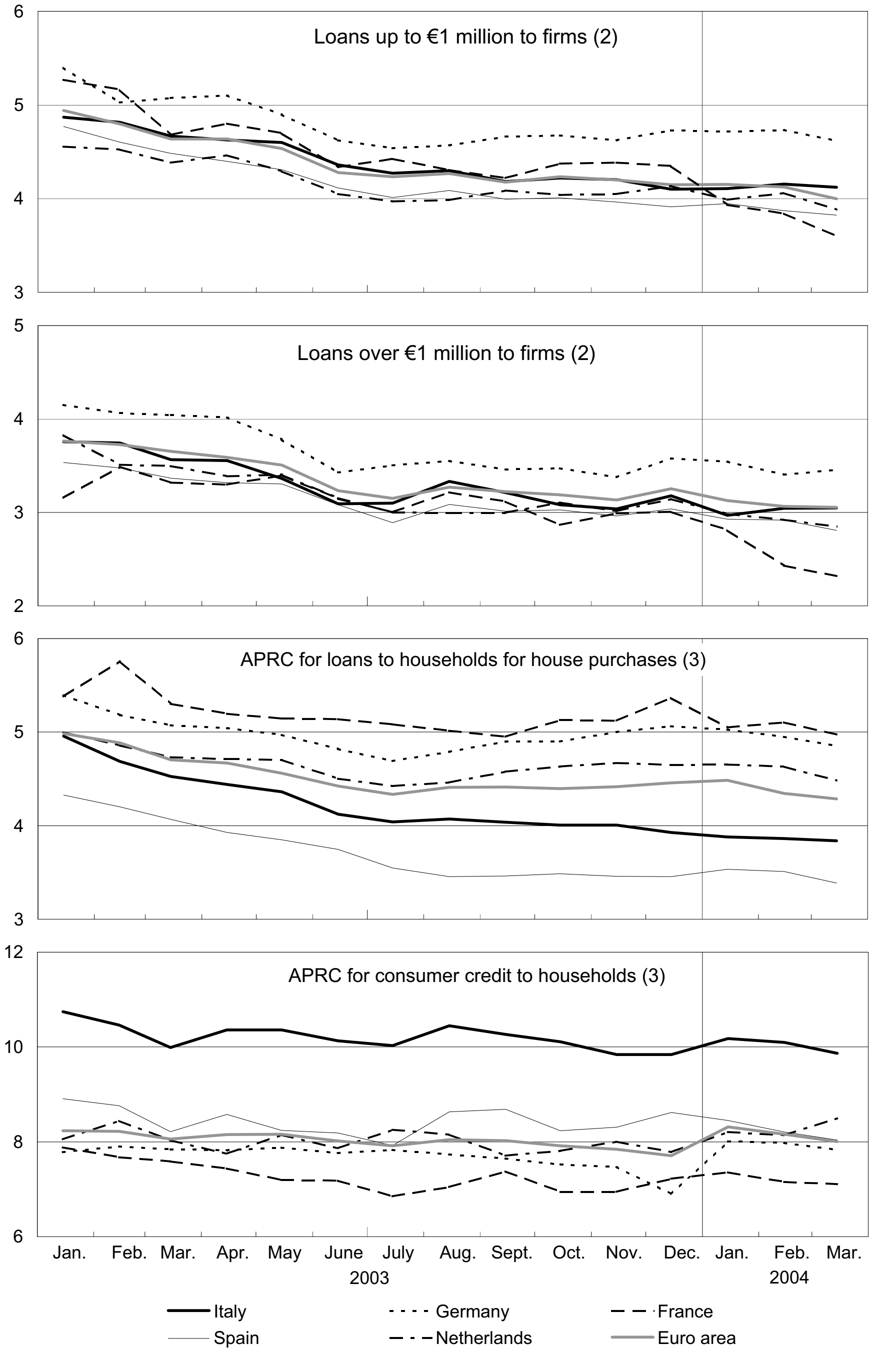
Interest rates. – Bank interest rates in Italy and the euro area continued to fall throughout 2003, reaching unprecedentedly low levels.

According to harmonized statistics (see the box "The new harmonized statistics on bank interest rates", *Economic Bulletin*, No. 37), bank interest rates in Italy were generally in line with those in the euro area. Between January and December 2003 the average rate on short-term loans to firms in Italy fell by 0.8 percentage points, to 5 per cent, while in the euro area it fell by 0.7 points to 4.5 per cent. The rate is higher in Italy because of the larger share of overdraft facilities, which are a more costly form of borrowing in all the main euro-area countries but more flexible and less collateralized. The interest rate on new loans up to €1 million, which proxies credit standards applied to small firms, decreased in both Italy and the euro area by 0.8 percentage points, to 4.1 per cent (Figure 34). The rate on outstanding medium and long-term loans fell from 4.8 to 4 per cent in Italy.

Figure 34

HARMONIZED INTEREST RATES ON NEW LOANS IN THE MAJOR EURO-AREA COUNTRIES (1)

(monthly data; percentages)



Sources: Based on ECB data and national statistics.

(1) New contracts concluded during the reference period or contracts renegotiating previous terms and conditions. – (2) Average lending rate to non-financial firms across all maturities, weighted by loan amounts. The loan amounts refer to single operations. – (3) The annual percentage rate of charge includes accessory expenses (administrative expenses, loan examination fees and insurance). It is calculated as the average rate across all maturities, weighted by loan amounts. Households include producer households and non-profit institutions serving households.

The Annual Percentage Rate of Charge on new loans to households for house purchases decreased in Italy by 1 percentage point, to 3.9 per cent, about 0.5 points less than the euro-area average. The APRC on consumer credit, which fell by 0.9 percentage points to 9.8 per cent, is higher than the euro-area average of 7.7 per cent. The interest rate on overdraft facilities, which are not included in statistics on consumer credit but are probably also used by Italian households to purchase goods, went down from 9.1 to 8.4 per cent, more than a point lower than the euro-area average.

In 2003 the differential between medium and long-term interest rates in the South and in the Centre and North widened by 10 basis points, while that in the short-term segment increased by around 40 points, to 2 percentage points. Adjusting for the sectoral and size characteristics of the borrower firms in the two areas, the difference between interest rates on short-term bank loans is 1.2 percentage points, reflecting differences in the share of bad and substandard loans.

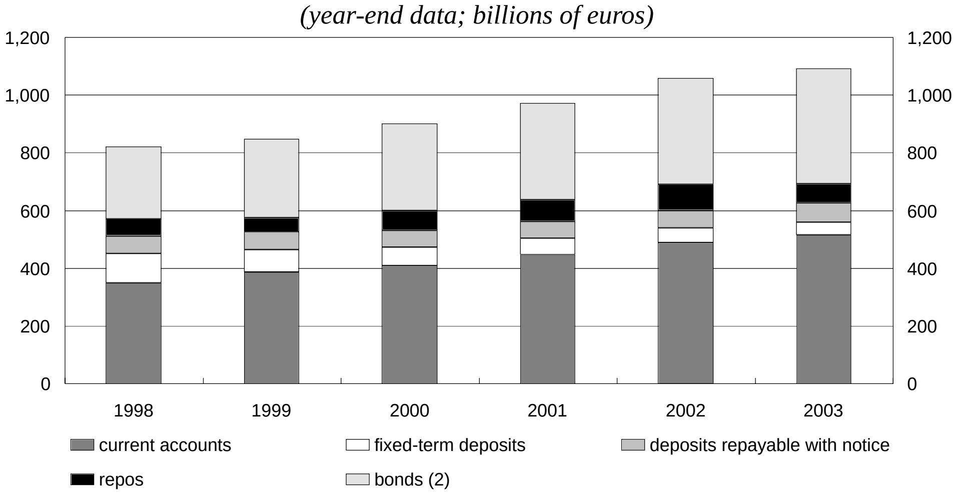
Domestic fund-raising

In 2003 domestic fund-raising by Italian banks slowed sharply, the twelve-month growth rate falling to 4.4 per cent (Table 44 and Figure 35). This can be ascribed mainly to the 15.7 per cent drop in securities repurchase agreements as households' purchases of investment fund units picked up.

Figure 35

BANK FUND-RAISING IN ITALY (1)

(year-end data; billions of euros)



Source: Supervisory reports.
(1) Net of deposits of central government departments. – (2) Total debt securities including bonds held by non-residents.

The rate of growth in current account deposits slowed to 5.9 per cent. Time deposits continued to expand at a rate of over 5 per cent. The fastest increase was recorded by deposits with the Italian branches of foreign banks, whose share of the market was boosted by the offer of high-yield deposits.

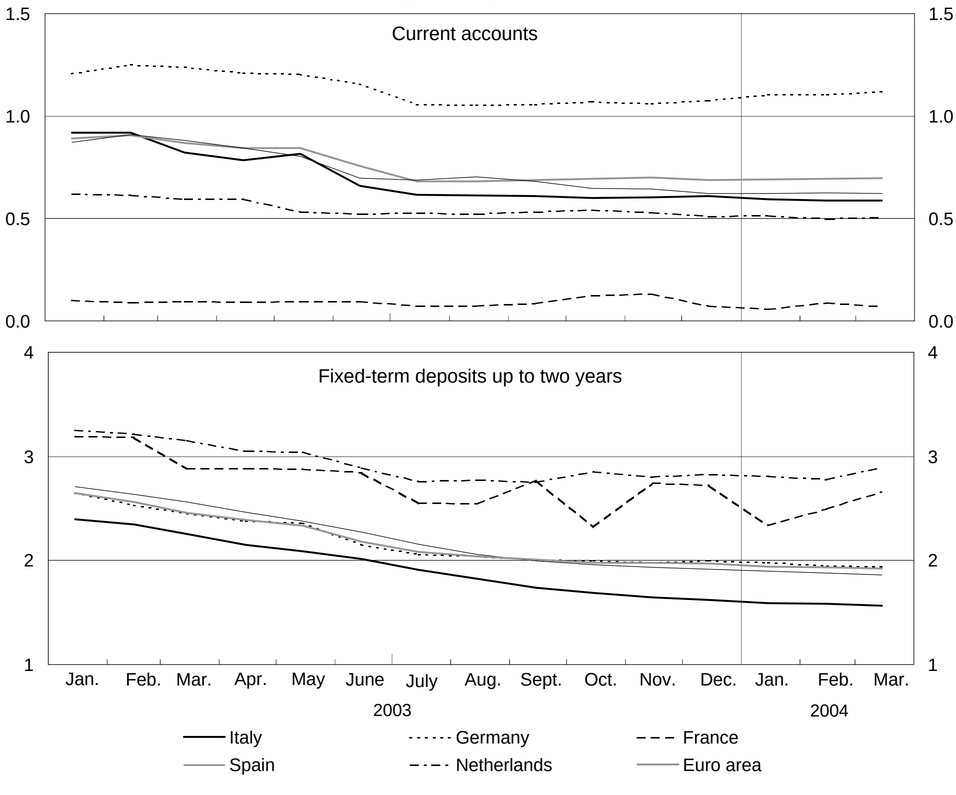
Banks' bonds continued to grow rapidly (8.6 per cent) and at the end of 2003 accounted for 36.3 per cent of total fund-raising, compared with 34.6 per cent in 2002. Subordinated bonds increased by 6.9 per cent.

Between January and December 2003 the rate of interest on households' current account deposits fell from 0.9 to 0.6 per cent in Italy and from 0.9 to 0.7 per cent in the euro area (Figure 36), with average inflation standing at 2.7 per cent. The average rate of interest on the deposits of households and firms declined by 0.4 percentage points in Italy and in the euro area, to 0.9 and 1.6 per cent respectively. The higher figure for the euro area is due to the greater popularity of longer-term deposits. The rates on households' deposits in the South of Italy are in line with those in the Centre and North.

Figure 36

HARMONIZED INTEREST RATES ON HOUSEHOLDS' DEPOSITS IN THE MAIN EURO-AREA COUNTRIES

(monthly data; percentages)



Sources: Based on ECB data and national statistics.

The securities portfolio and banks' net external position

The securities portfolio. – In 2003 the value of banks' securities portfolios, excluding the effect of variations in prices, increased by €6.9 billion, or 4.2 per cent (Table 44). The growth involved only private securities, principally bonds issued by banks, whose share of the total rose from 29.2 to 32 per cent. By contrast, the share of government securities fell by 4.3 percentage points to 58.5 per cent.

The ratio of liquid assets (cash and negotiable securities) to the aggregate of liquid assets plus loans diminished from 15.5 per cent to the historically low value of 15.3 per cent.

In 2003 the book value of banks' equity investments in companies resident in Italy, net of provisions funds and excluding investments on behalf of staff pension funds, rose from €69.4 billion to €84.7 billion; most of the increase can be ascribed to shareholdings in other banks and insurance companies, up from €43.1 billion to €55.7 billion. Shareholdings in non-financial corporations rose by a third compared with 2002 to a total of €8.3 billion; 85 per cent of this involved unlisted companies.

The net external position. – Italian banks' net external liabilities, excluding the effect of variations in exchange rates and prices, increased by €28.5 billion in 2003. At the end of the year their net external debtor position stood at €73.5 billion, equal to 3.5 per cent of total liabilities.

The balance on foreign currency assets and liabilities (net foreign exchange position) showed a deficit in all the main currencies. The share of net external fund-raising vulnerable to exchange risk decreased: in fact two-thirds of Italian banks' net liabilities were denominated in euros as opposed to about half in 2002.

The growth in net borrowing from non-residents reflected a sharp rise in liabilities, up by €29.3 billion and a marginal increase of €0.9 billion in assets. The largest expansion (€29.9 billion) was registered in net liabilities vis-à-vis non-euro-area residents, more than three quarters was in the United Kingdom.

Profit and loss accounts

According to data reported by individual Italian banks not consolidated at group level, net interest income rose by 1.8 per cent in 2003, compared

Table 46

PROFIT AND LOSS ACCOUNTS OF ITALIAN BANKS (1)

	2000	2001	2002	2003	2000	2001	2002	2003
	As a percentage of total assets				Percentage changes			
Net interest income (a)	**1.93**	**1.93**	**1.91**	**1.79**	**7.8**	**5.6**	**4.9**	**1.8**
Non-interest income (b) (2)	**1.76**	**1.75**	**1.47**	**1.41**	**20.6** ***(16.6)***	**4.1** ***(–3.7)***	**–11.9** ***(–8.2)***	**4.6** ***(8.0)***
of which: trading	*0.14*	*0.13*	*0.07*	*0.13*	*–13.6*	*–18.0*	*–42.9*	*96.6*
services	*0.81*	*0.67*	*0.59*	*0.55*	*21.4*	*–12.7*	*–7.7*	*0.9*
other financial operations (2)	*0.52*	*0.67*	*0.51*	*0.42*	*35.5* *(22.1)*	*34.7* *(17.4)*	*–19.0* *(–10.0)*	*–10.9* *(–8.6)*
Gross income (c=a+b) (2)	**3.69**	**3.68**	**3.37**	**3.20**	**13.5** ***(11.5)***	**4.9** ***(1.5)***	**–3.1** ***(–0.6)***	**3.0** ***(4.3)***
Operating expenses (d) (3)	**2.06**	**2.03**	**2.02**	**1.95**	**4.8**	**4.0**	**4.5**	**4.9**
of which: banking staff costs (3)	*1.16*	*1.11*	*1.10*	*1.07*	*1.0*	*1.0*	*4.9*	*5.2*
Operating profit (e=c-d) (2)	**1.63**	**1.65**	**1.36**	**1.25**	**26.9** ***(23.0)***	**6.1** ***(–2.2)***	**–12.5** ***(–8.6)***	**0.3** ***(3.1)***
Value adjustments, readjustments and allocations to provisions (f) (2) (4)	**0.36**	**0.66**	**0.56**	**0.53**	**10.4** ***(0.9)***	**91.3**	**–10.2**	**3.1**
of which: loan losses	*0.35*	*0.37*	*0.38*	*0.42*	*–11.8*	*11.0*	*7.5*	*20.4*
Profit before tax (g=e-f) (2) (4)	**1.27**	**0.99**	**0.80**	**0.72**	**33.4** **(34.9)**	**–17.9** **(–34.2)**	**–14.1** **(–7.0)**	**–1.7** **(3.1)**
Tax (h)	**0.48**	**0.39**	**0.30**	**0.22**	**32.5**	**–14.4**	**–18.8**	**–22.0**
Net profit (g-h) (4)	**0.79**	**0.59**	**0.50**	**0.51**	**41.9**	**–20.1**	**–11.0**	**10.7**
Dividends distributed	0.43	0.39	0.33	0.34	27.7	–3.7	–11.5	11.5
	Other data							
	Profit before tax				Net profit			
Profit as a percentage of capital and reserves (ROE) (5)	18.4	14.5	10.5	10.3	11.5	8.8	6.2	7.2
	Amounts				Percentage changes			
Total assets *(millions of euros)*	1,785,475	1,889,724	1,998,625	2,169,963	9.7	5.5	5.7	8.5
Average total number of employees	343,036	345,193	342,555	339,278	0.1	0.5	–0.7	–1.1
of which: banking staff	*339,054*	*342,279*	*340,560*	*338,189*	*0.1*	*0.8*	*–0.4*	*–0.8*
Total assets per employee *(thousands of euros)*								
at current prices	5,205	5,474	5,835	6,396	9.7	5.0	6.5	9.6
at constant prices (6)	4,614	4,723	4,911	5,243	7.0	2.2	3.9	6.8
Staff costs per employee (3) *(thousands of euros)*								
at current prices (7)	60.5	61.1	62.4	64.2	2.2	0.8	2.0	3.0
at constant prices (6) (7)	53.6	52.7	52.5	52.6	–0.4	–1.9	–0.6	0.4
Memorandum items: (8)								
Total assets *(millions of euros)*	1,789,484	1,893,413	2,006,180	2,174,484	9.4	5.8	6.0	8.4
Total number of employees (9)	344,348	343,814	341,614	337,665	1.1	–0.2	–0.6	–1.2
of which: banking staff (9)	*340,884*	*341,297*	*340,439*	*336,630*	*1.3*	*0.1*	*–0.3*	*–1.1*

(1) Rounding may cause discrepancies in totals. The data for 2003 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.

with 4.9 per cent in the previous year (Table 46). The slowdown was due to a narrowing of the spread between the average rate on loans and the average cost of funds and to losses on derivatives contracts. Income from services, which had declined in 2001, turned upwards, rising by 0.9 per cent.

Net income from trading in securities and other assets almost doubled with respect to 2002, partly owing to higher earnings from interest rate derivatives and fee income from trading in securities. By contrast, net income from other financial operations diminished. Excluding dividends on shareholdings in banks, which represent a duplication on a system-wide basis, gross income rose by 4.3 per cent.

Dividends from shareholdings and equity capital, which represent more than 90 per cent of net income from other financial operations, decreased by €1.1 billion, or 12.2 per cent. Only dividends paid by Italian companies were affected, partly due to a change in tax law (Legislative Decree 344/2003). Until the end of 2002, in fact, tax credits on dividends accrued by banks were usually entered under both fee income and tax charges. From 2003 this double entry system is no longer possible. As a result, gross income, net income, gross profits and taxes have all declined. Consequently, the aggregates are not fully comparable with those of the previous year. The discontinuity is less noticeable if dividend income on shareholdings in other Italian banks, which accounts for over half the total, is excluded from net income from other financial operations.

Total staff costs rose by 5.2 per cent, compared with 4.9 per cent in 2002, partly owing to the sharp rise in extraordinary charges for incentives to encourage early retirement. The average number of bank employees decreased by 0.8 per cent to 338,000. Costs per employee rose by 3 per cent to €64,200, over three quarters of the rise being due to wage increases provided for in the collective labour contract for the banking industry. Administrative expenses other than staff costs grew by 4.5 per cent, compared with 4 per cent in 2002.

Excluding dividends on bank equity, operating profit rose by 3.1 per cent last year, after decreasing by 8.6 per cent in 2002. Net value adjustments were 3.1 per cent higher and absorbed 42 per cent of operating profit. The increase concerned only loans, partly because of the writedown of loans to companies in the Parmalat group.

Profit after tax increased by 10.7 per cent. Return on equity, which is calculated on the sum of profit plus net income of foreign branches (€276 million) and withdrawals of €466 million from the fund for general banking risks, rose from 6.2 to 7.2 per cent.

INSTITUTIONAL INVESTORS

Italian institutional investors' consolidated net fund-raising rose by 6.1 per cent to €45.6 billion in 2003 (Table 47). Consolidated assets under management increased by 5.8 per cent to €1,006 billion; as a percentage of GDP they rose by 1.9 points to 77.3 per cent.

Table 47

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

	Net flows		End-of-period stocks			
					Percentage composition	
	2002	2003 (1)	2002	2003 (1)	2002	2003 (1)
Investment funds (2)	–12,340	6,628	360,557	378,781	33.6	33.0
Insurance companies (3)	34,813	46,310	283,569	329,879	26.4	28.8
Pension funds (4)	893	1,581	27,402	28,983	2.6	2.5
Individually managed portfolios	4,037	2,285	402,682	408,587	37.5	35.7
Total ...	**27,404**	**56,804**	**1,074,210**	**1,146,230**	**100.0**	**100.0**
Consolidated total (5) ..	**42,976**	**45,582**	**950,160**	**1,005,603**	**–**	**–**

Sources: Based on Bank of Italy, Isvap, ANIA and Covip data.
(1) Provisional. – (2) Harmonized investment funds and SICAVs. – (3) Technical reserves. – (4) Total balance sheet assets. – (4) Net of investments among the different categories of intermediary.

The share of households' financial assets invested in instruments offered by institutional investors was equal to 31.9 per cent (Table 48). The proportion of the total held in the form of investment fund units and insurance technical reserves increased by 0.3 and 1.1 points to 12.3 and 10.3 per cent respectively; the share of pension funds remained low at 1 per cent. Comparable figures for other countries in 2002 show that the share of households' financial investment channeled through institutional investors was smaller in Italy than in the other main countries.

In 2003 net fund-raising by Italian investment funds turned positive. A contributory factor, especially in the first half of the year, was the strong demand for funds specializing in short-term assets.

Table 48

ASSETS OF INSTITUTIONAL INVESTORS HELD BY HOUSEHOLDS IN THE MAIN EURO-AREA COUNTRIES AND THE UNITED STATES

(end-of-period data; percentages)

	1999				2002				2003 (1)
	Italy	France	Germany	United States	Italy	France	Germany	United States	Italy
	As a percentage of households' total financial assets								
Investment funds (2)	18.6	8.7	10.1	11.3	12.0	9.1	11.4	11.9	12.3
Insurance companies	6.1	21.8	19.5	7.0	9.2	28.9	22.7	9.1	10.3
Pension funds	0.9	–	1.9	19.6	1.0	–	2.0	18.5	1.0
Other institutions (3)	7.7	–	–	3.2	8.6	–	–	2.8	8.3
Total ...	**33.3**	**30.5**	**31.5**	**41.1**	**30.8**	**38.0**	**36.1**	**42.3**	**31.9**
	As a percentage of GDP								
Investment funds (2)	43.8	20.3	18.3	40.1	26.5	17.2	20.1	34.5	27.4
Insurance companies	14.4	50.9	35.3	25.1	20.3	54.9	40.1	26.3	23.1
Pension funds	2.0	–	3.4	69.9	2.1	–	3.6	53.6	2.2
Other institutions (3)	18.0	–	–	11.5	19.1	–	–	8.0	18.5
Total ...	**78.2**	**71.2**	**57.0**	**146.6**	**68.0**	**72.1**	**63.8**	**122.4**	**71.2**

Sources: Based on Eurostat, OECD, Bundesbank and Federal Reserve data.
(1) Provisional. – (2) Includes foreign funds. – (3) For Italy, individually managed portfolios net of investments in investment fund units; includes the portfolios of institutional sectors other than households.

Italian hedge funds, first introduced in March 2001, enjoyed further rapid growth, fostered by the supply of new instruments by Italian asset management companies. Net subscriptions came to €3.3 billion, while net assets totaled €5.8 billion at the end of the year.

After three years of negative returns, in 2003 Italian harmonized investment funds showed a positive average net return, albeit a modest one of 3.6 per cent. The best results were turned in by equity funds.

As in 2002, individually managed portfolios recorded a small net inflow of fresh funds. The financial result turned slightly positive (0.9 per cent). The share of total assets invested in private-sector bonds and Italian investment fund units increased.

The premium income of insurance companies rose by 11 per cent in 2003, slightly less than in the previous three years; technical reserves increased by 16 per cent. New life policies connected with individual retirement plans continued to grow.

Pension funds' assets increased by 5.8 per cent, thanks to the growth of the intermediaries established after the 1993 reform. The volume of resources under management is still very small, however. Occupational pension funds and open pension funds had average returns of 5 and 5.7 per cent respectively.

Securities investment funds

Fund-raising and net assets. – After three successive years of net outflows, in 2003 Italian investment funds registered a net inflow of €6.6 billion. Net inflows to foreign investment funds controlled by Italian intermediaries were larger (€15.6 billion, compared with €4.4 billion in 2002).

As in 2001 and 2002, the bulk of net subscriptions involved money-market and short-term bond funds; those of flexible funds, which have fewer restrictions on their investment strategies, were smaller. Other bond funds, equity funds and balanced funds registered net redemptions.

In most of the euro-area countries net fund-raising by harmonized investment funds increased significantly in 2003. From the second quarter there was a recovery in net subscriptions of equity and balanced funds and a parallel decline in those of bond and money-market funds.

In Italy the net assets of investment funds amounted to about €380 billion at the end of 2003; including Italian-controlled foreign funds, net assets totaled about €500 billion, an increase of 8.5 per cent with respect to the end of the previous year (Table 49). In the euro area the net assets of investment funds were equal to about €3,200 billion at the end of 2003, 12.6 per cent more than a year earlier.

In Italy the share of total assets of investment funds that invest in short-duration securities and therefore have a low exposure to interest rates rose between 2000 and 2003. The share of money-market funds and that of short-term bond funds grew by 17 and 11 percentage points respectively, to 21 per cent each at the end of last year. Meanwhile, those of other bond funds, equity funds and balanced funds declined to 22, 23 and 13 per cent respectively. In the euro area the share of total assets of money-market funds also rose significantly, from 14 per cent in 2000 to 20 per cent in 2003.

Table 49

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 intermedia-ries			
Net assets	2002	361	199	806	1,005	98	2,818	275	6,095
	2003	379	219	909	1,160	119	3,172	314	5,869
as a % of GDP	*2002*	*28.6*	*9.5*	*52.8*			*39.8*	*17.2*	*61.0*
	2003	*29.1*	*10.3*	*58.4*			*43.7*	*20.1*	*67.5*
Composition by sector									
Equity funds	2002	73	80	173	223	31	692	205	2,543
	2003	75	96	214	282	38	832	234	2,916
domestic	2002	9	2	0	....	2	15	16	....
	2003	12	25	105	....	3	174	135	....
euro area and European	2002	11	3	0	....	7	18	13	....
	2003	22	24	50	....	12	137	33	....
other	2002	52	75	173	....	22	436	176	....
	2003	40	47	59	....	23	208	66	....
Bond funds	2002	153	64	148	351	51	862	46	1,073
	2003	151	68	164	394	63	923	53	983
Balanced funds	2002	59	15	181	55	9	377	23	312
	2003	57	14	204	65	8	409	25	346
Money market funds	2002	76	39	304	88	6	590	2	2,166
	2003	96	39	329	77	10	640	3	1,625
Other funds	2002	0	2	0	49	0	58	0	0
	2003	0	2	0	56	0	82	0	0

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 composition data are not available for Ireland. – (4) The data for the Netherlands refer to December 2002.

Supply. – In 2003 Italian fund management companies continued to broaden the range of hedge funds and closed-end securities investment funds they offer. The number of harmonized open funds diminished for the second year in a row as a consequence of numerous mergers.

The number of operational Italian hedge funds rose from 48 to 80. These funds are characterized by a low correlation between their returns and those of broad market indices and the possibility they have to take leveraged positions. In Italy, nearly all of them invest in units of other investment funds, operating as “funds of funds”. In 2003 their net fund-raising rose considerably again, rising from €1.4 billion to €3.3 billion, while their net assets increased to €5.8 billion, or 1.3 per cent of the total net assets of Italian investment funds.

Investment funds that specialize in the listed shares of small and medium capitalization companies (market value of up to €800 million) are underdeveloped in Italy. According to a Borsa Italiana survey, in September 2003 there were only 38 such funds, compared with 178 in France and 196 in the United Kingdom. Their net assets amounted to €1.8 billion, equal to 1.7 per cent of the total for equity funds controlled by Italian intermediaries. In order to foster demand for this category of funds, Decree Law 269/2003 (ratified by Law 326/2003) reduced the rate of flat-rate tax on their operating result from 12.5 to 5 per cent.

The supply of exchange-traded funds (ETFs) on the Italian stock market expanded in 2003. In April 2004 there were 17 ETFs listed, compared with 8 in December 2002. Recent developments include the launch of the first ETF based on the S&P/Mib index of the Italian stock exchange and of two ETFs based on bond indices (the EuroMTS index of euro-area government securities and the iBoxx index of high-rated euro-denominated corporate bonds).

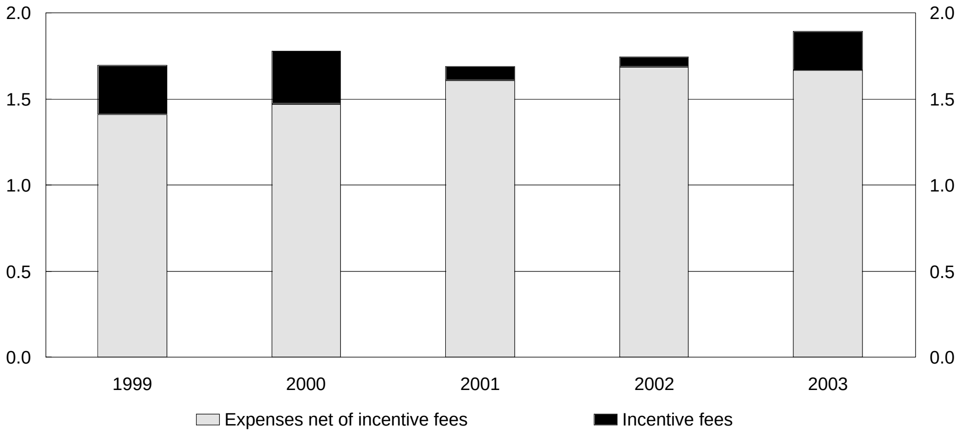
ETFs are collective investment vehicles with passive investment strategies designed to replicate financial indices. As they are listed on regulated markets, they can be traded during the day in the same way as any other share. ETFs have low management costs: annual management fees on Italian ETFs averaged 0.42 per cent (0.18 and 0.45 per cent for bond and equity funds respectively). In 2003 the average monthly trading volume in ETFs on the Italian stock exchange was €0.1 billion, compared with €3.5 billion on the German stock exchange and €1.4 billion on Euronext. Recent studies show that average bid-ask spreads on trades in ETFs in Italy are quite narrow, well below the ceilings set by the stock exchange.

Returns and fees. - In 2003 the average return on Italian harmonized investment funds was 3.6 per cent, compared with losses of 3.6 per cent in 2000, 8 per cent in 2001 and 9.1 per cent in 2002. The improvement last year was due to the recovery in share prices: equity, flexible and balanced funds returned an average of 10.1, 6.6 and 5.6 per cent respectively. By contrast, the performance of bond and money-market funds reflected the low level of interest rates, with returns of 1.6 and 1.9 per cent respectively.

In 2003 the total operating expenses paid by Italian harmonized investment funds (management fees, incentive fees, fees to depositary banks and other expenses) decreased by 4.8 per cent to €4.7 billion; those paid to management companies fell by 6.6 per cent to €4.2 billion. The decline was attributable to the lower average value of net assets and the rise in the market share of money-market and bond funds, which charge lower fees. The ratio of total expenses to average annual net assets rose by 0.15 percentage points to 1.89 per cent (Figure 37). The rise was entirely due to the increase in incentive fees from 0.06 to 0.23 per cent, slightly less than their level in 1999 and 2000 (about 0.3 per cent).

Figure 37

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



(1) Simple average of total operating expenses of the individual funds, calculated as the percentage ratio of average annual operating expenses to average annual net assets. Operating expenses include management fees, incentive fees, fees to depositary banks and other expenses; they do not include fees paid to intermediaries for brokerage services. The data are for harmonized investment funds and SICAVs. The data for the last two years are provisional.

The total expense ratio rose by 0.27 percentage points to 2.45 per cent for equity funds and by 0.13 points to 1.89 per cent for balanced funds. Bond and money-market funds' total expense ratios remained unchanged at 1.29 and 0.66 per cent respectively.

Data collected by Lipper, a company specialized in fund evaluation, on about 500 euro-area investment funds that began operations in 2003 permit an international comparison of the management fees paid by newly-established investment funds to their management companies. Last year average management fees paid by new funds were equal to 1.1 per cent, about 0.1 points less than in 2002. Management fees averaged 0.6 per cent for money-market funds, 0.8 per cent for bond funds, 1.2 per cent for balanced funds and 1.5 per cent for equity funds. For new Italian funds, management fees were slightly higher for bond and balanced funds, and lower for money-market and equity funds. However, management fees for equity funds do not include incentive fees, which are normally not charged in other euro-area countries.

Portfolio allocation. – In 2003 Italian harmonized investment funds made net purchases of securities of about €22 billion. Most of the buying came in the first half of the year and was concentrated in short-term and floating-rate

Italian government securities and foreign government paper. In the second half net purchases of government securities diminished considerably, while those of Italian private-sector bonds and above all foreign equities increased.

At the end of 2003 the portfolio of Italian investment funds was equally divided between Italian and foreign securities. The share of BTPs, which between 1999 and 2002 had remained at just over 20 per cent, fell to 18.5 per cent. Other government securities accounted for 22.6 per cent of the overall portfolio and Italian private-sector bonds and equities for 9.2 per cent. The share of foreign fixed-income securities remained at about 30 per cent, and that of foreign equities at 20 per cent. The share of assets denominated in currencies other than the euro decreased slightly to one fifth, of which equities accounted for 74 per cent, 5 percentage points more than a year earlier (Table 50).

Table 50

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 other currencies			Total portfolio (2)		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
Fixed-income securities									
Italian issuers									
Public sector	120.3	126.8	138.4	2.9	2.7	2.7	123.2	129.5	141.1
Banks	5.3	4.9	4.9	0.0	0.0	0.0	5.3	4.9	4.9
Firms	4.6	5.4	6.3	0.0	0.0	0.0	4.6	5.4	6.3
Foreign issuers									
Euro area	65.8	64.6	72.5	1.6	1.1	0.8	67.4	65.7	73.3
of which: government securities ...	*52.1*	*49.8*	*57.4*	*0.2*	*0.1*	*0.2*	*52.3*	*50.0*	*57.6*
Other	13.7	10.6	10.7	26.6	17.5	13.8	40.3	28.0	24.5
Equities									
Italians issuers	26.1	18.1	16.8	0.0	0.0	0.0	26.1	18.1	16.8
Foreign issuers									
Euro area	28.8	16.4	19.4	1.5	0.1	0.1	30.3	16.5	19.5
Other	0.1	0.1	0.1	72.5	48.0	50.5	72.5	48.1	50.6
Total ...	**264.6**	**246.9**	**269.1**	**105.1**	**69.4**	**67.9**	**369.8**	**316.3**	**337.0**

(1) The data refer to harmonized investment funds and SICAVs.

Individual portfolio management

The net flow of savings to individually managed portfolios was again very small in 2003 and declined from €4 billion to €2.3 billion (Table 51). Total assets under management edged up from €402.7 billion to €408.6 billion. The market share of investment firms fell from 8.5 to 5.4 per cent, that of asset management companies rose further, to 54.1 per cent, while that of banks remained virtually unchanged at 40.5 per cent.

Table 51

ITALIAN INDIVIDUALLY MANAGED PORTFOLIOS: SECURITIES PORTFOLIO

(millions of euros and percentages)

	2001	2002	2003 (1)	2001	2002	2003 (1)
	Net flows			End-of-period stocks *(percentage composition)*		
Italian fixed-income securities	**21,028**	**13,921**	**–13,002**	**39.6**	**47.1**	**44.5**
Short-term and floating-rate	745	12,641	–1,657	8.3	12.6	12.3
BOTs	217	1,721	2,771	0.6	1.1	1.9
CCTs	528	10,920	–4,428	7.7	11.4	10.4
Medium and long-term	20,282	1,280	–11,345	31.2	34.5	32.3
CTZs	–1,252	–211	210	0.9	1.2	1.2
BTPs	16,250	–2,457	–19,489	21.2	22.4	17.9
Other	273	1,606	141	0.7	0.8	0.9
Private-sector bonds	5,012	2,343	7,793	8.4	10.0	12.1
Italian equities	**–3,451**	**–2,735**	**–1,399**	**5.3**	**3.3**	**3.3**
Italian investment fund units	**–6,832**	**–11,980**	**7,210**	**35.6**	**29.0**	**31.7**
Foreign securities	**4,523**	**12,136**	**11,711**	**18.9**	**20.2**	**19.4**
Government securities and private-sector bonds	–1,006	6,363	10,707	4.5	6.0	7.3
Equities	–1,903	2,025	–508	2.0	1.6	1.6
Investment fund units	7,432	3,748	1,512	12.4	12.6	10.6
Other financial assets	**–7,393**	**–423**	**1,752**	**0.6**	**0.5**	**1.0**
Total portfolio	**7,875**	**10,919**	**6,272**	**100.0**	**100.0**	**100.0**
Memorandum items:						
Net fund-raising	**27,343**	**4,037**	**2,285**	–	–	–
Banks	–22,391	–13,036	–756	–	–	–
Investment firms	2,853	–1,802	–12,528	–	–	–
Asset management companies	46,881	18,875	15,569	–	–	–
Portfolio	–	–	–	**398,645**	**389,674**	**395,427**
Total assets under management	–	–	–	**410,406**	**402,682**	**408,587**

(1) Provisional.

In 2003 the sector's financial result (measured by the increase in net assets less funds raised, which approximates the return on the portfolio on the assumption that all income is reinvested) was slightly positive at 0.9 per cent after three years of losses.

The share of Italian public-sector securities in individually managed portfolios decreased, while that of private-sector bonds and Italian investment fund units increased.

Insurance companies and pension funds

Insurance companies. – In 2003 the growth in insurance companies' premium income slowed from 15 to 10.6 per cent. Premiums increased by 13.5 per cent in the life sector and 5.5 per cent in the non-life sector (Table 52). The rise in premium income was especially pronounced for with-profits life policies (16.5 per cent), but smaller for unit- and index-linked polices (8.1 per cent).

Table 52

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								
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	5,070	231,984	1,133	903	9,308	248,398	228,214	20,184	55,294
2003 (6)...	5,107	278,785	1,136	823	8,761	294,612	271,981	22,631	62,780
	Non-life sector (7)								
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	2,965	58,746	–2,814	4,581	9,095	72,573	55,355	17,218	32,415
2003 (6)...	2,497	63,051	–2,671	3,712	9,844	76,433	57,898	18,535	34,212
	Total								
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	8,035	290,730	–1,681	5,484	18,403	320,971	283,569	37,402	87,709
2003 (6)...	7,604	341,836	–1,535	4,535	18,605	371,045	329,879	41,166	96,992

Sources: Based on Isvap and ANIA data.

(1) Excluding branches of companies based in other EU countries and including those of companies based in non-EU countries. – (2) Including assets invested in individually managed portfolios. – (3) Net of corresponding liabilities. – (4) Net of reinsurance. – (5) Italian direct insurance; includes premium income of branches in other EU countries. – (6) Partly estimated. – (7) Includes companies engaged solely in reinsurance.

A survey of 397 Italian banks showed that in 2003 there were 102 life insurance companies with agreements to market their products through bank branches. About 30 per cent of the products were introduced in 2003, some 50 per cent in 2002 and 2003. The average guaranteed return on policies with a guaranteed minimum was 2.5 per cent (2 per cent for policies introduced in 2003).

Insurance policies connected with individual pension plans, which were introduced in January 2001, continued to grow. At the end of 2003 the technical reserves associated with these products amounted to €1.3 billion. At the same date, the assets of open pension funds, which can also be used as individual pension instruments, were only slightly larger (€1.7 billion).

Insurance companies' technical reserves increased by 16.3 per cent, in line with the rapid pace of the two previous years. At the end of 2003 they totaled €329.9 billion. The share of securities in insurance companies' assets continued to rise, while that of real estate declined further.

The percentage of government securities and private-sector bonds was broadly unchanged at 71.7 per cent, while that of investment fund units began to increase again and rose to 15 per cent. The share of equities slipped further to 13.3 per cent (Table 53). The proportion of foreign-currency securities fell to 1.6 per cent, while that of securities issued by non-residents rose further to 22.6 per cent.

Table 53

ITALIAN INSURANCE COMPANIES: SECURITIES PORTFOLIO (1)

(balance sheet values; end-of-period data in millions of euros)

	Securities denominated in euros					Securities denominated in other currencies		Investment fund units	Total
	Bonds and public-sector securities			Equities (2)	Total				
	Public-sector securities	Private sector bonds	Total				*of which*: equities (2)		
				Life sector					
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	94,294	74,920	169,214	17,648	186,862	5,079	1,031	40,043	231,984
2003 (3) ..	102,985	101,187	204,172	20,232	224,404	4,459	942	49,922	278,785
				Casualty sector (4)					
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	25,170	8,879	34,049	22,057	56,106	1,280	672	1,360	58,746
2003 (3) ..	24,768	12,038	36,806	23,544	60,350	1,181	648	1,520	63,051
				Total					
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	119,464	83,799	203,263	39,705	242,968	6,359	1,703	41,403	290,730
2003 (3)...	127,753	113,225	240,978	43,776	284,754	5,640	1,590	51,442	341,836

Sources: Based on Isvap and ANIA data.

(1) Including assets invested in individually managed portfolios. The portfolio of assets in respect of pension funds, unit- and index-linked products and companies engaged solely in reinsurance is partly estimated. Excluding the branches of companies based in other EU countries and including those of companies based in non-EU countries. – (2) Includes participating interests. – (3) Partly estimated. – (4) Includes companies engaged solely in reinsurance.

Pension funds and non-INPS social security funds. – The assets managed by pension funds rose to €29 billion, reflecting the increase from €4.5 billion to €6.3 billion in resources managed by funds set up after the reform of 1993 (Table 54). Nevertheless, pension funds continue to account for an extremely small share of households' financial assets (Table 48).

Table 54

ITALIAN PENSION FUNDS AND NON-INPS SOCIAL SECURITY FUNDS: MAIN ASSETS (1)

(balance sheet values; end-of-period data in millions of euros)

	2002				2003 (2)			
	Pension funds			Non-INPS social security funds	Pension funds			Non-INPS social security funds
		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)	
Securities portfolio	**20,985**	**16,493**	**4,492**	**21,731**	**21,908**	**15,586**	**6,322**	**19,237**
Liquid assets	3,827	2,986	841	12,385	3,038	1,989	1,049	9,620
Fixed-income securities	13,274	10,905	2,368	7,725	12,789	9,479	3,310	7,583
of which: *pubblic-sector* (4)	....	*923*	....	*3,117*	....	*860*	....	*2,774*
Equities	2,117	1,261	856	1,162	2,557	1,239	1,318	1,480
Investment fund units	1,768	1,341	427	459	3,524	2,879	645	555
Loans and other assets	**2,404**	**2,368**	**36**	**3,433**	**2,793**	**2,796**	**–3**	**3,289**
Real estate	**4,013**	**4,013**	**–**	**11,825**	**4,282**	**4,282**	**–**	**10,877**
Total	**27,402**	**22,874**	**4,528**	**36,989**	**28,983**	**22,664**	**6,319**	**33,403**

Sources: Based on Bank of Italy and Covip data.

(1) The composition is partly estimated. – (2) Provisional. – (3) Includes the Bank of Italy and UIC employees' pension funds. "Loans and other assets" is net of liabilities. – (4) For funds formed before the reform of 1993, the data refer only to intermediaries supervised by the Bank of Italy.

The portfolio allocation of pension funds did not change significantly. At the end of the year securities accounted for 76 per cent of their portfolio, real estate for 14 per cent and loans and other financial assets for 10 per cent. There were significant changes within the securities portfolio, however, as the shares of liquid assets and fixed-income securities declined considerably (to 16 and 57 per cent respectively), in favour of equities (11 per cent) and above all investment fund units (15 per cent).

The securities portfolio of pension funds set up after the 1993 reform has a smaller share of fixed-income securities and investment fund units (52 and 10 per cent respectively) and a larger share of equities (21 per cent).

According to data published by Covip, the Pension Fund Supervisory Authority, the average return of occupational pension funds was 5 per cent in 2003, while that of open pension funds was 5.7 per cent.

THE SECURITIES MARKETS

Share prices rose in Italy in 2003, thus ending a three-year decline. As in the other main international markets, the rise in equities reflected progressively firmer expectations of world economic recovery. The general index of the Italian Stock Exchange gained 15 per cent over the year. The volatility of prices fell to very low levels; in some sectors short-term earnings expectations improved significantly. Despite the upturn in prices, the ratio of current earnings to prices remained higher than the average for the period from 1990 to 2002 and close to the levels of the first half of the 1990s. Very few companies went public.

Yields on medium and long-term Italian government securities remained very low, albeit with considerable fluctuations, in an environment marked by contrasting signals about the strength of the economic recovery in the euro area and the absence of significant inflationary pressures. The real ten-year interest rate averaged about 2 per cent over the year, an historically low figure. The yield differential between ten-year BTPs and comparable Bunds, which was stable during 2003, began to widen again in the first quarter of 2004.

On the international bond market, the cost of borrowing in euros fell considerably; the yield differential between private bonds and government securities halved to 0.6 percentage points. The favourable trend in yields fostered an increase in bond issuance in the euro area. In Italy, by contrast, net bond issues decreased in 2003; placements by both large borrowers and smaller issuers were low by comparison with the four years from 1999 to 2002. The cost of financing for Italian non-financial corporations remained generally in line with that for corporate borrowers in other countries.

Since the Parmalat crisis in December 2003, bond prices on the secondary market have reflected a more selective attitude on the part of investors towards low-rated and unrated Italian firms.

Issuance of asset-backed securities continued to grow in Italy. Between 2000 and 2003 Italian gross issues of such securities accounted for 7.5 per cent of the European market total. The proportion of these securities backed by bank loans, which is by far the largest, is in line with that in the other main European countries. The market in credit derivatives continued to expand at a rapid pace.

Public-sector securities

Supply and demand. – Net issues of Italian public-sector securities declined from €29 billion to €21.3 billion (Table 55). The reduction reflected both the decrease in the overall general government borrowing requirement, which was largely due to the transformation of Cassa Depositi e Prestiti into a company limited by shares, and the greater amount drawn on the Treasury's payments account with the Bank of Italy.

Net issues were recorded for Republic of Italy securities, BOTs and BTPs (€5.6 billion, €5.9 billion and €31.8 billion respectively), while there were net redemptions of CTZs (€7.9 billion) and, for the sixth consecutive year, CCTs (€16.3 billion). The average residual maturity and the duration of outstanding government securities lengthened by 7 and 4 months, respectively, to 6 years and to 4 years and 1 month.

In September 2003 and February 2004 the Treasury inaugurated BTPs indexed to euro-area consumer price inflation, issuing a total of €13 billion of five-year and €8 billion of ten-year paper. The real yield at issue on the ten-year security was in line with that on comparable French government securities, approximately 2.3 per cent. Inflation-indexed securities meet the demand of investors, such as insurance companies and pension funds, especially interested in financial instruments that ensure a constant stream of income in real terms over medium and long-term horizons. Securities of this type allow issuers to achieve greater diversification of their forms of financing and risk.

Net local government bond issues accounted for a significant share of total public-sector issues in Italy. They amounted to €3.4 billion, an historically high figure although below the peak recorded in 2002 (€5.5 billion). Local government bonds constituted 1.5 per cent of the stock of Italian public-sector securities outstanding at the end of 2003.

Italian local authorities' recourse to bond financing has grown considerably in recent years. Around 89 per cent of their bonds are placed on the international market, generally through syndicates composed of banks of several countries. Nearly all the local government bonds outstanding at the end of 2003 were denominated in euros. More than half of the total were issued by regions of central Italy, a quarter by provinces and municipalities of the South and a fifth by those of the North. The majority of the securities have an original maturity of between 15 and 20 years and half are fixed-rate issues. More than a third of the international issues are rated on a par with Italian government securities (AA or Aa2), the rest are rated one notch lower.

Table 55

BONDS AND PUBLIC-SECTOR SECURITIES: ISSUES AND STOCKS IN ITALY (1)

(millions of euros)

	Gross issues			Net issues			Stocks		
	2002	2003	2004 Q1 (2)	2002	2003	2004 Q1 (2)	December 2002	December 2003	March 2004 (2)
Public sector	**441,628**	**454,505**	**154,116**	**29,016**	**21,259**	**39,135**	**1,157,224**	**1,174,303**	**1,214,904**
BOTs	208,761	214,093	72,955	–70	5,905	21,960	113,740	119,645	141,605
CTZs	32,556	31,185	11,150	8,335	–7,907	–1,151	59,193	52,636	51,900
CCTs (3)	44,535	38,313	11,525	–12,290	–16,348	–1,914	213,146	196,313	194,243
BTPs	133,646	144,882	49,270	42,364	31,764	14,877	670,615	700,655	715,650
Republic of Italy issues	16,135	21,998	8,387	4,388	5,582	5,157	81,033	83,759	89,911
Other	5,995	4,033	829	–13,711	2,262	206	19,497	21,295	21,595
Banks	**92,346**	**115,758**	**33,121**	**32,941**	**30,738**	**11,749**	**367,969**	**399,137**	**410,955**
Firms	**44,389**	**42,359**	**12,241**	**36,364**	**34,308**	**7,355**	**124,641**	**158,773**	**166,276**
Total ...	**578,362**	**612,621**	**199,478**	**98,321**	**86,305**	**58,239**	**1,649,834**	**1,732,213**	**1,792,135**
	Percentage composition (4)								
Public sector	**76.4**	**74.2**	**77.3**	**29.5**	**24.6**	**67.2**	**70.1**	**67.8**	**67.8**
BOTs	47.3	47.1	47.3	–0.2	27.8	56.1	9.8	10.2	11.7
CTZs	7.4	6.9	7.2	28.7	–37.2	–2.9	5.1	4.5	4.3
CCTs (3)	10.1	8.4	7.5	–42.4	–76.9	–4.9	18.4	16.7	16.0
BTPs	30.3	31.9	32.0	146.0	149.4	38.0	58.0	59.7	58.9
Republic of Italy issues	3.7	4.8	5.4	15.1	26.3	13.2	7.0	7.1	7.4
Other	1.4	0.9	0.5	–47.3	10.6	0.5	1.7	1.8	1.8
Banks	**16.0**	**18.9**	**16.6**	**33.5**	**35.6**	**20.2**	**22.3**	**23.0**	**22.9**
Firms	**7.7**	**6.9**	**6.1**	**37.0**	**39.8**	**12.6**	**7.6**	**9.2**	**9.3**
Total ...	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
As a percentage of GDP	*45.9*	*47.1*	*15.1*	*7.8*	*6.6*	*4.4*	*130.9*	*133.2*	*135.7*

(1) Rounding may cause discrepancies. – (2) Provisional. – (3) Comprises only variable-coupon Treasury credit certificates. – (4) The figures for the various types of public-sector securities are percentage ratios of total public-sector securities.

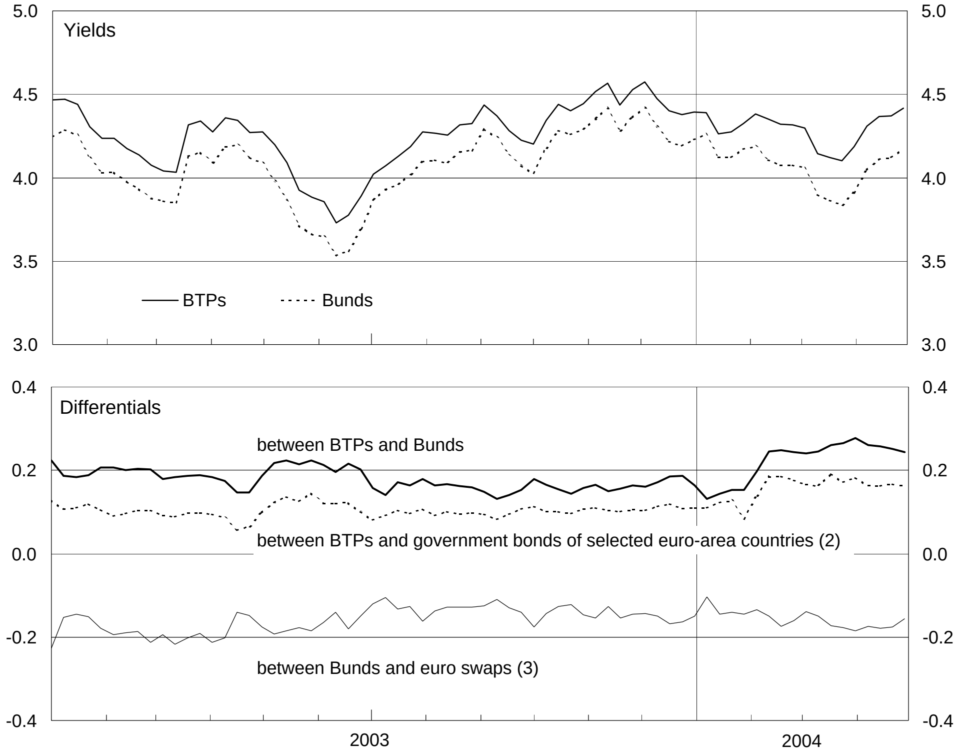
For the seventh consecutive year banks made net disposals of Italian public-sector securities, while Italian investment funds and non-residents continued to make sizeable net purchases. The low level of yields prompted the non-financial private sector, composed mainly of households, to reduce its portfolio of government securities by a very substantial amount. In 2003 the share of Italian public-sector securities held by non-resident investors rose from 43.3 to 48.7 per cent of the total.

Interest rates. – Medium and long-term interest rates fluctuated sharply during the year but at the end of 2003 were at approximately the same levels as a year earlier. The yields on five and ten-year benchmark BTPs were 3.5 and 4.4 per cent respectively (Figure 38), while the yield on thirty-year paper was 5.2 per cent.

Figure 38

GROSS YIELDS ON TEN-YEAR ITALIAN AND GERMAN GOVERNMENT BONDS AND MAIN INTEREST RATE DIFFERENTIALS (1)

(weekly averages; percentages and percentage points)



Source: BIS.
(1) Yields on benchmark ten-year bonds. – (2) Simple average of yield differentials between ten-year BTPs and the corresponding government securities of the countries that recorded a budget surplus in 2003 (Belgium, Finland and Spain). – (3) Differential between ten-year Bunds and ten-year euro swaps.

After remaining stable in 2003, the yield differential between ten-year benchmark BTPs and the corresponding German government securities widened slightly in the first quarter of 2004. Part of the increase was due to the substitution of the Italian benchmark security at the beginning of February; concern about a possible downgrade for Italy by a leading international rating agency also contributed. At the end of April 2004 the differential was about 0.25 percentage points (Figure 38).

The yield differential between Italian local government bonds and Italian Treasury securities is very small. Data on the secondary-market prices of a sample of euro-denominated, fixed-rate local government securities (representing about a quarter of all such issues and 57 per cent of the euro-denominated, fixed-rate issues) indicate that at the end of March 2004 Italian local government bonds were yielding an average of about 0.1 percentage points more than Italian Treasury securities.

The secondary market. – The volume of trading in Italian government securities fell in 2003, but liquidity conditions did not show strains. Average daily turnover in spot trading on the MTS screen-based market for government securities fell from €8.6 billion to €8.4 billion; the largest decline was in the BTP segment (13.2 per cent). Bid-ask spreads narrowed in all segments except BTPs, where they nonetheless remained small.

The market in interest-rate derivatives. – Driven up by the pronounced volatility of interest rates, average daily turnover in both ten-year Bund futures and three-month euro-deposit futures rose by more than 30 per cent. Options trading also grew appreciably.

Bank bonds and corporate bonds

Issuance. – Net issues of medium and long-term bonds by Italian banks, other financial corporations and non-financial corporations diminished by 4.5 per cent to €65.6 billion (Table 56). Net issues of such securities by non-financial corporations dropped from €6.6 billion to €3.7 billion; at the end of the year these companies still had €38 billion outstanding. Net issues by banks fell by 6.1 per cent, while those by other financial corporations, which include securitizations, rose by 6.3 per cent. In contrast with developments in Italy, in the euro area as a whole net issues by banks and firms increased, rising by 40.5 per cent to €365 billion.

The fall in net issues by Italian non-financial corporations is partly ascribable to a measure of difficulty Italian issuers encountered in tapping the international bond market after the defaults by Cirio in November 2002 and Parmalat in December 2003. On the basis of Dealogic data, gross bond issues on the international market by Italian non-financial corporations fell to €13.9 billion from an annual average of €19 billion in the four years 1999-2002; by contrast, those by their counterparts in the rest of the euro area rose from €113.2 billion to €125.4 billion. Around 80 per cent of the reduction is attributable to decreased borrowing by the ten largest issuers; there was also a decline in recourse to the market by minor issuers. In 2003 only 5 Italian non-financial corporations made small issues (for a total of less than €300 million), compared with an average of 13 in the four years 1999-2002. The number of unrated issues fell from 18 to 3 and that of new issuers from 9 to 5. In the first three months of 2004 issues by Italian non-financial corporations totaled €3.2 billion, against an average of €3.4 billion in the corresponding period of the four previous years. All of these issues were made by large groups.

Table 56

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
	2001	2002	2003	2001	2002	2003	2003
				Italy			
Banks	33,917	33,239	31,215	334,546	367,785	398,999	31
Other financial corporations	36,030	28,854	30,682	61,545	90,286	120,794	9
Non-financial corporations	7,013	6,584	3,659	28,286	34,869	38,494	3
Total ..	**76,960**	**68,677**	**65,556**	**424,377**	**492,940**	**558,287**	**43**
Memorandum item: International market (3)	75,303	36,151	43,897	216,517	249,819	291,188	22
				Euro area			
Banks (4).........................	196,895	116,244	182,364	2,668,658	2,779,068	2,940,201	41
Other financial corporations (4)	115,815	115,437	129,978	472,036	559,143	676,314	9
Non-financial corporations (4)	78,848	28,168	52,684	431,832	453,040	497,372	7
Total ..	**391,558**	**259,849**	**365,026**	**3,572,526**	**3,791,251**	**4,113,887**	**57**
Memorandum item: International market (3)	574,560	424,558	542,168	2,480,042	2,806,829	3,247,135	45

Source: For the euro area, based on ECB data.

(1) The nationality and sector refer to the issuer and not to its parent company, except as indicated. Only includes securities with a maturity at issue of more than one year. – (2) Difference between the face value of issues and redemptions. – (3) BIS data. The nationality and sector refer to the issuer's parent company and not to the issuer. Includes medium term notes with a maturity at issue of less than one year. The international market consists of bonds sold partly to residents of countries other than that of the issuer. – (4) The data do not cover some segments of the euro-area market, including securities issued by companies resident in Luxembourg and Ireland.

Net issues of asset-backed securities by Italian companies totaled €29.7 billion in 2003, about the same as in 2002. As in previous years, banks and public-sector bodies accounted for the majority of these issues. The largest issue (€3 billion) was in connection with the securitization of INPS claims for social security contributions.

Asset-backed securities have also expanded rapidly in the other European countries since the end of the 1990s. According to the Bond Market Association, between 2000 and 2003 some 58 per cent of European companies' total issues of €1.4 trillion consisted of securities backed by assets that remain on the balance sheet of the borrower (with characteristics similar to German Pfandbriefe). Between 2000 and 2003 Italian asset-backed issues accounted for around 7.5 per cent of the European total, similar to the French and Spanish shares (5.6 and 7.4 per cent respectively) but lower than those of Germany and the United Kingdom (51 and 14.9 per cent). On the basis of Dealogic data for the international market, between 2000 and 2003 the bulk of the securities in question are backed by assets held by the banking sector; the share was 61 per cent for Italian issuers, slightly less for French and UK issues (around 55 per cent) and substantially more for German and Spanish issues (91 and 95 per cent respectively).

Yields. – On the international market the yield on euro-denominated bonds of non-financial corporations with a high credit rating (at least BBB or Baa3) fell further in 2003 and then stabilized in the early months of this year; at the end of April it was equal to 3.9 per cent, an historically low figure. The fall in the cost of borrowing is attributable to the sharp contraction in risk premiums, as well as to a slight decline in long-term rates on government securities. At the end of April 2004 the yield spread between euro-denominated corporate bonds and government securities was 0.6 percentage points, about half what it had been a year earlier (Figure 39).

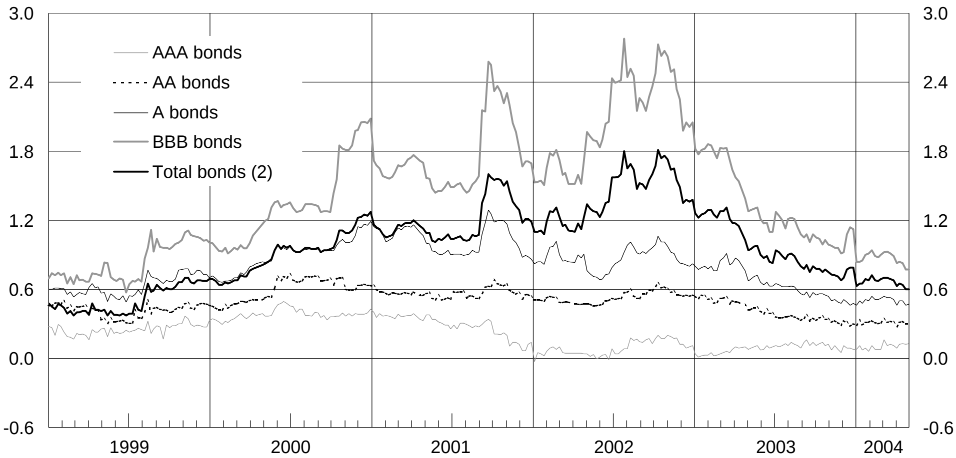
At the beginning of 2004 the substantial increase in risk premiums recorded between April 2000 and October 2002 had been completely absorbed. The sharp rise in the credit risk on corporate bonds during that period reflected the prolonged slowdown of the world economy and the consequent deterioration in corporate profitability. Another factor was the emergence of cases of serious accounting irregularities on the part of large companies (Enron and WorldCom in the United States, Vivendi in France and Ahold in the Netherlands), which raised doubts about the transparency of companies' accounts and the effectiveness of internal, external and public controls on issuers.

The contraction in risk premiums in 2003 reflected an appreciable decline in defaults and a gradual improvement in the ratings assigned by rating agencies. A contributory factor was growing demand for higher-yielding financial assets, given the very expansionary monetary policy stance in the main economies and the consequent abundance of liquidity and very low interest rates on government securities.

Figure 39

YIELD DIFFERENTIALS BETWEEN EURO-DENOMINATED CORPORATE BONDS AND GOVERNMENT SECURITIES (1)

(weekly data; percentage points)



Source: Merrill Lynch.
(1) 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 BBB or Baa3. The differentials are calculated with reference to French and German government securities of corresponding duration. – (2) Includes all high-rated bonds (i.e. rated at least BBB or Baa3).

Econometric analyses performed by the Bank's Economic Research Department on a sample of euro-denominated, fixed-rate bonds issued on the international market by European non-financial corporations indicate that the yield differentials vis-à-vis government securities respond to factors that affect the likelihood of default (such as the degree of a company's leverage, the interest rates on government securities and the variability of the company's share price) and factors connected with the liquidity of the bond market. However, like comparable studies of the US market, these factors only explain part of the variations in yield differentials.

The impact on yield spreads of changes in the issuer's leverage appears to be greater for short-term and riskier securities. Compared with the US market, the yield differentials of European corporate bonds are more sensitive to changes in leverage; this may be due to apprehension over the higher debt burden of some major telecommunications and automobile companies in Europe. In addition, liquidity conditions on the secondary market seem to have a greater impact on spreads in Europe.

For Italian issuers, the reduction in corporate bond yields during 2003 was in line with the general trend of the international market. Since December, following the Parmalat default, yields have risen for riskier Italian securities, whereas for high-rated Italian issuers they have remained virtually unchanged. Thus, although the Parmalat group's crisis has not had repercussions across the board, it appears to have led the market to become more selective towards unrated or low-rated Italian borrowers.

In the case of euro-denominated, fixed-rate bonds with a BBB rating, the average yield spread between Italian bonds and foreign securities of similar duration issued by companies in the same sector of economic activity was less than 0.1 percentage points in 2003. The primary market yields of bonds issued in the early part of 2004 were also in line with those of comparable foreign securities.

On the secondary market, after the Parmalat crisis broke the yield differentials of high-rated Italian paper with respect to Morgan Stanley indices for corresponding sectors and ratings were mostly unchanged. By contrast, price movements on the secondary market signal greater caution among investors regarding riskier Italian issuers. Between the beginning of December 2003 and the end of February 2004 the yields on a sample of unrated or low-rated Italian corporate bonds rose by an average of around 3 percentage points, while those on similar securities issued by firms of other countries showed no corresponding increase.

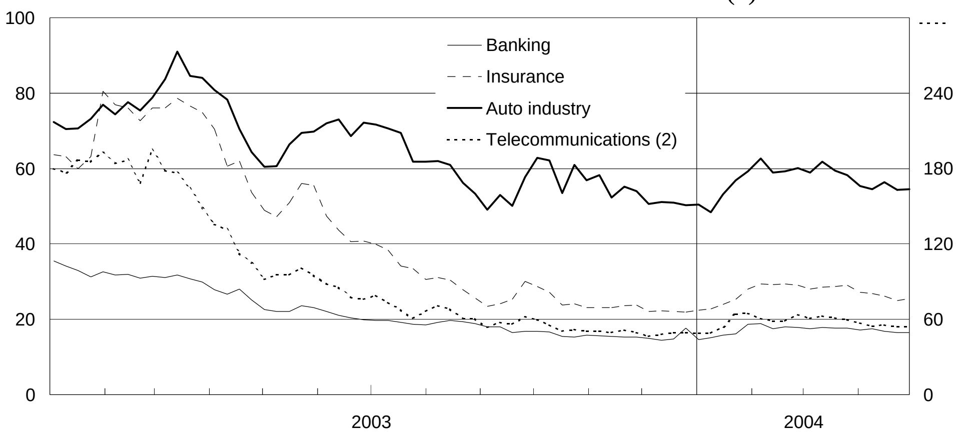
The credit derivatives market. – The credit derivatives market continued to expand in 2003. According to a recent estimate by the International Swaps and Derivatives Association (ISDA), the notional value of these derivatives rose over the year by 64 per cent to $3,600 billion. Their implications for the functioning of the financial markets are under examination in the international fora for cooperation among financial supervisory authorities.

The most frequently used instrument is the credit default swap, which gives the buyer the right to receive from the seller the nominal value of a security issued by a given company in the event that the company defaults. Since credit derivative swaps are only traded in over-the-counter markets, the features of individual contracts can vary on the basis of bilateral agreements between the parties. The market's consequent segmentation and the difficulty of providing unambiguous interpretations of the legal obligations of the parties hampered the market's growth for a considerable time. In 1999 the ISDA issued a series of guidelines for contracts (Credit Derivatives Definitions), which are now widely used by market participants. Following the proliferation of lawsuits over the obligations deriving from credit derivative swaps, the ISDA issued new guidelines in 2003. Although legal risks persist, in the most recent cases of default the contracts concluded under the new standards do not appear to have given rise to significant interpretative disputes. The growth of the market is also hindered by the as yet inadequate development of techniques for pricing these instruments. A further critical aspect is the possible occurrence of high risk concentrations among intermediaries, owing to the scant transparency of trades.

In 2003 the premiums on credit default swaps showed a general decline, in parallel with the yield differentials of bank bonds and corporate bonds with respect to government securities. The premiums on CDSs written on obligations of leading euro-area banks fell by a half to an average of less than 0.2 percentage points. Those on CDSs written on obligations of telecommunications companies, which had risen considerably in the preceding years in connection with the companies' increased leverage, plummeted from an average of 2.3 to 0.6 points (Figure 40).

Figure 40

PREMIUMS ON CREDIT DERIVATIVES FOR SELECTED EURO-AREA SECTORS (1)



Source: Based on Bloomberg data.

(1) Simple averages of premiums on 5-year credit default swaps written on senior debt in euros of the main euro-area companies belonging to the sector indicated. – (2) Right-hand scale.

Econometric estimates performed on credit default swaps that insure against the risk of default of an individual bank, based on a sample of contracts regarding the leading international banks, show that the premiums on these instruments are able to provide indications concerning the approach of a downgrade of the bank concerned by the main rating agencies. The information content of the premiums on credit default swaps is similar to that which can be extracted from the stock market prices of the bank's shares, but is appreciably greater than that transmitted by the yield spreads between the bank's bonds and government securities, which tend to move only with a lag. By contrast, none of these indicators provides significant information when a rating upgrade is imminent.

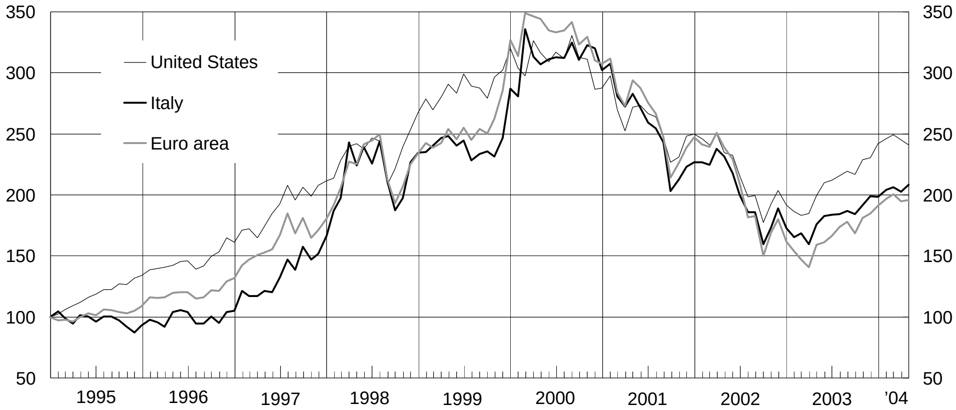
The equity market

Share prices and trading. – Share prices rose in the euro area in 2003, after three successive years of virtually uninterrupted decline. The Dow Jones Euro Stoxx index of the shares of the area's largest companies in terms of market capitalization gained 18 per cent (Figure 41). The increase in share prices in Italy was smaller (15 per cent).

Figure 41

SHARE PRICES (1)

(end-of-month data; indices, 31 December 1994=100)



Source: Bloomberg.
(1) Indices: MIB for Italy, Dow Jones Euro Stoxx for the euro area, Standard & Poor's 500 for the United States.

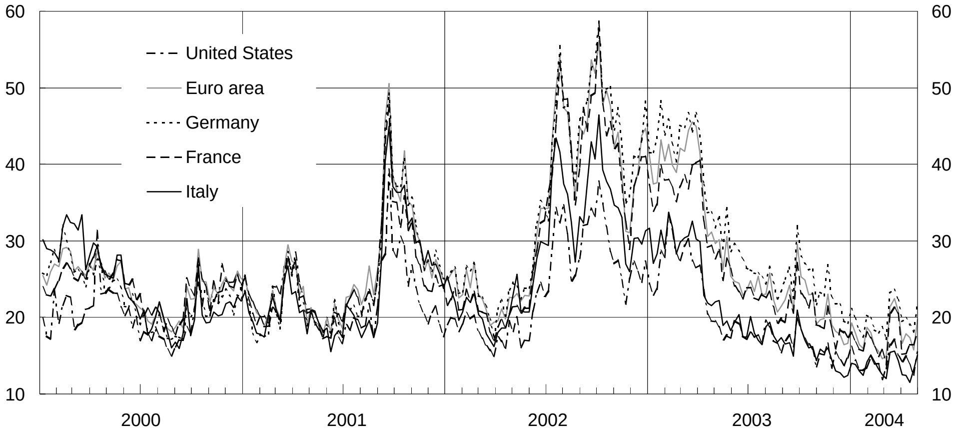
In the euro area, as in the United States, the rise in equities was propelled not only by expansionary monetary conditions but also by the reduction in real long-term interest rates, the increased profitability of listed companies and the decline in the risk premium demanded for holding shares. The main factor in reducing the risk premium was the diminution of uncertainty about the outlook for the world economy and, from the second quarter onwards, about the armed conflict in Iraq (Figure 42); a reduction in investors' risk aversion probably also played a part.

The fluctuations in investors' risk aversion in recent years have had a substantial impact on the performance of stock market indices and on savings allocation decisions. Indicators of risk aversion based on the prices of stock index options in Italy (the MIB30 index), Germany (Dax30) and the United States (Standard and Poor's 500) show that in these countries the risk tolerance of equity investors as a whole varies considerably over time; this could reflect both changes in investor preferences and changes in the type of investor active in the market. In the three share markets, moreover, risk aversion tends to move in the same direction. On the Italian stock exchange, since the mid-1990s risk aversion appears to have been affected especially by international events. It reached a peak in the autumn of 1998, at the time of the LTCM crisis. Its subsequent peaks occurred at the height of the technology bubble (in the first quarter of 2000), in the wake of the events of 11 September 2001, and between the summer of 2002 and March 2003 (a period marked by corporate scandals in the United States and the war in Iraq). Since April 2003 it has declined significantly.

Figure 42

EXPECTED VOLATILITY OF SHARE PRICES ON THE MAIN INTERNATIONAL STOCK MARKETS (1)

(end-of-week data; percentages)



Source: Based on Bloomberg data.
(1) Volatility implied by stock index options.

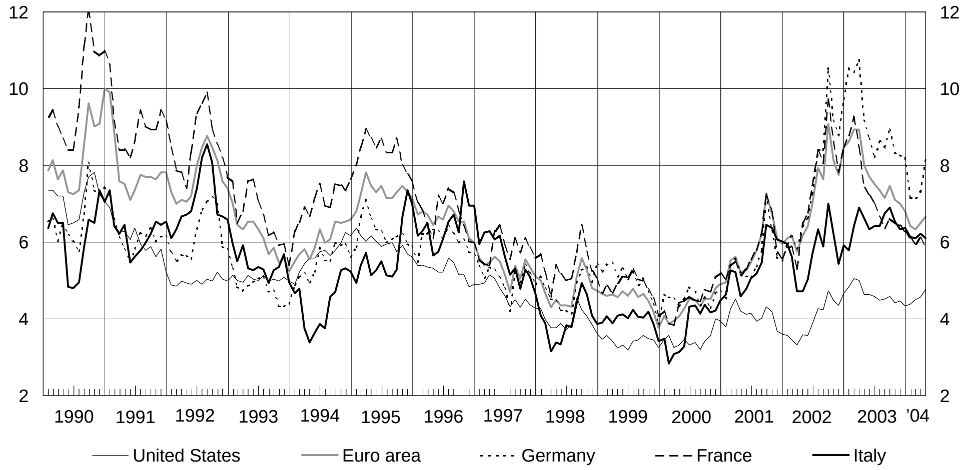
In 2003 the earnings prospects of euro-area listed companies benefited from the strengthening of firms' financial structures and the gradual improvement in expectations of economic recovery. According to data gathered by IBES, financial analysts' short-term forecasts for the earnings of listed companies in the three largest euro-area countries were lowered slightly in 2003; in the first quarter of 2004 they were raised. The downward revision of expected earnings growth over a medium-term horizon (five years), under way since 2001, came to a halt at the end of 2003. These predictions should be interpreted only as indicators of the trend of expectations, since analysts' growth forecasts systematically tend to overestimate the actual rate of earnings growth.

By comparison with the averages for the period 1990-2002, in April 2004 the current earnings/price ratio was about 1 percentage point higher in Germany and Italy, broadly unchanged in the United States and lower in France (Figure 43). Despite the substantial rise in share prices last year, in April 2004 the dividend yield in Italy (3.8 per cent) was appreciably higher than the average for the last fifteen years. The dividend yield was consistent with the real ten-year interest rate (2.3 per cent) and with the expectations of market participants (surveyed by Consensus Forecasts) for the Italian economy's long-term growth rate (1.9 per cent), assuming a risk premium of the order of 3 percentage points. The dividend yield for euro-area equity markets as a whole was also higher than the average for the last fifteen years and consistent with the forecasts for long-term growth in the major euro-area countries.

Figure 43

CURRENT EARNINGS/PRICE RATIOS IN SELECTED INDUSTRIAL COUNTRIES

(end-of-month data; percentages)



Source: Thomson Financial.

The recovery of the general index of the Italian Stock Exchange was led by bank shares. Compared with the euro-area as a whole, the gains were smaller in the telecommunications, insurance and electricity sectors. The index of auto industry shares fell in Italy, whereas it rose in the other countries. Small capitalization shares turned in especially positive figures, outperforming the general index by more than 6 percentage points and recording lower volatility as well.

During 2003 financial analysts' expectations for the earnings of Italian listed companies in 2004 held unchanged for the banking, insurance and telecommunications sectors and for the market as a whole; they were progressively revised upwards for the auto, oil and electricity sectors. In April 2004 financial analysts were forecasting higher profits in 2005 in all the main stock market sectors.

Average daily turnover of Italian shares on the Stock Exchange was unchanged in 2003 with respect to 2002 and equal to 0.5 per cent of total market capitalization. The shares included in the MIB30 index accounted for 89 per cent of total turnover, up from 87 per cent in 2002.

Supply and demand. – In Italy the rise in share prices has not been accompanied to date by a revival of initial public offerings. In 2003 there were just four new listings on the main market and one on the Mercato Ristretto (compared with five and two respectively in 2002) and none on the Nuovo Mercato (as in 2002). Initial public offerings and offerings by listed companies amounted to €8.7 billion (or around 2 per cent of total market capitalization), compared with €3.9 billion in 2002 (Table 57).

Table 57

MAIN INDICATORS OF THE ITALIAN STOCK EXCHANGE

(millions of euros, except as indicated)

	1999	2000	2001	2002	2003
Listed Italian companies (number at end of year)	264	291	288	288	271
of which: on the Nuovo Mercato	*6*	*39*	*44*	*44*	*41*
Total market capitalization (1)	726,566	818,384	592,319	457,992	487,446
of which: on the Nuovo Mercato	*6,981*	*22,166*	*12,489*	*6,438*	*8,265*
as a percentage of GDP	*65.6*	*70.2*	*48.6*	*36.3*	*37.5*
percentage breakdown: (2)					
industry	*20*	*21*	*23*	*25*	*23*
insurance	*11*	*14*	*13*	*11*	*12*
banking	*23*	*25*	*23*	*22*	*26*
finance	*3*	*3*	*3*	*3*	*4*
services	*43*	*37*	*39*	*39*	*35*
Total	**100**	**100**	**100**	**100**	**100**
Gross share issues (3)	22,543	9,148	6,171	3,894	8,710
of which: on the Nuovo Mercato	*280*	*4,402*	*222*	*115*	*5*
Market value of newly-listed companies (4)	189,822	29,764	10,554	5,142	1,412
of which: foreign companies	*119,415*	*0*	*0*	*2,067*	*0*
of which: on the Nuovo Mercato	*1,345*	*22,108*	*458*	*0*	*0*
Dividends distributed (5)	10,052	15,711	15,889	18,650	17,030
Earnings/price ratio (6)	3.4	4.5	6.0	5.9	6.4
Dividend yield (6)	1.5	2.1	2.8	3.8	3.4
Turnover:					
spot market (7)	*504,070*	*845,193*	*620,004*	*572,940*	*580,703*
MIB30 index futures	*905,841*	*984,392*	*829,416*	*673,836*	*527,024*
MIB30 index options	*264,181*	*323,166*	*246,555*	*176,513*	*153,998*
Annual change in prices (8)	22.3	5.4	-25.1	-23.7	14.9
Turnover ratio (9)	83	109	88	109	123

(1) Italian companies; at end of period. – (2) Excludes the Nuovo Mercato and the Mercato Ristretto. – (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 market values of each company at the IPO price. – (5) Source: Mediobanca. Total gross dividends for the financial year preceding that indicated in the table. – (6) Source: Thomson Financial. End-of-period data. Percentages. Current earnings and dividends. – (7) Italian companies. – (8) Percentage change in the MIB index during the year. – (9) Italian companies. Turnover as a percentage of average market capitalization for the year.

A total of 267 companies were listed on the Italian Stock Exchange at the end of March 2004, down from 288 at the end of 2002. Delistings were due in 10 cases to mergers and in 18 to residual-acquisition tender offers. Thanks to the rebound in share prices, stock market capitalization rose from €458 billion to €487 billion in 2003. As a ratio to GDP, it rose by more than

1 percentage point, to 37.5 per cent (in 2000 it had reached 70 per cent); at the end of 2003 this ratio was equal to 40.1 per cent in Germany, 69.3 per cent in France, 123.6 per cent in the United Kingdom and 129.9 per cent in the United States.

November 2003 saw the closure of the Mercato Ristretto of the Italian Stock Exchange and the simultaneous inauguration of the Expandi market for the listing of small and medium-capitalization companies. To be listed on the Expandi market, a company must have a forecast market value of at least €1 million and a free float of at least 10 per cent of the share capital and not less than €750,000. Companies must have published their last two annual accounts, of which the latest must have been audited, and satisfy other requirements concerning the results of the last two financial years and their degree of indebtedness. In March 2004 there were 11 companies listed on the Expandi market, with a market capitalization of €4.6 billion.

Decree Law 269/2003, ratified by Law 326/2003, introduced a temporary tax incentive in favour of companies admitted to listing on regulated markets between 2 October 2003 and 31 December 2004. The incentive consists in the reduction to 20 per cent of the income tax rate applicable to the first €30 million of income and applies to the tax period in which the listing took place and the two subsequent periods. Decree Law 269 also reduced from 12.5 to 5 per cent the flat-rate tax in lieu of income tax levied on the accrued operating result of UCITS specialized in small and medium-capitalization listed companies with a market value not exceeding €800 million.

The derivatives market. – The average daily number of trades in MIB30 futures was 13 per cent lower than in 2002. For MIB30 options, average daily volume was down by 3 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 2003.

In 2003 the persistence of the phase of weak economic activity, under way since the first quarter of 2001, and the failure of some industrial groups had limited repercussions on the overall situation of banks, thanks to the advances made by the banking system in strengthening its efficiency, risk management and capital buffers.

The effectiveness of supervisory action in pursuit of these objectives was recognized by the International Monetary Fund in its report on compliance of Italian supervisory rules and practices with the Core Principles for Effective Banking Supervision established by the Basel Committee in 1997.

The report, published in mid-May 2004, found that Italy's system of banking supervision was of a high standard. Prudential regulations were considered to be in line with the best practices indicated by the international organizations. A positive assessment was made of the Bank of Italy's independence in supervisory activity, its cooperation with the control authorities of other sectors of the financial system, the transparency of its acts, the breadth and completeness of off-site and on-site supervision, and the integrity and professionalism of the Bank's supervisory staff.

The IMF recommended that loan classification criteria be made more stringent, that rules on connected lending be strengthened, and that the Bank of Italy be given powers on the firms appointed to audit banks' accounts.

The IMF also observed that the Italian legal system did not offer legal protection to the Bank of Italy and its supervisory staff against court proceedings stemming from measures adopted in the performance of their functions in good faith.

Analysis of the factors of vulnerability of financial systems continued in the fora for international cooperation. The Financial Stability Forum considered the soundness of financial systems in the face of the adverse cyclical phase to be satisfactory. In connection with important cases of fraud and corporate failures, it examined the measures different countries had adopted to strengthen corporate governance rules and accounting practices. The Forum also checked the progress of regulatory and supervisory systems of off-shore financial centres.

The Basel Committee completed the revision of the Accord on banks' capital. The text of the new version, to be published in June 2004, will serve as the basis for the amendment of national regulations. The Accord will enter into force at the end of December 2006. For banks that choose to adopt the more advanced methods of calculation, the rules will apply starting from the end of 2007.

The European Commission implemented the final stages of the reform of regulation, supervision and financial stability in the European Union, applying the procedures already adopted in the securities sector to the banking and insurance industries. The Committee of European Banking Supervisors started to operate at the beginning of this year. It advises the Commission on banking regulation and promotes uniform application of Community directives, convergence of supervisory practices and cooperation.

Important progress was made towards the completion of the Action Plan for Financial Services, scheduled for 2005. In the early part of this year the directive amending the rules on investment services and that on takeover bids were approved.

Important amendments were made to Italian banking and financial legislation with a view to adapting it to new provisions introduced at national and Community level. The measures to coordinate the Consolidated Law on Banking and the Consolidated Law on Finance with the reform of company law mainly concern fund-raising by means of securities issues on the part of non-banks, the holding of equity interests in intermediaries, and the possibility of adopting the new one-tier and two-tier models of corporate governance.

In the asset management field, the amendments to the Consolidated Law on Finance are designed to increase asset management companies' operational flexibility and streamline the administrative procedures for market entry.

At the level of secondary legislation, the new provisions aim at broadening intermediaries' scope of operations and strengthening their capital base and organization. In particular, the supervisory rules applicable to Poste S.p.A.'s banking activity and to electronic money institutions were issued. The rules on maturity transformation and for the computation of third-party interests in banks' consolidated supervisory capital were amended. The provisions on the transparency of contractual terms and conditions were updated; they fully regulate the different phases of the relationship between the intermediary and the customer, such as the prior publicizing of terms and conditions, the form and content of contracts, and periodic and final statements of account.

The reorganization of the banking system proceeded in 2003, after the intense phase of mergers and acquisitions in the second half of the 1990s. Consolidation led to a further reduction in the number of banks, especially of smaller intermediaries. Large banking groups took further steps to rationalize their corporate structures and distribution networks in Italy as well as abroad; medium-sized groups, which are of recent date, are developing organizational models better suited to their size, in order to make governance more effective and production processes more efficient. Banks are continuing to integrate their distribution channels, not least to facilitate unitary management of relationships with customers.

In the securities intermediation sector, the trend towards specialization of asset management companies grew more pronounced. The number of investment firms contracted, primarily as a consequence of restructuring within banking groups, while that of financial companies entered in the special register increased, owing mainly to the creation of securitization special-purpose vehicles.

Bank loans grew rapidly, by 6.2 per cent, outpacing GDP. The bulk of new lending went to households and small enterprises.

The quality of banks' assets deteriorated slightly. The ratio of bad debts to total loans rose from 4.5 per cent in 2002 (a ten-year low) to 4.7 per cent; new adjusted bad debts rose to 1.2 per cent of the value of the stock of loans at the beginning of the year, compared with 1 per cent in 2002.

After declining in 2001 and 2002, banks' profitability showed a small improvement. On a consolidated basis, the rate of return on bank capital rose from 6.4 to 6.7 per cent; for the main groups it increased from 6 to 9.2 per cent, above all as a consequence of the curbing of costs and the upturn in non-interest income. Self-financing of €3.3 billion and capital increases amounting to €2.5 billion contributed to the growth of 4 per cent in banks' capital and reserves. The solvency ratio, calculated on a consolidated basis, edged upwards from 11.2 to 11.4 per cent for the banking system as a whole and from 10.6 to 10.8 per cent for the main groups.

As regards other supervised intermediaries, the profitability of asset management companies and investment firms improved, while the profits of financial companies fell to €340 million.

The number of banks that in off-site analysis received unfavourable overall assessments fell further, from 122 to 98; these banks accounted for 7 per cent of the banking system's total assets, compared with 23 per cent in 1997. The results of on-site inspections were consistent with these trends.

Supervisory evaluations of securities intermediaries remained broadly unchanged with respect to the previous year; in 2003, out of a total of 41 intermediaries found to be in an anomalous situation, 32 were investment firms accounting for 14 per cent of the sector's total revenues. Among financial companies, the share of total assets accounted for by those displaying anomalies fell from 21 to 13.4 per cent.

Banking supervision in 2003 focused primarily on strengthening capital bases; major banking groups made progress in achieving the target capital ratios recommended by the Bank of Italy, which are higher than the compulsory ratios. In view of the gradual adoption of the internal rating systems envisaged by the new Capital Accord, meetings were held with large banking groups to evaluate the steps taken with regard to the measurement and management of credit risk.

The supervision of securities intermediaries concentrated on risk management and control procedures and the functioning of information systems. Some intermediaries were asked to recapitalize in order to cover their losses or finance the investments needed to strengthen their production and control structures.

Supervision of compliance with the rules on transparency of contractual conditions remained intense, notwithstanding the legislative changes introduced during the year. Inspections carried out at branches of 134 banks found a progressive correction of the anomalies discovered in past years and greater attention being paid to regulatory compliance. In the years from 2001 to 2003, supervisory staff carried out 2,390 checks on transparency at branches of 220 banks.

In general, during the year supervision of banks and non-bank intermediaries aimed at ensuring the adequacy of capital and organization for the activity performed.

Banks attained higher standards of efficiency both in their organization and in their risk-management procedures. The improvement in profitability and capital strengthening enabled them to satisfy the borrowing needs of households and firms. In the asset management industry, diversification of the forms of managed savings increased. Among investment firms and financial companies, the process of defining organizational structures and the scope of operations went forward.

THE REGULATORY FRAMEWORK

International cooperation and Community legislation

The reform of financial regulation, supervision and stability in Europe. – In November 2003 the European Commission implemented the final stages of the reform of organizational structures in the field of financial regulation, supervision and stability in the European Union, which the Ecofin Council had approved in December 2002. The measures extend to the banking and insurance industries the regulatory procedures already adopted in the securities sector following the approval of the Lamfalussy Report in 2001.

On 1 January 2004 the Committee of European Banking Supervisors began work. It is composed of senior representatives of the supervisory authorities and central banks of the European Union and has a permanent Secretariat in London.

International cooperation. – The stability of financial systems is one of the key issues covered in the principal fora of international cooperation. Analyses were carried out to identify systemic vulnerabilities and assess intermediaries' ability to cope with the risks they assume. Moreover, in the light of serious cases of fraud and corporate failures, work on suitable means of strengthening the safeguards for the correct functioning of the markets continued. In particular, the analyses examined accounting practices, corporate governance and the effectiveness of regulation and supervision in offshore centres.

The Financial Stability Forum, set up in 1999 by the Group of Seven countries, expressed satisfaction with the resilience of financial systems, despite the prolonged period of unfavourable economic conditions. It also affirmed the need for standards and practices designed to increase their efficiency and soundness.

At Community level, the Economic and Financial Committee discussed the stability of financial systems at its twice-yearly meetings, during which it analyzed financial conditions in the EU. The Committee also evaluated the effectiveness and completeness of the EU's and individual member states' regulatory framework for supervision, including mechanisms for the exchange of information during crises.

The ESCB's Banking Supervision Committee conducted regular reviews of the efficiency and soundness of EU banks. In November 2003 the second report on the stability of the European banking system was published, accompanied by a report on its structural evolution.

Community legislation. – In 2003 and the opening months of 2004 progress was made towards the completion of the Financial Services Action Plan by 2005.

During the year Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision and Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading were approved. In April 2004 the European Council and Parliament approved Directive 2004/39/EC amending the provisions governing investment services. In the same month Directive 2004/25/EC on takeover bids was approved. It regulates conditions and procedures for mandatory and voluntary takeover bids and is an important step towards the creation of a European market in corporate control.

The reform of the capital adequacy rules

The Basel Committee completed work on the new version of the Capital Accord at its meeting of 11 May 2004. The text of the agreement will be published in June; for the authorities it will form the basis for amending national legislation and for the intermediaries the reference for adapting procedures and structures.

In accordance with the third consultation document published in April 2003, the Accord will come into force at the end of December 2006. However, banks that opt for the more advanced calculation methods, which require greater technical and IT resources, will have until 2007 to comply with the rules.

Changes have been made with respect to the April document in the method of calculating capital requirements for credit risk using internal ratings; only unexpected losses are now to be taken into account while expected losses must be covered by provisions.

At Community level work on the revision of capital adequacy rules for banks and investment firms continued, taking account of the institutions' comments on the consultation document distributed in July. The European Commission expects to submit a proposal for a directive to the Parliament and Council before the end of this summer.

Italian legislation

The reform of company law. – Legislative Decree 37 of 6 February 2004 introduces several measures to coordinate the reform of company law with the Consolidated Law on Banking and the Consolidated Law on Finance. The approach chosen enables banking and financial intermediaries to take advantage of the opportunities offered by the reform, while incorporating a few changes designed to preserve the supervisory objectives, notably the sound and prudent management of intermediaries.

The principal amendments to the consolidated laws concern fund-raising by non-bank intermediaries, the ownership structures of banks and financial and securities intermediaries, and governance and control models.

Legislation on the ownership structure of banks and other intermediaries has been amended to ensure that controls retain their effectiveness under the new civil law provisions. These allow firms broader scope to issue special categories of shares, with the freedom to adapt ownership and administrative rights, and non-equity instruments that nonetheless confer administrative rights.

In the field of corporate governance the amendments to the consolidated laws are aimed at ensuring the continued effectiveness of controls on key aspects for sound and prudent management. Moreover, in cases in which the new two-tier and one-tier management models are adopted, the control body is to perform the same role of liaison with the supervisory authority that the traditional model assigns to the board of auditors.

The amendments to the regulatory framework entail a broad revision of secondary legislation. In March 2004 the Bank of Italy issued the first provisions concerning the steps to be taken by banks and parent companies of banking groups when the new company law comes into force.

Implementation of Directives 2002/65/EC, 2002/87/EC and 2003/6/EC. – Law 306 of 31 October 2003 (the Community Legislation Implementation Law for 2003) delegates authority to the Government to issue legislative decrees implementing the Community directives concerning the distance marketing of consumer financial services (Directive 2002/65/EC), the supplementary supervision of credit institutions, insurance undertaking and investment firms in a financial conglomerate (Directive 2002/87/EC), and insider dealing and market abuse (Directive 2003/6/EC).

Regulation of banking foundations. – Decree Law 143 of 24 June 2003 ratified, with amendments, by Law 212 of 1 August 2003, exempts banking foundations with own funds of less than €200 million and those with operating offices mainly in special-statute regions from having to dispose of controlling interests in banks pursuant to Legislative Decree 153 of 17 May 1999 as amended. The deadline for compliance by other foundations is postponed to 31 December 2005.

The regulation of banking foundations was the object of two rulings by the Constitutional Court (Decisions 300 and 301 of 24-29 September 2003). The most important findings of Decision 301 were that regulations requiring that the majority of members of the governing board of a foundation be designated by local authorities was unconstitutional and that the provision on the joint control of banks by foundations would only be constitutional if it applied to cases where control was exercised by a number of foundations under specific agreements.

Transposition of the second directive on money-laundering. – Legislative Decree 56 of 20 February 2004 transposed Directive 2001/97/EC on the prevention of the use of the financial system for money laundering. The provision: extends the application of the rule to auditing firms and some professional categories (bookkeepers, accountants, auditors, notaries and lawyers); updates the list of financial intermediaries required to comply with anti-money-laundering requirements with the inclusion of electronic money institutes and loan guarantee consortia; and sets out the obligations of general government, central securities depositories, and companies that manage regulated markets, settlement services and clearing and guarantee systems.

Collective investment undertakings. – Legislative Decree 274 of 1 August 2003, issued under the mandate contained in the Community Legislation Implementation Law for 2002, transposed Directives 2002/107/EC and 2002/108/EC on collective investment undertakings. The Decree introduces some amendments to the 1998 Consolidated Law on Finance regarding the collective management of savings that are designed to give greater flexibility to asset management companies' activity and faster access to the market. The time limit for approval of fund management rules has been reduced from four to three months; the Bank of Italy indicates, according to the object of investment, the category of investor or the fund's operating conditions, the cases in which the fund management rules are deemed approved on a general basis; depositary banks may be assigned the task of calculating the value of investment fund units.

Transformation of Cassa Depositi e Prestiti. – Law 326/2003 transformed Cassa Depositi e Prestiti into a company limited by shares and regulated its ownership structure, governance and scope of activity. From a supervisory point of view, Article 5.6 states that the provisions of the Consolidated Law on Banking relating to financial sector operators shall apply to Cassa Depositi e Prestiti.

In addition to continuing its existing activity, Cassa Depositi e Prestiti may also expand its business, raising funds by issuing securities to finance the works, plant, networks and facilities needed to provide services to the public, taking out loans and engaging in other financial transactions, without guarantees from the State. It is not allowed to take sight deposits.

Loan guarantee consortia. – Law 326/2003 regulates the activity of loan guarantee consortia and is designed to strengthen their capital base and foster their scaling up in order to render credit more accessible to small and medium-sized enterprises. The new rules establish the activities in which such consortia may engage and their manner of operation and envisage the possibility of their becoming supervised financial intermediaries; they also entrust the central guarantee fund for small and medium-sized enterprises to a mainly publicly-owned company limited by shares and regulate the syndicated guarantee funds set up by the consortia.

Secondary legislation

Transparency of contractual conditions. – Rules updating and completing the regulation of the transparency of contractual conditions in bank and financial operations and services were issued in July 2003, thereby implementing the resolution that the Credit Committee had adopted on 4 March, acting on a proposal submitted to it by the Bank of Italy in January 2002.

The new rules concern the different moments of the customer's relationship with the intermediary: prior disclosure of the conditions of contract to allow comparison of the terms offered by different intermediaries; the customer's effective knowledge of the clauses drawn up by the intermediary; the form and content of the contracts; the periodic statements and the final statement of the account.

Shareholdings of banks and banking groups. – In August 2003 the rules requiring banks and banking groups to notify the Bank of Italy of all non-financial equity interests acquired by way of recovery of claims or in firms in temporary financial difficulties were modified. Banks and parent companies of banking groups must file a statement, once the projected transaction is approved, declaring compliance with the conditions established by the supervisory regulations and providing the information needed to evaluate the effects of the transaction on the acquirer's balance sheet and financial position.

Maturity transformation. – A measure was issued in December 2003 amending the supervisory instructions on maturity transformation. In the case of banking groups, the new rules only apply at consolidated level, so that they will be neutral for intermediaries' organizational decisions but will facilitate the integrated management of financial risks at group level.

In view of intermediaries' increased ability to manage financial flows and in order to simplify the rules, the scope for engaging in operations beyond the short term was extended with the aim, among others, of facilitating the financing of investment.

Minority interests. – In January 2004 provisions were issued restricting the inclusion of minority shareholders' interests in auxiliary companies belonging to banking groups for the purpose of computing supervisory capital.

Organizational requirements for operations in innovative sectors. – With a decision of 23 March 2004 the Credit Committee, acting on a proposal from the Bank of Italy, amended its resolution of 2 August 1996 concerning the administrative and accounting organization and internal control systems of banks. In particular, the Bank of Italy is to issue provisions establishing minimum standards for transacting business in highly complex and innovative sectors, such as credit derivatives, particularly with regard to organizational requirements and risk evaluation methods.

The financial activities of the post office. – A measure issued in April 2004 implementing Presidential Decree 144 of 14 March 2001, sets out the supervisory rules applicable to Poste Italiane S.p.A. in relation to its banking business. Although the new institution is not entered in the register of banks, it will be subject to the same supervisory regulations, bearing in mind its specific characteristics.

Capital adequacy requirements for counterparty risk. – Provisions were issued in May 2003 in connection with the start of the Clearinghouse's function, in some regulated markets, as central counterparty for trades in financial instruments. They authorize banks and investment firms to exclude from the calculation of capital adequacy requirements for counterparty risk all spot trades not yet settled in markets in which collateralization mechanisms based on daily margins operate.

Italian asset management companies and collective investment undertakings. – A measure of August 2003 completes the framework of regulations implementing Law 410 of 23 November 2001 on closed-end investment funds. As a result fund managements' rules are required to detail the methods used to advertise the funds' transactions as well as the standards and procedures for calculating the value of units in the event of new issues or redemptions. Tight limits have also been set on the amount of capital that real-estate investment funds are allowed to invest in building companies.

Financial intermediaries. – Two decrees were issued on 14 November 2003 by the Ministry for the Economy and Finance amending the provisions governing financial intermediaries. Their purpose was to allow a technical and organizational appraisal to be carried out at the time of entry in the special registry and to improve the reliability of intermediaries issuing guarantees to the public. In December 2003 the Bank of Italy issued the measures implementing the ministerial decrees.

Electronic money institutions. – In March 2004 supervisory instructions on electronic money institutions were issued, defining the characteristics of these intermediaries and of electronic money, regulating the granting of authorizations and establishing prudential rules.

To obtain authorization, electronic money institutions must have at least €1 million of capital and submit a programme of initial operations and a report on their organizational structure, detailing the method of issue of electronic money and of conversion back into legal tender.

The main prudential requirements are: supervisory capital must be equal to at least 2 per cent of liabilities for outstanding electronic money; sums received in respect of outstanding electronic money may only be invested in readily liquidable assets; the value of assets must at all times be at least equal to that of outstanding electronic money; and investments in property and shareholdings must not exceed 50 per cent of supervisory capital. A simpler set of rules has been drawn up for electronic money institutions operating on a smaller scale, which cannot do business in other EU countries under the principle of mutual recognition.

THE STRUCTURE OF THE FINANCIAL SYSTEM

At the end of 2003 Italy had 788 banks and 644 other supervised intermediaries (asset management companies, investment firms and financial companies; Table 58). These two categories of institutions administered assets, including those in custody or under management, worth respectively €1.63 trillion and €650 billion and provided financing of €1.36 trillion and €390 billion. Banks had 337,900 employees, other supervised intermediaries 22,800.

Table 58

THE STRUCTURE OF THE ITALIAN FINANCIAL SYSTEM

	31 December 2002			31 December 2003		
	Inter-mediaries	No. of branches		Inter-mediaries	No. of branches	
		Italy	Abroad		Italy	Abroad
Banks	**814**	**29,926**	**88**	**788**	**30,502**	**75**
limited company banks	*253*	*22,924*	*81*	*244*	*23,617*	*71*
cooperative banks (banche popolari)	*40*	*3,704*	*7*	*38*	*3,471*	*4*
mutual banks (banche di credito cooperativo)	*461*	*3,192*	*–*	*445*	*3,323*	*–*
branches of foreign banks	*60*	*106*	*–*	*61*	*91*	*–*
Investment firms	**158**	–	–	**132**	–	–
Asset management companies and SICAVs	**142**	–	–	**153**	–	–
Financial companies entered in the register referred to in Article 106 of the Consolidated Law on Banking	**1,459**	–	–	**1,494**	–	–
of which: entered in the special register referred to in Article 107 of the Consolitated Law on Banking	*316*	–	–	*359*	–	–

The number of banks decreased by 26 during the year. The number of asset management companies and financial companies rose, while that of investment firms fell further, from 158 to 132.

There were 82 banking groups, encompassing 225 Italian banks, 101 Italian asset management companies and investment firms and 240 Italian financial companies. They also included 80 foreign banks and 239 foreign non-bank intermediaries. The groups' instrumental companies numbered 178, including 35 foreign companies.

Banks and banking groups

In 2003 the reorganization of the banking system mainly concerned the development of operating structures following the wave of consolidation that began in the second half of the 1990s. Large groups took further steps towards integrating information systems and corporate procedures in the wake of mergers and acquisitions. Corporate organization was streamlined; marketing channels, branches and networks of salesmen were rationalized. The medium-sized groups that have come into being in recent years are developing organizational models better suited to their size, in order to make group governance more effective and production processes more efficient.

Restructuring was accompanied by a reduction in staff. Large groups, above all, again made greater use of early severance incentive schemes, according to policies established in recent years.

During the year 26 mergers and acquisitions were concluded, involving banks holding 1.7 per cent of the banking system's total assets. Further impetus was imparted to the reorganization of cooperative banks by the merger between the Banca Popolare Commercio e Industria and the Banca Popolare di Bergamo - Credito Varesino groups.

The top five banking groups together accounted for 51 per cent of total system assets, slightly less than in 2002. Meanwhile, smaller banks' market position strengthened, in part as a consequence of the opening of branches in areas where they had not been present. The number of banks and groups in which a majority interest is held by a foundation fell to 19, with 9 per cent of total system assets.

Access to the domestic market and presence abroad. – Seventeen banks began operations in 2003, compared with 23 in 2002; 5 were converted investment firms or financial companies and 5 were branches of foreign banks. A total of 18 banking authorizations were granted in 2003, one less than in 2002.

The number of Italian banking groups present abroad remained unchanged at 23. However, the number of branches fell from 88 to 75 and that of subsidiaries from 87 to 80; subsidiaries and branches in non-EU countries numbered 50 and 42 respectively, down from 54 and 47 in 2002.

The rationalization of the foreign network has concentrated in recent years on the disposal of shareholdings no longer considered to be strategic, such as those in Latin America, and the elimination of overlap between branches belonging to banks of the same group. Foreign units' overall share in total consolidated assets fell from 12 to 9 per cent, largely as a consequence of the appreciation of the euro during 2003. The leading Italian banking groups strengthened their presence in Eastern Europe. Italian banks are also paying increasing attention to the growth prospects of the Turkish, Russian and Chinese markets.

At the end of 2003 a total of 61 foreign banks (49 of them EU) were established in Italy with 91 branches, 15 fewer than at the end of 2002. The Italian subsidiaries of foreign groups numbered 16, of which 10 belonged to EU groups. The volume of assets attributable to branches and subsidiaries of foreign banks remained stable at 7 per cent of the total assets of bank units operating in Italy; foreign groups hold larger shares in such segments as securities transactions on regulated markets and corporate services.

Distribution. – The number of bank branches rose last year by 576 to 30,502. The number of financial salesmen used by banks fell by 6 per cent to around 34,600. Financial salesmen working for investment firms belonging to banking groups numbered around 6,200 at the end of the year. Electronic channels of distribution came into even wider use.

Relations between banks and insurance companies. – At the end of 2003 Italian banks held equity interests in 68 Italian insurance companies and 32 Italian insurance brokers, as well as 19 foreign insurance companies and brokers. Insurance groups held equity interests in 34 Italian banks. Five of these insurance groups (2 of which EU) held interests in the top 6 Italian banking groups. Controlling interests held by insurance groups involved 9 small banks.

Asset management companies

Last year 17 asset management companies were entered in the register and 6 deleted, for a net increase of 11; at the end of the year there were 150 registered asset management companies and 3 registered SICAVs (Table 59).

Asset management companies can be divided into two broad groups as regards specialization: 81 concentrate almost exclusively on open-end securities funds and 72 specialize in closed-end and hedge funds.

At the end of 2003 collectively managed portfolios in Italy had total assets of €555.8 billion; the assets under management by companies controlled by Italian investors amounted to €490 billion, including those entrusted to asset management companies established abroad. In 2003 Italian and foreign harmonized funds run by Italian intermediaries recorded net subscriptions of around €22 billion, compared with net redemptions of €8.2 billion in 2002.

Table 59

ASSET MANAGEMENT COMPANIES AND SICAVS

	31 December 2002		31 December 2003	
	Total	*of which: bank investee companies*	Totale	*of which: bank investee companies*
Asset management companies (1)	**142**	**88**	**153**	**93**
of which, instituting and managing:				
open-end funds	*73*	*44*	*71*	*46*
closed-end securities funds	*22*	*14*	*32*	*17*
closed-end real-estate funds	*8*	*6*	*11*	*6*
open-end and closed-end funds	*13*	*9*	*10*	*6*
hedge funds	*26*	*15*	*29*	*18*
Memorandum items:				
Companies offering individual portfolio management	63	43	63	43
Companies managing funds instituted by others	15	10	16	12
Companies instituting open pension funds	15	12	16	13
Foreign SICAVs and management companies (2)	**250**		**274**	
of which: SICAVs	*175*		*195*	

(1) The data include Italian SICAVs. – (2) 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 to 1,556 at 31 December 2003, 13 more than a year earlier (Table 60).

At the end of 2003 open-end funds, including non-harmonized funds other than funds of funds, had assets amounting to €384.3 billion; almost all of these assets (€372.6 billion) were under management by companies belonging to banking and insurance groups. After two years of negative results, in 2003 open-end funds registered net subscriptions and a positive result for the year (€6.5 billion and €12 billion respectively), increasing their net assets by 5 per cent. The assets of funds of funds rose to €7.8 billion.

Hedge funds experienced further growth in 2003; their number rose to more than 100 and their assets to €5.8 billion. Most of their assets (€5.4 billion) are invested in hedge funds run by managers based mainly in the United States, the United Kingdom and Switzerland.

The 53 closed-end funds in operation at the end of the year had assets of €1.5 billion (securities funds) and €4.4 billion (real-estate funds). The shares of 18 closed-end funds, including 11 real-estate funds, are traded on the Italian Stock Exchange.

Table 60

COLLECTIVE INVESTMENT UNDERTAKINGS

	31 December 2002	31 December 2003
Italian collective investment undertakings: total (1)	**1,543**	**1,556**
of which:		
Harmonized open-end funds and SICAVs	**1,201**	**1,142**
of which: equity	*609*	*548*
bond and money-market	*479*	*435*
other	*113*	*159*
Non-harmonized open-end investment funds	**218**	**233**
of which: non-reserved funds of funds	*179*	*187*
funds of funds reserved to qualified investors	*8*	*8*
other non-reserved funds	*1*	*1*
other reserved funds	*30*	*37*
Closed-end investment funds	**61**	**76**
of which: non-reserved securities funds	*15*	*16*
securities funds reserved to qualified investors	*26*	*35*
non-reserved real estate funds	*16*	*18*
real estate funds reserved to qualified investors	*4*	*7*
Hedge funds	**63**	**105**
of which: funds of funds	*53*	*90*
Foreign funds and sub-funds marketed in Italy	**3,051**	**3,178**

(1) Sub-funds are considered individually.

Foreign harmonized collective investment undertakings held more than €152 billion of assets in Italy. Around €120 billion of this total is attributable to Italian-controlled companies established for the most part in Luxembourg and Ireland. These companies received net subscriptions in Italy of €15.6 billion in 2003, compared with €4.4 billion in 2002.

Investment firms

The number of registered investment firms fell to 132 in 2003 (Table 61); more than 20 per cent of those in the register at the beginning of the year were deleted, mainly as a consequence of restructuring within groups. The investment firms still in operation engage principally in intermediation (trading for customer account, reception of orders) and placement services; many of them are controlled by insurance groups or individual investors.

Table 61

ITALIAN INVESTMENT FIRMS

	31 December 2002	31 December 2003
Italian investment firms	**158**	**132**
of which: bank investee companies	*64*	*50*
Memorandum items: authorizations issued for:		
Trading on own account	45	38
Trading on account of third parties	60	49
Underwriting	32	23
Placement without guarantee	112	86
Individual portfolio management	80	70
Reception of orders and mediation	89	73

A total of 63 notifications were received concerning the provision of services subject to mutual recognition pursuant to Directive 93/22/EEC by EU investment firms in Italy; in 3 cases services were to be provided through the establishment of a branch.

Financial companies

At 31 December 2003 there were 359 financial companies in the special register referred to in Article 107 of the Consolidated Law on Banking, up by 43 from a year earlier as a result of 56 additions and 13 deletions (Table 62). Most of the new entries were special-purpose vehicles (45).

The number of intermediaries other than special-purpose vehicles remained practically unchanged, as in the preceding years. The number of merchant banks declined further, while the number engaged in consumer credit and making loans secured by one fifth of salary rose.

Among financial companies owned by the public sector, the number of intermediaries operating on a nationwide scale increased with the addition, in particular, of Infrastrutture S.p.A., an intermediary owned by Cassa Depositi e Prestiti whose business is the financing of infrastructure and major public works.

Table 62

SPECIAL REGISTER OF FINANCIAL COMPANIES

	Number of companies				
	31 December 2002		Registrations	31 December 2003	
		of which: bank investee companies			*of which: bank investee companies*
Principal activity: (1)					
Financing	142	75	10	142	76
Leasing	*60*	*43*	*1*	*59*	*40*
Factoring	*37*	*19*	*1*	*38*	*18*
Consumer credit	*16*	*9*	*3*	*19*	*11*
Other	*29*	*4*	*5*	*26*	*7*
Equity investment	18	11	–	16	8
Credit cards	12	3	–	12	3
Foreign exchange intermediation	3	–	–	3	–
Securitization under Law 130/1999	141	31	46	186	40
Servicers	*8*	*1*	*1*	*8*	*2*
Special purpose vehicles	*133*	*30*	*45*	*178*	*38*
Total	**316**	**120**	**56**	**359**	**127**

(1) Determined on the basis of statistical reports and inquiries conducted during the year; companies may thus move from one category to another.

Banking groups continue to maintain a significant presence in the leasing, factoring and consumer credit sectors through financial subsidiaries. At the end of 2003 bank-controlled companies had 86 per cent of the leasing market and 64 per cent of the factoring market. For consumer credit, their share rose from 72 to 79 per cent over the three years 2001-2003, reflecting the banking system’s growing interest in the sector.

PROFITABILITY, RISKS AND CAPITAL ADEQUACY OF INTERMEDIARIES

Banks

In 2003 the Italian banking system's lending to the private sector again outpaced GDP. Most of the growth in credit involved lending to households and small and medium-sized firms.

The progress made in the second half of the 1990s in credit risk evaluation and management limited the impact of the protracted weakness of economic activity on banks' balance sheets. Bad debts rose moderately in relation to total loans.

The curbing of costs and the increase in non-interest income contributed to a moderate improvement in profitability. Both self-financing and equity capital raised in the market strengthened banks' capital base.

Lending. – Italian banks' outstanding loans to resident customers rose by 6.2 per cent, similar to the increase recorded in 2002 (Table 63).

Table 63

BANKS: LENDING AND RISK INDICATORS (1)

(end-of-period data; millions of euros and percentages)

	Loans			Bad debts as a percentage of total loans (3)	Adjusted new bad debts (4)	Amount of securitizations (5)	
	Performing loans		Bad debts (2)			Performing loans	Bad debts
		Substandard					
2000	858,818	19,182	51,933	5.7	1.0	6,751	8,390
2001	925,502	19,572	45,429	4.7	0.9	12,013	7,644
2002	980,435	20,476	46,325	4.5	1.0	12,461	2,426
2003	1,038,412	21,252	51,267	4.7	1.2	12,327	80

Sources: Central Credit Register and prudential reports.

(1) Lending to resident customers by banks operating in Italy. – (2) Includes unpaid and protested bills. – (3) Loans include bad debts and unpaid and protested bills. – (4) Adjusted new bad debts during the year as a percentage of performing loans at the end of the previous year net of repos, net interest to be debited to customers and adjusted bad debts. – (5) Annual flow.

The particularly low level of interest rates, together with the reduction in firms’ self-financing, stimulated the demand for credit. The rate of increase in lending to non-financial corporations and producer households rose from 4.9 to 6.7 per cent; that in lending to companies in the service and construction sectors was considerable (10.9 and 12.7 per cent, respectively).

Credit to consumer households continued to grow at a rapid pace (11.1 per cent) and at the end of year accounted for 22 per cent of the system’s total outstanding loans. At the same date 62 per cent of the total credit provided to households consisted of mortgage loans for the purchase of dwellings, 14 per cent was in the form of consumer credit and the rest comprised current account financing (10 per cent) and other credits.

Credit quality. – There was a modest deterioration in the quality of credit, reflecting the prolonged weakness of the economy and the financial crisis of the Parmalat group. The evolution of the risk on loan portfolios this year will largely depend on how the performance of the economy affects the financial situation of firms.

In 2003 loans newly classified as adjusted bad debts, an aggregate that includes exposures that only some banks report as bad debts, were equal to 1.2 per cent of outstanding performing loans at the beginning of the year, compared with 1 per cent in 2002. The ratio of adjusted bad debts to accounting bad debts rose to 108.6 per cent, after falling to 106.5 per cent in 2002 (Tables 63 and a31).

The ratio of bad debts to total loans rose from 4.5 to 4.7 per cent Tables 63 and a31); in March 2004 it was equal to 4.8 per cent. Excluding exposures to the Parmalat group, the ratio would have been 4.5 per cent, as in 2002. On the same basis, the ratio of new adjusted bad debt to outstanding performing loans at the end of the previous year would also have remained unchanged, at 1 per cent; for industrial firms it would have increased from 1.2 to 1.4 per cent.

Concentration risk. – There was a decrease in the banking system’s large exposures, largely attributable to the main banking groups. The amount of exposures that on a risk-weighted basis exceeded 10 per cent of a bank’s supervisory capital fell by 19 per cent to €65.2 billion (Table 64) and from 6.5 to 5.2 per cent of risk-weighted assets. The number of banks with loans exceeding the limit of 25 per cent of capital decreased from 40 to 33; the overshoots, consisting mainly of small positions, fell from €1,100 million to €240 million.

Table 64

RISK CONCENTRATION OF ITALIAN BANKS (1)

(end-of-period data; millions of euros)

	Total nominal exposure	Amount of large exposures (2)	Number of borrowers classified as large exposures	Number of banks reporting large exposures	Overshoots with respect to rules		
					Amount of overshoots (3)	Large exposures: number of borrowers overshooting	Number of banks with overshoots of large exposures
2002	112,446	80,672	1,994	435	1,125	132	40
2003	92,390	65,207	2,083	444	241	83	33

(1) Consolidated reports for banking groups and individual reports for banks not belonging to a group. – (2) Exposures, weighted for risk, that exceed 10 per cent of supervisory capital. – (3) Net of risk assets held on the trading book and loans disbursed before October 1993 with contractual maturity beyond 31 December 2001.

Instruments for transferring credit risk. – In recent years banks of the leading countries have made increasing use of instruments for transferring credit risk, such as securitizations and derivatives.

In Italy, between 1999 – the year Law 130 of 30 April 1999 governing securitizations came into force – and 2003, the loans securitized by banks through transactions under that law and by means of foreign special-purpose vehicles amounted to around €72 billion (6.6 per cent of the end-2003 stock of outstanding loans including bad debts), compared with €1.6 billion in the three years from 1996 to 1998. Securitized bad debts (€26.4 billion) amounted to 37 per cent of total securitized loans. An examination of the securitizations of bad debts carried out by Italian banks between 1999 and 2002 shows that the originators already discounted a maximum potential loss of 75 per cent on the nominal value of the loans, both as an effect of the value adjustments to the underlying portfolio (50 per cent) and because they repurchased the subordinated securities deriving from the operation (25 per cent). The loss taken on by the banks is thus larger than the average incidence of losses on bad debts (63 per cent); it follows that the amount of risk on non-performing loans transferred to others is very small. Securitizations are subject to specific prudential and financial reporting requirements.

At the end of 2003 Italian banks had outstanding transactions in credit derivatives totaling €87.9 billion (4 per cent of system assets), which was slightly less than a year earlier. Italian banks were sellers of risk-protection contracts for a notional value of €42 billion and purchasers for €46 billion. Most of the contracts relating to the investment book were for the purchase of protection, while in their trading activity, attributable to a small number of intermediaries, banks mainly sold hedges.

In consideration of financial, operational and legal risks, credit derivatives are subject to specific prudential and financial reporting rules; there are also provisions on organizational matters.

Country risk. – Italian banks' exposure to non-OECD countries was reduced by 23 per cent last year to €40 billion. In proportion to total assets, the exposure to high-risk countries fell from 2.7 to 2.1 per cent.

The decline is mainly attributable to the depreciation of the dollar against the euro, but it also reflects the change, under way for several years, in the main Italian banking groups' strategies of expansion abroad.

Value adjustments required by supervisory rules amounted to €1.2 billion, 35 per cent less than in 2002, and fell from 1.3 to 0.8 per cent of supervisory capital. The decline in these value adjustments was mainly a consequence of the reduction in exposures; the average adjustment rate decreased slightly (from 31 to 28 per cent of banks' exposures to risky countries).

Profitability. – After worsening in 2001 and 2002, the profitability of banks and banking groups improved slightly last year. The return on equity (ROE) rose from 6.4 to 6.7 per cent (Table 65). Banks accounting for more than half of the system's assets recorded an ROE higher than 8 per cent.

Gross income rose by 2.7 per cent to €65.8 billion. The increase was entirely due to the increase of 9.4 per cent in non-interest income; the latter's contribution to gross income rose by more than two percentage points, to 39.2 per cent (Table a32).

Set against the expansion of revenues, operating expenses remained broadly stable (€38.7 billion); staff costs rose by approximately 1.1 per cent to €25.1 billion. The cost-income ratio fell by almost two percentage points, to 58.9 per cent. In 2002, the last year for which comparable data are available, the ratio was around five points lower than the average for EU banks (66 per cent).

Revenue and cost developments produced an increase of 7.1 per cent in operating profit, which amounted to €27.1 billion; loan losses, affected by the value adjustments to the exposures to the Parmalat and Cirio groups, absorbed around €9.6 billion. Allocations to increase supervisory capital amounted to €3.3 billion, the bulk of which was attributable to the main groups.

The main groups' return on equity rose by more than three percentage points to 9.2 per cent, compared with an average of 16.2 per cent in 1999 and 2000. Last year's improvement in profitability came from the growth in income from securities trading and the decline of 3.5 per cent in operating expenses, the latter due in part to the curbing of labour costs; the cost-income ratio fell from 60 to 57.2 per cent.

Capital adequacy. – The banking system's supervisory capital, calculated on a consolidated basis, grew by €5.5 billion in 2003 to €139.8 billion (Tables 65 and a33).

Table 65

RESULTS OF THE MAIN ITALIAN BANKING GROUPS AND OF THE BANKING SYSTEM (1)

(millions of euros)

	Main banking groups (2)		Banking system	
	2002	2003	2002	2003
Operating profit	14,748	15,988	25,255	27,055
Charges for loan losses	6,555	5,426	9,128	9,582
ROE (%)	6.0	9.2	6.4	6.7
Allocations to supervisory capital	1,187	2,037	3,625	3,261
Capital increases (3)	–	10	864	2,495
Supervisory capital	72,474	72,825	134,385	139,837
Solvency ratio (%)	10.6	10.8	11.2	11.4
Capital excesses	18,567	19,876	39,605	42,505
Capital shortfalls	–	–	198	–

(1) Consolidated reports for banking groups and individual reports for banks not belonging to a group. Excludes the Italian branches of foreign banks. – (2) Six largest groups by total assets. – (3) Capital increases net of redemptions.

Risk-weighted assets grew by around 2 per cent, while the solvency ratio rose from 11.2 to 11.4 per cent. Capital in excess of the minimum requirements increased to €42.5 billion; all of the capital shortfalls existing at the end of 2002 were made good.

For the main banking groups, supervisory capital remained stable. The solvency ratio rose from 10.6 to 10.8 per cent. The increase of €2.3 billion in core capital was largely offset by the decrease in supplementary capital and the growth in unconsolidated equity investments.

The banking system's exposure to market risks remained unchanged at 5.4 per cent of supervisory capital; a reduction for the main banking groups (from 6.9 to 6.4 per cent) was accompanied by an increase for the remaining banks (from 3.6 to 4.2 per cent).

Italian banks and preparations for the new Capital Accord. – The completion of the revision of the Capital Accord prompted the main Italian banks to speed up their implementation of projects to improve the measurement and management of credit risk. The Bank of Italy held meetings with 13 large banking groups to check on the progress they were making in order to be able to seize the opportunities offered by the new rules. It was found that some groups, accounting for 55 per cent of total system assets, had already brought their credit process into conformity with international best practices and met the conditions for immediately beginning the activities necessary for the validation of internal rating systems, which could take place according to a timetable consistent with the entry into force of the new rules. Other groups continued to display some shortcomings with regard to the existence of integrated databases and the availability of time series on exposures, guarantees and recoveries related to groups of borrowers.

Asset management companies

Profitability. – Asset management companies made net profits of around €400 million in 2003, an increase of 19 per cent with respect to 2002 (Table 66). There were 46 loss-making companies (44 in 2002), mainly intermediaries that recently started operations, with losses amounting to €24 million.

The improvement in profitability came from the 15 per cent increase in gross operating profit, to around €1,600 million, as a consequence of the reduction in fees paid to distribution networks. Operating costs remained stable at around €1,000 million; staff costs, which account for 37 per cent of the total, rose by 8 per cent.

Capital and risks. – At the end of 2003 the supervisory capital of asset management companies amounted to €1,130 million, compared with minimum requirements of €453 million. Half of the requirement was for the amount of assets under management and the other half in respect of “other risks” (equal to 25 per cent of the fixed operating costs stated in the accounts for the last financial year). Six companies did not comply with the capital requirements at the end of the year.

Table 66

PROFIT AND LOSS ACCOUNT OF ASSET MANAGEMENT COMPANIES

(millions of euros and percentages)

	2002		2003	
	Amount	Percentage (2)	Amount	Percentage (2)
Revenue from management of own products	5,387	388.1	5,370	337.3
of which: from open-end funds	*4,786*	*344.8*	*4,745*	*298.1*
Revenue from management of others' products	410	29.5	338	21.2
of which: from open-end funds	*134*	*9.7*	*91*	*5.7*
Free payable	4,409	317.7	4,116	258.5
of which: maintenance fees	*3,264*	*235.2*	*3,026*	*190.1*
Gross operating profit	**1,388**	100.0	**1,592**	100.0
Administrative expenses	870	62.7	899	56.5
of which: staff costs	*354*	*25.5*	*384*	*24.1*
Value adjustments to tangible and intangible fixed assets	132	9.5	126	7.9
Other operating expenses (–)	34	2.4	18	1.1
Total operating costs	**1,036**	74.6	**1,043**	65.5
Other operating income	92	6.6	91	5.7
Net operating profit	**444**	32.0	**640**	40.2
Result on financial operations (1)	**128**	9.2	**56**	3.5
Result on ordinary activities	**572**	41.2	**696**	43.7
Extraordinary income/expense	31	2.2	10	0.6
Net change in provision for general financial risks	–3	–0.2	3	0.2
Taxes	262	18.9	306	19.2
Net profit (loss) for the year	**338**	24.4	**403**	25.3

(1) Includes net income from management of companies' proprietary portfolios. – (2) Amount as a percentage of gross operating profit.

Investment firms

Profitability. – Italian investment firms made profits of €128 million, compared with losses of €72 million in 2002. The improvement stemmed mainly from the results of own-account trading of the largest investment firm, a member of a leading banking group, which in 2004 has been transformed into a bank. Excluding that intermediary, investment firms basically broke even. The incidence of loss-making firms nonetheless remained high: 55 out of the 122 investment firms in operation made losses totaling €140 million.

Capital and risks. – At the end of 2003 the supervisory capital of investment firms amounted to €1,400 million, compared with €1,500 million a year earlier. Capital requirements, equal to the larger of the charge in respect of market and credit risks and that for "other risks" (25 per cent of the fixed operating costs stated in the accounts for the last financial year), totaled €700 million, compared with €530 million in 2002. At 31 December, 13 investment firms did not comply with the capital requirements, mainly owing to their losses for the year.

Financial companies

Credit risk. – At 31 December 2003 the gross loans of financial companies entered in the special register, excluding securitization vehicles, amounted to €110 billion, an increase of 4.5 per cent. As in 2002, the growth in loans (including bad debts) was moderate, particularly as regards forms of financing other than those targeted to consumer households.

There was an overall deterioration in the quality of credit disbursed by financial companies and it grew more pronounced in the second half of the year. At the end of 2003 bad debts, gross of value adjustments, amounted to €3,200 million. Their ratio to total lending rose by one percentage point to 2.9 per cent.

Profitability. – Financial companies made net profits of €340 million, a little more than half the previous year's figure. Net interest income increased by 15.4 per cent; the decrease of 1.6 per cent in interest income, a consequence of the small growth in the volume of operations, was more than offset by savings on the cost of funds.

Gross income rose by 3.2 per cent but registered a decrease in income from fees and dividends. Operating costs increased by 11.2 per cent, mainly in connection with the growth in staff costs. The loan loss rate rose from 1 to 1.2 per cent during the year.

Capital adequacy. – The supervisory capital of financial companies amounted to €8,850 million at the end of the 2003, up by 2.8 per cent from a year earlier despite the fact that 22 intermediaries recorded a loss for the year, with a significant erosion of own funds in half of the cases. The ratio of leasing, factoring and consumer credit companies' capital to risk-weighted assets was 6.3 per cent at the end of the year.

SUPERVISION OF BANKS AND OTHER INTERMEDIARIES

Criteria and methods of supervision

The supervisory activity of the Bank of Italy is directed towards ensuring the sound and prudent management of supervised intermediaries – banks, financial companies, asset management companies and securities firms – and the overall stability, efficiency and competitiveness of the financial system. It is aimed, in the first place, at securing full compliance by supervised intermediaries with the provisions of law and regulations and inspired by criteria deriving from Italian legislation, Community law and principles agreed by the international community.

The entrepreneurial nature of banking and financial activity means that there must be respect for the autonomy of intermediaries in determining company policies and making individual decisions, especially those relating to the financing of customers.

The protection of stability is pursued by requiring supervised intermediaries to have capital buffers commensurate with the risks taken on and appropriate organizational structures.

The examination of an intermediary's technical profiles and organizational structures is conducted through off-site and on-site controls. These contribute to forming the overall evaluation of the company's situation, on whose basis supervisory measures and corrective actions are taken where necessary.

Off-site controls are performed systematically. They are based on information and documents acquired by the Bank of Italy through statistical reports and meetings with corporate officers. Inspections, carried out according to schedules and on the basis of the needs arising from off-site analysis, are aimed at checking the quality and correctness of the data and information provided for such analysis and supplementing it with more thorough examination of the organizational profiles of the activity performed by intermediaries.

There are limits to what can be learned through supervisory activity. The data in the possession of the Bank of Italy cannot cover the entire range of information that intermediaries acquire from customers. Supervisory activity presupposes that the data on the balance sheet and financial situation of borrowers are correct, not invalidated by fraudulent alteration or manipulation on the part of customers themselves.

The analysis of intermediaries focuses on the risks assumed. For credit risk, the assessment is designed to check the overall quality of loans and their concentration. Securitizations and transactions in credit derivatives are examined as part of these checks.

With regard to security intermediation, supervisory analysis concerns investment activity carried on for own account and for third parties. The Bank of Italy cooperates closely with Consob in this field and notifies it of any violations of the provisions on transparency and correctness that it has found in the course of supervisory controls. In some cases inspections are carried out at the specific request of Consob, according to the indications it provides case by case.

When the overall assessment of an intermediary is not positive, supervisory action consists of interventions whose forms and intensity are calibrated to the nature and importance of the shortcomings detected (for example, application of additional capital requirements, prohibition of undertaking new transactions, preparation of plans to eliminate inefficiencies). Where significant violations of the rules, irregularities or serious capital losses are found, especially rigorous measures are adopted, up to special administration and compulsory liquidation or, in the case of financial companies, deletion from the special register.

Supervision of banks and banking groups

The evaluation of banks situations. – The supervisory evaluations performed in 2003 (based on data for the 2002 financial year and information acquired during the first half of 2003) were favorable for 299 banks, intermediate for 316 and unfavorable for 98. The number of banks with a negative evaluation decreased; such banks accounted for 7 per cent of the banking system's total assets, compared with 23 per cent in 1997.

The improvement in overall evaluations last year was the consequence of better scores for credit risk and capital adequacy; the evaluations of organizational structure, profitability and liquidity remained virtually unchanged.

Supervisory interventions. – Supervisory interventions in 2003 were mainly directed towards strengthening the capital bases of large groups in terms of both the amount and the composition of own funds. The steps taken to limit the extent to which minority interests could be counted in consolidated capital were especially important.

The top 13 banking groups made progress in reaching the target ratios recommended by the Bank of Italy in 2001 (6 per cent of risk-weighted assets for tier 1 capital and 10 per cent for total capital). At the end of 2003 the average ratio for core capital was 6.3 per cent (5.4 per cent in 2000), while the average ratio for total capital was 10.4 per cent (8.7 per cent in 2000).

For the banking system as a whole, the interventions regarding the different technical profiles concerned 450 banks. During the year 456 meetings were held with banks' corporate officers, 225 at the Head Office and 231 at the Bank's branches. A total of 403 formal action letters were sent with observations regarding one or more profiles; 92 of these letters were sent to banks with unsatisfactory evaluations.

The organizational measures taken by banks with regard to corporate governance and internal controls on risk were reviewed in depth. Procedures for selecting and monitoring credit and market risks received special attention in discussions with banks.

In view of the prospective adoption of internal rating systems under the new Capital Accord, meetings were also held with banks' corporate officers to evaluate the activities initiated by 13 large banking groups..

On market risks, the validation of banks' internal models for the calculation of capital requirements continued. In 2003 the Bank of Italy validated the internal model of an intermediary belonging to one of the largest Italian banking groups, the second such procedure concluded after that performed for another large banking group, and initiated the procedures for two other banks.

As regards operational risks, the Bank of Italy held consultations with banks on the decisions under consideration by the Basel Committee and the European Union. It is closely monitoring the work begun by some banking groups to prepare advanced measurement systems.

Special attention was paid to the issue of business continuity. The need for a strengthening of the standards that operators are required to meet has emerged, partly in the light of the experiences at international level following the events of September 2001. The prevailing orientation is that the measures aimed at ensuring business continuity must not be limited to information systems but must also cover other factors that can affect business activity (for example, the preparation of contingency plans for the utilization and availability of human resources, access to buildings, the use of alternative, non-standard operating processes). In order to guard against systemic risks, it is considered necessary for larger intermediaries to adopt more rigorous systems and procedures than others in accessing financial markets and the main components of the payment system.

The examination of the levels of service provided by outsourcers, notably those of minor banks, led to interventions aimed at eliminating the most significant shortcomings found; intermediaries and some service providers were firmly reminded of the necessity of adopting disaster recovery procedures able to ensure business continuity.

Supervision of asset management companies and investment firms

Analysis of intermediaries' situations. – In a context marked by uncertainty in financial markets, the supervisory evaluations of intermediaries in 2003 did not differ substantially from those of the previous year; a considerable number again showed inadequate profitability.

The number of intermediaries with unsatisfactory evaluations fell from 54 to 41 (32 investment firms and 9 asset management companies), primarily as a consequence of the exit from the market of 9 investment firms that in 2002 had been found to have acute technical and organizational imbalances. The investment firms with unsatisfactory evaluations accounted for 14 per cent of the sector's total revenues (11 per cent in 2002), the corresponding asset management companies for only a marginal share of total assets under management (0.17 per cent).

Most of the asset management companies awarded unfavourable scores were recently formed companies whose efforts to achieve their fund-raising objectives were penalized by the performance of the financial markets in the last two years. Two of them, having verified the impossibility of fulfilling the business development plans envisaged at the time of their entry in the register, initiated the liquidation of their funds.

Supervisory interventions. – In 2003 the Bank of Italy carried out a total of 241 supervisory interventions (108 letters and 133 meetings) involving 157 intermediaries (81 investment firms and 76 asset management companies). Close coordination between the Head Office and the Bank's branches in conducting analyses ensured the efficacy and continuity of supervisory action, which has intensified in the last two years.

The action letters were mainly addressed to investment firms that engage in trading for customer account, placement and portfolio management, which were called on to take remedial action to ensure the reliability and operational efficiency of their organization. Requests were made for firms to recapitalize in order to make good their accumulated losses and finance the investments needed to strengthen their production and control structures.

Most of the interventions involving asset management companies concerned insufficient formalization of decision-making processes and internal procedures, inadequacies in information systems, and substandard services provided by outsourcers. Small asset management companies were invited to evaluate the repercussions of the modest growth in funds under management on profitability performance and, in the long run, on the companies' stability.

The meetings with corporate officers of investment firms and asset management companies examined the organizational structure and control systems of intermediaries that have more complex operations or make significant use of outsourcing of the main corporate functions.

Supervision of financial companies

Analysis of companies situations. – In 2003 the models of supervisory analysis continued to be extended to companies entered in the special register that are active in sectors other than leasing, factoring and consumer credit. Specific examinations were conducted of financial intermediaries with atypical operations.

In the securitizations sector, servicers were checked for constant monitoring of movements involving securitized assets, while controls on securitization vehicles centred on the set-up and orderly performance of securitizations and on compliance with the rules on financial reporting.

The number of financial companies that received satisfactory evaluations (28) was almost unchanged. The number whose situations showed anomalies rose from 30 to 36 but their share of total assets fell from 21 to 13.4 per cent, thanks to the improvement in the technical situation of some medium-sized/large intermediaries.

Supervisory interventions. – A total of 149 supervisory interventions were carried out in 2003, involving a roughly equal number of financial companies (compared with 101 in 2002). The majority of interventions (91) consisted in meetings with corporate officers.

In the last three years sectoral meetings on organizational issues relating to risk management and internal controls have been intensified. Most of the 58 action letters that were sent concerned the quality of loan portfolios and organizational structures.

The emergence of significant anomalies in technical situations and operational structures required the adoption of extraordinary measures in respect of 3 intermediaries specialized in providing guarantees.

Inspections

General developments. – Adjustments to the methods of planning and performing on-site controls have been constantly made with a view to ensuring the assiduous and thorough inspection of intermediaries. The greater use made of differentiated approaches – encompassing the whole of an intermediary's operations or focused on part of them, depending on the intermediary's complexity – has permitted more frequent and closely targeted inspection for each size category of bank. In 2003 it was accordingly possible to carry out inspections of important organizational units or risk areas of 6 of the 10 largest banking groups. Between 1998 and 2003 groups of this class were inspected on an average of once every three years. For all the banks inspected in 2003, the average duration of on-site checks was reduced to 47 working days, from 54 in 2002, and the associated administrative phases were shortened.

On-site activity. – The Bank of Italy initiated 217 inspections in 2003 (compared with 196 in 2002), of which 137 were performed by the Bank's branches. The banks inspected numbered 184 (175 in 2002) and accounted for 22.3 per cent of the banking system's total assets (15.6 per cent in 2002). In particular, 176 comprehensive inspections and eight sectoral inspections were carried out, three of which concerned the lending business of large banking groups. As part of the action taken in connection with the crisis of the Cirio group, Consob, pursuant to Article 10.2 of the Consolidated Law on Finance, asked the Bank of Italy to conduct on-site checks at four banks for compliance with the rules on fairness and transparency in the placement and trading of bonds with customers.

The overall scores of comprehensive inspections were favourable in about half the cases and partially favourable in about a third, an improvement on the previous year, when the assessments were concentrated in the intermediate class. Almost all the sectoral inspections resulted in partially favourable evaluations.

Between 2001 and 2003 inspections were ordered at 537 banks accounting for 59 per cent of the system's total assets, compared with coverage of 50 per cent in three years 1998-2000. A comparison of the comprehensive inspections initiated in the two periods shows an improvement in evaluations: the assets of banks that received unfavourable evaluations, which were mainly attributable to their procedures for granting loans, fell from 4.1 to 2.8 per cent of the system's total.

The inspections of non-bank intermediaries concerned ten investment firms, four asset management companies and nineteen financial companies (compared with eight, two and eleven, respectively, in 2002). In addition, five inspections were ordered to check on the performance of depositary bank functions.

Crisis and other special procedures

Special administration and compulsory administrative liquidation of banks. – Six special administration procedures were initiated in 2003 and still under way at the end of the year. All six involved mutual banks. Compulsory administrative liquidation was begun for three banks – all of them mutual banks, two of which had already been under special administration. Taking account of the conclusion of the compulsory administrative liquidation of one mutual bank, at 31 December 2003 there were 23 such procedures under way, compared with 21 at the end of 2002.

The compulsory administrative liquidation of Sicilcassa continued with the recovery of claims. Recourse to settlements was preferred, given the lengthiness of court proceedings. The most important part of the complex agreement concluded in 2002 in settlement of Sicilicassa's largest exposure to a debtor group took effect, bringing receipts of more than 170 million. At 31 December 2003 the liquidation had recovered a total of around 411 million.

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 2003 a total of 3,583 million had been recovered in respect of the claims acquired from Banco di Napoli. As a consequence of these receipts and the payments by Banco di Napoli to cover SGA's losses, the latter's debtor balance on the account originally held with Banco di Napoli and now with Sanpaolo-IMI fell further to 1,052 million at 31 December 2003. At the same date the net value of the residual claims on customers amounted to 1,701 million, of which 170 million acquired from Isveimer.

The liquidation of Isveimer, initiated in April 1996, continued to realize assets and extinguish liabilities. The accounts of the liquidation at the end of the year showed residual assets of 216 million (compared with 5,811 million at the start of the procedure) and residual liabilities of 145 million (compared with 6,237 million). The surplus of 71 million reduces the estimate of the procedure's final deficit to 846 million, compared with the final loss of 917 million reported in the earlier interim accounts and made good by Banco di Napoli, which the Bank of Italy has indemnified.

Special administration and compulsory administrative liquidation of investment firms. – The special administration procedure that had been begun at the end of 2002 was concluded in 2003 with the intermediary being put into compulsory administrative liquidation. At the end of the year eleven compulsory administrative liquidation procedures involving investment firms were under way; the ascertainment of liabilities had been completed in all eleven cases and in seven partial allotments and restitutions had been made to customers.

The protection of transparency in banking and financial transactions

The Bank's branches made 683 checks on the transparency of contractual conditions at branches of 134 banks in 2003, compared with 1,009 checks at 160 banks in 2002.

The examinations found that the anomalies detected during the checks performed in previous years had been progressively rectified and that intermediaries were paying closer attention to compliance with the provisions on transparency. The checks performed in 2003 led to the opening of three sanction procedures; 44 banks were warned to comply more scrupulously with the rules.

A total of 2,390 transparency checks were performed at branches of 220 banks in the three years 2001-2003. They led to 18 sanction procedures against 17 banks and 177 warnings addressed to 145 intermediaries. Since the start of this year around 350 transparency checks have been carried out at branches of 100 banks.

The transparency controls performed as part of ordinary on-site inspections in 2003 found irregularities at 35 mainly small banks and at 3 financial companies, corresponding to 19 per cent of the sample. Sanction procedures were initiated against 8 of the banks.

Access to the securities markets

Article 129 of the Consolidated Law on Banking and the related implementing provisions establish that issues of securities and offerings of foreign securities in Italy must be notified in advance to the Bank of Italy where the amounts exceed certain thresholds or the characteristics of the securities are not commonly found in the financial market. Within twenty days of receipt of notice the Bank of Italy may prohibit or defer the execution of an operation.

These rules, which do not have analogues in the legislation of the other main countries, are designed to safeguard the orderly functioning of the market in debt securities as a whole; they respect the principles of the free circulation of capital and competition in the financial markets. The control powers assigned to the Bank of Italy do not extend to evaluation of issuers' creditworthiness or the advantageousness of the operation for subscribers of the securities.

Notices of around 1,700 issues and offerings of securities in Italy were examined in 2003, compared with 1,300 in 2003. In 58 cases (52 in 2002) the operations notified did not take place either because they were withdrawn following the observations formulated by the Bank of Italy or because they were prohibited. In most of these cases the indexation mechanisms were too complex; in some issues and offerings did not comply with the provisions on public offerings.

In the case of bank securities, prior examination of the operations was supplemented by scrutiny of the information sheets that issuing banks are required to prepare under the rules on transparency of the contractual terms and conditions of banking operations and services.

Around 1,000 information sheets were examined, the majority relating to issues of structured bonds. In numerous cases revisions were suggested in order to improve the informational efficacy of the documents, with growing attention paid to statement of the fees implicit in products and of the risks assumed by subscribers.

Post-issue reports showed that domestic issues of bonds by Italian issuers in 2003 amounted to around 113 billion, an increase of 24 per cent on the previous year.

Bank bonds again accounted for the preponderant share of new issues with 109.8 billion, of which 75 per cent had a simple financial structure (either a fixed rate or a rate indexed to money-market parameters). Issues of structured bonds rose by 60 per cent to 26.2 billion, confirming the upward trend of the previous years. The action of the Bank of Italy induced banks to simplify indexation mechanisms and to consider paying minimum yields.

The Bank of Italy received 46 notifications of securitizations under Italian law, about the same as in 2002. The amount of the asset-backed securities issued fell from 33.7 billion to 28.3 billion. The securities were bought largely by foreign institutional investors, who confirmed their deep interest in the Italian market. The biggest transactions involved receivables originated by the public sector (Cassa Depositi e Prestiti, INPS and INPDAP), which were transferred to securitization vehicles under specific legislative provisions; the securities issued amounted to 11 billion.

In 2003 foreign securities amounting to 89.3 billion were placed in Italy, a large increase compared with 20.1 billion in 2002. Of the securities placed, 40 per cent were issued by banks, mainly belonging to the euro area, 36 per cent by governments of OECD countries, 13 per cent by governments of emerging countries and 11 per cent by other non-bank entities. More than 90 per cent of the total amount placed consisted of securities paying a fixed rate or indexed to the most commonly used market parameters.

Sanctions

In 2003 the Bank of Italy submitted 84 proposals to the Ministry for the Economy and Finance for the imposition of pecuniary administrative sanctions for irregularities discovered in the course of supervision. The proposals concerned 72 banks, four investment firms and eight financial companies (compared with 87 banks, one investment firm, one asset management company and four financial companies in 2002).

Cooperation with the judicial authorities and other governmental bodies. The prevention of financial crime

Cooperation by the Bank of Italy with the judiciary and the investigative bodies responsible for preventing and repressing illegal conduct in the financial sector remains intense, not least because of the growing complexity of economic crimes.

The Bank received 568 requests for information and documents. The most important concerned breaches of trust in the management of enterprises and alleged irregularities on the part of the banking system in the placement and trading of securities and in offering innovative financial products. Many of the requests involved the jurisdiction of different offices of the judiciary and were characterized by a higher level of detail of the information requested than in the past.

The Bank transmitted 40 reports to judicial authorities on suspected penal offences discovered in the course of supervisory controls (45 in 2002). Five inspection reports were turned over to the Bureau of Antimafia Investigation under special cooperation agreements. The Bank sent Consob 37 reports concerning irregularities in the performance of investment services by intermediaries or in the conduct of financial salesmen that had been found in the course of supervision.

As regards usury, the Bank of Italy and the Italian Foreign Exchange Office conducted a sample survey of the penalty rates that banks charged on arrears, with a view to reaching a greater uniformity of calculation. The size of the penalty, shown in the ministerial decrees on annual effective rates of charge, averaged 2.1 percentage points.

COMPETITION POLICY IN THE BANKING SECTOR

The development of competition

Since the beginning of the 1980s the convergence of supervisory rules and practices and progress in information technologies have helped to raise the level of competition in the banking sector in the European Union by reducing entry barriers and progressively eliminating geographical and product segmentation.

In Italy the pursuit of efficiency has led to a rapid concentration of the system, particularly in comparison with the other main European countries. Despite the reduction in the number of banks, competition has increased considerably as a result of the entry of new intermediaries and the exit of less efficient ones, the reorganization of the main groups, the broadening range of distribution channels for financial products and the greater transparency of the terms and conditions for available services.

The average number of banks per province rose from 27 at the beginning of the 1990s to 34 at the end of 2003. The Herfindahl-Hirschman index of concentration for the provincial deposit market on a consolidated basis declined by 9.8 per cent from its peak in 1999. In regional lending markets, the index dropped by 15.5 per cent between 1999 and 2003.

In the traditional deposit-taking and lending sector, there has been a substantial redistribution of market shares. Between 1995 and 2002 the average short-term bank lending rate in Italy came down by around 7 percentage points, gradually converging towards the level prevailing in the euro area. At the end of 2003 the rates on new loans up to €1 million, which proxy those applied to small enterprises, stood at around 4 per cent in Italy and the euro area.

Moreover, the banking sector is facing growing competition from the financial products of Poste Italiane. The Bancoposta division, which is subject to antitrust law pursuant to Presidential Decree 144 of 14 March 2001, has a distribution network consisting of around 14,000 offices, while Italy’s largest banking group has some 3,000 branches.

Competition from foreign intermediaries is particularly strong in non-traditional sectors of intermediation, such as corporate finance, professional asset management, securities trading, factoring, consumer credit and payment cards.

In safeguarding competition the Bank of Italy has benefited from the knowledge of the structure and behaviour of the banking industry acquired in the exercise of banking supervision. Since 1990 more than 700 concentrations and numerous agreements between intermediaries have been examined and checks have been carried out to ensure that institutions with a large market share do not abuse their dominant position.

Special efforts have been made to safeguard competition in the payment system. The Bank of Italy has authorized a limited number of agreements that are indispensable for the efficient supply of services; it has encouraged intermediaries to pass on to customers the benefits of the development of cashless means of payment.

During the year the investigation of a key aspect of competition in local markets – the existence of impediments to customer mobility – was concluded. In this connection a questionnaire was distributed to around 1,200 bank branches to examine the economic conditions and terms of contract applied to households' current accounts in 2002. The results indicated that customers weigh the terms and conditions offered and are prepared to change banks. During the year customers closed 12 per cent of accounts, in most cases also breaking off all other relations with the intermediary. One of the main reasons given was dissatisfaction with the conditions offered.

The safeguarding of competition

Concentrations. – In 2003 a total of 53 concentrations were notified to the Bank of Italy under Law 287/1990. Concentrations are analyzed on a regional basis with regard to lending and on a provincial basis with regard to deposits. If there is substantial geographical overlapping of the intermediaries involved in the operation, the impact on competition may be assessed over areas as small as a municipality and authorization may be conditional upon compliance with conditions designed to encourage the entry of competitors.

In 19 cases it was found that the reported concentrations did not fall within the scope of the antitrust provisions. In 33 cases they did not restrict competition in the relevant markets. The enquiries looked at the market shares of the banks concerned, the interest rates applied compared with averages in the relevant markets and the indices of the concentration of supply.

The merger of Banca Popolare Commercio e Industria scrl and Banca Popolare di Bergamo – Credito Varesino scrl. – The investigation of the sole operation involving the merger of two banking groups (Banca Popolare Commercio e Industria and Banca Popolare di Bergamo) that overlapped in a number of localities was opened and concluded during the year. In connection with the merging of Banca Popolare di Bergamo-Credito Varesino, Banca Popolare Commercio e Industria and its subsidiary Banca Popolare di Luino e Varese SpA to create the banking group Banche Popolari Unite, the investigation concerned the provincial deposit markets in Bergamo and Varese. The concentration was authorized on the condition that the total number of branches of the new group not increase in these provinces for three years (Order 48 of 9 August 2003).

The investigation into Servizi Interbancari – CartaSì. – The investigation was opened as a result of an enquiry into some aspects of the operation of Servizi Interbancari SpA (subsequently CartaSì SpA), which issues and manages payment cards. The procedure looked at the financial ties between the company and the participating banks and the setting of fees charged to customers. As a result of the recommendations issued during the course of the Bank of Italy's investigation, CartaSì eliminated the internal procedures that could lead to fee-setting policies being agreed with the banks. Since the agreements entered into by CartaSì for the operation of the system might affect competition in the sector, the Bank of Italy will continue to monitor the company's relationships with participating and shareholder banks. At the close of the investigation CartaSì was fined €500,000 (Order 47 of 4 August 2003).

The investigations opened in 2003. — During the year six investigations were opened into agreements that were potentially detrimental to competition. In two cases (CartaSì – American Express and the general terms and conditions of contract drawn up by the Italian Bankers' Association for the use of payment cards and investment services), the investigations were conducted in close collaboration with the Antitrust Authority, which opened its own proceedings at the same time.

The CartaSì – American Express order. – The investigation, which was opened in August 2003, concerned an agreement between CartaSì SpA and American Express Services Europe Ltd to set up a joint venture for the issue of credit cards to be distributed through banks subscribing to CartaSì's services (Order 224/A of 5 August 2003).

The aim was to determine whether the agreement would lead to coordinate action that might affect the prices of the products concerned, and the enquiry was later broadened to cover arrangements regarding the acceptance of American Express credit cards. As a consequence the time limit for concluding the procedure was postponed to 30 June 2004 (Order 244/A of 6 February 2004).

The Pagobancomat order. – The investigation was opened in October 2003 after the Bancomat Convention (CO.GE.BAN.) had presented, upon expiry of the deadline set by Order 23 of 8 October 1998, a request to renew the authorization, by way of derogation from the ban on agreements restricting competition, regarding fee-setting under the Pagobancomat agreement. The enquiry also looked into the general contractual terms governing the relationships between banks and card-holders and between banks and subscribing retailers for the acceptance of Pagobancomat cards (Order 234/A of 24 October 2003).

CO.GE.BAN. gave notice that it had revised the interchange fee calculated on the basis of its specific cost components. A sample survey of banks issuing cards led to the introduction of a partly fixed and partly variable interchange fee of €0.20, plus 0.10 per cent of the amount of the transaction. This figure is lower than the fee applied in 2003. In addition, a report was submitted on the effects of the interchange fee on retail prices.

The order concerning ABI: general terms and conditions of contract for third-party guarantees for bank transactions. – The investigation was opened in November 2003 after ABI had submitted a standardized contract covering third-party guarantees for bank transactions, called the “omnibus” guarantee, agreed with various consumer associations. The aim was to ascertain whether actual application of the conditions of contract distributed by ABI would lead to uniform behaviour on the part of participating banks and to examine the effects on overall terms applied to bank borrowers (Order 236/A of 8 November 2003).

The order concerning ABI: general terms and conditions of contract for the use of credit cards and for investment services. – The investigation was opened in November 2003 after ABI had submitted standardized contracts for the use of credit cards and provision of investment services agreed with a number of consumer associations. The aim was to verify whether uniform application of the model contract would affect the quality and the cost of services and the ability of customers to change intermediaries (Order 237/A of 8 November 2003).

The orders concerning Federazione piemontese delle banche di credito cooperativo/Banca di Credito Cooperativo di Boves and Federazione marchigiana delle banche di credito cooperativo/Banca di Credito Cooperativo di Ostra Vetere. – In November 2003 investigations were ordered into Federazione Piemontese delle banche di credito cooperativo and Banca di Credito Cooperativo di Boves, on the one hand, and Federazione Marchigiana delle banche di credito cooperativo and Banca di Credito Cooperativo di Ostra Vetere, on the other. Their purpose was to ascertain whether the mutual banks had entered into agreements with their respective federations with the aim or effect of dividing up the markets (Order 238/A and Order 239/A of 24 November 2003).

Agreements not giving rise to investigations. – In April 2003 VISA Italia gave notice that it was reducing the interchange fee applied to payments of fuel by means of VISA credit cards. The size of the reduction suggests that the new fee is in line with the charges imposed on VISA International by the European Commission with the decision of July 2002 (Order 223/A of 5 August 2003).

MARKET SUPERVISION

This section of the Report gives an account of the Bank of Italy's supervisory activities pursuant to Part III of the Consolidated Law on Finance.

European trading, settlement and clearing systems continued in their drive to improve efficiency and competitiveness in 2003 by modernizing procedures, broadening the range of services offered and growing in size. Competition on the supply side prompted firms to seek out new alliances.

The Italian marketplace notched up a number of important achievements in 2003. In May the central counterparty service, previously reserved to the derivatives market, was extended to the cash market for shares. In December the Express II settlement system went live, taking over from the Bank of Italy's securities settlement service, which was closed down in January. This completed the privatization of the institutions supplying market services.

The preparation of plans to strengthen financial systems' ability to cope with serious emergencies is at an advanced stage in the main countries. In Italy a working group has been set up to coordinate measures for ensuring continuity of the vital functions of the financial system during emergencies. The group is composed of representatives of the government, banks and other financial intermediaries and companies that manage payment, settlement and clearing systems and regulated markets.

The Committee on Payment and Settlement Systems of the Group of Ten central banks has formed a working group for mutual recognition of payment and settlement system oversight arrangements and practices. Another aspect marked for attention is the limitation of central counterparty risks, now being examined jointly with the International Organization of Securities Commissions.

Work on the drafting of European capital market regulations has accelerated, leading to significant progress in the implementation of the Financial Services Action Plan. On 30 April 2004 the directive on markets in financial instruments came into force, followed in May by the directive on takeover bids. In November 2003 the directive on prospectuses was approved. In April the European Commission issued a communication proposing, among other matters, a framework directive on common requirements for the provision of clearing and settlement services.

In Italy the supervisory authorities monitor trading and post-trading services on a continuous basis in order to contain systemic risks and promote efficiency. They have also focused on overseeing the projects of market operating companies to broaden their range of activities. The Bank of Italy, in agreement with Consob, ensured that these initiatives complied with international standards and were acceptable to users.

The wholesale market in government securities

The cash market. – In 2003 the volume of trading on the MTS cash market contracted slightly. The decline in the fixed-rate securities segment was offset to a large extent by a further increase in trading in both index-linked and short-term securities. The uncertain macroeconomic situation and international tensions led to instruments with short durations being used for the temporary investment of liquidity, while the particularly narrow bid-ask spread also rendered them suitable for intraday positions.

Daily turnover averaged €8.4 billion, down 2 per cent from the previous year. BTPs accounted for 54 per cent of the total (compared with 60 per cent in 2002) and BOTs for 8 per cent (compared with 7 per cent), while trading in CCTs and CTZs showed the largest increases, rising respectively from 25 to 28 per cent of the total and from 6 to 9 per cent.

Trading was less concentrated on single instruments, with the share of the five most traded securities falling from 28 to 22 per cent and that of the ten most traded from 40 to 35 per cent. In the last quarter of the year, 11 per cent of trades were settled through the central counterparty service, in which nine foreign intermediaries belonging to Clearnet participate by remote-access, compared with six when the service was launched on 16 December 2002.

Turnover on the grey market picked up again in 2003, totaling more than €37.9 billion, compared with €31.8 the previous year. As usual trading was concentrated on the last day, which is the auction day. Prices were generally slightly lower than issue prices, particularly at BTP and CTZ auctions, but this year also on several occasions in the BOT segment.

The bid-ask spread on the MTS cash market averaged 3.7 basis points, which is in line with the previous year. Primary dealers showed a more marked tendency to change their quotations just before the release of US economic statistics.

The number of market members fell from 153 to 141 while that of remote-access intermediaries rose from 36 to 38 and their market share from 38 to 48 per cent. The number of primary dealers went up from 32 to 33 (including 21 foreign intermediaries) and accounted for over 93 per cent of the market's total volume (90 per cent in 2002). The top five primary dealers handled 39 per cent of turnover (compared with 42 per cent in 2002) and the top ten 63 per cent (as against 62 per cent).

Specialists in government securities stepped up their contribution to the efficiency of the market and the supply of liquidity. On average the bid-ask spreads they quoted were lower than those of the other primary dealers. Italian specialists were again the most active on the market in terms of volume of trading and number of securities quoted and traded. The activity of foreign specialists also picked up.

The repo market. – The MTS repo market grew by 14 per cent with respect to 2002 as intermediaries increased the use of this instrument for their treasury management and securities lending.

Daily turnover averaged €48.9 billion, against €43 billion in 2002, with peaks of close to €65 billion in June and September. In the first quarter of 2004 volume increased further to average €56.2 billion. Spot-next and tom-next accounted, respectively, for 75 and 23 per cent of total trades, compared with 71 and 27 per cent in 2002.

The share of trading handled by the central counterparty service was again fairly small, amounting to just 4 per cent of the total in the last quarter of 2003. So far only a few intermediaries have opted for this method of trading. The imminent switch to the service by Italian primary dealers will cause the share to increase considerably and may boost the longer term segment.

After increasing sharply in 2002, turnover in the general collateral segment grew by a further 4 per cent, confirming dealers' preference for this instrument over deposits as a form of investment of liquidity for maturities other than overnight. The intraday distribution of trades was very similar to that on e-MID.

Turnover in the special repo segment rose by 33 per cent, indicating that greater use was made of this instrument to cover cash market positions. Trades conducted in the early hours of the day increased most. The special repo rate effectively signaled tensions in the secondary market, many of them due to a scarcity of specific securities and the disinclination of institutional investors to lend them.

On 26 January 2004 the close for trading of the overnight maturity on MTS was changed from 9.15 to 14.45, after which average daily turnover increased to €265 million, from €45 million in 2003, remaining fairly evenly distributed between the general collateral and the special repo segments. Intraday trades tend to take place between 9.00 and 13.00.

BondVision. – The regulated market devoted to institutional investors continued to expand rapidly. Daily turnover averaged €680 million (compared with €390 million in 2002), of which BTPs accounted for 37 per cent (compared with 45 per cent in 2002), CCTs for 19 per cent (compared with 18 per cent) and securities of other euro-area countries for 31 per cent (compared with 25 per cent). At the end of 2003 the number of dealers had risen from 99 to 159, almost entirely composed of institutional investors, while the number of market makers rose from 23 to 29. Remote-access intermediaries increased from 61 to 111. The top five primary dealers accounted for 51 per cent of total trading, while the ten most traded instruments represented 27 per cent of total turnover.

Other segments of the bond market

EuroMTS and other national MTSs. – The volume of trading in government securities on EuroMTS continued to decline, particularly in the Italian, German and French segments, while turnover in the securities of smaller European countries that had recently joined the circuit held steadier and in some cases even rose slightly. Since March 2004 short-term government securities of the main euro-area countries have also been listed on a separate segment of the market.

Average daily turnover fell from €2.9 billion to €2.4 billion. The share of Italian securities decreased from 28 to 17 per cent of the total and that of Italian, German, French and Spanish securities from 64 to 54 per cent. By contrast, turnover in the securities of other euro-area countries increased in both absolute and relative terms.

Falling levels of activity on EuroMTS appear to have benefited national euro-area circuits that use the MTS platform. Average daily turnover rose on MTS/Deutschland by almost 40 per cent, from €630 million to over €870 million, most of which in the short-term segment, and on MTS/Finland from €160 million to €215 million. The increase on MTS/Portugal was 17 per cent (total turnover of €500 million) and on MTS/Spain 21 per cent (€750 million). The volume of trading on the new euro-area markets, MTS/Austria and MTS/Greece, amounted respectively to €115 million and €220 million and topped €500 million on MTS/Denmark, where transactions are in krone. Turnover on the NewEuroMTS was smaller at around €26 million.

The market in bonds other than government securities. – Turnover remained slack on MTS/Corporate and declined on Eurocredit/MTS. Six new issues created by the securitization of receivables and public revenues were added to the range of securities quoted on MTS/Corporate, where average daily turnover declined from €97 million to €93 million and trading was almost entirely in European Investment Bank bonds. The volume of trading on EuroMTS fell from €1.8 billion to €1.47 billion.

The over-the-counter market. – According to a survey of OTC trading in Italian government securities by MTS primary dealers, turnover was up 6 per cent on the previous year. The survey was conducted on a sample of 17 intermediaries (10 of which resident in Italy) accounting for more than 60 per cent of trading on MTS by primary dealers. The sample carried out 42 per cent of its total trading on the OTC market, notably in the BTP segment (63 per cent), while CCTs and BOTs/CTZs accounted, respectively, for 20 and 17 per cent. Most OTC trades are still conducted by telephone, although on-line trading is on the rise, particularly among some Italian dealers. Demand for liquid instruments pushed up the volume of trading in short-term and index-linked securities.

The interbank deposit market

Daily turnover on e-MID averaged €17.8 billion in 2003, compared with €17.6 billion in 2002. Overnight deposits rose from 80 to 86 per cent of total turnover, while average daily turnover in dollar funds rose from $0.6 billion to $1.4 billion. In the first quarter of 2004 there was substantial growth, with average daily turnover rising to €18.4 billion in the euro segment and to $1.5 billion in the dollar segment.

Turnover in the large-deal segment accounted for 38 per cent of the total volume of euro transactions in the four maturities handled, compared with 29 per cent in 2002. Average daily turnover rose by 34 per cent to €6.5 billion, of which foreign intermediaries accounted for more than 64 per cent.

The intermediaries trading on the market numbered 183, of which 52 were foreign and resident in 16 different countries. Ten central banks, including the European Central Bank, are members with observer status.

The overnight indexed swap market (e-MIDER)

Trading on the market in overnight indexed swaps operated by e-MID S.p.A. grew by 24 per cent in 2003 despite the low volatility of short-term interest rates. Average daily turnover rose from €1.05 billion in 2002 to €1.3 billion in 2003; in the first quarter of 2004 it rose to €1.7 billion. The average contract lot was €230 million, compared with €252 in 2002, thus confirming the major role played by large banks. At the end of March 2004 there were 58 dealers trading on e-MIDER, including 27 foreign intermediaries.

Central securities depositories

Monte Titoli maintained its position as Europe's third largest central depository by value of securities held. Securities deposited with the Euroclear group rose in value by 9 per cent in 2003, to around €12 trillion, and those deposited with Clearstream International by 6.3 per cent to €7 trillion. At the end of 2003 Monte Titoli held financial instruments with a market value of €2,043 billion, 5.9 per cent more than a year earlier, and a face value of €1,643 billion, compared with €1,575. Government securities fell from 68 to 66.5 per cent of the total, whereas private sector bonds rose from 23.5 to 24.6 per cent. Shares, warrants and foreign securities remained broadly unchanged at 8.2 per cent of the total. The share of financial instruments held by means of the ten links existing with foreign central depositories was steady at 0.7 per cent.

The total number of participants fell from 1,916 to 1,869, with that of issuers increasing from 1,346 to 1,396 and that of intermediaries falling from 570 to 473. The number of participating banks decreased from 317 to 253, investment firms from 64 to 39 and stockbrokers from 13 to 5. Eleven foreign intermediaries participated in the system. The number of custody and settlement accounts increased from 35 to 100 and to 157 at the end of March this year with the launch of Express II.

Settlement of transactions in securities

On 8 December Monte Titoli launched the new Express II system. Introduced initially for bonds of private issuers and international bodies, it was extended to all other financial instruments as of 26 January 2004. The system is composed of a net and a gross settlement service. The first has two cycles: night-time, for the majority of transactions, and day-time for those not settled earlier. At the end of the day-time cycle transactions still awaiting settlement are transferred to the gross settlement service.

The new system has numerous advantages. It is as efficient as multilateral netting in terms of liquidity saving; it ensures the prompt closing of the settlement phase even when there are transactions for which cash or securities are lacking by allowing these to be handled on a “delivery-upon-payment” basis; from the very first day of operation cash and financial instruments released by the settlement process have been available for re-use; and, finally, participants have automatic access to intraday financing from the Bank of Italy.

Monte Titoli designed Express II according to the principles laid down by the authorities in compliance with international standards, with the active contribution of potential participants, such as Italian and foreign intermediaries, market operating companies and firms providing services for Italy’s marketplace. It has been passed as complying in full with the ECB’s standards for the settlement of Eurosystem credit transactions.

Between 26 January and 31 March 2004 the average daily value of transactions settled was €187 billion, which is in line with the figure recorded for the gross settlement system. The night-time netting cycle accounted for 90.3 per cent of the transactions handled, the day-time for 5.5 per cent and the subsequent gross settlement for 2.3 per cent. Only 1.9 per cent of transactions were not settled on the expected day. At the end of the firs quarter of 2004, there were 143 intermediaries participating in Express II, of which 7 by remote-access: 122 banks, 16 investment firms, 2 central counterparties, Poste Italiane S.p.A., the Bank of Italy and the Ministry for the Economy and Finance.

The gross settlement system. – 2003 was a year of growth, with increases in both the value and number of transactions. The system kept up its smooth performance. The daily average number of transactions settled rose from 402 in 2002 to 466 and their daily average value from €4,368 million to €4,973 million. As in the past, the system was used predominantly for transactions in government securities, which made up 85.2 per cent of total settlements by value and 28.5 per cent by number, while shares accounted for respectively 10.5 per cent and 66.9 per cent. Over-the-counter transactions represented 85.7 per cent of the value handled, compared with 79 per cent in 2002, and monetary policy operations 14.3 per cent (21 per cent in 2002). The concentration of transactions per participant increased, with the percentage handled by the top five rising from 76.5 to 78.2 per cent.

In the first quarter of 2004, with the addition of transactions coming from the net settlement cycles, the pattern of operation changed. The flexibility of Express II, which can also handle failures, means that activity peaks after the transfer of transactions not settled during the day-time cycle. This naturally increases the length of the queue and the average settlement time.

Clearing and guarantee systems

In the same way as other major clearing houses, Cassa di compensazione e garanzia extended its central counterparty service to the cash share markets. The change was made in May 2003 and led to a substantial growth in overall activity. In 2003 it handled 17.7 million derivatives contracts and 23.7 million cash transactions. The notional value of the contracts concluded on the Italian Derivatives Market (IDEM) fell by 17.6 per cent to around €777 billion, despite the 2.8 per cent rise in number. At the end of the year the members numbered 140, of which 78 operated in both segments. The number of remote-access dealers went up from 21 to 39.

In conjunction with the extension of the central counterparty service to the share market, Cassa di compensazione e garanzia also introduced a default fund for the spot and derivatives markets as a further means of containing risk. The fund will increase the amount of resources available in the event of a participant’s insolvency.

With the launch of Express II the Cassa took steps to ensure the final settlement of transactions by providing for mandatory execution procedures in the event of settlement failures caused by lack of the securities (buy-in) and lack of cash (buy-out).

On 8 March 2004 Borsa Italiana S.p.A. wound up the Contract Guarantee Fund and on 24 March took over the operation of a new fund set up by the TLX market for covered warrants and certificates. The Settlement Guarantee Fund, which amounted to €34.8 million at the end of 2003, compared with €36.9 million in 2002, was closed on 26 January 2004 when Express II went live.

The regulatory framework

The ESCB and the CESR have nearly completed work on the definition of common standards for European clearing and settlement systems based on the G-10/IOSCO Recommendations. The new standards aim to harmonize national legislation governing fundamental aspects of the systems, such as the legal and regulatory framework, efficiency requirements, rules of operation, risk control, access requirements, corporate governance and user relations, oversight and cooperation between authorities, business continuity and transparency.

In April 2004 Directive 2004/39/EC on markets in financial instruments was adopted, replacing Directive 93/22/EC on investment services. In order to increase competition in the supply of trading services, member states are no longer allowed to impose the concentration of trading in listed securities on regulated markets and the directive establishes uniform rules for the execution of orders, applying both to transactions on a regulated market or an electronic platform (Multilateral Trading Facility or MTF) and transactions carried out within a bank or investment company (known as internalization).

The extension of pre-trade transparency obligations to banks and investment firms was fiercely debated before a compromise was reached, making them applicable to banks and investment firms that systematically internalize client orders when trading – in quantities not above standard market size – liquid shares that are traded on regulated markets.

Again in April the European Commission issued a new communication to the European Council and Parliament on clearing and settlement in the European Union. Among other things it calls for a proposal for a framework directive guaranteeing the freedom to supply such services within the EU subject to compliance with standard requirements. Consultation on the communication will end on 30 July and in 2005 the Commission will announce its final decision regarding the guidelines and measures to be adopted.

In preparation for the launch of Express II, the part of Consob Regulation 11768/98 (issued in agreement with the Bank of Italy) concerning market insolvency was amended. On 20 October 2003, in agreement with Consob, the Bank of Italy designated Express II, pursuant to Legislative Decree 210 of 12 April 2001, in order to guarantee that transfer orders entered into the system before the opening of an insolvency procedure involving a participant were final, that is to say binding and enforceable in respect of third parties, including the bodies in charge of the procedure.

Consob has also made important amendments to Regulation 11971/99 on issuers and Regulation 11768/98 on markets to allow regulated markets to list financial instruments already listed on another regulated market without an application from the issuer.

Supervision of market operating companies

Supervisory activity focused on monitoring compliance with regulations, the adequacy of organizational structures, the efficiency of operation and the correct management of risks. In order to ensure the coherence of market operating rules with the overall regulatory framework and the objectives of supervision, the Bank provided opinions to the Ministry for the Economy and Finance regarding amendments to the operating rules of MTS and to the ministerial decree authorizing BondVision.

In September 2003 the Bank, in agreement with Consob, approved amendments to the operating rules of Monte Titoli and Cassa di compensazione e garanzia to bring them into line with the new services offered.

In its supervisory activity the Bank of Italy paid special attention to organizational issues and business continuity; it sought to make supervised companies more aware of these aspects of management and called for tighter internal controls and improved efficiency and security.

Meetings with the companies supervised again offered a useful opportunity for discussion, facilitating dialogue with corporate officers about the implications of new projects for the company and the examination of single issues and technical problems.

The supervision of trading and post-trading systems also involves a major commitment to real time control and analysis to ensure smooth operation and monitor specific risks. Quantitative indicators have been developed for this purpose.

With the international expansion of supervised markets the Bank of Italy was called upon to examine more than 50 applications from non-resident intermediaries, mainly to participate in BondVision. In over 30 cases it was necessary to exchange information with the competent authorities of the home country.

PAYMENT SYSTEM OVERSIGHT AND SERVICES

In 2003 central banks stepped up their efforts to harmonize policies and measures to cope with the risks and seize the opportunities inherent in the extension of markets and in technological advances. These trends are especially significant in Europe, given the completion of the single market in payment services, the integration of infrastructures and the enlargement of the EU.

The Bank for International Settlements undertook a survey of the oversight methods used by central banks, designed to produce an overview of policies and methods of intervention.

Increasing attention was paid to strengthening payment system infrastructures. The BIS's experience in setting standards for systems' reliability and efficiency was extended to countries outside the Group of Ten. A revision of the cooperative oversight of SWIFT was begun; as part of the strategy for containing major risks, special attention was paid to the measures adopted by SWIFT itself and the related policy action designed to ensure business continuity. The oversight authority strengthened its involvement in international action against money laundering and the financing of terrorism, given the danger that payments systems might be used for that purpose.

In Europe the main focus was the definition of a legal and operational framework that would guarantee stability and efficiency for the development of the single market.

In large-value payments, work on the second-generation TARGET2 system was intensified. The project will provide intermediaries with innovative high-tech operating procedures, reducing the costs of technical decentralization while still recognizing national specificities. The project is essential to the competitiveness of the European financial marketplace.

On the retail side, the banking industry's work on the Single Euro Payment Area proceeded. Central banks strengthened their cooperation with the market to spur banks to make up for delays in implementation.

In June 2003, after a public consultation, the Eurosystem adopted a common methodology – oversight standards – for the classification and evaluation of the efficiency and reliability of retail euro payment systems. The aim is to harmonize the national central banks' oversight activities in this field. Work to enhance the efficiency and reliability of innovative payment instruments continued; in May 2003 the Eurosystem issued its report "Electronic Money System Security Objectives".

The European Commission went ahead with the development of a new legal framework for European payments, designed to overcome national fragmentation. Study of the impact of Regulation 2560/2001 was stepped up in order to eliminate remaining differences between the charges for national and cross-border payments within the EU.

Within Italy, guidance and control were strengthened in February 2004 by a document laying down standards for the exercise of payment system oversight. In cooperation with the other competent authorities and with the banking industry, the Bank of Italy continued work on the modernization of the large-value, retail, and public administration payment systems.

In the sphere of large-value payments, the Bank of Italy's leading role in the TARGET2 project testifies to the technological and functional excellence of its New BI-REL system, which was acknowledged by the IMF in its evaluations of national payment systems. Banks have made efficient use of the system's liquidity management functions, especially after the start-up of the new Express II securities settlement system.

Oversight was intensified through projects to upgrade the quality and security of payment infrastructures and retail payment instruments and to adapt the Italian system to European standards. With a view to innovation, more highly articulated plans were drawn up to encourage greater use of new technology in the provision of payment services to firms, in parallel with work to complete the legal framework for the dematerialization of trade documents.

Action to extend the use of new technology in public payments continued in 2003 with the ongoing implementation of the strategic guidelines for the development of the public administration payment system and the information system for the transactions of public sector bodies. The public payment system achieved a major step forward with the extension of electronic credit transfers to the payment of state salaries and pensions. On the information side, the operational codes for receipts and payments already being used by central government departments are now being extended to local offices of central government and to local authorities. When the information system is fully phased in, which the Ministry for the Economy has scheduled for 2005, it will provide the Ministry with prompt and complete information on the cash flows of public sector bodies, for purposes of monitoring.

Oversight activities

The legal framework. – In implementation of Article 146 of the Consolidated Law on Banking, on 24 February 2004, after hearing the opinion of the ECB and consulting with the main domestic payment players, the Bank of Italy issued its framework guidelines for the exercise of payment system oversight. Characterized by transparency and consistent with the principles established by international fora, the guidelines specify the objectives of the oversight function and the corresponding obligations of payment system participants in the various sectors relevant for the regular functioning of the payment system.

The guidelines specify the aims of oversight, setting objectives for reliability (essentially, the prevention of operational and settlement risk) and for efficiency (gauged by the speed and cost of the entire money transfer cycle). They underscore the importance of interaction among all parties involved in the production and provision of payment services (end-to-end approach). The scope of the oversight function coincides with “important” payment systems, their infrastructure and non-cash instruments, both traditional and innovative. Responsibilities and obligations towards the oversight authority depend on participants’ activities, not their status (i.e. whether they are financial or non-financial institutions).

The new rules impose information requirements on system participants, some to be fulfilled at participants’ own initiative and some at the authority’s request. The Bank of Italy is empowered to make public any information that needs to be generally known. Participants must report any initiatives relevant for the functioning of payment systems to the Bank, including advance submission of any codes of conduct or self-regulation, so that the Bank can judge their consistency with the general purposes of oversight.The framework provision applies immediately, but the Bank of Italy may issue more detailed instructions in the future in areas of particular interest, consistent with its other regulatory actions.

Traditional payment instruments. – The number of transactions settled using bank and postal payment instruments increased by 3.7 per cent in 2003. Bank payment instruments, which account for most of the total, displayed divergent trends in the main components. The number of cheques and bankers’ drafts continued to fall (by 6.3 per cent), while automated credit transfers increased by 6.6 per cent and direct debits by 3.2 per cent. The most commonly used instrument was debit cards, with 570 million POS transactions, an increase of 8 per cent. The number of debit cards remained roughly unchanged at 25 million.

The supply of credit cards issued by intermediaries expanded substantially, owing more than in the past to consumer credit programmes and customer loyalty promotions (co-branded cards, fidelity cards and so on). The number of cards rose by about 1 million to 12.5 million at the end of the year, and the number of credit card transactions increased by 4.4 per cent.

The number of ATM cash withdrawals increased by 2.8 per cent, much less than in 2002, when they had been powerfully spurred by the dual circulation of lira and euro at the start of the year.

The supply of postal payment instruments requiring a postal current account also increased last year. The number of postal accounts rose by 800,000 and from 48 to 61 per thousand inhabitants. The very widespread branch network of the postal system fostered growth almost everywhere in Italy, and most of all in the South. The main factor behind the increasing popularity of postal accounts is low cost, which offers an incentive for their use by means of payment instruments that are now fully interoperable with those of the banking circuit.

Again last year the Bank of Italy, through its branches, conducted a survey at commercial banks' main offices and a sample of branches concerning the procedures and charges for the two most common payment instruments (cheques and credit transfers). The results are made public and also serve as a basis for oversight activities. The 2003 survey found some tendency among banks, partly at the Bank of Italy's urging, to simplify and make more transparent the terms for payment services and to begin shortening execution time.

Table 67

HANDLING TIME FOR CHEQUES AND CREDIT TRANSFERS
(*number of working days*)

	Average			Minimum			Maximum		
	2001	2002	2003	2001	2002	2003	2001	2002	2003
Cheques									
Value date	3.9	3.9	4.0	2.2	2.1	2.1	6.1	6.9	6.1
Availability of funds	6.6	6.8	6.4	5.5	5.6	5.4	7.9	7.9	7.5
Finality	9.4	9.6	9.3	8.1	8.4	7.9	10.0	11.0	10.5
Credit transfers									
Value date	2.1	2.3	2.0	1.9	2.1	1.8	4.5	4.0	2.8
Availability of funds	2.5	2.0	2.4	1.9	1.3	1.9	3.8	2.9	3.7

Source: Surveys conducted in March 2002, 2003 and 2004 (data for 2003 are partly estimated).

In March 2004 the "Patti chiari" agreement sponsored by the Italian Bankers' Association set 8 working days (to be reduced to 7 in

October) as the time limit for making the funds from negotiated cheques available to the beneficiary. The establishment of this maximum, within which the terms offered by individual banks must fall, represents an advance in certainty of collection and information to customers. There is considerable room for improvement here, in view of the high degree of automation and the possibility of shortening the interbank settlement cycle, which could be brought into line with the approximately 3 days that cheques clearance takes in the advanced countries where cheques are most commonly used.

On credit transfers, the Bank of Italy encouraged the banking system to enact self-regulation to bring Italian credit transfers up to the standards of certainty and transparency laid down at European level and embodied in the Credeuro convention. A survey of bank branches in 2003 found that the average charge for cross-border credit transfers was €22.50 for outgoing and €16.80 for incoming payments. Cross-border payments were thus more expensive than domestic credit transfers, in part because this area is not fully automated (which is essential to equalize the charges) and in part because the number of transfers remains small. The number of domestic credit transfers carrying incomplete bank account identification data remains large (nearly 10 per cent of the total). The lack is discovered only when the amount is actually credited to the beneficiary, so that the funds must then be placed in a transitory account and their availability to the beneficiary is thus delayed (by an average of two extra days).

Payment card fraud is the object of special attention from the authorities and from operators in view of their growing use, including for online transactions. In parallel with the actions undertaken by the European Commission and the ECB, domestic oversight activity has been intensified with interventions vis-à-vis associations and circuit operators. The effectiveness of oversight is enhanced by the strengthening of the information base. The data available indicate that payment card fraud involved less than 1 per mille of total transaction value in 2003. In cooperation with the Bank of Italy, CoGeBan, the operator of the Bancomat/Pagobancomat debit card circuit, warned the banks against the most common frauds (the cloning of cards in Italy for use at ATM and POS terminals abroad) and recommended special security measures.

Innovative payment instruments. – The legal framework for electronic money has been finalized. The aim is to direct the market towards solutions that ensure security. In line with the tendency of the Eurosystem, action was taken to sensitize those responsible for system-wide initiatives (CoGeBan, the postal payment circuit) to make sure that they are consistent with the EMSSO report.

Internet payments (via card or credit transfer) increased their share of the total substantially in 2003 thanks to lower costs, incentives for on-line purchases, and the spread of e-banking. Internet transactions using credit cards (the most common instrument) accounted for 7.4 per cent of all credit card transactions. Credit transfers ordered on-line numbered 15 million, or 4 per cent of all credit transfers, more than twice as many as in 2002. The number of on-line payments using prepaid cards and e-money quintupled to more than 60,000.

In January 2004 the Bank of Italy published a report on innovation in electronic payments ("Le innovazioni nel sistema dei pagamenti elettronici: luci ed ombre nella diffusione delle tecnologie dell'informazione e della comunicazione"). The findings were discussed at a conference with the parties involved – public institutions, economic agents, business associations – to judge the adequacy of current policies to overcome the legal and regulatory, technical and organizational obstacles to the spread of electronic payment services and e-commerce.

A study was begun of the growth of electronic invoicing in Italy, to determine the degree of integration with the banking system's payment and collection procedures. It is increasingly believed that recent technical and regulatory developments offer significant opportunities in this area, favouring complete automation of the trade and financial cycle. This process postulates effective intersectoral liaison to determine the needs of the various operators and to develop common rules and standards. The project, with its expected benefits for the efficiency of corporate payments, is central to the Bank's payment system oversight strategy.

Efficient use of on-line payment services by firms requires major advances in integration of trade and financial flows, which have traditionally been handled separately, resulting in costly and uncertain accounting reconciliation within firms and in their relations with banks. In an integrated vision, a crucial role is played by the processing of invoices, which are essential both in trade and in financial relations.

A recent survey of a substantial sample of large manufacturing and service corporations found that there is very ample room for improvement in the integration of payment procedures between businesses and between the latter and banks. With a few significant exceptions, electronic invoice exchange is still marginal (about 5 per cent of all invoices). Fully automated processes from order to settlement and reconciliation are practically non-existent. Despite the cooperative procedures introduced in the last decade (above all interbank corporate banking), payment and collection still rely on a variety of different procedures based on dedicated infrastructures, which means banks and firms may have costly invoice processes that differ according to counterparty. There is a lack of common standards functional to the automation of reconciliation of accounting entries with bank current accounts. Another finding was that electronic billing is more common in the "buyer cycle" (purchasing) and mainly at firms with a high degree of automation and relatively few suppliers; in the "seller cycle" (sales) there is apparently insufficient incentive for systematic introduction of such processes.

Payment infrastructures and systems. – The Bank of Italy's intervention to guarantee the regular functioning of payment systems and structures was broadened in 2003, in line with the increased importance attributed internationally to the prevention of operational risks, including those of systemic relevance. Within the Eurosystem shared oversight policy, monitoring was begun on the activities of the Interbank Company for Automation (SIA) as provider of the technological infrastructure for STEP2, the first pan-European automated clearing house. The Bank of Italy acted to verify that the SIA's system met the requirements of the system operator (EBA) and international standards. To these ends the reference parameters for significant infrastructures were laid down in the regulations implementing Article 146 of the Consolidated Law on Banking.

Private quasi-systems, long a focus of oversight activity, took on increased importance, also in international fora. The new settlement system of the Central Credit Institution for Rural and Artisans' Banks (ICCREA) became fully operational last year. The ICCREA system is particularly complex owing to the volume of funds handled, the large number of participants (about 400, mostly tiny mutual banks) and the infrastructure (regional EDP centres in support of the mutual banks' operations). ICCREA itself is crucial, handling the bulk of transactions involving Italy's extensive system of cooperatives and performing settlements for its member mutual banks both among themselves and with outside counterparties.

Oversight activity to prevent major risks was stepped up in the course of 2003. Analysis of potential system-wide solutions was conducted in cooperation with the other relevant functional areas of the Bank. A preliminary version of the guide to the requirements for guaranteeing business continuity was drafted for joint examination together with the operators of systemically important payment infrastructures.

At the behest of the Bank of Italy, last year ABI completed its FARO project to monitor the functioning of the ATM circuit. The project supplies users with information on the circuit and permits real-time checks on malfunctions. The circuit manager, authorized centres, terminal operators and banks can thus intervene promptly in case of problems. The interest of the oversight function lies in the fact that the project will improve the overall reliability of this very widely used circuit. Analogous reasons counsel the extension of monitoring to the POS system.

Direct provision of payment services

Cash settlement. – The flow of funds handled by the Bank of Italy's clearing and settlement systems amounted to nearly €36 trillion in 2003, or 27.5 times Italian GDP. This was a slight decrease compared with 2002. The BI-REL gross settlement system handled 86.2 per cent of all payments, about 45,000 transactions a day, worth more than €130 billion. Payments channeled through the BI-COMP retail clearing system accounted for 7.9 per cent and the multilateral cash balances generated by the securities net settlement procedure and the new Express II securities net settlement system for 5.9 per cent.

The average use of intraday liquidity in BI-REL decreased with respect to 2002 by 20 per cent to €2.4 billion a day, or just 2.4 per cent of the value of the total settlement flow and 20.2 per cent of the value of securities pledged as collateral. The latter was reduced by 20 per cent, once again reflecting concentrations and the rationalization of banks' cash-flow management. In the first quarter of 2004 the use of intraday liquidity rose by more than 50 in concomitance with the launch of the new Express II securities settlement system.

Start-up of New BI-REL. – The New BI-REL gross settlement system went into operation on 16 June 2003. It allows for more flexible, interactive management of payments in the course of the day, thanks to new facilities for intraday liquidity management and technology in line with international standards.

The number of direct participants diminished, but this did not significantly alter the degree of concentration of payments either by single participant or by banking group. There thus does not appear to have been any increase in liquidity risk or operational risk.

In the first three months of operation of Express II, the value of the multilateral debit balances for the two clearing cycles averaged €8.9 billion a day, €6.4 billion of this settled during the overnight cycle. This exceeds the average debit balances of €5.8 billion generated by the Bank of Italy's securities net settlement procedure in the corresponding period of the previous year.

Table 68

LARGE-VALUE GROSS AND NET SETTLEMENT SYSTEMS IN THE EU

(average daily flows in billions of euros)

System and country	2002 TARGET Domestic (1)	2002 TARGET Cross-border outgoing	2002 TARGET Cross-border incoming	2002 TARGET Total (1)	2003 TARGET Domestic (1)	2003 TARGET Cross-border outgoing	2003 TARGET Cross-border incoming	2003 TARGET Total (1)	Total percentage change 2003/2002
Gross settlement (TARGET)									
Italy	64.1	34.5	34.4	133.0	63.9	33.2	33.2	130.3	–2.1
Germany	360.1	129.3	129.4	618.8	363.6	140.5	140.5	644.6	4.2
France	287.4	68.9	68.9	425.2	302.3	75.5	75.5	453.3	6.6
Spain	231.0	17.8	17.8	266.6	255.2	20.1	20.1	295.4	10.8
Netherlands	37.6	45.0	45.0	127.6	37.2	46.6	46.6	130.4	2.2
Other EMU	59.7	91.9	91.9	243.5	61.7	108.0	108.0	277.7	14.0
Total EMU	**1,039.9**	**387.4**	**387.4**	**1,814.7**	**1,083.9**	**423.9**	**423.9**	**1,931.7**	**6.4**
Non-EMU countries	26.4	97.6	97.6	221.6	29.4	113.0	113.0	255.4	15.2
Total EU	**1,066.3**	**485.0**	**485.0**	**2,036.3**	**1,113.3**	**536.9**	**536.9**	**2,187.1**	**7.4**
Net settlement									
Paris Net Settlement (PNS)				78.3				70.5	–10.0
Servicio Español de Pagos Interbancarios (SEPI)				1.2				1.2	0.0
EBA Euro Clearing System (Euro1)				188.2				175.4	–6.8
Total other systems				**267.7**				**247.1**	**–7.7**

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.

Analysis and adaptation of payment systems. – In June 2003 the IMF assessed BI-REL's compliance with the Core Principles for Systemically Important Payment Systems laid down by the BIS and adopted by the ECB Governing Council. The exercise formed part of a broad programme of assessment aimed at emerging and industrial countries alike. The IMF was helped by the availability of the Bank of Italy's own self-assessment.

The outcome was largely satisfactory. The IMF gave a positive judgment on BI-REL's efficiency, especially in terms of system services and ease of use by participants, and on its technical and operational security. The IMF also judged that the introduction of New BI-REL would further strengthen Italy's real-time gross settlement system.

As for security and technical and operational reliability, an analysis of operational risks for BI-REL/TARGET (so-called risk analysis) was performed, using a new methodology developed by the ESCB. The analysis found a highly satisfactory degree of operational risk control.

TARGET2. – In October 2002 the ECB Governing Council approved the guidelines for the future European payment system TARGET2. In July 2003 the Bank of Italy, the Bundesbank and the Banque de France notified the President of the ECB of their decision to work together to develop the single shared platform for TARGET2, which all the other NCBs said they intended, in principle, to join. Over the months that followed these three central banks continued their work to define the architecture and the functional features, the organization of the project and the role and responsibilities of each central bank in the various phases of development and operation of the single shared platform.The initiative sped up the realization of the new system, and there is now a strong likelihood that TARGET2 will consist from the outset solely of the shared platform created by the central banks of Italy, Germany and France.

The TARGET2 project is crucial to the entire European financial marketplace. To reduce operational risks and contain costs, migration from the national RTGS systems to the single shared platform will be gradual, starting in January 2007.

Securities: the LDT net settlement procedure. – The value of the securities handled by the securities net settlement procedure amounted to €34.7 trillion in 2003, €1.6 trillion or 4.8 per cent more than in 2002. The increase was entirely due to greater turnover in government securities. Trading in shares settled through the procedure came to €1.2 trillion, 6.7 per cent less than in 2002. On 23 January 2004 the Bank of Italy wound up its securities net settlement procedure. From that date, Monte Titoli operates the Express II system for both gross and net settlement.

Securities: gross settlement. – Payments via BI-REL in settlement of the cash leg of over-the-counter securities transactions handled by Express increased in 2003. The average number of daily payments rose from 360 to 410 and their value from €3.4 billion to €4.2 billion.

The use of securities as collateral. – The volume of securities posted as collateral for Eurosystem monetary policy operations and intraday liquidity increased by 22 per cent, from a daily average of €689 billion to €730 billion. The trend towards greater use of foreign securities continued, the latter making up 36 per cent of the securities pledged, compared with 28 per cent in 2002 and 22 per cent in 2001. The increase involved both the Correspondent Central Banking Model (CCBM) and bilateral links between national central securities depositories.

The Bank of Italy continues to play a major role as correspondent central bank within the CCBM, handling nearly a quarter of the securities used as collateral in cross-border lending.

Correspondent banking services and cashier's cheques. – There was a significant increase in the Bank of Italy's correspondent banking services in 2003 in connection with the start-up of payments to residents in other EU countries on account of Italian government entities. The number of payments rose from 11,500 to 24,200. Activity involving central banks and international organizations remained stable; at the end of the year these bodies held 51 correspondent accounts with the Bank of Italy.

The payment of pensions to Italian residents on behalf of the Deutsche Bundesbank was initiated in 2004. The Bundesbank opened a correspondent account with the Bank of Italy using the BI-REL platform for straight-through processing.

The interbank database on irregular cheques and payment cards. – At the end of last year the database, which began operation in June 2002, contained 244,972 reports of unpaid bank and postal cheques worth €947 million. This represented an increase of 39 per cent in number and 49 per cent in value with respect to the end of 2002. The cheques averaged €3,865, compared with €3,619 a year earlier. Households were responsible for two thirds of the bad cheques (54 per cent by value). As in the previous year, reports were concentrated in the South and the island regions according to both number and value, while the North-East remained the area with the lowest incidence.

Measured in proportion to the value of all cheques written, the worst misuses of cheques appear to have abated. In 2003 the value of unpaid cheques fell significantly, from 0.84 per cent to 0.65 per cent of the total, for the decile with the highest bad cheque ratio. The continuation of the trend would suggest that the database has effectively deterred improper use of cheques.

Government payment services. – The aims of the Bank of Italy last year were to extend the use of the new technology for government payment services and integrate state treasury management with interbank payment procedures; to modernize the legal framework in which the state treasury service operates; and to construct the information system on public agencies' collections and payments. The latter will provide the Ministry for the Economy with prompt, full data on the payments and receipts of public bodies.

Significant advances were made on the project for the Computerized Public Administration Payment System. After the legal framework was finalized, standing payment orders were dematerialized. Starting in January some 16 million salaries worth €22.7 billion were converted to electronic payment. In October the new system was extended to pensions charged to the central government budget; this will involve some 5 million payments yearly.

The use of telematic networks gave added impulse to the integration of state treasury management with the other components of the payment system. Interbank procedures were used to make 91 per cent of the 44 million state treasury payments effected during the year. Using the unified tax payment form, credit transfers worth €348 billion were made, 64.5 per cent (€228 billion) in connection with central government tax receipts.

Agreements were concluded assigning to the Bank of Italy the cashier service for government fiscal agencies for the next three years. The Bank has adopted a new degressive fee schedule for these services, which allows for a reduction in the fixed charge and the application of the same schedule to agencies with significantly different transaction volumes.

The Bank of Italy's payments on account of government fiscal agencies and of the Advanced School for Economics and Finance increased by 10 per cent, from 200,000 in 2002 to 220,000 last year; their total value came to €1.3 billion. The bank continued to make payments of temporary benefits to some categories of beneficiaries on behalf of INPS. In fact, the number of such payments jumped from 781,000 to over 3.2 million. An agreement governing this service is being finalized.

With the new procedures for state collections and payments abroad under Presidential Decree 482 of 15 December 2001, the Bank is mandated to execute transactions within the EMU. Last year this service involved some 10,000 payments, mostly ordered by the Foreign Ministry and executed via TARGET, in addition to 6,500 pension payments by the Ministry for the Economy through correspondent banks. Another 13,000 payments were ordered by the revenue service for VAT refunds to EMU residents, for which the Bank temporarily relies on the Italian Foreign Exchange Office.

The Bank is also executing pension payments abroad on behalf of the public employees pension administration pending an agreement with that institute as provided by Presidential Decree 482/2001.

The Ministry for the Economy's project for reordering the regulations governing state treasury operations was broadened to adapt the rules to new instruments and procedures and to incorporate changes connected with telematic procedures. In 2003 the Ministry, with the cooperation of the Bank of Italy, completed its revision of the instructions on the closure of the state budget accounts for the fiscal year and on government securities.

As the body responsible for the state treasury service, the Bank of Italy, in cooperation with the Ministry for the Economy, continued development of the information system for public sector bodies' transactions and its data processing structures. The Bank worked together with Istat and the State Accounting Office to develop a single code for the institutional units that fall under the national accounts aggregate of general government (Sector S13). Active cooperation among the institutions involved can create a constantly updated database, facilitating statistical comparisons and the exchange of data on the public finances at European level as well.

Together with ABI and the banks most active in treasury services, the Bank of Italy defined the transmission application for data flows for the information system for public sector bodies' transactions. ABI also produced the standard for the local computerized payment order, which will permit telematic management of the relations between public sector bodies and their treasurers, significantly improving the efficiency of banks' cash management. The standard was approved by the centre for the computerization of the public administration and by the Bank of Italy as payment system oversight authority.

The Ministry for the Economy intends to have the information system for public sector bodies' transactions operational in 2005. When fully phased in, it will give the Ministry prompt and complete information on the cash flows of the entire public sector and permit monitoring, in the course of the year, of the public finance indicators relevant for EMU.

THE GOVERNOR'S CONCLUDING REMARKS

The Bank of Italy has proceeded in its drive to make the organizational and technical innovations that will improve the performance of its duties at national and local level and the carrying out of its increasing tasks in international fora.

Within the European System of Central Banks the Bank has contributed to the creation of the new institutional and organizational framework for the conduct of a common monetary policy in the enlarged EU.

The purpose of the work undertaken by the Economic Research Department, in collaboration with other departments and the branches of the Bank, is to study in ever greater depth the cyclical and structural aspects of our economy within the context of the European and world economies.

The Bank of Italy's supervision of the banking and payment systems was found to be of high quality in the assessment carried out worldwide by the International Monetary Fund. The report highlighted the professionalism and integrity of the Bank's officers, the pillar on which the independence of this function rests.

Within the Eurosystem we are working alongside the Deutsche Bundesbank and the Banque de France to build the shared platform for the new European gross settlement system. Known as Target 2, the new system will use the most advanced components of the German, Italian and French procedures; it will be based on our technical infrastructure.

We have undertaken to provide the European Central Bank with the operational support of the Donato Menichella Centre should it prove necessary. In the field of banknote production, the Bank of Italy is cooperating in every way to improve the quality and security of notes.

Meetings to exchange experiences and arrangements for technical assistance with countries in Eastern Europe and around the Mediterranean are constantly increasing. In Naples in January we organized, jointly with the European Central Bank, the first seminar of Eurosystem and Mediterranean countries.

With the agreement of the Ministry for the Economy and Finance and the participation of the banking system we are completing the far-reaching programme to modernize the Treasury Payment and Collection Service.

The Bank's financial statements for 2003 show a profit. The falls in the book values of the Eurosystem central banks' foreign currency reserves as a consequence of the appreciation of the euro do not constitute a loss. In the context of long-term plans, efforts are constantly directed at improving operational efficiency and reducing costs.

The Bank has always made public the reasons for its decisions. It systematically accounts for its findings and actions through the distribution of reports and studies and in testimony before Parliament.

On behalf of the Board of Directors and the Directorate I wish to thank all the staff who have worked with skill and self-sacrifice in the service of the Bank and the country.

The world economy

The monetary expansion

In 2003, as in the previous four years, the expansionary policies of the central banks of the United States, Europe and Japan boosted the growth of money above that of GDP at current prices. Official rates were cut during the year to 1 per cent in the United States and 2 per cent in the euro area, while in Japan they have long been close to nil.

The money supply in the seven main industrial countries rose from 67 per cent of GDP in 1998 to 75 per cent at the end of 2003. The interbank accounts of institutions in different monetary areas are growing fast, as are the deposits of non-resident private-sector clients. The money supply is also expanding rapidly in China and the other Asian countries.

Reflecting the growth in the money supply, average yields on long-term securities in the main industrial countries, adjusted for inflation, fell from 5 to around 2 per cent between 1995 and 2003. Real short-term interest rates dropped from 3.4 per cent to close to nil.

The decline in interest rates spread to all markets. In 2003 the margins between yields on government securities in the emerging and the advanced countries narrowed.

Stock market capitalization in the main industrial countries, which had risen to 130 per cent of GDP in 1999, fell to 70 per cent in 2002, largely owing to the crisis in the high-tech sector. Partly in response to the increase in liquidity, it returned to 93 per cent at the end of 2003.

Towards the end of the 1990s and in the first years of the new century it became possible to gear monetary policies to sustaining demand after price stability had been restored in the advanced economies and inflation curbed in the emerging ones. Inflation expectations had been quelled by tight monetary policies that were maintained throughout most of the 1990s.

Prices of internationally traded manufactures followed a downward trend. Non-oil raw material prices decreased up to the end of the last decade, partly owing to the strong dollar, while those of oil and other energy sources contracted slightly until 1998 and then jumped in the following two years as the world economy rapidly gained momentum.

In the United States the long period of economic growth and expansion of investment in high-tech sectors came to an end in the autumn of 2000. The sharp slowdown in economic activity spread to Europe, the other industrial countries and the emerging economies.

Monetary policy in the United States and Europe has been markedly expansionary since 2001. From the end of that year the Bank of Japan has been increasing the monetary base at annual rates of between 10 and 30 per cent.

In 2001 industrial production declined by 5 per cent in the United States, 14 per cent in Japan, 4 per cent in the euro area and 6 per cent in Italy. The September terrorist attacks, the international tensions that followed and the stock market crisis aggravated the cyclical downturn.

The expansion of world trade, which had grown at a rate of 12 per cent in 2000, came to a halt.

The growth of the world economy in 2002, driven by the US expansion, was interrupted in the second half of the year by the mounting international political tensions and subsequently held back by the war in Iraq and the terrorist attacks in Europe and the Middle East.

The recovery

The Keynesian-style policy adopted by the United States in 2001 revived domestic demand for consumer goods and investment. Economic growth resumed at a rate of 2.2 per cent in 2002 and 3.1 per cent in 2003.

The federal budget moved from a surplus of 2.4 per cent of GDP in 2000 to a deficit of 3.5 per cent in 2003. Correspondingly, in relation to GDP the financial balance of firms and households gained more than 4 percentage points.

The Federal Reserve cut interest rates on short-term funds by 5.5 percentage points between 2001 and the middle of 2003, putting them at 1 per cent, the lowest level since the Second World War.

Consumption, fostered by the rise in disposable income, increased by 9 per cent in the three years. Investment in residential building, encouraged by exceptionally low long-term interest rates, rose by 4.9 per cent in 2002 and 7.5 per cent in 2003.

Investment in plant, machinery and transport equipment diminished; that in the IT sector increased sharply.

Thanks to labour market flexibility and the massive technology investments of the previous decade, productivity in manufacturing continued to rise rapidly even in periods when production stagnated. Unit labour costs in manufacturing fell by 2.5 per cent in the three years.

Imports remained stationary in the first half of 2003 but rose by nearly 7 per cent in the second. The cyclical upturn spread to all the other economies.

Japan's gross domestic product grew by 4.1 per cent in the second half of 2003 and by 2.5 per cent in the year as a whole. In the United Kingdom the figures were 3.2 and 2.2 per cent respectively.

GDP growth in the emerging and transition economies was greater than in the previous year and particularly strong in China and India. The Latin American economies began to expand again after stagnating in 2002.

In the euro area, where growth was modest in 2002 and close to nil in the first half of 2003, the acceleration was less marked. The year closed with an increase in GDP of 0.4 per cent.

The expansion of liquidity, the availability of finance at low interest rates and the reduced cost of capital fueled demand for investment, especially in the economies with the most efficient markets for factors of production.

In the United States, private-sector fixed investment rose by 4.4 per cent in 2003, after falling sharply in the two previous years. Low interest rates also buoyed demand for consumer durables.

In the United Kingdom the cyclical upswing was investment-led. In Japan demand was sustained by exports and in 2003 by investment.

The growth of the Chinese economy was driven by a 27 per cent increase in investment at current prices, partly in relation to substantial inflows of foreign capital.

In the euro area low interest rates continued to boost home purchases; capital spending on machinery and equipment declined, as in 2002.

Above all it is uncertain whether the euro area will participate in the recovery of international trade. Exports were hampered in 2003 by the appreciation of the common currency and will be again in 2004.

Outlook. Productivity and competitiveness

In the short term world economic activity is driven by the level of demand.

The present expansion of consumption and investment and the performance of international trade suggest that the growth of the world economy in the second half of 2003 is likely to continue this year.

In the United States GDP is expected to grow by around 4.5 per cent in 2004. In Japan growth might be as much as 4 per cent; in the first quarter it amounted to 5.6 per cent, which was more than expected. In the emerging Asian economies GDP should grow by about 7 per cent, driven by the robust expansion in China and India.

In the euro area no contribution came from either business investment or exports in 2002 or 2003. GDP growth this year should exceed 1.5 per cent.

According to the International Monetary Fund, world economic growth will be around 4.5 per cent in 2004.

The strength of the recovery is vulnerable to uncertainties stemming from heightened international political tensions and the rise in oil prices.

The participation of each economy in the expansion now taking shape at the global level will depend on its competitiveness.

In the United States manufacturing output per employee rose by 4.3 per cent a year between 1996 and 2003.

The average annual increase in total factor productivity more than doubled by comparison with the previous two decades under the impulse of the introduction of new technologies and improvements in the organization of production.

The rise in productivity is accompanied by population growth stemming from the positive balance between birth and death rates, which has declined from 7 to 5.4 per mille in the last ten years, and from flows of immigrants attracted by the country's competitiveness and favourable prospects.

The increase in population stimulates consumption and simultaneously adds to the labour force. The age structure of the population shows a markedly lower proportion of elderly persons than in Europe and Japan both now and in the future. A young population with a long life expectancy is the basis for investment in human capital.

In the euro area investment in new technologies is lower and productivity growth much slower than in the United States. The natural rate of population growth is around 1 per mille; any increase comes almost exclusively from immigration. The population is aging rapidly.

Improvements in the industrial structure are still held back by constrictions and rigidities in factor markets.

In Japan the population is aging faster than in Europe, but exports are growing more rapidly than world trade and twice as fast as imports.

The far-reaching restructuring carried out by large manufacturers in the final years of the last decade reduced employment by 600,000 but boosted productivity and profits. Since 2000 employment has fallen by more than 1,300,000 at small and medium-sized manufacturing firms as a result of crises and reorganizations. The return to relatively rapid economic growth in 2003 has had a positive impact on these companies as well.

Investment accelerated sharply last year. Initially focused on introducing innovation and advanced technologies, it subsequently spread to the more traditional components. Direct investment by Japanese firms in the emerging Asian economies continues.

The potential growth rates of the emerging economies remain very high. Their gradual shift towards medium and even high-tech goods and services and their low labour costs pose a competitive challenge for the advanced economies.

An increasing share of world industrial capacity is coming to be located in the emerging economies.

The sustainability of the recovery

In the United States the lowering of interest rates, tax cuts and higher public spending appear to have triggered a new phase of rapid growth.

Gross federal government debt amounted to 58 per cent of GDP at the end of 2000; it rose to 62 per cent at the end of 2003. The portion held by the market is equal to just 36 per cent of GDP.

Economic growth will have a beneficial effect on tax revenues. The Administration has committed itself to reducing the federal budget deficit from the 4.5 per cent of GDP forecast this year to 1.6 per cent in 2009 by curbing discretionary spending. The decrease in the deficit will slow the rise in the ratio of debt to GDP and cause it to decline from 2008 onwards.

The financial position of firms has benefited not only from the growth in demand but also from lower interest expense and tax relief. The ratio of debt to equity has decreased.

The household saving rate rose back to 2 per cent in 2003. The value of property holdings reached 185 per cent of disposable income and the proportion of households that own their home rose to 68 per cent. However, household debt increased to 108 per cent of disposable income.

In the opinion of most analysts, house prices do not constitute a speculative bubble. Share prices are not out of line with current and expected dividends and interest rates.

With the disappearance of all signs of deflation, official interest rates are expected to return to normal levels before long.

The repercussions on the economy and whether they are positive or negative will depend on how markets and economic agents perceive the significance of the increase and on its effect on expectations.

The recovery in employment is helping to sustain consumption.

The rise in investment in information technology, the increase in productivity and the good financial position of firms should ensure the continuation of rapid growth despite the expected rise in interest rates.

One factor of risk is the state of the external accounts. The current account deficit is of the order of 5 per cent of GDP; two thirds of it is due to the difference between the rate of growth in domestic demand in the United States and in the rest of the world. Net foreign debt is now more than 25 per cent of GDP.

Until now the external deficit has been financed by substantial inflows of capital in the form of direct and portfolio investment. In the last two years Asian countries have increased their purchases of US Treasury securities. American multinationals are still investing heavily in the emerging economies in order to take advantage of lower labour costs. The volume of short-term dollar-denominated assets held by the rest of the world has risen continuously.

The dollar has depreciated by 11 per cent since February 2002; the competitiveness of the US economy has improved in equal measure. Massive purchases of dollars by Asian central banks have slowed the depreciation. The increase in US net foreign debt in dollars has been curbed in the last two years by the weakening of the currency. Given the elasticities with respect to prices, the reduction in the current account deficit that will result from the lower level of the dollar does not appear to be decisive; over two years it can be estimated at around 1 percentage point of GDP.

Since the spring of 2002 the effective exchange rate of the yen has risen by 6 per cent; competitiveness has remained broadly unchanged. The euro has appreciated more sharply; the euro area's competitiveness has fallen by 17 per cent in two years.

The recovery of the world economy and the rapid growth of the Asian countries have put increasing pressure on commodity markets.

Although the rises in metal prices are not out of line with their behaviour in previous expansionary phases, in real terms oil prices have returned to the high levels they reached at the end of 2000, when the last expansion peaked. Prices are affected by the political tensions in the Middle East.

The lower energy intensity of output compared with previous decades and the growth in activities and investment of an intangible nature will help contain the impact of rising energy prices on inflation and growth in the industrial countries. The effects could be greater in the emerging economies.

The "Millennium Development Goals" and poverty reduction

Achieving rapid and sustained world economic expansion requires faster growth in Europe and, above all, progress extending to the backward economies.

For the poor countries, integration into the world trade system is essential.

Value added in these countries is formed primarily in the agricultural sector. Restrictions on trade in agricultural products and farm subsidies in the more advanced regions are equivalent to imposing tariffs of the order of 25 per cent on imports from the backward countries.

Fresh impetus must be given to the resumption of the multilateral negotiations begun at Doha in 2001. The European Union's proposal to abolish export subsidies for agricultural products could help break the deadlock.

By April 2004 thirteen countries had completed the procedures for reducing their foreign debt as part of the initiative in favour of heavily indebted poor countries. Another eleven countries have not yet satisfied the conditions to be eligible for relief. Efforts are under way to extend the deadline, which is currently set for December this year.

Following the Monterrey Conference in 2002, the developed countries pledged to increase the amount of official development assistance to the backward economies from $58 billion to $77 billion a year, or 0.29 per cent of the donor countries' GDP, by 2006. To achieve the objectives set by the United Nations in 2001, official aid would have to increase to more than €100 billion a year.

A Bank of Italy study shows that reducing inequality in developing countries tends to be associated with faster income growth.

The goal of halving the percentage of persons living on less than $1 a day by 2015 is unlikely to be achieved. Improvements have occurred in China and India, but the number of poor people in sub-Saharan Africa increased by a third in the 1990s.

The gravest situation concerns the health of the population. Epidemic diseases have large social costs, afflicting people who could otherwise contribute to economic activity. The insufficient development of human capital hinders the use and spread of new production techniques.

Initiatives such as that aimed at ensuring elementary education for all children in the economically backward countries are highly commendable.

Recent meetings of the Development Committee of the World Bank have underscored the need to broaden the focus of international efforts from institutional issues to encompass basic education and the supply of medicines at accessible prices.

The inclusion in the growth process of countries that have not benefited from trade liberalization or whose backwardness has prevented them from taking advantage of globalization will help defuse tensions. It is a necessary condition for the sustained growth of the world economy.

The Italian economy

The euro area

Euro-area GDP increased by 0.4 per cent in 2003. Investment declined further despite interest rates remaining at historically low levels.

Household consumption increased by 1 per cent. Exports were unchanged on the previous year, while imports of goods and services rose by 1.8 per cent.

Despite the sharp upturn in the world economy, economic activity struggled to revive in the three largest economies, which account for 70 per cent of the area's output.

In Germany gross domestic product contracted in 2003.

The sluggishness of Europe's largest economy dates back some years now. Between 1998 and 2003 output increased by just over 1 per cent a year, half the average for the rest of the euro area. The slow growth is an indicator of structural difficulties in an economy endowed with high-quality and competitive industrial capacity.

Exports continued to grow, gaining market share in the dynamic economies of South-East Asia as well as in the euro area. Between 1998 and 2003 the volume of exports of goods and services rose by 33 per cent, compared with an increase of 29 per cent in world trade. Market share rose from 10.7 to 11.3 per cent in 2003.

Industrial production rose by 6.4 per cent over the five years.

Domestic demand failed to contribute to growth in the last three years.

Between 2001 and 2003 investment fell by 12 per cent. After performing well in 1999, consumption progressively lost momentum and has contracted in the last two years. The number of unemployed, which fell until 2000, rose to 3.8 million at the end of last year, equal to 9.7 per cent of the labour force; in addition, more than 1 million workers were on retraining courses.

The propensity to save has risen, reflecting the uncertainty of households about the performance of the economy and the reform of Germany's very generous public welfare and pension system.

In France economic growth between 1998 and 2003 was slightly higher than the euro-area average; it was nearly double that in Germany.

Gross domestic product increased by 0.5 per cent in 2003. Industrial production rose by 6.3 per cent over the last five years.

Investment declined in 2002 and again in 2003, although it picked up during the year. Household consumption continued to increase even in the last two years of economic weakness in the euro area.

Since the mid-1990s exports have risen in line with world demand; they declined last year. As in other euro-area countries, the penetration of the domestic market by foreign products is making rapid gains.

The Italian economy, like Germany's, has grown at a pace well below the European average over the past five years, expanding at an annual rate of 1.4 per cent.

Consumption growth was weak but not out of line with that in the other euro-area countries.

Since 1999 investment in construction, especially residential building, has recovered in connection with low interest rates. In the last five years bank lending for house purchases has more than doubled. The rise in property prices, while substantial, has still been less than in other European countries and North America, thanks in part to the response of supply.

The loss of competitiveness with respect to the developed countries and, even more, the emerging economies remains the greatest weakness of the Italian economy.

Industrial production has risen by only 0.9 per cent over the last five years.

Investment in machinery, equipment and transport equipment has slowed since 2001; in the last two years it has decreased by more than 5 per cent.

Exports of goods and services declined in volume by 3.4 per cent in 2002 and by a further 3.9 per cent in 2003; in five years they grew by just 3.6 per cent. Italy's share of world trade at constant prices fell from 4.5 per cent in 1995 to 3.9 per cent in 1998 and 3 per cent in 2003; at current prices the decline was smaller. As the euro has strengthened, firms have kept their prices unchanged, but at the cost of reduced export volumes.

Italian exports are concentrated in traditional and luxury sectors, where they owe their success to quality and style. Italian sales of leather products and footwear and of furniture account for about 14 per cent of the world total. Italy's share of the market for non-metallic mineral products is about 12 per cent, while that of textiles and clothing is 7 per cent. All are mature sectors that taken together account for just over one tenth of world trade.

Italy produces few technologically advanced products, for which world demand is growing more rapidly than the average.

The country's share of the market for machinery and mechanical equipment has remained stable at around 10 per cent; for transport equipment it fell from 3.7 per cent in 1998 to 3.3 per cent in 2003.

The outlook for growth

In the United States both potential and actual output increased at a markedly higher rate in the second half of the 1990s than in the preceding decades. Annual labour productivity growth in services and industry rose from the previous average of 1.5 per cent to 3 per cent between 1995 and 2003. Inflationary pressures were limited; real wages and employment increased.

The flexibility of the labour market, the allocative efficiency of the financial markets, the laws governing economic activity and the solidity of the institutional framework can continue, as in the past decade, to foster an expansion and composition of investment capable of coping with rising consumer demand and growing competition in international markets.

The economy's productivity and the central role of the dollar in the international monetary system have demonstrated their ability to attract savings from the rest of the world.

On the basis of the favourable underlying economic and demographic conditions, the US economy is estimated to be capable of annual growth of around 3.5 per cent over the medium term.

In the euro area both potential and actual growth are lower.

According to the European Commission, the euro area's potential output increased at an average annual rate of 2.3 per cent in the 1980s and 2.1 per cent in the 1990s; in the three years from 2001 to 2003 there was a further slowdown.

The low growth and progressive aging of the population limit the medium-to-long-term expansion of expected demand, especially for the products of industry.

Persistently weak investment in new technologies, rigidities in factor markets, the modest scale of public and private research, and legislative and administrative constraints act as a brake on productivity. In the euro area the annual growth rate of labour productivity across the whole economy was 0.9 per cent between 1995 and 2003, compared with 1.9 per cent in the four preceding years.

The trend of production costs and the composition of supply are reflected in losses of international competitiveness and world market shares.

The deceleration of potential growth is evident in the three largest economies. In Germany, the annual rate of increase in potential output fell from 2.5 per cent in the first half of the 1990s to 1.5 per cent in the second and to 1.2 per cent in the period from 2001 to 2003. In France, the expansion of capacity remained close to 2 per cent.

Italy

In Italy, the average annual increase in potential GDP, estimated at 2.4 per cent for the ten years from 1981 to 1990, fell to 1.6 per cent between

1991 and 2003. Weak business investment will tend to impose a further limit on supply growth in the coming years.

The expansion of expected demand is curbed by the loss of competitiveness caused by meagre productivity gains and rising production costs. In the last two years the appreciation of the euro has also played a role.

The social legislation in force in Italy and other European countries was enacted in the late 1960s and early 1970s, at the end of two decades of strong growth; it was designed on the assumption of continued rapid expansion of the economy.

In the 1970s slower growth and the crisis of important branches of industry led to radical restructurings of production, but action to remove the legislative rigidities and improper costs burdening firms was insufficient.

The imbalances had repercussions on the public finances; they worsened as the population aged and employment growth slowed. The increase in the public debt weighed on the structure of the financial markets and on the interest expense of both the State and firms.

The repeated realignments of the exchange rate from the mid-1970s onwards brought out the ability of small and medium-sized enterprises to react and their role as an engine of employment and growth. With their more streamlined, flexible organization, these firms were also able to establish a presence in international markets.

In the 1990s economic policy tackled the adjustment of the enormous budget deficit. The reforms of the pension system, health care and local authority finances cut into the imbalances, but not deeply enough; they must be completed. The public debt continued to rise, albeit more slowly. Tax revenue had to be increased.

The rigorous monetary policy initiated in August 1994 subdued inflationary expectations and fostered a decline in long-term interest rates, with benefits for the public finances and for firms.

Italy’s return to the exchange rate mechanism in November 1996 and its subsequent participation in monetary union allowed interest rates to be lowered further and contributed to the stability of the financial system. These developments ended the possibility of adjusting the exchange rate in order to compensate for the inefficiencies and competitive difficulties of the domestic economy.

The share of off-the-books employment remains large. The tendency of firm size to shrink, under way since the end of the 1970s, has intensified; the gap vis-à-vis the other main industrial countries has widened.

According to 2001 census data, the average number of workers in Italian firms is less than 4. Excluding the 2.4 million firms with a single worker, the average workforce numbers around 8, compared with 13 in France and Germany and 15 in the United Kingdom.

The fragmentation of the economic structure limits productivity gains, research, the development of innovative, technologically advanced products, and the conquest of new markets.

Against a background of wage moderation, in the late 1990s reforms aimed at increasing flexibility in the use of labour produced immediate effects, with a rise in the number of persons in work and a reduction in unemployment. Thanks also to the fall in the cost of money, corporate profitability remained generally satisfactory.

The banking system underwent a radical restructuring.

But competitiveness continued to weaken, especially in industry. Productivity gains lagged behind those achieved in the other major industrial countries in the 1990s, most notably in the second half of the decade.

Labour productivity in the economy as a whole rose by 0.7 per cent per year between 1995 and 2003; in the last two years it diminished. Total factor productivity increased by 0.9 per cent per year between 1991 and 1995. In the second half of the decade, this slowed to 0.5 per cent. In the last three years there was a decrease of 0.7 per cent per year.

Econometric analysis of the data on the major branches of the economy shows that gains in total factor productivity depend on the intensity of investment in new technologies and the extent of exposure to international competition. These characteristics in turn are correlated with firm size.

Low growth and loss of competitiveness are causing difficulties in an increasing number of companies, including some larger ones. In the last three years a significant number of firms operating in traditional sectors have had recourse to wage supplementation or mobility benefits for their workers, or have gone out of business. In 2001 the number of hours covered by wage supplementation was equivalent to the work of 90,000 full-time employees; in 2003 this figure rose to 130,000.

It is necessary to reverse the trend, to return to a path of rapid growth.

Building on widely distributed and lively entrepreneurial abilities, on restored cooperation with the banking system, industry must regain its propulsive role and contribute to the creation of a new model of development.

Italy's economy has long been distinguished by industrial districts, which have attenuated the disadvantages of smallness.

A profitable, competitive core of some 3,700 medium-sized firms, with between 50 and 500 workers each and employing a total of almost 500,000, achieved above-average sales growth and helped to sustain exports in the second half of the 1990s.

Most of these firms are family-controlled, well-capitalized and operate in traditional sectors and market niches.

An increase in their size, more investment in research, expansion into adjacent segments of activity and greater penetration of foreign markets could significantly improve the Italian economy's growth prospects.

An opening to the capital market and more efficient corporate governance structures are necessary.

These companies can act as reference points and poles of attraction for smaller firms.

The role of the credit system will be decisive. Banks have made an important contribution to the reorganization of large industrial groups, of which Italy has relatively few. Large companies are essential to augmenting Italian industry's capacity for innovation.

The privatization and liberalization begun in the 1990s must be carried through to completion. Action must be taken to improve the low tenor of competition in the service sector, particularly in business services.

In agriculture and food-processing, more stress on quality products and an increase in the average size of production units can enable Italian firms to succeed in foreign markets. In tourism, action to protect the environment and to improve tourist services and facilities can, indeed must raise Italy's market shares to a level consistent with the country's wealth of cultural and natural resources.

To achieve widespread application of information technologies, the commitment of producers, possibly joined in consortia of small and medium-sized firms, and cooperation with the high-level scientific research centres that exist in Italian universities are indispensable.

Basic research, reorganized according to the needs of an advanced nation, and, in a shorter-term perspective, more intensive and pervasive use of the new technologies are crucial for the growth of the Italian economy and for Italy to be a player in an ever-more competitive world arena.

Competitiveness is weighed down by energy costs that are more sensitive in Italy than elsewhere to oil price fluctuations. Italy is in the forefront in experimenting with renewable, clean, competitive energy sources. Public support and private-sector interest must ensure we maintain the comparative advantage we now enjoy even with respect to the most advanced economies.

Productivity depends significantly on the external economies generated by public infrastructure.

Projects for the creation of Community infrastructure networks, with the contribution of private capital, were defined during Italy's presidency of the European Union. With the public works enabling law, Italy launched a programme to close its infrastructure endowment gap vis-à-vis the other EU countries; execution of the programme must be accelerated.

The cyclical situation

Public works spending turned upwards in 2003. Most of the growth in activity occurred in the northern regions; in the South, the value of the works executed fell slightly.

The works carried out in 2003 were largely the continuation or completion of projects begun in previous years, only in part new projects. The obstacles to carrying out the programmes derive from the small volume of resources available and administrative difficulties. In the northern regions, labour shortages are also a problem.

Considering the good progress of contract tenders, activity can be expected to pick up over the next two years, giving impetus to domestic demand.

The divergence between the downward trend of industrial production in Italy and the expansion in the other European countries has become more evident since the middle of 2002. In the first quarter of this year industrial production rose again in Germany and France. In Italy it fell by 0.5 per cent and according to preliminary estimates the decline continued in April and May.

GDP did not expand in the final part of 2003; despite a progressive reduction in industrial output, it did increase in the first quarter of this year.

According to the Bank of Italy's survey of the investment plans of companies with at least 20 employees, after contracting last year investment in the manufacturing sector is likely to stage a moderate recovery in 2004. Large firms above all are expected to step up their investment; planned capital spending by companies with fewer than 200 employees is set to be cut once more.

The growth of international trade in 2004 is forecast to be of the order of 7 per cent. Italian exports are rising again, albeit more slowly than world demand.

The impulse imparted by exports, together with the upturn in business investment and the recovery in public works, should boost overall demand and lead to an increase in output of the order of 1 per cent. The growth in output would remain below potential.

In a favourable international context, national output growth could rise to 2 per cent in 2005. Employment could expand faster.

The financial markets and banking

The worldwide abundance of liquidity contributed to further expansion of activity in the financial markets in 2003. The volume of funds raised by firms and governments increased and bank lending continued to grow.

The financing of the economy

In Italy total finance to all sectors of the economy in the form of bank loans, bond and equity issues and other instruments was equal to €255 billion last year; of this amount €65 billion flowed directly from abroad to non-bank sectors.

The corporate sector, including finance companies, received €108 billion, households €32 billion. Counting the assets and liabilities of Cassa Depositi e Prestiti in the public sector, the latter registered inflows of €36 billion. A total of €79 billion flowed abroad, partly for asset purchases by investment funds.

The share of total saving absorbed by the public sector has diminished gradually since the mid-1990s, while that going to firms has increased. In eight years credit to households, mainly for the purchase of housing and consumer durables, has risen from 8 to 13 per cent of the total flow.

The funding of firms in 2003 comprised €29 billion of equity, €34 billion of bond issues and €45 billion of bank loans. In 2002 corporate bond issues had amounted to €38 billion. In the mid-1990s, firms' recourse to the bond market had been negligible.

The efficient operation of the capital market presupposes that issuers disclose complete and correct information on their profits and losses and balance-sheet situation, so as to enable intermediaries and investors to make a well-founded evaluation of the risk and expected return on their securities.

Companies' internal control systems, enjoying the necessary independence, must ensure reliable operations and correct reporting to top management. Companies' governing bodies are liable for the truthfulness of the data made public, first and foremost in their financial statements, which guide financial analysts' evaluations and investors' decisions.

For listed firms and others that raise funds on the market, the law assigns auditing firms the task of certifying that the accounts are properly prepared and transactions exactly recorded, and that the financial statements correspond to the company's books.

The reforms enacted in the United States following the corporate scandals of recent years have reinforced the controls that corporate bodies and outside auditors must exercise over companies' operations and the information that must be made public. More severe sanctions have been enacted for directors and auditors for incomplete or false disclosure in financial statements. The controls of the Securities and Exchange Commission have been stepped up. A new agency under the SEC has been formed to oversee auditing firms.

In the light of the conduct that marked the recent corporate crises in Italy, internal and external controls need to be reinforced here too, thus strengthening the market's capacity to gauge the real performance of companies and their directors.

The resources allocated to the authority charged with supervising companies and markets must be increased so that by examining periodic filings and carrying out inspections it can promptly and systematically verify the correctness of operating procedures and the quality of the data made available to the market.

Investor protection also requires full disclosure and proper conduct on the part of the intermediaries that place or trade securities.

We welcome measures aimed, in part through closer international cooperation, at preventing the use of complicated corporate structures with ramifications in off-shore centres whose sole purpose is to evade the rules on transparent financial reporting.

Banks and credit risk

In the United States the economic recovery has had positive effects on the accounts of the banking system. Commercial and industrial loans diminished again in 2003, but credit supply conditions are easing. The quality of loan assets improved, and writedowns were less than in 2002. Income continued to increase rapidly, owing in part to large-scale securitization of credit claims and relending of the proceeds. In connection with the modest rise in operating costs, the return on equity amounted to 15 per cent. Non-interest income accounted for 45 per cent of revenues.

Japan's banks are also benefiting from the economic recovery and higher share prices. There was a further reduction in the volume of bad debts, primarily among the largest banks.

In the euro area there was a modest acceleration in bank lending in 2003. The fastest-growing component was household credit. In Germany lending to firms diminished and banks' profitability remained very low, especially for the largest groups, which undertook reorganization and substantial staff downsizing. Lending to firms decreased in France as well, although banks' income and profits increased.

In recent years swings in the stock markets and exchange rates, the world business cycle and severe political and military tensions have subjected the international financial system to heavy pressures. It has absorbed the fluctuations better than in the past; there have been no significant cases of instability.

The soundness of financial systems has benefited from the development of the markets and derivative instruments, which have helped redistribute risks among the institutions prepared to assume and manage them.

The international derivatives market registered particularly rapid growth last year. These instruments enhance intermediaries' operational possibilities; resort to them modifies banks' *modus operandi*; the reallocation of credit, exchange rate and interest rate risk has contributed to the stability of banking systems.

The supervisory authorities are carefully monitoring the phenomenon, individually and in the fora for international cooperation.

The Bank of Italy issued prudential regulations on credit derivatives some years ago, together with rules for the presentation of derivatives in banks' accounts. Regulations on the organizational structures of intermediaries that do business in these instruments are being finalized.

Bank lending to firms rose by 6.3 per cent in Italy last year, 3 points above the growth rate of nominal GDP and also 3 points more than the average rise in the euro area.

The cost of credit to firms is very low in both real and nominal terms, owing in part to more intense competition. Rates on both short-term and medium and long-term loans came down over the year by 0.8 percentage points, to 5 and 4 per cent respectively. These rates are in line with the rest of the euro area, even though the average Italian borrower is smaller.

Credit supply conditions remained expansive; undrawn margins on current account overdrafts are ample for all categories of customer.

As in 2002, lending to small firms grew more rapidly than that to larger firms, with increases of 7.6 and 6.1 per cent respectively.

Southern firms in particular benefited from easy access to credit. The increase in lending has been significantly greater than for firms in the Centre and North of Italy. Adjusting for the different size and sectoral distribution of firms in the two parts of the country, the gap in short-term lending rates has remained equal to 1.2 percentage points, reflecting the higher credit risk in the South.

Continuing a trend that began in the second half of the 1990s, lending to households rose substantially. Demand was fueled by low interest rates; not only home mortgages but also consumer credit expanded rapidly.

The annual percentage rate of charge on new home mortgage loans decreased by 1 percentage point in Italy last year to 3.9 per cent. More than three quarters of the loans were at variable rates. The advantage of small initial instalments comes at the cost of a possible rise in interest rates, and borrowers must be aware of this.

Credit quality suffered from the Cirio and Parmalat defaults. Exposures equal to 1.2 per cent of loans outstanding at the start of the year were classified as bad debts during the year, compared with 1 per cent in 2002.

Credit risk remains generally low by comparison with the period following the cyclical downturn of the early 1990s. From 1994 to 1996 new bad debts averaged 2.5 per cent of outstanding loans each year. The evolution of loan portfolio risk depends on the prospects of the economy returning to a path of sustained, rapid growth.

Between 1999 and 2003 banks transferred loans amounting to €71.9 billion to the market through securitizations, including €26.4 billion of bad debts. Securitizations of bad debts essentially came to an end in 2002.

The risk on the securitized credits was virtually all taken up by Italian or foreign institutional investors. In the case of securitizations of bad debts, the originator banks not only charged the writedowns to income but also took up the riskiest securities.

To protect themselves against the possible deterioration of their portfolios, banks took out credit derivative contracts for a notional value of €46 billion. In turn, they provided hedges for €42 billion.

The new Capital Accord now nearing completion at the Basel Committee for Banking Supervision adopts risk management techniques consistent with international best practice.

The new Accord introduces procedures of varying complexity for calculating capital requirements. It leaves it to banks themselves to choose the method that best suits their loan portfolio and their risk measurement and management techniques. The new Accord is expected to take effect in 2006 or 2007. On the basis of statistical analyses conducted in 2003 by the Bank of Italy, trade associations and Italian and foreign research centres, adverse consequences are not expected for the financing of firms, especially small and medium-sized ones.

Profitability and capital

In recent years the Italian banking system has carried out a restructuring and a reallocation of ownership comparable in breadth – albeit in a different context – to that of the 1930s. The Bank of Italy made sure that consolidations did not undermine competition.

The experience of a number of countries indicates that for larger banks an increase in the scale of business does not necessarily improve stability or efficiency, owing to the difficulty of integrating and managing complex structures.

In Italy the banking groups arising out of consolidations between banks with dissimilar operational characteristics are engaged in restructuring their organizations in order to enhance efficiency and profitability.

A simplification of corporate structures is under way, in order to improve group governance. Operating and IT procedures for risk control are being standardized. On-line banking channels, networks of financial salesmen and branch networks are being rationalized.

Strategies to expand abroad require a major effort. With a view to EU enlargement and in support of Italian firms' business operations, Italian banks have moved into Central and Eastern Europe. In four countries they now have significant shares of the local banking market.

The total assets of Italian banks were 31.7 per cent higher in 2003 than in 1996 at constant prices and net revenues 18.3 per cent higher. Over the same period the number of employees decreased by 3.5 per cent.

Operating expenses held broadly stable last year, while consolidated gross income rose by 2.7 per cent to €65.8 billion.

The ratio of operating expenses to gross income is low by comparison with other European banking systems. The share of staff costs in operating expenses is higher.

Return on equity improved by 0.3 percentage points to 6.7 per cent. The profitability of the system was affected by the writing down of exposures to the Cirio and Parmalat groups.

Self-financing amounted to €3.3 billion and equity issues to €2.5 billion.

The banking system's consolidated capital rose to €139.8 billion. The solvency ratio improved slightly to 11.4 per cent, which is still about one point below the average for EU banks in 2002.

The Bank of Italy regularly reviews the capital adequacy of the banking system using statistical procedures that simulate highly unfavourable market conditions. These analyses indicate that the banks have sufficient capital to cope with sudden changes in interest rates or even with the extreme contingency of a deterioration in the financial position of firms and a fall in real estate values comparable to that of the recession of the early 1990s.

The assessment of the International Monetary Fund

Supervisory activity is carried out within the legal framework established by the Consolidated Law on Banking and the Consolidated Law on Finance in accordance with European law and the principles agreed by the international financial community.

In 1997 the Basel Committee laid down the “Core Principles for Effective Banking Supervision”.

Underlying Italy’s legislation in this field is the concept of banking as an entrepreneurial activity, in line with the First Banking Directive. Supervision is performed without infringing on banks’ operational autonomy in any way, as regards either corporate policies or individual decisions, especially the granting of loans.

The International Monetary Fund has been entrusted by its member governments with the task of making detailed assessments of the supervisory rules and practices adopted by both developed and emerging countries, with a view to verifying their compliance with international standards. At the end of last year 101 countries had been assessed, of which 7 belonged to the Group of Ten. The assessment of Italy was conducted in 2003.

The Fund’s report, published in the last few weeks, judged the Italian system of banking supervision to be of high quality: with reference to the 30 Basel Core Principles, Italy was found to comply with 24 and to be largely compliant with 5; in only one case was it found to be non-compliant. The assessment is highly satisfactory, also when compared with those of other important countries. The non-compliance concerns the absence in the Italian legal system of rules protecting its supervisors against liability for measures adopted in good faith in carrying out their functions.

Appreciation was expressed for the independence with which supervisory activity is performed and the transparent way in which the Bank makes the principles and methods of supervision public; a positive judgement was passed on the collaboration with the supervisory authorities of the other sectors of the financial system.

The Fund deemed that the rules of prudential supervision in force in Italy conformed with the best practices recommended by international bodies. The analysis of supervisory data was judged to be systematic and thorough, thanks to the integration of the examination of statistical reports with on-site controls. It considered the Bank's interventions to be appropriately graduated according to the seriousness of banks' situations.

Households and the protection of savings

Wealth, both real and financial, is the result of the accumulation of savings over time and of the change in the value of its components. It is held by the public sector, households and the foreign sector. Ultimately, the value of industrial and financial businesses also belongs, directly or via intermediaries, to these sectors.

At the end of 2003 the gross wealth held by households was some €8,200 billion or more than 6 times GDP, a ratio that was in line with those of other economically and financially developed countries.

Of households' total wealth, €5,300 consisted of real estate and other real property, €2,900 of financial assets.

Households' holdings of cash, deposits, bonds and other bank fund-raising instruments amounted to €854 billion, or 29 per cent of their total financial wealth. Their holdings of postal deposits and public-sector securities amounted to €421 billion, or 15 per cent of the total, while shares and other equity interests were valued at €567 billion. The corporate bonds issued by Italians firms held directly by households amounted to €54 billion.

Italian households' purchases of the bonds issued, directly or through foreign subsidiaries, by the two companies that have collapsed amounted to about €3 billion.

The rest of households' financial wealth consisted of investment fund units totaling €326 billion, insurance companies' technical reserves, a small amount in respect of pension funds, and severance pay entitlements and foreign assets.

Compared with more financially developed countries, there is still a widespread tendency for savers to take their own investment decisions; these need to be based on detailed evaluations of financial instruments that differ considerably in terms of maturity, yield structure and issuer risk.

The provisions of the Consolidated Law on Finance concerning investment services and the implementing regulations issued by Consob require intermediaries to comply with transparency obligations and rules of conduct designed to put customers in a position to make informed investment choices. When trading securities, intermediaries are required to ensure counterparties are aware of the features of the financial instruments and to evaluate their suitability with respect to investors' risk propensity and wealth.

The corporate failures have highlighted the need for a financial system long oriented towards deposit-taking and the placement of government securities to adapt corporate conduct and structures to the rapid shift in investors' preferences towards assets with higher risks and yields. Intermediaries must thoroughly evaluate the riskiness of securities they trade and make it clear to investors.

The ability to promote customers' interests is the basis of intermediaries' reputation, the essential condition for maintaining and expanding profitable business dealings with households and firms.

This is the contribution of ethics and professionalism to customer relations that I have repeatedly called on all those operating in the securities market to make, banks first and foremost.

At the request of Consob, the Bank of Italy verified compliance with the rules on investment services at some banks. The formal acts required were found to have been performed for the bulk of the transactions examined.

There is a need for banks to improve the quality of their procedures for the provision of investment services. Their internal control systems must ensure appropriate conduct and the supply of adequate information to investors.

Attention must be paid to the training of the persons charged with assisting customers. Every investor must be aware that higher yields necessarily entail higher risks.

The economic and social importance of savings is enshrined in Article 47 of the Constitution.

The volume of savings generated in the economy is decisive for the welfare of households; by financing investment, savings provide the basis for the growth of economic activity and employment.

The protection of savings, founded in the Constitution, is entrusted, as far as the banking component is concerned, to the supervision of the Bank of Italy. The security of these savings depends on banks' stability. It follows that a unitary view of the savings entrusted to banks and their utilization in favour of investment and production is indispensable.

Ever since the adoption of the 1936 Banking Law, no depositor in Italy has ever lost any money. The total cost of public intervention in crises has been much less than in the other leading countries.

The stability of insurance companies and other institutional investors is also the key to the protection of the savings they are entrusted with.

In the case of funds raised by companies directly in the market, the possibility of losses is inherent in the riskiness of entrepreneurial activity; it is compensated, on average, by a higher yield.

The protection of savings is being debated in Parliament. The European Central Bank has issued an opinion on this matter in which it stresses, in the light of Community legislation: the specific nature of bank fund-raising and lending; the essential role of the central bank in fostering the soundness of financial institutions and the financial system as a whole; and the broad scope of prudential supervision in a necessary context of institutional independence.

As a direct response to the events that have revealed the need, steps must be taken to increase the effectiveness of the controls on activities which have seen situations arise that have harmed thousands of families and impinged on the orderly functioning of parts of the financial market.

At the Bank we are respectfully following the debate under way; we are convinced that Parliament’s decisions will reinforce the confidence of savers.

We have invited banks to re-establish a relationship with their customers founded on trust in the cases in which, even if only on the basis of internal investigations, it was found that the needs of investors had not been looked after as well as possible. Several banks have taken steps in this direction.

The restoration of a favourable climate in the financial market and in attitudes towards intermediaries is essential for the continuity of support for production and investment, especially at a time of cyclical weakness and difficulties at some companies.

In Italy an excessively large share of savings has been absorbed by the public sector. Bringing the ratio of public debt to GDP down towards the values obtaining in the other industrial countries, especially those participating in the Monetary Union, will increase the resources available to the private sector.

The formation of savings and their amount depend on the growth of the economy. Economic policy, firms' activity and the behaviour of the social partners must be directed first and foremost at achieving growth.

The primary task of economic policy in the present difficult context is to curb the quantity of resources absorbed by the public sector.

General government net borrowing on an accrual basis was equal to 2.4 per cent of GDP in 2003.

The figure forecast for this year is 2.9 per cent.

The state sector borrowing requirement on a cash basis was €43 billion in 2003. In the first five months of this year it is estimated to have been €48 billion, compared with €37 billion in the corresponding period in 2003. The Government does not rule out the possibility of measures to curb the imbalances in the public finances in the second half of the year.

In the absence of corrective measures net borrowing will exceed 3 per cent of GDP; it might rise to 3.5 per cent. As a consequence of the drying up of receipts from one-off measures, net borrowing in 2005 would be around 4 per cent of GDP.

The increase in the budget deficit in recent years has been influenced by the cyclical weakness of the economy. It also reflects the failure to correct the underlying trends that lead to a widening gap between the growth of current primary expenditure and that of taxes and social security contributions.

Expenditure on health care and social security outlays are rising in relation to GDP. The primary surplus was 5.2 per cent of GDP in 1998; it fell to 2.9 per cent in 2003 and is forecast by the Government to fall to 2.2 per cent this year.

The public debt remains very large. International monetary developments have permitted interest payments to be reduced; the return of interest rates to normal levels will affect the deficit.

The performance of the public finances and the volume of debt reduce the scope for budgetary policies to support domestic demand by increasing the deficit. The positive effect produced by an increase in the private sector's disposable income would be more than offset by the adverse effect deriving from the further increase in public debt.

A decrease in the tax burden must be the outcome of a reduction in current expenditure in relation to GDP; what is required is a rationalization of governmental activity and an increase in the efficiency of public services.

It is necessary to revive growth, starting with investment demand.

The contribution of expenditure on infrastructure has been less than expected. Now that the necessary legislative groundwork has been laid, it is important to proceed with the realization of projects, to support demand and give certainty to the prospects of the removal of the external diseconomies caused by the inadequate endowment of public capital.

The downward trend of industrial production is a threat to the stability of a growing number of marginal firms.

The banking system must be strong enough to provide production and investment with support in this difficult phase of the economic cycle; it can help reverse the trend. It must improve its ability to assist Italian firms in their expansion abroad.

A renewed collaborative relationship between the social partners makes it possible to focus on growth in a medium-term perspective again.

Italy needs an economic policy that is clear, certain and based on reliable data and well-defined and widely accepted measures set within a long-term strategy.

The restoration, in an appropriate number of years, of balanced public finances and a reduction in the weight of the debt are indispensable conditions for the return to macroeconomic stability.

Research must become a priority goal of investment.

The labour market reforms enacted have stimulated employment and ensured sufficient flexibility. For this not to turn into precariousness and lower productivity, a higher rate of growth is indispensable. To this end, it is necessary to maintain a degree of wage moderation that safeguards the link with productivity.

A stable economic policy framework can increase the interest of foreign businesses and investors. A South of Italy more closely integrated into the national and European economies offers a reserve of potential growth in view of the abundance of young people and the cultural and environmental resources on the basis of which to develop tourism and forms of production hinging on human capital, new technologies, especially information technology, and renewable energy sources.

Artisanal businesses play an important role in Italy’s economic and social fabric. Firms that wish to grow in the domestic market and expand abroad must necessarily aim to rationalize and increase their scale of production, with the help of information technology and possibly through consortium arrangements.

There will have to be aggregations, reorganizations of ownership and financial structures. Cultural barriers and difficulties must be overcome.

Banks, their initiative and their ability to play a role in team efforts are essential for a new phase of growth.

The major banking groups, their increased efficiency and the spirit of enterprise of local banks can make an important contribution, thanks in part to their store of information, to the birth of new projects and to the modernization, enlargement and enhancement of the many, already highly profitable, medium-sized firms present in the Italian economy.

Further progress needs to be made in the reform of the law governing economic activity. Banks must be able to support firms in difficulty, restructure them and relaunch the viable parts, possibly under new owners.

There are signs of an upturn in investment by the largest industrial firms; public investment is set to accelerate; world demand for goods and services is expanding rapidly.

We must take part in the international recovery, with respect to which Europe and especially Italy have remained on the sidelines.

It is within our reach. The social partners and the banks need a clearly defined and agreed reference framework. The forthcoming Economic and Financial Planning Document must provide guidelines in this respect.

In harmony with Italy’s civil traditions, economic growth and social development cannot be pursued independently of Europe.

We must learn from younger and more dynamic countries, worldwide, emulate the good things they have created in economic and public life. In developing Italy’s political and cultural relations, we must look, in friendship, to the West but also to the East and the southern shore of the Mediterranean.

Economic growth is slow in Europe owing to the aging of the population and the stratification of legal and social structures put in place in an earlier age of faster growth. We must conserve the spirit of those structures. The demographic crisis needs to be tackled by an opening, carefully regulated, of our country to foreigners who come here to find better living conditions and to contribute to our economy. Above all there is a need to give renewed vigour to policies for taxation and public services and for measures to support families and create a climate of confidence for the education of young people. The ability to look ahead with optimism must not be lost.

On the first day of this month of May 2004 the European Union made a historic advance.

Ten new countries joined, bringing with them a variety of cultures, traditions and languages that cannot but enrich our patrimony of civil values; a substratum of common historical, cultural and religious roots is clearly intelligible.

The immediate problems facing the government of the new Union are considerable, as are those facing the economy.

But by enlarging the Union we have enlarged the market; in time this will prove beneficial. In many cases Italian firms and banks are already grasping the opportunities created.

The new Union is better placed to have its values accepted by the nations of the world and to contribute to peace, the indispensable condition for relations among peoples, for the advancement of trade and for the economy.

We are working to create a future that, in order to provide security, must be based on a harmonic set of moral values, laws and economic structures that will realize the expectations of all those, including many in our advanced societies, who await an improvement in their living conditions, and give confidence and hope to the new generations.

ANNUAL ACCOUNTS

NOTES TO THE ACCOUNTS [1]

The Bank's results for the year 2003 were affected both by the depreciation of the US dollar and the yen against the euro, the former by about 20 per cent (from 1.0487 to 1.2630) and the latter by about 9 per cent (from 124.39 to 135.05) and by the fall in interest rates in the euro area and the dollar area.

The year-end balance sheet total was equal to €145,526 million, slightly down from €147,338 million at the end of 2002. On the assets side most of the reduction was due to the fall in the value of foreign currency assets as a result of exchange rate movements, partly offset by the increase in refinancing operations, and on the liabilities side to the contraction in the balances on the Treasury's accounts, foreign currency liabilities and provisions for risks following withdrawals, partly offset in turn by the increase in banknotes in circulation.

The net profit for the year amounted to €52 million, compared with €64 million in 2002. The result for the year, which benefited from the increased interest income from the government securities received in the bond conversion carried out under Law 289/2002, was influenced by the €4,629 million of foreign exchange writedowns, which were partly covered by withdrawals from provisions for risks. These unrealized losses contributed to a tax loss of €2,949 million.

On 30 April 2004 the exchange rate of the dollar against the euro was 1.1947 and that of the yen 131.87, a recovery of respectively 5 and 2 per cent with respect to the year-end exchange rates.

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 special statutory provisions 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 where appropriate 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 5 December 2002 (ECB/2002/10), which has replaced similar instruments adopted from 1998 onwards, 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 for the Economy and Finance;

– 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 2003 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. Unrealized gains are included in the corresponding revaluation account; unrealized losses in excess of earlier unrealized 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 65.3 of Law 289/2002;*
– *the cost of gold, for civil law and tax purposes as well, is equal to the amount stated in the accounts net of the pertinent revaluation account.*

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. Unrealized 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. Unrealized losses in excess of earlier unrealized 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;*
– *shares denominated in foreign currency held as fixed assets continue to be valued at the historical exchange rate;*

– *the International Monetary Fund quota is translated on the basis of the euro/SDR exchange rate communicated by the IMF on the occasion of the last transaction undertaken 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 par 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 valued, 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; unrealized gains are included in the corresponding revaluation accounts; unrealized gains 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; unrealized losses in excess of earlier unrealized 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;*

     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 or special situations of 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):*

     a) *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 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 accelerated depreciation may be 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

– *valued at purchase or production cost.*

Procedures, studies and designs completed

– *valued 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, 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.

As of 2002 the ECB has been allocated a share of 8 per cent of the total value of euro banknotes in circulation, whereas the remaining 92 per cent has been allocated to each NCB according to its weighting 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 that of the euro banknotes it actually puts into circulation gives rise to remunerated intra-Eurosystem balances. From 2002 until 2007 the intra-system balances arising from the allocation of euro banknotes are 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 to 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 recognized separately to the NCBs on a quarterly basis 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 and subject to any decision by the Governing Council to reduce this income in respect of costs incurred by the ECB in connection with the issue and handling of euro banknotes. The interim distributions by the ECB, corresponding to the share of the ECB's seigniorage income recognized as pertaining to the Bank of Italy, are recorded on an accrual basis in the year to which the income refers, by way of derogation from the cash policy applied in general to dividends and profits from participating interests.

For 2003 the Governing Council decided, in the light of the result recorded by the ECB, that the full amount of the seigniorage income should be retained by the ECB.

INTRA-EUROSYSTEM ASSETS AND LIABILITIES

For each NCB the intra-Eurosystem balance arising from the allocation of euro banknotes within the Eurosystem is included 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 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 of amounts arising from possible disputes with the tax authorities.

SUNDRY STAFF-RELATED PROVISIONS

Transfers to the provision for severance pay and pensions of staff hired before 28 April 1993 are included in the annual accounts under Article 3 of the related Rules for an amount that comprises the severance pay accrued at the end of the year, the actuarial reserves for the disbursements to pensioners and those corresponding to the situation of staff having entitlement.

The provision for staff costs includes the estimated amount of costs that had accrued (such as sundry bonuses, holidays not taken, contributions set aside for newly-hired staff) but not been paid at 31 December 2003.

Transfers to the provision for grants to BI pensioners and their surviving dependents are made in accordance with 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, are determined in accordance with Law 297/1982.

For staff hired from 28 April 1993 onwards a defined-contribution supplementary pension fund has been created (for more details see below under Other assets and liabilities).

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 from 28 April 1993 onwards. 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.

The item "Other liabilities" includes the lira banknotes that have not yet been presented for conversion.

INTEREST RATE FUTURES ON THE DOLLAR MARKET

Initial margins and daily variation margins are recorded in the balance sheet; when positions are closed, the positive or negative variation margins are taken to the profit and loss account, converted at the exchange rate on the day.

At the end of the financial year the negative margins on open positions are taken to the profit and loss account while the positive margins are transferred to the corresponding revaluation accounts.

MEMORANDUM ACCOUNTS

Securities held on deposit are stated at their nominal value; shares are stated on a quantity basis; those of other kinds at face value or at conventional value.

Futures contracts are recorded on the trade date at their notional value.

Foreign currency amounts are converted at the year-end exchange rates communicated by the ECB.

2. Comment on the accounts

2.1. *Balance sheet*. – Excluding memorandum items, the year-end balance sheet total was equal to €145,526 million, compared with €147,338 million at the end of 2002 (Tables 1 and 2).

Assets:

The item *Gold and gold receivables* rose by €279 million (from €25,763 million to €26,042 million) owing to the increase in the year-end market price communicated by the ECB (from €326.83 to €330.36

Table 1

BALANCE SHEET - ASSETS

(thousands of euros)

		Amounts at end- 2003	Amounts at end- 2002	Changes
1	**Gold and gold receivables**	**26,042,196**	**25,763,615**	**278,581**
2	**Claims on non-euro-area residents denominated in foreign currency**	**24,064,857**	**27,316,456**	**–3,251,599**
2.1	Receivables from the IMF	4,211,995	4,681,552	–469,557
2.2	Securities (other than shares)	14,764,932	18,770,623	–4,005,691
2.3	Current accounts and deposits	5,085,718	3,687,102	1,398,616
2.4	Reverse operations	–	174,826	–174,826
2.5	Other claims	2,212	2,353	–141
3	**Claims on euro-area residents denominated in foreign currency**	**6,449,176**	**5,298,229**	**1,150,947**
3.1	Financial counterparties	6,449,176	5,298,229	1,150,947
	3.1.1 Securities (other than shares)	*1,848,797*	*2,125,504*	*–276,707*
	3.1.2 Reverse operations	–	–	–
	3.1.3 Other claims	*4,600,379*	*3,172,725*	*1,427,654*
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**	**8,196,819**	**6,933,008**	**1,263,811**
5.1	Main refinancing operations	8,190,918	6,932,866	1,258,052
5.2	Longer-term refinancing operations	–	–	–
5.3	Fine-tuning reverse operations	–	–	–
5.4	Structural reverse operations	–	–	–
5.5	Marginal lending facility	5,901	–	5,901
5.6	Credits related to margin calls	–	142	–142
6	**Other claims on euro-area banks**	**227**	**401**	**–174**
7	**Securities issued by euro-area residents (other than shares)**	**1,672,191**	**1,577,708**	**94,483**

Table 1 *cont.*

BALANCE SHEET - ASSETS

(thousands of euros)

		Amounts at end- 2003	2002	Changes
8	**General government debt**	**18,716,265**	**18,872,448**	**–156,183**
	Government securities deriving from the conversion of bonds under Law 289/2002	*17,620,737*	*17,727,042*	*–106,305*
	Items arising from the Bank's former management of stockpiling bills - securitized part	*1,061,836*	*1,111,714*	*–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**	**8,192,250**	**–**
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	**Items to be settled**	**10,975**	**7,161**	**3,814**
11	**Other assets**	**52,180,741**	**53,377,152**	**–1,196,411**
11.1	Euro-area coins	18,375	25,744	–7,369
11.2	UIC endowment fund	258,228	258,228	–
11.3	Investments of reserves and provisions (including shares)	28,433,560	28,291,710	141,850
	Governments securities	*22,501,646*	*23,132,701*	*–631,055*
	Shares and participating interests	*5,398,307*	*4,933,521*	*464,786*
	Other securities	*326,043*	*225,488*	*100,555*
	Reverse operations	*207,564*	*–*	*207,564*
11.4	Intangible fixed assets	24,294	24,340	–46
11.5	Deferred charges	6,379	9,684	–3,305
11.6	Tangible fixed assets (net of depreciation)	2,582,288	2,732,847	–150,559
11.7	Accrued income and prepaid expenses	697,771	679,337	18,434
11.8	Sundry	20,159,846	21,355,262	–1,195,416
	Advances under Ministerial Decree of 1974	*–*	*12,287,868*	*–12,287,868*
	Euro-denominated securities held as fixed assets	*10,102,123*	*–*	*10,102,123*
	Other investments of severance pay and pension provisions	*65,205*	*55,002*	*10,203*
	Deferred tax assets	*8,075,456*	*7,090,587*	*984,869*
	Other items	*1,917,062*	*1,921,805*	*–4,743*
	Total	**145,525,697**	**147,338,428**	**–1,812,731**

Table 2

BALANCE SHEET - LIABILITIES

(thousands of euros)

		Amounts at end-		Changes
		2003	2002	
1	**Banknotes in circulation**	**73,807,446**	(1) **60,657,830**	**13,149,616**
2	**Liabilities to euro-area banks related to monetary policy operations**	**10,303,853**	**10,454,353**	**–150,500**
2.1	Current accounts (covering the minimum reserve system)	10,302,910	10,452,311	–149,401
2.2	Deposit facility	943	2,042	–1,099
2.3	Fixed-term deposits	–	–	–
2.4	Fine-tuning reverse operations	–	–	–
2.5	Deposits related to margin calls	–	–	–
3	**Other liabilities to euro-area banks**	**–**	**–**	**–**
4	**Liabilities to other euro-area residents denominated in euros**	**13,371,028**	**21,322,140**	**–7,951,112**
4.1	General government	13,294,609	21,316,379	–8,021,770
	4.1.1 Treasury payments account	*13,208,117*	*20,617,850*	*–7,409,733*
	4.1.2 Sinking fund for the redemption of government securities	*23,510*	*633,200*	*–609,690*
	4.1.3 Other liabilities	*62,982*	*65,329*	*–2,347*
4.2	Other counterparties	76,419	5,761	70,658
5	**Liabilities to non-euro-area residents denominated in euros**	**28,971**	**53,952**	**–24,981**
5.1	Liabilities to non-euro-area EU central banks	1	1	–
5.2	Other liabilities	28,970	53,951	–24,981
6	**Liabilities to euro-area residents denominated in foreign currency**	**–**	**–**	**–**
7	**Liabilities to non-euro-area residents denominated in foreign currency**	**373,753**	**2,880,825**	**–2,507,072**
7.1	Deposits and balances	10,446	12,439	–1,993
7.2	Other liabilities	363,307	2,868,386	–2,505,079
8	**Counterpart of SDRs allocated by the IMF**	**827,427**	**910,521**	**–83,094**
9	**Intra-Eurosystem liabilities**	**7,713,041**	**7,866,469**	**–153,428**
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	5,687,330	5,731,537	–44,207
9.3	Other liabilities within the Eurosystem (net)	2,025,711	2,134,932	–109,221

(1) Reclassified amounts.

Table 2 *cont.*

BALANCE SHEET - LIABILITIES

(thousands of euros)

		Amounts at end- 2003	Amounts at end- 2002	Changes
10	**Items to be settled**	**33,905**	**37,088**	**–3,183**
11	**Other liabilities**	**2,499,260**	(1) **3,925,537**	**–1,426,277**
11.1	Banks of Italy drafts	646,587	839,204	–192,617
11.2	Cashier's department services	2,313	1,190	1,123
11.3	Accrued expenses and deferred income	8,934	12,699	–3,765
11.4	Sundry	1,841,426	(1) 3,072,444	–1,231,018
12	**Provisions**	**6,015,637**	**7,516,567**	**–1,500,930**
12.1	Provisions for specific risks:	399,767	1,966,367	–1,566,600
	for exchange rate losses	–	*1,537,605*	*–1,537,605*
	for insurance cover	*309,874*	*309,874*	–
	for taxation	*89,893*	*118,888*	*–28,995*
12.2	Sundry staff-related provisions:	5,615,870	5,550,200	65,670
	for staff severance pay and pensions	*5,520,930*	*5,461,272*	*59,658*
	for grants to BI pensioners and their surviving dependents	*1,647*	*1,625*	*22*
	for severance pay of contract staff	*1,591*	*1,467*	*124*
	for staff costs	*91,702*	*85,836*	*5,866*
13	**Revaluation accounts**	**9,246,351**	**9,645,480**	**–399,129**
14	**Provisions for general risks**	**7,586,782**	**8,789,382**	**–1,202,600**
15	**Capital and reserves**	**13,665,846**	**13,213,982**	**451,864**
15.1	Capital	156	156	–
15.2	Ordinary and extraordinary reserves	9,495,816	9,044,071	451,745
15.3	Other reserves	4,169,874	4,169,755	119
16	**Net profits for distribution**	**52,397**	**64,302**	**–11,905**
	Total	**145,525,697**	**147,338,428**	**–1,812,731**

(1) Reclassified amounts.

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 €3,252 million (from €27,317 million to €24,065 million).

Within this item:

– *receivables from the IMF* decreased from €4,682 million to €4,212 million. They comprised:
  a) Italy's net position vis-à-vis the IMF, which fell from €3,739 million to €3,306 million;
  b) Italy's share of the loan to support debt-reduction initiatives for the poorest countries (PRGF), which declined from €840 million to €783 million;
  c) the Bank's SDRs, which rose from €103 million to €123 million.
– *securities (other than shares)* totaled €14,765 million, with a decrease of €4,006 million compared with the end of 2002 (€18,771 million), primarily as a consequence of the exchange losses recorded at the end of the year. The year-end portfolio consisted of securities denominated in US dollars (€12,643 million) and yen (€2,122 million) and for the most part issued by the US and Japanese Treasuries and the BIS;
– *current accounts and deposits*, denominated mostly in US dollars, Swiss francs and yen, rose by €1,399 million (from €3,687 million to €5,086 million); sight and overnight deposits rose from €1,126 million to €2,393 million and time deposits from €2,561 million to €2,692 million;
– *reverse operations* fell to zero from €175 million at the end of 2002;
– *other claims* consisted exclusively of foreign banknotes and remained unchanged at €2 million.

Claims on euro-area residents denominated in foreign currency, valued at market prices and exchange rates, increased by €1,151 million (from €5,298 million to €6,449 million). In particular:

– *securities (other than shares)* decreased by €276 million (from €2,125 million to € 1,849 million), primarily as a consequence of the exchange losses recorded at the end of the year; they consisted of securities denominated in US dollars issued by financial counterparties in France, Germany and the Netherlands;
– *other claims* increased by €1,427 million (from €3,173 million to €4,600 million) and consisted of deposits with correspondent banks, mostly in the form of time deposits in US dollars, yen and Swiss francs.

Lending to euro-area banks related to monetary policy operations rose by €1,264 million (from €6,933 million to €8,197 million), primarily as a consequence of the increase in main refinancing operations (from €6,933 million to €8,197 million); on an annual average basis the latter were showed a marginal increase (from €7,913 million to €7,957 million).

Longer-term refinancing operations were zero at the end of both 2002 and 2003, while the annual average value of this item rose from €44 million to €52 million.

No use was made of *fine-tuning reverse operations* during the year (in 2002, although the year-end balance was zero, they were used three times).

The balance of the *marginal lending facility* rose from zero to €6 million; the annual average value of this item declined from €6 million to €4 million.

As in 2002, no use was made of *structural reverse operations* during the year. The year-end balance of *credits related to margin calls* was zero (€0.1 million at the end of 2002); the annual average value of this item was €0.1 million (compared with €0.2 million in 2002).

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, remained small, declining from €0.4 million to €0.2 million.

Securities issued by euro-area residents (other than shares), valued at market prices and consisting of Italian government securities denominated in euros not held as fixed assets except for investments of the reserves and provisions, rose by €94 million (from €1,578 million to €1,672 million) as a consequence of net purchases.

General government debt fell by €156 million (from €18,872 million to €18,716 million). In particular:

– the securities received following the bond conversion provided for in Law 289/2002 decreased by €106 million (from €17,727 million to €17,621 million) as a consequence of the annual accrual of the related premiums and discounts;
– the overall position in respect of the past management of stockpiling bills decreased by €50 million (from €1,145 million to €1,095 million).

The Bank's *participating interest in the ECB* of €745 million and €7,447 million of *claims deriving from the transfer of foreign reserves to* *the ECB* in the form of gold, foreign securities and foreign currencies at the beginning of Stage Three of EMU were unchanged and are shown under Intra-Eurosystem claims.

At 31 December 2003, considering all the countries participating in the ESCB, the Bank of Italy's interest in the capital of the ECB was equal to 14.8950 per cent; considering only the Eurosystem countries, it was equal to 18.3902 per cent.

Article 29.3 of the Statute of the ESCB provides for the keys of NCBs for subscription of the ECB's capital to be adjusted every five years. The first five-year change since the establishment of the ECB took effect on 1 January 2004.

On 1 May 2004 a second change to the ECB's capital key followed as a result of the accession of 10 member states.

Based on the Decision of the ECB's Governing Council of 15 July 2003 (concerning the statistical data to be used for the determination of the key for subscription of the capital of the European Central Bank), the Bank of Italy's capital decreased as of 1 January 2004 to 14.5726 per cent and as of 1 May 2004 to 13.0516 per cent. Consequently, with effect from the same dates its participating interest in the ECB diminished to respectively €729 million and €726 million.

The adjustments to the capital key weightings and the resulting changes in the euro-area NCBs' shares in the ECB's subscribed capital also led to a reduction in the Bank of Italy's claims deriving from the transfer of foreign reserves to the ECB (to €7,286 million as of 1 January 2004 and €7,263 million as of 1 May 2004).

Items to be settled rose by €4 million (from €7 million to €11 million).

Other assets diminished from €53,377 million to €52,181 million. In particular:

– *euro-area coins,* which includes lira coins, fell from €26 million to €18 million;
– the *UIC endowment fund* remained unchanged at €258 million;
– *investments of reserves and provisions (including shares)* amounted to €28,434 million, basically unchanged compared with 31 December 2002 (€28,292 million);
– *intangible fixed assets* (net of amortization) remained unchanged at €24 million;
– *deferred charges* fell from €10 million to €6 million, primarily as a consequence of the decrease in multi-year software licence fees;
– *tangible fixed assets (net of depreciation)* amounted to €2,582 million. The decrease of €151 million compared with 31 December 2002 was due to €34 million of purchases and capitalized own work, €20 million of disposals and €165 million of depreciation;

- *accrued income and prepaid expenses* increased by €19 million (from €679 million to 698 million);
- *sundry* other assets decreased from €21,355 million to €20,160 million. They included:
  a) €10,102 million of euro securities held as fixed assets, including those reinserted in the portfolio upon the extinction of the advance granted under Treasury Ministry Decree 27.9.1974 to Banco di Napoli (subsequently merged into Sanpaolo IMI S.p.A.) pursuant to Law 588/1996 (€12,288 million at 31 December 2002);
  b) €8,075 of deferred tax assets (€7,091 million at the end of 2002), of which €1 million in respect of the regional tax on productive activities (IRAP) and €8,074 million in respect of net corporate income tax (Irpeg), as the algebraic sum of the following:
     - €7,119 million of deferred tax assets deriving from the carry forward of the 2002 tax loss incurred as a consequence of the bond conversion described above and offsettable up to 2022 under Law 289/2002. Compared with the amount stated at the end of 2002, there was an increase of €3 million following the final calculation made in the corporate income tax return submitted in 2003;
     - €973 million of deferred tax assets deriving from the tax loss recorded in 2003, which, under Article 84 of Legislative Decree 344/2003 (the new Tax Code), can be deducted from the taxable income of the next five financial years;
     - €32 million of deferred tax assets deriving from other expense items; in particular the allocation of €23 million to the provision for staff costs and €9 million of prior-year depreciation at rates in excess of those allowed for tax purposes;

The inclusion of deferred tax assets in the balance sheet is based on the reasonable expectation − considering the outlook for the Bank's income − of offsetting, within the time limits established by law, the full amount of the tax losses produced both by the bond conversion and by the exceptional diminution in 2003 of the current value of the positions denominated in foreign currency. In this respect there was confirmation of the fulfilment of the conditions − discussed in last year's annual report − for a lasting improvement in the profitability of the Bank's ordinary operations, which did indeed begin in 2003 even though it did not appear in the overall result for the year owing to the exceptional unrealized loss on foreign exchange.

     - €50 million of deferred tax liabilities in relation in particular to gains on disposals of fixed assets (€5 million) and accelerated depreciation under Article 67.3 of the Income Tax Code (€45 million);

The deferred tax assets and liabilities were calculated using the 33 per cent rate of the new corporate income tax (IRES) in force as of 1 January 2004 and the IRAP rates expected to apply in 2004 and the subsequent years.

c) €44 million, the balance-sheet total of the supplementary pension fund. Up by €10 million, this item is matched on the liabilities side by an equal amount entered under other *liabilities – sundry*.

Liabilities:

Banknotes in circulation amounted to €73,807 million (€60,658 million at the end of 2002 with reference exclusively to euro banknotes). This item is the Bank of Italy's share of the total Eurosystem note issue (see the section on *Banknotes in circulation* under *Accounting policies*).

The value of the actual circulation, excluding the adjustments in connection with the allocation of euro banknotes within Eurosystem, increased by €13,106 million (from €66,389 million to €79,495) in line with the rising trend within the euro area.

Liabilities to euro-area banks related to monetary policy operations amounted to €10,304 million (€10,454 million at the end of 2002) and comprised:

- *current accounts (covering the minimum reserve system),* which consisted almost entirely of banks' deposits under the minimum reserve system and declined from €10,452 million to €10,303 million (by contrast, the annual average value rose, from €13,562 million to €14,195 million).
- *deposit facility*, which dropped from €2 million to €1 million;
- *fixed-term deposits, fine-tuning reverse operations* and *deposits related to margin calls* were all equal to zero, as at the end of 2002.

Liabilities to other euro-area residents decreased by €7,951 million (from €21,322 million to €13,371 million). The subitem *general government* (€13,295 million) recorded the following changes:

- the *Treasury payments account* fell from €20,618 million to €13,208 million. By contrast, the average balance on the account rose (from €26,918 million €28,400 million);

- the *sinking fund for the redemption of government securities* fell from €633 million to €24 million. By contrast, the annual average value of this item rose (from €231 million to €665 million);
- *other liabilities*, comprising the current account deposits of other general government bodies, fell from €65 million to €63 million.

The subitem liabilities to *other counterparties* rose from €6 million to €76 million, almost exclusively in connection with the movement in the balance on the UIC's current account, the annual average value of which declined instead (from €52 million to €32 million).

Liabilities to non-euro-area residents fell from €54 million to €29 million and refer almost exclusively to the accounts held by central banks and international organizations, which are included under *other liabilities*.

Liabilities to non-euro-area residents denominated in foreign currency, denominated exclusively in US dollars and valued at market exchange rates, fell from €2,881 million to €374 million. In particular, the *other liabilities* consisting of repos fell from €2,868 million to €363 million. The subitem *deposits and balances* declined from €13 million to €11 million and included the daily variation margins for futures contracts (€0.1 million).

The item *Counterpart of SDRs allocated by the IMF* fell from €911 million to €827 million, owing to the valuation at the year-end SDR exchange rate.

Intra-Eurosystem liabilities declined from €7,867 million to €7,713 million and included:

- the 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 and declined from €5,732 million to €5,687 million;
- the subitem *Other liabilities within the Eurosystem (net)*, which shows the Bank's net debtor position vis-à-vis the Eurosystem in respect of the TARGET system and declined from €2,135 million to €2,026 million.

Items to be settled declined from €37 million to €34 million.

Other liabilities amounted to €2,499 million and from 1 January 2003 includes the lira banknotes still in circulation (see the item *Banknotes in circulation*). Among the subitems, *Sundry* fell by €1,231 million, *Bank of Italy drafts* by €193 million and *Accrued expenses and deferred income* by €4 million, while *Cashier's department services* rose from €1 million to €2 million.

In particular, the subitem *Sundry* other liabilities (€1,841 million) included:

- €1,337 million, the amount of lira banknotes not yet presented for conversion, excluding the €593 million payment on account that the Bank of Italy has already made to the Treasury for the banknotes that will presumably not be presented within the legal time limit;

- €44 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 €7,517 million to €6,016 million. In particular:

- *provisions for specific risks* decreased from €1,966 million to €399 million. The decrease was due to:

  a) the withdrawal of the entire amount of the provision for losses on foreign exchange (€1,538 million) to cover part of the unrealized losses on foreign currency assets owing to the depreciation of the US dollar and the yen against the euro;

  b) the reduction of €29 million in the tax provision, as a consequence of the payment of taxes and, for a minimal part, of the decrease in deferred tax liabilities in respect of IRAP.

The provision for insurance cover remained unchanged at €310 million.

- *sundry staff-related provisions* rose from €5,550 million to €5,616 million. In particular, the provisions for staff severance pay and pensions rose from €5,461 million to €5,521 million (the provision for severance pay accounted for €31 million of the increase and that for pensions the remaining €29 million). The provision for staff costs rose from €86 million to €92 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 2003 are detailed in Table 3.

Table 3

PROVISIONS

(thousands of euros)

	Amounts at end-2002	Changes			Amounts at end-2003
		Transfers from	Transferts to	Other	
Provisions for specific risks:	**1,966,367**	**–1,566,127**	**–**	**–473**	**399,767**
for exchange risk	1,537,605	–1,537,605	–	–	–
for insurance cover	309,874	–	–	–	309,874
for taxation	118,888	–28,522	–	(1) –473	89,893
Sundry staff-related provisions:	**5,550,200**	**–64,673**	**130,343**	**–**	**5,615,870**
for staff severance pay and pensions	5,461,272	(2) –19	59,677	–	5,520,930
for grants to BI pensioners and their surviving dependents ..	1,625	–48	70	–	1,647
for severance pay of contract staff under Law 297/1982	1,467	–127	251	–	1,591
for staff costs	85,836	–64,479	70,345	–	91,702
Total ...	**7,516,567**	**–1,630,800**	**130,343**	**–473**	**6,015,637**

(1) The decrease is related to deferred tax liabilities. – (2) Transfer to the supplementary pension fund.

The *revaluation accounts* fell from €9,645 million to €9,246 million.

The *provision for general risks* fell from €8,789 million to €7,587 million following the withdrawal decided by the Board of Directors of €1,202 million to cover part of the unrealized losses on foreign currency assets.

Table 4

SHAREHOLDERS

	At 31 December 2003				At 31 December 2002			
	Number	Shares held (1)	%	Votes	Number	Shares held (1)	%	Votes
Shareholders with voting rights ..	70	299,934	100.0	684	71	299,934	100.0	692
Limited company banks	*63*	*253,434*	*84.5*	*563*	*64*	*253,434*	*84.5*	*571*
Social security institutions........	*1*	*15,000*	*5.0*	*34*	*1*	*15,000*	*5.0*	*34*
Insurance companies	*6*	*31,500*	*10.5*	*87*	*6*	*31,500*	*10.5*	*87*
Shareholders without voting rights	6	66	..	–	6	66	..	–
Total ...	**76**	**300,000**	**100.0**	**684**	**77**	**300,000**	**100.0**	**692**

(1) With a par value of €0.52 each.

The item *capital and reserves* amounted to €13,666 million and comprised the *ordinary reserve* (€4,800 million), the *extraordinary reserve* (€4,696 million), which together increased by €452 million, and the *other reserves*, which remained virtually unchanged.

The holders of the Bank's capital are shown in Table 4 and the movements in the item *capital and reserves* in Table 5.

Table 5

MOVEMENTS IN CAPITAL AND RESERVES

(thousands of euros)

	Balance at end-2002	Increases	Decreases	Balance at end-2003
Share capital	156	–	–	156
Ordinary reserve	4,575,657	(1) 245,984	(2) 21,865	4,799,776
Extraordinary reserve	4,468,414	(1) 248,706	(2) 21,080	4,696,040
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)	147,057	–	–	147,057
Reserve (under Legislative Decree 124/1993)	205	119	–	324
Special provision for the renewal of tangible fixed assets	1,805,044	–	–	1,805,044
Total	**13,213,982**	**494,809**	**42,945**	**13,665,846**

(1) The movement was due to the allocation of the net profit for 2002 and the return earned in 2003 on the investment of the reserve. – (2) The movement was due to the dividend paid to shareholders in respect of the return earned in 2002 on the investment of the reserve (under Art. 56 of the Bank's Statute).

2.2. *Income statement*. – The net profit for the year amounted to €52 million (Table 6), down from €64 million in 2002.

Among the items included under *net income from institutional operations, net interest income* swung from a negative value of €61 million to a positive value of €672 million, reflecting both an increase in *interest income* and a fall in *interest expense*.

Table 6

ANALYSIS OF THE INCOME STATEMENT

(euros)

	2003		2002		Changes	
A) NET INCOME FROM INSTITUTIONAL OPERATIONS:		**–574,885,536**		**–6,373,433,456**		**5,798,547,920**
Interest income		2,088,545,167		1,885,967,592		202,577,575
securities and other assets denominated in foreign currency	*630,291,710*		*785,272,233*		*–154,980,523*	
IMF position	*70,900,963*		*95,413,480*		*–24,512,517*	
refinancing operations	*188,488,717*		*267,009,309*		*–78,520,592*	
securities denominated in euros	*65,762,854*		*85,537,896*		*–19,775,042*	
claims on the State	*928,114,565*		*396,532,924*		*531,581,641*	
intra-Eurosystem balances	*325,215,993*		*328,042,511*		*–2,826,518*	
advances under Ministerial Decree 1974	*119,983,117*		*139,838,232*		*–19,855,115*	
UIC current account	*59,516*		*45,807*		*13,709*	
bond premiums and discounts	*–240,272,804*		*–211,725,634*		*–28,547,170*	
other	*536*		*834*		*–298*	
Interest expense		–1,476,836,951		–1,946,502,469		469,665,518
Treasury payments account	*–1,021,368,793*		*–1,212,418,822*		*191,050,029*	
sinking fund for the redemption of government securities	*–17,783,405*		*–8,169,406*		*–9,613,999*	
current account deposits of required reserves	*–331,742,500*		*–448,259,584*		*116,517,084*	
overnight deposits, term deposits and deposits related to margin calls	*–95,017*		*–246,373*		*151,356*	
UIC current account	*–390,719*		*–1,214,138*		*823,419*	
intra-Eurosystem balances	*–73,495,211*		*–203,104,442*		*129,609,231*	
sundry interest denominated in foreign currency	*–31,254,692*		*–38,539,392*		*7,284,700*	
other	*–706,614*		*–34,550,312*		*33,843,698*	
Net interest income		**611,708,216**		**–60,534,877**		**672,243,093**
Profits and losses on financial operations		477,167,233		–20,630,574,618		21,107,741,851
profits/losses on securities trading	*435,417,524*		*–21,347,974,515*		*21,783,392,039*	
profits/losses on foreign exchange trading	*–71,773,381*		*288,003,004*		*–359,776,385*	
profits/losses on derivatives contracts denominated in foreign currency	*449,884*		–		*449,884*	
profits/losses on forward transactions in securities under Ministerial Decree 1974	*113,073,206*		*429,396,893*		*–316,323,687*	
Writedowns of financial assets and positions		–4,645,447,695		–1,206,920,529		–3,438,527,166
foreign securities	*–15,173,420*		*–224,197*		*–14,949,223*	
foreign currencies	*–4,629,388,356*		*–821,756,571*		*–3,807,631,785*	
securities denominated in euros	*–48,646*		*–21,787*		*–26,859*	
foreign currency derivatives	*–837,273*		–		*–837,273*	
forward transactions in securities under Ministerial Decree 1974	–		*–384,917,974*		*384,917,974*	
Transfers to/from provisions for losses on foreign exchange and securities		2,750,754,453		15,206,927,979		–12,456,173,526
transfers from "pre-system" revaluations reserves	*10,549,730*		*12,553,792,201*		*–12,543,242,471*	
transfers from the provision for general risks	*1,202,600,000*		*1,008,690,046*		*193,909,954*	
transfers from the provisions for losses on foreign exchange and securities	*1,537,604,723*		*1,644,445,732*		*–106,841,009*	
Net result of financial operations, writedowns and risk provision transfers		**–1,417,526,009**		**–6,630,567,168**		**5,213,041,159**
Fee and commission income		19,822,190		20,335,870		–513,680
Fee and commission expense		–18,968,247		–17,709,199		–1,259,048
Net income from fees and commissions		**853,943**		**2,626,671**		**–1,772,728**
Income from equity shares and participating interests		215,074,412		387,951,300		–172,876,888
income from participating interest in ECB	*112,999,262*		*379,473,323*		*–266,474,061*	
income from participating interest in UIC endowment fund	*102,075,150*		*8,477,977*		*93,597,173*	
Net result of the pooling of monetary income		15,003,902		–72,909,382		87,913,284
monetary income pooled	*1,427,184,703*		*1,770,306,284*		*–343,121,581*	
monetary income redistribuited	*–1,412,180,801*		*–1,843,215,666*		*431,034,865*	

Table 6 *cont.*

ANALYSIS OF THE INCOME STATEMENT

(euros)

	2003		2002		Changes	
B) OTHER INCOME:		**1,630,133,236**		**1,464,954,164**		**165,179,072**
Income from the investment of reserves and provisions		1,431,002,283		1,294,023,772		136,978,511
interest income	*954,977,626*		*1,048,954,347*		*–93,976,721*	
bond premiums and discounts	*–34,251,936*		*–26,077,538*		*–8,174,398*	
dividends on equity shares and participating interests	*167,550,705*		*231,865,768*		*–64,315,063*	
trading profits and gains on disposals	*342,725,888*		*39,281,195*		*303,444,693*	
Prior-year income		83,527,105		83,623,705		–96,600
Sundry		115,603,848		87,306,687		28,297,161
rental income from buildings	*19,973,686*		*18,506,330*		*1,467,356*	
interest on tax credits	*22,748,807*		*29,353,300*		*–6,604,493*	
other interest income	*2,125,317*		*1,614,378*		*510,939*	
Ministry for the Economy and Finance commissions	*299,407*		*275,884*		*23,523*	
procedures, studies and designs completed	*10,124,950*		*13,624,742*		*–3,499,792*	
closing stocks	*663,113*		*574,007*		*89,106*	
other	*59,668,568*		*23,358,046*		*36,310,522*	
TOTAL NET INCOME (A+B)		**1,055,247,700**		**–4,908,479,292**		**5,963,726,992**
C) SUNDRY EXPENSES AND CHARGES						
Staff wages and salaries and related costs		–614,612,177		(*) –627,121,768		12,509,591
Emoluments paid to head and branch office collegial bodies (1)		–3,006,845		–2,862,972		–143,873
Transfers to provisions for accrued expenses and staff severance pay and pensions		–130,343,405		–132,353,750		2,010,345
severance pay and pensions	*–59,677,598*		*–65,977,843*		*6,300,245*	
expenses accrued but not yet paid	*–70,345,172*		*–66,073,128*		*–4,272,044*	
other provisions	*–320,635*		*–302,779*		*–17,856*	
Other staff costs		–41,266,905		(*) –39,800,489		–1,466,416
Pensions and severance payments		–242,815,476		–237,290,842		–5,524,634
Administrative costs		–360,659,064		(*) –383,213,344		22,554,280
Depreciation of tangible and intangible fixed assets		–190,498,010		–186,350,136		–4,147,874
Other costs:						
losses on investments of reserves and provisions		–42,391,394		–281,726,808		239,335,414
losses on trading and disposals	–		*–27,902,197*		*27,902,197*	
writedowns	*–42,391,394*		*–253,824,611*		*211,433,217*	
other transfers to provisions		–118,554		–16,820,747		16,702,193
prior-year expense		–1,705,197		–2,400,437		695,240
appropriation of investment income to reserves (2)		–468,969,171		–297,281,479		–171,687,692
other taxes and duties		–15,903,440		–16,190,519		287,079
sundry		–6,664,741		–3,805,123		–2,859,618
other interest expense	*–580,050*		*–9,089*		*–570,961*	
opening stocks	*–574,007*		*–440,030*		*–133,977*	
miscellaneous payables	*–5,510,684*		*–3,356,004*		*–2,154,680*	
Taxes on income for the year and productive activities (3)		1,116,103,942		7,200,000,000		–6,083,896,058
NET PROFIT FOR THE YEAR		**52,397,263**		**64,302,294**		**–11,905,031**

(*) Reclassified amounts.

(1) Includes the remuneration of the Board of Directors (€648,353 in 2003 and €863,205 in 2002) and the Board of Auditors (€33,210 in both years). – (2) Pursuant to Article 55 of the Statute.

Total *interest income* increased by €203 million (from €1,886 million to €2,089 million). In particular, there was an increase of

– €531 million in interest income from claims on the State, which rose from €397 million to €928 million as a consequence of the higher rate of interest on the bonds received in the conversion under Law 289/2002.

Interest income earned on foreign currency assets and positions in euros fell. In the latter case this was due to the decreases of:

– €79 million in income from refinancing operations (from €267 million to €188 million) that was almost entirely due to the decrease of €77 million in income from main refinancing operations as a consequence of the fall in the average rate of return (from 3.34 to 2.35 per cent); the annual average amount outstanding remained virtually unchanged at €7,957 million (€7,913 million in 2002);
– €20 million (from €140 million to €120 million) in the interest earned at the rate of 1 per cent on advances under Treasury Ministry Decree 27.9.1974, owing to the fall in the annual average amount outstanding (from €13,792 million to €11,834 million). At the end of the year the advances in question had been completely repaid;
– €19 million (from €85 million to €66 million) in income from securities (other than those in which the reserves and provisions are invested), primarily as a consequence of interest rate movements;
– €3 million (from €328 million to €325 million) in income from intra-Eurosystem balances as a consequence of:
  a) the fall in interest income (from €210 million to €148 million) earned on the claims deriving from the transfer of foreign reserves to the ECB owing to the lower average interest rate applied;
  b) the fall from €7 million to zero of the interest earned on the balances related to the allocation of euro banknotes within the Eurosystem since these balances, which are calculated monthly, were always negative for the Bank of Italy;
  c) the increase (from €111 million to €177 million) in income from the Bank's positive TARGET balances.

The reduction in interest income earned on foreign currency assets was due to the decreases of:

– €155 million in income from securities and other foreign currency assets as a consequence of the decline in the average interest rate, the effects of which were partly offset by the increase in the annual average stock (from €27,364 to €29,683 million);
– €24 million in income from the position with the IMF, primarily owing to the reduction in the interest rate paid by the Fund.

Premiums and discounts on securities denominated in euros and foreign currencies were negative in both years, and increased from €212 million to €240 million.

Interest expense fell by €469 million (from €1,946 million to €1,477 million). In particular, the reduction in interest expense in respect of positions denominated in euros was due to the decreases of:

– €191 million in interest on the Treasury payment account (from €1,212 million to €1,021 million) as a consequence of the decline in the average interest rate (from 4.5 to 3.6 per cent), the effects of which were partly offset by the increase in the annual average balance (from €26,918 to €28,400 million);
– €129 million in interest on intra-Eurosystem balances (from €203 million to €74 million) as a consequence of the reduction in the interest payable in connection with the net position on the Bank's TARGET accounts (from €96 million to €21 million) and in that payable on the balances related to the allocation of euro banknotes within the Eurosystem (from €107 million to €53 million);
– €116 million in interest on current account deposits of required reserves (from €448 million to €332 million) owing to the fall in the average rate of return on required reserves (from 3.31 to 2.34 per cent), the effect of which was partly offset by the increase in the annual average amount of required reserves (from €13,562 million to €14,195 million);
– €34 million in other interest (from €35 million to €1 million); the figure for 2002 consisted almost entirely (€33 million) of the interest paid to financial institutions on their deposits of collateral for the euro notes and coins provided in the front-loading phase;
– €0.8 million (from €1.2 million to €0.4 million) in interest on the current account held by the UIC and €0.1 million (from €0.2 million to € 0.1 million) in interest on overnight deposits, fixed-term deposits and deposits related to margin calls.

Interest on the sinking fund for the redemption of government securities rose by €10 million (from €8 million to €18 million) owing to the increase in the average amount outstanding (from €231 million to €665 million), the effects of which were partly offset by the decrease in the average rate of return (from 3.53 to 2.67 per cent);

The interest paid on positions denominated in foreign currency fell by €8 million (from €39 million to €31 million), almost exclusively as a result of the decrease in payments in respect of allocations of SDRs (from €21 million to €14 million).

The *net result of financial operations, writedowns and risk provision transfers* showed a negative result of €1,418 million (€6,631 million in 2002). The balance was the result of:

– €4,645 million of writedowns of financial assets and positions, of which €4,629 million (€822 million at the end of 2002) of foreign exchange writedowns of net foreign currency positions (primarily in US dollars and yen) and €16 million of price writedowns in respect of securities in foreign currencies and euros and futures positions.

– €477 million of profits on financial transactions (the negative result of €20,631 million in 2002 was affected by the loss of €21,837 million incurred as a consequence of the bond conversion under Law 289/2002), comprising:

  a) a profit of €436 million on trading in securities and futures (€489 million in 2002) and of €113 on forward positions in connection with advances granted under Treasury Ministry Decree 27.9.1974 (€429 million in 2002);

  b) a loss of €72 million on foreign exchange trading (a profit of €288 million in 2002);

– provision transfers amounting to €2,750 million (€15,207 million in 2002), as detailed below:

  a) €1,538 million withdrawn from the provision for foreign exchange losses and €1,202 million from the provision for general risks to cover part of the unrealized losses on foreign currency positions;

  b) €10 million 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 decreased by €2 million (from €3 million to €1 million).

Income from equity shares and participating interests fell by €173 million (from €388 million to €215 million) and comprised:

– €102 million of profits allocated to the Bank in respect of its interest in the UIC’s endowment fund (up from €9 million in 2002).

– €113 million of dividends for the year 2002 distributed in 2003 in respect of the Bank’s interest in the capital of the ECB (down from €268 million in 2002);

The *net result of the pooling of monetary income*, calculated using the new method established by the Governing Council of the ECB for the period 2003-07, swung from minus €73 million to plus €15 million, the resultant of €1,412 million of monetary income pooled by the Bank and €1,427 million redistributed to the Bank.

The monetary income (to be pooled) of each NCB is determined by measuring the actual annual income that derives from the earmarkable assets held against its liability base.

The liability base of each NCB consists of: banknotes in circulation; liabilities to credit institutions 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 deducted from the monetary income to be pooled.

The earmarkable assets of each NCB consist of: lending to euro-area credit institutions related to monetary policy operations denominated in euros; intra-Eurosystem claims equivalent to the transfer of foreign reserve assets to the ECB; net intra-Eurosystem claims resulting from TARGET transactions; net intra-Eurosystem claims related to the allocation of euro banknotes within the Eurosystem; and a limited amount of each NCB's gold holdings in proportion to each NCB's capital key. Gold is considered to generate no income. Where the value of an NCB's earmarkable assets exceeds or falls short of the value of its liability base, the difference is offset by applying the average rate of return on the earmarkable assets of all NCBs taken together to the value of the difference.

The monetary income pooled by the Eurosystem is allocated to each NCB according to its subscribed capital key.

Other income increased by €165 million (from €1,465 million to €1,630 million). In particular:

– *income from the investment of reserves and provisions* rose by €137 million (from €1,294 million to €1,431 million) as a result of the increase in profits from trading of assets and disposals (from €39 million to €343 million), which was partially offset by the fall in the income from securities, including premiums and discounts (from €1,255 million to €1,088 million);

– *prior-year income* remained unchanged at €84 million;

– *sundry* income rose by €28 million (from €87 million to €115 million).

With effect from 2003 the item *Sundry expenses and charges* is shown in more detail in the profit and loss account. The corresponding figures for 2002 have been reclassified. In particular:

– *Staff wages and salaries and related costs* declined by €12 million (from €627 million to €615 million);

– *Pensions and severance payments* rose by €6 million (from €237 million to €243 million);

– *Other staff costs* rose from €40 million to €41 million;

– *Transfers to provisions for accrued expenses and staff severance pay and pensions* declined overall by €2 million (from €132 million to €130 million). Of the total €60 million referred to the provision for staff severance pay and pensions (€66 million in 2002) and €70 million to the provision for staff costs accrued that had not been paid at the end of the year (€66 million in 2002).

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	
	2003	2002	2003	2002
Managerial	2,011	1,991	24.1	23.5
Clerical	4,910	4,931	58.8	58.3
General services and security	880	974	10.5	11.5
Blue-collar	550	570	6.6	6.7
TOTAL PAYROLL WORKERS	**8,351**	**8,466**	**100.0**	**100.0**
Contract workers	**34**	**33**		

Administrative costs fell by €23 million.

Depreciation of tangible and intangible fixed assets, which refers exclusively to ordinary depreciation, increased slightly (from €186 million to €190 million).

Other costs fell by €82 million (from €618 million to €536 million) and comprised:

– *losses on investments of reserves and provisions*, which amounted to €42 million (€282 million in 2002) and referred almost exclusively to writedowns of equity investments denominated in euros;

– *other transfers to provisions,* which amounted to €0.1 million and referred to those made to the special reserve set up under Legislative

Decree 124/1993. In 2003 no charges were made for accelerated depreciation (€17 million in 2002);

– *prior-year expense*, which remained unchanged at €2 million;

– *appropriation of investment income to reserves*, which amounted to €469 million, up from €297 million in 2002, owing to the smaller volume of writedowns and the larger profits on share disposals;

– *other taxes and duties* (i.e. excluding income tax for the year and the regional tax on productive activities), which remained unchanged at €16 million;

– *sundry* other costs, which rose by €3 million (from €4 million to €7 million), primarily as a consequence of larger donations.

Taxes for the year show a positive net result equal to €1,116 million (as against one of €7,200 million in 2002). In the absence of an IRAP liability, the amount derives from the deferred corporate income tax (Irpeg) asset in connection with the carry forward of the tax loss for 2003 (€973 million), the tax credit on dividends cashed (€131 million), and the residual net deferred tax asset (€12 million).

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 2003 of €52,397,263:

	euros
– 20 per cent to the ordinary reserve	10,479,453
– an amount equal to 6 per cent of the share capital to shareholders	9,360
– 20 per cent to the extraordinary reserve	10,479,453
– an additional amount equal to 4 per cent of the share capital to shareholders	6,240
– the remaining amount to the State	31,422,757
TOTAL	52,397,263

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 €45,219,000, equal to 0.50 per cent (as in 2002) of the total reserves at 31 December 2002.

If these proposals are approved, the total dividend will be equal to €45,234,600 corresponding to €150,782 per share.

THE GOVERNOR
Antonio Fazio

BALANCE SHEET
AND INCOME STATEMENT
for the year ended 31 December 2003

ASSETS	amounts in euros 2003	amounts in euros 2002
1 GOLD AND GOLD RECEIVABLES	**26,042,196,103**	**25,763,615,140**
2 CLAIMS ON NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	**24,064,856,474**	**27,316,455,914**
2.1 Receivables from the IMF	4,211,994,537	4,681,552,173
2.2 Securities (other than shares)	14,764,931,919	18,770,622,928
2.3 Current accounts and deposits	5,085,717,614	3,687,101,568
2.4 Reverse operations	-	174,826,533
2.5 Other claims	2,212,404	2,352,712
3 CLAIMS ON EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	**6,449,175,541**	**5,298,228,670**
3.1 Financial counterparties	6,449,175,541	5,298,228,670
3.1.1 Securities (other than shares)	*1,848,796,804*	*2,125,503,559*
3.1.2 Reverse operations	-	-
3.1.3 Other claims	*4,600,378,737*	*3,172,725,111*
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	**8,196,818,477**	**6,933,007,746**
5.1 Main refinancing operations	8,190,917,667	6,932,865,946
5.2 Longer-term refinancing operations	-	-
5.3 Fine-tuning reverse operations	-	-
5.4 Structural reverse operations	-	-
5.5 Marginal lending facility	5,900,810	-
5.6 Credits related to margin calls	-	141,800
6 OTHER CLAIMS ON EURO-AREA BANKS	**227,195**	**400,710**
7 SECURITIES ISSUED BY EURO-AREA RESIDENTS (other than shares)	**1,672,191,348**	**1,577,708,552**
8 GENERAL GOVERNMENT DEBT	**18,716,265,228**	**18,872,447,779**
9 INTRA-EUROSYSTEM CLAIMS	**8,192,250,000**	**8,192,250,000**
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 ITEMS TO BE SETTLED	**10,974,891**	**7,161,407**
11 OTHER ASSETS	**52,180,741,403**	**53,377,152,464**
11.1 Euro-area coins	18,374,486	25,744,271
11.2 UIC endowment fund	258,228,450	258,228,450
11.3 Investments of reserves and provisions (including shares)	28,433,560,388	28,291,710,474
11.4 Intangible fixed assets	24,293,642	24,339,495
11.5 Deferred charges	6,378,808	9,683,493
11.6 Tangible fixed assets (net of depreciation)	2,582,288,268	2,732,847,192
11.7 Accrued income and prepaid expenses	697,771,469	679,336,952
11.8 Sundry	20,159,845,892	21,355,262,137
TOTAL	**145,525,696,660**	**147,338,428,382**
13 MEMORANDUM ACCOUNTS	**418,246,089,603**	**365,360,119,127**

Audited and found correct - 29 April 2004

THE AUDITORS: Giuseppe Bruni, Enrico Nuzzo, Angelo Provasoli, Massimo Stipo, Gianfranco Zanda

SHEET

LIABILITIES	amounts in euros 2003	2002
1 BANKNOTES IN CIRCULATION	**73,807,445,600**	**60,657,829,610**
2 LIABILITIES TO EURO-AREA BANKS RELATED TO MONETARY POLICY OPERATIONS	**10,303,853,566**	**10,454,353,301**
2.1 Current accounts (covering the minimum reserve system)	10,302,910,669	10,452,311,385
2.2 Deposit facility	942,897	2,041,916
2.3 Fixed-term deposits	-	-
2.4 Fine-tuning reverse operations	-	-
2.5 Deposits related to margin calls	-	-
3 OTHER LIABILITIES TO EURO-AREA BANKS	**-**	**-**
4 LIABILITIES TO OTHER EURO-AREA RESIDENTS DENOMINATED IN EUROS	**13,371,028,021**	**21,322,140,595**
4.1 General government	13,294,608,579	21,316,379,333
4.1.1 Treasury payments account	*13,208,116,796*	*20,617,850,101*
4.1.2 Sinking fund for the redemption of government securities	*23,509,723*	*633,200,291*
4.1.3 Other liabilities	*62,982,060*	*65,328,941*
4.2 Other counterparties	76,419,442	5,761,262
5 LIABILITIES TO NON-EURO-AREA RESIDENTS DENOMINATED IN EUROS	**28,970,683**	**53,952,167**
5.1 Liabilities to non-euro-area EU central banks	858	847
5.2 Other liabilities	28,969,825	53,951,320
6 LIABILITIES TO EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	**-**	**-**
6.1 Financial sector counterparties	-	-
6.2 General government	-	-
6.3 Other liabilities	-	-
7 LIABILITIES TO NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	**373,752,751**	**2,880,824,617**
7.1 Deposits and balances	10,445,935	12,439,170
7.2 Other liabilities	363,306,816	2,868,385,447
8 COUNTERPART OF SDRs ALLOCATED BY THE IMF	**827,427,200**	**910,521,120**
9 INTRA-EUROSYSTEM LIABILITIES	**7,713,040,731**	**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	5,687,329,465	5,731,537,490
9.3 Other liabilities within the Eurosystem (net)	2,025,711,266	2,134,931,508
10 ITEMS TO BE SETTLED	**33,905,286**	**37,087,693**
11 OTHER LIABILITIES	**2,499,260,409**	**3,925,537,441**
11.1 Bank of Italy drafts	646,587,178	839,203,894
11.2 Cashier's department services	2,312,894	1,189,803
11.3 Accrued expenses and deferred income	8,934,436	12,699,227
11.4 Sundry	1,841,425,901	3,072,444,517
12 PROVISIONS	**6,015,636,567**	**7,516,566,695**
12.1 Provisions for specific risks	399,766,823	1,966,367,143
12.2 Sundry staff-related provisions	5,615,869,744	5,550,199,552
13 REVALUATION ACCOUNTS	**9,246,350,725**	**9,645,479,636**
14 PROVISION FOR GENERAL RISKS	**7,586,781,997**	**8,789,381,997**
15 CAPITAL AND RESERVES	**13,665,845,861**	**13,213,982,218**
15.1 Capital	156,000	156,000
15.2 Ordinary and extraordinary reserves	9,495,815,772	9,044,070,683
15.3 Other reserves	4,169,874,089	4,169,755,535
16 NET PROFITS FOR DISTRIBUTION	**52,397,263**	**64,302,294**
TOTAL	**145,525,696,660**	**147,338,428,382**
18 MEMORANDUM ACCOUNTS	**418,246,089,603**	**365,360,119,127**

THE ACCOUNTANT GENERAL
ANTONIO PASQUALE SODA

THE GOVERNOR
ANTONIO FAZIO

INCOME STATEMENT

	amounts in euros 2003	amounts in euros 2002
a) Net income from institutional operations		
Interest income	*2,088,545,167*	*1,885,967,592*
Interest expense	*- 1,476,836,951*	*- 1,946,502,469*
Net interest income	**611,708,216**	**- 60,534,877**
Profits and losses on financial operations	*477,167,233*	*- 20,630,574,618*
Writedowns of financial assets and positions	*- 4,645,447,695*	*- 1,206,920,529*
Transfers to/from provisions for losses on foreign exchange and securities	*2,750,754,453*	*15,206,927,979*
Net result of financial operations, writedowns and risk provision transfers	**- 1,417,526,009**	**- 6,630,567,168**
Fee and commission income	*19,822,190*	*20,335,870*
Fee and commission expense	*- 18,968,247*	*- 17,709,199*
Net income from fees and commissions	**853,943**	**2,626,671**
Income from equity shares and participating interests	215,074,412	387,951,300
Net result of the pooling of monetary income	15,003,902	- 72,909,382
b) Other income		
– income from the investment of reserves and provisions	1,431,002,283	1,294,023,772
– prior-year income	83,527,105	83,623,705
– sundry	115,603,848	87,306,687
Total net income (a+b)	**1,055,247,700**	**- 4,908,479,292**
Sundry expenses and charges		
Staff wages and salaries and related costs (1)	- 614,612,177	- 627,121,768
Emoluments paid to head and branch office collegial bodies	- 3,006,845	- 2,862,972
Transfers to provisions for accrued expenses and staff severance pay and pensions	- 130,343,405	- 132,353,750
Other staff costs	- 41,266,905	- 39,800,489
Pensions and severance payments	- 242,815,476	- 237,290,842
Administrative costs	- 360,659,064	- 383,213,344
Depreciation of tangible and intangible fixed assets	- 190,498,010	- 186,350,136
Banknote production services	-	-
Other costs:		
– losses on investments of reserves and provisions	- 42,391,394	- 281,726,808
– other transfers to provisions	- 118,554	- 16,820,747
– prior-year expense	- 1,705,197	- 2,400,437
– appropriation of investment income to reserves (2)	- 468,969,171	- 297,281,479
– other taxes and duties	- 15,903,440	- 16,190,519
– sundry	- 6,664,741	- 3,805,123
Taxes on income for the year and productive activities (3)	1,116,103,942	7,200,000,000
Net profit for the year	**52,397,263**	**64,302,294**

(1) The Bank's staff averaged 8,385 in 2003, against 8,499 in 2002. – (2) Pursuant to Article 55 of the Statute. – (3) Under the layout of the income statement adopted, this item includes amounts with a positive sign.

ALLOCATION OF THE NET PROFIT FOR THE YEAR	amounts in euros
TO THE ORDINARY RESERVE	**10,479,453**
TO THE EXTRAORDINARY RESERVE	**10,479,453**
TO SHAREHOLDERS: 6% OF THE CAPITAL	**9,360**
AN ADDITIONAL 4% OF THE CAPITAL	**6,240**
TO THE STATE	**31,422,757**
TOTAL	**52,397,263**

Audited and found correct
29 April 2004. **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 110th FINANCIAL YEAR OF THE BANK OF ITALY AND THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2003

To the shareholders,

The accounts for the year ended 31 December 2003 submitted for your approval show the following results (in euros):

Assets	145,525,696,660
Liabilities	131,807,453,536
Capital and reserves	13,665,845,861
Net proÞt for the year (as shown in the vertical income statement)	52,397,263

The memorandum accounts, shown on both sides of the balance sheet for an amount of €418,246,089,603, refer to deposits of securities and sundry valuables and commitments and contingent liabilities (for purchases and sales of securities and sundry valuables), in foreign currencies 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 supplemented compared with the previous year to take account of:

- the start, in the last part of 2003, of trading in interest rate futures on the dollar market; the valuation methods applied for such transactions are in line with what is laid down in the current ÒAccounting GuidelinesÓ (ECB/2002/10);

- the decision adopted by the Governing Council of the ECB on 18 December 2003 to the effect that the full amount of the seigniorage income should be retained by the ECB.

The criteria for preparing the annual accounts for 2003 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 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.

The results for the year, which closed with a net proÞt of €52,397,263, were affected by the exceptionally large unrealized losses on positions denominated in foreign currency owing to the depreciation of the US dollar and the yen against the euro.

In order to cover part of these losses, the Board of Directors resolved to withdraw: a) the entire amount of €1,538 million from the provision for losses on foreign exchange; and b) €1,202 million from the provision for general risks. The above-mentioned unrealized losses contributed to the Bank incurring a loss for corporate income tax purposes; this allowed it to carry forward deferred tax assets amounting to €973 million that can be offset, under Article 84 of the new Income Tax Code, against taxable income in the next Þve Þnancial years. This amount, in addition to the €131 million of tax credits on dividends and the €12 million of other net changes in deferred tax, led to the inclusion of a positive result of €1,116 million under taxes for the year. The above-mentioned amount of €973 million supplements the deferred tax assets connected with the deductibility of the corporate income tax loss caused by the bond conversion under Law 289/2002, which is recoverable by 2022 (€7,116 million at the end of 2002, now €7,119 as a consequence of the corporate income tax return submitted for 2003). The inclusion in the balance sheet of deferred tax assets is based on a careful assessment of the prospects for the BankÕs ordinary income, which makes it possible to afÞrm that there is a reasonable expectation of offsetting, within the legal time limits, the entire amount of the tax losses deriving from the bond conversion and the exceptional diminution in the current value of foreign exchange assets in 2003.

We declare that the total amount of the BankÕs general and speciÞc risk provisions stand at a prudent level in our opinion, despite the withdrawals discussed above. 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 proÞt for 2003 of €52,397,263:

Ð 20 per cent to the ordinary reserve	€	10,479,453
Ð an amount equal to 6 per cent of the share capital to shareholders	ó	9,360
Ð 20 per cent to the extraordinary reserve.........................	ó	10,479,453
Ð an additional amount equal to 4 per cent of the share capital to shareholders	ó	6,240
Ð the remaining amount to the State	ó	31,422,757
Total	€	52,397,263

Pursuant to Article 56 of the Statute, the Board of Directors also proposes the distribution to shareholders Ð drawing on the income earned on the ordinary and extraordinary reserves Ð of an additional €45,219,000, equal to 0.50 per cent of such reserves at 31 December 2002 and within the limit laid down in the above-mentioned article.

During the year we attended all 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 BankÕs Statute and General Regulations.

We monitored the activity of the BankÕs peripheral units in close contact, in accordance with Articles 23 and 24 of the BankÕs Statute, with the examiners at the main branches and the branches, whom we thank warmly.

We recommend that you approve the accounts for 2003 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 proÞt for the year and distribution to shareholders of an additional amount pursuant to Article 56 of the Statute.

The mandate conferred on us has expired; we thank you for the trust you have honoured us with.

THE AUDITORS

GIUSEPPE BRUNI

ENRICO NUZZO

ANGELO PROVASOLI

MASSIMO STIPO

GIANFRANCO ZANDA

STATISTICAL APPENDIX

LIST OF TABLES

Page

Table a1

SOURCES AND USES OF INCOME IN FRANCE (1)
(at 1995 prices; billions of euros)

	Sources			Uses							
				Domestic demand							Exports of good 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	298.7	7.3	1,273.2	347.6
2000	1,348.8	368.2	1,717.0	116.8	160.2	276.9	729.1	307.1	12.8	1,325.7	391.3
2001	1,377.1	373.0	1,750.1	118.4	163.8	282.3	749.2	316.2	4.9	1,352.4	397.7
2002	1,393.4	383.8	1,777.2	116.6	160.2	276.8	760.7	330.8	3.4	1,372.0	405.2
2003	1,399.9	383.5	1,783.4	116.9	159.4	276.3	771.9	338.7	0.4	1,388.3	395.1
2000 – I	334.8	87.8	422.6	28.7	39.6	68.3	182.6	76.0	2.0	328.8	93.8
II	338.2	91.2	429.3	29.2	40.4	69.7	183.1	76.7	2.2	331.7	97.6
III	339.5	94.5	434.0	29.2	40.7	70.0	183.9	77.1	3.5	334.5	99.5
IV	344.2	97.1	441.4	29.6	42.0	71.6	184.8	77.7	4.3	338.4	103.0
2001 – I	345.8	95.4	441.2	30.0	41.8	71.8	187.3	77.9	1.5	338.5	102.7
II	345.8	94.4	440.2	29.5	41.9	71.3	188.1	78.4	2.2	340.1	100.1
III	347.9	93.7	441.5	29.5	41.9	71.5	189.7	79.9	0.1	341.2	100.3
IV	345.8	92.9	438.7	29.4	41.3	70.7	190.1	80.1	-0.1	340.6	98.1
2002 – I	348.4	95.7	444.1	29.2	41.2	70.4	190.8	81.5	1.2	343.8	100.3
II	350.4	97.4	447.8	29.4	40.8	70.2	191.8	82.6	0.2	344.8	103.1
III	350.9	98.3	449.2	29.1	40.8	69.9	192.9	83.1	0.6	346.4	102.8
IV	350.6	97.3	447.9	28.9	40.6	69.5	193.5	83.9	-0.8	346.1	101.8
2003 – I	351.1	96.8	447.9	29.0	40.7	69.7	195.0	84.1	-0.4	348.4	99.5
II	350.1	96.7	446.8	29.1	40.9	70.1	194.6	84.4	-0.4	348.6	98.1
III	352.2	96.9	449.1	29.2	40.8	70.1	195.8	85.0	-0.7	350.1	99.0
IV	354.4	99.4	453.7	29.6	41.1	70.6	196.7	85.8	0.1	353.3	100.5
2004 – I	357.1	100.0	457.1	29.8	41.7	71.5	198.8	86.1	..	356.4	100.7

Source: National statistics.

(1) The quarterly data are adjusted for seasonal factor 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 good 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	567.2	2,482.0	248.7	183.7	432.4	1,099.1	374.3	–5.7	1,900.2		581.8
2000	1,969.5	626.7	2,596.2	242.1	202.0	444.1	1,120.6	378.0	–8.1	1,934.7		661.5
2001	1,986.2	632.0	2,618.2	230.5	194.8	425.3	1,136.9	382.0	–24.7	1,919.4		698.8
2002	1,989.7	621.5	2,611.2	217.1	179.9	396.9	1,125.3	388.4	–22.0	1,888.6		722.6
2003	1,987.7	637.4	2,625.1	209.8	175.8	385.6	1,124.1	391.7	–7.4	1,894.0		731.1
2000 – I	488.4	148.9	637.2	61.4	48.7	110.0	277.8	94.7	–2.9	479.7		157.4
II	493.5	153.4	646.9	60.9	49.9	110.8	281.7	94.2	–2.8	483.9		163.1
III	493.3	158.1	651.4	60.2	51.8	112.0	281.1	93.9	–1.8	485.3		166.1
IV	493.5	165.9	659.4	59.3	51.5	110.7	280.1	95.2	–1.2	484.8		174.6
2001 – I	497.9	160.3	658.2	58.1	51.1	109.1	283.6	95.4	–4.9	483.3		174.8
II	497.6	160.2	657.8	57.9	49.4	107.4	284.9	94.9	–4.8	482.4		175.4
III	496.8	157.6	654.4	57.6	48.1	105.7	285.6	94.8	–7.8	478.4		176.1
IV	496.0	155.6	651.7	57.2	46.8	104.0	283.6	96.8	–7.5	477.0		174.9
2002 – I	497.0	151.0	648.0	56.7	45.5	102.2	280.9	96.7	–8.3	471.5		176.6
II	498.2	155.9	654.1	53.8	45.1	98.8	281.5	97.1	–3.7	473.7		180.4
III	498.9	157.5	656.4	53.8	45.1	99.0	282.2	97.6	–6.4	472.3		184.1
IV	498.6	158.9	657.5	53.7	44.9	98.7	281.8	97.0	–4.2	473.3		184.3
2003 – I	497.4	161.4	658.7	52.5	44.8	97.2	282.8	97.1	–1.7	475.5		183.3
II	496.5	157.6	654.1	52.5	44.0	96.5	281.6	97.8	–0.3	475.6		178.6
III	497.6	157.9	655.4	52.6	43.4	96.0	280.8	98.5	–5.1	470.2		185.3
IV	498.9	162.1	660.9	53.4	44.2	97.6	279.6	98.3	–0.5	474.9		185.9

Source: National statistics.

(1) The quarterly data are adjusted for seasonal factor 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 good 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	507.3	155.6	662.9	64.9	58.5	123.5	301.3	89.0	2.4	516.1	146.8	
2000	528.7	172.1	700.8	68.9	61.5	130.5	313.3	93.4	2.0	539.2	161.5	
2001	543.7	178.9	722.7	72.9	61.8	134.7	322.2	96.8	1.6	555.4	167.3	
2002	554.9	182.1	736.9	76.0	60.1	136.1	330.7	101.1	1.7	569.6	167.3	
2003	568.3	194.2	762.5	78.8	61.4	140.2	340.5	105.7	1.9	588.5	174.0	
2000 – I	130.5	42.0	172.5	16.9	15.4	32.3	77.6	23.0	1.3	134.1	38.4	
II	132.2	42.6	174.8	17.1	15.4	32.5	78.3	23.3	0.6	134.8	40.1	
III	132.5	43.9	176.4	17.4	15.5	32.9	78.3	23.4	1.0	135.6	40.8	
IV	133.5	43.5	177.0	17.5	15.2	32.7	79.1	23.7	–0.8	134.7	42.3	
2001 – I	134.5	45.5	180.0	17.9	15.6	33.5	80.2	23.8	0.4	137.8	42.1	
II	135.6	45.4	181.0	18.2	15.7	33.9	80.5	24.1	1.0	139.4	41.7	
III	136.7	44.6	181.3	18.2	15.5	33.8	80.6	24.4	0.3	139.1	42.2	
IV	136.9	43.5	180.4	18.6	15.0	33.6	81.0	24.6	–0.1	139.1	41.3	
2002 – I	137.5	43.5	181.0	18.7	15.0	33.7	81.8	24.9	0.1	140.4	40.6	
II	138.4	43.8	182.2	18.9	14.7	33.6	82.7	25.2	–0.1	141.3	40.9	
III	139.2	46.1	185.3	19.1	15.2	34.3	82.6	25.4	0.3	142.6	42.7	
IV	139.8	48.6	188.4	19.3	15.3	34.6	83.6	25.6	1.4	145.3	43.1	
2003 – I	140.6	47.2	187.8	19.4	15.4	34.8	84.2	26.0	0.5	145.4	42.4	
II	141.6	48.2	189.9	19.6	15.1	34.7	85.1	26.3	–0.3	145.8	44.1	
III	142.5	48.8	191.4	19.8	15.5	35.3	85.2	26.6	0.6	147.7	43.6	
IV	143.6	49.9	193.5	20.0	15.5	35.5	86.1	26.9	1.1	149.6	43.9	

Source: National statistics.

(1) The quarterly data are adjusted for seasonal factor 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

	1999	2000	2001	2002	2003
	Value added at factor cost per standard labour unit (1) *(euros at 1995 prices)*				
Agriculture, forestry and fishing	**23,403**	**23,184**	**23,088**	**22,627**	**22,168**
Industry excluding construction	**42,496**	**43,478**	**43,604**	**43,244**	**42,962**
of which: manufacturing	*39,122*	*40,260*	*40,254*	*39,512*	*39,035*
Construction	**29,905**	**30,076**	**29,624**	**29,603**	**29,489**
Services (2)	**35,914**	**36,792**	**37,075**	**36,854**	**36,775**
Wholesale and retail trade, repair of household goods etc.	35,269	36,523	36,636	36,218	35,852
Hotels and restaurants	26,141	26,292	26,182	25,855	25,444
Transport, storage and communication	49,212	51,305	53,289	53,517	53,036
Financial intermediation	89,388	97,561	96,590	94,959	92,773
Sundry business and household services (2) (3)	36,906	37,670	38,586	38,208	38,162
Public administration (4)	35,188	35,316	35,344	35,446	36,679
Education	27,080	26,847	26,319	26,292	26,556
Health and social work services	30,929	31,871	33,387	34,555	35,106
Other public, social and personal services	35,118	33,988	33,268	32,356	31,970
Private households with employed persons	9,568	9,553	9,541	9,552	9,552
Total (2)	**36,270**	**37,057**	**37,201**	**36,958**	**36,822**
	Unit labour costs (1) (5) *(current euros per euros at 1995 prices)*				
Agriculture, forestry and fishing	**0.575**	**0.577**	**0.584**	**0.604**	**0.641**
Industry excluding construction	**0.686**	**0.691**	**0.710**	**0.732**	**0.759**
of which: manufacturing	*0.729*	*0.731*	*0.754*	*0.786*	*0.821*
Construction	**0.767**	**0.784**	**0.812**	**0.832**	**0.862**
Services (2)	**0.799**	**0.805**	**0.826**	**0.854**	**0.890**
Wholesale and retail trade, repair of household goods etc.	0.686	0.683	0.702	0.734	0.766
Hotels and restaurants	0.890	0.907	0.946	1.001	1.067
Transport, storage and communication	0.620	0.606	0.594	0.594	0.614
Financial intermediation	0.574	0.537	0.553	0.579	0.602
Sundry business and household services (2) (3)	0.757	0.788	0.814	0.835	0.853
Public administration (4)	0.951	0.958	1.001	1.063	1.120
Education	1.155	1.217	1.272	1.293	1.371
Health and social work services	1.010	1.063	1.075	1.069	1.074
Other public, social and personal services	0.716	0.754	0.792	0.830	0.862
Private households with employed persons	1.123	1.159	1.177	1.216	1.269
Total (2)	**0.773**	**0.779**	**0.801**	**0.827**	**0.861**

Source: Istat, national accounts.

(1) Includes indirectly measured financial intermediation services. – (2) Excludes renting of buildings. – (3) Excludes renting 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 of import	Gross domestic product	Imports of goods and services (*fob*) (4)	
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	596,143	881,280	82,901	342,103	114,842	1,907,716	517,660	2,425,376
	(29,051)	(307,882)	(455,143)	(42,815)	(176,681)	(59,311)	(985,253)	(267,349)	(1,252,602)
2000	54,639	608,342	930,400	92,411	345,534	118,959	1,965,463	554,583	2,520,046
	(28,219)	(314,182)	(480,512)	(47,726)	(178,453)	(61,437)	(1,015,077)	(286,418)	(1,301,495)
2001	54,395	610,514	960,119	98,979	352,638	121,451	2,000,138	557,254	2,557,392
	(28,093)	(315,304)	(495,860)	(51,119)	(182,123)	(62,724)	(1,032,985)	(287,798)	(1,320,783)
2002	52,220	607,866	969,755	100,818	356,706	121,603	2,007,332	556,026	2,563,358
	(26,969)	(313,937)	(500,837)	(52,068)	(184,223)	(62,803)	(1,036,701)	(287,164)	(1,323,864)
2003	49,282	609,826	976,364	100,848	359,010	118,861	2,012,495	552,421	2,564,916
	(25,452)	(314,949)	(504,250)	(52,083)	(185,413)	(61,386)	(1,039,367)	(285,302)	(1,324,669)
2001 – I	13,653	153,655	239,079	24,500	87,942	30,305	500,131	143,212	643,345
	(7,051)	(79,356)	(123,474)	(12,653)	(45,418)	(15,651)	(258,296)	(73,963)	(332,260)
II	13,201	152,667	240,047	24,668	88,323	30,502	500,073	141,905	641,976
	(6,818)	(78,846)	(123,974)	(12,740)	(45,615)	(15,753)	(258,266)	(73,288)	(331,553)
III	13,596	152,319	240,396	24,817	88,222	30,297	500,013	136,501	636,514
	(7,022)	(78,666)	(124,154)	(12,817)	(45,563)	(15,647)	(258,235)	(70,497)	(328,732)
IV	13,945	151,571	240,576	24,993	88,155	30,347	499,598	135,634	635,232
	(7,202)	(78,280)	(124,247)	(12,908)	(45,528)	(15,673)	(258,021)	(70,049)	(328,070)
2002 – I	13,219	151,573	240,835	24,947	88,582	30,401	499,662	136,875	636,535
	(6,827)	(78,281)	(124,381)	(12,884)	(45,749)	(15,701)	(258,054)	(70,690)	(328,743)
II	13,018	151,252	242,518	25,077	88,939	30,425	501,072	139,592	640,663
	(6,723)	(78,115)	(125,250)	(12,951)	(45,933)	(15,713)	(258,782)	(72,093)	(330,875)
III	12,948	152,268	242,500	25,268	89,438	30,403	502,288	137,107	639,395
	(6,687)	(78,640)	(125,241)	(13,050)	(46,191)	(15,702)	(259,410)	(70,810)	(330,220)
IV	13,037	152,561	243,912	25,526	89,765	30,374	504,123	142,453	646,577
	(6,733)	(78,791)	(125,970)	(13,183)	(46,360)	(15,687)	(260,358)	(73,571)	(333,929)
2003 – I	13,116	152,408	242,710	25,065	89,818	29,908	502,894	135,612	638,506
	(6,774)	(78,712)	(125,349)	(12,945)	(46,387)	(15,446)	(259,723)	(70,038)	(329,761)
II	11,862	151,521	244,818	25,342	89,826	29,631	502,317	135,781	638,098
	(6,126)	(78,254)	(126,438)	(13,088)	(46,391)	(15,303)	(259,425)	(70,125)	(329,550)
III	11,834	153,680	244,983	25,359	89,736	29,700	504,575	142,790	647,365
	(6,112)	(79,369)	(126,523)	(13,097)	(46,345)	(15,339)	(260,591)	(73,745)	(334,336)
IV	12,470	153,194	244,506	25,081	89,806	29,621	504,516	138,238	642,755
	(6,440)	(79,118)	(126,277)	(12,953)	(46,381)	(15,298)	(260,561)	(71,394)	(331,955)

Sources: 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 institution; real estate
expenditure abroad. – (5) Expenditure of general government and non-profit institutions serving households. – (6) Includes non-residents' expenditure in Italy.

Table a5

OF INCOME						HOUSEHOLD DOMESTIC CONSUMPTION				
Uses						By type of consumption			By type of good	
Investment in building and public works	Investment in machinery, equipment, transport equipment and intangible assets	Domestic consumption		Change in stocks and valuables	Export 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)							
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)
164,291	240,809	1,184,165	343,159	331	587,291	528,345	146,660	530,676	212,830	992,851
(84,849)	(124,368)	(611,570)	(177,227)	(171)	(303,311)	(272,867)	(75,744)	(274,071)	(109,918)	(512,765)
169,169	243,490	1,193,569	356,296	–1,755	596,624	528,879	145,636	539,385	213,571	1,000,329
(87,369)	(125,752)	(616,427)	(184,011)	(–906)	(308,131)	(273,143)	(75,215)	(278,569)	(110,300)	(516,627)
174,701	242,801	1,199,000	362,988	7,377	576,491	529,080	143,010	542,615	214,913	999,792
(90,226)	(125,396)	(619,232)	(187,468)	(3,810)	(297,733)	(273,247)	(73,859)	(280,237)	(110,993)	(516,350)
177,882	230,915	1,214,219	371,054	16,793	554,052	531,971	145,550	549,449	215,150	1,011,820
(91,868)	(119,258)	(627,092)	(191,633)	(8,673)	(286,144)	(274,740)	(75,170)	(283,767)	(111,116)	(522,561)
41,872	62,216	299,127	87,994	–2,846	154,983	132,909	36,822	134,511	53,464	250,776
(21,625)	(32,132)	(154,486)	(45,445)	(–1,470)	(80,042)	(68,642)	(19,017)	(69,469)	(27,612)	(129,515)
41,794	61,428	299,134	88,999	45	150,578	132,869	37,083	134,553	53,544	250,964
(21,585)	(31,725)	(154,490)	(45,964)	(23)	(77,767)	(68,621)	(19,152)	(69,491)	(27,653)	(129,612)
42,550	60,195	297,692	89,260	1,319	145,499	131,788	35,862	135,165	53,548	249,270
(21,975)	(31,088)	(153,745)	(46,099)	(681)	(75,144)	(68,063)	(18,521)	(69,807)	(27,655)	(128,737)
42,867	59,604	297,988	90,042	–835	145,565	131,682	35,862	135,161	53,387	249,320
(22,139)	(30,783)	(153,898)	(46,503)	(–431)	(75,178)	(68,008)	(18,521)	(69,805)	(27,572)	(128,763)
43,109	58,969	297,179	90,197	3,522	143,561	131,825	35,261	134,307	53,367	248,028
(22,264)	(30,455)	(153,480)	(46,583)	(1,819)	(74,143)	(68,082)	(18,211)	(69,364)	(27,562)	(128,096)
42,604	59,258	299,272	90,683	5,160	143,689	132,588	35,184	135,460	53,873	249,359
(22,003)	(30,604)	(154,561)	(46,834)	(2,665)	(74,209)	(68,476)	(18,171)	(69,959)	(27,823)	(128,783)
43,949	60,718	300,358	90,890	–2,020	145,501	132,695	35,474	135,870	53,943	250,094
(22,698)	(31,358)	(155,122)	(46,941)	(–1,043)	(75,145)	(68,531)	(18,321)	(70,171)	(27,859)	(129,163)
45,055	64,065	302,378	91,218	120	143,741	132,118	37,043	137,065	53,877	252,350
(23,269)	(33,087)	(156,165)	(47,110)	(62)	(74,236)	(68,233)	(19,131)	(70,788)	(27,825)	(130,328)
44,782	58,971	303,048	92,143	3,433	136,129	132,348	36,960	137,012	54,221	252,098
(23,128)	(30,456)	(156,511)	(47,588)	(1,773)	(70,305)	(68,352)	(19,088)	(70,761)	(28,003)	(130,198)
44,668	58,073	303,303	92,639	3,462	135,953	133,136	35,802	137,148	53,943	252,145
(23,069)	(29,992)	(156,643)	(47,844)	(1,788)	(70,214)	(68,759)	(18,490)	(70,831)	(27,859)	(130,222)
44,217	57,589	304,416	93,133	4,285	143,724	133,684	36,359	137,330	53,788	253,586
(22,836)	(29,742)	(157,218)	(48,099)	(2,213)	(74,227)	(69,042)	(18,778)	(70,925)	(27,779)	(130,966)
44,261	56,357	303,350	93,140	7,400	138,246	132,561	36,415	138,114	52,953	254,139
(22,859)	(29,106)	(156,667)	(48,103)	(3,822)	(71,398)	(68,462)	(18,807)	(71,330)	(27,348)	(131,252)

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					
1994	77.5	92.7	89.4	82.3	91.3	86.1	88.5	88.1
1995	84.2	94.8	92.6	92.6	94.7	89.0	93.5	92.8
1996	83.8	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	97.0	97.2	95.6	97.0	96.8
1999	93.6	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	99.1	100.8	100.5	99.0	98.2	99.6	99.1	99.2
2002	96.0	99.0	98.3	97.7	95.5	103.8	97.0	97.8
2003	91.7	98.8	97.3	95.3	94.3	108.1	95.5	97.0
1997 – I	83.6	95.6	93.2	93.3	90.2	91.0	92.2	92.0
II	85.8	97.1	94.8	97.7	95.6	93.2	95.7	95.3
III	85.3	99.0	96.2	98.3	96.7	93.3	96.8	96.5
IV	86.3	98.2	95.7	99.5	98.7	95.1	97.9	97.6
1998 – I	87.5	96.9	95.0	97.6	98.9	94.6	97.3	97.0
II	90.0	98.9	97.1	97.8	98.6	94.7	97.8	97.3
III	90.1	99.1	97.1	97.2	96.2	95.6	96.8	96.7
IV	88.9	98.9	96.8	93.3	94.3	97.0	95.2	95.5
1999 – I	88.9	98.8	97.0	96.0	93.2	97.8	94.8	95.2
II	90.6	98.0	96.4	95.9	93.9	95.2	95.2	95.1
III	94.6	101.4	99.8	96.7	94.6	97.6	96.9	97.0
IV	98.1	99.9	99.5	98.3	97.3	98.2	98.3	98.3
2000 – I	98.4	97.5	97.9	99.3	98.4	99.5	98.5	98.6
II	101.0	100.5	100.6	101.1	100.2	100.6	100.5	100.3
III	99.9	100.9	100.3	100.7	100.3	100.6	100.4	100.5
IV	103.3	103.3	103.4	101.0	102.5	99.3	102.4	102.1
2001 – I	102.8	104.0	104.2	102.3	100.9	97.5	102.3	101.7
II	100.1	101.1	100.9	100.0	99.5	98.6	100.1	100.1
III	96.5	100.4	99.2	98.0	97.9	99.2	98.5	98.6
IV	96.8	98.3	98.0	95.8	94.8	103.0	96.2	97.0
2002 – I	96.5	99.4	99.2	97.1	95.1	103.4	96.8	97.6
II	96.5	99.6	98.9	97.8	95.7	104.5	97.3	98.2
III	95.5	98.4	97.6	98.0	96.3	105.3	97.3	98.3
IV	95.1	98.7	98.1	97.9	95.4	102.5	97.0	97.7
2003 – I	90.2	98.6	97.2	96.0	95.6	107.7	96.2	97.5
II	89.7	98.8	96.7	94.8	94.2	107.7	95.1	96.6
III	93.7	100.2	98.6	96.3	94.8	109.6	96.5	98.0
IV	95.1	99.5	98.8	96.5	94.1	108.8	96.4	97.9

Source: Based on Istat data.

Table a7

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					
1994	93.8	98.1	96.8	85.2	95.1	97.4	94.0	94.4
1995	99.7	99.1	98.9	95.4	98.0	98.4	98.7	98.9
1996	95.5	96.5	95.8	95.3	92.9	95.9	95.6	96.0
1997	93.6	98.6	97.2	97.6	96.1	97.8	98.1	98.1
1998	94.5	98.2	97.0	96.2	96.9	97.9	97.9	98.0
1999	95.4	97.9	96.9	95.7	93.7	97.2	95.9	96.3
2000	99.4	97.5	97.5	98.7	98.3	97.8	98.6	98.9
2001	96.3	97.0	96.5	96.8	95.8	95.2	96.9	97.3
2002	93.3	95.2	94.4	95.5	93.3	97.2	94.8	96.0
2003	89.6	95.4	93.8	93.7	92.4	99.3	93.8	95.5
1997 – I	93.1	97.2	96.0	94.0	91.3	96.4	94.9	95.2
II	94.6	98.4	97.2	98.2	96.6	98.1	98.3	98.3
III	93.3	100.0	98.2	98.6	97.4	97.7	99.1	99.1
IV	93.5	98.9	97.2	99.7	99.2	98.9	100.0	99.9
1998 – I	94.0	97.2	96.2	97.6	99.1	97.9	99.0	98.9
II	95.8	98.8	97.8	97.6	98.6	97.3	99.1	98.8
III	95.2	98.7	97.3	96.9	95.9	97.7	97.7	97.9
IV	93.1	98.2	96.6	92.8	93.8	98.6	95.8	96.3
1999 – I	92.2	97.7	96.3	95.3	92.5	98.7	95.0	95.6
II	93.3	96.5	95.4	95.0	93.0	95.5	95.0	95.2
III	96.6	99.6	98.2	95.6	93.5	97.4	96.4	96.8
IV	99.3	97.7	97.6	97.0	95.8	97.3	97.3	97.7
2000 – I	98.9	95.1	95.5	97.8	96.8	98.1	97.2	97.7
II	100.0	97.6	97.8	99.3	98.3	98.7	98.9	99.0
III	98.8	97.7	97.1	98.8	98.1	98.1	98.4	98.8
IV	100.0	99.7	99.6	98.9	100.0	96.2	100.0	100.0
2001 – I	100.0	100.0	100.0	100.0	98.4	94.0	99.9	99.6
II	97.3	97.2	96.8	97.7	97.0	94.5	97.8	98.1
III	93.9	96.5	95.2	95.8	95.5	94.6	96.2	96.6
IV	94.2	94.5	94.0	93.6	92.5	97.6	93.9	95.0
2002 – I	93.8	95.6	95.2	94.9	92.8	97.4	94.5	95.6
II	93.9	95.8	94.8	95.6	93.3	98.0	95.0	96.2
III	92.9	94.7	93.6	95.8	94.0	98.2	95.0	96.3
IV	92.5	95.0	94.1	95.6	93.1	95.1	94.7	95.7
2003 – I	87.7	94.8	93.2	93.8	93.3	99.3	93.9	95.6
II	87.2	95.0	92.8	92.7	91.9	98.8	92.9	94.6
III	91.1	96.3	94.6	94.1	92.5	100.0	94.2	96.0
IV	92.5	95.6	94.7	94.3	91.8	99.3	94.1	95.9

Source: Based on Istat data.

ITALY: CONSUMER PRICE INDICES
(percentage changes on corresponding period)

	CPI (1)													WEH (2)
	Goods and services with unregulated prices (4)							Goods and services with regulated prices (4)			Rents	Overall index (6)	Total net of food and energy products and those with regulated prices	Overall index (6)
	Non-food and non-energy products	Ser-vices	Food products			Energy products	Total	Energy products	Non-energy products (5)	Total				
			Processed	Un-processed	Total									
Weights (3)	*30.7*	*31.6*	*9.9*	*6.9*	*16.8*	*2.9*	*82.0*	*2.7*	*12.2*	*14.9*	*3.1*	*100.0*	*62.3*	*100.0*
1999	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	2.8	1.2	2.0	1.6	13.2	2.5	9.8	1.2	3.0	2.5	2.6	2.1	2.6
2001	2.0	3.2	2.4	6.4	4.0	–2.0	2.7	5.8	3.1	3.7	2.3	2.8	2.6	2.7
2002	2.2	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
2003	1.9	3.5	2.4	4.2	3.2	2.3	2.8	4.1	1.6	2.1	2.8	2.6	2.7	2.5
2001 – Jan.	1.9	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	2.8	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	2.8	1.9	5.8	3.5	0.2	2.5	11.6	3.2	5.0	2.4	2.9	2.4	2.8
Apr.	2.1	3.2	2.2	5.5	3.6	2.2	2.8	11.8	3.6	5.4	2.2	3.2	2.6	3.1
May	2.1	3.2	2.3	6.1	3.9	3.6	2.9	6.1	3.5	4.0	2.2	3.1	2.6	3.0
June	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	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	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
Sep.	2.1	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	3.5	2.7	6.9	4.4	–7.9	2.6	1.5	2.9	2.6	2.2	2.6	2.7	2.6
Nov.	1.9	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	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	3.7	2.8	7.7	4.8	–6.5	2.8	–4.0	1.8	0.6	2.1	2.5	2.8	2.3
Feb.	2.2	3.8	2.6	6.5	4.2	–5.4	2.9	–4.3	1.6	0.4	2.1	2.5	3.0	2.3
Mar.	2.2	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	3.7	2.4	6.8	4.2	–1.6	2.9	–6.4	1.3	–0.4	2.4	2.4	2.8	2.4
May	2.1	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	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	4.0	2.3	3.7	2.9	–3.4	2.7	–1.9	0.9	0.4	2.1	2.3	3.0	2.3
Aug.	2.2	4.2	2.3	3.8	2.9	–1.4	2.9	–1.8	1.2	0.6	2.1	2.5	3.1	2.5
Sep.	2.3	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	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	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	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	3.8	2.1	3.1	2.5	7.2	3.0	1.5	1.3	1.3	2.7	2.7	3.0	2.7
Feb.	2.0	3.6	2.2	2.6	2.4	8.4	2.9	2.0	0.5	0.8	2.7	2.5	2.8	2.5
Mar.	2.0	3.7	2.3	2.8	2.5	9.5	3.0	3.2	0.5	1.0	2.7	2.6	2.8	2.6
Apr.	2.1	3.7	2.3	2.1	2.2	3.2	2.7	6.0	1.7	2.5	2.8	2.6	2.8	2.5
May	2.0	3.6	2.3	2.4	2.4	–0.4	2.6	6.3	2.6	3.3	2.8	2.6	2.8	2.4
June	2.0	3.6	2.4	3.9	3.0	–1.3	2.7	6.4	2.1	2.9	2.8	2.7	2.8	2.3
July	1.9	3.6	2.4	4.6	3.3	–0.2	2.7	4.5	1.9	2.4	2.9	2.7	2.7	2.5
Aug.	1.9	3.7	2.4	5.2	3.6	1.3	2.9	4.5	1.8	2.3	2.9	2.8	2.7	2.5
Sep.	1.8	3.4	2.4	6.0	3.9	1.8	2.8	4.4	1.8	2.3	2.9	2.8	2.6	2.5
Oct.	1.6	3.4	2.6	6.3	4.2	–1.1	2.7	3.7	1.7	2.1	2.7	2.6	2.5	2.4
Nov.	1.4	3.3	2.7	6.1	4.1	–0.3	2.6	3.7	1.9	2.2	2.7	2.6	2.3	2.4
Dec.	1.4	3.2	2.8	5.4	3.9	0.3	2.5	3.7	1.9	2.3	2.7	2.5	2.3	2.3
2004 – Jan.	1.3	3.2	2.8	5.5	3.9	–1.7	2.4	1.6	1.6	1.6	2.7	2.3	2.2	2.0
Feb.	1.2	3.1	2.8	5.7	4.0	–2.4	2.4	0.6	2.6	2.2	2.7	2.3	2.2	2.2
Mar.	0.9	3.2	2.7	5.1	3.7	–3.2	2.2	0.2	3.6	2.9	2.7	2.3	2.1	1.9
Apr.	0.8	3.5	2.6	4.5	3.4	0.7	2.3	-2.4	2.4	1.5	3.0	2.2	2.1	2.0

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 2004. – (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.

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	*34.3*	*40.1*	*74.4*	*11.4*	*8.4*	*19.8*	*5.8*	*85.7*	*100.0*
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
2003	1.9	3.2	2.6	3.4	3.9	3.6	3.2	2.7	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
Sep.	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
Sep.	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
May	2.2	3.3	2.8	3.8	2.3	3.2	2.8	2.9	2.9
June	2.2	3.3	2.8	3.6	3.6	3.6	2.3	2.9	2.9
July	1.8	3.2	2.6	3.6	4.3	3.9	2.1	2.7	2.9
Aug.	1.5	3.3	2.5	3.5	4.8	4.1	2.8	2.6	2.7
Sep.	1.7	3.1	2.4	3.5	5.6	4.4	3.0	2.6	3.0
Oct.	2.0	2.8	2.4	3.7	5.9	4.6	1.1	2.6	2.8
Nov.	1.9	2.7	2.3	3.9	5.7	4.7	1.6	2.5	2.8
Dec.	1.8	2.6	2.2	4.0	5.0	4.4	1.9	2.4	2.5
2004 – Jan.	1.0	2.4	1.8	3.9	5.1	4.4	–0.1	2.1	2.2
Feb.	2.0	2.4	2.3	4.0	5.2	4.5	–1.0	2.5	2.4
Mar.	1.5	2.3	2.0	5.1	4.7	4.9	–1.5	2.4	2.3
Apr.	1.8	2.5	2.2	3.6	4.2	3.9	–0.8	2.4	2.3

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 2004. – (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	*31.0*	*41.3*	*72.3*	*11.8*	*7.7*	*19.5*	*8.1*	*84.2*	*100.0*
2000	0.5	1.5	1.0	1.2	1.8	1.4	13.0	1.0	2.1
2001	0.9	2.5	1.8	2.9	7.0	4.5	2.2	1.9	2.3
2002	1.5	3.1	2.4	3.1	3.1	3.1	–0.6	2.5	2.3
2003	0.8	2.5	1.8	3.3	2.1	2.8	3.0	2.0	2.1
2001 – Jan.	0.2	1.9	1.2	1.6	4.5	2.8	7.2	1.2	2.0
Feb.	–0.2	2.1	1.0	2.0	4.6	3.0	7.5	1.2	1.9
Mar.	0.6	2.1	1.4	2.2	6.6	3.9	4.8	1.5	2.2
Apr.	1.1	2.3	1.7	2.5	7.1	4.3	7.2	1.9	2.7
May	1.3	2.5	1.9	2.7	8.9	5.1	7.9	2.0	3.1
June	1.2	2.5	1.9	3.0	8.8	5.3	4.9	2.1	2.8
July	0.8	2.5	1.8	3.2	8.5	5.3	2.4	2.0	2.5
Aug.	0.5	2.6	1.7	3.3	7.5	5.0	1.5	1.9	2.4
Sept.	1.0	2.7	1.9	3.4	7.5	5.0	–1.7	2.1	2.2
Oct.	1.4	2.8	2.2	3.5	7.5	5.1	–3.0	2.4	2.2
Nov.	1.5	2.9	2.2	3.4	6.1	4.5	–5.3	2.4	2.0
Dec.	1.5	2.8	2.2	3.4	6.3	4.5	–4.7	2.4	2.1
2002 – Jan.	1.6	3.0	2.4	3.8	8.4	5.6	–1.9	2.6	2.6
Feb.	1.8	3.0	2.5	3.4	7.1	4.9	–2.9	2.6	2.5
Mar.	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	2.5	1.9
July	1.3	3.2	2.4	3.0	0.9	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	2.6	1.7	2.2	2.6	2.3	2.3
Nov.	1.3	3.1	2.3	2.6	1.9	2.3	2.4	2.3	2.3
Dec.	1.2	3.0	2.2	2.7	1.3	2.1	3.8	2.2	2.3
2003 – Jan.	0.6	2.8	1.9	2.8	–0.7	1.4	6.0	2.0	2.1
Feb.	0.7	2.7	1.9	3.2	0.3	2.0	7.7	2.0	2.4
Mar.	0.8	2.6	1.8	3.3	0.7	2.2	7.5	2.0	2.4
Apr.	0.8	2.9	2.0	3.3	0.9	2.3	2.2	2.2	2.1
May	0.9	2.5	1.8	3.3	1.1	2.4	0.6	2.0	1.8
June	0.8	2.5	1.8	3.2	2.5	2.9	1.6	2.0	1.9
July	0.7	2.3	1.6	3.1	2.7	3.0	2.0	1.8	1.9
Aug.	0.6	2.5	1.7	3.0	3.3	3.1	2.7	1.9	2.1
Sept.	0.8	2.5	1.8	3.2	4.2	3.6	1.6	2.0	2.2
Oct.	0.8	2.5	1.7	3.5	3.8	3.6	0.7	2.0	2.0
Nov.	0.7	2.4	1.7	4.0	3.8	3.9	2.2	2.0	2.2
Dec.	0.7	2.3	1.6	3.8	3.2	3.6	1.8	1.9	2.0
2004 – Jan.	0.6	2.5	1.7	3.3	2.9	3.1	–0.4	1.9	1.9
Feb.	0.8	2.6	1.8	3.2	1.9	2.7	–2.2	2.0	1.6
Mar.	0.8	2.5	1.8	4.1	1.7	3.1	–2.0	2.1	1.7
Apr.	1.0	2.5	1.8	3.9	1.6	3.0	2.0	2.1	2.0

Source: Eurostat.

(1) Weighted average of the indices of the euro-area countries. The weights shown in the table are those for January 2004. – (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.

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	*17.2*	*13.1*	*17.9*	*34.3*	*17.5*	*69.4*	*100*
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
2003	1.1	2.7	0.7	1.5	2.5	1.2	1.6
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
Apr.	1.6	2.6	0.5	2.4	3.1	1.7	2.0
May	1.5	2.4	0.7	2.0	0.8	1.5	1.6
June	1.2	2.7	0.7	1.3	2.2	1.1	1.5
July	1.1	2.6	0.9	0.8	2.0	0.9	1.3
Aug.	0.8	2.9	0.9	0.4	2.9	0.6	1.4
Sept.	0.8	3.6	0.9	0.6	0.1	0.7	1.0
Oct.	0.4	3.4	0.8	0.8	–1.4	0.7	0.7
Nov.	0.5	3.3	0.8	1.0	1.0	0.8	1.2
Dec.	0.3	2.8	0.9	1.0	–1.4	0.8	0.8
2004 – Jan.	0.2	2.7	1.1	1.2	–3.6	0.9	0.4
Feb.	0.1	2.6	1.2	1.5	–5.9	1.1	0.1
Mar.	..	3.1	1.3	2.8	–5.6	1.7	0.7

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 (2)	Intermediate goods		Overall index net of food and energy products	Overall index
		Non-energy products	Energy products				Non-energy products	Energy products		
Weights (1)	*13.5*	*31.2*	*18.1*	*68.0*	*100.0*	*13.5*	*34.3*	*17.5*	*65.2*	*100.0*
2001	1.6	0.8	9.1	0.9	3.0	0.8	1.5	–2.2	1.2	1.2
2002	0.3	–0.7	–3.7	0.1	–0.6	–0.2	–0.6	–0.7	–0.2	–0.2
2003	–0.2	0.4	7.1	0.2	1.7	0.4	0.4	2.6	0.3	0.9
2002 – Sept.	–0.1	..	–6.2	0.3	–1.1	0.4	0.1	0.8	0.2	0.4
Oct.	–0.5	0.2	–1.2	0.3	0.1	–0.1	0.1	3.1	0.1	0.7
Nov.	–0.4	0.2	–0.9	0.3	0.2	0.2	0.2	4.0	0.2	0.9
Dec.	–0.2	0.5	0.5	0.5	0.6	0.4	0.3	6.5	0.3	1.3
2003 – Jan.	–0.6	0.9	5.1	0.4	1.5	0.8	0.7	7.9	0.5	1.7
Feb.	–0.3	1.4	6.2	0.5	1.9	0.7	0.9	9.9	0.6	2.2
Mar.	–0.2	1.3	5.7	0.6	1.7	1.0	1.1	8.3	0.7	2.1
Apr.	–0.2	1.0	5.8	0.5	1.7	0.8	1.2	1.7	0.8	1.0
May	–0.3	0.9	5.0	0.4	1.4	1.0	0.8	0.4	0.7	0.7
June	–0.1	0.3	5.8	0.1	1.4	0.7	0.6	1.8	0.6	0.9
July	0.3	–0.1	8.6	..	1.9	0.6	–0.3	1.7	0.1	0.6
Aug.	–0.1	–0.4	9.8	–0.2	2.0	0.3	–0.6	1.6	–0.1	0.5
Sept.	..	–0.3	9.0	–0.1	2.0	0.2	–0.3	–0.8	0.1	0.1
Oct.	..	–0.4	7.9	–0.2	1.7	..	–0.1	–0.6	0.1	0.3
Nov.	..	–0.1	8.5	..	2.0	–0.2	0.2	1.0	0.2	0.8
Dec.	–0.3	–0.1	8.0	–0.1	1.8	–0.6	0.3	–1.0	..	0.3
2004 – Jan.	–0.3	–0.2	0.7	–0.1	0.2	–1.0	0.4	–2.0	0.1	0.2
Feb.	–0.5	0.1	–0.7	..	–0.1	–0.7	0.8	–4.6	0.3	–0.1
Mar.	–0.7	0.6	–1.1	0.1	0.3	–1.3	1.1	–3.3	0.2	0.1
	SPAIN					**EURO** (3)				
Weights (1)	*16.8*	*31.6*	*18.0*	*66.7*	*100.0*	*14.0*	*31.7*	*16.8*	*66.8*	*100.0*
2001	3.0	1.4	–2.0	1.8	1.7	1.7	1.2	2.7	1.2	2.1
2002	1.9	0.2	–1.3	1.1	0.7	0.8	–0.3	–2.0	0.3	–0.1
2003	2.3	0.8	1.3	1.3	1.4	0.6	0.8	4.1	0.6	1.6
2002 – Sept.	2.0	0.8	–0.3	1.4	1.0	0.9	0.4	–1.5	0.6	0.2
Oct.	1.9	1.1	3.8	1.5	1.7	0.7	0.8	2.2	0.7	1.0
Nov.	2.2	1.4	4.1	1.7	1.7	0.8	1.1	2.3	0.9	1.1
Dec.	2.1	1.9	6.2	1.9	2.0	1.0	1.1	3.8	1.0	1.5
2003 – Jan.	2.3	1.2	7.4	1.5	2.5	0.8	1.4	6.9	0.9	2.2
Feb.	2.5	1.5	8.9	1.7	2.9	0.8	1.7	8.4	1.0	2.6
Mar.	2.7	1.5	9.5	1.7	3.0	0.9	1.7	7.5	1.1	2.4
Apr.	2.5	1.3	1.3	1.5	1.4	0.9	1.5	3.4	1.0	1.7
May	2.2	1.0	–2.3	1.4	0.7	1.9	1.3	1.8	1.1	1.3
June	2.6	0.4	–0.9	1.2	0.9	0.8	0.7	3.2	0.6	1.4
July	2.4	0.1	0.2	1.0	1.1	0.7	0.1	3.7	0.3	1.3
Aug.	2.4	0.0	0.1	0.9	1.1	0.4	–0.1	4.5	0.2	1.3
Sept.	2.5	0.3	–2.4	1.1	0.8	0.5	..	2.3	0.3	1.1
Oct.	2.2	0.7	–3.6	1.2	0.6	..	0.2	1.7	0.2	0.9
Nov.	2.1	0.9	–0.4	1.3	1.3	–0.2	0.4	3.6	0.3	1.4
Dec.	1.6	1.0	–1.2	1.2	1.1	–0.7	0.4	2.1	0.2	1.0
2004 – Jan.	1.3	1.4	–3.6	1.3	0.7	–0.8	0.5	–1.2	0.2	0.3
Feb.	1.1	2.0	–5.4	1.6	0.7	–0.8	0.9	–3.2	0.4	..
Mar.	0.9	2.6	–5.6	1.8	0.8	–1.1	1.4	–2.7	0.6	0.4

Source: Based on Eurostat data.
(1) 1995=100 for Germany; 2000=100 for France, Spain and euro area. – (2) The item does not include energy products. – (3) GDP-weighted average for the 12 euro-area countries.

ITALY: BALANCE OF PAYMENTS
(millions of euros)

	1999	2000	2001	2002	2003
Current account	**7,692**	**–6,305**	**–740**	**–10,014**	**–18,363**
Goods	22,044	10,368	17,405	14,049	8,788
Credits	221,484	260,906	273,596	267,582	259,098
Debits	199,440	250,538	256,191	253,533	250,310
Services	1,125	1,167	18	–3,043	–3,032
Credits	55,307	61,479	64,614	63,760	62,932
Debits	54,182	60,312	64,596	66,803	65,964
Income	–10,392	–13,099	–11,635	–15,396	–17,002
Credits	43,483	41,894	43,111	45,782	47,313
Debits	53,875	54,993	54,746	61,178	64,316
Transfers	–5,085	–4,742	–6,527	–5,624	–7,117
Credits	15,608	16,996	17,962	22,183	18,406
EU institutions	*5,756*	*6,275*	*6,121*	*6,183*	*6,531*
Debits	20,693	21,738	24,489	27,807	25,523
EU institutions	*10,441*	*11,180*	*11,755*	*11,910*	*12,820*
Capital account	**2,789**	**3,195**	**936**	**–67**	**2,454**
Intangible assets	–3	–72	–312	–206	–86
Transfers	2,792	3,267	1,248	139	2,540
EU institutions	*3,201*	*3,624*	*1,748*	*1,625*	*3,635*
Financial account	**–8,867**	**4,287**	**–3,294**	**8,532**	**16,775**
Direct investment	178	1,149	–7,377	–2,739	6,507
Abroad	–6,309	–13,368	–23,995	–18,194	–8,037
In Italy	6,487	14,517	16,618	15,455	14,544
Portfolio investment	–23,635	–26,255	–7,640	16,107	3,373
Assets	–121,493	–86,340	–40,070	–16,968	–51,064
Shares	–60,122	–82,894	–11,153	–6,039	–13,806
Debt securities	–61,371	–3,446	–28,917	–10,929	–37,258
bonds	*–60,908*	*–1,698*	*–27,017*	*–10,301*	*–40,129*
Liabilities	97,858	60,085	32,430	33,075	54,437
Shares	–4,336	–1,714	–354	–7,155	–2,191
Debt securities	102,194	61,799	32,784	40,230	56,628
bonds	*65,800*	*75,160*	*43,171*	*32,064*	*48,276*
Financial derivatives	1,766	2,501	–477	*–2,710*	*–4,831*
Other investment	5,725	29,950	11,716	985	13,132
Assets	–31,471	987	3,007	8,296	–19,860
Liabilities	37,196	28,963	8,709	–7,311	32,992
Change in official reserves	7,099	–3,058	484	–3,111	–1,406
Errors and omissions	**–1,614**	**–1,177**	**3,098**	**1,549**	**–865**

Table a14

ITALY: NET INTERNATIONAL INVESTMENT POSITION
(millions of euros)

	1999	2000	2001	2002	2003
ASSETS	**1,097,059**	**1,220,570**	**1,223,640**	**1,147,872**	**1,228,252**
Non-bank sectors	**849,893**	**955,517**	**958,264**	**851,961**	**903,536**
Direct investment	170,860	178,948	191,630	170,155	174,767
Real estate	6,106	6,682	7,490	7,609	8,067
Other	164,754	172,266	184,140	162,546	166,700
Portfolio investment	508,876	597,869	588,912	526,659	554,376
Other investment	168,782	176,296	174,347	146,977	163,245
Financial derivatives	1,375	2,404	3,375	8,170	11,148
Banks	**184,752**	**203,420**	**188,615**	**229,491**	**260,550**
Direct investment	10,157	14,791	15,305	15,306	14,371
Portfolio investment	34,948	36,298	36,558	39,055	60,862
Other investment	138,084	150,938	135,231	172,762	178,488
Financial derivatives	1,563	1,393	1,521	2,368	6,829
Central bank	**62,414**	**61,633**	**76,761**	**66,420**	**64,166**
Direct investment	4	4	5	5	5
Portfolio investment	577	715	912	2,673	2,436
Other investment	16,733	10,548	23,407	10,702	11,637
Financial derivatives	45,100	50,366	52,437	53,040	50,088
Gold	*22,775*	*23,098*	*24,732*	*25,764*	*26,042*
LIABILITIES	**1,043,934**	**1,170,420**	**1,192,914**	**1,215,317**	**1,303,390**
Non-bank sectors	**773,839**	**852,966**	**876,866**	**908,665**	**972,594**
Direct investment	107,531	120,967	121,701	119,706	136,522
Real estate	2,282	2,961	3,249	3,566	4,835
Other	105,249	118,006	118,452	116,140	131,687
Portfolio investment	541,306	599,693	621,083	656,944	707,165
Government securities (1)	*424,915*	*470,349*	*485,224*	*515,343*	*568,043*
BOTs	*64,870*	*61,369*	*55,799*	*43,533*	*57,582*
BTPs	*210,020*	*257,994*	*283,700*	*326,404*	*371,266*
Other	*95,566*	*82,749*	*65,333*	*62,596*	*54,045*
Republic of Italy	*54,459*	*68,237*	*80,392*	*82,810*	*85,150*
Other investment	123,352	130,408	130,491	126,485	121,369
Financial derivatives	1,650	1,898	3,591	5,530	7,538
Banks	**248,244**	**299,436**	**313,555**	**301,544**	**328,352**
Direct investment	670	524	854	901	928
Portfolio investment	5,432	13,134	15,503	14,767	15,979
Other investment	240,563	284,838	295,657	282,901	306,396
Financial derivatives	1,579	940	1,541	2,975	5,048
Central bank	**21,851**	**18,018**	**2,493**	**5,108**	**2,444**
Direct investment	....	....	....	....	....
Portfolio investment	....	....	....	....	....
Other investment	21,851	18,018	2,493	5,108	2,444
OVERALL NET POSITION	**53,125**	**50,150**	**30,726**	**–67,445**	**–75,137**

(1) The breakdown by instrument is estimated and subject to revision.

CONSOLIDATED ACCOUNTS OF GENERAL GOVERNMENT (1)
(billions of lire and millions of euros)

	1998	1999		2000		2001		2002		2003	
	lire		euros	lire	euros	lire	euros	lire	euros	lire	euros
Revenue											
Direct taxes	299,065	322,263	166,435	330,225	170,547	353,737	182,690	346,523	178,964	343,436	177,370
Indirect taxes	318,311	324,325	167,500	339,178	175,171	341,736	176,492	358,435	185,116	365,029	188,522
Actual social security contributions	258,978	265,892	137,322	279,208	144,199	290,299	149,927	305,133	157,588	323,963	167,313
Imputed social security contributions	7,670	7,375	3,809	7,520	3,884	7,702	3,978	7,236	3,737	7,193	3,715
Income from capital	10,440	13,777	7,115	10,876	5,617	14,882	7,686	14,857	7,673	15,157	7,828
Other	56,587	56,568	29,215	57,840	29,872	62,743	32,404	63,781	32,940	64,898	33,517
Total current revenue	**951,051**	**990,201**	**511,396**	**1,024,848**	**529,290**	**1,071,100**	**553,177**	**1,095,964**	**566,018**	**1,119,677**	**578,265**
Capital taxes	7,985	2,424	1,252	2,163	1,117	2,062	1,065	5,782	2,986	39,120	20,204
Other	6,289	8,388	4,332	7,732	3,993	4,525	2,337	5,034	2,600	8,314	4,294
Total capital revenue	**14,274**	**10,812**	**5,584**	**9,894**	**5,110**	**6,587**	**3,402**	**10,816**	**5,586**	**47,435**	**24,498**
Total revenue ...	**965,325**	**1,001,013**	**516,980**	**1,034,743**	**534,400**	**1,077,687**	**556,579**	**1,106,780**	**571,604**	**1,167,112**	**602,763**
as a % of GDP	*46.5*	*46.7*		*45.8*		*45.7*		*45.3*		*46.3*	
Expenditure											
Compensation of employees..	221,606	228,393	117,955	239,091	123,480	253,814	131,084	264,152	136,423	278,060	143,606
Intermediate consumption ...	99,298	105,622	54,549	112,718	58,214	120,703	62,338	122,781	63,411	133,645	69,022
Social assistance benefits in kind (market purchases) ..	43,078	45,715	23,610	53,271	27,512	60,603	31,299	64,060	33,084	64,396	33,258
Social assistance benefits in cash	352,196	367,872	189,990	378,463	195,460	391,690	202,291	414,430	214,035	434,131	224,210
Subsidies to firms	27,921	26,490	13,681	26,920	13,903	28,405	14,670	26,413	13,641	28,095	14,510
Interest payments.................	166,541	144,713	74,738	145,865	75,333	154,069	79,570	140,471	72,547	134,166	69,291
Other	33,101	33,873	17,494	35,532	18,351	38,218	19,738	45,504	23,501	53,447	27,603
Total current expenditure	**943,741**	**952,678**	**492,017**	**991,860**	**512,253**	**1,047,503**	**540,990**	**1,077,809**	**556,642**	**1,125,941**	**581,500**
Gross investment (2)	49,421	51,840	26,773	53,842	27,807	58,468	30,196	46,021	23,768	66,662	34,428
Investment grants	22,077	25,747	13,297	25,737	13,292	30,376	15,688	34,510	17,823	33,501	17,302
Other (3)	8,558	7,780	4,018	–22,089	–11,408	3,809	1,967	3,435	1,774	2,643	1,365
Total capital account expenditure (2) (3)	**80,056**	**85,366**	**44,088**	**57,490**	**29,691**	**92,652**	**47,851**	**83,966**	**43,365**	**102,806**	**53,095**
Total expenditure (2) (3)	**1,023,797**	**1,038,044**	**536,105**	**1,049,350**	**541,944**	**1,140,155**	**588,841**	**1,161,776**	**600,007**	**1,228,747**	**634,595**
as a % of GDP	*493*	*48.4*		*46.5*		*48.3*		*47.6*		*48.8*	
Deficit on current account (surplus –)	**–7,310**	**–37,523**	**–19,379**	**–32,988**	**–17,037**	**–23,597**	**–12,187**	**–18,154**	**–9,376**	**6,264**	**3,235**
Net borrowing (4)	**58,472**	**37,031**	**19,125**	**14,607**	**7,544**	**62,468**	**32,262**	**54,996**	**28,403**	**61,635**	**31,832**
as a % of GDP	*2.8*	*1.7*		*0.6*		*2.6*		*2.3*		*2.4*	

Source: Based on Istat data.

(1) Rounding and lira-euro conversion 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.

GENERAL GOVERNMENT DEBT BY INSTRUMENT AND SUBSECTOR (1)
(face values in billions of lire and millions of euros)

	1997	1998	1999		2000	
	lire			euros	lire	euros
Currency and deposits	**178,390**	**185,155**	**208,747**	**107,809**	**217,955**	**112,564**
of which: PO funds	176,198	182,598	206,146	106,466	215,349	111,218
savings certificates	*117,687*	*122,707*	*129,498*	*66,880*	*134,096*	*69,255*
memorandum item: redemption value (2)	187,004	203,098	218,963	113,085	232,562	120,108
savings books	*52,330*	*59,813*	*70,519*	*36,420*	*74,943*	*38,705*
current accounts	*6,181*	*78*	*6,130*	*3,166*	*6,309*	*3,258*
Short-term securities	**301,503**	**266,107**	**231,875**	**119,753**	**197,351**	**101,923**
of which: in foreign currencies	–	–	–	–	–	–
in non-euro-area foreign currencies	–	–	–	–	–	–
issued abroad	–	–	713	368	255	132
Medium and long-term securities	**1,754,440**	**1,829,874**	**1,880,912**	**971,410**	**1,952,953**	**1,008,616**
of which: in foreign currencies	132,473	126,357	74,253	38,348	85,111	43,956
in non-euro-area foreign currencies	66,326	65,665	74,253	38,348	85,111	43,956
variable rate	557,281	517,791	466,473	240,913	451,519	233,190
issued abroad	108,259	108,974	115,980	59,898	149,379	77,148
Other liabilities	**160,918**	**143,887**	**155,505**	**80,311**	**143,276**	**73,996**
of which: MFI loans (3)	156,183	139,026	141,620	73,140	129,583	66,924
in foreign currencies	*25,226*	*12,588*	*4,401*	*2,273*	*3,661*	*1,891*
in non-euro-area currencies	*5,290*	*4,611*	*4,401*	*2,273*	*3,661*	*1,891*
resident MFIs	*121,378*	*117,504*	*121,332*	*62,663*	*115,912*	*59,863*
non-resident MFIs	*34,805*	*21,522*	*20,287*	*10,478*	*13,671*	*7,060*
towards the central bank	2,794	2,927	2,901	1,498	184	95
GENERAL GOVERNMENT DEBT (4)	**2,395,252**	**2,425,023**	**2,477,038**	**1,279,283**	**2,511,536**	**1,297,100**
as a % of GDP	*120.5*	*116.7*	*115.5*		*111.2*	
Central government debt	**2,345,069**	**2,373,152**	**2,413,533**	**1,246,486**	**2,436,001**	**1,258,090**
securities	2,053,583	2,091,957	2,104,419	1,086,842	2,136,889	1,103,611
MFI loans (3)	108,636	91,408	86,710	44,782	67,691	34,960
other	182,850	189,787	222,404	114,862	231,421	119,519
Local government debt	**49,621**	**51,480**	**63,243**	**32,662**	**75,271**	**38,874**
securities	2,360	4,024	8,367	4,321	13,415	6,928
MFI loans (3)	46,985	47,227	54,648	28,223	61,628	31,828
other	275	228	228	118	228	118
Debt of social security institutions (5)	**563**	**391**	**262**	**135**	**264**	**136**
Treasury assets held with the Bank of Italy	**58,997**	**43,168**	**56,394**	**29,125**	**37,825**	**19,535**
DEBT NET OF THE TREASURY ASSETS HELD WITH THE BANK OF ITALY	**2,336,255**	**2,381,856**	**2,420,644**	**1,250,158**	**2,473,711**	**1,277,565**
of which: in foreign currencies	157,699	138,945	78,654	40,621	88,771	45,846
in non-euro-area currencies	71,616	70,276	78,654	40,621	88,771	45,846
Memorandum items:						
bank deposits	32,227	35,522	41,274	21,316	42,701	22,053
debts of other entities serviced by the government	38,479	27,394	25,520	13,180	21,229	10,964

(1) Rounding and lira-euro conversion may cause discrepancies. – (2) Calculated including accrued interest. From 2003 also includes the withholding tax on interest income. – (3) Excluding the central
down in Council Regulation (EC) No. 3605/93. – (5) Exclusively MFI loans.

2001		2002		2003		
lire	euros	lire	euros	lire	euros	
249,485	**128,848**	**277,250**	**143,188**	**195,015**	**100,717**	**Currency and deposits**
247,124	127,629	269,382	139,124	143,900	74,318	*of which:* PO funds
142,097	*73,387*	*149,577*	*77,250*	*111,384*	*57,525*	*savings certificates*
251,027	129,644	267,916	138,367	246,489	127,301	*memorandum item: redemption value* (2)
88,086	*45,493*	*94,716*	*48,917*	–	–	*savings books*
16,941	*8,749*	*25,089*	*12,958*	*32,516*	*16,793*	*current accounts*
220,153	**113,699**	**219,428**	**113,325**	**231,156**	**119,382**	**Short-term securities**
–	–	–	–	–	–	*of which: in foreign currencies*
–	–	–	–	–	–	*in non-euro-area foreign currencies*
648	335	–	–	–	–	*issued abroad*
1,994,093	**1,029,863**	**2,002,049**	**1,033,972**	**2,033,627**	**1,050,281**	**Medium and long-term securities**
71,458	36,905	73,579	38,001	49,803	25,721	*of which: in foreign currencies*
71,458	36,905	73,579	38,001	49,803	25,721	*in non-euro-area foreign currencies*
432,109	223,166	405,189	209,262	377,087	194,749	*variable rate*
169,558	87,569	180,437	93,188	190,513	98,392	*issued abroad*
145,984	**75,395**	**135,090**	**69,768**	**214,954**	**111,015**	**Other liabilities**
122,928	63,487	118,233	61,062	107,967	55,760	*of which:* MFI loans (3)
2,727	*1,408*	*2,060*	*1,064*	*1,101*	*569*	*in foreign currencies*
2,727	*1,408*	*2,060*	*1,064*	*1,101*	*569*	*in non-euro-area currencies*
111,184	*57,422*	*108,462*	*56,016*	*100,590*	*51,950*	*resident MFIs*
11,744	*6,065*	*9,771*	*5,046*	*7,377*	*3,810*	*non-resident MFIs*
82	42	158	82	404	209	towards the central bank
2,609,715	**1,347,805**	**2,633,818**	**1,360,253**	**2,674,751**	**1,381,394**	**GENERAL GOVERNMENT DEBT** (4)
110.6		*107.9*		*106.2*		*as a % of GDP*
2,530,697	**1,306,996**	**2,545,772**	**1,314,782**	**2,538,295**	**1,310,920**	**Central government debt**
2,197,229	1,134,774	2,195,484	1,133,873	2,232,221	1,152,846	securities
61,154	31,583	56,181	29,015	47,524	24,544	MFI loans (3)
272,314	140,638	294,107	151,894	258,550	133,530	other
78,677	**40,633**	**87,773**	**45,331**	**136,334**	**70,411**	**Local government debt**
17,016	8,788	25,994	13,425	32,562	16,817	securities
61,433	31,728	61,779	31,906	60,320	31,153	MFI loans (3)
228	118	–	–	43,452	22,441	other
341	**176**	**273**	**141**	**122**	**63**	**Debt of social security institutions** (5)
45,546	**23,523**	**41,193**	**21,275**	**25,661**	**13,253**	**Treasury assets held with the Bank of Italy**
2,564,169	**1,324,283**	**2,592,624**	**1,338,979**	**2,649,091**	**1,368,141**	**DEBT NET OF THE TREASURY ASSETS HELD WITH THE BANK OF ITALY**
74,185	38,314	75,640	39,065	50,904	26,289	*of which: in foreign currencies*
74,185	38,314	75,640	39,065	50,904	26,289	*in non-euro-area currencies*
						Memorandum items:
42,621	22,012	46,175	23,847	47,253	24,404	bank deposits
13,412	6,926	9,459	4,885	6,565	3,391	debts of other entities serviced by the government

bank, which is prohibited from providing any form of credit facility to general government (Article 101 of the Treaty Establishing the European Community). – (4) Calculated according to the criteria laid

GENERAL GOVERNMENT DEBT BY HOLDING SECTOR (1)
(nominal values in billions of lire and millions of euros)

	1998	1999		2000	
	lire		euros	lire	euros
Currency and deposits	**185,155**	**208,747**	**107,809**	**217,955**	**112,564**
Short-term securities	**266,107**	**231,875**	**119,753**	**197,351**	**101,923**
held by:					
Bank of Italy	230	–	–	150	78
MFIs	50,207	37,036	19,127	18,030	9,312
of which: banks	*46,552*	*34,309*	*17,719*	*15,574*	*8,043*
other financial institutions	36,691	9,972	5,150	5,996	3,097
other residents	92,557	56,972	29,424	51,983	26,847
non-residents	86,422	127,895	66,052	121,191	62,590
Medium and long-term securities	**1,829,874**	**1,880,912**	**971,410**	**1,952,953**	**1,008,616**
held by:					
Bank of Italy	120,169	112,113	57,902	120,669	62,320
MFIs	247,197	286,962	148,204	245,343	126,709
of which: banks	*243,980*	*275,236*	*142,147*	*233,580*	*120,634*
other financial institutions	443,393	271,634	140,287	276,022	142,554
other residents	472,709	522,794	270,001	530,877	274,175
non-residents	546,406	687,409	355,017	780,041	402,858
Other liabilities	**143,887**	**155,505**	**80,311**	**143,276**	**73,996**
of which: MFI loans (2)	139,026	141,620	73,140	129,583	66,924
resident MFIs	*117,504*	*121,332*	*62,663*	*115,912*	*59,863*
non-resident MFIs	*21,522*	*20,287*	*10,478*	*13,671*	*7,060*
towards the central bank	2,927	2,901	1,498	184	95
GENERAL GOVERNMENT DEBT (3)	**2,425,023**	**2,477,038**	**1,279,283**	**2,511,536**	**1,297,100**
as a % of GDP	*116.7*	*115.5*		*111.2*	
held by:					
Bank of Italy	123,326	115,015	59,400	121,003	62,493
MFIs	414,909	445,330	229,994	379,285	195,885
other financial institutions	480,083	281,606	145,437	282,018	145,650
other residents	752,354	799,497	412,906	814,326	420,564
non-residents	654,351	835,591	431,547	914,904	472,508
Memorandum item:					
Debt issued abroad	130,497	136,980	70,744	163,305	84,340

(1) Rounding and lira-euro conversion may cause discrepancies. – (2) Excluding the central bank, which is prohibited from providing any form of credit facility to general government (Article 101 of

Table a17

2001		2002		2003		
lire	euros	lire	euros	lire	euros	
249,485	**128,848**	**277,250**	**143,188**	**195,015**	**100,717**	**Currency and deposits**
220,153	**113,699**	**219,428**	**113,325**	**231,156**	**119,382**	**Short-term securities**
						held by:
–	–	349	180	–	–	Bank of Italy
40,996	21,172	52,144	26,930	86,449	44,647	MFIs
23,669	*12,224*	*31,683*	*16,363*	*36,970*	*19,093*	*of which: banks*
10,205	5,271	11,999	6,197	11,685	6,035	other financial institutions
59,035	30,489	69,881	36,090	20,706	10,694	other residents
109,917	56,767	85,056	43,928	112,315	58,006	non-residents
1,994,093	**1,029,863**	**2,002,049**	**1,033,972**	**2,033,627**	**1,050,281**	**Medium and long-term securities**
						held by:
124,470	64,283	79,231	40,920	95,017	49,072	Bank of Italy
227,368	117,426	195,125	100,774	224,626	116,010	MFIs
208,033	*107,440*	*158,511*	*81,864*	*143,229*	*73,972*	*of which: banks*
336,070	173,566	306,852	158,476	262,602	135,623	other financial institutions
494,029	255,145	551,308	284,727	504,132	260,362	other residents
812,155	419,443	869,533	449,076	947,249	489,213	non-residents
145,984	**75,395**	**135,090**	**69,768**	**214,954**	**111,015**	**Other liabilities**
122,928	63,487	118,233	61,062	107,967	55,760	*of which:* MFI loans (2)
111,184	*57,422*	*108,462*	*56,016*	*100,590*	*51,950*	*resident MFIs*
11,744	*6,065*	*9,771*	*5,046*	*7,377*	*3,810*	*non-resident MFIs*
82	42	158	82	404	209	towards the central bank
2,609,715	**1,347,805**	**2,633,818**	**1,360,253**	**2,674,751**	**1,381,394**	**GENERAL GOVERNMENT DEBT** (3)
110.6		*107.9*		*106.2*		*as a % of GDP*
						held by:
124,552	64,326	79,738	41,181	95,422	49,281	Bank of Italy
379,548	196,020	355,731	183,720	411,665	212,607	MFI
346,275	178,836	318,851	164,673	404,053	208,676	other financial institutions
825,524	426,348	915,138	472,629	696,671	359,801	other residents
933,816	482,276	964,361	498,051	1,066,941	551,029	non-residents
						Memorandum item:
181,950	93,969	190,208	98,234	197,890	102,202	Debt issued abroad

the Treaty Establishing the European Community). – (3) Calculated according to the criteria laid down in Council Regulation (EC) No. 3605/93.

Table a18

LOCAL GOVERNMENT DEBT BY INSTRUMENT AND SUBSECTOR (1)

(billions of lire and millions of euros)

	1998	1999		2000		2001		2002		2003	
	lire		euros	lire	euros	lire	euros	lire	euros	lire	euros
Securities	**4,024**	**8,367**	**4,321**	**13,415**	**6,928**	**17,016**	**8,788**	**25,994**	**13,425**	**37,299**	**19,264**
issued in Italy	2,022	2,929	1,513	3,511	1,813	4,303	2,222	5,619	2,902	12,026	6,211
issued abroad	2,003	5,439	2,809	9,904	5,115	12,713	6,566	20,375	10,523	25,273	13,052
MFI loans (2)	**47,455**	**54,876**	**28,341**	**61,856**	**31,946**	**61,661**	**31,845**	**61,779**	**31,906**	**99,035**	**51,147**
resident MFIs	45,715	52,871	27,306	59,908	30,940	59,702	30,833	59,568	30,764	96,371	49,772
non-resident MFIs	1,741	2,004	1,035	1,948	1,006	1,959	1,012	2,211	1,142	2,664	1,376
LOCAL GOVERNMENT DEBT	**51,480**	**63,243**	**32,662**	**75,271**	**38,874**	**78,677**	**40,633**	**87,773**	**45,331**	**136,334**	**70,411**
as a % of GDP	*2.5*	*2.9*		*3.3*		*3.3*		*3.6*		*5.4*	
Debt of the regions (3)	**22,883**	**28,615**	**14,779**	**34,232**	**17,680**	**36,134**	**18,662**	**41,803**	**21,590**	**48,997**	**25,305**
Securities	1,948	4,947	2,555	9,374	4,841	12,078	6,238	19,247	9,940	26,655	13,766
issued in Italy	*205*	*176*	*91*	*143*	*74*	*164*	*85*	*567*	*293*	*4,550*	*2,350*
issued abroad	*1,743*	*4,772*	*2,465*	*9,231*	*4,767*	*11,914*	*6,153*	*18,680*	*9,647*	*22,104*	*11,416*
MFI loans (2)	20,935	23,668	12,223	24,858	12,838	24,055	12,424	22,556	11,649	22,342	11,539
resident MFIs (3)	*19,206*	*21,731*	*11,223*	*23,103*	*11,932*	*22,493*	*11,617*	*21,176*	*10,937*	*20,797*	*10,741*
non-resident MFIs	*1,729*	*1,937*	*1,000*	*1,755*	*906*	*1,562*	*807*	*1,380*	*713*	*1,545*	*798*
Debt of provinces and municipalities (3) (4)	**24,961**	**28,752**	**14,849**	**32,299**	**16,681**	**33,117**	**17,104**	**35,299**	**18,230**	**38,542**	**19,905**
Securities	2,076	3,420	1,766	4,041	2,087	4,938	2,550	6,747	3,484	10,644	5,497
issued in Italy	*1,816*	*2,753*	*1,422*	*3,368*	*1,739*	*4,139*	*2,138*	*5,052*	*2,609*	*7,476*	*3,861*
issued abroad	*260*	*667*	*344*	*673*	*348*	*799*	*412*	*1,695*	*875*	*3,169*	*1,636*
MFI loans (2)	22,885	25,332	13,083	28,258	14,594	28,180	14,554	28,553	14,746	27,898	14,408
resident MFIs (3)	*22,873*	*25,265*	*13,048*	*28,065*	*14,494*	*27,783*	*14,349*	*27,721*	*14,317*	*26,780*	*13,830*
non-resident MFIs	*11*	*68*	*35*	*193*	*100*	*397*	*205*	*831*	*429*	*1,118*	*578*
Debt of other entities (3)	**3,636**	**5,876**	**3,035**	**8,740**	**4,514**	**9,426**	**4,868**	**10,670**	**5,511**	**10,080**	**5,206**
Loans from Cassa Depositi e Prestiti S.p.A.										**38,714**	**19,994**

(1) Rounding and lira-euro conversion may cause discrepancies. – (2) Excluding the central bank, which is prohibited from providing any form of credit facility to general government (Article 101 of the Treaty Establishing the European Community). – (3) Excluding loans from Cassa Depositi e Prestiti S.p.A., for which data classified by subsector are not available. – (4) Including metropolitan areas and municipal unions.

Table a19

FINANCING OF THE GENERAL GOVERNMENT BORROWING REQUIREMENT (1)
(billions of lire and millions of euros)

	1998	1999		2000		2001		2002		2003	
	lire		euros	lire	euros	lire	euros	lire	euros	lire	euros
Currency and deposits	**6,764**	**23,592**	**12,184**	**9,209**	**4,756**	**31,530**	**16,284**	**27,764**	**14,339**	**–82,235**	**–42,471**
of which: PO funds	6,400	23,548	12,162	9,203	4,753	31,775	16,410	22,259	11,496	–125,483	–64,806
savings certificates	*5,020*	*6,791*	*3,507*	*4,599*	*2,375*	*8,000*	*4,132*	*7,480*	*3,863*	*–38,193*	*–19,725*
savings books	*7,483*	*10,706*	*5,529*	*4,424*	*2,285*	*13,143*	*6,788*	*6,630*	*3,424*	*–94,716*	*–48,917*
current accounts	*–6,104*	*6,052*	*3,126*	*179*	*92*	*10,632*	*5,491*	*8,149*	*4,208*	*7,426*	*3,835*
Short-terms securities	**–35,397**	**–34,232**	**–17,680**	**–34,524**	**–17,830**	**22,799**	**11,775**	**–721**	**–372**	**11,728**	**6,057**
of which: issued abroad	–	*713*	*368*	*–458*	*–237*	*390*	*202*	*–644*	*–333*	–	–
Medium and long-term securities	**84,221**	**41,149**	**21,252**	**68,984**	**35,627**	**44,921**	**23,200**	**61,499**	**31,762**	**45,365**	**23,429**
of which: variable rate	*–39,116*	*–51,902*	*–26,805*	*–14,735*	*–7,610*	*–18,994*	*–9,810*	*–26,081*	*–13,470*	*–27,128*	*–14,010*
issued abroad	*1,660*	*–5,325*	*–2,750*	*30,991*	*16,005*	*19,780*	*10,216*	*17,489*	*9,032*	*16,266*	*8,400*
Other liabilities	**–17,529**	**10,377**	**5,360**	**–12,424**	**–6,416**	**2,116**	**1,093**	**–10,781**	**–5,568**	**80,013**	**41,323**
of which: MFI loans (2)	–17,655	2,143	1,107	–12,232	–6,317	–7,246	–3,742	–4,582	–2,367	–10,117	–5,225
resident banks	*–3,874*	*3,828*	*1,977*	*–5,420*	*–2,799*	*–4,728*	*–2,442*	*–2,723*	*–1,406*	*–7,872*	*–4,065*
non-resident banks	*–13,782*	*–1,684*	*–870*	*–6,812*	*–3,518*	*–2,519*	*–1,301*	*–1,860*	*–960*	*–2,246*	*–1,160*
towards the central bank	133	–816	–422	–2,718	–1,403	–101	–52	76	39	246	127
Treasury assets held with the Bank of Italy	**15,830**	**–13,226**	**–6,831**	**18,568**	**9,590**	**–7,721**	**–3,988**	**4,353**	**2,248**	**15,533**	**8,022**
TOTAL BORROWING REQUIREMENT	**53,888**	**27,660**	**14,285**	**49,813**	**25,726**	**93,646**	**48,364**	**82,115**	**42,409**	**70,402**	**36,360**
as a % of GDP	*2.6*	*1.3*		*2.2*		*4.0*		*3.4*		*2.8*	
Settlements of past debts (3)	**4,770**	**12,118**	**6,259**	**8,909**	**4,601**	**18,027**	**9,310**	**10,316**	**5,328**	**16,530**	**8,537**
Privatization receipts (3)	**–15,277**	**–43,839**	**–22,641**	**–29,915**	**–15,450**	**–8,383**	**–4,329**	**–3,735**	**–1,929**	**–32,614**	**–16,844**
Borrowing requirement net of debt settlements and privatization receipts	**64,395**	**59,381**	**30,668**	**70,819**	**36,575**	**84,002**	**43,383**	**75,534**	**39,010**	**86,486**	**44,667**
Memorandum items:											
change in bank deposits	3,295	5,752	2,971	1,428	737	–81	–42	3,554	1,836	1,078	557
debts of other entities serviced by the government	–10,996	–2,146	–1,108	–4,485	–2,317	–7,972	–4,117	–3,627	–1,873	–2,531	–1,307
Central government borrowing requirement	**52,187**	**16,468**	**8,505**	**37,795**	**19,519**	**90,177**	**46,573**	**72,896**	**37,648**	**21,680**	**11,197**
securities	47,146	3,014	1,557	29,423	15,196	64,121	33,116	51,609	26,654	50,185	25,919
MFI loans (2)	–17,726	–5,146	–2,658	–19,214	–9,923	–7,115	–3,674	–4,859	–2,510	–8,481	–4,380
other	22,767	18,600	9,606	27,586	14,247	33,172	17,132	26,147	13,504	–20,024	–10,342
Local government borrowing requirement	**1,872**	**11,322**	**5,847**	**12,017**	**6,206**	**3,391**	**1,751**	**9,287**	**4,796**	**48,872**	**25,241**
securities	1,678	3,902	2,015	5,037	2,601	3,600	1,859	9,170	4,736	6,907	3,567
MFI loans (2)	242	7,419	3,832	6,980	3,605	–209	–108	345	178	–1,486	–768
other	–47	–	–	–	–	–	–	–228	–118	43,452	22,441
Borrowing requirement of social security institutions (4)	**–171**	**–129**	**–67**	**1**	**1**	**77**	**40**	**–68**	**–35**	**–150**	**–78**

(1) Rounding and lira-euro conversion may cause discrepancies. – (2) Excluding the central bank, which is prohibited from providing any form of credit facility to general government (Article 101 of the Treaty Establishing the European Community). – (3) Central government transactions. Includes other extraordinary receipts (e.g. in 2000 the part of the proceeds of the sale of UMTS licences used to reduce debt). – (4) Exclusively MFI loans.

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
2000 – Dec.	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 – ”	9,566	285,834	56,763	979,517	72,827	110	13,544	71,406	48,040	145,094	13,127
2003 – Jan.	6,799	295,538	56,862	991,030	76,355	111	15,189	66,623	49,012	162,335	15,305
Feb.	6,523	293,491	57,621	993,252	84,182	110	13,157	70,938	48,842	165,200	16,138
Mar.	6,975	293,392	56,213	991,292	80,087	110	12,971	71,225	49,011	167,039	16,681
Apr.	7,334	281,383	56,416	994,698	86,744	111	13,681	71,296	49,800	166,355	18,249
May	6,758	290,871	55,944	994,750	78,286	113	13,978	71,083	49,914	169,672	18,273
June	6,954	298,792	57,099	1,008,860	74,518	114	12,427	74,752	49,905	169,823	18,107
July	7,203	301,365	54,723	1,012,374	74,665	110	12,077	71,771	49,277	173,178	18,757
Aug.	6,956	298,632	53,761	1,014,214	75,305	110	12,370	68,654	49,383	174,417	18,818
Sept.	7,201	317,886	54,409	1,017,697	72,461	110	12,970	73,491	49,444	172,741	18,187
Oct.	6,846	312,613	54,634	1,021,261	69,671	109	12,866	75,218	49,578	171,805	18,026
Nov.	6,823	317,064	54,977	1,029,327	70,505	111	12,996	71,405	49,966	177,862	18,887
Dec.	9,488	324,798	53,868	1,048,430	75,234	110	15,653	69,802	56,170	167,100	19,002
2004 – Jan. (2) ..	6,779	341,183	54,566	1,037,794	72,097	110	14,719	82,040	57,139	167,963	19,250
Feb. (2) ..	6,506	340,380	54,595	1,033,057	67,861	95	14,622	72,581	57,161	169,467	21,859
Mar. (2) ..	7,013	344,590	54,973	1,036,938	75,074	97	15,078	74,549	60,695	172,858	21,323

(1) ESCB harmonized statistics. Rounding may cause discrepancies in totals. – (2) Provisional.

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					
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	...... Dec. –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
4,456	5,692	8,333	11,354	42,179	38,105	6,692	11,073	6,818	49,992	185,600	2,066,122	...... ” – 2002
5,774	13,812	9,474	13,577	42,030	38,214	6,636	10,631	7,672	49,568	194,337	2,127,439	...... Jan. – 2003
6,317	15,606	9,788	14,154	42,831	38,931	6,637	9,864	8,179	49,161	194,547	2,146,095	...... Feb.
6,550	14,877	9,734	14,235	43,681	42,046	6,467	9,460	8,531	47,341	202,517	2,151,208	...... Mar.
6,637	14,733	9,016	16,870	44,142	46,492	6,692	9,923	8,779	45,305	198,989	2,154,719	...... Apr.
6,682	15,405	9,202	16,537	45,263	50,746	6,523	10,117	8,724	45,578	208,384	2,173,929	...... May
6,725	16,413	9,309	16,771	43,748	48,451	6,056	10,343	8,069	45,455	208,287	2,192,265	...... June
6,692	16,950	9,028	17,358	47,152	42,294	6,321	10,381	8,233	45,633	192,020	2,178,913	...... July
6,475	17,357	9,026	18,052	47,112	42,626	6,130	10,588	8,475	45,769	175,686	2,161,303	...... Aug.
6,495	16,611	9,344	18,510	47,071	43,778	6,223	10,575	8,099	45,944	193,186	2,203,820	...... Sept.
6,532	17,321	9,791	18,493	47,370	45,249	6,126	11,701	9,230	45,610	180,220	2,191,298	...... Oct.
7,117	18,617	9,679	18,137	48,309	46,085	5,997	11,698	9,284	45,432	184,274	2,215,813	...... Nov.
6,914	17,475	9,489	15,754	51,014	43,287	5,219	12,154	7,635	46,883	189,840	2,245,554	...... Dec.
7,409	20,490	10,337	16,175	52,057	43,649	5,345	12,391	7,800	45,764	208,968	2,285,367	...(2) Jan. – 2004
7,480	23,133	10,492	15,601	52,446	46,245	5,090	12,454	9,501	46,507	202,080	2,270,538	...(2) Feb.
8,005	22,230	10,691	17,734	53,166	50,723	5,182	12,426	9,510	46,564	211,865	2,312,658	...(2) 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
2000 – Dec.	206,307	6,964	598,170	107,605	34	7,032
2001 – ”	192,934	7,214	636,656	109,572	291	5,525
2002 – ”	285,275	7,109	689,068	111,654	8	9,279
2003 – Jan.	291,052	7,357	653,746	122,898	808	11,689
Feb.	288,441	7,098	656,304	132,020	8	13,437
Mar.	279,472	8,163	662,407	126,614	8	12,822
Apr.	270,763	8,064	671,137	120,797	13	12,037
May	276,235	7,965	675,281	125,209	70	11,597
June	278,064	8,736	676,840	126,886	18	11,057
July	285,764	7,820	672,675	123,604	1,367	9,471
Aug.	287,730	8,238	668,078	123,751	896	10,419
Sept.	301,278	8,146	672,388	122,596	187	11,050
Oct.	300,909	8,414	678,259	115,077	118	9,386
Nov.	305,001	8,251	677,018	120,995	10	9,194
Dec.	314,457	7,732	692,782	117,404	17	8,630
2004 – Jan. (2)................	323,451	7,670	680,926	123,887	2,220	11,141
Feb. (2)	320,701	7,639	675,232	131,212	2,013	10,167
Mar. (2)	329,668	7,767	681,260	129,437	1,012	11,908

(1) ESCB harmonized statistics. Rounding may cause discrepancies in totals. – (2) Provisional.

Table a20 *cont.*

LIABILITIES

Rest of the world	Money market fund shares/units	Debt securities issued	Capital and reserves	Remaining liabilities	Total liabilities	
157,710	10,075	302,481	123,930	260,894	1,781,201	.... Dec. – 2000
171,121	26,164	334,672	133,633	260,372	1,878,155	.... ” – 2001
146,026	41,966	367,969	146,172	261,595	2,066,123	.... ” – 2002
147,043	88,059	367,584	147,115	290,087	2,127,478	.... Jan. – 2003
150,751	91,214	368,648	146,878	291,297	2,146,132	.... Feb.
152,191	95,145	373,332	147,815	293,240	2,152,302	.... Mar.
148,653	97,695	375,523	149,092	300,947	2,154,915	.... Apr.
146,305	98,700	379,615	149,827	303,124	2,174,067	.... May
152,759	98,877	380,512	149,846	308,669	2,192,851	.... June
152,108	100,466	380,378	153,270	291,989	2,179,692	.... July
158,079	102,608	381,445	153,421	266,639	2,166,334	.... Aug.
153,967	100,377	383,934	153,926	295,971	2,203,820	.... Sept.
162,119	100,008	386,890	153,794	276,322	2,191,298	.... Oct.
160,559	105,895	388,692	153,986	286,211	2,215,813	.... Nov.
160,394	107,031	399,137	156,870	281,099	2,245,554	.... Dec.
159,137	106,102	398,698	158,488	313,645	2,285,366	.... (2) Jan. – 2004
153,468	105,666	402,023	158,980	303,437	2,270,539	.... (2) Feb.
162,022	103,597	411,171	160,824	313,992	2,312,658	.... (2) Mar.

BANK INTEREST RATES ON EURO LOANS: OUTSTANDING AMOUNTS (1)
(percentages)

	Households							
		Loans for house purchases			Consumer credit and other loans			Overdrafts
			of which:					
			from 1 to 5 years	*more than 5 years*	up to 1 year (2)	from 1 to 5 years	more than 5 years	
2003 – Jan.	6.62	5.49	5.70	5.48	8.65	8.00	6.07	9.07
Feb.	6.58	5.46	5.68	5.45	8.61	8.04	6.02	9.03
Mar.	6.53	5.40	5.57	5.39	8.56	8.06	5.96	8.96
Apr.	6.45	5.28	5.47	5.27	8.51	8.05	5.89	8.90
May	6.39	5.22	5.43	5.21	8.48	8.06	5.83	8.87
June	6.30	5.11	5.20	5.11	8.36	8.01	5.78	8.79
July	6.13	4.89	4.95	4.89	8.25	7.96	5.60	8.70
Aug.	6.09	4.85	4.93	4.85	8.22	7.99	5.55	8.66
Sept.	6.07	4.83	4.90	4.83	8.20	7.97	5.54	8.65
Oct.	6.00	4.77	4.88	4.76	8.18	7.93	5.49	8.59
Nov.	5.96	4.74	4.85	4.73	8.11	7.91	5.46	8.53
Dec.	5.90	4.68	4.76	4.68	8.05	7.86	5.42	8.44
2004 – Jan. (3)...........	5.90	4.66	4.76	4.66	8.18	7.84	5.40	8.56
Feb. (3)..........	5.85	4.62	4.72	4.62	8.21	7.79	5.37	8.60
Mar. (3)...........	5.80	4.58	4.69	4.57	8.13	7.75	5.33	8.51

(1) ESCB harmonized statistics. – (2) Includes all overdrafts. – (3) Provisional.

Non-financial corporations					Households and non-financial corporations	
	Loans with original maturity			Overdrafts	up to 1 year	*of which: overdrafts*
	up to 1 year (2)	from 1 to 5 years	more than 5 years			
5.30	5.86	4.64	4.87	6.57	6.30	7.03
5.22	5.73	4.60	4.84	6.47	6.18	6.95
5.14	5.66	4.56	4.76	6.43	6.12	6.90
5.05	5.54	4.54	4.67	6.26	6.01	6.74
5.00	5.52	4.48	4.60	6.19	5.99	6.69
4.83	5.32	4.33	4.45	6.04	5.79	6.55
4.66	5.25	4.05	4.21	5.95	5.71	6.45
4.59	5.16	4.03	4.18	5.88	5.63	6.39
4.56	5.15	3.98	4.15	5.86	5.63	6.38
4.52	5.13	3.95	4.09	5.83	5.61	6.34
4.47	5.07	3.93	4.06	5.73	5.55	6.24
4.45	5.01	3.94	4.05	5.62	5.48	6.12
4.49	5.13	3.93	4.03	5.77	5.60	6.26
4.49	5.15	3.93	4.01	5.79	5.62	6.29
4.42	5.06	3.85	4.00	5.66	5.54	6.18

BANK INTEREST RATES ON EURO DEPOSITS: OUTSTANDING AMOUNTS AND NEW BUSINESS (1)
(percentages)

	Outstanding amounts							New business		
		of which:						Deposits of households with agreed maturity		Repos
		Overnight deposits		Deposits of households with agreed maturity		Deposits of households redeemable at notice up to 3 months	Repos		*of which: up to 1 year*	
			of which: households	up to 2 years	more than 2 years					
2003 – Jan.	1.31	1.02	0.92	2.39	4.05	1.10	2.72	2.09	2.07	2.62
Feb.	1.29	1.02	0.92	2.34	4.05	1.09	2.64	2.04	2.03	2.55
Mar.	1.19	0.91	0.82	2.25	3.98	1.12	2.46	1.89	1.88	2.33
Apr.	1.14	0.89	0.79	2.15	3.89	1.09	2.36	1.80	1.80	2.32
May	1.15	0.91	0.81	2.09	3.87	1.04	2.29	1.80	1.79	2.25
June	0.97	0.74	0.66	2.02	3.82	0.92	2.12	1.60	1.59	1.97
July	0.91	0.69	0.62	1.91	3.79	0.86	1.99	1.49	1.49	1.91
Aug.	0.92	0.70	0.61	1.82	3.77	0.91	1.93	1.50	1.49	1.90
Sept.	0.90	0.70	0.61	1.74	3.74	0.88	1.93	1.49	1.48	1.92
Oct.	0.89	0.69	0.60	1.69	3.69	0.89	1.93	1.51	1.50	1.91
Nov.	0.90	0.70	0.60	1.65	3.67	0.89	1.94	1.51	1.50	1.93
Dec.	0.88	0.71	0.61	1.62	3.67	0.89	1.95	1.49	1.47	1.96
2004 – Jan. (2)	0.87	0.68	0.59	1.59	3.66	0.91	1.94	1.52	1.50	1.91
Feb. (2)	0.87	0.68	0.59	1.58	3.65	0.94	1.92	1.53	1.51	1.89
Mar. (2)	0.88	0.68	0.59	1.56	3.72	1.02	1.89	1.50	1.48	1.87

(1) ESCB harmonized statistics. – (2) Provisional.

Table a23

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			
month	day	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
2001	23	51,193	7,937	10,087	270	14	1,057
2002	23	51,533	7,493	7,315	15	0	128
2003 – Jan.	23	50,693	3,609	7,407	..	1	..
Feb.	23	53,743	7,227	6,646	7	5	..
Mar.	23	54,858	14,291	6,944	8	..	..
Apr.	23	52,567	7,810	6,775	8	..	1
May	23	52,276	–656	6,155	162	2	1
June	23	52,186	6,754	6,627	200	1	..
July	23	50,907	8,253	7,029	200	32	..
Aug.	23	51,127	9,327	8,725	45	..	..
Sept.	23	51,333	9,930	8,612	..	..	..
Oct.	23	52,638	2,906	9,491	..	..	..
Nov.	23	53,246	–2,608	9,904	..	6	..
Dec.	23	53,520	12,524	10,895	..	1	..
2004 – Jan.	23	50,405	5,638	7,910	..	8	..
Feb.	–	–	–	–	–	–	–
Mar.	9	49,735	14,388	8,380	42	16	2
Apr.	6	49,240	14,638	10,848	176	8	5
May	11	51,582	8,671	12,036	327	..	..

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						
month	day	Other liquidity-absorbing operations	Deposit facility (a)	Currency in circulation (b)	Central government deposits	Other factor (net)		
2001	23	..	24	67,269	19,350	–29,198	13,113	80,405
2002	23	..	11	68,420	31,866	–47,272	13,458	81,889
2003 – Jan..	23	..	10	68,335	25,071	–45,256	13,550	81,896
Feb.	23	..	3	64,911	32,706	–44,271	14,277	79,191
Mar.	23	..	10	66,438	40,674	–44,751	13,729	80,178
Apr.	23	..	5	68,241	31,838	–46,811	13,889	82,135
May	23	..	4	69,899	20,933	–46,950	14,052	83,955
June	23	..	23	70,963	29,285	–48,714	14,211	85,197
July	23	..	16	72,613	30,533	–51,007	14,265	86,894
Aug.	23	..	3	74,817	30,297	–50,463	14,571	89,391
Sept.	23	..	5	74,636	32,800	–51,880	14,314	88,955
Oct.	23	..	3	75,273	26,078	–50,699	14,381	89,656
Nov.	23	..	8	76,205	20,544	–50,653	14,443	90,656
Dec.	23	..	2	80,669	33,368	–51,706	14,606	95,277
2004 – Jan.	23	..	6	81,503	17,086	–49,186	14,551	96,060
Feb.	–	–	–	–	–	–	–	–
Mar.	9	..	11	78,998	28,563	–50,092	15,083	94,093
Apr.	6	..	3	80,533	30,441	–51,008	14,947	95,483
May	11	38	1	82,287	25,185	–49,453	14,559	96,847

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 and overnight deposits (2)	Deposits with agreed maturity up to 2 years	Deposits redeemable at notice up to 3 months	Total	Repurchase agreements
2001....................	524,623	52,623	138,556	715,802	76,213
2002....................	572,306	50,669	151,026	774,000	89,310
2003 – Jan.	543,119	51,100	151,517	745,736	82,714
Feb.	548,595	52,900	154,023	755,517	81,997
Mar.	559,035	51,717	156,650	767,403	78,515
Apr.	567,874	52,195	155,873	775,942	78,968
May	576,563	50,954	156,183	783,701	79,284
June	586,879	49,504	156,872	793,256	71,819
July	582,069	49,026	157,796	788,891	74,070
Aug.	577,813	49,426	159,889	787,128	74,141
Sept.	586,491	49,219	160,236	795,946	70,940
Oct.	590,771	48,127	161,336	800,234	72,912
Nov.	594,207	46,690	162,803	803,700	72,904
Dec.	616,323	43,955	165,920	826,198	68,468
2004 – Jan.	608,380	46,848	167,713	822,941	63,554
Feb.	603,195	45,705	168,759	817,659	64,516
Mar.	612,001	46,434	170,351	828,786	62,533

(1) Liabilities of Italian MFIs and the Post Office to the “money-holding sector”, except for the items specified in footnote (3), for the whole euro area. – (2) Includes Bank of Italy banknotes and Treasury by the MFIs of the rest of the area or that held by central government, it is not possible to determine exactly the amount held by the “money-holding sector”.

Table a24

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	
26,103	10,118	828,236	467,117	658,296	770,730	 2001
41,690	9,814	914,814	510,801	712,496	853,310	 2002
87,243	9,949	925,642	485,076	687,693	867,599	.... Jan. – 2003
90,166	9,514	937,194	489,184	696,107	877,784	.... Feb.
94,180	9,895	949,993	498,717	707,084	889,674	.... Mar.
96,298	9,511	960,719	505,488	713,556	898,333	.... Apr.
97,259	9,326	969,570	512,649	719,786	905,655	.... May
97,276	9,496	971,847	521,812	728,188	906,779	.... June
98,841	8,520	970,322	515,010	721,831	903,262	.... July
101,037	8,764	971,070	510,415	719,730	903,672	.... Aug.
98,784	8,457	974,127	518,923	728,377	906,558	.... Sept.
98,734	7,973	979,853	521,794	731,257	910,876	.... Oct.
104,338	7,749	988,691	523,954	733,447	918,438	.... Nov.
105,464	7,198	1,007,328	543,017	752,892	934,022	.... Dec.
104,425	6,825	997,745	536,526	751,088	925,892	.... Jan. – 2004
103,994	6,895	993,064	530,450	744,914	920,320	.... Feb.
101,870	6,437	999,626	538,539	755,324	926,164	.... 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

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 gevernment	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
2001	828,236	30,968	6,407	..	280,877	131,139	418,423	174,324	58,161
2002	914,814	28,433	4,067	..	306,916	128,344	439,327	149,678	56,907
2003 – Jan.	925,642	50,128	3,930	29	305,662	131,175	440,796	149,275	56,809
Feb.	937,194	53,903	3,905	30	307,191	128,778	439,904	152,863	57,573
Mar.	949,993	51,426	3,838	32	311,669	127,511	443,050	154,560	56,173
Apr.	960,719	42,275	4,124	34	312,591	126,129	442,878	151,507	56,372
May	969,570	45,179	4,056	36	316,890	126,880	447,862	148,493	55,868
June	971,847	52,504	4,294	37	318,734	127 ,763	450,828	155,459	57,136
July	970,322	52,476	4,410	39	320,331	127,962	452,742	155,833	54,690
Aug.	971,070	49,695	4,356	40	321,203	131,328	456,927	161,294	53,905
Sept.	974,127	53,797	4,376	42	323,950	129,767	458,135	157,196	54,459
Oct.	979,853	35,655	4,305	45	327,100	129,040	460,490	164,995	54,614
Nov.	988,691	45,592	4,601	46	328,706	127,985	461,338	161,053	55,134
Dec.	1,007,328	21,044	4,423	49	332,961	126,163	463,596	161,221	53,352
2004 – Jan.	997,745	44,884	4,412	51	324,991	127,127	456,581	160,362	54,710
Feb.	993,064	50,015	4,332	53	327,927	131,162	463,474	154,488	54,724
Mar.	999,626	41,950	4,015	55	333,198	135,285	472,554	163,479	55,103

(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 the other residents				Total			
Bonds	Total	Loans	Bonds	Holdings of shares/other equity	Total				
218,843	277,004	936,346	20,083	47,355	1,003,784	1,280,788	108,437	62,726	 2001
195,237	252,144	993,061	21,522	54,397	1,068,980	1,321,124	112,723	98,405	 2002
220,690	277,499	1,006,377	24,870	53,887	1,085,134	1,362,633	113,240	89,968	.... Jan. – 2003
225,219	282,792	1,006,598	25,976	53,636	1,086,210	1,369,002	119,099	95,763	.... Feb.
225,960	282,133	1,004,402	26,492	55,919	1,086,813	1,368,946	119,896	110,187	.... Mar.
224,759	281,131	1,008,600	27,347	61,210	1,097,157	1,378,288	122,600	96,491	.... Apr.
230,255	286,123	1,008,853	27,594	65,890	1,102,337	1,388,460	119,967	102,677	.... May
231,483	288,619	1,021,373	27,555	64,387	1,113,315	1,401,934	124,486	104,218	.... June
233,837	288,527	1,025,202	27,850	57,845	1,110,897	1,399,424	123,274	108,675	.... July
235,757	289,662	1,026,584	27,941	58,486	1,113,011	1,402,673	121,972	114,341	.... Aug.
233,876	288,335	1,030,021	27,593	59,609	1,117,223	1,405,558	125,990	111,707	.... Sept.
233,136	287,750	1,033,803	27,922	62,358	1,124,083	1,411,833	127,823	101,337	.... Oct.
240,699	295,833	1,042,259	28,679	63,429	1,134,367	1,430,200	123,056	103,418	.... Nov.
238,265	291,617	1,063,823	28,563	61,263	1,153,649	1,445,266	113,595	94,328	.... Dec.
242,577	297,286	1,052,562	29,640	61,911	1,144,114	1,441,400	127,082	91,090	.... Jan. – 2004
247,809	302,533	1,047,680	32,405	64,709	1,144,794	1,447,326	118,672	95,042	.... Feb.
250,646	305,749	1,052,113	32,068	69,155	1,153,336	1,459,085	122,431	96,093	.... Mar.

MFIs of the rest of the area or that held by central government, it is not possible to determine exactly the amount held by the “money-holding sector”.

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 subordinated liabilities	Liabilities to non-residents		
						Limited company banks (2)						
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	620	47,457	5,504	6,467	4,162	8,881	183	6,231	12,093	5,910	-1,032	29,881
2003 (3)	470	44,729	4,867	6,552	3,511	6,301	126	6,257	10,778	4,554	-1,491	30,623
						Cooperative banks *(banche popolari)*						
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	88	6,555	892	573	509	1,375	18	645	1,489	427	-132	4,531
2003 (3)	48	5,827	779	579	525	906	13	685	1,543	310	-194	4,107
						Mutual banks *(banche di credito cooperativo)*						
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	45	3,503	848	223	36	937	..	31	778	3	24	2,932
2003 (3)	38	3,722	678	163	45	747	..	22	773	2	57	3,158
						Branches of foreign banks						
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	121	1,975	467	467	594	402	60	529	..	1,713	-157	765
2003 (3)	114	2,145	229	298	681	585	148	476	..	1,233	-99	1,927
						Total banks						
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	874	59,491	7,712	7,731	5,301	11,595	261	7,434	14,361	8,053	-1,296	38,109
2003 (3)	671	56,423	6,552	7,592	4,762	8,538	287	7,440	13,094	6,099	-1,727	38,815

(1) Rounding may cause descrepancies in totals. – (2) Includes central credit institutions. – (3) Provisional.

Table a26

Non-interest income			Gross income (c)=(a)+(b)	Operating expenses		Operating profit (e)=(c)-(d)	Value adjustments and re-adjustments and allocations to provisions		Tax (g)	Net profit (e)-(f)-(g)	Total assets	Capital and reserves	Number of banking staff (average)
(b)	*of which: trading*	*of which: services*		(d)	*of which: banking staff costs*		(f)	*of which: for loan losses*					
Limited company banks (2)													
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
24,721	1,183	9,721	54,602	32,088	17,647	22,515	9,610	6,451	4,944	7,961	1,605,476	111,392	273,369
25,596	2,385	9,962	56,220	33,855	18,730	22,365	9,584	7,616	3,714	9,067	1,774,304	121,085	274,711
Cooperative banks *(banche popolari)*													
4,015	421	2,141	9,319	5,385	3,062	3,934	1,568	1,046	1,002	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
3,203	134	1,439	7,734	4,716	2,573	3,018	1,086	651	762	1,170	213,992	17,137	39,717
3,506	279	1,234	7,613	4,668	2,567	2,945	1,062	759	625	1,259	195,665	17,222	35,042
Mutual banks *(banche di credito cooperativo)*													
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	347	3,734	2,584	1,363	1,150	356	269	164	630	96,274	10,480	23,637
916	93	379	4,074	2,736	1,446	1,338	414	324	183	742	109,637	11,209	24,797
Branches of foreign banks													
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
553	30	321	1,319	917	428	401	116	138	153	133	82,883	1,273	3,837
597	-7	341	1,524	1,002	420	522	413	338	187	–78	90,357	1,351	3,638
Total banks													
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
29,280	1,399	11,827	67,389	40,305	22,012	27,084	11,167	7,509	6,022	9,895	1,998,625	140,282	340,560
30,616	2,750	11,916	69,430	42,261	23,164	27,170	11,473	9,037	4,708	10,989	2,169,963	150,866	338,189

ITALY’S FINANCIAL ASSETS AND LIABILITIES IN 2003 (1)

(stocks in millions of euros)

Institutional sectors / Financial instruments	Non-financial corporations – Assets	Non-financial corporations – Liabilities	Financial corporations: Monetary financial institutions – Assets	Monetary financial institutions – Liabilities	Other financial intermediaries – Assets	Other financial intermediaries – Liabilities	Financial auxiliaries – Assets	Financial auxiliaries – Liabilities	Insurance corporations and pension funds – Assets	Insurance corporations and pension funds – Liabilities
Monetary gold and SDRs	**–**	**–**	**26,166**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Currency and transferable deposits, with	**141,277**	**–**	**134,264**	**794,926**	**16,912**	**–**	**50,737**	**–**	**27,348**	**–**
MFIs	118,944	–	112,331	794,926	16,815	–	13,455	–	9,047	–
other residents	960	–	353	–	96	–	–	–	85	–
rest of the world	21,373	–	21,581	–	..	–	37,282	–	18,216	–
Other deposits, with	**10,067**	**–**	**255,555**	**478,783**	**20,484**	**79,850**	**3,192**	**–**	**1,695**	**–**
MFIs	8,897	–	210,918	478,783	20,484	–	3,192	–	1,628	–
other residents	1,170	–	–	–	–	79,850	–	–	–	–
rest of the world	..	–	44,637	–	..	–	..	–	68	–
Short-term securities, issued by	**1,391**	**5,720**	**58,140**	**4**	**5,582**	**79**	**4**	**–**	**5,375**	**–**
general government	68	–	44,404	–	4,604	–	4	–	4,716	–
other residents	2	5,720	5,544	4	108	79	–	–	–	–
rest of the world	1,322	–	8,192	–	869	–	–	–	659	–
Bonds, issued by	**44,955**	**41,575**	**273,533**	**404,633**	**248,815**	**115,578**	**9,139**	**–**	**209,298**	**4,503**
MFIs	10,747	–	49,160	404,633	11,913	–	348	–	29,090	–
central government: CCTs	2,802	–	69,656	–	18,602	–	1,062	–	39,872	–
central government: other	5,260	–	96,633	–	58,702	–	4,786	–	92,109	–
local government	2,188	–	3,855	–	2,237	–	1,107	–	1,201	–
other residents	6,377	41,575	9,807	–	20,868	115,578	1,836	–	8,904	4,503
rest of the world	17,580	–	44,421	–	136,494	–	–	–	38,121	–
Derivatives	**4,602**	**6,565**	**78,459**	**67,934**	**1,842**	**2,116**	**–**	**–**	**2,761**	**3,283**
Short-term loans, of	**40,436**	**388,145**	**589,422**	**95,567**	**50,858**	**151,441**	**..**	**5,427**	**4,631**	**713**
MFIs	–	283,574	589,422	25,267	–	119,030	–	5,427	–	713
other financial corporations	–	30,355	–	612	50,858	–	..	–	4,631	..
general government	–	–	–	–	–	–	–	–	–	–
other residents	40,436	–	–	–	–	–	–	–	–	–
rest of the world	–	74,216	–	69,688	–	32,411	–	–	–	–
Medium and long-term loans, of	**–**	**370,394**	**652,432**	**63,619**	**152,994**	**38,387**	**17**	**2,151**	**1,404**	**8,925**
MFIs	–	295,133	652,432	5,110	–	28,409	–	745	–	5,402
other financial corporations	–	47,002	–	774	152,994	–	17	–	1,404	23
general government	–	24,068	–	2,992	–	–	–	1,406	–	1,558
other residents	–	–	–	–	–	–	–	–	–	–
rest of the world	–	4,191	–	54,743	–	9,977	–	–	–	1,943
Shares and other equity, issued by	**518,074**	**1,021,439**	**140,448**	**272,239**	**187,887**	**34,004**	**..**	**3,708**	**71,833**	**102,014**
residents	388,114	1,021,439	121,218	272,239	52,436	34,004	..	3,708	45,586	102,014
of which: listed shares	*171,718*	*299,934*	*25,983*	*130,095*	*37,170*	*1,135*	–	–	*18,573*	*56,283*
rest of the world	129,961	–	19,230	–	135,451	–	–	–	26,248	–
Mutual fund shares, issued by	**13,610**	**–**	**9,486**	**107,031**	**23,884**	**271,751**	**408**	**–**	**42,000**	**–**
residents	4,532	–	4,334	107,031	–	271,751	408	–	38,599	–
rest of the world	9,079	–	5,153	–	23,884	–	–	–	3,401	–
Insurance technical reserves	**18,128**	**90,916**	**1,025**	**17,603**	**–**	**–**	**–**	**–**	**–**	**365,535**
net equity of households	–	90,916	–	17,603	–	–	–	–	–	305,645
prepayments and other claims	18,128	–	1,025	–	–	–	–	–	–	59,890
Other accounts receivable/payable	**330,162**	**292,444**	**229**	**261**	**1,138**	**..**	**–**	**–**	**50**	**2,704**
Trade credits	307,511	279,880	–	–	–	–	–	–	–	–
Other	22,651	12,564	229	261	1,138	..	–	–	50	2,704
Total	**1,122,703**	**2,217,199**	**2,219,159**	**2,302,599**	**710,395**	**693,205**	**63,497**	**11,286**	**366,395**	**487,677**

(1) Provisional. Rounding may cause discrepancies in totals.

Table a27

General governmet						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
–	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**26,166**	**26,166**	**26,166**	**Monetary gold and SDRs**
12,008	**40,756**	**33,887**	**–**	**13,660**	**–**	**489,051**	**–**	**25,206**	**108,668**	**944,349**	**944,349**	**Currency and transferable deposits,** with
10,765	–	11,599	–	13,189	–	463,662	–	25,120	–	794,926	794,926	MFIs
–	40,756	21,507	–	..	–	17,669	–	86	–	40,756	40,756	other residents
1,244	–	781	–	470	–	7,721	–	–	108,668	108,668	108,668	rest of the world
1,160	**129,999**	**1,139**	**–**	**883**	**–**	**298,645**	**–**	**140,863**	**45,052**	**733,684**	**733,684**	**Other deposits,** with
1,157	–	1,023	–	882	–	89,738	–	140,863	–	478,783	478,783	MFIs
–	129,999	–	–	–	–	208,679	–	–	–	209,849	209,849	other residents
3	–	115	–	1	–	228	–	–	45,052	45,052	45,052	rest of the world
7	**118,771**	**13**	**..**	**107**	**–**	**6,864**	**–**	**58,482**	**11,390**	**135,965**	**135,965**	**Short-term securities,** issued by
7	118,771	13	..	107	–	6,367	–	58,482	–	118,771	118,771	general government
–	–	–	–	–	–	149	–	–	–	5,803	5,803	other residents
–	–	–	–	–	–	348	–	–	11,390	11,390	11,390	rest of the world
917	**1,105,068**	**4,227**	**17,137**	**6,678**	**–**	**633,179**	**–**	**589,132**	**331,378**	**2,019,873**	**2,019,873**	**Bonds,** issued by
228	–	637	–	882	–	298,263	–	3,366	–	404,633	404,633	MFIs
86	201,659	126	–	1,394	–	33,079	–	34,981	–	201,659	201,659	central government: CCTs
334	903,409	321	–	2,433	–	154,804	–	488,026	–	903,409	903,409	central government: other
50	–	1,094	17,137	..	–	2,198	–	3,206	–	17,137	17,137	local government
219	–	435	–	117	–	53,540	–	59,552	–	161,656	161,656	other residents
–	–	1,614	–	1,853	–	91,295	–	–	331,378	331,378	331,378	rest of the world
–	**6,585**	**–**	**–**	**–**	**–**	**–**	**–**	**43,302**	**44,484**	**130,967**	**130,967**	**Derivatives**
13,752	**1,514**	**–**	**4,249**	**–**	**942**	**..**	**53,584**	**176,315**	**173,831**	**875,414**	**875,414**	**Short-term loans,** of
–	1,514	–	4,085	–	16	–	52,513	–	97,282	589,422	589,422	MFIs
–	–	–	164	–	–	–	1,071	–	23,287	55,489	55,489	other financial corporations
13,752	–	–	–	–	926	–	–	–	12,825	13,752	13,752	general government
–	–	–	–	–	–	..	–	–	40,436	40,436	40,436	other residents
–	–	–	–	–	–	–	–	176,315	–	176,315	176,315	rest of the world
66,786	**87,099**	**–**	**65,606**	**–**	**52**	**–**	**283,255**	**78,487**	**32,632**	**952,120**	**952,120**	**Medium and long-term loans,** of
–	20,777	–	26,044	–	47	–	257,549	–	13,215	652,432	652,432	MFIs
–	52,773	–	23,023	–	5	–	25,684	–	5,131	154,415	154,415	other financial corporations
66,786	6,984	–	15,470	–	–	–	22	–	14,285	66,786	66,786	general government
–	–	–	–	–	–	–	–	–	–	–	–	other residents
–	6,565	–	1,069	–	–	–	–	78,487	–	78,487	78,487	rest of the world
82,652	**–**	**6,166**	**116**	**716**	**–**	**640,845**	**–**	**177,440**	**392,541**	**1,826,062**	**1,826,062**	**Shares and other equity,** issued by
75,617	–	5,300	116	319	–	567,491	–	177,440	–	1,433,521	1,433,521	residents
31,046	–	*1,856*	–	*227*	–	*136,793*	–	*64,082*	–	*487,447*	*487,447*	*of which: listed shares*
7,035	–	866	–	397	–	73,353	–	–	392,541	392,541	392,541	rest of the world
146	**–**	**5,362**	**–**	**1,362**	**–**	**356,704**	**–**	**4,108**	**78,288**	**457,069**	**457,069**	**Mutual fund shares,** issued by
46	–	43	–	876	–	325,835	–	4,108	–	378,781	378,781	residents
99	–	5,318	–	486	–	30,868	–	–	78,288	78,288	78,288	rest of the world
133	**–**	**1,106**	**–**	**29**	**–**	**467,177**	**27,807**	**14,263**	**–**	**501,861**	**501,861**	**Insurance technical reserves**
–	–	–	–	–	–	436,729	27,807	5,243	–	441,971	441,971	net equity of households
133	–	1,106	–	29	–	30,449	–	9,021	–	59,890	59,890	prepayments and other claims
48,588	**17,824**	**27,703**	**24,710**	**30,065**	**2,851**	**19,146**	**83,786**	**36,350**	**68,852**	**493,430**	**493,430**	**Other accounts receivable/payable**
–	–	–	–	–	–	4,871	–	36,350	68,852	348,731	348,731	Trade credits
48,588	17,824	27,703	24,710	30,065	2,851	14,276	83,786	–	–	144,699	144,699	Other
226,149	**1,507,615**	**79,601**	**111,819**	**53,501**	**3,845**	**2,911,611**	**448,433**	**1,343,948**	**1,313,282**	**9,096,959**	**9,096,959**	**Total**

ITALY'S FINANCIAL ASSETS AND LIABILITIES IN 2003 (1)

(flows 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	**–**	**–**	**32**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Currency and transferable deposits, with	**10,170**	**–**	**–13,623**	**31,916**	**–1,307**	**–**	**13,740**	**–**	**9,085**	**–**
MFIs	7,594	–	–15,189	31,916	–1,404	–	–3,326	–	312	–
other residents	960	–	–196	–	96	–	–	–	85	–
rest of the world	1,616	–	1,762	–	..	–	17,066	–	8,688	–
Other deposits, with	**1,213**	**–**	**33,980**	**22,378**	**–1,544**	**79,850**	**–6,481**	**–**	**–1,178**	**–**
MFIs	1,078	–	36,373	22,378	–1,544	–	–6,481	–	–1,178	–
other residents	135	–	–	–	–	79,850	–	–	–	–
rest of the world	..	–	–2,392	–	..	–	..	–	..	–
Short-term securities, issued by	**–1,346**	**1,845**	**19,681**	**–2**	**–2,165**	**7**	**–403**	**–**	**2,006**	**–**
general government	–877	–	15,993	–	–265	–	–403	–	2,438	–
other residents	–1	1,845	2,005	–2	30	7	–	–	–	–
rest of the world	–467	–	1,682	–	–1,929	–	–	–	–432	–
Bonds, issued by	**–3,173**	**5,567**	**8,864**	**30,871**	**16,210**	**28,704**	**–956**	**–**	**18,164**	**519**
MFIs	767	–	5,600	30,871	–28	–	–444	–	4,356	–
central government: CCTs	–2,074	–	–9,067	–	2,178	–	–441	–	3,007	–
central government: other	–5,075	–	1,787	–	–6,562	–	–741	–	–1,202	–
local government	361	–	1,373	–	363	–	207	–	154	–
other residents	268	5,567	2,572	–	8,422	28,704	463	–	1,898	519
rest of the world	2,580	–	6,599	–	11,837	–	–	–	9,952	–
Derivatives	**–**	**–792**	**5,647**	**–**	**–**	**1,415**	**–**	**–**	**–**	**519**
Short-term loans, of	**5,317**	**–2,879**	**11,356**	**28,232**	**–8,232**	**–4,937**	**..**	**735**	**–5,475**	**–152**
MFIs	–	–3,086	11,356	11,948	–	554	–	735	–	–152
other financial corporations	–	–131	–	–358	–8,232	–	..	–	–5,475	..
general government	–	–	–	–	–	–	–	–	–	–
other residents	5,317	–	–	–	–	–	–	–	–	–
rest of the world	–	338	–	16,642	–	–5,491	–	–	–	–
Medium and long-term loans, of	**–**	**45,398**	**70,427**	**–9,342**	**69,006**	**6,276**	**–3**	**162**	**52**	**2,714**
MFIs	–	44,905	70,427	–9,650	–	–387	–	164	–	2,624
other financial corporations	–	1,691	–	–21	69,006	–	–3	–	52	–15
general government	–	657	–	–31	–	–	–	–2	–	–3
other residents	–	–	–	–	–	–	–	–	–	–
rest of the world	–	–1,857	–	360	–	6,663	–	–	–	108
Shares and other equity, issued by	**34,696**	**28,368**	**9,534**	**3,973**	**10,710**	**837**	**890**	**–40**	**3,415**	**929**
residents	26,101	28,368	9,638	3,973	5,668	837	890	–40	2,027	929
of which: listed shares	....	....	....	....	....	....	–	–	....	....
rest of the world	8,595	–	–103	–	5,042	–	–	–	1,388	–
Mutual fund shares, issued by	**654**	**–**	**1,973**	**1,582**	**2,754**	**17,118**	**20**	**–**	**3,178**	**–**
residents	227	–	184	1,582	–	17,118	20	–	1,911	–
rest of the world	427	–	1,789	–	2,754	–	–	–	1,267	–
Insurance technical reserves	**796**	**5,781**	**45**	**–173**	**–**	**–**	**–**	**–**	**–**	**48,797**
net equity of households	–	5,781	–	–173	–	–	–	–	–	46,033
prepayments and other claims	796	–	45	–	–	–	–	–	–	2,766
Other accounts receivable/payable	**–12,191**	**–15,107**	**6**	**214**	**21**	**..**	**–**	**–**	**10**	**862**
Trade credits	–9,757	–11,415	–	–	–	–	–	–	–	–
Other	–2,435	–3,693	6	214	21	..	–	–	10	862
Total	**36,135**	**68,181**	**147,924**	**109,649**	**85,455**	**129,269**	**6,807**	**857**	**29,256**	**54,190**

(1) Provisional. Rounding may cause discrepancies in totals.

Table a28

General governmet						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
–	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**32**	**32**	**32**	**Monetary gold and SDRs**
–8,381	**3,831**	**1,393**	**–**	**–874**	**–**	**28,766**	**–**	**18,661**	**21,884**	**57,630**	**57,630**	**Currency and transferable deposits,** with
–7,647	–	1,248	–	–723	–	32,475	–	18,576	–	31,916	31,916	MFIs
–	3,831	30	–	..	–	2,770	–	86	–	3,831	3,831	other residents
–733	–	114	–	–151	–	–6,479	–	–	21,884	21,884	21,884	rest of the world
266	**–64,027**	**–406**	**–**	**–192**	**–**	**5,187**	**–**	**4,964**	**–2,392**	**35,808**	**35,808**	**Other deposits,** with
266	–	–406	–	–192	–	–10,502	–	4,964	–	22,378	22,378	MFIs
–	–64,027	–	–	–	–	15,689	–	–	–	15,823	15,823	other residents
..	–	..	–	..	–	..	–	–	–2,392	–2,392	–2,392	rest of the world
–108	**6,277**	**–23**	**..**	**7**	**–**	**–26,326**	**–**	**15,568**	**–1,236**	**6,891**	**6,891**	**Short-term securities,** issued by
–108	6,277	–23	..	7	–	–26,052	–	15,568	–	6,277	6,277	general government
–	–	–	–	–	–	–184	–	–	–	1,850	1,850	other residents
–	–	–	–	–	–	–90	–	–	–1,236	–1,236	–1,236	rest of the world
–4,454	**13,181**	**516**	**3,388**	**–1,143**	**–**	**34,181**	**–**	**50,216**	**36,194**	**118,425**	**118,425**	**Bonds,** issued by
91	–	–89	–	–196	–	20,662	–	152	–	30,871	30,871	MFIs
–2,018	–18,497	13	–	–400	–	–9,613	–	–81	–	–18,497	–18,497	central government: CCTs
–2,530	31,680	–6	–	–355	–	–3,158	–	49,520	–	31,680	31,680	central government: other
..	–	517	3,388	. .	–	379	–	35	–	3,388	3,388	local government
4	–	203	–	–393	–	20,762	–	590	–	34,791	34,791	other residents
–	–	–122	–	201	–	5,148	–	–	36,194	36,194	36,194	rest of the world
–	**302**	**–**	**–**	**–**	**–**	**–**	**–**	**–4,203**	**–**	**1,444**	**1,444**	**Derivatives**
..	**–815**	**–**	**–809**	**–**	**–108**	**..**	**–1,204**	**11,489**	**–3,607**	**14,456**	**14,456**	**Short-term loans,** of
–	–815	–	–819	–	–108	–	–1,368	–	4,467	11,356	11,356	MFIs
–	–	–	10	–	–	–	164	–	–13,391	–13,706	–13,706	other financial corporations
..	–	–	–	–	..	–	–	–	..	..	..	general government
–	–	–	–	–	–	..	–	–	5,317	5,317	5,317	other residents
–	–	–	–	–	–	–	–	11,489	–	11,489	11,489	rest of the world
–45,259	**14,983**	**–**	**3,212**	**–**	**–2,620**	**–**	**33,352**	**3,670**	**3,759**	**97,894**	**97,894**	**Medium and long-term loans,** of
–	–1,667	–	184	–	30	–	31,248	–	2,975	70,427	70,427	MFIs
–	44,723	–	22,434	–	–2,650	–	2,104	–	789	69,055	69,055	other financial corporations
–45,259	–26,537	–	–19,338	–	–	–	..	–	–4	–45,259	–45,259	general government
–	–	–	–	–	–	–	–	–	–	–	–	other residents
–	–1,536	–	–68	–	–	–	–	3,670	–	3,670	3,670	rest of the world
–10,860	**–**	**1,036**	**13**	**–67**	**–**	**–949**	**–**	**482**	**14,806**	**48,886**	**48,886**	**Shares and other equity,** issued by
–10,860	–	1,036	13	–23	–	–878	–	482	–	34,080	34,080	residents
….	–	….	–	….	–	….	–	….	–	….	….	*of which: listed shares*
..	–	..	–	–44	–	–71	–	–	14,806	14,806	14,806	rest of the world
59	**–**	**22**	**–**	**390**	**–**	**19,804**	**–**	**–3**	**10,152**	**28,852**	**28,852**	**Mutual fund shares,** issued by
2	–	2	–	44	–	16,311	–	–3	–	18,699	18,699	residents
57	–	19	–	346	–	3,493	–	–	10,152	10,152	10,152	rest of the world
6	**–**	**49**	**–**	**1**	**–**	**54,723**	**2,026**	**813**	**–**	**56,434**	**56,434**	**Insurance technical reserves**
–	–	–	–	–	–	53,251	2,026	417	–	53,668	53,668	net equity of households
6	–	49	–	1	–	1,473	–	396	–	2,766	2,766	prepayments and other claims
2,712	**–847**	**1,381**	**1,088**	**3,998**	**–228**	**1,754**	**10,448**	**8,421**	**9,683**	**6,111**	**6,111**	**Other accounts receivable/payable**
–	–	–	–	–	–	–397	–	8,421	9,683	–1,733	–1,733	Trade credits
2,712	–847	1,381	1,088	3,998	–228	2,151	10,448	–	–	7,844	7,844	Other
–66,017	**–27,114**	**3,967**	**6,892**	**2,120**	**–2,956**	**117,140**	**44,622**	**110,080**	**89,274**	**472,862**	**472,862**	**Total**

ITALIAN FINANCIAL MARKET: GROSS AND NET ISSUES OF SECURITIES

(millions of euros)

	BONDS AND PUBLIC							
	Public sector							
	Government securities							
	BOTs	CTZs	CCTs (1)	BTPs (1)	CTEs	Republic of Italy issues	Other (2)	Total
	Gross issues							
1999	192,893	49,099	20,567	142,149	–	10,190	–	414,898
2000	164,650	33,317	19,866	106,737	–	19,646	1,167	345,383
2001	188,677	35,528	28,330	119,929	–	22,529	54	395,047
2002	208,761	32,556	44,535	133,646	–	16,135	–	435,633
2003	214,093	31,185	38,313	144,882	–	21,998	–	450,471
	Redemptions							
1999	211,024	55,416	47,953	65,757	9,750	14,202	4,231	408,333
2000	182,200	53,401	27,912	57,916	1,744	6,922	–	330,094
2001	176,960	49,367	38,357	83,562	1,500	14,037	48	363,830
2002	208,831	21,940	57,279	93,797	–	11,404	39,407	432,657
2003	208,188	37,742	55,146	114,843	–	15,482	1,180	432,580
	Issue discounts							
1999	–	2,512	–157	546	–	–20	–	2,881
2000	–	2,379	–105	1,202	–	15	–	3,491
2001	–	2,637	–215	–1,636	–	22	–	808
2002	–	2,282	–462	–2,591	–	35	–21,836	–22,572
2003	–	1,349	–487	–1,976	–	51	–	–1,063
	Net issues (5)							
1999	–18,131	–8,830	–27,229	75,846	–9,750	–3,925	–4,231	3,750
2000	–17,550	–22,462	–7,932	47,626	–1,744	13,804	1,167	12,909
2001	11,717	–16,476	–9,812	38,006	–1,500	9,049	6	30,990
2002	–70	8,335	–12,290	42,364	–	4,388	–17,571	25,157
2003	5,905	–7,907	–16,348	31,764	–	5,582	–1,180	17,817
	Coupons (6)							
1999	3,754	5,262	11,588	37,443	906	2,936	1,216	63,105
2000	4,854	3,293	10,419	37,531	236	3,385	394	60,111
2001	4,817	3,111	13,159	38,424	95	4,107	394	64,106
2002	4,256	1,906	9,522	37,799	–	4,643	394	58,520
2003	2,990	2,855	7,190	38,680	–	4,279	–	55,994

(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. – (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) Issues for cash. include accounting lags. – (6) The figures refer only to fixed rate securities, except for CCTs.

Table a29

SECTOR SECURITIES								
			Firms and international institutions			Total bonds and public sector securities	Listed shares of Italian companies (4)	
Autonomous government agencies and State Railways	Local governments	Total (3)	Banks	Private firms	Total			
Gross issues								
–	2,487	417,385	81,449	13,186	94,636	512,020	22,543	 1999
–	3,114	348,497	86,915	20,309	107,224	455,721	9,148	 2000
–	2,408	397,454	95,777	50,821	146,598	544,052	6,171	 2001
–	5,995	441,628	92,346	44,389	136,735	578,362	3,894	 2002
–	4,033	454,505	115,758	42,359	158,116	612,621	8,710	 2003
Redemptions								
785	218	409,337	60,928	2,520	63,448	472,785	81	 1999
1,420	347	331,862	55,987	5,221	61,208	393,070	384	 2000
1,937	400	366,167	63,586	5,845	69,431	435,598	767	 2001
1,653	486	434,796	59,049	7,913	66,962	501,758	40	 2002
–	592	433,172	84,589	8,018	92,607	525,779	983	 2003
Issue discounts								
–	. .	2,881	319	290	609	3,490	_	 1999
–	. .	3,491	342	672	1,014	4,505	_	 2000
–	. .	808	357	697	1,054	1,862	_	 2001
–	–4	–22,576	355	112	467	–22,109	_	 2002
–	. .	–1,063	429	27	456	–607	_	 2003
Net issues (5)								
–785	2,269	5,234	20,203	10,376	30,578	35,812	22,462	 1999
–1,420	2,767	14,255	30,585	14,416	45,001	59,257	8,764	 2000
–1,937	2,007	31,061	31,834	44,279	76,113	107,174	5,404	 2001
–1,653	5,512	29,016	32,941	36,364	69,305	98,321	3,854	 2002
–	3,442	21,259	30,738	34,308	65,047	86,305	7,727	 2003
Coupons (6)								
194	126	63,426	11,635	. . . .	11,635	75,061	10,052	 1999
192	249	60,552	12,485	. . . .	12,485	73,037	15,711	 2000
144	437	64,687	13,274	. . . .	13,274	77,961	15,889	 2001
83	604	59,207	12,178	. . . .	12,178	71,385	18,650	 2002
83	712	56,789	11,020	. . . .	11,020	67,809	17,030	 2003

(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 2002. – Redemptions refer to the market value of shares bought back and cancelled. Share cancellations following mergers are not included. – (5) The net issues of Republic of Italy loans

ITALIAN FINANCIAL MARKET: GROSS AND NET ISSUES OF SECURITIES
(millions of euros)

	BONDS AND PUBLIC							
	Public sector							
	Government securities							
	BOTs	CTZs	CCTs (1)	BTPs (1)	CTEs	Republic of Italy issues	Other (2)	Total
				Gross issues				
1999 …………	192,893	49,099	20,567	142,149	–	10,190	–	414,898
2000 …………	164,650	33,317	19,866	106,737	–	19,646	1,167	345,383
2001 …………	188,677	35,528	28,330	119,929	–	22,529	54	395,047
2002 …………	208,761	32,556	44,535	133,646	–	16,135	–	435,633
2003 …………	214,093	31,185	38,313	144,882	–	21,998	–	450,471
				Redemptions				
1999 …………	211,024	55,416	47,953	65,757	9,750	14,202	4,231	408,333
2000 …………	182,200	53,401	27,912	57,916	1,744	6,922	–	330,094
2001 …………	176,960	49,367	38,357	83,562	1,500	14,037	48	363,830
2002 …………	208,831	21,940	57,279	93,797	–	11,404	39,407	432,657
2003 …………	208,188	37,742	55,146	114,843	–	15,482	1,180	432,580
				Issue discounts				
1999 …………	–	2,512	–157	546	–	–20	–	2,881
2000 …………	–	2,379	–105	1,202	–	15	–	3,491
2001 …………	–	2,637	–215	–1,636	–	22	–	808
2002 …………	–	2,282	–462	–2,591	–	35	–21,836	–22,572
2003 …………	–	1,349	–487	–1,976	–	51	–	–1,063
				Net issues (5)				
1999 …………	–18,131	–8,830	–27,229	75,846	–9,750	–3,925	–4,231	3,750
2000 …………	–17,550	–22,462	–7,932	47,626	–1,744	13,804	1,167	12,909
2001 …………	11,717	–16,476	–9,812	38,006	–1,500	9,049	6	30,990
2002 …………	–70	8,335	–12,290	42,364	–	4,388	–17,571	25,157
2003 …………	5,905	–7,907	–16,348	31,764	–	5,582	–1,180	17,817
				Coupons (6)				
1999 …………	3,754	5,262	11,588	37,443	906	2,936	1,216	63,105
2000 …………	4,854	3,293	10,419	37,531	236	3,385	394	60,111
2001 …………	4,817	3,111	13,159	38,424	95	4,107	394	64,106
2002 …………	4,256	1,906	9,522	37,799	–	4,643	394	58,520
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(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. – (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) Issues for cash. include accounting lags. – (6) The figures refer only to fixed rate securities, except for CCTs.

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1,420	347	331,862	55,987	5,221	61,208	393,070	384	 2000
1,937	400	366,167	63,586	5,845	69,431	435,598	767	 2001
1,653	486	434,796	59,049	7,913	66,962	501,758	40	 2002
–	592	433,172	84,589	8,018	92,607	525,779	983	 2003
			Issue discounts					
–	. .	2,881	319	290	609	3,490	_	 1999
–	. .	3,491	342	672	1,014	4,505	_	 2000
–	. .	808	357	697	1,054	1,862	_	 2001
–	–4	–22,576	355	112	467	–22,109	_	 2002
–	. .	–1,063	429	27	456	–607	_	 2003
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Table a30

INTEREST RATES ON SECURITIES LISTED ON THE ITALIAN STOCK EXCHANGE
(average values before tax)

	CCTs	CTEs	CTOs	BTPs	CTZs	Fixed-rate bank bonds
1994	9.97	7.64	10.53	10.68	–	10.14
1995	11.60	8.82	11.64	11.94	11.40	11.58
1996	9.01	6.33	8.77	9.06	8.49	9.20
1997	6.81	5.42	7.17	6.76	6.45	7.41
1998	4.89	4.87	7.01	4.92	4.58	5.45
1999	3.13	4.35	–	4.71	3.21	4.80
2000	4.58	5.94	–	5.59	4.70	5.80
2001	4.34	6.02	–	5.17	4.04	5.13
2002	3.37	–	–	4.95	3.49	4.90
2003	2.30	–	–	4.28	2.30	3.87
2002 – Jan.	3.30	–	–	5.01	3.54	4.92
Feb.	3.48	–	–	5.12	3.67	5.06
Mar.	3.47	–	–	5.30	3.90	5.18
Apr.	3.58	–	–	5.32	3.94	5.20
May	3.58	–	–	5.31	4.01	5.24
June	3.67	–	–	5.17	3.89	5.17
July	3.53	–	–	5.01	3.65	4.99
Aug.	3.37	–	–	4.77	3.38	4.82
Sept.	3.31	–	–	4.58	3.15	4.61
Oct.	3.16	–	–	4.65	3.04	4.60
Nov.	3.10	–	–	4.62	2.95	4.57
Dec.	2.92	–	–	4.48	2.74	4.42
2003 – Jan.	2.77	–	–	4.35	2.59	4.13
Feb.	2.63	–	–	4.18	2.40	3.88
Mar.	2.41	–	–	4.21	2.34	3.95
Apr.	2.44	–	–	4.30	2.39	4.00
May	2.45	–	–	4.05	2.18	3.68
June	2.16	–	–	3.89	1.95	3.40
July	2.01	–	–	4.16	2.06	3.63
Aug.	2.10	–	–	4.34	2.30	3.94
Sept.	2.18	–	–	4.36	2.27	3.90
Oct.	2.14	–	–	4.43	2.32	3.91
Nov.	2.19	–	–	4.53	2.42	4.02
Dec.	2.18	–	–	4.50	2.35	4.04
2004 – Jan.	2.13	–	–	4.38	2.18	3.80
Feb.	2.08	–	–	4.34	2.11	3.69
Mar.	2.04	–	–	4.18	1.99	3.48
Apr.	1.93	–	–	4.35	2.15	3.65

Table a31

CREDIT RISK INDICATORS

(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	*of which: bad debts*	Adjusted bad debts	New bad debts (2)	
			Banking system			
2001	973,859	6.7	4.7	5.0	0.9	107.6
2002	1,029.072	6.5	4.5	4.8	1.0	106.5
2003	1,091.106	6.6	4.7	5.1	1.2	108.6
			Limited company banks (*società per azioni*)			
2001	849,499	6.7	4.8	5.2	0.9	107.6
2002	886,526	6.5	4.6	4.9	1.0	106.5
2003	923,427	6.8	4.9	5.3	1.2	108.2
			Cooperative banks *(banche popolari)*			
2001	75,988	5.6	3.4	3.7	0.9	107.9
2002	85,627	6.2	4.2	4.4	1.0	106.1
2003	100,948	5.2	3.6	4.0	1.2	112.0
			Mutual banks *(banche di credito cooperativo)*			
2001	48,372	8.0	4.2	4.4	0.9	106.0
2002	56,919	6.8	3.2	3.5	0.9	107.5
2003	66,731	6.5	2.9	3.2	0.9	109.7
			Major, large and medium-sized banks *(banche maggiori, grandi e medie)*			
2001	721,094	6.0	4.0	4.3	0.9	107.8
2002	738,245	6.2	4.2	4.5	1.0	106.3
2003	755,752	6.6	4.7	5.1	1.3	108.2
			Other banks			
2001	252,765	8.6	6.5	7.0	0.9	107.2
2002	290,827	7.3	5.2	5.6	0.9	107.0
2003	335,354	6.6	4.6	5.1	1.0	109.5
			Banks based in the Centre or North			
2001	908,179	6.0	4.1	4.4	0.9	108.8
2002	965,625	6.1	4.1	4.4	1.0	107.3
2003	1,030.009	6.2	4.3	4.7	1.2	109.2
			Banks based in the South			
2001	65,680	15.5	12.9	13.2	1.3	102.1
2002	63,447	12.7	10.2	10.3	1.0	101.5
2003	61,097	13.8	11.0	11.5	1.4	104.1

(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 repo assets, net interest to be debited to customers and adjusted bad debts.

Table a32

CONSOLIDATED INCOME STATEMENT:
CONTRIBUTION OF OPERATIONS TO SUPERVISORY CAPITAL (1)
(percentages of total assets)

	Banking system				
	Classification by size			Classification by geographical area	
	Main banking groups	Rest of the system		Centre and North	South
			Net interest income		
2001	1.94	2.56	2.16	2.15	3.02
2002	2.02	2.55	2.22	2.20	3.13
2003	1.96	2.52	2.19	2.17	3.05
			Non-interest income		
2001	1.46	1.46	1.46	1.47	1.01
2002	1.27	1.33	1.29	1.30	0.99
2003	1.50	1.28	1.41	1.42	1.08
			Gross income		
2001	3.40	4.02	3.63	3.62	4.03
2002	3.29	3.88	3.51	3.50	4.13
2003	3.46	3.79	3.60	3.59	4.13
			Operating expenses		
2001	1.98	2.43	2.14	2.13	2.68
2002	1.97	2.38	2.13	2.11	2.90
2003	1.98	2.32	2.12	2.10	2.82
			Operating profit		
2001	1.42	1.59	1.49	1.49	1.35
2002	1.31	1.50	1.39	1.39	1.23
2003	1.48	1.48	1.48	1.48	1.31
			Non-recurring items (net) and allocations to provisions		
2001	0.17	0.24	0.19	0.19	0.17
2002	0.23	0.24	0.24	0.24	0.14
2003	0.24	0.33	0.28	0.28	0.14
			Loan losses		
2001	0.57	0.35	0.49	0.49	0.46
2002	0.58	0.37	0.50	0.50	0.33
2003	0.50	0.56	0.52	0.53	0.39
			Tax		
2001	0.27	0.42	0.32	0.32	0.30
2002	0.21	0.37	0.27	0.27	0.30
2003	0.30	0.25	0.28	0.28	0.27
			Dividends		
2001	0.18	0.15	0.17	0.17	0.07
2002	0.18	0.18	0.18	0.18	0.08
2003	0.25	0.18	0.22	0.22	0.06
			Allocations to supervisory capital		
2001	0.24	0.43	0.31	0.31	0.36
2002	0.11	0.35	0.20	0.20	0.39
2003	0.19	0.16	0.18	0.17	0.46
			Share of non-interest income in gross income *(percentages)*		
2001	43.0	36.4	40.3	40.7	25.1
2002	38.7	34.3	36.8	37.1	24.1
2003	43.4	33.7	39.2	39.5	26.2
			Cost-income ratio *(percentages)* (3)		
2001	58.2	60.3	59.0	58.9	66.6
2002	60.0	61.3	60.6	60.3	70.2
2003	57.2	61.0	58.9	58.7	68.3
			ROE *(percentages)*		
2001	12.5	6.4	9.1	9.2	4.3
2002	6.0	6.8	6.4	6.5	4.5
2003	9.2	4.4	6.7	6.7	5.1
			Memorandum item: **Total assets** *(average values in millions of euros)* (4)		
2001	1,152,248	659,056	1,811,304	1,777,478	33,826
2002	1,123,271	699,116	1,822,387	1,789,511	32,876
2003	1,080,657	748,605	1,829,262	1,795,599	33,663

(1) Consolidated data for banking groups and data on a solo basis for banks not belonging to a group. – (2) Six largest banking groups in terms of total assets. – (3) The cost-income ratio is the ratio of operating expenses to gross income. – (4) Refers only to the banks that submitted reports with income statement data.

SUPERVISORY CAPITAL AND SOLVENCY RATIO (1)

(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 (2)				Number of banks	Amount
				Banking system				
2001	97,434	39,180	34,286	129,217	10.4	31,722	6	550
2002	98,828	40,272	36,084	134,385	11.2	39,605	7	198
2003	104,401	41,521	37,117	139,837	11.4	42,505	–	–
				Main banking groups (3)				
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	–	–
2003	50,928	25,745	24,304	72,825	10.8	19,876	–	–
				Other banks and banking groups				
2001	51,270	13,491	10,150	62,430	12.0	21,630	6	550
2002	50,173	13,658	11,213	61,911	12.0	21,038	7	198
2003	53,473	15,776	12,813	67,012	12.0	22,629	–	–
				Banks and banking groups based in the Centre or North				
2001	94,460	38,907	34,104	125,984	10.3	29,930	3	536
2002	95,802	40,004	35,920	131,093	11.1	37,769	6	196
2003	101,256	41,180	36,882	136,352	11.3	40,564	–	–
				Banks and banking groups based in the South				
2001	2,974	273	182	3,233	17.8	1,792	3	14
2002	3,026	268	164	3,292	18.1	1,836	1	2
2003	3,145	341	235	3,485	18.1	1,941	–	–

(1) Consolidated data for banking groups and data on a solo basis for banks not belonging to a group. Excludes the Italian branches of foreign banks. – (2) Includes innovative and hybrid capital instruments. – (3) Six largest banking groups in terms of total assets.

LIST OF ABBREVIATIONS

ABI – *Associazione bancaria italiana*
Italian Bankers' Association

BI–COMP – *Banca d'Italia Compensazione*
Bank of Italy Clearing System

BI–REL – *Banca d'Italia Regolamento Lordo*
Bank of Italy real-time gross settlement system

BOT – *Buoni ordinari del Tesoro*
Treasury bills

BTP – *Buoni del Tesoro poliennali*
Treasury bonds

CCT – *Certificati di credito del Tesoro*
Treasury credit certificates

CIPA – *Convenzione interbancaria per i problemi dell'automazione*
Interbank Convention on Automation

Confindustria – *Confederazione generale dell'industria italiana*
Confederation of Italian Industry

Consob – *Commissione nazionale per le società e la borsa*
Companies and Stock Exchange Commission

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 Treasury certificates

EFPD – Economic and Financial Planning Document

FPR – Forecasting and Planning Report

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
QRBR	–	Quarterly Report on the Borrowing Requirement
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 2003

DIRECTORATE

Antonio FAZIO	- Governor and chairman of the board of directors
Vincenzo DESARIO	- Director general
Pierluigi CIOCCA	- Deputy director general
Antonio FINOCCHIARO	- Deputy director general and Secretary to the Board

BOARD OF DIRECTORS

Angelo BAROVIER
Paolo BLASI
Paolo DE FEO
Giampaolo de FERRA
Paolo Emilio FERRERI*
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Vincenzo CATAPANO	- Legal research (general counsel)
Carlo TRESOLDI	- Payment system and treasury operations
Giancarlo MORCALDO	- Economic research
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