BANCA D'ITALIA
EUROSISTEMA

Annual Report
Abridged Version

Ordinary Meeting of Shareholders
Rome, 30 May 2014

120th FINANCIAL YEAR

2013

Financial Year 120th

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Address
Via Nazionale, 91
00184 Rome - Italy

Telephone
+39 0647921

Website
www.bancaditalia.it

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THE INTERNATIONAL ECONOMY

1. ECONOMIC DEVELOPMENTS AND POLICIES IN THE MAIN COUNTRIES AND AREAS

In 2013 world output decelerated slightly. Economic growth in the main advanced countries was modest overall, but showed some signs of strengthening. In the emerging economies, growth was subdued compared with the five years preceding the global crisis.

The monetary policy stance in the main advanced countries remained strongly expansionary; communication strategies were fine-tuned to reduce uncertainty. In the spring, the Federal Reserve announced the possibility of gradually reducing its purchases of financial assets. This tapering began at the start of 2014. The main emerging countries adopted restrictive monetary policies to counter inflationary pressures and outflows of capital and, in China, to contain credit growth.

Budgetary policy in the United States was characterized by considerable uncertainty, leading to a temporary interruption of some federal public services last October. The uncertainty subsided with the approval of the budget for the following two years and the suspension of the federal debt ceiling. Japan's fiscal policy stance was expansionary; the consolidation of the public finances should begin in the current financial year. In China a start was made on plans to contain public spending, with the exception of welfare spending.

In the early months of 2014 the worsening of the tensions between Ukraine and Russia and the sanctions imposed on Russia by the United States and the European Union, although modest to date, had a deleterious effect on Russia's growth prospects. Nevertheless, there is still a risk of the situation worsening further, with repercussions for the global economy.

The United States

In the United States, economic growth decreased to 1.9 per cent in 2013 (Table 1.1), affected by the slowdown in investment. Growth, which was modest in the first quarter, strengthened as the year progressed, buoyed by private consumption and exports.

Consumption grew by 2.0 per cent on an average annual basis and more than household disposable income (0.7 per cent). As a result, the saving rate decreased to 4.5 per cent. Households' financial situation improved, returning to pre-crisis levels.

Table 1.1

GDP, demand and inflation in the leading industrial countries
(percentage changes)

	2011	2012	2013	2013				2014
				Q1	Q2	Q3	Q4	Q1
United States								
GDP (1)	1.8	2.8	1.9	1.1	2.5	4.1	2.6	0.1
Domestic demand (1)	1.7	2.6	1.7	1.4	2.5	3.9	1.6	0.9
Inflation (2)	3.2	2.1	1.5	1.7	1.4	1.6	1.2	1.4
Japan								
GDP (1)	-0.5	1.4	1.6	4.9	3.5	1.3	0.3	5.9
Domestic demand (1)	0.4	2.3	1.9	3.1	2.9	3.3	2.5	6.8
Inflation (2)	-0.3	..	0.4	-0.6	-0.3	0.9	1.4	1.5
European Union								
GDP (1)	1.6	-0.4	0.1	-0.2	1.6	1.2	1.6	1.3
Domestic demand (1)	0.7	-1.5	-0.5	-0.9	0.2	3.1	-0.1	....
Inflation (2)	3.1	2.6	1.5	2.0	1.6	1.5	1.0	0.8
United Kingdom								
GDP (1)	1.1	0.3	1.7	1.4	3.1	3.4	2.7	3.2
Domestic demand (1)	-0.1	1.2	1.8	-0.2	3.1	8.0	-1.2	....
Inflation (2)	4.5	2.8	2.6	2.8	2.7	2.7	2.1	1.7
Canada								
GDP (1)	2.5	1.7	2.0	2.9	2.2	2.7	2.9	....
Domestic demand (1) (3)	2.4	2.3	1.4	0.2	2.0	1.5	1.2	....
Inflation (2)	2.9	1.5	0.9	0.9	0.8	1.2	0.9	1.4
Advanced economies								
GDP (4)	1.7	1.4	1.3	....	....	....	....	....
Memorandum item:								
World output (4)	3.9	3.2	3.0	....	....	....	....	....

Sources: ECB. IMF and national statistics.
(1) Volumes at chain-linked prices; quarterly changes on previous quarter at an annual rate. – (2) Consumer price index; for quarterly data, changes on the corresponding quarter of the previous year. – (3) For Canada, domestic final demand. – (4) Weighted average, weighted by GDP at purchasing power parity, of the growth rates of the economies included in the aggregate.

In 2013 fixed capital investment slowed to year-on-year growth of 4.5 per cent, from 8.3 per cent in 2012, reflecting the deceleration of non-residential investment (2.7 per cent), despite the steady rise in profits of non-financial firms. However, residential investment continued to grow well at a rate of 12.2 per cent, despite a decline in the fourth quarter.

For the third year running, labour productivity increased moderately; unit labour costs were held down by the very small growth in hourly wages.

Labour market conditions improved. Last year, there were 2.3 million more jobs in non-farm payroll employment. Overall, the unemployment rate decreased by more than 1 percentage point to 6.7 per cent in December. This reduction, however, benefited from the lower labour force participation rate, which in the first quarter of this year stood at below 63 per cent, the lowest level since the end of the 1970s.

Preliminary national accounts estimates show that in the first quarter of 2014 GDP continued to stagnate, mainly due to transitory factors, including adverse weather conditions. In the first four months of the year the unemployment rate continued to fall, reaching 6.3 per cent.

In the real estate market, after the recovery recorded between the spring of 2012 and the middle of last year, there were signs of the market slowing, mainly because of the rise in mortgage rates.

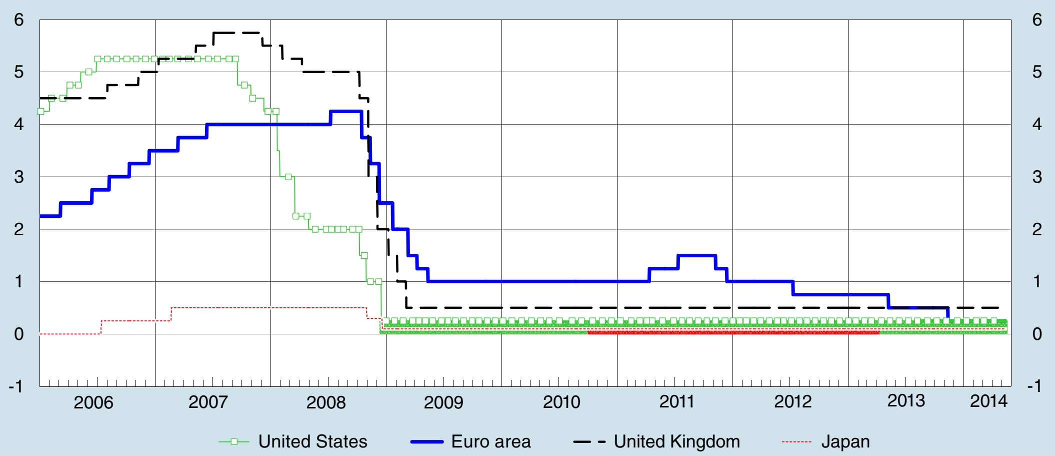
Inflation, measured by the twelve-month increase in the consumer price index, dropped to 1.1 per cent in February, returning to 2.0 per cent in April; inflation excluding food and energy products declined less, falling to 1.6 per cent and then rising to 1.8 per cent.

The Federal Reserve's monetary policy stance remained strongly expansionary, leaving the target range for the federal funds rate unchanged at 0.0 to 0.25 per cent (Figure 1.1). As a result of programmes decided in the second half of 2012 to purchase long-term Treasury bonds and mortgage-backed securities, the Federal Reserve's balance sheet began to expand again, increasing in 2013 by about 6 percentage points of GDP to 23 per cent (Figure 1.2). In May 2013, taking note of the strengthening of the macroeconomic framework, the Fed announced the possibility of tapering its purchases, causing an increase in volatility in the financial markets. Since January, tapering has led to an overall reduction of monthly purchases from $85 billion to $45 billion but has had no further impact on the markets, partly thanks to a stronger communication strategy giving forward guidance about policy rates.

The public budget deficit in 2012-13, the provisional management of which was extended until the closure of the fiscal year on 30 September 2013, stood at $680 billion, equal to 4.1 per cent of GDP, almost 3 percentage points less than in the previous year. Total revenue rose by 13 per cent, the largest annual increase since 2005, while spending was down by 2 per cent.

Figure 1.1

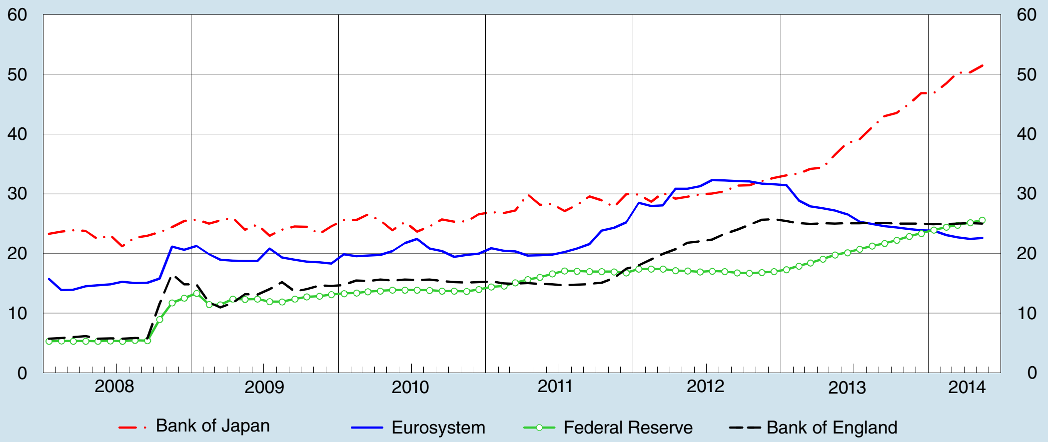
Official interest rates (1)
(daily data; per cent)



Sources: ECB and national statistics.
(1) For the United States, federal funds target rate; for Japan, uncollateralized overnight call rate target (up to 9 March 2006 and after 5 April 2013, the Bank of Japan's monetary policy was based on a quantitative target, not on an official reference rate); for the euro area, interest rate on main refinancing operations; for the United Kingdom, interest rate on commercial banks' reserves with the Bank of England and, before 18 May 2006, the repo rate.

Figure 1.2

Size of balance sheets of four central banks (1)
(monthly data; per cent of GDP in 2013)

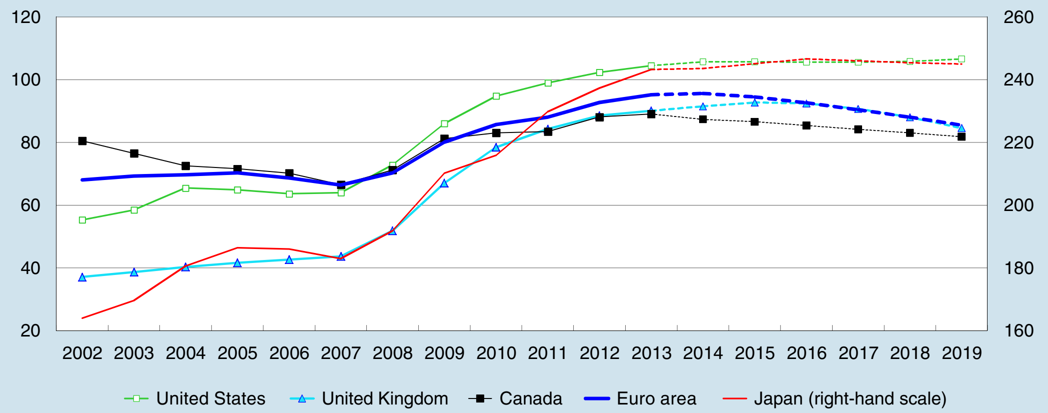


Sources: ECB and national statistics.
(1) Total assets. The movements in this aggregate also reflect factors not directly related to monetary policy decisions.

Since no agreement was reached between the Administration and Congress to extend the temporary management to the current fiscal year, at the beginning of October some federal public services were temporarily shut down. On 16 October, the agreement in Congress to refinance the Government's activity resolved the situation, helping to limit its negative impact on the economy. Last December's agreement on the budget for the fiscal year ending in September 2015 (the Bipartisan Budget Act of 2013) ended temporary management, helping to mitigate the uncertainty that has for years clouded the outlook for budgetary policy in the United States. In a similar vein, Congress decided to suspend the rule that sets a limit on the public debt until March of next year. The IMF forecasts that general government gross debt will climb from 104.5 per cent of GDP in 2013 to 105.7 per cent by the end of 2014, remaining stable thereafter (Figure 1.3).

Figure 1.3

General government gross debt (1)
(per cent of GDP)



Sources: IMF, *World Economic Outlook*, April 2014 and *Fiscal Monitor*, April 2014.
(1) The dotted lines represent forecasts.

Japan

In 2013 Japan's GDP growth remained basically stable at 1.6 per cent (Table 1.1). Economic activity was buoyed by private consumption, which grew by 2.0 per cent, and by the strong acceleration in government investment (to 11.4 per cent from 2.8 per cent in 2012) and in private residential investment (to 8.9 per cent from 2.9 per cent). Productive investment declined however, for the first time since 2009, by 1.5 per cent. The unemployment rate fell by 0.6 percentage points to 3.7 per cent in December 2013.

According to preliminary national accounts estimates for the first quarter of 2014, growth in economic activity accelerated to an annual 5.9 per cent, fuelled by productive investment and, above all, by consumption, driven by expectations of the introduction in April of an increase in consumption tax (from 5 to 8 per cent).

In 2013 annual inflation turned positive for the first time since 2008. Deflationary pressures, still in evidence in the early part of the year, gave way to a gradual acceleration in the consumer price index; in March it was up by 1.6 per cent on a twelve-month basis.

Economic activity was driven by the expansionary stance of monetary and fiscal policy, part of a programme to revive the economy of Japan known as Abenomics, after the Prime Minister, Shinzo Abe.

In order to combat deflation, in January 2013 the Bank of Japan introduced an explicit inflation target of 2 per cent; in the following April, it also started a new programme of quantitative easing, designed to double the monetary base within the next two years. At the same time this was made the new operational target, replacing the uncollateralized overnight call rate. Last February, the Bank of Japan strengthened two packages designed to stimulate credit to the economy (the Stimulating Bank Lending Facility and the Growth-Supporting Funding Facility). In April 2014, the value of the balance sheet of the Bank of Japan exceeded 50 per cent of GDP, an increase of 18 percentage points compared with the end of 2012 (Figure 1.2).

The fiscal policy stance has been expansionary. At the beginning of 2013 and then last February, two substantial fiscal packages were introduced, amounting to 2.0 and 1.1 per cent of GDP respectively. However, the expansionary phase was intended to be completed by the end of fiscal year 2013-14; the increase in the indirect tax on consumption in April will be followed by a further increase of 2 percentage points in October 2015.

According to the latest IMF estimates, the overall deficit of Japanese general government, which in 2013 amounted to 8.4 per cent of GDP (8.7 per cent in 2012), should gradually come down further over the next few years. The ratio of gross debt to GDP, which last year reached 243.2 per cent, is not expected to diminish until 2017 (Figure 1.2).

The third important component of Abenomics, in addition to monetary expansion and flexible fiscal policy, is an ambitious programme of structural reforms to raise the country's productive capacity. So far, no significant measures have materialized under this programme; a relaunch is expected by the middle of this year.

The European Union

In 2013 output growth in the European Union stagnated, rising by 0.1 per cent, while in the euro area alone it shrank.

United Kingdom. – In 2013 GDP growth accelerated in the UK to 1.7 per cent, thanks mainly to household consumption which grew by 2.2 per cent and residential investment which returned to growth and rose by 4.7 per cent.

Employment in the private sector grew at a slower pace than in 2012 (2.8 per cent, down from 3.9 per cent); the unemployment rate fell by 1 percentage point, bringing it to 6.8 per cent in February.

According to preliminary national accounts estimates, in the first quarter of 2014 GDP increased strongly at an annualized rate of 3.2 per cent.

Consumer price inflation reached a high of 2.9 per cent in June of last year but then fell sharply to 1.8 per cent in April of this year.

The Bank of England kept its monetary policy reference rate unchanged at 0.5 per cent and maintained the quantity of financial assets in its portfolio at £375 billion. In April 2013, the Funding for Lending Scheme was extended for one year and restructured so as to provide incentives for lending to small and medium-sized enterprises in the current year. Since last summer, the Bank of England has strengthened its communication strategy, adopting an explicit form of forward guidance, which was later modified in the light of the good performance of the economy.

In the 2013-14 fiscal year, the public sector deficit (calculated according to the Maastricht Treaty definition, which includes some extraordinary items) increased to 6.0 per cent of GDP from 5.2 per cent a year earlier. The latest estimates of the British government show that the ratio of public debt to GDP will start to decline in the 2017-18 financial year, one year earlier with respect to that forecast in 2013.

The latest IMF estimates showed that public sector gross debt would rise to almost 92.7 per cent of GDP in 2015 (from about 90 per cent in 2013) and would then begin to decrease during the following year (Figure 1.2).

The EU countries of Central and Eastern Europe. – On 1 July 2013 Croatia joined the European Union, becoming the twenty-eighth member state. In 2013 in the eight countries of Central and Eastern Europe that had not yet adopted the euro, economic activity remained weak overall (Table 1.2). Over the year GDP grew by an average of 1.3 per cent (up from 0.7 per cent in 2012), with significant differences from country to country: strong growth in Latvia, Lithuania and Romania, but a decline in GDP in the Czech Republic and, for the fifth consecutive year, in Croatia. The performance of domestic demand was very weak in almost all these countries. During the year, GDP did however steadily accelerate, thanks to more buoyant activity in the euro area, which boosted exports.

In 2013, consumer price inflation in these countries decreased sharply, to an average of 1.4 per cent (from 3.7 per cent in 2012). The slowdown reflected the fall in commodity prices and considerable spare capacity in most of the economies. Reductions in administered prices, particularly in Bulgaria, Lithuania, Hungary and the Czech Republic, were also a contributory factor. In the first few months of 2014, inflation declined further to historically low levels, even turning negative in Hungary, Croatia and Bulgaria.

Table 1.2

Main macroeconomic indicators for EU countries of Central and Eastern Europe not in the euro area (1)

(percentage changes; balances as per cent of GDP)

	GDP		Consumer prices (2)		Current account balance		Government budget balance	
	2012	2013	2012	2013	2012	2013	2012	2013
Bulgaria	0.6	0.9	2.4	0.4	-0.8	1.9	-0.8	-1.5
Croatia	-1.9	-1.0	3.4	2.3	0.1	1.2	-5.0	-4.9
Czech Republic	-1.0	-0.9	3.5	1.4	-1.3	-1.4	-4.2	-1.5
Hungary	-1.7	1.1	5.7	1.7	0.8	3.0	-2.1	-2.2
Lithuania	3.7	3.3	3.2	1.2	-0.2	1.5	-3.2	-2.2
Latvia	5.2	4.1	2.3	..	-2.5	-0.8	-1.3	-1.0
Poland	2.0	1.6	3.7	0.8	-3.7	-1.3	-3.9	-4.3
Romania	0.6	3.5	3.4	3.2	-4.5	-1.1	-3.0	-2.3
Total	**0.7**	**1.3**	**3.7**	**1.4**	**-2.5**	**-0.4**	**-3.4**	**-3.0**

Source: based on Eurostat data.
(1) Latvia is only included after it joined the euro area on 1 January 2014. – (2) Harmonized Index of Consumer Prices.

In 2013 and the early months of this year the central banks of countries that have adopted an inflation targeting strategy (Poland, Romania, the Czech Republic and Hungary) have strengthened their expansionary monetary policy stance, against a background of moderate growth in prices and a persistently weak economic cycle. In Poland, Hungary and Romania the reference rates were lowered by 175, 175 and 325 basis points, respectively; in the Czech Republic they were kept at the close to zero levels reached at the end of 2012. In the economies that adopt a fixed exchange rate regime (Bulgaria, Latvia and Lithuania) or a managed floating exchange rate against the euro (Croatia), monetary conditions remained accommodative. The central bank of Latvia reduced interest rates to align them with those of the European Central Bank, in preparation for Latvia joining the euro area on 1 January 2014.

In 2013, general government net borrowing was less than 3 per cent of GDP in all these countries, with the exception of Poland and Croatia. In terms of structural balances (i.e. corrected for the effects of the economic cycle and other temporary measures), the public finances improved slightly compared with 2012.

The main emerging economies: China, India, Brazil, Russia and Turkey

China. – In 2013 GDP expanded by 7.7 per cent, just above the target of 7.5 per cent announced by the authorities (Table 1.3). The slowdown in the growth of private and public consumption (to 7.8 per cent) was offset by an acceleration of fixed capital investment (to 9.4 per cent), which provided the main driver for growth. The contribution of net exports remained negative (at -0.3 percentage points), due to imports accelerating faster than exports.

Table 1.3

Main macroeconomic indicators for China, India, Brazil, Russia and Turkey
(percentage changes on previous year; balances as per cent of GDP)

	GDP		Consumer prices		Current account balance		Government budget balance (1)	
	2012	2013	2012	2013	2012	2013	2012	2013
China	7.7	7.7	2.7	2.6	2.6	2.0	-2.2	-1.9
India (2)	4.8	4.6	9.7	10.1	-5.4	-2.7	-7.4	-7.3
Brazil	1.0	2.3	5.4	6.2	-2.4	-3.6	-2.8	-3.3
Russia	3.4	1.3	5.1	6.8	3.6	1.6	0.4	-1.3
Turkey	2.1	4.0	9.0	7.5	-6.2	-7.9	-2.1	-1.2

Sources: IMF, Eurostat and national statistics.
(1) Consolidated public sector. – (2) GDP at factor cost over the calendar year. The government budget balance includes the deficits of local states and refers to this country's fiscal year (April-March).

Private consumption was affected by disposable income, whose growth, while still robust, fell by about 3 percentage points in real terms compared with 2012 in both urban and rural areas (to 7 and 9 per cent respectively). Public sector consumption was influenced by the austerity measures linked to the anti-corruption campaign launched by the authorities. Investment was buoyed by the fiscal stimulus measures introduced by the government over the summer to combat the excessive economic slowdown.

The slowdown that began in 2011 is partly due to cyclical factors that will lapse and partly to structural factors that will weigh on the longer-term outlook. Our estimates show that at the end of 2013, growth potential, i.e. GDP growth consistent with full capacity utilization, stood at 7.7 per cent, 4 percentage points lower than in 2006-07. Among the reasons for the reduction in the medium term is the persistent weakening of foreign demand, which in turn affects the performance of fixed capital investment, which is significantly lower than in the past, especially in manufacturing. In the longer term, other structural factors, in particular demographic changes, could lead to a further decline in the country's growth potential.

On the supply side, in 2013 the shift in activity towards the services sector continued with value added growing at a higher rate than that of industry, for the second consecutive year (8.3 per cent compared with 7.8 per cent).

The Bank for International Settlements estimates that the stock of public and private debt exceeded 200 per cent of GDP in 2013, which was high by international standards.

Since last summer, monetary policy has been tightening in order to limit credit growth.

Consumer price inflation remained subdued in 2013 (2.6 per cent on average for the year), while producer prices continued to fall. By contrast, property prices continued to rise, prompting fears of speculative bubbles, particularly in the luxury homes segment.

In November, at the Third Plenary Session of the CPC Central Committee, the authorities announced a comprehensive programme of reforms aimed at encouraging China's transition towards a new model of development less dependent on exports and investment, at the same time seeking to curb the risk of financial instability and avoid a sudden slowdown of activity. The reforms are divided into three lines of action: (1) increasing the role of the market in the sectors where it ensures a more efficient allocation of resources; (2) limiting and strengthening the State's intervention to specific sectors (pensions, social welfare, and market regulation and supervision); and (3) reviewing the relationship between the State and its citizens, giving more protection to individual choices. The reforms undertaken so far have focused mostly on the financial sector.

India. – In 2013 the rate of growth of the Indian economy declined to 4.4 per cent, mainly due to weak investment caused by supply-side rigidities and bottlenecks, which have still to be resolved. India's lack of attractiveness to foreign investors was also reflected in the further decline in foreign direct investment, which fell to 1.4 per cent of GDP, the lowest since 2006.

The current account deficit in 2013 was halved to 2.7 per cent of GDP, thanks to the recovery in exports and a decrease in imports of gold, which declined in value by three quarters in the second half of the year compared with the first.

Preliminary data indicate that the central government managed to consolidate the public finances to some extent in fiscal year 2013-14, which ended last March; the state deficit fell from 5.2 to 4.6 per cent of GDP.

Inflationary pressures remained high, fuelled by the depreciation of the rupee. In 2013 the consumer price index, the new benchmark for monetary policy, rose by 10.1 per cent (9.7 per cent in 2012), the highest rate among the major emerging countries.

In the first half of 2013, monetary policy remained expansionary to counteract the weakness of domestic demand. Then, owing to the pressure on the exchange rate caused by the growing current account deficit, exceptional measures were introduced, including restrictions on imports of gold and crude oil, and a temporary increase in short-term interest rates. In January 2014 the committee of experts appointed by the new Governor of the Reserve Bank to make recommendations on the conduct of monetary policy suggested the explicit adoption of an inflation targeting regime.

Brazil. – In 2013, Brazil's GDP grew by 2.3 per cent, thanks to the recovery in investment, which increased by 6.3 per cent. Private consumption growth, while slowing, remained high at 2.3 per cent, thanks to the positive trend in real wages. The external sector made a negative contribution to growth (-0.9 per cent), reflecting the weakness of demand in the main destination markets (the euro area, China, the United States and Argentina).

Despite the limited growth of domestic demand, inflationary pressure remained high, affected by persistent bottlenecks on the supply side. At the end of 2013, consumer price inflation reached a twelve-month rate of 5.9 per cent, close to the upper limit of the Reserve Bank's target range (4.5 per cent with a symmetrical margin of 2 percentage points).

In 2013 the state of the public finances deteriorated due to the loss of revenue resulting from the tax relief on the cost of labour in some sectors of manufacturing and an increase in interest payments. The enlarged public sector deficit grew to 3.3 per cent of GDP and the primary surplus declined to 1.9 per cent, the lowest since 2009. The ratio of public debt to GDP fell by 2 percentage points, to 66.3 per cent. However, reduced growth prospects recently prompted Standard & Poor's to lower their rating for Brazil's sovereign debt. Last February the government decided on cuts in the 2014 budget for a total of €14 billion (0.6 per cent of GDP), confirming its objective to maintain the primary surplus at 1.9 per cent of GDP.

Since May 2013 the monetary policy stance has changed in order to counter the persistent inflationary pressure and capital outflows: the Selic target rate, which in April 2013 had reached 7.25 per cent, its lowest level since 1996, has since been raised nine times, reaching 11 per cent in April this year.

Russia. – In 2013, growth in economic activity slowed to 1.3 per cent, the lowest level in the last four years. Consumption growth slowed from 6.7 to 3.8 per cent and foreign demand remained weak. Investment was affected, falling by 0.3 per cent after recording strong growth of 6.3 per cent in 2012.

Despite weak demand, annual consumer price inflation remained high at 6.8 per cent, which exceeded the upper limit of 6 per cent set by the authorities. Nevertheless, monetary policy remained accommodative to support growth. Only in March and April of this year did the central bank raise its main policy rate in two steps totalling 200 basis points, to 7.5 per cent, to stem the depreciation of the rouble and capital outflows, which, already high in 2013, have accelerated this year due to fears of a tightening of sanctions because of tensions in Ukraine. According to the Russian Ministry of Economic Development, in the first four months of this year, outflows had already reached the total recorded for the whole of 2013 (about $70 billion). In parallel, the rouble lost value, falling in March to its lowest levels in the last ten years against the dollar and the euro.

The budget balance deteriorated, with a deficit equal to 1.3 per cent of GDP (compared with a surplus of 0.4 per cent in 2012). This was due to the slowdown of income from energy exports, which accounts for about a third of total public revenue.

Turkey. – In 2013 the Turkish economy grew by 4.0 per cent, driven by domestic demand, especially that of the public sector. The result was a further worsening of the external current account deficit, which rose to 7.9 per cent of GDP.

Because of its external vulnerability, since last summer Turkey has been particularly affected by the turmoil related to the Federal Reserve's tapering announcements: in 2013 the Turkish lira lost about a quarter of its value against the euro and a fifth of its value against the dollar. The depreciation was also reflected in consumer price inflation (7.5 per cent), which remained well above the target rate of 5 per cent.

In 2013 the Central Bank of Turkey implemented a gradual tightening of monetary policy (with an average increase in interbank rates of 200 basis points) and interventions in the foreign exchange market. These measures failed, however, to curb outflows of capital. The sudden further depreciation of the Turkish lira at the beginning of 2014 (by about 10 per cent in January), linked to the greater domestic political uncertainty, necessitated more radical measures. At the end of January, the Monetary Policy Committee decided on a dramatic increase of the whole range of reference rates (of more than 400 basis points), which, combined with a radical simplification of the operational framework of monetary policy, has helped to stabilize the currency.

2. THE FINANCIAL AND FOREIGN EXCHANGE MARKETS

In 2013 financial conditions strengthened in the advanced countries but weakened in the emerging economies. The improvement in the advanced economies was driven primarily by the consolidation of growth and, in the euro area, the dispelling of fears about the soundness of the monetary union. Tensions emerged in May in connection with the uncertainty about how and when the United States would begin to reduce monetary stimulus but they had already died down by the summer, thanks to more effective communication by the Federal Reserve. One contributory factor in the relaxation of financial conditions was the decision taken by the ECB's Governing Council in July to provide forward guidance on the evolution of the monetary policy stance in the area. The improvement continued in the early months of 2014, even after the Federal Reserve began to taper its purchases of long-term securities.

Financial conditions in the emerging economies deteriorated after investors reacted ahead of the reduction of monetary stimulus in the United States, in a context already characterized by a number of weaknesses. In the first part of the year international portfolio investment inflows diminished in response to signs of slowing growth, particularly in China. From May onwards the tensions led portfolio investment outflows, currency depreciations, rising bond yields, and a fall in share prices. During the summer international investors penalized the emerging economies that were more vulnerable owing to macroeconomic imbalances. In the EU countries of Central and Eastern Europe there was relatively little turbulence, reflecting these countries' limited dependence on international funding in the portfolio investment segment and the gradual improvement in growth prospects.

The advanced countries

The improvement in the financial conditions of the advanced countries in 2013 was seen in all the markets: the risk premiums on the government bonds of Italy, Spain, Portugal and Ireland diminished; share prices rose in all the leading countries; the risk premiums on corporate bonds decreased. Ten-year government bond yields rose in the United States, the United Kingdom and, to a lesser extent, in Germany; they remained almost unchanged in Japan, partly as a result of the monetary expansion implemented by the central bank.

The ten-year government bond yields in the various advanced countries reflected uneven cyclical trends and monetary policy expectations. In the United States and the United Kingdom yields rose by more than 120 basis points to 3 per cent; in Germany by 60 basis points to 1.9 per cent; in Japan they were basically unchanged at 0.7 per cent. In the first quarter of 2014, there was a decline in yields, mostly owing to shifts in the composition of investors' portfolios towards less risky assets (flight to quality). In mid-May yields stood at 2.6 per cent in the United States, 2.7 per cent in the United Kingdom, 1.5 per cent in Germany, and 0.6 per cent in Japan.

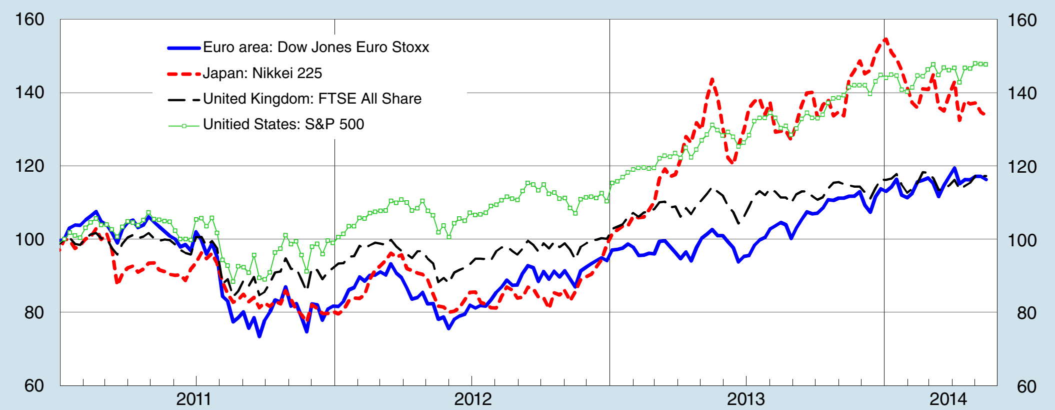
In the European countries most affected by the sovereign debt tensions the spreads between ten-year government bonds and the corresponding German Bund fell significantly in 2013, benefiting from the strengthening of the EU's institutional architecture and the prospects for economic recovery. In the first part of 2013 spreads widened briefly in connection with the banking crisis in Cyprus and political uncertainty in Italy. Starting in the summer, the spreads of Italy, Spain, Portugal and Ireland began to decline again, to 220, 222, 420 and 151 basis points respectively at the end of the year. This trend continued in the early months of 2014, buoyed also by strengthening prospects for recovery in the euro area and by capital inflows from the emerging economies. In April, for the first time since April 2010, Greece resumed bond issuance on the international markets.

In 2013 share prices in the United States, the euro area, Japan and the United Kingdom rose by 31, 21, 56 and 16 per cent respectively (Figure 2.1). The volatility of the main stock market indices gradually declined to levels close to those observed in mid-2007, before the outbreak of the financial crisis. In the early months of 2014 share prices climbed to record highs in the United States and the United Kingdom; in the euro area they made further gains, while in Japan they fell, reflecting the downward revision of the economy's growth prospects.

Figure 2.1

Share prices

(end-of-week data; indices, 1st week of January 2011=100)



Source: Thomson Reuters Datastream.

As in 2012, last year the profits of US listed companies continued to grow (at annual rates of around 5 per cent), while those of euro-area firms continued to decline, although at a slower pace than in the previous year. In both economies the cyclically adjusted price-earnings ratio went up; in the United States it is now just above the average for the period 1983-2009; in the euro area, where the recovery is weaker, it is still almost one quarter below the historical average.

After rising briefly between May and July last year, risk premiums on the bonds of private non-financial corporations began to fall again in the United States and the euro area, reaching their lowest levels since the beginning of 2007. From the end of 2012 the yield spreads between dollar- and euro-denominated investment grade bonds of non-financial corporations (BBB) and the corresponding government bonds declined by almost 40 basis points each to about 150 and 120 points respectively; spreads on high-yield bonds fell by approximately 160 and 250 basis points to 370 and 300 points respectively. Corporate bond issuance, while down on 2012, was nonetheless considerable, favoured by strong demand for high-yield bonds and, in Europe, the persistent difficulties in accessing bank credit. In 2013 total issues (net of redemptions) in the United States, the euro area and the United Kingdom came to about $370 billion, almost one fifth lower than in the previous year but well above the average for recent years.

Bank credit to non-financial corporations continued to grow at a rapid pace (7 per cent in 2013 compared with 12 per cent the previous year), while it decreased further in the euro area and the United Kingdom. At the start of 2014 there were signs of credit growth consolidating in the United States and of recovery in the other economies.

In 2013 perceived risk in the interbank market was still low, in line with the level prevailing before 2007: in all the major countries and areas, the interest rate spreads between unsecured three-month interbank deposits and three-month overnight index swaps remained basically unchanged.

Both the dollar and the euro appreciated by 5 per cent in nominal effective terms during the year, compared with a depreciation of the yen and of many currencies in the emerging countries. The strengthening of the dollar was favoured by the rise in long-term interest rates; that of the euro by portfolio investment inflows related to reduced sovereign risk, with yields still high in several euro-area countries. The yen depreciated by 19 per cent in nominal effective terms, driven by the Japanese authorities' adoption of measures to restore consumer price growth to consistently positive levels.

The emerging economies

The financial conditions in the emerging countries had already begun to deteriorate in the first half of 2013 in relation to weakening growth prospects, particularly for China. Starting from the end of May the uncertainty about the timing and way in which the Federal Reserve would launch its planned tapering of securities purchases led to a deterioration of external monetary conditions, helping to further aggravate tensions.

These tensions sparked a depreciation of the currencies of the main Asian and Latin American countries during the summer, especially in economies where macroeconomic imbalances were most severe. In the second half of 2013 there was a closer correlation between exchange rates and current account deficits, with the countries with the largest deficits – defined by the market as The Fragile Five (Brazil, India, Indonesia, South Africa and Turkey) – undergoing the largest adjustments.

The stock markets in the emerging economies had already displayed a negative trend in the first half of 2013, compounded by expectations of a tightening of liquidity conditions in the United States. At the end of the year the share indices (measured in dollars) returned to levels close to the lows recorded in the second half of 2011. The gap widened between the emerging and the advanced countries, whose share prices instead continued to strengthen, following the trend observed since the spring of 2012. Among the various emerging areas the decline was sharpest in Latin America, where it continued into the first two months of 2014 and led, in February, to prices reaching their lowest level in four years.

After expanding to nearly 400 basis points in June, sovereign risk premiums, measured by the yield spread between the dollar-denominated government debt securities issued by the emerging countries and those of the United States, fell to 330 points at the end of the year, still more than 60 basis points higher than at the end of 2012. The tensions that resurfaced at the beginning of 2014 provoked a further temporary increase, which was quickly reabsorbed.

In 2013 portfolio investment flows towards the emerging and developing countries fell by more than 20 per cent (to $186 billion, from $235 billion in 2012), due to the outflows recorded during the summer months. Nevertheless, the net flows of private capital increased overall from about $230 billion in 2012 to more than $400 billion (1.5 per cent of the recipient countries' GDP). Contributory factors included the lower level of outflows under the item *other investment* in the balance of payments, which includes movements of bank capital, and direct investment, which remained stable despite the downward revision of the medium-term growth prospects of many emerging economies.

Data published by EPFR Global, a company that collects information weekly on the portfolio activity of the leading international investment funds, show that in the equity segment net outflows were recorded as early as March 2013, due to deteriorating growth prospects in the leading emerging economies. From the end of May the bond segment also recorded net outflows, after 18 consecutive months of net inflows.

In 2013 the cross-border claims on emerging areas held by BIS reporting banks grew by $446 billion (1.6 per cent of the GDP of the same areas). The increase, however, was concentrated in the first three months of the year ($268 billion) and reflected the expansion of interbank activity in Asian and Caribbean offshore centres to borrowers in Asia (especially China) and Latin America (in particular Brazil). For the first time since 2011 some euro-area banks also appear to have been involved (France, Netherlands, Germany and Luxembourg).

The EU countries of Central and Eastern Europe

Expectations of less accommodating monetary policy in the United States had a brief and relatively subdued impact on the EU countries of Central and Eastern Europe; already in the summer financial conditions had begun to improve.

The greater resilience of the markets of Central and Eastern European countries compared with the set of all emerging countries reflects not only the recovery of economic activity in the euro area, but also the reduction of imbalances in these economies. In particular, their external vulnerability diminished, thanks to a clear improvement in the current account balances and reduced dependence on international funding in the portfolio segment. In almost all the euro-area economies the sustainability of the public finances also improved.

In 2013 the pace of the reduction in the cross-border claims held on the countries of Central and Eastern Europe by foreign BIS reporting foreign banks eased. These came to about $14 billion (1.2 per cent of GDP), almost half the $27 billion drop observed in 2012 (2.4 per cent of GDP). However, the picture varies greatly from country to country: against the background of large international bank capital outflows from Croatia, Romania and Hungary, foreign banks' claims increased in Poland and the Czech Republic. Bank lending to the private sector continued to be weak in real terms and was even negative in Croatia, Romania and Hungary, prompting their central banks to take measures to foster a recovery. Reduced lending activity continued to be affected by weak demand, owing to the fragile financial situation of households and firms.

3. WORLD TRADE AND PAYMENTS BALANCES

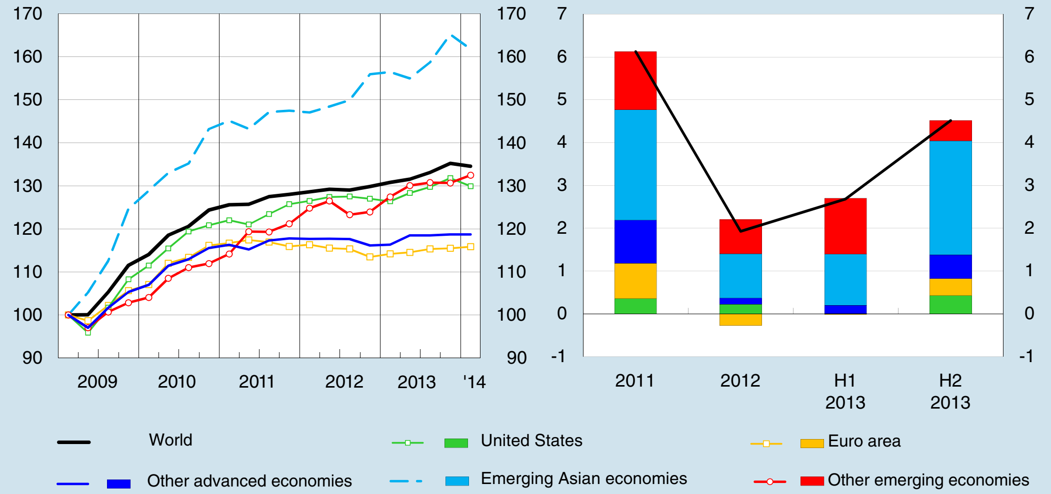
World trade in goods and services continued to expand in 2013, albeit at a modest pace of 3.0 per cent, thanks to faster growth in the second half of the year. The main commodity price index fell by 1.6 per cent. Oil prices fluctuated around an average of $104.1 a barrel, a level that was still high by historical standards. Balance-of-payments disequilibria continued to diminish in 2013. Both the current account surpluses of China and of the main oil-exporting countries contracted, as did the US deficit. The euro area, whose surplus grew again, was an exception.

World trade and regional trade agreements

World trade. – World trade in goods and services grew at a modest pace of 3.0 per cent in 2013, far below the average annual growth rate of 8.3 per cent recorded in the five years 2002-07.

Figure 3.1

World trade in goods: main geographical areas



Source: CPB Netherlands Bureau for Economic Policy Analysis.
(1) For Q1 2014, average of the first two months of the year.

The stagnation of trade in the first half of the year, marked by the deterioration of the cyclical situation in the emerging economies and by slack demand from the advanced economies, was followed by a recovery in the second half. The annualized growth rate of merchandise trade rose from 0.4 per cent in the first half to 2.7 per cent in the second in the advanced countries, and from 3.7 to 8.2 per cent in the emerging Asian economies (Figure 3.1.a).

In the second half of 2013 the emerging Asian economies made the largest contribution to the growth of world trade, more than offsetting the slowdown in the other emerging economies (Figure 3.1.b).

In the first quarter of the current year world trade is estimated to have weakened again. According to the latest IMF forecasts, the volume of trade will expand by 4.3 per cent in 2014.

Free trade agreements. – The year 2013 marked a turning point for free trade initiatives with the opening of negotiations on the Transatlantic Trade and Investment Partnership (TTIP), an ambitious bilateral agreement between the United States and the European Union, the progress in talks on the Trans-Pacific Partnership Agreement (TPP), involving not only the United States and Japan but also numerous Asian countries (with the exception of China) and several Latin American countries, and the conclusion last December in Bali of the first multilateral trade agreement of the Doha Round.

The TTIP and TPP agreements stem from the rethinking of trade policy that followed the global crisis. In contrast to the early 2000s, when the stalled negotiations on the Doha Development Agenda had resulted in a proliferation of lower-impact bilateral agreements, in the aftermath of the recent global crisis the United States, the European Union and Japan have concentrated their efforts on concluding regional agreements outside of the multilateral framework, which involve economic blocs of comparable bargaining power and meet the needs of a productive system that is increasingly organized on a planetary scale. Talks between economies of equal standing, however, are especially delicate and difficult, since they require a greater willingness to make compromises. Thus there is a real risk that the talks extend past set deadlines, as is attested to by the difficulties that have emerged during the negotiations for the TTIP and TTP.

The harmonization of the regulations and technical standards for the production of goods and services has become the focal point of the talks, given the obstacles that these pose to investment options in foreign countries. In view of their central role in global value chains, the US and the EU aim to preserve their role as world regulators through the accreditation of their own standards, which already govern a large portion of international trade.

The main economies' decision to invest in high-potential free trade agreements was partly influenced by cyclical factors. At a time of stringent constraints on public expenditure, these agreements represent tools for stimulating economic activity and international trade that do not weigh directly on the state finances.

The attention paid by national public opinion and governments to the major regional agreements has rekindled the debate on their implications for the advancement of the Doha Development Agenda. The conclusion of a first multilateral accord last December appears to signal that the new major regional talks have raised political pressure and made it more imperative to finalize the Doha Round.

Commodity prices

The prices of the main commodities showed little variation overall in 2013, falling by barely 1.6 per cent compared with 2012. Specific factors in the individual sectors, such as poor harvests for food commodities, the moderation of demand for metals in China, and the gradual shift in oil supply towards crude oil extracted using more costly techniques prevailed over common determinants, leading to a growing differentiation of price trends throughout the year.

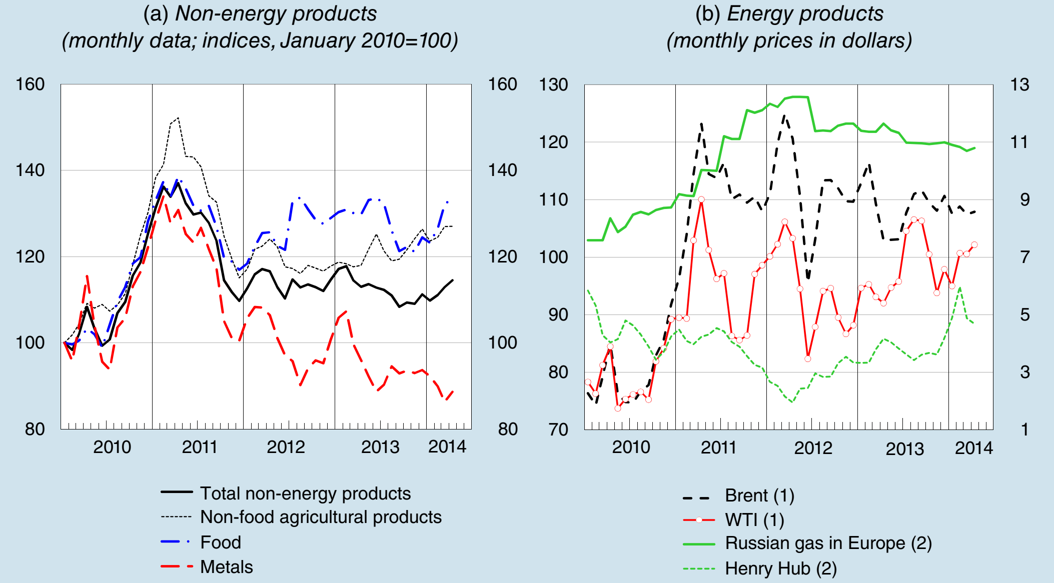
The base metals price index fell by 4.2 per cent owing to the pressure exerted, in the first half of the year, by the slowdown in industrial activity in China. Prices stabilized from the summer onwards, with the improvement in the global outlook (Figure 3.2.a).

Agricultural commodity prices rose by 1.2 per cent; the upward trend, under way since the start of 2012, was interrupted briefly in the second half of the year, when good harvests of grain in Russia and of rice in the Asian producing countries drove prices downward.

In the energy sector, in 2013 there continued to be substantial differences in price levels and trends between the world's main geographical areas. The average price of natural gas in the United States at the Henry Hub pricing point in Louisiana rose to \$3.7 per million BTU, from the all-time low of \$2.7 recorded in 2012. The increase brought the market price into line with the average effective cost of using non-conventional extraction methods (around \$4 per million BTU), making it possible to reactivate numerous extraction sites. Elsewhere in the world, despite the fall induced by lower demand, prices remained higher at \$11.2 and \$17.8 per million BTU in Europe and Asia respectively, reflecting the anchoring to crude oil prices, which dominates in Asian supply contracts and also features in some in Europe (Figure 3.2.b).

Figure 3.2

Commodity prices



Source: IMF.
(1) For WTI and Brent crude, dollars per barrel. – (2) Right-hand scale. For natural gas, dollars per million BTU. Henry Hub is the benchmark for the US market; Russian gas in Europe is that imported into Germany from Russia, the benchmark for the European market.

The average prices of the three main grades of crude oil continued to fluctuate around $104.1 a barrel, with a modest fall of 0.9 per cent with respect to 2012. Prices were sustained by the widespread stoppages in production in North Africa and the Middle East.

With respect to 2011 and 2012, last year the spread between Brent, the benchmark for the European market and in part for the Asian market, and WTI, the benchmark for the United States, narrowed by almost one third to $10.9 a barrel.

In the early months of 2013 the opening of some oil pipelines that carry crude oil from the central areas of the United States to the Gulf of Mexico pushed up the price of WTI; at the same time, the slowdown in activity in Asia is likely to have curbed the price of Brent, fostering a narrowing of the differential between the two grades to a low of $3.2 a barrel in July. The subsequent widening, with the recovery in global economic activity in the second half of the year, indicates that the differential could remain positive at least until the end of the year, by which time all the new American pipelines are expected to be fully operational.

Despite the drop in production by the OPEC countries (down by 700,000 barrels a day, equal to 0.8 per cent of world supply), in 2013 the crude oil market recorded an excess of supply equal to 0.2 per cent of world demand. This was entirely due to the annual increase in fracking in the United States (1.1 million barrels per day), which surpassed the projections of the US Energy Information Administration. The shift in supply towards non-conventional energy sources, with high extraction costs, nonetheless prevented a lowering of the market prices.

Global oil demand expanded at an average rate of 1.3 per cent for the year. The return to growth of consumption in the United States (2.1 per cent) more than offset the decline in the other advanced countries and weaker growth in the emerging countries as a whole (2.5 per cent). The latter was almost entirely accounted for by the modest rate of growth in Chinese consumption, the lowest since 2008 (2.0 per cent, compared with 6.5 per cent in 2012).

In the early months of 2014 metal prices fell again, in connection with the weakening of industrial activity in Asia. The price index of food rose following the tensions that exploded between Russia and Ukraine, the third-largest grain exporters in the world after the United States and the European Union. By contrast, the energy commodity markets have not yet reacted to the fears about the potential effects of a tightening of the sanctions imposed on Russia by the US and the EU. Any repercussions would be more severe in the gas market, given the limited substitutability of supply sources in the near term.

Gas and oil prices were influenced by the weather conditions in the early months of 2014: price increases in the United States reflected the extremely cold winter while mild weather depressed prices in Europe.

Balance of payments disequilibria

Against a backdrop of weak global growth and relatively stable oil prices, in 2013 global disequilibria continued to moderate. The current account surpluses of China, Japan and the main oil exporters all narrowed, as did the deficit of the United States.

The US deficit on current account fell to 2.3 per cent of GDP, the lowest in more than 15 years. This trend mainly reflected the further contraction of more than 20 per cent ($59 billion) in the energy deficit, which occurred despite the increase in domestic consumption, and the larger surplus on services. Part of these gains were reabsorbed by the higher deficit on trade in non-energy goods, which expanded by $19.6 billion. The positive contribution from the balance on income was marginal.

The geographical breakdown of the US balance on current account is consistent with the aggregate situation: the deficits with China, Japan and the euro area fell slightly, and trade balances remained virtually unchanged with respect to 2012; the current account deficit with oil-exporting countries declined by almost 40 per cent in 2013 (to just over one quarter of the peak recorded in 2008).

Net foreign capital inflows rose to $906 billion. In contrast to 2012, last year private capital funded the bulk of the US current account deficit; inflows from foreign official authorities weakened, dropping to a similar level to that of the two years 2010-11 (30 per cent of total net inflows). After declining in 2012 the *other investment* item, which includes bank movements, strengthened considerably ($350 billion). Net purchases of debt securities also expanded, albeit to a lesser extent (up by 6.4 per cent to $526 billion), as did foreign direct investment. At the same time, there was a heavy outflow of capital portfolio investment in US shares (Table 3.1).

Table 3.1

Balance of payments of the United States: net capital inflows from non-residents (1)
(billions of dollars)

	2009	2010	2011	2012	2013
Total	315.1	1333.9	969.0	543.9	906.1
by type of flow					
Direct investment	150.4	205.9	230.2	166.4	193.4
Portfolio investment	484.9	873.3	413.0	726.6	435.3
of which: shares	*219.3*	*179.0*	*133.7*	*232.1*	*-90.2*
debt instruments	*265.6*	*694.3*	*279.3*	*494.5*	*525.5*
Other investment	-320.3	254.8	325.8	-349.1	277.4
by foreign investor					
Private	-165.2	935.6	715.2	150.0	622.3
Official authorities	480.3	398.3	253.8	393.9	283.7
Memorandum items:					
Balance on current account	-381.6	-449.5	-457.7	-440.4	-379.3
Balance on capital account	-0.1	-0.2	-1.2	7.0	-0.4
Balance on financial account (2)	231.1	438.0	551.7	439.4	351.2
Direct investment	-159.9	-95.2	-178.8	-221.9	-166.3
Portfolio investment	257.9	734.2	269.2	581.7	46.4
Other investment	140.5	-213.2	442.2	91.0	469.9
Derivatives transactions	44.8	14.1	35.0	-7.1	-1.9
Change in reserves	-52.3	-1.8	-15.9	-4.5	3.1
Errors and omissions	150.8	11.6	-92.8	-5.9	28.5

Source: Bureau of Economic Analysis.
(1) Net of disinvestment. – (2) Net inflows from non-residents minus net outflows from residents.

Last year the current account surplus of the oil-exporting countries fell to 7.4 per cent of GDP from 10.4 per cent in 2012. The drop, widespread among the OPEC countries, was most pronounced for Saudi Arabia ($35 billion) and Libya ($31 billion). Among the other exporters Russia also recorded a sharp fall, with oil revenues down by more than half from 2012.

The current account surplus of the euro area rose to 2.4 per cent of GDP from 1.4 per cent in 2012, reflecting very different positions across the area: the persistent weakness of consumption, especially in the countries held back by the recession, contrasted with more robust growth in demand from the rest of the world. Almost all the member countries recorded larger surpluses or smaller deficits on their current accounts; Spain and Italy swung from deficit to surplus; there were large surpluses again in Germany and the Netherlands.

In concomitance with the weak recovery of international trade, the current account surplus of Asia's economies showed renewed moderate growth (2.1 per cent of GDP, as against 1.8 per cent in the previous two years), driven by the newly industrialized countries. That of Japan narrowed again (0.7 per cent of GDP), falling to barely one third of the peak recorded in 2011, owing to the increased foreign energy dependency following the accident at the Fukushima nuclear power station and the depreciation of the yen. Imports of refined petroleum products rose to 3.7 per cent of GDP in 2013, from the low of 2.4 per cent recorded in 2010.

In China the current account surplus narrowed slightly in nominal terms compared with 2012 ($189 billion), falling to 2.1 per cent of GDP. The merchandise trade surplus registered a modest increase, barely offsetting the higher deficit on services.

As a share of GDP, China's current account balance has fallen continually from the all-time high of 10 per cent in 2007. In the two years 2009-10 this trend was driven by a drop in exports and an increase in imports of goods, especially commodities, thanks in part to the policies to stimulate demand. More recently, the lower growth rate of world trade in goods was accompanied by a sharp expansion in imports of services, the deficit on which in 2013 ($122 billion) was four times that of 2010. The aggregate performance primarily reflects that of tourist services, which account for 72 per cent of the increase in the deficit with respect to 2012. Transport services, which are partly related to tourism and represent the second largest component in the services trade balance, account for the remainder.

In 2013 the build-up of foreign currency reserves worldwide amounted to $513 billion, half the highest levels recorded in the three years 2009-11. It was entirely attributable to currency purchases by China, which rose to $508 billion. Even adjusted for valuation effects, net purchases by the People's Bank of China on the currency market were still considerable, at around $480 billion.

Elsewhere in Asia the accumulation of reserves in 2013 was negligible, equal to barely 5 per cent of the average rate of growth in the four years 2009-12. As in other emerging economies, this trend reflected interventions on the currency markets to combat the effect of capital outflows on the exchange rate and the excessive volatility of national currencies in the months following the announcement of tapering in the United States.

The oil-exporting countries' foreign currency reserves diminished by almost $50 billion with respect to 2012, the first yearly decrease since the global crisis. Around three quarters of the fall was concentrated in Libya, Nigeria and Russia.

4. INTERNATIONAL ECONOMIC COOPERATION

In 2013 the international community and major financial institutions remained committed to fostering global growth. The IMF approved new programmes of financial assistance. Pending ratification by the United States, the 14th General Review of Quotas and the reform of the Fund's governance, both approved by the Board of Governors in December 2010, have not yet entered into force.

The G20 maintained its role as economic policy coordinator, with the activities of its working group on the Framework for Strong, Sustainable and Balanced Growth. In 2014 Australia's G20 Presidency pledged to give fresh impetus to the process, aiming to make the G20 the main forum for the design and coordination of economic policies for growth. In this context the G20 redoubled its efforts to facilitate investment in infrastructure and by small and medium-sized enterprises.

In 2013, as part of the G20 development agenda, efforts to promote financial inclusion were intensified. Under the aegis of the United Nations consultations continued for the definition of new guidelines to replace the Millennium Development Goals approved in 2000 by the General Assembly with a target date of 2015. The World Bank launched a thoroughgoing organizational and financial reform to support its strategic goals, announced in 2013, to end extreme poverty and provide income support to the most vulnerable members of the world's population. Official development assistance grew again last year after declines in 2011 and 2012 owing essentially to donor countries' measures to correct their public finances.

IMF support for member countries and ongoing reforms

IMF resources and loans to member countries. – In 2013 and in the first four months of 2014 the IMF approved eight new financial assistance programmes for a total of SDR 20.1 billion, equal to around $32 billion. It also renewed two Flexible Credit Lines – to Poland for SDR 22 billion and Colombia for SDR 3.9 billion. The renewals extended the programmes by two years, bringing the total duration of the Fund's commitment to these countries to six years from their first subscription in 2009.

At the end of April the stock of IMF credit outstanding under Stand-By Arrangements (SBAs) and Extended Fund Facilities (EFFs) was slightly lower than in past years, at around SDR 81 billion. On the same date, the stock of financial resources committed by the IMF for loans to member countries came to almost SDR 195 billion, of which 40 per cent was available under precautionary programmes.

The IMF's financial resources normally come from the quotas of member countries, whose total amount and individual size are periodically reviewed. In recent years, in response to the increase in potential demand for funds and ahead of the entry into force of the 14th General Review of Quotas, the Fund has utilized additional, temporary sources of funding: the New Arrangements to Borrow (NAB) and bilateral loans. In April 2014 the NAB, which were activated in April 2011 and have remained in place since then, were renewed for a further six months, giving the Fund access to resources amounting to almost SDR 166 billion. These resources represent some 60 per cent of the IMF's present twelve-month Forward Commitment Capacity (FCC) of SDR 265 billion. At the 2012 Los Cabos summit, 38 countries pledged a further SDR 300 billion ($460 billion) in bilateral loans; by April 2014 the bilateral agreements had been signed by 31 countries, for a total of SDR 276 billion. These resources represent a second line of defence since they can only be deployed if the FCC, defined taking account of the quotas and accessible resources following the activation of the NAB, falls below SDR 100 billion.

In the future the growth of the Fund's resources will depend on the entry into force of the 14th General Review of Quotas. If ratified, its total quotas would be doubled, the NAB would be reduced by an equivalent amount, and the FCC would remain largely unchanged. If it is not ratified, the Fund's financing capacity is likely to remain mostly reliant on the renewal of the NAB and bilateral loans; the latter, however, will begin to fall due at the end of 2015, unless the countries that signed the related agreements decide to extend them for another year.

IMF quotas and governance. – The reform of the Fund's quotas and governance is at an impasse, owing to the failed adoption of the amendments approved in December 2010. The reforms have not yet been ratified by the United States which, with 16.75 per cent of the total votes, has a de facto veto. The hold-up is also blocking the start of negotiations on the 15th General Review of Quotas which, under the Fund's Articles of Agreement, should be completed by 15 December 2015. At the Washington meeting of Finance Ministers and Central Bank Governors in April, the G20 asked the IMF to develop a contingency plan in case the reforms are not ratified by the United States and thus do not take effect by the end of 2014.

G20 initiatives

Framework for Strong, Sustainable and Balanced Growth. – In 2013 work continued on the project launched in 2009 to coordinate and reciprocally evaluate the national macroeconomic policies of G20 countries. At last September's summit in St. Petersburg, the countries assessed the progress made in implementing past economic policy commitments under the Accountability Assessment Framework and drew up an action plan for the following year. This sets out the economic policy measures proposed by each member country to address near-term risks to recovery and the reforms they intend to undertake to strengthen long-term growth prospects. These reforms must aim to ensure the sustainability of public accounts, encourage investment, raise productivity levels and the labour force participation rate, and correct internal and external imbalances.

Australia's G20 Presidency put growth and the reinforcement of the global economy's resilience to shocks at the centre of its agenda. In particular, it aimed to impart new impetus to macroeconomic coordination by setting a concrete, measurable target for world economic growth. Last February the G20 countries accordingly pledged to to lift their collective GDP by more than 2 percent above the trajectory implied by current policies and forecast by the IMF for the five-year period 2014-18. This would mean raising the annual growth rate of the G20 economies by 0.5 percentage points on average.

To reach this objective, the countries were called on to present their strategies for growth, which will be collectively examined and assessed during the year before being presented at November's Brisbane summit. As regards content, four main areas of interest were identified: investment (above all in infrastructure), employment (especially the participation rate), trade and competition.

Long-term investment finance. – In 2013 a specially convened G20 Study Group on Financing for Investment analysed the factors affecting trends in lending for long-term investments. Amongst other things, the analysis highlighted the need for policies to promote both the role of banking systems and that of the capital markets in financing investment.

For 2014 Australia's G20 Presidency has resolved to translate the results of the study group's analysis into a set of concrete commitments. In particular, it intends to emphasize investment in infrastructure and SMEs with a view to raising growth potential and supporting job creation. With this objective in mind, it established the new Investment and Infrastructure Working Group to develop proposals for the Brisbane summit. These will include (a) a series of commitments by each member country to improve the business climate for investment; (b) channelling international private savings to investment in infrastructure, in part by facilitating access to credit for SMEs; (c) optimizing the contribution of the multilateral development banks; and (d) streamlining the procedures for investment in public-private partnership initiatives.

Public debt management. – In February 2013 the G20 called on the IMF and the World Bank to revise the guidelines for public debt management, which were introduced in 2001 and amended in 2003. The updated version published by the IMF last April takes account of the growing complexity of the international financial markets and the extraordinary increase in public debt issuance worldwide in the past decade. New guidelines have been introduced to promote (a) a clearer definition of the roles and responsibilities of public debt managers; (b) better communication with investors; (c) greater recourse to collective action clauses in sovereign debt contracts; (d) the reinforcement of risk containment strategies; (e) stress tests; and (f) greater liquidity in national debt markets.

Policies for development and poverty reduction

The G20's development agenda. – The G20's work on development continued along the lines established by the Seoul Development Consensus for Shared Growth, on the assumption that the reduction of poverty can be achieved through strong, inclusive and sustainable growth. The agenda's fulfilment was entrusted to the Development Working Group (DWG), based on a specific Multi-Year Action Plan on Development (MYAP).

In 2013 Russia's G20 Presidency encouraged the DWG to carry out an assessment of its first three years of activity. It collected all the declarations made on development-related issues in the 2010 MYAP, and in the press releases from the 2011 and 2012 summits, and verified their state of implementation. The assessment found that of a total of 67 undertakings 33 had been accomplished and 33 were in the process of being accomplished; in just one case there was no follow-up.

An important line of action in the G20's development agenda relates to the extension of access to financial services for the world's poorest people (financial inclusion). In 2013 the Global Partnership for Financial Inclusion (GPFI), a permanent discussion group established by the G20, focused on the need to strengthen consumer protection and increase financial education. For 2014 Australia's G20 Presidency is aiming to direct the GPFI's activity towards the development of inclusive payment systems, including through the spread of innovative instruments.

The Millennium Development Goals. – According to UN estimates, only a handful of the 21 points identified in the eight Millennium Development Goals will be achieved or nearly achieved by the 2015 target date. In particular, progress on environmental sustainability, universal primary education, maternal health, child mortality, and the treatment and prevention of AIDs is still insufficient.

The activities of the main multilateral development banks. – In the financial year ending June 2013 the World Bank approved new loans worth $31.6 billion, continuing the downward trend with respect to the exceptional amounts approved immediately after the crisis to combat the effects of the resulting global recession. In 2013 new financing and co-financing operations approved by the Asian Development Bank amounted to $21 billion, unchanged from 2012. The Inter-American Development Bank approved new loans and underwrote guarantees for a total of $13.3 billion, up by 23 per cent from 2012.

In 2013 the World Bank launched two new strategic objectives: to bring the share of those below the poverty line in the developing countries to less than 3 per cent of the population by 2030 and to boost income growth for the poorest 40 per cent in each country. Following the recent revision of the national accounts data for several big emerging and developing economies, and based on the new purchasing power parity estimates, the share of the world's population living in poverty could be revised significantly downwards.

Bilateral assistance. – Based on OECD estimates in 2013 the net flows of official development assistance, measured at constant prices and exchange rates (2012), reached an all-time high of $134.7 billion, up by more than 6 per cent on the previous year. After falling for two years in a row in connection with efforts by many donor countries to correct their public accounts, aid was expanded last year by 17 of the 28 members of the Development Assistance Committee (DAC).

MACROECONOMIC DEVELOPMENTS, BUDGETARY POLICIES AND MONETARY POLICY IN THE EURO AREA

5. MACROECONOMIC DEVELOPMENTS

A gradual, export-led recovery of economic activity, still hesitant and uneven, got under way in the euro area in 2013. From the spring onwards it spread progressively to several of the countries most exposed to the sovereign debt crisis. On an annual basis GDP contracted slightly.

The current account imbalances within the area continued to diminish, especially those of the economies that had been in deficit; the trade balances of the countries that had run large deficits in the preceding years improved, while the very large surpluses of Germany and the Netherlands did not shrink.

Consumer price inflation came down appreciably in 2013, to well below the Eurosystem's definition of price stability, and reached a low of 0.5 per cent in March 2014. This reflected not only the trend of the more volatile items (energy and food) but also that of core inflation, which fell to historically low levels in response to the protracted weakness of the economy. Part of the reduction in inflation reflects a heightened cyclical sensitivity of prices.

The decline in inflation was steeper than expected, prompting professional forecasters to make repeated downward revisions to their estimates of 2014 inflation, which in the latest surveys were just below 1.0 per cent. Analysts expect consumer price inflation to remain well below 2.0 per cent in both 2015 and 2016.

The euro area

In 2013 euro-area GDP contracted by 0.4 per cent, slightly less than in 2012 (Table 5.1). Economic activity expanded slightly in Germany and France, with gains of 0.4 and 0.3 per cent respectively, while in Spain and Italy it declined again, though less sharply than in the previous year, falling by 1.2 and 1.9 per cent respectively. Among the countries subject to assistance programmes, Greece and Portugal recorded significantly better, though still negative, changes in GDP.

Euro-area GDP was sustained by exports of goods and services, which grew by 1.3 per cent, which was less than in 2012. The slowdown reflected both the loss of competitiveness due to the nominal appreciation of the euro and the modest expansion of world trade. Measured on the basis of producer prices, from the summer of 2012 onwards competitiveness suffered a cumulative decline of about 4 percentage points in Italy, France and Germany and slightly less than that in Spain (Figure 5.1). Exports accelerated sharply in Spain, expanding by 4.9 per cent; they grew by 0.8 per cent in Germany and 2.2 per cent in France; in Italy the annual change was barely positive, reflecting a temporary dip in the first quarter.

Table 5.1

GDP, imports and the main components of demand in the major euro-area countries (1)
(chain-linked volumes; percentage changes on previous period)

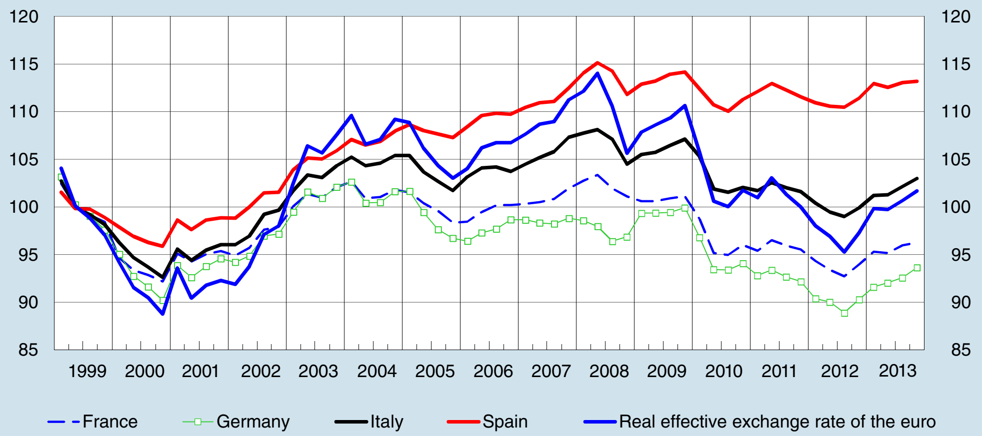
	2011	2012	2013	2013			
				Q1	Q2	Q3	Q4
				GDP			
France (2) (3)	2.1	0.3	0.3	..	0.6	-0.1	0.2
Germany (2)	3.3	0.7	0.4	..	0.7	0.3	0.4
Italy (2)	0.4	-2.4	-1.9	-0.6	-0.3	-0.1	0.1
Spain (2) (3)	0.1	-1.6	-1.2	-0.3	-0.1	0.1	0.2
Euro area (2) (4)	1.6	-0.7	-0.4	-0.2	0.3	0.1	0.2
				Imports			
France (3)	6.3	-1.3	1.7	0.5	1.7	1.2	0.5
Germany	7.4	1.4	0.9	-0.5	1.9	0.8	0.6
Italy	0.8	-7.0	-2.8	-1.0	-0.2	0.9	0.2
Spain (3)	-0.1	-5.7	0.4	-4.6	6.1	2.1	-0.6
Euro area (4)	4.5	-0.9	-0.1	-1.2	1.7	0.9	0.5
				Exports			
France (3)	6.9	1.1	2.2	0.3	2.7	-0.4	1.6
Germany	8.0	3.2	0.8	-1.0	2.4	0.2	2.6
Italy	6.2	2.1	0.1	-1.3	0.6	0.5	1.2
Spain (3)	7.6	2.1	4.9	-4.5	7.0	0.6	0.8
Euro area (4)	6.5	2.5	1.3	-0.9	2.4	0.1	1.3
				Household consumption (5)			
France (3)	0.6	-0.3	0.3	0.4	0.2	-0.1	0.2
Germany	2.3	0.8	0.9	0.3	0.6	0.2	-0.1
Italy	-0.3	-4.0	-2.6	-0.6	-0.6	-0.2	-0.1
Spain (3)	-1.2	-2.8	-2.1	-0.4	0.1	0.5	0.5
Euro area (4)	0.3	-1.3	-0.7	-0.2	0.1	0.1	0.1
				Government consumption			
France (3)	2.4	3.1	3.4	0.4	0.8	0.3	0.5
Germany	1.0	1.0	0.7	0.2	-0.4	1.2	..
Italy	-1.3	-2.6	-0.8	..	-0.1	-0.2	0.2
Spain (3)	-0.5	-4.8	-2.3	1.0	-1.1	0.6	-3.9
Euro area (4)	-0.1	-0.6	0.1	0.2	-0.1	0.4	-0.3
				Gross fixed investment			
France (3)	2.1	0.3	-1.0	-0.4	0.2	-0.2	-0.1
Germany	6.9	-2.1	-0.7	-1.4	1.2	1.3	1.4
Italy	-2.2	-8.0	-4.7	-2.8	0.1	-0.6	0.9
Spain (3)	-5.4	-7.0	-5.1	-1.2	-1.9	0.7	0.7
Euro area (4)	1.6	-4.0	-3.1	-1.7	0.1	0.5	1.0
				National demand (6)			
France (3)	2.2	..	0.5	0.1	0.4	0.4	-0.1
Germany	2.8	-0.3	0.7	0.3	0.4	0.6	-0.7
Italy	-1.0	-5.0	-2.7	-0.5	-0.5	..	-0.2
Spain (3)	-2.1	-4.1	-2.8	-0.3	-0.6	0.5	-0.3
Euro area (4)	0.7	-2.2	-1.1	-0.3	..	0.5	-0.2

Sources: Based on national statistics and Eurostat data.
(1) The quarterly data are adjusted for seasonal and calendar effects. – (2) The quarterly data include information made available after the publication of the full set of national accounts. – (3) The annual percentage change is based on raw quarterly data. – (4) The aggregate for the euro area relates to 18 countries. – (5) Consumption of resident households and non-profit institutions serving households. – (6) Includes changes in stocks and valuables.

Figure 5.1

Indicators of competitiveness of the major euro-area countries and the real effective exchange rate of the euro based on the producer prices of manufactures (1)

(indices, 1999=100)



Sources: Bank of Italy and, for the real effective exchange rate of the euro, ECB.
(1) An increase indicates a loss of competitiveness. The indicators of competitiveness are calculated vis-à-vis 61 competitor countries, including the members of the euro area; the real exchange rate of the euro is calculated vis-à-vis 20 non-euro-area competitor countries.

Imports remained unchanged at the 2012 level. Over the year as a whole, the contribution of foreign trade to the growth in the area's GDP amounted to 0.6 percentage points, the smallest since 2009.

The annual contraction in euro-area domestic demand eased to 1.1 per cent. The 0.7 per cent fall in household expenditure was half that of the previous year, thanks to a moderate revival from the spring onwards. However, developments differed among the largest countries, with household consumption growing by 0.9 per cent in Germany and 0.3 per cent in France but falling by 2.6 per cent in Italy and 2.1 per cent in Spain. Household behaviour was affected by the fifth consecutive annual decline in real disposable income (down by 0.6 per cent for the year and by a cumulative 3.2 per cent between 2008 and 2012), which suffered from the contraction in employment in most of the area's countries.

Households' propensity to save stabilized in 2013 at historically low levels (13.1 per cent). The household saving rate fell slightly in Germany (to 16.2 per cent) and held steady in France and Spain, while in Italy it rose for the first time since 2004.

Gross fixed investment diminished for the second year in a row, its decline of 3.1 per cent reflecting the difficulty of obtaining finance and ample margins of spare capacity. The crisis, the most severe since the Second World War, has deeply eroded the propensity to invest of the area's largest economies. Compared with 2007, the ratio of investment to GDP at current prices was lower last year by 1 percentage point in Germany, by 2 points in France, by 4 in Italy and by 13 in Spain.

Investment in machinery and equipment, though down again on average for the year by 1.8 per cent, began to expand again in the second half, benefiting from improving business sentiment and easier conditions in the financial markets.

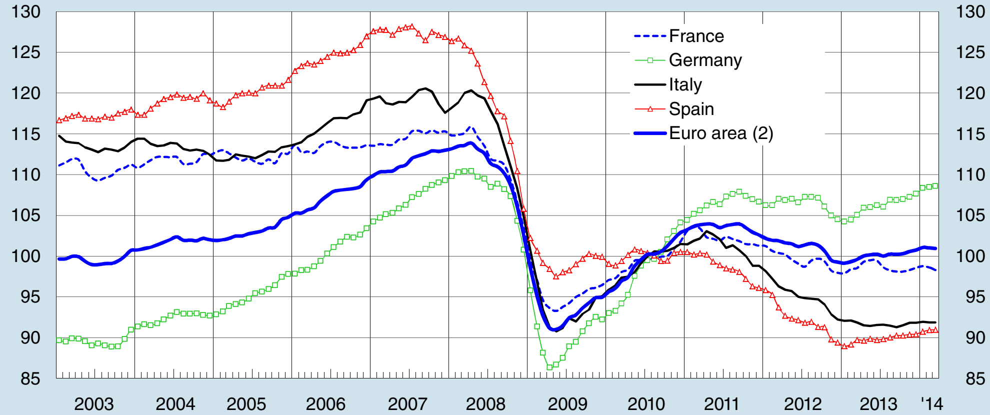
Construction investment continued to decline, with a contraction of 4.1 per cent. Difficulties in the property markets in many countries of the area persisted.

Industrial production in the area fell by 0.7 per cent in 2013 as a whole but gradually revived in the course of the year. The upward trend persisted in the first quarter of 2014, although it was modest (Figure 5.2), and the latest cyclical indicators suggest it will continue in the coming months.

Figure 5.2

Industrial production in the major euro-area countries (1)

(moving averages for the 3 months ending in the reference month)



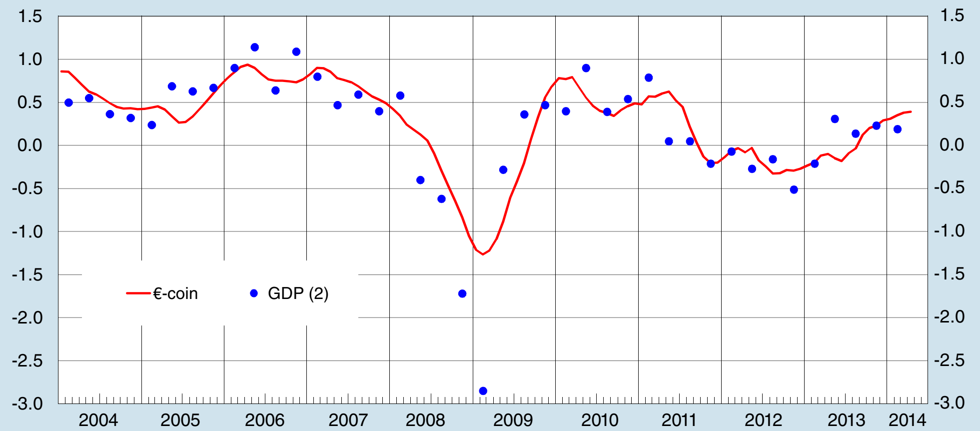
Sources: Based on Istat and Eurostat data.
(1) Indices, 2010=100; seasonally adjusted data. – (2) The aggregate for the euro area relates to 18 countries.

In the first quarter of 2014 the area's GDP grew by 0.2 per cent compared with the previous quarter, boosted by the large increase in Germany (0.8 per cent) thanks in part to good weather. Output was nearly flat in Italy (-0.1 per cent) and unchanged in France, while in Spain it rose by 0.4 per cent.

Figure 5.3

Coincident cyclical indicator (€-coin) and euro-area GDP (1)

(3-month percentage changes)



Fonte: Bank of Italy and Eurostat.
(1) For details on the €-coin indicator, see http://eurocoin.bancaditalia.it. – (2) The aggregate for the euro area relates to 18 countries.

The €-coin indicator, with which the Bank of Italy provides monthly estimates of the performance of euro-area GDP adjusted for short-term volatility, signalled a decline in economic activity through August 2013 and then rose gradually, entering slightly positive territory for the first time since the summer of 2011 in the final months of the year. The indicator continued to improve in the first few months of 2014; in April it stabilized at just below 0.4 per cent (Figure 5.3).

Prices and costs

Euro-area inflation, measured by the change in the harmonized index of consumer prices with respect to a year earlier, gradually subsided during 2013, from 2.0 per cent in January to just below 1.0 per cent in the final months of the year; it averaged 1.4 per cent for the year, compared with 2.5 per cent in 2012 (Table 5.2). Inflation continued to fall in the first quarter of 2014, reaching 0.5 per cent in March, and then rose to 0.7 per cent in April, a level from which analysts expect it to rise very modestly over the rest of the year.

Table 5.2

Inflation indicators in the major euro-area countries
(percentage changes on previous year)

	France			Germany			Italy			Spain			Euro area		
	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
Consumer prices (1)															
Overall index	2.3	2.2	2.0	2.5	2.1	1.6	2.9	3.3	1.3	3.1	2.4	1.5	2.7	2.5	1.4
Index excluding food and energy products	1.1	1.5	0.7	1.2	1.3	1.2	2.0	2.0	1.3	1.2	1.3	1.3	1.4	1.5	1.1
of which: goods	*0.5*	*1.3*	*0.2*	*1.0*	*1.3*	*0.7*	*1.4*	*1.8*	*0.6*	*0.5*	*1.0*	*1.1*	*0.8*	*1.2*	*0.6*
services	*1.6*	*1.6*	*1.0*	*1.4*	*1.3*	*1.5*	*2.5*	*2.2*	*1.6*	*1.6*	*1.5*	*1.3*	*1.8*	*1.8*	*1.4*
Food products	2.3	3.3	1.9	2.5	3.2	3.4	2.7	3.1	2.0	2.8	2.6	3.2	2.7	3.1	2.7
of which: processed	*2.9*	*3.1*	*1.4*	*3.0*	*2.6*	*2.6*	*2.9*	*3.6*	*1.5*	*4.2*	*3.5*	*3.1*	*3.3*	*3.1*	*2.2*
unprocessed	*1.4*	*3.7*	*2.9*	*1.4*	*4.5*	*5.0*	*2.5*	*2.4*	*2.7*	*1.3*	*1.6*	*3.4*	*1.8*	*3.0*	*3.5*
Energy products	12.0	5.2	0.9	10.0	5.6	1.8	11.2	13.9	-0.2	15.7	8.8	0.0	11.9	7.6	0.6
Producer prices (2)	**5.4**	**2.8**	**0.3**	**5.1**	**1.7**	**0.0**	**5.1**	**4.1**	**-1.2**	**6.9**	**3.8**	**0.6**	**5.7**	**2.8**	**-0.2**

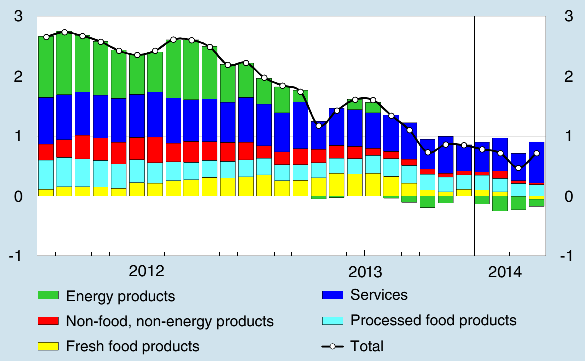
Source: Based and Eurostat data.
(1) Harmonized index of consumer prices. – (2) Producer price index for industrial products sold in the domestic market.

A contribution to disinflation came from the core component, the increase in which fell to 0.7 per cent at the end of 2013, the lowest level since the launch of the euro. The reduction involved both services and goods other than energy and food products (Figure 5.4). The more volatile items (energy and food) also played a part: the rate of growth in the prices of energy products decreased by about 5 percentage points between the opening months of 2013 and those of 2014, in relation to a moderate decline in the euro prices of oil products, while that of unprocessed foods, which had stood at about 5.0 per cent at the beginning of 2013, turned negative (Figure 5.4).

The weakness of inflation is an area-wide phenomenon. The overall index has decelerated in all the member countries since the start of 2013. This trend has been particularly accentuated in the economies most directly hit by the sovereign debt crisis: in the first few months of 2014 the change in prices with respect to a year earlier was negative in Greece, Cyprus, Spain and Portugal and low by historical standards in Italy.

Figure 5.4

Inflation in the euro area and contributions of its components (1)
(12-month percentage changes and percentage points)



Source: Based on Eurostat data.
(1) Harmonized index of consumer prices.

Table 5.3

Unit labour costs and their components in the major euro-area countries (1)
(percentage changes on previous year)

	Hourly labour costs		Hourly productivity		Value added (2)		Hours worked		Unit labour costs	
	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013
					Industry excluding construction (3)					
France	2.9	1.2	1.5	0.8	0.9	-0.4	-0.6	-1.2	1.3	0.4
Germany	3.9	2.1	-0.2	-0.7	-0.4	0.0	-0.2	0.7	4.1	2.8
Italy	2.8	1.7	-0.2	-2.1	-3.0	-3.2	-2.8	-1.1	3.0	3.9
Spain	-0.7	-0.1	2.4	3.0	-2.0	-0.2	-4.3	-3.1	-3.0	-3.0
Portugal	2.6	0.9	5.4	4.1	-0.5	-1.2	-5.5	-5.1	-2.7	-3.1
Euro area	3.6	2.2	1.0	0.5	-1.1	-0.7	-2.1	-1.2	2.6	1.7
					Services (4)					
France	2.7	1.9	1.7	1.2	1.3	1.1	-0.4	-0.1	0.9	0.7
Germany	3.2	2.5	1.0	0.6	1.4	0.7	0.4	0.1	2.1	1.9
Italy	0.5	1.0	-1.5	0.5	-1.6	-0.9	-0.2	-1.4	1.9	0.5
Spain	-4.8	3.0	0.4	-0.3	-1.4	-0.6	-1.8	-0.3	-5.2	3.3
Portugal	-0.5	0.2	3.1	1.4	-0.3	-0.5	-3.3	-1.9	-3.5	-1.2
Euro area	2.1	1.7	0.7	0.8	0.0	0.0	-0.7	-0.7	1.4	1.0
					Total economy					
France	2.6	1.7	1.3	0.9	0.9	0.6	-0.3	-0.3	1.3	0.7
Germany	3.3	2.2	0.5	0.3	0.8	0.5	0.2	0.2	2.7	1.9
Italy	1.2	1.4	-0.7	0.4	-2.2	-1.6	-1.4	-2.0	2.0	1.0
Spain	-3.2	2.3	1.5	0.9	-2.3	-1.2	-3.7	-2.1	-4.6	1.4
Portugal	0.4	0.3	3.8	1.6	-1.3	-1.4	-4.9	-3.0	-3.2	-1.3
Euro area	2.6	1.9	0.9	0.8	-0.5	-0.4	-1.4	-1.1	1.7	1.1

Sources: Based on Eurostat data; for Italy, based on Istat data.
(1) On the basis of the number of hours worked. For France, Portugal and Spain (in the latter case only for *Industry excluding construction* and *services*), annual percentage change on the basis of raw quarterly data. – (2) Added value at base prices, chain-linked volumes, reference year 2005. – (3) Manufacturing, mining and quarrying, and electricity generation and distribution. – (4) *Wholesale and retail trade, transport* and *telecommunication*; *financial and real-estate services*; *other services*.

Table 5.4

Inflation expectations in the euro-area surveyed by Consensus Economics (1)

	2014	2015	2016	2017	2018	2019	2020-24
France	0.8	1.3	1.5	1.6	1.7	1.7	1.8
Germany	1.3	1.9	2.0	2.0	1.9	1.9	1.9
Italy	0.8	1.1	1.7	2.0	1.9	1.5	2.0
Spain	0.3	0.9	1.5	1.7	1.9	1.8	1.7
Euro area	0.8	1.3	1.5	1.7	1.8	1.9	2.0

Source: Consensus Economics.
(1) Forecasts made in May 2014 for the two years 2014 and 2015, in April for the subsequent horizons.

Producer prices, costs and margins. – Producer price inflation also diminished progressively during 2013. The index of producer prices of products sold on the domestic market, which showed a twelve-month increase of about 1.5 per cent at the start of 2013, recorded significant declines compared with corresponding periods of the previous year from the summer onwards. The downward pressure on producer prices persisted in 2014: in March the twelve-month change in the overall index was negative by 1.6 per cent.

The rate of growth in unit labour costs in the entire economy slowed in 2013 to 1.1 per cent (Table 5.3). The change with respect to a year earlier diminished continually as the year progressed, reaching 0.5 per cent in the fourth quarter. One factor was the slowdown in compensation per hour worked, which outweighed the slight deterioration in productivity.

Inflation expectations. – The larger than expected fall in inflation showed up in the short- and medium-term forecasts of the professional analysts polled by Consensus Forecasts, who between October 2013 and May of this year revised down their inflation forecasts for 2014 by more than half a percentage point, to 0.8 per cent. In the next two years consumer price inflation is expected to remain well below 2.0 per cent, at 1.3 per cent in 2015 and 1.5 per cent in 2016 (Table 5.4). This assessment is consistent with the projections made by the ECB in March. Similar indications derive from the inflation expectations implied by swap contracts.

Employment

According to national accounts data, employment in the euro area fell by 0.9 per cent in 2013. The overall figure masks considerable differences across countries: employment rose by 0.6 per cent in Germany, remained stable in France for the second consecutive year, and diminished again both in Italy (by 2 per cent) and in Spain (by 3 per cent).

The euro-area unemployment rate rose to an average of 12.0 per cent in 2013. This trend was common to all the largest economies of the area except Germany, where unemployment came down modestly. The gradual cyclical improvement in the course of the year was reflected in a stabilization of the seasonally adjusted unemployment rate, which in March of this year stood at 11.8 per cent in the area as a whole, 5.1 per cent in Germany, 10.4 per cent in France, 12.7 per cent in Italy and 25.3 per cent in Spain.

The area-wide unemployment rate for the population aged 15 to 24 increased in line with the overall unemployment rate, though it remained at markedly higher levels, reaching an average of 24.0 per cent in 2013, compared with 23.1 per cent in 2012 and 20.8 per cent in 2011. Pronounced geographical differences are also found in the youth unemployment rate, which was equal to 7.9 per cent in Germany, 24.8 per cent in France, 40.0 per cent in Italy and 55.5 per cent in Spain.

The balance of payments

The area's balance of payments. – In 2013 the surplus on the area's current account reached €227.7 billion, equal to 2.4 per cent of GDP, 1 percentage point more than in 2012 (Table 5.5). The improvement reflected the increase in the trade surplus, which almost doubled (€165.2 billion, up from €89.0 billion in 2012); the chief contributory factor was the 1.8 per cent improvement in the terms of trade connected with the appreciation of the euro and the moderation of commodity prices.

Table 5.5

The balance of payments of the euro area (1)
(billions of euros)

	2007	2008	2009	2010	2011
Current account	**-12.0**	**10.0**	**12.1**	**133.1**	**227.7**
Goods	28.4	14.6	0.9	89.0	165.2
Services	46.9	64.2	77.9	95.0	113.2
Income	9.9	39.3	39.6	56.3	70.3
Transfers	-97.2	-108.1	-106.3	-107.3	-121.1
Capital account	**9.1**	**6.3**	**10.7**	**6.5**	**20.1**
Financial account	**10.3**	**-13.4**	**-50.9**	**-165.0**	**-246.9**
Direct investment	-64.8	-77.4	-101.7	-71.6	-24.9
Portfolio investment	249.6	80.2	238.6	95.4	105.8
Financial derivatives	19.1	10.2	-5.6	5.3	18.2
Other investment	-198.1	-16.0	-172.0	-179.3	-341.7
of which: monetary financial institutions (2)	*63.7*	*-20.9*	*-341.6*	*-111.9*	*-268.5*
Change in official reserves (3)	4.6	-10.5	-10.3	-15.0	-4.4
Errors and omissions	**-7.4**	**-2.8**	**28.2**	**25.5**	**-0.9**

Source: ECB.
(1) The aggregate for the euro area relates to 18 countries. – (2) Excluding the Eurosystem. – (3) A minus sign indicates an increase in reserves.

In conjunction with the widening of the current account surplus, the financial account recorded increased net outflows under the heading of *direct investment* and especially *other investment* (loans, deposits and trade credits), the latter stemming from the reduction in external funding by the area's banking sector.

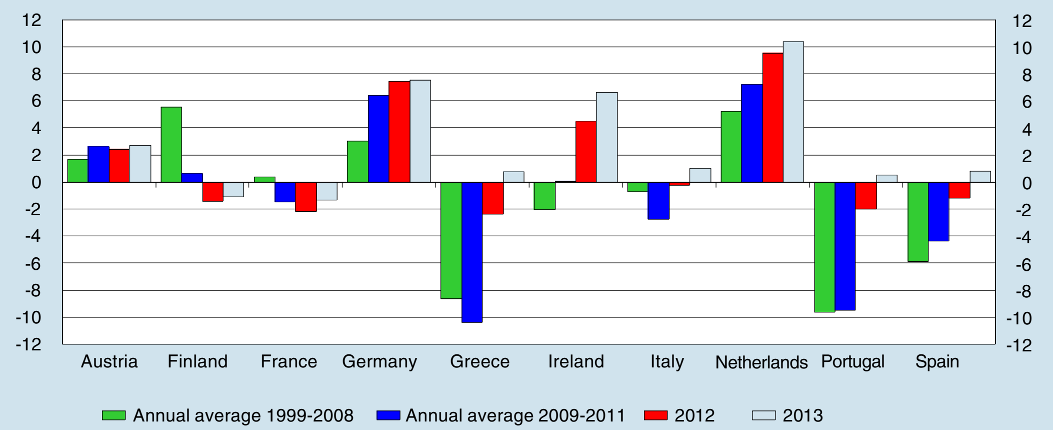
With a current and capital account surplus equal to 2.6 per cent of GDP, the area's net external debtor position improved between the end of 2012 and end-2013, decreasing from 13.2 to 12.1 per cent of GDP.

Individual countries' payment balances. – The reduction of external account imbalances proceeded in 2013. Most of the euro-area countries that had accumulated growing current account deficits in the period before the crisis recorded surpluses, but, as in 2012, there was no reduction in the massive surpluses of Germany and the Netherlands.

In 2013, besides Ireland, whose current account surplus improved further (to 6.6 per cent of GDP, from 4.4 per cent in 2012; Figure 5.5), Spain, Portugal and Greece also recorded surpluses (equal to 0.8, 0.5 and 0.7 per cent of GDP respectively, as against deficits of 1.2, 2.0 and 2.4 per cent in 2012). Italy's current account showed its first surplus since 2001 (1.0 per cent of GDP, compared with a peak deficit of 3.4 per cent in 2010). France's deficit decreased from 2.2 to 1.3 per cent of GDP and Finland's from 1.4 to 1.1 per cent. The Netherlands' already large surplus increased by nearly 1 percentage point of GDP, from 9.5 to 10.4 per cent, while Germany's practically stabilized at 7.5 per cent of GDP.

Figure 5.5

Current account balances of ten euro-area countries
(per cent of GDP; annual averages)



Sources: Based on Bank of Italy and Eurostat data.

In all the countries worst hit by the crisis, the fall in imports due to slumping national demand and the slowdown in the prices of imported products contributed in varying degrees to the adjustment of the current account. In Greece, the extreme case, the improvement in the external accounts between 2007 and 2013 corresponded to a collapse of 33 per cent in purchases of goods from abroad (this €19 billion reduction accounted for more than half of the overall adjustment). In other countries, such as Portugal, Italy and especially Spain, a significant positive contribution also came from the growth in exports of goods. According to the European Commission's most recent estimates, these three countries' current account positions are almost back in balance on a cyclically adjusted basis.

From 2010 to the summer of 2012, Greece, Italy, Portugal and Spain suffered massive foreign portfolio disinvestment (amounting to €415 billion in the three years).

With the stabilization of financial markets that began in the final part of 2012 and gained strength in 2013, net purchases of Italian and Spanish securities resumed and disposals of Greek and Portuguese securities diminished sharply. In 2013 as a whole, the four countries received foreign portfolio investment inflows of €56 billion. In Ireland, by contrast, net investment by non-residents in portfolio securities diminished (from €70 billion to €52 billion).

After the huge outflows of funds from banks resident in Greece, Italy, Portugal and Spain in the three years 2010-12 (for a total of €419 billion), in 2013 the reduction in lending abroad and the easing of the decline in foreign funding by the banking systems of those four countries determined a resumption of net inflows, amounting to €68 billion, under the heading of *loans, deposits and other investment*. This, together with the resumption of non-residents' investment in bonds, helped to reduce the debtor positions of the four countries' central banks in the TARGET2 settlement system, which reflect imbalances in private capital movements.

TARGET2 balances. – The movement towards adjustment of the imbalances in TARGET2 positions that began in the autumn of 2012 continued last year. In August 2012 the aggregate debtor position with the ECB of Greece, Ireland, Italy, Portugal and Spain had peaked at €1 trillion, while the combined creditor positions of Finland, Germany and the Netherlands had risen to €939 billion. Thanks to the abatement of the tensions in the financial markets and the resumption of capital inflows to the countries hit hardest by the crisis, the debtor balance of the first group of countries and the creditor balance of the second shrank progressively, to -€609 billion and €583 billion at the end of last year. The negative balances of the central banks of Spain and Italy declined to €221 billion and €60 billion respectively, the positive balances of those of Germany and the Netherlands to €241 billion and €79 billion. The reduction continued in the opening months of 2014.

The Macroeconomic Imbalance Procedure. – As part of the Macroeconomic Imbalance Procedure, on 5 March the European Commission released the results of the in-depth review of the macroeconomic conditions of the 14 EU countries (including Italy and eight other euro-area countries) for which the alert mechanism based on a set of quantitative indicators had detected imbalances in November. These imbalances were confirmed by the in-depth review for all 14 countries; they were deemed excessive for Croatia, Slovenia and, for the first time, Italy.

According to the Commission, Italy, which in the latest Alert Mechanism Report had values exceeding the indicative thresholds for three indicators (loss of export market shares, strengthening of the real effective exchange rate and ratio of public debt to GDP) necessitates decisive policy actions; in the report's analysis, the country's main vulnerabilities lie in its high ratio of public debt to GDP and inadequate international competitiveness, both factors originating from the protraction of the phase of low productivity growth.

6. BUDGETARY POLICIES

In 2013 euro-area net borrowing decreased further, falling to 3.0 per cent of GDP despite still unfavourable macroeconomic conditions. The contraction involved most of the euro-area countries. According to the European Commission's forecasts, the improvement will continue this year and to a lesser extent in 2015. The ratio of debt to GDP increased in 2013 by more than 2 percentage points, rising to 95.0 per cent; this was partly due to the financial support provided to the countries in difficulty (amounting to 0.4 percentage points of GDP). After rising to a more limited extent this year, the ratio should start to come down in 2015.

The programmes for granting loans to Ireland and Spain have come to an end, while that for Portugal should be completed by the middle of 2014. The European programme for Greece should be wound up by the end of this year.

The reform of European economic governance continued, as did the debate on the institutional architecture of EMU. In May 2013 the two regulations making up the so-called two-pack came into force and the autumn saw the application of one of their main innovations: the common calendar for the preparation of the euro-area countries' draft budgets and their assessment by the Commission for compliance with the European rules. Last year the fiscal compact entered into force; during the year the transposition of its provisions was completed in most of the euro-area countries. The proposals aimed at creating an autonomous euro-area fiscal capacity, including those aimed at macroeconomic stabilization, have not yet been translated into concrete action, although they have engendered a lively debate. By contrast, significant progress has been made in the creation of the Banking Union.

Outturns and outlook

Budgetary outturns for 2013. – General government net borrowing in the euro area decreased for the fourth consecutive year, falling to 3.0 per cent of GDP from 3.7 per cent in 2012 (Table 6.1). The deficit had surged in 2009, from 2.1 to 6.3 per cent of GDP.

The public finances improved in 11 countries, where net borrowing decreased by 1.3 percentage points of GDP on average; the improvement in Spain was especially large (3.5 points). The deficit stabilized at 3.0 per cent of GDP in Italy, while in Estonia, Germany and Luxembourg the budgetary position was close to balance. Net borrowing increased significantly in Slovenia, where it rose by 10.7 percentage points of GDP to 14.7 per cent, and in Greece, where it rose by 3.8 percentage points to 12.7 per cent, as a consequence of the support of the banking and financial systems amounting to 10.4 and 10.6 per cent of GDP respectively.

Table 6.1

General government net borrowing and debt: outturns and forecasts
(per cent of GDP)

	Net borrowing				Debt (1)			
	2012	2013	2014	2015	2012	2013	2014	2015
Austria	2.6	1.5	2.8	1.5	74.4	74.5	80.3	79.2
Belgium	4.1	2.6	2.6	2.8	101.1	101.5	101.7	101.5
Cyprus	6.4	5.4	5.8	6.1	86.6	111.7	122.2	126.4
Estonia	0.2	0.2	0.5	0.6	9.8	10.0	9.8	9.6
Finland	1.8	2.1	2.3	1.3	53.6	57.0	59.9	61.2
France	4.9	4.3	3.9	3.4	90.6	93.5	95.6	96.6
Germany	-0.1	0.0	0.0	0.1	81.0	78.4	76.0	73.6
Greece	8.9	12.7	1.6	1.0	157.2	175.1	177.2	172.4
Ireland	8.2	7.2	4.8	4.2	117.4	123.7	121.0	120.4
Italy	3.0	3.0	2.6	2.2	127.0	132.6	135.2	133.9
Latvia	1.3	1.0	1.0	1.1	40.8	38.1	39.5	33.4
Luxembourg	0.0	-0.1	0.2	1.4	21.7	23.1	23.4	25.5
Malta	3.3	2.8	2.5	2.5	70.8	73.0	72.5	71.1
Netherlands	4.1	2.5	2.8	1.8	71.3	73.5	73.8	73.4
Portugal	6.4	4.9	4.0	2.5	124.1	129.0	126.7	124.8
Slovakia	4.5	2.8	2.9	2.8	52.7	55.4	56.3	57.8
Slovenia	4.0	14.7	4.3	3.1	54.4	71.7	80.4	81.3
Spain	10.6	7.1	5.6	6.1	86.0	93.9	100.2	103.8
Euro area (2)	**3.7**	**3.0**	**2.5**	**2.3**	**92.7**	**95.0**	**96.0**	**95.4**

Source: European Commission, *Spring Forecast*, May 2014.
(1) The debt of each country includes its share of loans granted by the EFSF, bilateral loans to other euro-area countries and its share in the capital of the ESM. – (2) Latvia adopted the euro on 1 January 2014; for the sake of comparability, the euro-area data for 2012 and 2013 have been calculated including this country.

The improvement in the average euro-area budgetary position was in line with what the governments had planned in the spring of 2013. The GDP growth rate was, on average, similar to that included in the forecasts.

According to the European Commission's estimates, the structural deficit (adjusted for the effects of the business cycle and temporary measures) improved by 0.8 percentage points of GDP to 1.3 per cent.

The euro-area's primary surplus decreased in 2013 by 0.5 percentage points of GDP, to 0.1 per cent. Germany and Italy recorded sizeable but slightly smaller primary surpluses, equal in both cases to 2.2 per cent of GDP. Consolidation of the public finances allowed Austria to record a surplus last year equal to 1 per cent of GDP. In the rest of the area there was a primary deficit equal on average to 2.2 per cent of GDP.

Compared with 2012 the ratio of revenue to GDP rose by 0.5 percentage points to 46.8 per cent, while the ratio of primary expenditure to GDP was basically unchanged at 46.9 per cent. Interest payments contracted by 0.2 percentage points of GDP to 2.9 per cent.

The euro-area ratio of public debt to GDP rose by 2.3 percentage points to 95.0 per cent. The increase was mainly due to the gap, albeit smaller than in 2012, between the average cost of the debt (3.1 per cent) and the nominal GDP growth rate (1.0 per cent). Excluding the loans in support of countries in difficulty, the ratio of debt to GDP was 92.6 per cent (as against 90.7 per cent in 2012).

Only six euro-area countries are not subject to the excessive deficit procedure at present (Estonia, Finland, Germany, Italy, Latvia and Luxembourg). Among the countries subject to the procedure, net borrowing was below the 3 per cent threshold in Austria, Belgium, Malta, the Netherlands and Slovakia.

Between May and June 2013, taking account of the effects of slower economic growth than originally expected and of the size of the adjustments needed, the Council extended the period for bringing the deficit below the 3 per cent threshold by one year for the Netherlands (to 2014) and Portugal (to 2015), two years for France (to 2015), Slovenia (to 2015) and Spain (to 2016), and four years for Cyprus (to 2016). The deadline for eliminating excessive deficits ranges from 2013 (for Austria, Belgium and Slovakia) to 2016 (for Cyprus, Greece and Spain).

Financial support to countries in difficulty. – Under the various support programmes European countries and institutions and the International Monetary Fund disbursed nearly €60 billion in 2013; about €12 billion was disbursed in the early months of this year. The total disbursed since 2010 has thus reached about €411 billion (Table 6.2).

With effect from July 2013 the European Financial Stability Facility (EFSF) was replaced by the European Stability Mechanism (ESM) as the instrument for financing any new interventions in favour of euro-area countries in difficulty. Accordingly, the EFSF remains in operation only for the programmes in which it has already played a role (Greece, Ireland and Portugal).

The ESM's capital amounts to about €700 billion, of which €620 billion is callable and €80 billion has been paid in by the participating countries in five equal instalments, of which two were paid in 2013 and one, the last, in April 2014. Thanks to these disbursements, the ESM's total lending capacity is now €500 billion, or about €450 billion net of the resources already disbursed (€46.1 billion) and those already committed (€4.2 billion).

Last year Greece received about €32 billion of loans under the second support programme (drawn up in March 2012), which replaced the one subscribed in May 2010. Under the two programmes, between 2010 and the early months of 2014 Greece received about €221 billion in loans (equal to 122 per cent of its 2013 GDP); almost 90 per cent of these funds came from other euro-area countries in bilateral loans or through the EFSF, while the IMF contribuited the rest. EFSF disbursements are scheduled to stop by the end of this year and IMF support to end in 2016.

In March of this year the financial support programme drawn up in 2010 for Ireland came to an end with a last payment by the European Financial Stabilisation Mechanism (EFSM). The country received about €68 billion (equal to 41 per cent of its 2013 GDP), of which nearly €11 billion in 2013. Of these loans the IMF granted about €23 billion, the EFSM €22.5 billion, the EFSF €17.7 billion and, under bilateral agreements, the United Kingdom, Sweden and Denmark €4.8 billion. Under the current programmes the principal amounts of the loans should be repaid between 2015 and 2042; the bilateral loans and those granted by the IMF should be repaid by the end of 2023.

Table 6.2

Financial support to countries in difficulty: detail (1)
(billions of euros)

	2010	2011	2012	2013	2014 (Jan.-May) (2)	Total to May 2014	Total support programme
IRELAND							
Bilateral loans	0.0	0.5	2.5	1.9	–	4.8	4.8
EFSF	0.0	7.6	4.4	5.7	–	17.7	17.7
EFSM	0.0	13.9	7.8	0.0	0.8	22.5	22.5
IMF	0.0	12.8	6.4	3.3	–	22.6	22.5
Total	**0.0**	**34.7**	**21.1**	**10.9**	**0.8**	**67.6**	**67.5** (3)
PORTUGAL							
EFSF	–	6.9	11.3	6.6	1.2	26.0	26.0
EFSM	–	14.1	8.0	0.0	1.8	23.9	26.0
IMF	–	13.0	8.2	3.4	1.8	26.3	26.0
Total	–	**34.0**	**27.5**	**10.0**	**4.8**	**76.2**	**78.0**
GREECE							
First support programme							
Bilateral loans	21.0	31.9	–	–	–	52.9	52.9
IMF	10.5	9.6	–	–	–	20.1	20.1
Total	**31.5**	**41.5**	–	–	–	**73.0**	**73.0** (4)
Second support programme							
EFSF	–	–	108.3	25.3	6.3	139.9	144.6 (5)
IMF	–	–	1.7	6.7	0.0	8.4	28.0
Total	–	–	**110.0**	**32.0**	**6.3**	**148.3**	**172.6**
SPAIN							
ESM	–	–	39.5	1.9	–	41.3	41.3
Total	–	–	**39.5**	**1.9**	**–**	**41.3**	**41.3** (6)
CYPRUS							
ESM	–	–	–	4.6	0.2	4.8	9.0
IMF	–	–	–	0.3	0.1	0.3	1.0
Total	–	–	**–**	**4.9**	**0.2**	**5.1**	**10.0**

Sources: For bilateral loans to Ireland, National Treasury Management Agency; for loans granted by the EFSF, EFSF website; for loans granted by the EFSM, European Commission, "Investor presentation", 15 May 2014, and the Commission's website; for IMF loans not included in the first support programme for Greece, IMF press releases issued with each disbursement; for the first support programme for Greece, European Commission, "The second economic adjustment programme for Greece", March 2012; for ESM loans, ESM press releases.
(1) Rounding and exchange rate fluctuations may cause discrepancies in totals. – (2) Based on data available at 20 May. – (3) Does not include the €17.5 billion contribution of Ireland using the funds of the Irish Treasury and the National Pensions Reserve Fund. – (4) The first financial support programme for Greece amounted to €110 billion, €30 billion of which was pledged by the IMF. The figure reported in the table is the amount actually disbursed through the end of 2011. The remaining sum was incorporated in the second support programme. – (5) Does not include €35 billion of securities issued by the EFSF to activate the buy-back scheme underpinning the quality of securities issued or fully guaranteed by Greece. – (6) In July 2012 the Eurogroup approved a financial assistance programme for Spain of up to €100 billion; the loans actually granted by the end of the programme in December 2013 amounted to €41.3 billion.

The programme for Portugal, finalized in May 2011, continued, with loans of €10.0 billion in 2013 and €4.8 billion in the early months of 2014. These resources brought the total financial support to Portugal to more than €76 billion, or 46 per cent of its 2013 GDP. The funds were provided by the EFSF and the IMF in almost equal portions and by the EFSM for a slightly smaller amount. The disbursements to Portugal should come to an end in the middle of 2014, with the last payments by the EFSM and the IMF.

The plan for the support of Spain, managed by the ESM and aimed at the recapitalization of some banks, came to an end in December 2013. The total amount disbursed (€41.3 billion, equal to about 4 per cent of the country's 2013 GDP) was less than the maximum of €100 billion decided by the Eurogroup in July 2012. The agreement provides for the Spanish government to repay the principal amounts of the loans by means of roughly equal instalments between 2022 and 2027.

A financial support programme for Cyprus amounting to some €10 billion (equal to about 61 per cent of the country's 2013 GDP) was agreed in the spring of 2013. Under the agreement the ESM has so far granted loans of €4.8 billion to the Cyprus government, while the IMF has contributed about €0.3 billion.

The outlook. – According to the forecasts published by the European Commission on 5 May, euro-area net borrowing will decrease in 2014 by another 0.5 percentage points of GDP, falling to 2.5 per cent (Table 6.1).

In the absence of additional interventions with respect to those already decided, the European Commission expects euro-area net borrowing to decrease further in 2015, to 2.3 per cent of GDP. The ratio of the public debt to GDP is expected to fall for the first time since 2007, to 95.4 per cent.

According to the European Commission's forecasts, the stance of euro-area budgetary policy, expressed in terms of the change in the cyclically-adjusted primary balance will continue to be restrictive in 2014, although much less so than in the three years 2011-13. The stance is expected to become moderately expansionary in 2015. The cyclically adjusted primary surplus, equal to 0.8 per cent of GDP in 2007, is expected to be equal to 1.8 per cent of GDP this year.

The reform of European governance

The first application of the two-pack. – In May 2013, with the entry into force of the two regulations known as the two-pack, a further step was taken in the reform of European economic governance initiated in March 2010 in response to the surfacing of financial tensions. The autumn saw the initial application of one of the main innovations contained in the two new regulations, i.e. the adoption of the single calendar for the preparation of budgets for the following year by the euro-area countries. In October the European Commission received and analysed, on the basis of its forecasts, the programmes of the individual countries to verify their conformity with the Stability and Growth Pact. In November the assessments of the individual plans were published, together with an analysis of the impact of the measures announced on the public finances of the euro area as a whole. No plan was deemed not to conform with the Pact and accordingly no revisions were requested.

In assessing the budget programmes for 2014, the European Commission adopted for the first time a criterion giving preferential treatment to investment expenditure. In particular, according to this approach, a divergence from the medium-term objective or from the adjustment path is admissible if (a) the deficit does not exceed the 3 per cent threshold; (b) the debt rule is complied with; and (c) outlays are used for programmes cofinanced by the EU having a positive long-term effect on the sustainability of the public finances. This treatment is permitted only if a country is in recession or is growing at a rate far below its potential. The Commission nonetheless ruled that the conditions for applying this criterion had not been met by the two euro-area countries that had requested its implementation: Italy and Slovakia.

The transposition of the fiscal compact. – The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed in March 2012, came into force on 1 January 2013. The part better known as the fiscal compact required signatories to include in their national law, by January 2014 and preferably at constitutional level, rules providing for the achievement and maintenance of a budgetary position that is in balance or in surplus in structural terms and an automatic mechanism for the correction of deviations. The ways in which the Treaty has been transposed vary widely from country to country.

The debate on fiscal capacity. – Among the reform proposals put forward at the end of 2012 by the President of the European Council and by the European Commission for the completion of the Economic and Monetary Union, there was the creation of a euro-area fiscal capacity. This proposal has not yet been translated into action, although it has triggered a wide-ranging debate on its possible functions, such as macroeconomic stabilization and the financing of structural reforms and infrastructure, with direct and indirect benefits for the euro area as a whole.

As regards the macroeconomic stabilization function, a common budget would help to attenuate the impact of the shocks that produce asymmetric effects on the different euro-area countries and the economic and social costs of adjustment. Compared with other associations of states, the automatic stabilization effect guaranteed by a supranational budget would be especially useful in the case of the euro area, where wage flexibility and cross-border labour mobility are limited, and it would validly supplement individual member states' countercyclical fiscal policies, whose effectiveness is diminished by the high degree of commercial interdependence.

It would be necessary, however, to reduce the risk that the creation of an autonomous euro-area fiscal capacity could lead to forms of moral hazard (for example, governments would have less incentive to implement structural reforms), by strengthening the safeguards for the European budgetary rules. There would also be a need for institutional changes to guarantee adequate democratic legitimation of the decisions on the common budget (for example by significantly increasing the powers of the European Parliament), moving in the direction of an outright political union. In addition to difficulties of a general nature, complex questions regarding the size and purpose of the common budget will have to be addressed.

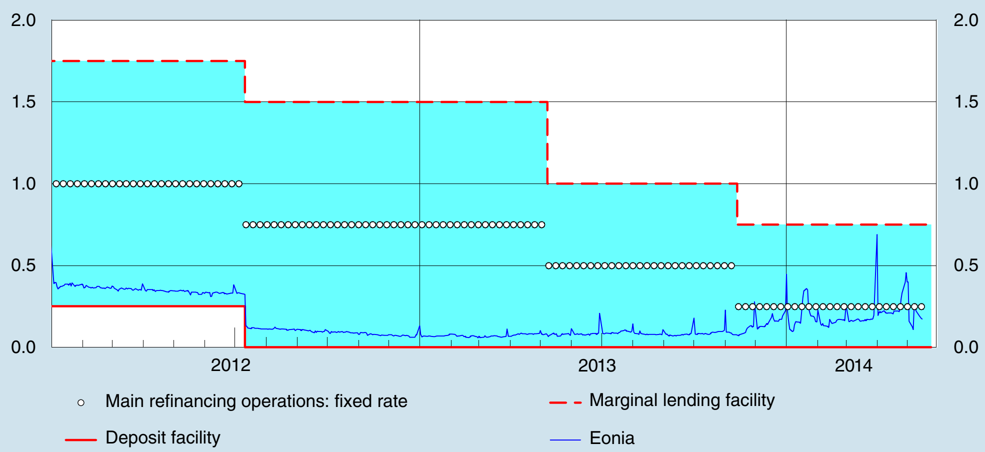
An autonomous euro-area fiscal capacity could be created either by means of an automatic system of transfers to states hit by adverse events or through the sharing of specific items of expenditure and revenue.

7. THE SINGLE MONETARY POLICY

Faced with persistently weak economic activity, credit contraction and steadily falling actual and expected inflation, in 2013 the Governing Council of the European Central Bank reduced official interest rates twice to all-time lows (Figure 7.1). To prevent excessive volatility of monetary conditions, beginning in July the Council also provided forward guidance concerning its monetary policy stance, stating it would remain accommodative for as long as necessary. In the early months of 2014, as the inflation outlook weakened further, the Council announced that it was also prepared to use unconventional measures to counter the risks of a too prolonged period of low inflation.

Figure 7.1

Official interest rates and money market rates in the euro area
(daily data; per cent)



Sources: ECB and Thomson Reuters Datastream.

Monetary policy action

In the early part of 2013 economic activity began to diminish even in the euro area's strongest economies, helping to reduce inflation expectations. At its meeting in early May the Governing Council lowered the fixed rate on main refinancing operations by 25 basis points to 0.50 per cent and that on the marginal lending facility by 50 basis points to 1.0 per cent, while keeping the rate on the deposit facility unchanged at zero.

Starting in mid-May, the market's expectations concerning the ECB's reference rates and the term premiums embodied in long-term euro interest rates became more sensitive to factors unrelated to economic and monetary conditions in the euro area, such as the announcement of the possible normalization of monetary conditions in the

United States. The yield curve shifted upwards and its volatility increased. To counter these developments, beginning with its meeting in early July the Governing Council provided forward guidance on its policy stance, announcing that it expected official interest rates to remain at the levels then current for an extended period of time. This expectation was based on the prospects of subdued inflation in the medium term, given the weakness of economic activity and the moderate dynamics of money and credit. The announcement resulted in an immediate downward shift of the yield curve and a reduction in uncertainty about the future course of reference rates; it had only transitory effects on the exchange rate of the euro.

Actual and expected inflation subsided further during the second half of the year, falling well below the definition of price stability, in a context of appreciation of the euro and slack money and credit growth and despite timid signs of economic recovery. Faced with the risk of a further worsening of the outlook for price rises, in November the Council lowered the main refinancing rate and the marginal lending rate by 25 basis points each, to 0.25 and 0.75 per cent respectively.

The improvement of financial market conditions in the euro area, which had begun in 2012 following the ECB's adoption of unconventional measures, the strengthening of European governance and action by national governments, all continued in 2013. The risk premiums on government securities came sharply down, especially in the countries most severely affected by the sovereign debt crisis; banks' funding conditions improved, and the area recorded net portfolio investment inflows.

The segmentation of financial markets along national lines was attenuated but remained significant and continued to interfere with monetary policy transmission. The conditions of credit supply to the private sector still differed from country to country, owing in particular to high counterparty risk in connection with the poor growth outlook in the countries most exposed to the crisis.

Preparations were begun last year for the creation of Banking Union in the area, with the aim of averting a negative spiral between sovereign debt market conditions and banking activity and of providing comparable information on the relative soundness of bank balance sheets in different countries. Banking Union will contribute to financial stability within the euro area and, by countering market segmentation, will foster more uniform transmission of monetary policy impulses to the member states.

Inflation in the area diminished further at the end of 2013 and in the early months of this year, falling below forecasters' expectations. In part this trend has affected medium-term inflation expectations, accentuating their distance from the definition of price stability. An unduly long period of low inflation could have a number of undesirable consequences for the economy: (a) it would have an adverse effect on demand because of the increase in real interest rates and the incentive to postpone purchases; (b) it would make it harder to correct the external imbalances between the countries of the euro area; (c) it would slow the reduction of public and private debt; and (d) it would increase the unemployment rate, given downward rigidity of nominal wages. In addition, long-term inflation expectations could become unanchored from the objective of price stability.

In keeping with its mandate, the ECB Governing Council has firmly reiterated that it intends to maintain accommodative monetary conditions for as long as necessary and has declared its readiness to use unconventional measures to counter the risks connected with a too prolonged a period of low inflation. One such measure under consideration is the purchase of private and public sector securities on the secondary market.

Interest rates and the exchange rate of the euro

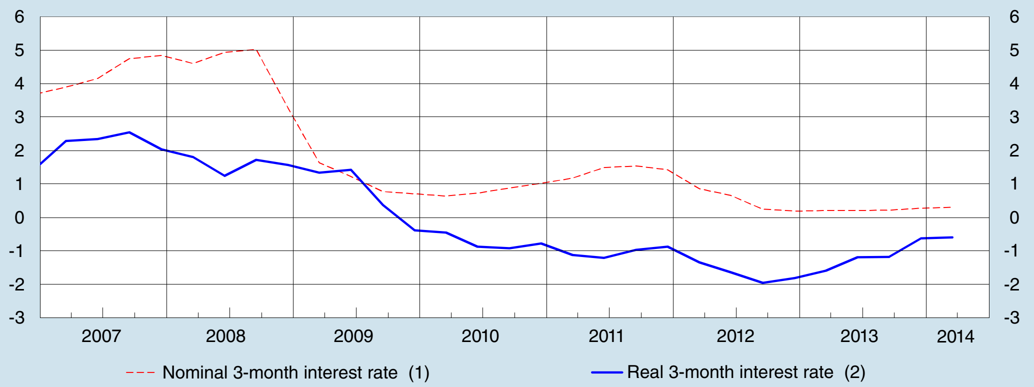
Short-term interest rates. – The banking system's abundant excess liquidity helped to keep money market rates very low in 2013. Towards the end of the year and in the early part of 2014 the progressive reduction of the excess resulted in a modest rise in short-term rates. In mid-May three-month Euribor hovered around 0.3 per cent, compared with 0.2 per cent at the start of 2013.

In mid-May 2013 the yield curve began to show pronounced volatility and shifted upwards, reflecting factors unrelated to the economic and monetary conditions of the euro area, such as the announcement by the US Federal Reserve of the possible tapering of its asset purchase programme to support economic activity. At its meeting at the start of July, the ECB Governing Council began to provide forward guidance, announcing that it expected official interest rates to remain at or below the levels then current for an extended period of time. The purpose of forward guidance is to anchor market expectations about policy rates at levels that are consistent with the Council's intentions.

With the reduction in expected inflation, real short-term interest rates have risen. In March of this year the real rate of interest, calculated as the difference between three-month Euribor and the inflation forecasts of the analysts surveyed by Consensus Economics for the next quarter, was 0.6 per cent, compared with -1.8 per cent in December of 2012 (Figure 7.2).

Figure 7.2

Short-term nominal and real interest rates
(quarterly data; per cent)

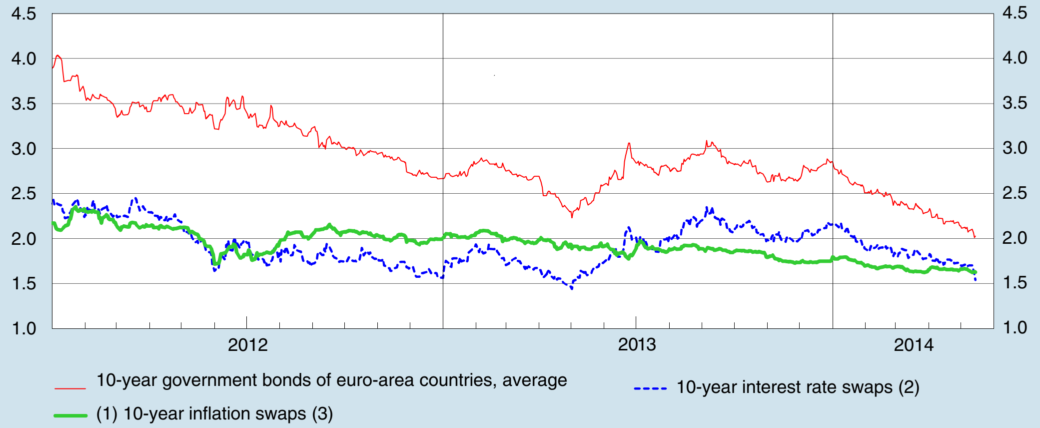


Sources: Based on Thomson Reuters Datastream and Consensus Economics data.
(1) Threee-month Euribor (average of daily data in last month of the quarter). – (2) Difference between the nominal interest rate and the inflation expectations for the next quarter of the professional analysts surveyed by Consensus Economics.

Long-term interest rates. – Nominal long-term interest rates in euro, measured on the basis of ten-year swaps, rose in the second quarter of 2013 after the Federal Reserve's announcement of the possible tapering of its asset purchase programme. They then stabilized following the ECB Governing Council's forward guidance announcement and the Fed's clarification on the pace of the normalization of monetary conditions in the United States. They declined in the early months of 2014, owing to the lowering of inflation expectations and the prospects of a more extended period of monetary accommodation by the ECB. In mid-May long-term euro interest rates stood at 1.5 per cent, against 1.6 per cent in December 2012 (Figure 7.3).

Figure 7.3

Long-term nominal yields and inflation expectations
(daily data; per cent)

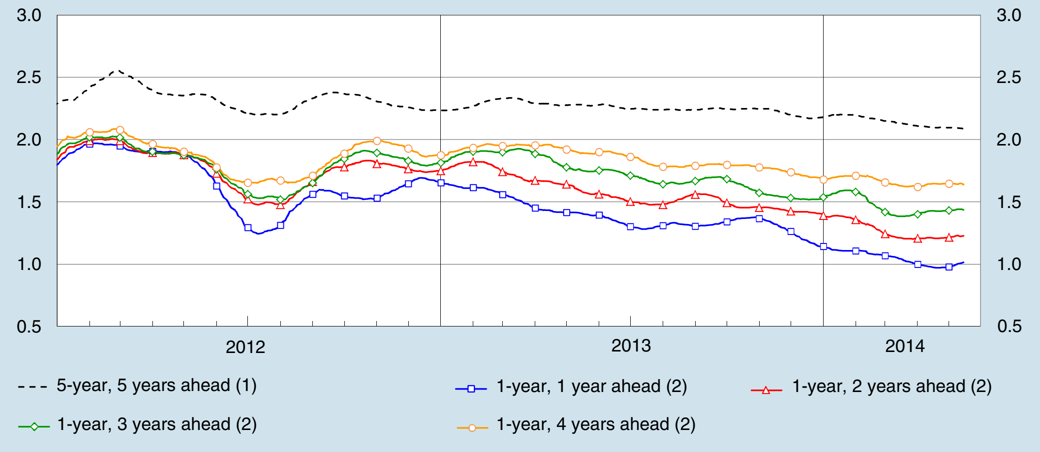


Sources: Thomson Reuters Datastream and calculations based on Bloomberg data.
(1) Average yields on benchmark 10-year government bonds of Austria, Belgium, Finland, France, Ireland, Italy, the Netherlands, Portugal, Spain and Germany weighted by GDP at constant 2013 prices. – (2) Fixed-rate yield of 10-year interest rate swaps. – (3) Fixed-rate 10-year yield.

The yields on ten-year government bonds in the main euro-area countries declined to an average of 2.0 per cent in mid-May 2014, compared with 2.7 per cent at the start of 2013 (Figure 7.3). The very significant reduction of the sovereign-risk component for the countries most severely affected by the financial tensions contributed to the decline, as the effects of the ECB's announcement of Outright Monetary Transactions, the strengthening of European governance and the action of national governments unfolded. Between the end of 2012 and the middle of May 2014 the spreads between ten-year Italian and Spanish government bonds and German Bunds narrowed by 140 and 220 basis points respectively to about 1.8 percentage points in both cases.

Figure 7.4

Inflation expectations implied by euro-area inflation swaps
(daily data; per cent; 30-day moving average)



Source: Based on Bloomberg data.
(1) Five-year fixed forward rate, 5 years ahead, implied by euro-area inflation swap contracts. – (2) Five-year fixed forward rate, 1 to 4 years ahead, implied by euro-area inflation swap contracts.

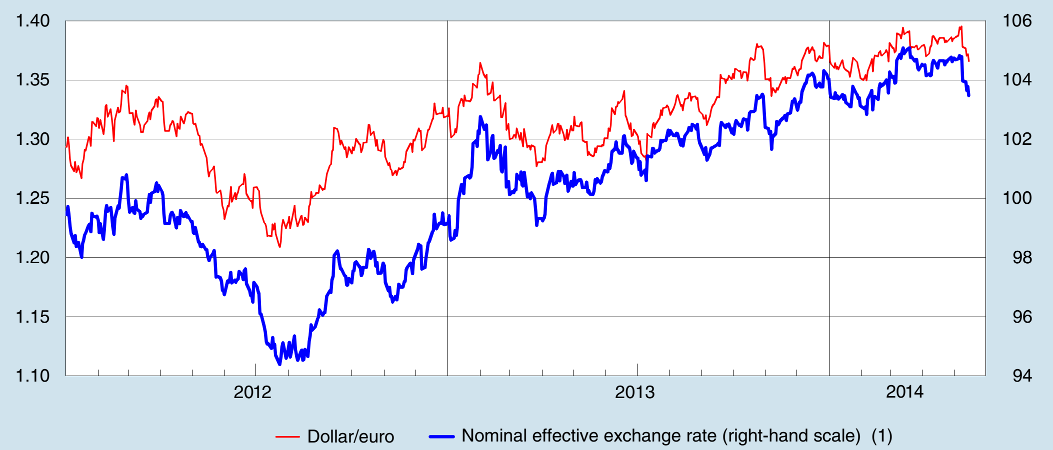
Inflation expectations up to three years ahead have come down sharply since the start of 2013 (Figure 7.4). In mid-May of this year the one-year forward inflation expectations implied by euro-area inflation swaps, which include a risk premium, stood at 1.0 per cent for contracts one year ahead and 1.4 per cent for three years ahead (compared with 1.7 and 1.8 per cent at the end of 2012). The ECB's Survey of Professional Forecasters in April indicated that with a 30 per cent probability the rate of inflation in 2015 would be no more than 0.9 per cent, compared with a 10 per cent chance in the January 2013 survey.

The longer-term inflation expectations implicit in euro-area inflation swaps have also come down. In mid-May one-year expectations four years ahead were just over 1.6 per cent, compared with 1.9 per cent at the start of 2013. The same pattern emerges from Consensus Economics surveys and the ECB's Survey of Professional Forecasters, which reported inflation forecasts for 2018 of 1.8 per cent in April, compared with 2.0 per cent in July 2013.

The exchange rate of the euro. – The euro appreciated in 2013, continuing the rise that began following the ECB's announcement of Outright Monetary Transactions in the summer of 2012 (Figure 7.5). This trend was due to increasing investor appetite for euro-denominated assets – whetted by the perception of diminishing sovereign risk for the area's countries and heightened vulnerability of some emerging economies – and to the further easing of monetary conditions in Japan. Between the start of 2013 and mid-May 2014 the euro gained 3 per cent against the dollar and 4 per cent in nominal effective terms. A major contribution came from the euro's appreciation of 21 per cent against the yen.

Figure 7.5

Dollar/euro exchange rate and nominal effective exchange rate of the euro
(daily data)



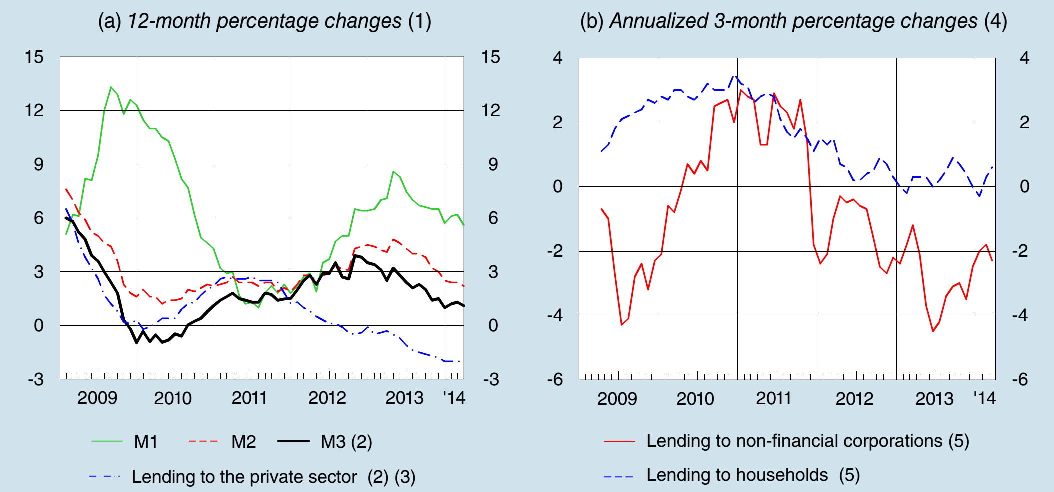
Source: ECB.
(1) Index, 1999 Q1=100. A rise in the index corresponds to an appreciation.

Money and credit

Money. – M3 slowed down in 2013, reflecting the very modest growth of nominal GDP and portfolio shifts towards higher-yield financial instruments. The impact of these factors on the money supply was only partly offset by a greater preference for the liquid assets comprised in M1 and by the flows of foreign capital into euro-area financial assets. The growth of M3 from January through December came to 1.0 per cent, compared with 3.5 per cent in 2012, and continued at about that pace in the first few months of 2014 as well (1.1 per cent in March; Figure 7.6).

Figure 7.6

Money and credit aggregates in the euro area
(monthly data)



Source: ECB.
(1) Changes calculated on end-of-month data adjusted for calendar effects. – (2) From June 2010 onwards the data are based on the definitions of M3 and of lending to the private sector adopted by the ECB in September 2012, which exclude repos with central counterparties from those aggregates. (3) Loans in euros and other currencies granted by monetary financial institutions. The data are adjusted for the accounting effects of securitizations. The private sector consists of households, non-profit institutions serving households, non-financial corporations, insurance companies and pension funds, non-money-market investment funds and other financial institutions. – (4) Changes calculated on the basis of end-of-month data, adjusted for seasonal and calendar effects. – (5) Loans in euros and other currencies granted by monetary financial institutions, adjusted for the accounting effects of securitizations; data available since January 2009.

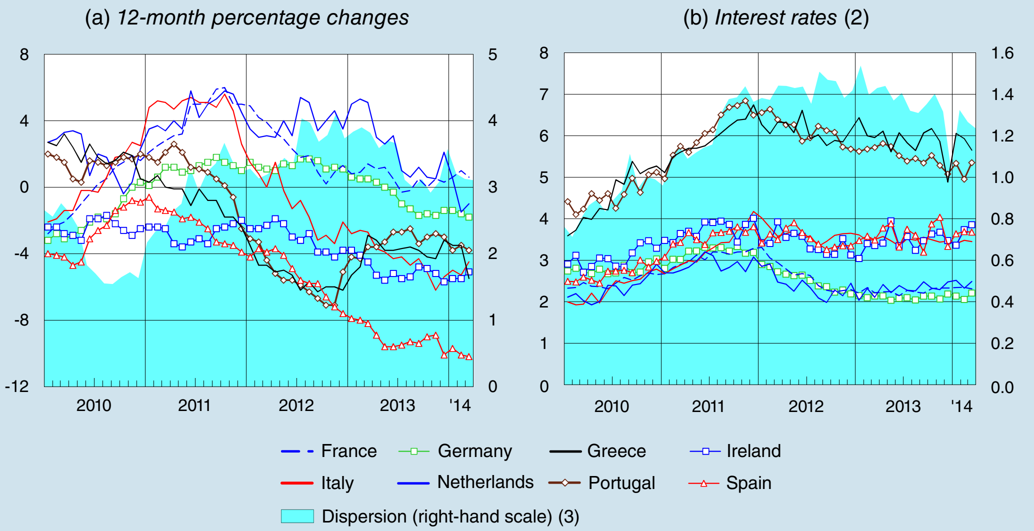
Credit. – The twelve-month rate of contraction in bank lending to the private sector intensified throughout 2013 to 2.0 per cent in December, compared with 0.1 per cent in December 2012. It steadied at that rate in the first quarter of 2014. These developments were driven mainly by the sharp fall in lending to non-financial corporations, which shrank by 2.8 per cent in the twelve months to December compared with 1.3 per cent in December 2012, and to a lesser extent by the gradual slowdown in the growth of lending to households (from 0.7 to 0.3 per cent). In the course of the year the annualized quarterly decline in lending to firms steepened markedly from 2.2 per cent in December 2012 to 4.5 per cent in June, on a seasonally adjusted basis, and then returned to near the rate registered at the start of the year (Figure 7.6). The quarterly rate of growth in lending to households stayed close to zero.

The average interest rates on new loans to firms and to households remained broadly unchanged last year at 2.7 and 3.1 per cent respectively in December and remained at about those levels in the first quarter of 2014.

The national divergences in the trend and cost of credit to the non-financial private sector diminished somewhat in 2013 but remain significant owing to the differences in financial conditions and cyclical developments within the area. Lending to non-financial corporations fell steeply in all the countries affected by the tensions and contracted even in the stronger economies (Figure 7.7). Interest rates on new loans to firms also continue to be highly uneven.

Figure 7.7

Lending to non-financial corporations in selected euro-area countries (1)
(monthly data)



Source: ECB.
(1) Loans in euros and other currencies granted by monetary financial institutions, adjusted for the accounting effects of securitizations. – (2) Interest rates on new loans. – (3) Unweighted standard deviations of lending growth rates and interest rates.

According to the quarterly euro-area Bank Lending Survey, lending in 2013 reflected both slack demand and persistently restrictive supply conditions, especially for non-financial corporations. Firms' demand for credit diminished owing to low propensity to invest and, to a lesser extent, more frequent recourse to alternative sources of funding. Households' demand for loans was held back mainly by the fragility of consumer confidence and the protracted decline in real incomes. At the same time, while banks' funding conditions improved, the main factor in the tightening of lending conditions to firms and households alike was credit risk in connection with the poor economic outlook.

The role of these factors in weakening demand and worsening credit supply conditions diminished in the course of the year in all the main economies of the area. The terms of access to credit nevertheless remain highly uneven from country to country. Moreover, credit access continues to be more difficult for smaller than for larger firms, according to the ECB's Survey on the Access to Finance of SMEs.

Monetary policy operations

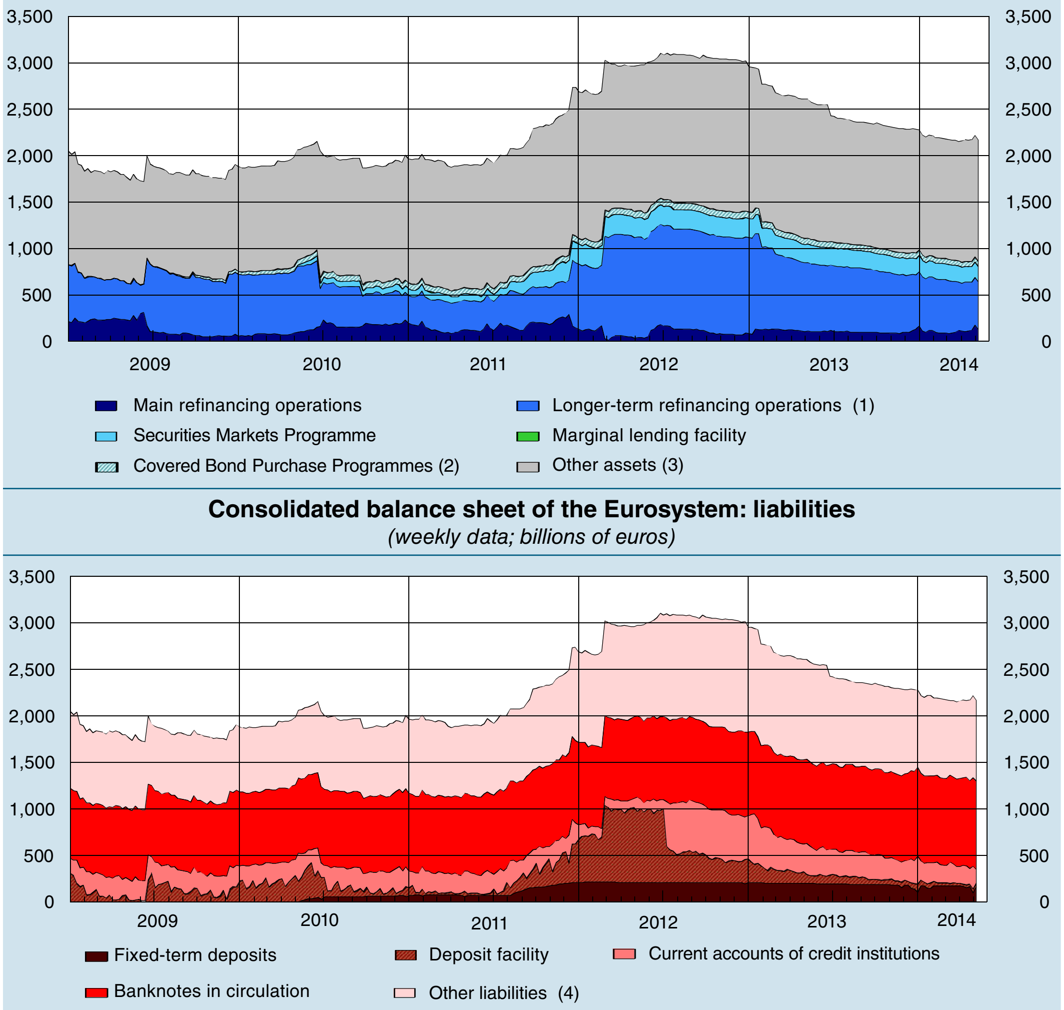
Money market conditions stayed accommodative throughout 2013 and the early months of 2014 owing to the abundant excess liquidity of the banking system and the ECB's announcements that the policy of full allotment in Eurosystem refinancing operations would remain in place as long as necessary.

Since the end of January 2013 banks have had the option, on a weekly basis, of early repayment of the funds obtained in the three-year longer-term refinancing operation conducted in December 2011. The next month that option was extended to the March 2012 LTRO as well. The amounts repaid were substantial at end-January and end-

February, more limited in the subsequent months (Figure 7.8). The repayments also involved banks in the countries most severely affected by the tensions, thanks both to better funding conditions and to the attenuation of market segmentation along national lines. Both these factors increased the circulation of liquidity within the area and produced a significant reduction of the imbalances within the TARGET2 settlement system. By mid-May 2014 the area's banking system had repaid about half the €1 trillion disbursed in the two three-year LTROs; about €80 billion (out of borrowings of €250 billion) involved counterparties of the Bank of Italy.

Figure 7.8

Consolidated balance sheet of the Eurosystem: assets
(weekly data; billions of euros)



Source: ECB.
(1) Special-term operations with a maturity of one reserve maintenance period and longer-term refinancing operations with maturities of 3, 6, 12 and 36 months. – (2) CBPP, initiated in July 2009, and CBPP2, initiated in November 2011. (3) Gold, foreign currency assets and other minor items. – (4) Revaluation accounts, foreign currency liabilities, capital, reserves and other minor items.

The repayment of these funds resulted in a gradual absorption of the excess liquidity, which from the fourth quarter of 2013 onwards has translated into a modest rise in money market rates. In the early months of 2014 the Eonia rate averaged 0.20 per cent, about 10 basis points higher than the 2013 average (Table 7.1). The volatility of the rate has increased, especially in conjunction with the end-of-quarter technical requirements of banks.

Table 7.1

Monetary policy operations and money market interest rates
(daily averages for the period shown)

	14 Dec. 2011 12 June 2012	13 June 2012 11 Dec. 2012	12 Dec. 2012 11 June 2013	12 June 2013 10 Dec. 2013	11 Dec. 2013 13 May 2014
Main refinancing operations (MROs)					
Volume (1)					
Euro area	91.9	118.0	111.4	97.9	112.9
Italy	23.2	6.6	6.6	3.0	8.8
Italy's share (2)	25.3	5.6	5.9	3.1	7.8
Number of participants per tender					
Euro area	111	89	73	72	133
Italy	25	17	15	17	27
Longer-term refinancing operations					
Volume (3)					
Euro area	904.0	1,065.3	852.7	675.0	558.8
Italy	214.7	270.6	263.5	236.3	207.6
Italy's share (2)	23.7	25.4	30.9	35.0	37.2
Number of participants per tender					
Euro area	126	35	31	34	54
Italy	22	16	17	19	27
Standing facilities (4)					
Marginal lending facility					
Euro area	2.8	1.2	1.2	0.4	0.3
Italy	0.1	0.0	0.1	0.0	0.0
Deposit facility					
Euro area	633.1	366.4	152.2	68.6	38.7
Italy	14.0	3.0	2.2	0.5	0.3
Excess reserves (5)					
Euro area	4.72	355.69	282.96	156.39	107.82
Italy	0.15	16.05	17.63	8.98	6.72
Money market rates					
Eonia	0.37	0.13	0.07	0.09	0.20
Eonia – deposit facility rate spread (6)	12.1	9.4	7.3	9.2	20.0
Volatility of Eonia – deposit facility rate spread (7)	5.8	1.6	1.1	2.9	8.3

Sources: Bank of Italy and ECB.
(1) Daily average stock of funds disbursed to monetary financial institutions through main refinancing operations; billions of euros. – (2) Funds assigned to Italian counterparties as a percentage of the total allotted. – (3) Daily average stock of funds disbursed to monetary financial institutions through longer-term refinancing operations with a maturity of 3, 6, 12 or 36 months or special-term refinancing operations with a maturity equal to one maintenance period; billions of euros. – (4) Billions of euros. – (5) Difference between the funds held by counterparties on current accounts with national central banks and required reserves; billions of euros. – (6) Spread between Eonia and the deposit facility rate; basis points. – (7) Standard deviation of the spread between Eonia and the deposit facility rate; basis points.

To guarantee the maintenance of relaxed liquidity conditions in the future and to make sure the maturing of the three-year LTROs does not cause turbulence in the money market, at its November 2013 meeting the Governing Council decided that the Eurosystem would continue to conduct all refinancing operations as fixed-rate tender procedures with full allotment for as long as necessary and in any event at least until July 2015.

The ECB also announced that it was prepared to intervene in the case of new money market tensions being transmitted to longer-term interest rates, in particular in a situation of progressive absorption of excess liquidity. The possible measures should such a situation arise comprise (a) a further cut in official interest rates, including a negative rate on the Eurosystem's overnight deposit facility; (b) an extension beyond the term now envisaged of the full allotment procedure for refinancing operations; and (c) new injections of liquidity, including by fixed-rate longer term refinancing operations.

THE ITALIAN ECONOMY

8. DEMAND, SUPPLY AND PRICES

The contraction of Italy's GDP that began in the second quarter of 2011 gradually moderated in the course of 2013, and the fourth quarter saw a modest upturn in economic activity. However, preliminary estimates released by Istat on 15 May indicate that in the first quarter of 2014 output declined marginally (by 0.1 per cent). In 2013 as a whole GDP shrank by 1.9 per cent.

Manufacturing activity has been recovering since last summer, but the upswing is still tenuous. The firms responding to the Bank of Italy's Survey of Industrial and Service Firms expect investment in industry to stabilize in 2014.

The recession of the past two years, which came on the heels of the even more severe slump of 2008-09, has been long and deep. The protracted decline in disposable income has affected consumers' assessments of their ability to earn income in the future, crimping their spending plans. Firms have pruned capacity, especially in industry. The speed of the recovery and the magnitude of Italy's growth potential in the years to come will depend on the behaviour of households and firms in the medium term, which could benefit from the agenda of structural reforms initiated or planned in recent years, if they are consistently and systematically implemented.

Italian economic activity in 2013 was weighed down chiefly by the contraction in national demand. The fall in consumption was even sharper than the significant decline in disposable income, owing in part to the persistently poor state of the labour market. Investment was discouraged by widespread uncertainty over the outlook for the economy, low capacity utilization and financing conditions that, while gradually improving, remained tight. Exports increased somewhat, however, and the current account balance came back into surplus for the first time since 2001.

On an annual average basis, harmonized consumer price inflation dropped by 2 percentage points in 2013 to 1.3 per cent. Prices slowed steadily throughout the year and in the first three months of 2014 as well, bringing inflation to historically low levels. Along with the fall in energy prices, there was an unbroken decline in core inflation, whose components were affected by the slackness of domestic demand. The swiftness and extent of disinflation led analysts to revise their price forecasts repeatedly downwards, especially for the relatively short term. Both professional forecasters and firms expect inflation to remain low for the next two years.

The causes of the recession

The impact of the sovereign debt crisis on the Italian economy in 2013 can be assessed by comparing actual developments during the year with a hypothetical alternative scenario, using the Bank of Italy's econometric model based on assumptions consistent with the forecasts made by the main international organizations in the spring of 2011, before the tensions turned acute (see F. Busetti and P. Cova, "L'impatto macroeconomico della crisi del debito sovrano: un'analisi controfattuale per l'economia italiana," Banca d'Italia, *Questioni di economia e finanza (Occasional Papers)*, No. 201, 2013).

This exercise suggests that had there been no sovereign debt crisis, the Italian economy would have grown by just over 1 per cent in 2013, more than 3 points better than its actual performance. The impact of the crisis on demand from Italy's main trading partners, in the euro area in particular, can be estimated to have subtracted nearly one percentage point from GDP growth in 2013, and a comparable effect was produced by the fiscal adjustment measures in 2012 and 2013, which were gradually transmitted to household spending.

The tightening of access to credit for households and firms, though it was attenuated in the course of the year, had a negative impact on output that can be put at about half a percentage point in 2013. The rest of the gap can be attributed to the uncertainty over the outlook for the economy and for employment, which impinged on consumption and investment plans. By comparison with the assessments for 2012 set out in last year's Annual Report, the negative effect of the change in foreign demand was greater, that in connection with credit conditions less marked.

Looking forward, the acceleration in foreign demand and the diminished necessity of further fiscal adjustment should allow a modest recovery in economic activity this year. An additional contribution could come from the progressive easing of firms' liquidity conditions and a lessening of the uncertainty over demand and employment.

Household consumption

Household expenditure at constant prices contracted more than real disposable income in 2013, by 2.6 per cent (Table 8.1) as against 1.1 per cent. The decline in consumption decelerated progressively in the course of the year and ceased entirely in the fourth quarter in concomitance with a sharp improvement in confidence and the stabilization of disposable income (Figure 8.1). Nevertheless, household spending remains some 8 per cent below the level registered before the outbreak of the global financial crisis.

The decrease in consumption involved all the main components but was sharpest for durable and semi-durable goods, spending on both of which fell by 5.2 per cent (Table 8.2). Consumption of non-durables, half of which consists of food, came down by 3.4 per cent, while expenditure on services declined by a more moderate 1.2 per cent.

Consumer households' propensity to save rose by 1.4 percentage points to 9.5 per cent of disposable income, returning to the levels recorded before the sovereign debt crisis. The increase can be attributed not only to the adjustment of consumption to poorer income prospects but also to an effort to build wealth back to the desired level, offsetting its erosion during the slump. Preliminary estimates indicate that the net wealth of consumer households diminished in 2013, as the further fall in the value of real estate was only partially offset by an increase in financial wealth.

Table 8.1

Sources and uses of income

	Per cent of GDP in 2013 (volumes at previous-year prices)	2012			2013		
		Percentage changes		Contribution to GDP growth (chain-linked volumes)	Percentage changes		Contribution to GDP growth (chain-linked volumes)
		Chain-linked volumes	Deflators		Chain-linked volumes	Deflators	
Sources							
GDP	–	-2.4	1.6	–	-1.9	1.4	–
Imports of goods *fob* and services (1)	28.9	-7.0	3.0	2.1	-2.8	-1.9	0.8
of which: goods	*23.5*	*-7.6*	*2.7*	*1.9*	*-3.3*	*-2.3*	*0.8*
Uses							
National demand	98.1	-5.0	1.9	-5.1	-2.7	0.9	-2.7
Consumption of resident households	60.0	-4.0	2.7	-2.4	-2.6	1.3	-1.6
Consumption of general government and non-profit institutions serving households	20.6	-2.6	0.1	-0.5	-0.8	..	-0.2
Gross fixed investment	17.4	-8.0	1.6	-1.5	-4.7	0.3	-0.8
machinery, equipment and transport equipment	*7.3*	*-11.1*	*0.8*	*-0.9*	*-2.5*	*-0.5*	*-0.2*
intangible assets	*1.0*	*-2.7*	*1.7*	*..*	*-1.4*	*1.7*	*..*
construction	*9.1*	*-6.1*	*2.3*	*-0.6*	*-6.7*	*0.9*	*-0.6*
Change in stocks and valuables (2)	–	–	–	-0.6	–	–	-0.1
Exports of goods *fob* and services (3)	30.9	2.1	1.8	0.6	0.1	..	..
of which: goods	*25.4*	*2.1*	*1.7*	*0.5*	*0.2*	*-0.3*	*0.1*
Net exports	–	–	–	2.7	–	–	0.8

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

Table 8.2

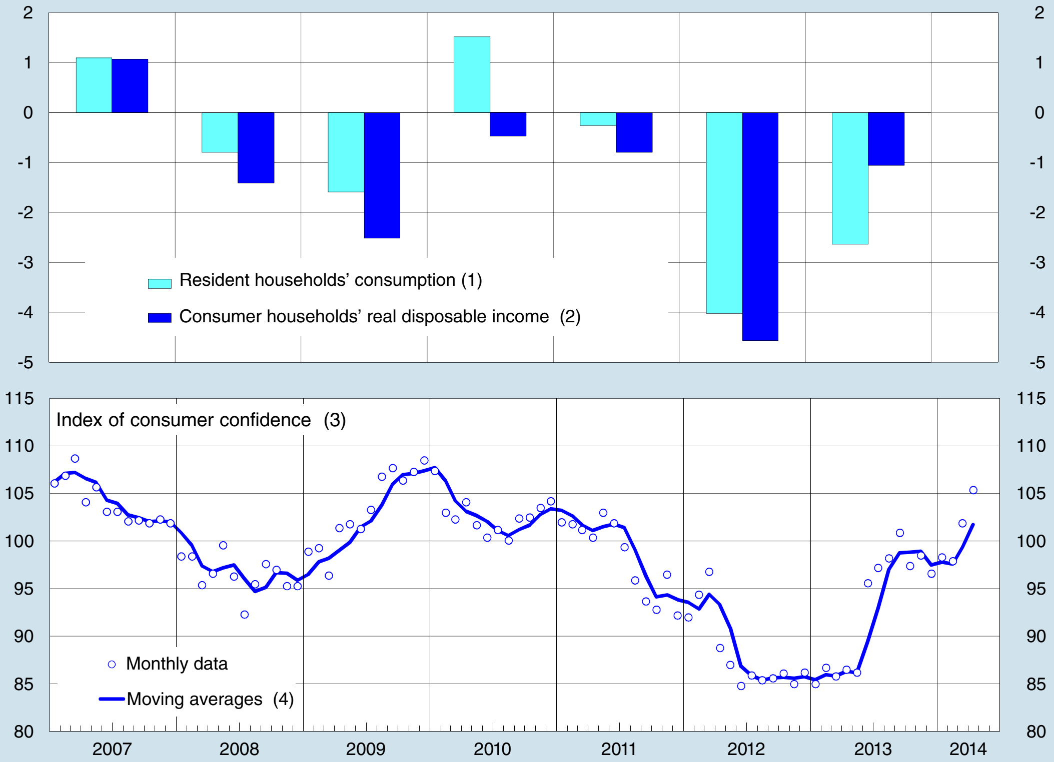
Expenditure of Italian households
(chain-linked volumes, unless otherwise indicated; percentage changes)

	Per cent of total expenditure in 2013 (volumes at previous-year prices)	2010	2011	2012	2013
Non-durable goods	30.4	1.1	-1.3	-4.2	-3.4
of which: foods and non-alcoholic beverages	*14.3*	*0.5*	*-1.2*	*-2.8*	*-3.1*
Semi-durable goods	9.8	5.1	0.5	-9.0	-5.2
of which: clothing and footwear	*6.8*	*3.5*	*0.8*	*-9.8*	*-5.2*
Durable goods	7.0	-0.3	-4.1	-12.0	-5.2
Services	52.9	1.4	1.1	-1.3	-1.2
of which: hotels and restaurants	*10.1*	*1.0*	*0.9*	*-1.7*	*-2.1*
education	*1.0*	*0.1*	*-0.2*	*-2.7*	*-2.3*
Total domestic expenditure	**100.0**	**1.5**	**-0.1**	**-3.8**	**-2.5**
Italian residents' expenditure abroad	(1)	-3.3	-2.4	-6.1	0.5
Non-residents' expenditure in Italy	(1)	-0.2	2.7	0.8	1.9
Total national expenditure	**–**	**1.5**	**-0.3**	**-4.0**	**-2.6**
Memorandum item:					
National expenditure deflator	–	1.5	2.8	2.7	1.3

Source: Istat, national accounts.
(1) In 2013 Italian residents' expenditure abroad amounted to 1.7 per cent and non-residents' expenditure in Italy to 3.5 per cent of total Italian household expenditure.

Figure 8.1

Consumption, real income and consumer confidence
(growth rates and indices)



Source: Based on Istat data.
(1) Chain-linked volumes; percentage changes on previous year. – (2) Deflated using the resident households' consumption deflator. – (3) Indices, 2005=100; seasonally adjusted data. Methodological changes concerning the sample and data collection techniques were made in June 2013, and the data from that date on are not directly comparable with those of previous months. – (4) For the three months ending in the reference month.

Saving in the economy as a whole continued to increase in 2013. Gross national saving rose to 18.4 per cent of disposable income, approaching the average registered between 2000 and 2010 (Table 8.3). A rise in private sector saving was partly offset by the increase in dissaving by general government. The external current account was in surplus for the first time since the start of the last decade.

Table 8.3

Saving and gross investment
(per cent of gross national disposable income)

	Average 1981-1990	Average 1991-2000	Average 2001-2010	2010	2011	2012	2013
Saving by general government	-6.6	-3.3	..	-1.5	-1.4	-0.3	-0.9
Saving by private sector	28.8	24.6	19.9	18.3	18.4	18.1	19.3
of which: consumer households	*20.0*	*13.0*	*8.1*	*6.1*	*5.8*	*5.4*	*6.4*
Gross national saving	22.3	21.3	19.9	16.8	17.0	17.8	18.4
Gross investment	23.2	20.5	21.2	20.4	20.1	18.3	17.5
Memorandum item:							
Balance on current transactions with rest of world	-0.9	0.9	-1.2	-3.6	-3.1	-0.4	0.9

Source: Based on Istat data.

Investment

Gross fixed investment contracted by 4.7 per cent in 2013, bringing the cumulative fall to nearly 15 per cent in three years (Table 8.4). The fall in construction investment was again quite steep (6.7 per cent), while that in investment in machinery, equipment and transport equipment moderated significantly to 2.4 per cent for the year as a whole, with a return to expansion in the second half.

Table 8.4

Fixed investment
(chain-linked volumes, unless otherwise indicated)

	Percentage composition in 2013 (1) (volumes at previous-year prices)	Percentage changes			Per cent of GDP (1) (volumes at previous-year prices)	
		2010	2011	2012	2000	2012
Construction	52.4	-3.7	-6.1	-6.7	9.5	9.1
residential	*24.3*	*-7.0*	*-6.9*	*-6.2*	*4.2*	*4.2*
other	*23.4*	*-0.6*	*-5.6*	*-7.8*	*4.5*	*4.1*
property transfer costs	*4.7*	*-1.3*	*-4.1*	*-4.5*	*0.8*	*0.8*
Machinery and equipment	32.1	-0.5	-10.5	-6.3	7.4	5.6
Transport equipment	9.6	-1.5	-12.7	12.9	2.2	1.7
Intangible assets	5.9	0.7	-2.7	-1.4	1.2	1.0
Total gross fixed investment	**100.0**	**-2.2**	**-8.0**	**-4.7**	**20.3**	**17.4**
Total excluding residential buildings	–	-0.6	-8.3	-4.2	16.1	13.2
Total excluding construction	–	-0.5	-10.0	-2.4	10.7	8.3

Source: Istat, national accounts.
(1) Rounding may cause discrepancies in totals. – (2) Net of depreciation and amortization.

Total investment has fallen by nearly 27 per cent since 2007, compared with 16 per cent in the recession of the early 1990s. Overall the investment rate has fallen by four percentage points to 17.4 per cent of GDP, owing to uncertainty over the economic outlook, difficulties in credit access and, in industry excluding construction, where capital intensity is greatest, the increase in idle capacity.

The decline in construction investment in 2013 was less pronounced in residential building (6.2 per cent) than in the rest of the sector (7.8 per cent). The number of house sales continued to decrease (by 9.2 per cent), though less sharply than in 2012, as demand was dampened by households' declining income and by persistent difficulty in obtaining credit. House prices fell further, by 5.6 per cent, or 6.9 per cent net of consumer price inflation.

The Bank of Italy branches' early-2014 survey of 4,216 firms with 20 or more workers in industry excluding construction and private non-financial services confirmed the reduction in purchases of capital goods that firms had forecast in the spring of 2013 (Table 8.5), which was practically in line with the national accounts data. However, firms with over 500 workers reported that they had increased their investment expenditure.

Table 8.5

Gross fixed investment of the firms in the Bank of Italy sample according to size, capacity utilization and change in turnover
(percentage changes at 2013 prices, unless otherwise indicated) (1)

	Total	Number of employees				Capacity utilization (2) (3)		Change in turnover (2)	
		20-49	50-199	200-499	500 or more	High	Low	High	Low
Industry excluding construction									
of which: manufacturing									
realized investment in 2013	*-1.3*	*-11.0*	*-12.6*	*-13.7*	*19.2*	*-4.7*	*3.8*	*5.6*	*-8.4*
realization rate (4)	*105.3*	*103.8*	*95.7*	*97.0*	*116.0*	*100.5*	*111.0*	*114.2*	*96.9*
plans for 2014	*-0.5*	*-4.7*	*3.6*	*2.5*	*-1.6*	*0.9*	*-0.9*	*-4.2*	*4.1*
Realized investment in 2013	-2.3	-11.3	-10.9	-9.6	9.3	-4.6	2.3	4.2	-8.4
Realization rate (4)	101.2	105.0	95.8	94.8	105.4	97.2	108.0	108.5	94.9
Plans for 2014	-0.8	-5.0	2.8	2.8	-2.2	-0.3	-0.9	-3.6	2.1
Services (5)									
Realized investment in 2013	-5.3	-6.2	-15.1	4.6	2.5	....	....	-5.7	-4.5
Realization rate (4)	97.4	102.2	102.1	102.4	91.6	....	....	96.0	100.4
Plans for 2014	-2.0	-7.6	-1.8	-6.1	2.3	....	....	-2.9	-0.5
Total									
Realized investment in 2013	-3.8	-8.6	-13.0	-3.7	3.3	-4.6	2.3	-1.3	-6.7
Plans for 2014	-1.4	-6.6	0.7	-1.5	-0.1	-0.3	-0.9	-3.2	1.0

Source: Banca d'Italia, *Survey of Industrial and Service Firms*.
(1) Robust means obtained by adjusting both the positive and negative outliers of the distribution of annual changes in investment. The investment deflator was estimated by the firms interviewed. – (2) The firms are distributed according to whether they are above (high) or below (low) the median value calculated separately for industry and services with reference to 2013. – (3) Refers only to industrial firms with 50 workers or more. – (4) Realized investment during the year as a percentage of investment planned (according to the previous year's survey), both at current prices. – (5) Private-sector non-financial services.

Investment plans for this year indicate substantial stabilization in industry excluding construction and further decline in private services. Manufacturing firms with 50 or more workers reported a slight rise in planned investment outlays, while those of smaller firms continued to diminish.

A survey of 556 construction firms conducted by the Bank's branches in the early months of 2014 found that the volume of new public works shrank again in 2013, by 5 per cent compared with 2012. Respondents expected a further decline, though more moderate (just over 2 per cent), this year as well.

Exports and imports

Exports. – Italian exports of goods and services stagnated in 2013, with growth of just 0.1 per cent for the year as a whole (Table 8.1), after contracting temporarily in the early months. In the second half they expanded by 1.4 per cent compared with the first.

Over the last four years, on average Italy's merchandise exports have grown faster than the potential demand for them, which itself, however, has expanded by about a third less than world trade (Table 8.6). Italy's worldwide market share, at current prices and exchange rates, stabilized last year at 2.8 per cent (compared with 3.6 per cent in 2007).

Table 8.6

Italian merchandise export volumes, foreign demand and world trade
(percentage changes on previous year)

	Italian merchandise exports	of which: *euro area*	of which: *non-euro area*	Foreign demand (1)	World trade
2010	12.4	*11.2*	*13.3*	10.8	14.0
2011	6.9	*4.0*	*9.2*	5.0	6.9
2012	2.1	*-2.5*	*5.4*	1.3	2.3
2013	0.2	*-1.6*	*1.5*	1.9	2.7
Total 4-year period	22.9	*10.9*	*32.4*	20.1	28.0

Sources: Based on IMF and Istat data.
(1) Foreign demand is calculated as the weighted average of imports by volume of Italy's trading partners, weighted by their shares of Italian exports by value.

Export growth was penalized by a loss of competitiveness due chiefly to the appreciation of the euro. Gauged by unit labour costs in manufacturing, Italy's price competitiveness deteriorated by 9.4 per cent between the third quarter of 2012 and the end of 2013, some 7 percentage points more than that of Germany and France, while Spain's competitiveness actually gained 3 per cent. However, according to indicators based on the producer prices of manufactures, Italian exporters' loss of competitiveness was much less severe, amounting to 4.1 per cent, about the same as in Germany and France and slightly greater than in Spain.

Exports of merchandise alone increased slightly in first quarter of 2014, thanks to sales in European markets. According to firms, the short-term outlook continues to be positive.

Imports. – Purchases of goods and services from abroad contracted again in 2013, by 2.8 per cent, but considerably less than in 2012. The performance of imports reflected above all decreased investment and the slowdown in the growth of exports, which are the most import-intensive components of demand.

Estimates based on foreign trade data indicate that in volume terms imports from EU countries decreased less steeply than those from the rest of the world (down by 1.5 and 4.0 per cent respectively). The latter were affected by the decline in imports of energy commodities.

Supply

Value added in industry excluding construction fell by 3.2 per cent in 2013, accounting for 0.5 percentage points of the contraction in GDP. The decline was sharpest in the wood and paper industries, while electronics and electrical equipment recorded a marginal expansion and pharmaceuticals a stronger gain. Industry's share of total value added diminished again, falling to 18 per cent compared with 21 per cent in 2007. It nevertheless remains higher than in the other main euro-area economies except Germany, where it stands at 25 per cent, only slightly less than in 2007.

Value added in services decreased by 0.9 per cent, contributing 0.6 points to the fall in GDP. The sharpest declines came in information and communications, transport, trade and restaurant services.

Value added in construction also fell substantially, by 5.9 per cent, for the sixth consecutive year. Construction output was 26.7 per cent lower on average than in 2007.

Prices and costs

The twelve-month rate of consumer price inflation as measured by the HICP came down to an average of 1.3 per cent in 2013 (Table 8.7). It diminished progressively in the course of the year, from 2.1 per cent in the first quarter to 0.7 per cent in the fourth; it reached a historic low of 0.3 per cent in March 2014 (Figure 8.2). One factor in the disinflation was energy prices, which were lower than in the year-earlier period from the second quarter on, as the dollar price of oil declined and the euro appreciated, but core inflation also came down to historically low levels (under 1.0 per cent on a twelve-month basis in December), against the backdrop of prolonged weakness of domestic demand.

There is evidence that the inflation-dampening effect of ample idle capacity was greater in 2013 than in the past.

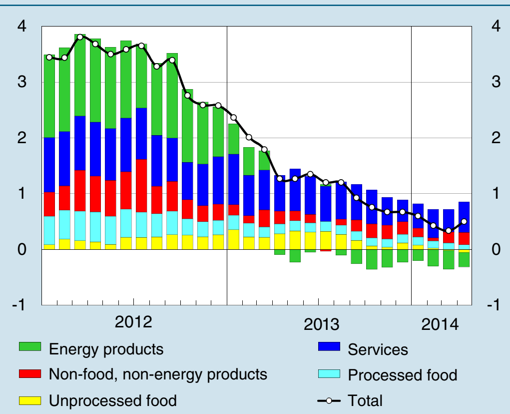
The reduction in core inflation, under way since mid-2012, involved both non-energy, non-food goods and services. The rise in goods prices slowed from 2.0 per cent on average in the first half of 2012 to 0.6 per cent in the first four months of 2014, that in service prices from 2.4 to 1.1 per cent.

The subsidence of consumer price inflation came to an end in April this year, when the HICP rose by 0.5 per cent. The portion of elementary items whose prices declined on a twelve-month basis was 27 per cent, just barely higher than in 2009-10. The risk of deflation is still limited. In April only about 7 per cent of consumers expected that prices would decline in the next twelve months. However, the public perceives a considerable risk of excessively low price increases for an extended period of time: 61 per cent of consumers expect prices to be declining or stable.

Figure 8.2

Inflation in Italy and the contributions of the main components (1)

(12-month percentage changes and percentage points)



Source: Based on Eurostat data.
(1) Harmonized Index of Consumer Prices.

Table 8.7

Consumer prices

	Percentage changes on previous year		Percentage weights
	2012	2013	2013
Harmonized Index of Consumer Prices	**2.8**	**3.0**	**100.0**
Unregulated goods and services	**2.7**	**2.8**	**86.8**
Unprocessed food	2.5	2.2	6.5
Processed food	2.4	2.7	10.4
Energy products	14.6	14.3	5.2
Non-food and non-energy products	1.4	1.7	25.8
Services	2.2	1.9	36.7
Tobacco	4.1	6.8	2.2
Regulated goods and services	**3.3**	**4.8**	**13.2**
Overall index excluding food, energy and tobacco	**1.9**	**1.7**	**73.0**
Harmonized index of consumer prices	**2.9**	**3.3**	**100.0**

Source: Based on Istat data.

Producer prices, costs and margins. – The producer prices of goods sold on the domestic market declined by 1.2 per cent on average in 2013, after rising by 4.1 per cent in 2012. Producer price inflation came down in the early months of 2014 to negative rates. The main factor was the fall in energy prices, down by 4.7 per cent on average in 2013 (following the 11.2 per cent increase of 2012). In a persistently weak economy, for non-food consumer goods the rate of increase in producer prices fell from 1.1 per cent in 2012 to 0.4 per cent in 2013.

Inflation expectations. – Since last autumn the analysts surveyed by Consensus Economics have revised their 2014 inflation forecasts downwards, to 0.8 per cent this May. They expect inflation to come back up to 1.1 per cent in 2015. A similar picture emerges from the business survey conducted by the Bank of Italy with *Il Sole-24 Ore* this March. Over a longer horizon of three to five years, the firms interviewed expected price inflation to continue to be low, at 1.2 per cent.

9. THE PRODUCTIVE ECONOMY AND THE REFORMS

In the last five years the Italian economy has suffered from the global crisis: value added and productivity have declined and the business birth rate has fallen. Growth had already suffered in the previous decade from a series of unresolved structural problems that highlighted the difficulty the Italian economy had in adjusting to the major changes in the world economy and technology. Productivity had risen less than in the past and more slowly than in other countries; Italy had lost market shares of world trade, including by comparison with the other European economies; the participation of Italian firms in global production chains remained generally marginal and subordinate. The growth in the size of firms and their propensity to innovate were unsatisfactory owing to the influence of external factors (such as the ineffectiveness of the general government sector and regulations and the limited endowment of human capital) and internal factors (such as low levels of capital and inefficient management structures).

As time passed the gap widened between the performance of the most efficient firms, especially exporters, and that of the weakest firms, less willing to innovate and internationalize.

To foster growth requires measures regarding all its determinants: labour supply and demand, the quality of human capital, public and private investment, research and development, innovation and the external conditions that influence firms' productivity and the allocation of resources.

Structural reforms can affect growth significantly, but they often take a long time to implement and their benefits are not immediate. Setting the various measures within a clear and comprehensive framework facilitates the reform process by diminishing the resistance of individual categories and makes it possible to obtain the positive effects earlier. The establishment of intermediate targets and provision for stringent progress checks help to maintain a high level of attention on the reform process and to identify and solve problems.

In the second half of 2011 a wide-ranging reform process was launched, although many of the measures have so far been implemented only in part. In 2013 measures were adopted to reduce administrative costs, raise the efficiency of civil justice and improve infrastructure. In the early months of 2014 steps were taken to simplify the law governing fixed-term employment and apprenticeship contracts and measures adopted to support the disposable income of the least well-off payroll workers.

The 2014 National Reform Programme contained in the 2014 Economic and Financial Document emphasizes the need to give the reform process new impetus and outlines a broad range of interventions. The complete framework, the timetable and the manner of monitoring the proposed measures still have to be established.

Sectoral dynamics and productivity

Since 2007 value added in manufacturing has fallen in real terms at an average annual rate of 3.2 per cent, and productivity has stagnated. The sharp contraction in value added triggered by the crisis of foreign demand in 2008-09 grew worse from the middle of 2011 onwards as a consequence of the decrease in domestic demand (Table 9.1).

Table 9.1

Value added and labour productivity by sector of economic activity
(average annual percentage shares and changes)

	Share of total value added (1)		Value added (2)				Productivity (3)			
	2007	2013	2001-2007	2008-2013	2012	2013	2001-2007	2008-2013	2012	2013
Agriculture	**2.1**	**2.1**	**-0.5**	**-0.8**	**-4.3**	**0.3**	**0.4**	**1.9**	**1.6**	**1.9**
Industry	**27.2**	**23.9**	**1.1**	**-3.5**	**-3.6**	**-3.9**	**0.2**	**-0.2**	**0.3**	**-0.1**
Industry excluding construction	20.8	18.3	0.8	-3.0	-3.0	-3.2	0.8	0.0	-0.2	-2.1
Mining and quarrying	0.4	0.3	-1.2	-2.9	3.1	-6.3	-0.9	0.4	11.1	-4.7
Manufacturing	18.3	15.5	0.8	-3.2	-3.5	-3.1	0.9	0.0	-0.5	-1.9
Food products	1.8	1.9	-0.6	-0.6	0.9	-1.5	-1.0	0.6	1.9	0.7
Textiles, clothing and leather	1.9	1.6	-2.0	-2.6	-6.0	-2.0	0.7	1.4	-4.2	-0.5
Wood, paper, and publishing	1.2	0.9	-0.3	-5.0	-9.1	-6.7	0.7	-0.9	-3.4	-4.2
Coke and refined petroleum products (4)	0.4	0.1	-4.0	-2.4	-3.5	....	-3.8	-0.1	1.6	....
Chemical products	0.7	0.7	-0.9	-3.4	-5.0	-2.2	-0.2	-1.6	-3.4	-0.1
Pharmaceutical products	0.4	0.5	2.7	3.1	5.9	4.3	3.4	4.0	8.3	-1.9
Rubber, plastic and non-metallic mineral products	1.8	1.3	0.9	-4.7	-7.7	-3.6	1.3	0.6	-1.2	0.4
Basic metals and metal products	3.3	2.5	2.7	-4.1	-5.6	-2.0	1.3	-0.5	-0.9	-0.2
Computers, electronic and optical products	0.7	0.8	1.2	-2.0	1.8	1.4	0.8	-0.2	3.8	0.0
Electrical equipment	0.8	0.8	2.4	-1.8	-5.5	0.7	1.9	1.3	-1.4	-0.9
Machinery and equipment	2.3	2.1	2.5	-2.5	-3.0	-4.2	1.3	-0.8	-3.1	-2.2
Transport equipment	1.1	0.9	0.5	-4.6	-4.0	-2.2	0.8	-1.1	-0.8	-6.3
Furniture, other industries, repairs and installation	1.8	1.5	1.0	-5.8	-7.0	-3.9	0.3	-2.3	-4.7	-3.4
Electricity, gas, steam and air conditioning	1.5	1.5	1.8	-1.6	-0.5	-5.5	4.1	-1.1	-1.5	-6.2
Water, sewerage networks, waste	0.7	1.0	0.0	-1.3	0.7	1.4	-2.4	-2.1	0.3	0.2
Construction	6.3	5.6	2.5	-5.1	-5.6	-5.9	-0.9	-1.2	0.9	4.4
Services	**70.8**	**74.0**	**1.4**	**-0.6**	**-1.6**	**-0.9**	**0.2**	**-0.2**	**-1.5**	**0.5**
of which:										
Trade and repairs	*11.0*	*10.7*	*0.5*	*-2.0*	*-3.4*	*-2.2*	*0.4*	*-0.4*	*-2.3*	*1.9*
Transport and storage	*5.5*	*6.0*	*1.4*	*-2.8*	*-5.7*	*-2.2*	*0.3*	*-1.3*	*-3.1*	*-1.2*
Hotels and restaurants	*4.1*	*4.2*	*0.4*	*-0.5*	*-1.0*	*-2.0*	*-2.1*	*-0.1*	*-1.8*	*-0.6*
Information and communication	*4.5*	*3.9*	*4.4*	*-0.4*	*-2.0*	*-4.3*	*2.9*	*-0.1*	*-2.3*	*-5.7*
Financial activities	*5.3*	*5.5*	*3.2*	*2.2*	*0.7*	*1.5*	*2.0*	*2.6*	*0.5*	*3.6*
Real estate activities	*12.6*	*14.3*	*1.0*	*-0.2*	*-0.7*	*0.4*	*-2.1*	*1.3*	*3.9*	*3.2*
Professional activities	*6.0*	*6.1*	*0.5*	*-1.9*	*-2.7*	*1.6*	*-1.6*	*-2.3*	*-3.4*	*1.8*
Administrative and support service activities	*2.5*	*2.7*	*4.0*	*-1.1*	*-1.5*	*-2.1*	*-1.6*	*-2.9*	*-3.4*	*-3.7*
Total	**100.0**	**100.0**	**1.3**	**-1.4**	**-2.2**	**-1.6**	**0.3**	**-0.1**	**-0.7**	**0.4**

Source: Istat, national accounts.
(1) At base prices; current prices. Rounding may cause discrepancies in totals. – (2) At base prices; chain-linked volumes. – (3) Value added at base prices per hour worked; chain-linked volumes. – (4) The figure for 2013 is not available. The average is calculated with reference to the period 2008-12.

Value added in the services sector decreased in real terms over the last five years at an average annual rate of 0.6 per cent, while productivity declined by 0.2 per cent per year. The sector was adversely affected by the difficulties encountered by manufacturing, which it supplies with a substantial volume of production inputs and by the fall in households' demand.

In the leading European countries the demand for services is driven mainly by industrial firms, in contrast with the situation in the United States, where it is driven mainly by households. According to data made available by the World Input-Output Database, between 1995 and 2009 in the United States nearly 70 per cent of the increase in the production of market services at constant prices was due to the rise in households' final consumption; in Germany and France households' final consumption accounted for 50 per cent of the increase, in Italy it accounted for 36 per cent. In the three leading euro-area countries, whose productive structures are very similar, the demand for services is directed above all at the commercial distribution and land transport sectors, marked by a low level of worker skills and technology.

Firm dynamics

The persistent crisis of the Italian productive economy has also affected firm demographics. Chamber of Commerce data show that the net birth rate for the whole economy, equal to 0.2 per cent in 2013, fell over the last five years by 0.8 percentage points compared with the average for 2003-07. Since the exit rate remained almost unchanged, this result was due above all to the fall in the entry rate, which was affected not only by the increase in the uncertainty about the outlook for demand but also by the increased difficulty of obtaining credit. The fall in the net birth rate was largest in manufacturing, where it reached its lowest level since 1996 (-2.5 per cent).

The demographic dynamics of businesses contribute to the reallocation of production between sectors and, within each sector, between firms with different levels of productivity. On the basis of Istat's Statistical Archive of Active Enterprises in the period 1999-2011 the rise in aggregate productivity – proxied by turnover per employee at constant prices – was equal to 4.9 per cent and largely due to the reallocation of resources to the most efficient firms in the same sector; the effects of shifts across sectors were less important. By contrast, overall growth has been weakened by the movements in the average productivity of existing firms, which were negative, especially in the years of the crisis, and by firm demographics, since closures of firms with below-average productivity were accompanied by low levels of productivity among new entries.

Developments in value added and productivity in Italy are affected by a productive structure biased towards small and medium-sized enterprises with limited equity capital. Unable to exploit economies of scale and scope to the full, they are less involved in innovation and internationalization.

According to Istat's Ninth General Census of Industry and Services, in 2011 the average firm had 3.7 workers (as against 3.8 in 2001 and 4.9 in 1971). Italy's highly fragmented productive structure compared with the other leading European countries is common to every sector. In manufacturing the average size is 9.3 workers in Italy, 14.7 in France and 34.4 in Germany. In the market services sector, where firms with fewer than 20 workers account for more than 98 per cent of the total, the average size is 3.2 workers in Italy, 5.4 in France and 9.9 in Germany.

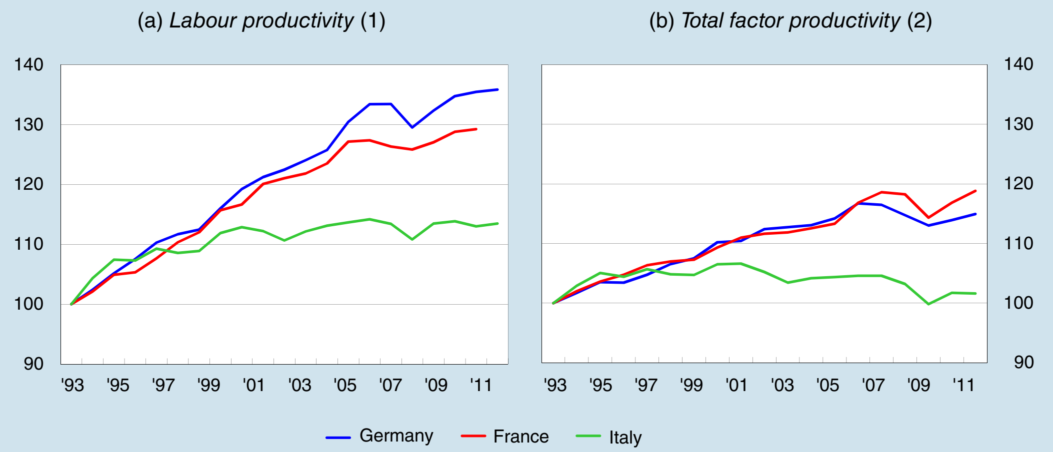
Economic growth factors and structural reforms

Economic growth can be broken down into the contributions made by changes in the factors of production (labour and capital) and those in total factor productivity, a proxy for the ways in which production inputs are combined from the technological and organizational standpoint.

Until 2008 the GDP growth rate was held back, compared with other countries, by the performance of total factor productivity, which stagnated between 2000 and 2007 in Italy, whereas it rose at annual average rates of 0.8 per cent in France and 1.2 per cent in Germany (Figure 9.1).

Figure 9.1

Productivity dynamics in the leading euro-area countries: total economy
(indices, 1993=100)



Sources: Eurostat, *National accounts* and OECD.
(1) Value added at base prices per hour worked; chain-linked volumes. – (2) Contribution to the growth in GDP not explained by the dynamics of labour and capital.

These dynamics are the result of various determinants. Analyses based on OECD data indicate that in Italy the contribution deriving from the reallocation of production to the more efficient firms and sectors is smaller than in the other main advanced countries owing to more restrictive regulation of the markets for goods, services and productive factors and a less business-friendly institutional context. Firms' efficiency is restrained by the limited propensity for process and product innovation, which can be attributed to sectoral and size characteristics, the overall regulation of business and the endowment of human capital. Production costs, which are high by international standards above all owing to the level of taxation, have been a brake on firms' competitiveness in international markets.

Since 2008 and especially since the second half of 2011 the recession that has hit the Italian economy has been accompanied by a sharp fall in investment and employment; total factor productivity declined significantly, by 0.8 per cent.

Starting in 2011 extensive reforms have been initiated with the aim of creating conditions more conducive to growth. Measures have been adopted to (a) make the labour market more efficient; (b) facilitate firms' recourse to equity capital and provide incentives for investments in venture capital funds and in the equity of start-ups; (c) increase competition, especially in services; (d) reduce the cost of bureaucratic formalities; (e) improve the functioning of civil justice; (f) step up the construction of infrastructure; and (g) combat corruption. In 2013 additional measures were approved to improve the institutional environment for business, notably with Decree Law 69/2013, converted into Law 98/2013.

According to a substantial body of research, structural reforms such as those indicated have positive effects on growth but have long lead times and their benefits are not immediate.

Each year the National Reform Programme indicates the measures to be adopted to achieve the national objectives for growth, productivity, employment and sustainability, as part of the European Semester, taking account of the European Commission's Annual Growth Survey and the guidelines laid down by the European Council in March. In line with earlier editions, the 2014 National Reform Programme outlines structural interventions in several fields: product market regulation and competition; the labour market; schools and universities; the financial and tax systems; subsidies for business activities; and the institutional context. It focuses attention on rationalizing institutional arrangements, which is considered essential to recoup efficiency.

The Programme lays down guidelines for the reforms. The complete picture of the interventions still has to be finalized as regards: the time needed for their implementation; the content of the individual measures; and how they are to be carried out, which, in the recent past, has proved to be the main weakness of the reform process.

Regulation and competition in services. – Competition fosters productive and allocative efficiency and provides an incentive to make the best use of resources both within each firm and in the market. It helps to stimulate innovation and productivity gains.

The most recent liberalization measures in the services sector date back, as regards legislation, to 2011-12. Thanks in part to these measures the OECD indicators for 2013 show a greater opening up to competition. In professional services and network services as a whole (which include transport, energy and communications) between 2008 and 2013 Italy improved its ranking in these areas by 12 and 4 positions respectively, rising to an intermediate position among the OECD countries considered. However, in some sectors (especially the distributive trades and postal services) regulation remains especially restrictive.

As regards implementation, the process of opening up the market has encountered difficulties in several sectors.

The National Reform Programme calls for the approval of an annual law on competition, albeit without specifying the markets involved. This instrument, envisaged by the Italian legal system since 2009 but never used, could guarantee continuity to the process of economic liberalization. In the local public services sector, where the phenomenon of in-house providing is widespread, provision is made for the adoption of measures aimed at fostering a greater opening up of the market.

The labour market. – Labour market participation and employment are key determinants of potential output. A well-functioning labour market is essential to ensure allocative efficiency, grasp the opportunities offered by technological progress and the change in trade flows, and hold down the cost of adjusting to external shocks.

Law 92/2012 (the Fornero reform) brought a comprehensive reorganization of the main features of the labour market, to arrive at a more homogeneous distribution among the various categories of workers of job safeguards and access to income support and unemployment benefits and active labour policies, while preserving an adequate margin of flexibility in the use of labour.

The measures contained in Decree Law 34/2014 continue on the path taken by Law 99/2013 and simplify, to the advantage of firms, the use of fixed-term contracts, by eliminating the risk of disputes connected with the specification of the grounds for their adoption, and the training obligations inherent in apprenticeship contracts, entrusted to regional initiatives that are not always of high quality.

Simplification of the rules, during a cyclical upturn, could stimulate new hiring. The measures nonetheless need to be completed to ensure their consistency with the planned introduction of a contract offering increasing protection over time (the subject of a draft enabling law). To avoid the creation of a dual labour market, the coexistence of a contract offering increasing protection with the fixed-term contract requires the former to be more advantageous for firms than the latter. For the apprenticeship contract, firms' activity of inserting apprentices into the labour market should be preferred and stimulated, since with hindsight it can be seen to be the most effective. There remains the need to reduce the procedural costs of dismissal, both individual and collective.

Curbing the social costs deriving from increased flexibility requires the completion of the comprehensive overhaul of active and passive policies. This overhaul, deferred to a draft enabling law, also envisages the creation of a national agency devoted above all to strengthening the integration of the two types of policy. The amount of resources needed to carry out these interventions remains to be clarified, as does the manner of revising the organization of employment services, including recourse to the private sector through competitive tenders, and setting up the new agency. This would make it possible to increase the new unemployment benefit, which is low by international standards, by making it subject to more stringent job-search or training requirements.

The National Reform Programme proposes the introduction of a minimum hourly wage laid down by law and tax interventions to support the supply of labour, measures with a potentially vast impact whose effectiveness will depend on the details of their implementation and on their interaction. An overall design of the interventions is needed, accompanied by a preliminary experimental phase.

The supply of labour is also discouraged in Italy by the tax system, especially for women: the deductions and other transfers, calculated on the basis of household income, raise the effective marginal income tax rate of second earners (typically female spouses) and discourage them from participating in the labour market. The distortion is greater for women with limited earnings prospects and a husband with a low-income job. If it is made permanent, the bonus of €80 per month envisaged for employees by Decree Law 66/2014 could have a positive impact on labour-market participation.

Human capital. – Human capital is a crucial factor for economic growth and, more generally, for social welfare; it fosters innovative activity and the use of new technologies, raises productivity, improves health, social cohesion and compliance with the rules. Italy's human capital endowment is low by international standards and inadequate with respect to its status as an advanced country; it reflects shortcomings in the educational system and insufficient demand for qualified labour on the part of the productive system.

In the National Reform Programme increasing and enhancing human capital are based on the assessment of schools and universities and on the opening of the world of education and research to the world of work and to international contacts.

Reinforcing assessment activity by strengthening the competent bodies and confirming their necessary impartiality may improve the stock of information on which to base the revision of policies. The complete implementation of the National Assessment System in schools should be accompanied by measures that give them greater autonomy and make those running them more accountable. Additional resources should be made available to support schools in more critical conditions – where there are detailed plans for improving the situation – and to cope with more difficult social contexts. The quality of teachers and their motivation, key factors for the effective operation of the system, would benefit from the adoption of selective hiring procedures and not completely automatic career paths, as well as from more adequate remuneration.

Greater recourse to competition might bring an improvement, especially in the university system. To this end it would be helpful to give preference, in the use of resources, to the support of less well-off students and their geographical mobility.

The financing of firms. – Firms' strategies and allocative efficiency are also influenced by the characteristics of the financial markets. In Italy the under-development of sources of financing alternative to bank credit is one of the reasons why firms, especially small and medium-sized enterprises, have an excessive amount of debt and a high ratio of bank debt to total debt. Strengthening firms' equity capital and giving them access to non-bank forms of medium- and long-term financing would have positive effects on their ability to invest, their growth potential and innovation, as well as increasing the productive system's ability to cope with periods of tight bank credit.

Innovation. – Innovative activity, a crucial factor for economic growth, is at a lower level in Italy than in the other main advanced countries, especially in the private sector. The public resources devoted to promoting innovation are less than in the other main advanced countries; to date their effectiveness has been limited.

Consolidating the provisions of Decree Law 145/2013, converted into Law 9/2014, the National Reform Programme outlines measures for the support of investment in R&D and business innovation, to be implemented through an increase in tax credits for R&D spending and for hiring research workers. Greater effectiveness could be achieved by reducing the fragmentation and improvised nature of interventions and, above all, the uncertainty about the time needed for the disbursement of the support.

Firms' energy costs. – To improve the price competitiveness of Italian firms the Government has set itself the objective of reducing the cost of electricity for small and medium-sized enterprises by 10 per cent, without any additional burden on the public finances. This would offset part of the increases approved in 2013 to finance a discount in 2014 for mainly medium-sized and large firms with a heavy consumption of electricity.

Taxation. – The high level of taxation in Italy and the complexity and variability of the tax rules have an adverse impact on firms' competitiveness and economic growth; they also augment the propensity to avoid and evade taxes.

The National Reform Programme envisaged a 10 per cent cut in the rate of the regional tax on productive activities (already carried out by Decree Law 66/2014) and the implementation of the enabling law for the reform of the tax system (Law 23/2014). Partly to combat tax avoidance and evasion, this law aims, among other things, at simplifying the tax rules and guaranteeing greater stability and certainty of the law. In particular, new rules on the abuse of law, rewards for the most reliable taxpayers and the revision of the system of punishments are envisaged. In a globalized economy it is crucial, for the purpose of countering tax avoidance, to have automatic exchanges of information among the various countries' tax authorities.

Firms' costs and productivity and the effectiveness of the mechanisms for the allocation of resources are considerably influenced by the quality of the institutional setting. For economic agents it is essential to be able to count on (a) a framework of clear, certain and stable rules; (b) administrative regulations that do not impose excessive costs in pursuit of the general interest; (c) a general government sector that is able to provide prompt and competent answers at a reasonable cost; and (d) an efficient system for protecting contracts and legality.

From all these standpoints the conditions for doing business in Italy still appear to be rather unfavourable by international standards.

Legislative and administrative simplification. – With a view to legislative and administrative simplification the Government has undertaken to launch a process of regulatory revision and reform of the administrative coordination conference and of the system of authorizations.

As regards simplification, the instruments, methods and best practices are all known and available, but implementation often encounters obstacles, reflecting an unclear setting of priorities and sometimes an inadequate quantity of human and technological resources. In the last few years considerable progress has been made, but there continue to be lags in moving from general legislative rules to the related implementing provisions and their actual application by the government bodies concerned.

Recourse to greater automation of procedures and the introduction of incentives and penalties for government bodies could help to overcome inertia and resistance. However, administrative simplification can go only so far unless it is set within a broader process of organizational revision and computerization of government bodies.

General government. – The Government has set itself the objective of reviving the efficiency and effectiveness of the general government sector. The main aspects of the intervention are the reform of public managers; a national mobility plan to achieve a more rational distribution of human resources; a generational turnover programme; and computerization. The practical measures for the implementation of these guidelines are crucial to the success of the reform programme.

Making public managers more accountable for the overall results of the organization they belong to is a key feature of the reform of the general government sector; it requires independence in the measurement of performance and maximum transparency in the appointment and assessment of managers. Greater accountability must be accompanied by a reduction in procedural prescriptions, an increase in managers' operational autonomy and a revision of the entry mechanisms to foster a diversified range of professional talents and raise managerial skills.

A revision of the organizational and geographical distribution of the general government sector – that would go beyond the traditional province-based arrangements and rationalize the number of entities – and greater mobility of public sector workers are necessary to make the distribution of human resources more efficient. This presupposes quantifying the real staff needs (standard requirements) and the removal of the current constraints and disincentives to voluntary mobility, attributable in part to the existence of an earnings structure with different levels for the same functions, and of the restrictions on compulsory mobility.

Generational turnover would lead to new and more specialized skills and increase the effectiveness of other interventions, such as computerization. To achieve these objectives, compatibly with the present budget constraints, it will be necessary to overcome the inefficiencies in the hiring procedures and selection mechanisms. Identifying specialized professionals, to be selected through periodic competitive exams that focus on profiles currently lacking in the public sector, could make it possible to overcome the present rigidities and formalisms. Within the public sector competence and merit should be rewarded with higher pay.

In the process of structural reorganization technological innovation can make an important contribution, by facilitating greater transparency, comparative assessments and entities' accountability.

Corruption. – Corruption impairs the working of the economy, with substantial costs for individuals, the productive and financial systems and society. It is seen as widespread in Italy, while confidence in the action to combat it is limited.

The instruments for fighting corruption have recently been strengthened (Law 190/2012). Their implementation is still inadequate, however, hindered as it is, among other things, by the sometimes very substantial increase in the burden of bureaucratic formalities weighing on general government entities.

To prevent and suppress corruption is one of the National Reform Programme's objectives. The lines of action identified – such as strengthening the powers of the National Anticorruption Authority, the revision of the rules governing criminal trials, with special reference to the statute of limitations, and the introduction of the crime of own-proceeds laundering – address some of the present weaknesses. The introduction of transparency rules based on the principle of access to all the documents of the general government sector, as in some Anglo-Saxon countries, is likely to help the action to curb corruption.

Civil justice. – Achieving international standards of efficiency in this field is a priority. In the last few years there have been numerous interventions aimed at increasing the productivity of judicial offices, by means of geographical reorganization and the creation of business courts, and reducing the number of disputes by introducing forms of compulsory mediation and filtering recourse to the appeal courts and the Court of Cassation.

The measures adopted are important; the introduction of any corrective and additional measures should be based on an assessment of the effects produced. The degree of litigiousness remains high, as a consequence of several factors: some are of a transversal nature (the quality of the regulation and efficiency of public action), others concern specific matters. The productivity of judicial offices would benefit from more rigorous systems for assessing and comparing performances and from the spread of the organizational good practices developed by the best offices.

The institutional context: the 2013 measures

Administrative simplification. – In 2013 some new provisions were adopted to reduce the length of civil trials; there nonetheless remain delays in the implementation of important measures approved in the recent past.

Company law. – Decree Law 76/2013, converted into Law 99/2013, lowered the minimum capital for the establishment of an ordinary private limited company from €10,000 to €1. This change brought Italian law into line with that of the other main European countries. The ordinary private limited company with a capital of €1 parallels the simplified private limited company, introduced in 2012, with the same capital requirement and standard and unalterable bylaws. These two measures have contributed to slowing the fall in the company birth rate.

Bankruptcy law. – Decree Law 69/2013, converted into Law 98/2013, made some changes to the rules governing the mechanism for a simplified restructuring with creditors (the *concordato in bianco*), which was introduced in 2012. By strengthening the disclosure requirements to which firms are subject, the decree reduces the scope for abuse of the instrument.

Civil justice. – With the aim of reducing the enormous backlog of civil cases, provision has been made for the temporary use of auxiliary staff to support ordinary magistrates in the appeal courts and the Court of Cassation; to overcome the shortages of administrative personnel in judicial offices, forms of mobility with incentives are envisaged.

To lessen the number of disputes, measures providing for compulsory attempts to reach reconciliation have been reintroduced for some types of civil and commercial litigation (Decree Law 69/2013). Significant reductions in litigiousness can be seen for some types of cases for which measures have been adopted in recent years with a view to reducing the caseload.

Infrastructure. – Supplementing the measures adopted in recent years, Decree Law 69/2013 introduced additional measures to foster the construction of infrastructure, in particular by allocating part of the financial resources for some major projects awaiting authorization and planning advances to projects that have already been finalized and approved. In addition, Decree Law 66/2014 strengthened the measures promoting the management of tenders on an aggregate basis. The implementation of projects nonetheless continues to be adversely affected by the uncertainty surrounding the budgetary situation and the shortcomings in the process of evaluating and selecting projects. The entry into operation of important measures adopted in past years has been repeatedly postponed.

In 2013 the scope of the tax incentives to stimulate the implementation of public-private partnership projects was broadened and measures were adopted to encourage greater involvement of financial institutions in the stages preceding the award of contracts. It remains necessary to address the shortcomings in the preparation of contracts and the monitoring of projects, which is essential to ensure the efficient construction and operation of works.

10. THE LABOUR MARKET

The fall in employment accelerated in 2013, in response to the deterioration of the economic cycle. The number of persons in work declined by 2 per cent. By comparison with the peak in 2008, the diminution amounts to 1.1 million jobs, or 4.3 per cent. Young people were affected by the cyclical downturn more severely than workers in the prime age groups. Preliminary data indicate that the reduction in employment virtually halted in the first quarter of 2014.

The decline in the number of hours worked per capita came to a stop last year, and this variable remained broadly unchanged as the diminished resort to wage supplementation was offset by a reduction in overtime and a further shift towards part-time jobs. A larger portion of part-time positions involved workers who would have preferred full-time jobs.

The unemployment rate rose to 12.2 per cent on average for the year and reached 12.7 per cent in the first three months of 2014, 0.9 percentage points above the euro-area average. The increase was moderated by a rise in the number of discouraged workers who, while available for work, declare that they have stopped actively seeking jobs.

Wage increases were in line with the modest rise in consumer prices. In the private sector earnings increased by 1.9 per cent, the gain in industry outstripping that in the service sector. In the public sector nominal wages remained stable owing to the freeze both on collective bargaining and on seniority increments. Since the start of the recession in 2008 real hourly earnings have declined by 1.3 per cent.

Employment and hours worked

According to national accounts figures, the average number of persons employed fell by 2 per cent in 2013 (Table 10.1 and Figure 10.1), the sharpest decline since 1993.

The number of hours worked per capita was unchanged. The decline in overtime and a further, less marked shift towards part-time employment were counterbalanced by the 1.4 per cent reduction in wage supplementation benefit hours. The sharp decline of 22.9 per cent in wage supplementation under a waiver, which accounted for about a quarter of authorized hours in 2013, was offset by increases of 2.4 and 14.6 per cent in ordinary and extraordinary supplementation hours respectively. In industry excluding construction, the ratio of benefit hours to total hours worked was unchanged (Figure 10.2). INPS estimates that firms actually utilized about half the hours authorized, as in previous years.

Table 10.1

Labour input in the Italian economy by sector (1)
(percentage shares and percentage changes)

	Persons in employment		Standard labour units		Total hours worked		Jobs	
	Share	Percentage change (2)	Share	Percentage change (2)	Share	Percentage change (2)	Share	Percentage change (2)
	2013	2012-13	2013	2012-13	2013	2012-13	2013	2012-13
Agriculture, forestry, fisheries	**3.7**	**-2.9**	**5.0**	**-1.7**	**5.0**	**-1.6**	**5.8**	**-2.6**
Industry excl. construction	**19.1**	**-1.7**	**18.2**	**-1.4**	**17.9**	**-1.1**	**16.3**	**-1.7**
Mining and quarrying	0.1	-1.9	0.1	-2.3	0.1	-1.8	0.1	-1.9
Manufacturing	17.8	-1.8	16.9	-1.6	16.7	-1.3	15.2	-1.8
Energy, gas and water supply; sewerage networks and waste management	1.2	0.6	1.2	0.8	1.1	1.1	1.0	0.7
Construction	**6.6**	**-9.4**	**7.0**	**-9.0**	**6.8**	**-9.9**	**6.5**	**-8.0**
Services	**70.6**	**-1.3**	**69.8**	**-1.3**	**70.3**	**-1.4**	**71.3**	**-0.7**
Wholesale and retail trade, repair of motor vehicles	14.5	-2.8	14.2	-3.6	15.4	-4.0	13.0	-2.7
Accommodation and food services	5.5	-1.6	6.4	-1.3	7.0	-1.4	8.0	0.9
Transport, storage and communications	6.9	-1.1	8.6	-0.5	8.1	-0.3	9.5	-0.8
Financial and insurance services	2.6	-2.3	2.6	-2.5	2.4	-2.0	2.3	-2.2
Sundry business and household services (3)	12.3	0.5	12.0	0.3	12.5	0.4	11.8	0.5
General government (4)	5.3	-1.3	5.5	-1.3	4.5	-1.5	4.5	-1.3
Education	5.9	0.3	5.9	0.3	4.2	0.1	5.1	0.2
Healthcare	6.8	-2.4	6.7	-2.2	6.1	-2.5	6.0	-2.5
Other public, social and personal services	3.9	-1.7	3.8	-0.8	3.9	-0.8	3.5	-1.5
Activities of households and residential institutions	6.8	-0.4	4.2	0.7	6.2	0.6	7.6	1.0
Total	**100.0**	**-2.0**	**100.0**	**-1.9**	**100.0**	**-2.0**	**100.0**	**-1.5**

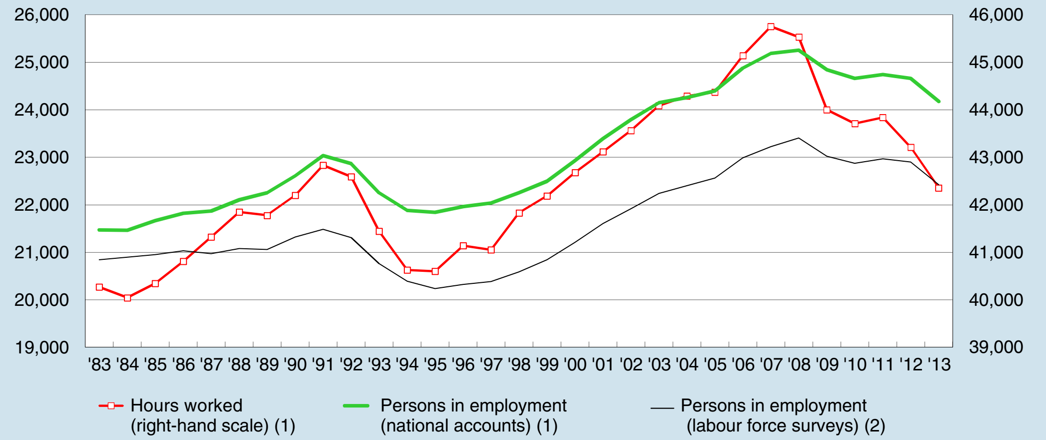
Source: Based on Istat, national accounts.
(1) Rounding may cause discrepancies in totals. – (2) Change in level. – (3) Real estate, professional, scientific and technical, administrative and support services. – (4) Includes defence and compulsory social insurance.

Istat's labour force surveys found that the decline in labour input involved both payroll employment and self-employment, with decreases of 1.9 and 2.5 per cent respectively (Table 10.2). Among employees, the shift from full-time to part-time positions continued, although less intensively than in the past; full-time work declined by 3 per cent during the year while part-time work increased by 2.8 per cent. Compared with 2008, part-time employment was 24 per cent higher and full-time employment 8 per cent lower.

The significant decline in self-employment was due mainly to a reduction in the number of self-employed workers and workers on collaboration contracts; the numbers of professionals and entrepreneurs increased.

Figure 10.1

Measures of employment
(thousands of persons and millions of hours)



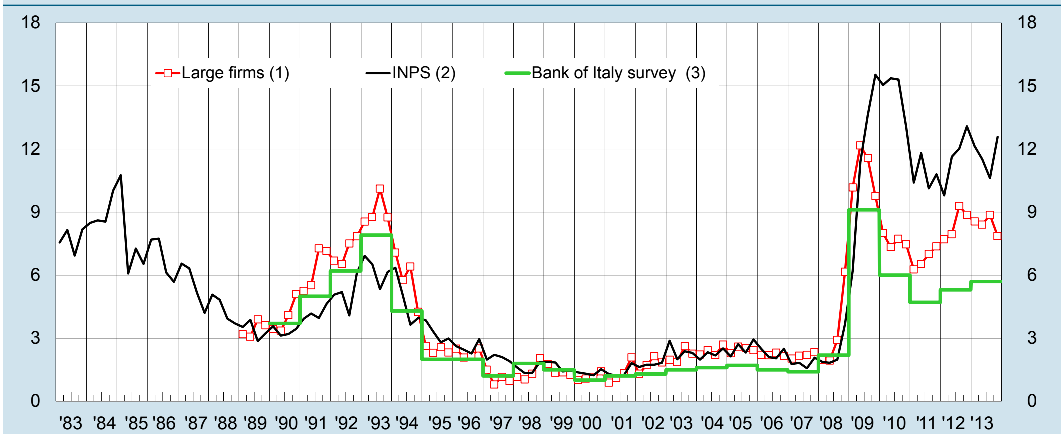
Sources: Istat, national accounts and labour force surveys.
(1) Refers to resident and non-resident workers, official and unreported, employed in resident firms. – (2) Number of officially registered residents in work (excluding those living permanently in institutions).

The number of persons employed fell in all parts of the country and all sectors, but most of all in the South (4.6 per cent, as against 1.2 per cent in the Centre and North) and, by sector, in construction (9.3 per cent) and general government (5.1 per cent). It also declined (by 0.9 per cent) in the private service sector, where it had continued to grow during the previous three years.

Provisional data indicate that the contraction in employment practically came to a halt in the first three months of 2014. The most recent surveys have found an improvement in firms' employment expectations, which nevertheless remain prevalently pessimistic.

Figure 10.2

Ratio of wage supplementation benefit hours to total hours worked in industry excluding construction
(per cent)



Sources: Based on data from Banca d'Italia, *Survey of Industrial and Service Firms*; INPS; Istat, national accounts and survey of large firms.
(1) Firms with 500 or more employees; actual hours worked. – (2) Hours authorized (INPS) as a percentage of total hours worked by employees in industry excluding construction (national accounts). Until 1991, national accounts are classified according to NACE 2002 and thereafter according to NACE 2007. – (3) Firms with 50 or more workers; actual hours worked.

Table 10.2

Structure of employment in 2013 (1)
(thousands of persons and per cent)

	Centre and North		South		Italy	
	Thousands of persons	Percentage change 2012-13	Thousands of persons	Percentage change 2012-13	Thousands of persons	Percentage change 2012-13
Employees	**12,552**	**-1.1**	**4,326**	**-4.2**	**16,878**	**-1.9**
Permanent	11,070	-0.4	3,578	-3.8	14,649	-1.3
full-time	9,099	-1.5	2,994	-5.5	12,093	-2.5
part-time	1,971	4.8	584	6.1	2,556	5.1
Fixed-term	1,482	-6.1	748	-6.2	2,229	-6.1
full-time	1,068	-5.9	524	-7.3	1,592	-6.4
part-time	414	-6.5	224	-3.6	638	-5.5
Self-employed	**3,969**	**-1.3**	**1,573**	**-5.4**	**5,542**	**-2.5**
Business owners, professionals and own-account workers	3,402	-0.4	1,401	-4.0	4,803	-1.5
Family workers	246	-1.2	73	-11.4	320	-3.7
Cooperative members	26	-17.8	12	-14.1	38	-16.7
Collaborators	198	-17.1	61	-24.7	259	-19.0
Occasional workers	97	11.7	26	-1.5	123	8.7
Full-time	3,347	-2.3	1,375	-5.8	4,722	-3.4
Part-time	623	4.5	197	-2.9	820	2.6
Total employment	**16,522**	**-1.2**	**5,899**	**-4.6**	**22,420**	**-2.1**

Source: Based on Istat, labour force surveys.
(1) Rounding may cause discrepancies in totals.

The composition of employment of the resident population

The number of residents in employment declined by 480,000 or 2.1 per cent on average in 2013. The employment rate for the population aged 15-64 came down from 56.8 to 55.6 per cent. The decline was more pronounced among men (from 66.5 to 64.8 per cent) and especially younger men (in the 15-34 age group the rate fell by 3.9 percentage points). For the population aged 55-64, by contrast, the employment rate rose by 2.3 points to 42.7 per cent, owing in part to the pension reform enacted in 2011.

The employment rate for non-Italian citizens of working age fell significantly, from 60.6 to 58.1 per cent. All age groups and both sexes were affected, but the decline was sharper among men, whose employment is more concentrated in the sectors hardest hit by the recession.

Labour supply and unemployment

The number of persons active in the labour market, following the substantial increase registered in 2012, diminished last year by 100,000 (0.4 per cent). The participation rate among people of working age fell by 0.2 percentage points to 63.5 per cent (Table 10.3). Among men, the decline was sharpest among those aged 15-34. There was a decline in participation among women in that age group as well, but this was more than offset by an increase in the older age groups.

Table 10.3

Labour supply in 2013
(thousands of persons and per cent)

	Centre and North		South		Italy	
	Thousands of persons (1)	Percentage change 2012-13 (2)	Thousands of persons (1)	Percentage change 2012-13 (2)	Thousands of persons (1)	Percentage change 2012-13 (2)
Labour force	**18,184**	**0.0**	**7,349**	**-1.5**	**25,533**	**-0.4**
Women	7,996	0.6	2,745	-1.3	10,741	0.1
Men	10,188	-0.4	4,604	-1.6	14,792	-0.8
Italians	15,715	-0.7	6,969	-1.8	22,684	-1.1
Foreigners	2,469	5.0	380	4.0	2,849	4.9
Total employment	**16,522**	**-1.2**	**5,899**	**-4.6**	**22,420**	**-2.1**
Women	7,174	-0.6	2,156	-3.9	9,330	-1.4
Men	9,347	-1.7	3,743	-4.9	13,090	-2.6
Italians	14,478	-1.5	5,586	-4.8	20,064	-2.4
Foreigners	2,043	1.1	313	0.0	2,356	0.9
Job seekers	**1,663**	**13.7**	**1,450**	**13.2**	**3,113**	**13.4**
Women	822	11.4	589	9.7	1,411	10.7
Men	841	15.9	861	15.8	1,702	15.8
Italians	1,237	9.2	1,383	12.6	2,620	11.0
Foreigners	426	29.0	67	27.9	493	28.8
Participation rate (ages 15-64)	**69.4**	**-0.1**	**52.5**	**-0.5**	**63.5**	**-0.2**
Women	61.6	0.3	39.0	-0.3	53.6	0.1
Men	77.2	-0.4	66.3	-0.7	73.4	-0.5
Italians	69.1	-0.1	52.0	-0.5	62.7	-0.2
Foreigners	71.6	0.1	62.6	-2.0	70.3	-0.3
Employment rate (ages 15-64)	**62.9**	**-0.8**	**42.0**	**-1.8**	**55.6**	**-1.1**
Women	55.2	-0.4	30.6	-1.1	46.5	-0.6
Men	70.7	-1.3	53.7	-2.5	64.8	-1.7
Italians	63.5	-0.6	41.6	-1.7	55.3	-1.0
Foreigners	59.2	-2.3	51.5	-3.8	58.1	-2.5
Unemployment rate	**9.1**	**1.1**	**19.7**	**2.6**	**12.2**	**1.5**
Women	10.3	1.0	21.5	2.1	13.1	1.3
Men	8.3	1.2	18.7	2.8	11.5	1.7
Italians	7.9	0.7	19.8	2.5	11.5	1.3
Foreigners	17.3	3.2	17.6	3.3	17.3	3.2
Youth unemployment rate (ages 15-24)	**33.7**	**4.8**	**51.6**	**4.7**	**40.0**	**4.7**
Women	35.3	4.1	53.7	3.8	41.4	3.9
Men	32.4	5.2	50.3	5.3	39.0	5.3
Italians	32.1	4.1	52.3	4.8	39.9	4.4
Foreigners	40.7	7.6	38.1	2.3	40.4	6.9

Source: Based on Istat, labour force surveys.
(1) For rates, per cent. Rounding may cause discrepancies in totals. – (2) For rates, changes in percentage points.

According to Istat's labour force surveys, the contraction of the labour force can be ascribed largely to the increase of 155,000 in the number of persons who, while wanting and available to work, said they had stopped actively seeking employment because there are no job openings. This increase, the largest since 2007, brought the number of these discouraged workers to 1.4 million, 400,000 more than in 2008.

Despite the contraction of the labour force, the sharp decline in employment resulted in a further increase in the number of unemployed persons, which rose by 370,000 to 3.1 million on average in 2013. The average unemployment rate rose to 12.2 per cent. The increase was more pronounced among young people. The jobless rate among those aged 15-24 reached 40 per cent, nearly twice as high as in 2008. In this age group, whose participation rates are low given the large number of students, the unemployed account for 10.9 of the population. In the next youngest age group (25-34) the unemployment rate rose by 2.8 points to 17.7 per cent (and 12.9 per cent of the population).

On average in 2013, as in 2012, about a quarter of the unemployed had had jobs a year earlier. The flow of individuals shifting from economic inactivity to unemployment diminished while the share of those remaining unemployed increased. The greater persistence of joblessness was reflected in the increased share of the long-term unemployed (at least twelve months) from 52.4 to 56 per cent of total unemployment. Since the start of the recession this share has risen by 11 percentage points.

In the first quarter of 2014 the number of persons employed was broadly stable; a slight increase in the labour force resulted in a rise of 0.1 points in the unemployment rate to 12.7 per cent.

Earnings and labour costs

Hourly earnings in the entire economy rose by 1.4 per cent in 2013, about the same as in 2012 (Table 10.4). Real earnings remained unchanged following the 1.6 per cent drop in 2012. Since the start of the recession in 2008, real hourly earnings have decreased by 1.3 per cent.

In the prevalently public sector, nominal earnings continued to stagnate, as collective bargaining was blocked and seniority increments frozen. In the private sector, the earnings gain was larger in industry (2.3 per cent) than in services.

According to our calculations, between 2009 and 2013 increases in the average educational attainment, age and seniority of the work force accounted for nearly a fifth of the total increase in gross nominal hourly earnings in the non-farm private sector (1.7 percentage points out of 9). Sectoral and geographical reallocation and changes in contract type (fixed-term and part-time) had only marginal impact.

For the economy as a whole actual earnings have moved in line with the contractual increments under collective bargaining agreements. Increases due to the changing composition of the work force have apparently been offset by decreases due to

Table 10.4

Labour costs and productivity in Italy
(annual percentage changes, except as indicated)

	Value added (1)	Total hours worked	Value added per hour (1)	Hourly employee earnings	Hourly employee labour costs (2)	Unit labour costs (2) (3)	Labour's share of value added (2) (4)	Real hourly employee labour costs (2) (5)	Real hourly employee earnings (6)
					Industry excluding construction				
1993-2007	1.2	-0.5	1.7	3.5	3.2	1.5	68.1	1.0	0.7
2008-2013	-3.0	-3.0	0.0	3.0	3.1	3.1	72.7	2.1	0.9
2009	-15.1	-10.3	-5.3	3.6	3.5	9.3	72.8	-0.7	2.8
2010	6.0	-2.0	8.2	3.4	3.1	-4.8	70.8	5.4	1.9
2011	1.5	0.3	1.2	2.8	2.8	1.6	72.5	3.5	0.0
2012	-3.0	-2.8	-0.2	3.1	2.8	3.0	75.0	3.3	0.0
2013	-3.2	-1.1	-2.1	1.5	1.7	3.9	75.9	-0.9	0.3
					Construction				
1993-2007	0.9	1.8	-0.9	2.5	2.2	3.1	73.3	-1.2	-0.3
2008-2013	-5.1	-3.9	-1.2	3.5	3.3	4.6	76.3	0.0	1.3
2009	-8.4	-1.5	-7.0	3.5	3.2	10.9	75.8	-1.6	2.7
2010	-3.1	-2.4	-0.7	3.2	2.9	3.6	78.9	3.4	1.7
2011	-4.5	-2.4	-2.2	3.8	3.4	5.7	78.8	-2.3	1.0
2012	-5.6	-6.4	0.9	3.0	2.4	1.5	77.2	-1.2	-0.1
2013	-5.9	-9.9	4.4	3.1	3.4	-1.0	75.7	2.5	1.9
					Private services (7)				
1993-2007	2.0	1.1	0.9	2.8	2.4	1.5	58.9	-0.6	0.0
2008-2013	-0.8	-0.6	-0.2	1.6	1.7	1.9	57.1	0.1	-0.5
2009	-3.9	-2.7	-1.2	1.9	1.7	2.9	56.9	-0.2	1.1
2010	1.6	0.0	1.6	2.5	2.5	0.9	57.4	2.4	0.9
2011	1.0	1.2	-0.1	0.9	1.0	1.1	57.2	-0.4	-1.9
2012	-2.0	-0.3	-1.7	1.4	1.0	2.8	57.6	-1.2	-1.6
2013	-0.9	-1.7	0.8	1.6	1.7	0.9	57.4	0.5	0.4
					Private sector				
1993-2007	1.7	0.4	1.2	3.1	2.7	1.5	64.4	0.0	0.3
2008-2013	-1.7	-1.7	0.0	2.3	2.3	2.3	64.3	0.7	0.2
2009	-7.0	-4.6	-2.6	2.6	2.3	5.0	64.3	-0.1	1.8
2010	2.2	-0.8	3.0	2.8	2.6	-0.4	64.4	3.1	1.2
2011	0.7	0.3	0.4	1.8	1.8	1.5	64.5	0.5	-1.0
2012	-2.6	-1.9	-0.7	2.3	1.9	2.6	65.0	0.1	-0.8
2013	-1.7	-2.3	0.6	1.9	2.0	1.4	64.9	0.4	0.6
					Total economy				
1993-2007	1.5	0.5	1.0	3.1	2.9	1.8	68.4	0.0	0.3
2008-2013	-1.4	-1.3	-0.1	1.8	1.8	2.0	68.3	0.4	-0.3
2009	-5.6	-3.4	-2.3	2.1	2.0	4.4	68.6	-0.3	1.3
2010	1.7	-0.7	2.4	2.3	2.3	-0.1	68.6	2.5	0.8
2011	0.6	0.3	0.3	0.8	1.0	0.6	68.3	-0.1	-2.0
2012	-2.2	-1.4	-0.7	1.4	1.2	2.0	68.7	-0.2	-1.6
2013	-1.6	-2.0	0.4	1.4	1.4	1.0	68.4	0.0	0.1

Source: Based on Istat, national accounts.
(1) Value added at base prices, chain-linked volumes, reference year 2005. – (2) The introduction of the regional tax on productive activities and the simultaneous elimination of some employers' contributions in 1998 caused a significant break in the series. – (3) Hourly compensation of employees as a percentage of value added per work hour at base prices, chain-linked volumes, reference year 2005. – (4) Percentages; value added at base prices. – (5) Hourly labour income of employees deflated by the value added deflator at base prices. – (6) Hourly compensation of employees deflated by the consumer price index. – (7) Wholesale and retail trade and repairs; accommodation and food services; transport and storage; information and communications; financial and insurance, real estate, professional, scientific and technical, administrative and support services.

reduction in overtime and in company and individual raises, which are more sensitive to the business cycle and labour market conditions.

Nominal earnings continue to move upward. In the coming months there are expected to be increments even in real terms. Under the framework agreement of 2009 (see the Annual Report on that year), the economic portion of collective bargaining agreements is renewed every three years, with increases based on Istat's forecast for the harmonized index of consumer prices net of imported energy goods. For the contracts renewed in 2012 and 2013, wage increments were determined on the basis of the rises forecast at that time for the HICP, which turned out to be greater than actual inflation. The wage increases specified in these contracts will make a positive contribution to real wage dynamics for their entire duration. In 2014 and 2015 contracts covering workers accounting for about half the total wage bill expire, and the renewals will presumably provide for increases based on updated estimates of HICP.

Since the start of the recession, the adjustment of labour costs to growing unemployment, as inferred from national accounts data, was not as swift in Italy as in the other countries. The increments provided for in national collective bargaining agreements largely reflect labour market conditions at the time of renewal. The adjustment of wage levels to post-agreement changes in cyclical conditions is limited, in any case, by their three-year duration. At company level, while the state of the labour market impinges on the probability of agreements for increments above the industry-wide contract levels, for a good number of firms those wage levels appear to be a stringent constraint on downward adjustment of labour costs.

Labour market regulations and industrial relations

Law 99 of 9 August 2013 abrogated some of the rules either introduced or accentuated by the Fornero reform that had been perceived as especially onerous by employers. In particular, (a) it shortened the mandatory interval between two fixed-term contracts with the same worker; (b) it lifted the ban on extending fixed-term contracts whose grounds had not originally been specified; (c) it allowed industry-wide or company-level bargaining agreements to determine situations in which such grounds need not be specified; and (d) it eliminated some restrictions on jobs on call, occasional work, and continuous collaboration contracts.

Additional measures were taken in early 2014 to simplify the regulations governing fixed-term and apprenticeship contracts (Law 78 of 16 May 2014). For fixed-term contracts, the requirement to specify the grounds – a possible source of disputes – was eliminated outright. At the same time, the law set a ceiling on recourse to these contracts (20 per cent of the employer's full-time permanent employees), with a fine for violations. For apprenticeships, the training requirements were simplified; in addition, the share of apprentices required to be hired subsequently on a permanent basis was lowered, and the scope of the requirement was limited to firms with more than 50 employees.

The rules on flexibility in dismissals have not been modified. The Fornero reform had relaxed the rules on individual dismissals, narrowing the scope of the provision for reinstatement of improperly dismissed workers and setting a limit on the amount of compensation payable. In addition, it introduced a preventive reconciliation procedure to avoid litigation. Finally, in order to limit the length of the judicial process, the law instituted a special procedure in the matter of dismissals.

Examination of a small sample of labour court rulings (about 1 per cent of lower court rulings on termination of employment relationships established after the reform law went into effect) indicates that recourse to the reinstatement remedy has diminished. In about a third of the cases of illegitimate dismissal employers were required only to pay compensation, where previously they would have been required to take the worker back on payroll. There has also been some shortening of proceedings, accompanied by an increase in the total number of labour disputes brought to court. This is because complaints that could once be brought together with those concerning the dismissal, since they were subject to the same procedure, must now be brought separately, with a duplication of rulings (about 40 per cent of all the cases in our sample).

The industrial relations reform initiated with the agreement between employer and trade union confederations in 2011 proceeded in 2013. An agreement on union representation signed in May established the criteria governing unions' eligibility to take part in industry-wide collective bargaining and provided mechamisms for contract approval by majority in order to guarantee the enforceability of the national agreements. The consolidated bargaining agreement on union representation reached in January 2014 incorporated and codified the contents of previous agreements and established the procedures for measuring union membership at national level.

The general purpose of the agreements is to enhance the certainty of the rules, in particular by anchoring the determination of the various unions' representativeness to objective standards and providing for majority endorsement for both industry-wide and company-level agreements as well as for their effective enforceability. Nevertheless, many of these measures have not been implemented, among other things because, owing to their contractual rather than legislative nature, they only bind the contracting parties.

Earnings differentials and the distribution of household income

The Bank of Italy's biannual Survey of Household Income and Wealth has found that real monthly take-home pay per full-time equivalent worker fell by 4.1 per cent between 2010 and 2012 and the share of low-wage workers rose by 1 percentage point to 10.4 per cent. Owing to the increase in part-time work, average take-home pay for all employees fell by 5.8 per cent (Table 10.5).

Real equivalent household disposable income fell by 10.5 per cent between 2010 and 2012. This was the sharpest drop registered during the current recession, following broad stability recorded in the previous two years and a 3.5 per cent decline between 2006 and 2008 (Table 10.6). In the decade from 2002 to 2012 there was a decline of 6.4 per cent. For all households, employee income accounted for 39.9

Table 10.5

Real monthly take-home pay in Italy (1)
(euros at 2012 prices; values and per cent)

	2002	2004	2006	2008	2010	2012
			All employees			
Average take-home pay	1,526	1,556	1,578	1,528	1,525	1,436
Men	*1,655*	*1,688*	*1,719*	*1,685*	*1,681*	*1,567*
Women	*1,341*	*1,368*	*1,390*	*1,326*	*1,328*	*1,273*
Centre and North	*1,583*	*1,619*	*1,641*	*1,593*	*1,593*	*1,486*
South	*1,383*	*1,385*	*1,412*	*1,366*	*1,352*	*1,310*
Gini index (2)	0.251	0.242	0.233	0.237	0.237	0.260
Interdecile ratio (3)	2.9	3.0	2.8	2.8	2.9	3.2
Share of low-paid workers (4)	17.8	15.4	16.3	16.5	18.4	20.5
Men	*10.6*	*9.7*	*10.0*	*9.2*	*10.4*	*13.8*
Women	*28.0*	*23.4*	*24.7*	*26.0*	*28.5*	*28.9*
Centre and North	*14.9*	*13.2*	*13.8*	*13.0*	*15.6*	*18.8*
South	*24.9*	*21.2*	*22.8*	*25.3*	*25.4*	*24.8*
			Full-time employees			
Average take-home pay	1,609	1,623	1,657	1,621	1,635	1,568
Men	*1,689*	*1,709*	*1,744*	*1,719*	*1,722*	*1,643*
Women	*1,474*	*1,477*	*1,518*	*1,467*	*1,496*	*1,450*
Centre and North	*1,663*	*1,691*	*1,727*	*1,685*	*1,702*	*1,623*
South	*1,469*	*1,438*	*1,475*	*1,459*	*1,463*	*1,432*
Gini index (2)	0.228	0.225	0.212	0.212	0.206	0.227
Interdecile ratio (3)	2.6	2.5	2.4	2.3	2.2	2.4
Share of low-paid workers (4)	11.3	10.0	10.0	9.0	9.4	10.4
Men	*8.0*	*8.2*	*8.2*	*6.7*	*7.1*	*7.8*
Women	*16.9*	*13.0*	*12.7*	*12.7*	*13.2*	*14.3*
Centre and North	*8.6*	*7.5*	*7.2*	*5.8*	*7.0*	*8.4*
South	*18.4*	*16.7*	*17.1*	*17.1*	*15.7*	*15.0*

Source: Banca d'Italia, *Survey of Household Income and Wealth*, historical archives (Version 8.0, January 2014).
(1) Primary job (hence, excludes second jobs). Earnings deflated with the cost-of-living index and net of taxes and social security contributions. – (2) Ranges from 0 (perfect equality) to 1 (perfect inequality). – (3) Pay corresponding to the 9th decile as a multiple of that corresponding to the 1st decile. – (4) Per cent. The OECD defines low-paid workers as those earning less than two thirds of the median for full-time workers.

per cent of total income in 2012, slightly higher than in 2010. However, the decline in the share of self-employment income continued, from 12.8 to 10.9 per cent. The share of pension income and transfers increased by 2.1 points to 27.5 per cent, while investment income slipped by 0.6 points to 21.6 per cent. Incomes fell across the board, but the decline was greatest among individuals whose equivalent household income was lowest. The overall inequality of household income distribution increased slightly.

Table 10.6

Real equivalent household disposable income in Italy (1) (2)
(euros at 2012 prices)

	2002	2004	2006	2008	2010	2012
Average equivalent income	19,765	20,629	21,460	20,707	20,664	18,494
Centre and North	*23,283*	*24,383*	*25,089*	*24,184*	*24,129*	*21,096*
South	*13,505*	*13,861*	*14,802*	*14,215*	*14,108*	*13,594*
Production worker, apprentice, sales assistant	*14,577*	*14,495*	*15,256*	*14,406*	*14,030*	*12,856*
Clerical worker, technician, teacher	*21,645*	*22,184*	*22,481*	*22,258*	*22,546*	*21,270*
Manager	*43,190*	*40,627*	*46,159*	*43,114*	*40,240*	*37,753*
Self-employed worker	*24,742*	*28,858*	*30,251*	*27,130*	*27,876*	*24,401*
Pensioner	*18,329*	*18,583*	*19,568*	*20,648*	*20,290*	*19,119*
Not employed non-pensioner	*7,073*	*10,576*	*8,344*	*7,584*	*7,946*	*5,398*
1 member	*19,258*	*23,626*	*27,789*	*21,789*	*21,976*	*18,888*
2 members	*22,464*	*23,537*	*23,798*	*23,677*	*23,957*	*21,465*
3 members	*22,720*	*21,511*	*21,971*	*22,604*	*22,074*	*20,752*
4 members	*18,406*	*19,660*	*20,279*	*19,127*	*19,324*	*16,408*
5 or more members	*14,443*	*13,995*	*16,742*	*14,148*	*13,815*	*13,451*
Home owner	*21,689*	*22,817*	*23,717*	*23,081*	*23,368*	*21,273*
Tenant	*15,029*	*15,599*	*15,790*	*14,795*	*14,408*	*12,300*
Gini index (3)	0.330	0.343	0.337	0.330	0.335	0.340
Centre and North	*0.292*	*0.306*	*0.304*	*0.295*	*0.301*	*0.313*
South	*0.329*	*0.334*	*0.324*	*0.326*	*0.330*	*0.343*
Interdecline ratio (4)	4.4	4.5	4.4	4.5	4.6	4.8

Source: Banca d'Italia, *Survey of Household Income and Wealth*, historical archives (Version 8.0, January 2014).
(1) Total household income (including imputed rental income on homes used by owners), net of direct tax, divided by the national household consumption deflator (national accounts) and made comparable using the OECD's modified equivalence scale, which assigns a value of 1 to the first adult member of the household, 0.5 to each additional member aged 14 or older, and 0.3 to every member younger than 14. Values weighted by number of persons. – (2) Occupational status is that of the household head, defined as the individual with the highest labour or pension income. – (3) Ranges from 0 (perfect equality) to 1 (perfect inequality). – (4) Income corresponding to the 9th decile as a multiple of that corresponding to the 1st decile.

11. EDUCATION AND TRAINING IN THE PRODUCTIVE ECONOMY

A larger supply of human capital, meaning the fund of knowledge, skills and talent with which individuals are endowed, goes together with higher levels of development. It helps to boost productivity both directly, by increasing the capacity of the labour force, and indirectly, by encouraging the adoption of more advanced technologies. Other indicators of economic and social welfare, such as health conditions or sense of civic duty, improve with higher levels of education. In 2010, among the targets of the Europe 2020 strategy to promote lasting and sustainable growth, the European Commission included reducing the school dropout rate to below 10 per cent and increasing the share of university graduates in the population aged 30-34 to 40 per cent. On both of these fronts Italy's numbers – 17 and 22 per cent respectively – are inconsistent with advanced-country status.

The advantage to be gained in terms of employment and earnings prospects from a higher level of educational attainment is not as great in Italy as in other countries, especially for persons who have just completed an educational cycle. The difficulty of the transition from school to work is a factor, as is the structure of Italy's productive economy, specialized in traditional sectors and dominated by small firms, which does not express a large need for human capital. The weakness of the demand for skilled labour, magnified during the crisis, contributes to reducing the incentives to invest in training and knowledge.

The effectiveness of the most recent actions to improve the education system, pursued by introducing national evaluation standards in a context in which individual schools and universities enjoy growing autonomy, has been undercut by the reform efforts' lack of an overarching approach and by the many measures to restrict spending. Training programmes for adults, including retraining for the unemployed and for workers with less prospects of employment, remain a factor of weakness of the Italian system.

Education and economic growth

The increase in schooling has played a key role in fostering growth since the Second World War. According to data published by the World Bank, in Europe the average number of years of formal education of the working-age population has doubled since the middle of the last century, rising from 5 to 7 between 1950 and 1980 and then to 11 in 2010. This, and particularly the increase in the share of university graduates (from 8 to 21 per cent in the last thirty years), has contributed significantly to the growth in labour productivity.

In Italy, up to the end of the 1980s economic growth, driven above all by labour-intensive industries, benefited mainly from higher literacy as a result of the lengthening of compulsory schooling; university education has played a larger role only in the last two decades.

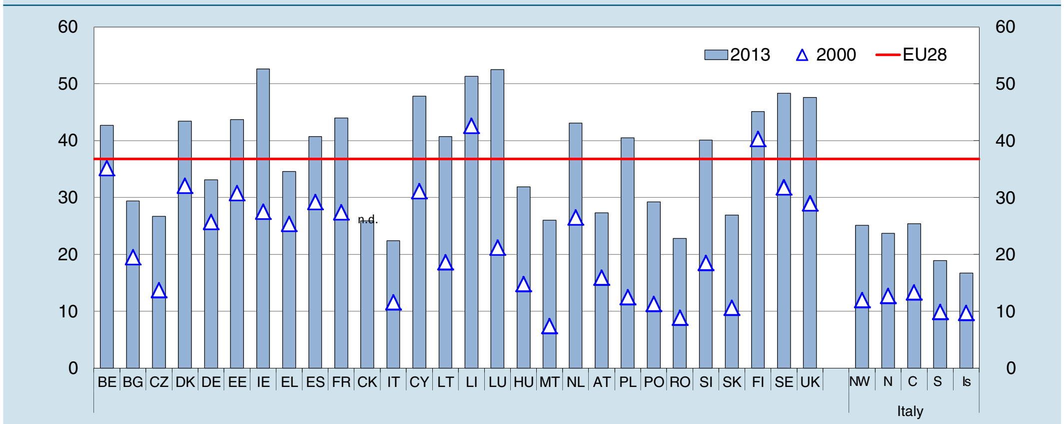
The impact of education extends beyond the merely economic sphere. Better education is associated with better health outcomes, social cohesion and greater law-abidingness.

Italy's human capital endowment: an international comparison and domestic disparities

Between 2000 and 2013 the share of university graduates in the population aged 25-64 rose from 9.7 to 16.3 per cent in Italy and from 19.5 to 28.5 per cent on average in the European Union. In the population aged 30-34, the share in Italy in 2013 was equal to 22.4 per cent, the lowest among the EU countries (36.8 per cent on average) and short of the national objective of 26-27 per cent that the Government had established in the April 2011 National Reform Programme. In no region of Italy did the share exceed 28 per cent; the gap between the Centre and North on the one hand and the South and Islands on the other grew from around 3 percentage points in 2000 to more than 7 in 2013 (Figure 11.1).

Figure 11.1

Share of university graduates in the 30-34 age group (1)
(per cent)



Source: Eurostat, *Labour Force Survey.*
(1) The figure for Croatia for 2000 is not available. For Italy, the data are broken down by macro-region: North-West (NW), North-East (NE), Centre (C), South (S) and Islands (Is).

Though gradually declining since 2005, in 2013 the share of young people aged 18-24 with at most a middle-school diploma and not in education or training still stood at 17 per cent, 5 percentage points above the European average and 7 points above the Europe 2020 strategy's target.

Between the 2003-04 and 2012-13 academic years, the number of first-year students in Italian universities fell from 339,000 to 270,000. The reduction largely regarded persons aged 23 and over (down by 48,000), but from 2009-10 onwards it also involved those aged 18-20 (down by 15,000). In the last three years the share of university students in the population aged 18-20 (which contracted by 20,000) decreased from 14.1 to 13.5 per cent, notwithstanding a slight rise in the number of new high-school graduates.

The participation of adults in training, though ever more necessary owing to radical technological change and the lengthening of life expectancy, is also modest.

A disparity is also observed in the level of achievement of those taking part in formal education. For primary school, the PIRLS and TIMSS surveys conducted for the last time in 2011 by the International Association for the Evaluation of Education Achievement found that Italian pupils had practically the same level of achievement in literacy as their peers in the European Union but underperformed in mathematics. Larger gaps with respect to the other countries emerge in secondary education: despite significant improvements between 2006 and 2009 followed by marginal gains in the next three years, the 2012 PISA surveys show Italian students aged 15 lagging considerably behind their peers in the OECD area. The weaknesses are greater in the field of mathematics and science and in the South and Islands: according to the recent Invalsi achievement tests, the gap between the results of students in the North and those of the same age in the Mezzogiorno, which at the beginning of their school careers also reflects the legacy of the differential in educational attainment of their parents, tends to widen in the course of their studies.

Lower levels of participation in formal education and of achievement are inevitably reflected in the logical-analytical and cognitive skills of the adult population. The results of the PIAAC survey of adult skills for 2012 ranked Italy last in language skills and next to last in numeracy among the 23 participating OECD countries; Japan, the Netherlands and the Nordic countries held the top positions.

Individual returns to education and the role of labour demand

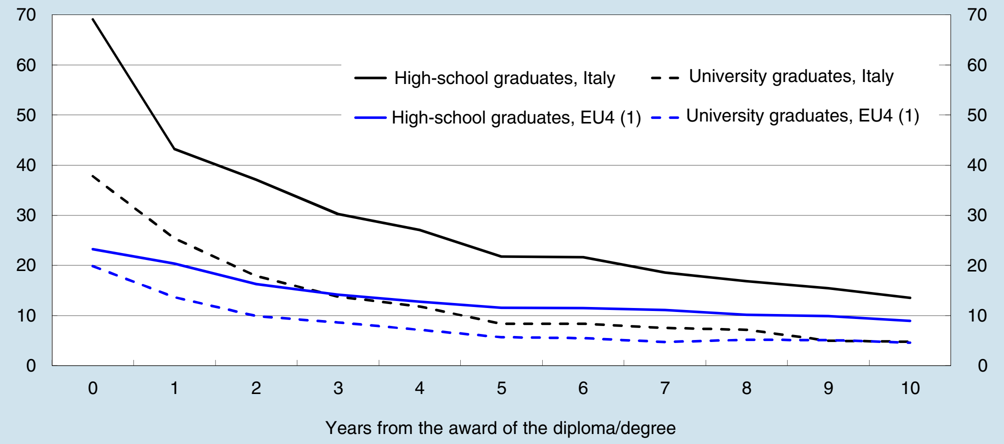
According to the Eurostat Labour Force Survey, in 2012 the probability of being in work of Italian university graduates aged 25-64 was 9 percentage points higher than that of high-school graduates of the same age, not unlike the difference in Spain, France, Germany and the United Kingdom. However, in the 25-34 age group the employment probability for university graduates was 5 percentage points lower than for high-school graduates in Italy, whereas it was 10 percentage points higher in the other main European countries. This chiefly reflects the longer actual duration of university studies, a longer transition from education to work, and the choice of fields of study with less immediate prospects of employment. In Italy, moreover, the use of less stable employment contracts is more common among young university graduates than among high-school graduates.

By contrast, the employment advantage of university graduates emerges after the completion of studies: at three years' distance, the unemployment rate is 25 per cent in Italy (14 per cent for university graduates, 30 per cent for high-school graduates) and 14 per cent on average in the European countries considered (10 per cent for university graduates, 14 per cent for high-school graduates; Figure 11.2).

According to the Eurostat survey on income and living conditions (EU-SILC), in 2010 the annual gross income from payroll employment of a university graduate exceeded that of a high-school graduate of the same age by 33 per cent in Italy and 43 per cent in the other major European countries (by 15 and 26 per cent respectively in the 25-34 age group).

Figure 11.2

Unemployment rates
(per cent)



Source: Eurostat, *Labour Force Survey*.
(1) Average of France, Germany, the United Kingdom and Spain.

Compared with the average of the OECD countries participating in the PIAAC survey, the return on human capital in terms of hourly wages, even when measured on the basis of the cognitive skills actually possessed and controlling for the level of educational attainment, is lower in Italy and increases more slowly during individuals' working career.

A synthetic measure of the economic advantage associated with achieving an educational qualification is provided by the internal rate of return to education, obtained by comparing the present-day value of individual benefits, in terms of higher pay and greater probability of employment, with that of the costs, both direct and in terms of foregone earnings. According to the latest OECD estimates, in Italy the annual return on a university degree is 8 per cent for a man and 7 per cent for a woman, higher than the average returns on financial assets but some 5 percentage points lower than the average figure for the other euro-area countries.

The more limited return to human capital in the Italian labour market is due at least in part to the strategies adopted by firms, whose demand for skilled labour is curbed by specialization in traditional, labour-intensive sectors, by the small scale of companies and by the institutional and regulatory framework. Using the classification of the International Labour Organization, based on the skills actually required for the performance of each occupation, the Eurostat *Labour Force Survey* indicates that in 2012 low-skilled occupations accounted for 65.3 per cent of total employment in Italy and high-skilled occupations for 15.4 per hhhhhcent, significantly different from the average figures for the four other major European countries, namely France, Germany, Spain and the United Kingdom (56.8 and 23.8 per cent respectively; Table 11.1). In Italy, it is more common for specialized occupations to be filled by workers with no more than a high-school diploma (28.6 per cent against 17.9 per cent on average in the four other countries).

Firms' scant demand for skilled labour is also seen in the comparatively modest resources allocated to on-the-job training. This reflects the fragmentation of Italy's productive fabric, in which small firms do not necessarily have an in-house training capacity, and workers' lack incentives to acquire new skills in a context in which wages are often entirely set by national labour contracts.

Table 11.1

Composition of employment
(per cent)

	Italy		EU4 (1)		Italy		EU4 (1)	
	2007	2012	2007	2012	2007	2012	2007	2012
	Share of high-skilled occupations (2)				**Share of ICT occupations** (2)			
Total economy	**17.8**	**15.4**	**22.7**	**23.8**	**24.0**	**20.9**	**23.8**	**24.0**
Agriculture	12.9	1.4	7.3	5.8	4.5	3.0	6.3	7.8
Industry excl. construction	8.3	6.8	17.6	18.1	25.2	22.9	29.3	34.1
Construction	6.9	5.8	10.9	12.4	15.2	24.2	15.9	32.0
Services	22.7	19.8	26.0	26.6	25.9	20.9	24.0	21.6
By worker's level of education								
Primary	*8.2*	*1.4*	*7.5*	*4.1*	*7.3*	*6.1*	*9.1*	*8.8*
Secondary	*11.9*	*9.3*	*11.7*	*9.4*	*32.0*	*24.9*	*20.5*	*18.3*
Tertiary	*57.4*	*56.0*	*51.8*	*53.4*	*41.4*	*37.4*	*40.4*	*40.0*

Source: Eurostat, *Labour Force Survey*.
(1) Average of France, Germany, the United Kingdom and Spain. – (2) OECD definitions based on the International Labour Organization's ISCO classification. ICT occupations involve the production or use of information and communication technology.

These findings suggest that negative feedback effects between the demand for and supply of human capital are amplifying the shortcomings. The propensity to invest in new technologies and thus the demand for skilled labour are restrained by firms' difficulty in recruiting highly educated workers, and the resulting lower return to investment in human capital then limits the incentives of young people to accumulate it.

The functioning of the education and training system in Italy

The efficacy of an education and training system depends on the complex interaction of multiple factors. Some of these concern the amount of resources allocated to the system, others, often hard to measure, the overall organization of schools and universities, which in turn affects teachers' motivation and incentives.

Childhood services. – In 2011 around 27 per cent of the population under age 3 benefited from daycare, nursery schools and other education services in 2011, 3 percentage points more than in 2007 but still below the European target of 33 per cent.

Despite the financing of the Special Plan for the Development of Early Childhood Social and Education Services (Law 296/2006), Istat data show that only half of the children in nursery school were enrolled in public nursery schools or schools operated under a convention. In the Bank of Italy's intermediate survey on Italian households, the main reasons cited for recourse to private facilities at this level, unlike at the subsequent levels of schooling, were the insufficient number of places available and the short school day.

The school system. – In 2011 public spending on early childhood, primary and secondary education amounted to 3.5 per cent of GDP (4.3 per cent including university education), one of the lowest levels since the start of the 1990s and less than in the four other major EU countries. Including the private component, at purchasing power parity annual expenditure per pupil on schooling in Italy in 2010 was higher than the average of the EU countries belonging to the OECD for early childhood and primary schools but lower for secondary education ($8,607 against $9,471).

For a given amount of expenditure, the effectiveness of a school system reflects a variety of factors, such as the quality and motivation of teachers, the organization of studies, teaching techniques and hours, and the infrastructure endowment.

The current system of teacher recruitment does not feature significant mechanisms to preserve staff quality. Public competitions for teaching positions are sporadic, and the consequent use of seniority of registration in the lists of aspiring teachers as the sole selection criterion has slowed the rejuvenation of staff and merit-based permanent hiring. The prospect of delayed appointment to a permanent position, after a prolonged period of precarious employment that does not envisage evaluation of teaching skills and performance, has created mechanisms of adverse selection in the profession. Additional investment by teachers in training and refresher courses is discouraged.

The introduction of post-graduate courses of specialization in secondary education, provided for by Law 341/1990 but not activated until the period from 1999 to 2008, did not affect the method of teacher recruitment. Initially conceived as a path of training and privileged access to the profession, these courses became de facto an additional channel for gaining a permanent position. By contrast, the revival of public competitions for the selection of the teaching corps pursuant to Ministerial Decree 82 of 24 September 2012 does mark a change.

The university system. – In 2010 annual spending per university student at purchasing power parity amounted to $9,580 in Italy, 25 per cent less than the average of the EU countries belonging to the OECD; Italy's lower per capita expenditure is due in part to the large number of students who continue to be enrolled after not completing their studies within the normal span of time. In Italy, participation of the private sector does not make up for the deficiency of public funds, in part because of the lack of targeted programmes such as student loans, which could help families sustain the costs of education. The number of scholarships is modest (8.6 per cent of the student population in the 2012-13 academic year) and insufficient to cover all eligible students (one in five was excluded).

In addition to commanding a smaller volume of financial resources, students at Italian universities are also disadvantaged by the smaller number of faculty members compared with other advanced countries: at Italian universities there are 19 students per teacher, against an OECD average of 16.

Recruitment procedures, whose ability to select the most meritorious teachers was the subject of a hot debate, were reformed by Law 240/2010. The new procedure calls for periodic academic certification at national level in order to ensure minimum standards of quality, followed by hiring procedures decided autonomously by each university. In this second phase, the actual selection of the most highly qualified staff depends on making full use of evaluations of the quality of research and eventually, teaching.

Adult training. – The need for those who have completed their formal education to update their skills conflicts with the limited volume of resources allocated to adult training, and particularly the paucity of investment in active policies for the re-skilling of persons who have lost their jobs, taking into account the demand for skills in the labour market.

Law 92/2012 (the Fornero reform), Decree Law 34/2014 and Draft Enabling Act S. 1428/2014 have delegated the Government to reform the system of active labour market policies and have made changes to contracts involving training, such as trainee and apprenticeship contracts. The European Youth Guarantee programme is to finance interventions, for the two years 2014-15, to create job and training opportunities for youths aged 15-29 within four months of their becoming unemployed or leaving formal education.

12. THE BALANCE OF PAYMENTS AND THE NET INTERNATIONAL INVESTMENT POSITION

In 2013 the current account of Italy's balance of payments recorded a surplus for the first time since 2001 (1.0 per cent of GDP). The correction was substantial, equal to 1.3 percentage points of GDP vis-à-vis 2012 and 4.4 points with respect to 2010.

The adjustment over the last three years came from the improvement in the goods account, which reached a surplus of €37.2 billion, reflecting both the reduction in imports and the good performance of exports. From 2010 to 2013 the latter expanded in volume by nearly 3 percentage points more than the potential demand from importing countries, with an increase in the market shares outside the euro area.

After large disposals of Italian public debt securities in connection with the sovereign debt crisis, in 2013 foreign investors returned to the market for Italian portfolio securities. The Bank of Italy's TARGET2 debtor position shrank, after a pronounced two-year expansion.

After valuation adjustments to assets and liabilities, Italy's net external debt increased, ending the year at the relatively moderate level of just under 30 per cent of GDP. This was due both to the changes in the value of the official reserves, owing to the depreciation of gold, and to the revaluation of liabilities in the form of debt securities (recorded at market value in accordance with international statistical conventions), as a result of the decline in risk premiums.

The current and capital accounts

The current account. – The external account swung into surplus by €15.5 billion (1.0 per cent of GDP), compared with a deficit of €4.1 billion (0.3 per cent of GDP) in 2012 (Table 12.1). The adjustment, equal to 1.3 percentage points of GPD, came on top of that of 2.7 points the previous year. Between 2010, when the deficit reached a post-1974 high of 3.4 per cent of GDP, and 2013, the current account improved by a total of 4.4 points, reflecting mainly the 12.2 per cent increase in receipts and only marginally the 1.7 per cent decline in payments.

Merchandise trade. – The *fob-fob* merchandise trade surplus grew to €37.2 billion (2.4 per cent of GDP). The improvement reflected a further increase in the non-energy surplus, which reached its highest level since the introduction of the euro (€90.5 billion, or 5.8 per cent of GDP) and, in contrast with 2012, a reduction in the energy deficit (€53.3 billion, or 3.4 per cent of GDP).

Table 12.1

Balance of payments
(billions of euros, except as indicated)

	2009	2010	2011	2012	2013
Current account	**-29.0**	**-52.6**	**-47.3**	**-4.1**	**15.5**
per cent of GDP	*-1.9*	*-3.4*	*-3.0*	*-0.3*	*1.0*
Goods	0.8	-20.9	-17.4	17.0	37.2
Non-energy products (2)	41.5	29.5	42.4	78.7	90.5
Energy products (2)	-40.7	-50.4	-59.7	-61.7	-53.3
Services	-7.3	-7.4	-5.6	0.9	2.6
Income	-10.4	-8.1	-8.5	-6.7	-9.8
Transfers	-12.2	-16.1	-15.8	-15.2	-14.5
of which: EU institutions	*-7.0*	*-10.1*	*-10.4*	*-9.6*	*-11.3*
Capital account	**0.2**	**..**	**1.0**	**3.9**	**-0.1**
Intangible assets	-0.3	-0.1	-0.1	1.8	-3.4
Transfers	0.5	0.1	1.1	2.1	3.3
of which: EU institutions	*1.6*	*1.5*	*2.7*	*3.2*	*4.2*
Financial account	**37.6**	**84.8**	**67.6**	**13.4**	**-24.7**
Direct investment	-0.9	-17.7	-13.9	-6.1	-11.4
Outward	-15.3	-24.7	-38.6	-6.2	-23.8
Inward	14.5	6.9	24.7	0.1	12.4
Portfolio investment	39.9	-42.7	-8.9	25.9	14.6
Equity and investment funds	2.6	-38.2	8.9	0.8	-34.5
Debt securities	37.3	-4.5	-17.8	25.1	49.2
Financial derivatives	4.3	-4.7	7.5	-5.7	-3.0
Other investment	-5.8	151.0	83.8	0.8	-23.4
of which: monetary financial institutions (3)	*-2.4*	*8.3*	*-73.2*	*-58.7*	*18.8*
Change in official reserves (3)	0.1	-1.0	-0.9	-1.5	-1.5
Errors and omissions	**-8.8**	**-32.2**	**-21.3**	**-13.2**	**9.3**

(1) Based on Istat foreign trade data. – (2) Excluding the Bank of Italy. – (3) A minus sign indicates an increase in reserves.

Exports of goods in value terms remained stationary with respect to 2012 against the backdrop of falling producer prices of goods sold on foreign markets. The overall performance in 2013 suffered from the sharply negative result for the first quarter; exports expanded in the second half of the year, and especially in the last quarter.

The performance of exports was highly uneven. Among the sectors in expansion, there was a sharp gain for pharmaceutical products (13.8 per cent at current prices) and increases of between 4 and 5 per cent for food products, clothing and leather products, motor vehicles, and other manufacturing products. By contrast, sales of metals contracted by 10.6 per cent, suffering from the decline (mainly in volume) in exports of non-monetary gold, as did those of refined petroleum products, computers, and electronic and optical equipment.

Italy's share of world exports of goods (at constant prices and exchange rates), which has been stable since 2010 after deteriorating steadily in the previous ten years, remained broadly unchanged in 2013 as well (3.0 per cent); in value terms the share inched up from 2.7 to 2.8 per cent, thanks to the euro's appreciation against the dollar.

For the second consecutive year imports of goods *cif* fell in value by more than 5 per cent (1.3 per cent of GDP in 2013), owing to the persistent slackness of investment and household consumption. The most significant contraction was that in energy goods (down by 15.6 per cent following an increase of 7.3 per cent in 2012), due in part to the fall in prices. Purchases of intermediate products and capital goods also declined; only those of consumer goods rose, and then only slightly. In particular, motor vehicle imports declined again, continuing the downward trend that began in 2008, and those of photovoltaic cells dwindled almost to nil. A handful of goods sectors bucked the trend, including refined petroleum products (where the import expansion was connected with a decline in refining capacity), pharmaceuticals and rubber and plastic products.

The improvement of the trade balance came mainly from a growing surplus with non-EU countries (from €6.3 billion to €25.2 billion, *fob-fob*) and to a lesser extent with the EU (from €10.7 billion to €12.0 billion), which regarded the countries not belonging to the euro area, chiefly the United Kingdom and Poland. Despite the appreciation of the euro against the dollar, there was a further growth in the surplus with the United States, due largely to the fall in imports. The bilateral deficit with China diminished again, as exports rose and imports fell, but still remains Italy's largest.

Services. – The surplus on services widened from €0.9 billion in 2012 to €2.6 billion in 2013 as a result of the 2.1 per cent increase in exports and the stagnation of imports.

The surplus on foreign travel grew to €12.8 billion, with increased receipts and decreased outlays. There was a decline in spending by tourists from the rest of the EU (especially from Germany, France and Spain), in contrast with a pick-up in receipts from non-EU countries, particularly the United States, Switzerland and Russia. Spending by Italian travellers abroad diminished for the second consecutive year, falling by 1.0 per cent; the reduction in tourist spending, which continued to be depressed by the fall in household consumption, was only partially offset by growth in work-related travel expenses.

The deficit on transport services registered a slight decline for the second successive year, easing to €7.8 billion mainly as a result of the smaller deficit on air passenger transport (€3.3 billion), thanks to the increase in the number of foreign tourists; Italian airlines' market share remained about the same. For goods transport, the deficit stayed at roughly the previous year's level; the decrease in the volume of goods purchased abroad broadly counterbalanced the moderate rise in freight rates and the decline in Italian carriers' market shares.

Following a sharp improvement in 2012, the deficit on services other than transport and travel was practically unchanged (€2.3 billion). Exports and imports both rose only slightly. An exception was financial and commercial services, one of the few sectors where the overall trend was positive. The growth in exports of services was also due to increases in sales of R&D, IT and business consulting services.

Income. – The deficit on the income account rose to €9.8 billion in 2013. Some €1.8 billion of the deterioration was due to the reduction in income from direct investment, an item that may undergo important revisions by the end of the current year once final company accounts data become available. Receipts from portfolio investment also diminished, by €2.2 billion, owing to the decline in interest payments to resident investors, especially holders of foreign debt securities. By contrast, a positive contribution came from the reduction of €1.2 billion in income outlays, reflecting the smaller risk premium on securities issued and smaller dividend payments to foreign investors.

Transfers. – The deficit on current transfers edged down to €14.5 billion. The increase in the deficit on public transfers (to €11.9 billion), consisting almost entirely of payments to EU institutions, was more than offset by the reduction in that on private transfers. Among the latter, workers' remittances, which nearly doubled between 2005 and 2011 with the surge in the number of foreigners living in Italy, diminished for the second year in a row. This reflected the fall in the employment rate of foreigners in Italy and the protracted Italian economic slump.

The capital account. – After running a surplus in 2012, the capital account reverted to rough balance (a deficit of just €0.1 billion) owing to the worsening of the balance on intangible assets as a result of large-scale purchases of $C0_2$ emission rights abroad (in 2012 there had been sales, instead, for a similar amount). The surplus vis-à-vis the EU institutions amounted to €4.2 billion.

The financial account

Direct investment. – According to preliminary data that will be revised by the end of this year, in 2013 Italian direct investment abroad amounted to €23.8 billion, up by €17.6 billion from the previous year. About half of the increase was due to firms' greater equity investment in their foreign affiliates; it was also fuelled by intra-group loans, unlike what happened in 2012, when resident investors drained liquidity from foreign subsidiaries.

Foreign direct investment in Italy recovered from practically nil to an estimated €12.4 billion, chiefly as a result of two major acquisitions in the traditional "made in Italy" export products sector and in the mining and quarrying sector.

Portfolio investment. – The balance on portfolio investment recorded a €14.6 billion net inflow. Residents' purchases of foreign securities (€20.6 billion) were more than offset by foreign investors' purchases of Italian securities (€35.2 billion), the highest figure since 2009.

After enormous disposals of Italian public debt securities in connection with the sovereign debt crisis (€102 billion in the two years 2011-12), in 2013 foreign investors returned to the market for Italian portfolio securities, including both shares (€13.0 billion) and debt securities (€22.2 billion, of which €13.5 billion issued by general government entities). The debt purchases involved short-term liabilities (up to 1-year) issued by the public sector (€17.0 billion) but also included medium- and long-term securities issued by non-bank private corporations (€16.4 billion, largely counterbalanced by disposals of bank and public sector bonds). In the first three months of 2014 foreign investors purchased some €32 billion worth of medium- and long-term public debt securities as confidence in Italy strengthened.

Continuing a trend that began in 2011, resident investors other than investment funds made net disposals of medium- and long-term foreign bonds (€25.8 billion). By contrast, households, insurance companies and non-bank financial intermediaries invested mainly in foreign shares and investment fund units (€44.1 billion); a part of these flows originated from the shifting of investments from Italian to foreign funds.

Other investment. – There were net outflows of €23.4 billion in 2013 under the heading *other investment*. Foreign assets in the form of loans and deposits diminished by €32.8 billion. Resident banks reduced their assets abroad by €43.3 billion, equally divided between short-term loans and sight deposits. By contrast, the foreign assets of the public sector grew by €14.6 billion as a result of contributions of capital to the European Stability Mechanism (€5.7 billion) and the European Investment Bank (€1.6 billion) and participation in the financial assistance operations of the European Financial Stability Facility (€6.8 billion). The latter entailed entering a corresponding liability item, with no impact on the external balance.

Foreign liabilities decreased by €51.2 billion overall, thanks mainly to the further contraction of €24.1 billion in resident banks' funding in deposits and loans on international markets and the €26.0 billion reduction in the Bank of Italy's TARGET2 debtor position. The improvement in the latter, which began in the second half of 2012 and continued in the first quarter of this year, reflects the resumption of capital inflows from abroad, particularly in portfolio investment.

The net international investment position

At the end of 2013 Italy's net external debtor position amounted to €465.7 billion (29.9 per cent of GDP), compared with €443.1 billion a year earlier (Table 12.2). The difference was due entirely to valuation adjustments.

On the asset side, the drop in the price of gold led to a reduction of almost €31 billion in the value of the Bank of Italy's official reserves in 2013. On the liability side, the gain in value of the Italian public sector securities held by non-residents, in connection with the decrease in the sovereign risk premium, caused a €10.5 billion worsening of the net debtor position, as these securities are recorded at market value. Even greater was the increase of €28.3 billion in liabilities connected with the value of portfolio securities issued by private companies, concentrated in the equity component and the bank sector, here too as the consequence of a recovery in prices. This valuation gain of liabilities contrasts with developments in 2011, when the decline in the market value of Italian public sector securities led to an improvement in Italy's net international investment position.

Table 12.2

Net international investment position
(billions of euros)

	Stocks at end-2010 (1)	January-December 2013					Stocks at end-2013 (1)
		Flows (2)	Value adjustments			Change in stocks	
			Total	Exchange rate	Other		
	(a)	(b)	(c)=(d)+(e)	(d)	(e)	(f)=(b)+(c)	(a)+(f)
				Resident non-banks			
Assets	1,235.1	67.1	23.1	-7.3	30.4	90.2	1,325.3
Direct investment	342.2	24.7	4.6	..	4.6	29.3	371.5
Portfolio investment	664.3	27.2	17.3	-7.3	24.7	44.6	708.8
of which: equities and investment funds	*355.7*	*45.0*	*25.5*	*-4.3*	*29.8*	*70.5*	*426.2*
Other investment	207.4	14.7	1.1	..	1.1	15.8	223.2
Derivatives	21.2	0.5	0.1	..	0.1	0.6	21.8
Liabilities	1,414.9	40.6	26.8	-2.2	29.0	67.4	1,482.3
Direct investment	255.4	9.3	7.1	..	7.1	16.5	271.8
Portfolio investment	906.7	36.9	21.9	-2.2	24.1	58.8	965.6
of which: equities and investment funds	*118.8*	*8.4*	*11.8*	*..*	*11.8*	*20.2*	*139.0*
Other investment	198.3	-5.4	1.2	..	1.2	-4.2	194.2
Derivatives	54.5	-0.3	-3.5	..	-3.5	-3.7	50.7
Net position	**-179.8**	**26.5**	**-3.7**	**-5.2**	**1.5**	**22.8**	**-157.0**
				Resident banks			
Assets	489.1	-48.7	-43.9	-2.0	-41.9	-92.5	396.6
Liabilities	710.1	-28.5	-34.5	-1.7	-32.8	-63.0	647.1
Net position	**-221.0**	**-20.1**	**-9.4**	**-0.3**	**-9.1**	**-29.5**	**-250.5**
				Central bank			
Assets	213.8	-3.0	-34.2	-3.3	-30.9	-37.2	176.5
Liabilities	256.1	-21.3	..	..	..	-21.3	234.8
Net position	**-42.3**	**18.3**	**-34.2**	**-3.3**	**-30.9**	**-15.9**	**-58.2**
				All sectors			
Total assets	1,938.0	15.4	-55.0	-12.7	-42.3	-39.6	1.898.4
Total Liabilities	2,381.1	-9.3	-7.7	-3.9	-3.8	-17.0	2.364.1
Total net position	**-443.1**	**24.7**	**-47.3**	**-8.8**	**-38.5**	**-22.6**	**-465.7**

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

13. THE PUBLIC FINANCES

In 2013 budgetary policy was less restrictive than in the previous year. General government net borrowing held stable at 3.0 per cent of GDP, notwithstanding a further contraction in output. The primary surplus decreased slightly, to 2.2 per cent, but nonetheless was still more than 3 percentage points over the average for the other EU countries. The ratio of debt to GDP rose from 127.0 to 132.6 per cent; about a third of the increase in liabilities financed disbursements to support EMU countries and bring forward payment of general government commercial debts, now significantly reduced.

For 2014 the Economic and Financial Document (EFD) forecasts that net borrowing will decrease to 2.6 per cent of GDP, in line with the recent estimates of the European Commission. The structural deficit will narrow by 0.2 percentage points (to 0.6 per cent of GDP), which is less than the 0.5 points required under EU budgetary rules, which have been transposed into Italian legislation. The Government's request for a temporary departure from the rules has been approved by Parliament; in June the European Commission will decide whether this is admissible. The debt is expected to increase by a further 2.3 percentage points of GDP.

In April the Government passed a decree introducing tax reliefs for 2014, for the most part only temporary in nature, amounting to over €7 billion; they will be financed by revenue increases, also largely transitory, and expenditure reductions. With account also taken of this decree, official estimates indicate that the fiscal burden will remain unchanged; the planned improvement in the primary surplus (by 0.4 percentage points of GDP) will come from a reduction in the ratio of primary expenditure to GDP. The borrowing requirement in the early months of this year appears consistent with a small decline in net borrowing.

From 2015 the Government aims to resume progress towards consolidation, in line with the budgetary rules: net borrowing is expected to fall to 1.8 per cent of GDP next year; structural net borrowing should decrease by 0.5 percentage points, coming close to balance. According to the EFD, an adjustment of 0.3 percentage points of GDP is needed to achieve these objectives. Additional resources that the Government plans to make available largely by curbing expenditure would be used to make the reduction in the tax wedge introduced in the April decree permanent, render unnecessary the revenue increases already envisaged in the budget on a current legislation basis, and finance the unavoidable part of the increased requirement based on unchanged policies (assuming current programmes remain in place).

Budgetary policy for 2013: objectives and results

The objective for net borrowing in 2013 was set at 0.5 per cent of GDP in the April 2012 EFD. That figure was revised upwards several times, reaching 3.0 per cent in September last year (Table 13.1). Similarly, the objective for the primary surplus was reduced from 4.9 to 2.4 per cent.

Table 13.1

Public finance objectives, estimates and outturn for the year 2013
(billions of euros and per cent of GDP)

	General government				*Memorandum items:*			
	Net borrowing	Primary surplus	Structural deficit	Debt (1)	Real GDP growth rate (%)	Nominal GDP	Structural deficit 2012	Net borrowing 2012
Objectives								
EFD 2012 (April 2012) (2)	8.6	79.9	….	1,977.1	0.5	1,626.9	….	27.2
per cent of GDP	*0.5*	*4.9*	*-0.6*	*121.5*			*0.4*	*1.7*
EFD 2012 Update (September 2012)	….	….	….	….	-0.2	1,582.4	….	41.2
per cent of GDP	*1.8*	*3.8*	*0.0*	*126.1*			*0.9*	*2.6*
EFD 2013 Update (*September* 2013)	….	….	….	2,069.5	-1.7	1,557.3	….	47.6
per cent of GDP	*3.0*	*2.4*	*0.4*	*132.9*			*1.3*	*3.0*
Estimates released in 2013								
EFD 2013 (April 2013) (2)	45.4	38.5	….	2,051.4	-1.3	1,573.2	….	47.6
per cent of GDP	*2.9*	*2.4*	*0.0*	*130.4*			*1.2*	*3.0*
EFD 2013 Update (September 2013)	48.7	35.2	….	….	-1.7	1,557.3	….	47.6
per cent of GDP	*3.1*	*2.3*	*0.5*	*133.0*			*1.3*	*3.0*
Draft budgetary plan 2014 (October 2013)	….	….	….	….	-1.8	….	….	….
per cent of GDP	*3.0*	*2.4*	*0.5*	*132.9*			….	*3.0*
Outturn (3)	**47.3**	**34.7**	**….**	**2,069.4**	**-1.9**	**1,560.0**	**….**	**47.4**
per cent of GDP	*3.0*	*2.2*	….	*132.6*			….	*3.0*

(1) The estimates and objectives given in the official documents are not fully consistent, as the treatment of the effects of financial support to EMU countries in difficulty and Italy's contribution to the European Stability Mechanism (ESM) is not uniform. – (2) The EFD includes the Stability Programme. – (3) Sources: Istat and, for the debt, Bank of Italy.

The revisions were made largely in response to the progressive worsening of the economic situation. In April 2012 it was forecast that GDP would contract by 0.7 percentage points overall in the two years 2012-13, while in October 2013 the decline was estimated to be 4.3 points, in line with the final result; the gap is even larger in terms of nominal GDP. About 0.5 percentage points of the upward revision of the objective for the deficit came from budgetary measures, in particular the provision introduced in April 2013 to accelerate the payment of general government commercial debts.

A number of measures were adopted after the April decree, aimed at supporting the economy, employment and households' income and coping with social emergencies and natural disasters; according to official estimates they had no impact on net borrowing (Table 13.2). They were financed mainly by increasing indirect taxes and payments on account of some direct taxes and by reducing expenditure.

Table 13.2

Effects of the 2013 public finance measures on the general government consolidated accounts (1)
(millions of euros)

	2013	2014	2015
PROCUREMENT OF RESOURCES	**8,821**	**6,397**	**5,504**
Measures that increase revenue (A)	**5,639**	**4,191**	**2,938**
VAT revenue from payment of commercial debts (2) (9)	540	600	0
Reduction in the provision for company-level contribution relief (3) (9)	500	0	0
VAT rules on the dispensing of food and drink and publications (4)	0	194	194
Extension of company surtax to the energy sector (5)	0	0	150
Raising of payments on account for personal income tax, company tax, Irap and company surtax (6) (9)	1,324	668	0
Raising of payments on account for withholding tax on interest from bank deposits and current accounts (6)	209	0	0
Tax on consumption of tobacco substitutes and raising of tax rate on tobacco products (6) (7)	0	167	167
Lowering of upper limit on insurance premiums deductible from personal income tax (9)	0	459	661
Compensation for loss of tax due by online gaming licensees (9)	340	0	0
Revenue from part of electricity charges (9)	300	0	0
Raising of excise duties on fuels (9)	0	0	671
Mortgage and land registry taxes on sale of property (10)	0	120	120
Increase of 27.5 percentage points in payment on account of company tax and Irap for banks and financial institutions (12)	1,496	0	0
Company surtax of 8.5 percentage points for banks and financial institutions (12)	0	1,536	0
Introduction of payment on account of withholding tax on managed savings (12)	670	0	0
Other measures (3) (4) (5) (6) (7) (8) (10) (13) (14)	261	447	975
Measures that reduce expenditure (B)	**-3,182**	**-2,206**	**-2,565**
Reduction in endowment of various funds (2) (3) (4)	-183	-105	-666
Revised arrangements with the Stretto di Messina construction company and other public works projects (5)	-150	-395	-592
Structural funds 2007-2013 and revision of the Action and Cohesion Plan (6)	-208	-358	-329
Reduction of expenditure allocations and categories (9) (10) (11)	-1,710	-206	-249
Other measures (2) (3) (5) (6) (8) (9) (10) (11) (13) (14)	-931	-1,142	-729
USE OF RESOURCES	**14,976**	**5,305**	**4,515**
Measures that reduce revenue (C)	**-5,965**	**-2,645**	**-1,938**
Postponement to 1 October 2013 of increase in ordinary VAT rate (6)	-1,059	0	0
Increase in payments on account of personal income tax, company tax, Irap and company surtax (6) (9)	0	-1,113	-668
Increase in payments on account of withholding tax on interest from bank deposits and current accounts (6)	0	0	-209
Measures relating to municipal property tax (IMU) (9) (12)	-4,605	-79	-79
Increase of 27.5 percentage points in payment on account of company tax and Irap (12)	0	-1,496	0
Other measures (2) (3) (4) (5) (6) (7) (8) (9) (10) (13) (14)	-301	43	-982
Measures that increase expenditure (D)	**9,010**	**2,660**	**2,577**
Payment of commercial debts on capital account (2)	7,500	0	0
Unemployment and welfare benefits and employment measures (3) (4) (6) (9)	788	474	349
Fund to re-start construction projects (5)	195	470	662
Cultural activities (5) (7) (10)	2	238	214
Schools and universities (5) (10)	10	355	411
Interest expense relating to payment of commercial debts (9)	0	190	248
Other measures (2) (3) (5) (6) (7) (8) (9) (10) (11) (12) (13) (14)	515	933	693
Net change in revenue (E=A+C)	**-326**	**1,546**	**1,000**
Net change in expenditure (F=B+D)	**5,829**	**454**	**12**
Change in net borrowing (G=F-E)	**6,155**	**-1,092**	**-988**
per cent of GDP	*0.4*	*-0.1*	*-0.1*

Source: Based on official data from various documents published by the Ministry for the Economy and Finance: EFD 2013 Update, *La manovra di finanza pubblica per il 2014* and EFD for 2014.
(1) Rounding may cause discrepancies. – (2) Decree Law 35/2013 (converted in Law 64/2013). – (3) Decree Law 54/2013 (converted in Law 85/2013). – (4) Decree Law 63/2013 (converted in Law 90/2013). – (5) Decree Law 69/2013 (converted in Law 98/2013). – (6) Decree Law 76/2013 (converted in Law 99/2013). – (7) Decree Law 91/2013 (converted in Law 112/2013). – (8) Decree Law 101/2013 (converted in Law 125/2013). – 9) Decree Law 102/2013 (converted in Law 124/2013) adjusted with the effects of the safeguard clause implemented by Ministerial Decree of 30.11.2013. – (10) Decree Law 104/2013 (converted in Law 128/2013). – (11) Decree Law 120/2013 (converted in Law 137/2013). – (12) Decree Law 133/2013 (converted in Law 5/2014). – (13) Decree Law 145/2013 (converted in Law 9/2014). – (14) Decree Law 150/2013 (converted in Law 15/2014).

Table 13.3

Main indicators of the general government finances (1)
(per cent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Revenue	44.3	43.9	45.5	46.5	46.5	47.1	46.7	46.5	48.1	48.2
Expenditure (2)	47.8	48.3	49.0	48.2	49.2	52.5	51.2	50.3	51.1	51.2
of which: *interest payments*	*4.7*	*4.6*	*4.6*	*5.0*	*5.2*	*4.7*	*4.6*	*5.0*	*5.5*	*5.3*
Primary surplus	1.2	0.2	1.2	3.4	2.5	-0.8	0.1	1.2	2.5	2.2
Net borrowing	3.5	4.4	3.4	1.6	2.7	5.5	4.5	3.7	3.0	3.0
Total borrowing requirement	3.6	5.0	3.9	1.7	3.2	5.7	4.5	4.0	4.3	4.9
Borrowing requirement net of privatization receipts	4.2	5.3	3.9	1.9	3.2	5.8	4.5	4.1	4.8	5.1
Debt	103.7	105.7	106.3	103.3	106.1	116.4	119.3	120.7	127.0	132.6
Debt net of the financial support given to EMU countries (3)	103.7	105.7	106.3	103.3	106.1	116.4	119.0	119.9	124.3	129.1

Source: Based on Istat data for the general government consolidated accounts items.
(1) Rounding may cause discrepancies. – (2) The proceeds of sales of public assets are recorded as a deduction from this item. – (3) Net of direct loans to Greece, Italy's share of loans granted via the European Financial Stability Facility (EFSF) and its contribution to the capital of the ESM.

In June 2013 the EU Council abrogated the decision regarding the existence of an excessive deficit in Italy on the basis of the outturn for net borrowing in 2012 (3.0 per cent of GDP).

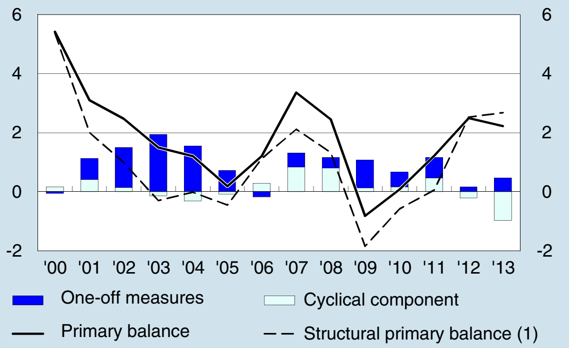
In October further adjustment measures were adopted to ensure that net borrowing, which was forecast to reach 3.1 per cent of GDP in the EFD 2013 Update, did not overshoot the 3.0 per cent limit. They included property disposals, expenditure cuts and changes to the rules of the Domestic Stability Pact for municipalities (Decree Law 120/2013).

The outturn for net borrowing in 2013 was unchanged at 3.0 per cent of GDP, 0.4 percentage points below the average for the other EU countries; the primary surplus decreased by 0.3 points to 2.2 per cent (Table 13.3). Revenue diminished by 0.3 per cent, in line with nominal GDP. Expenditure decreased by 0.2 per cent as a result of smaller disbursements for interest payments and on capital account.

In September 2014, when the new European system of national accounts (SEC 2010) enters into force, interest expense will be revised, retrospectively as well, to exclude the net interest generated by swaps and forward rate agreements. Without any other changes being made, this revision will reduce net borrowing to 2.8 per cent of GDP in 2013 and to 2.9 per cent in 2012.

Figure 13.1

Primary balance and temporary effects
(per cent of GDP)



(1) Adjusted for the effects of the economic cycle and one-off measures; per cent of trend GDP.

In 2013, as in the previous two years, revenue and primary expenditure were lower than projected by the Government in April and September. The difference can be ascribed only in part to measures introduced during the year and, in the case of revenue, to the worse than expected performance of the economy.

The stance of budgetary policy remained restrictive, although markedly less so than in 2012. The cyclically adjusted primary surplus increased by just under 0.5 percentage points, against almost 2 points in the previous year. The structural primary surplus (adjusted for the effects of the economic cycle and one-off measures) rose by 0.1 per cent of GDP (Figure 13.1).

General government revenue and expenditure

Revenue. – General government revenue decreased by 0.3 per cent or €1.9 billion in 2013, in line with nominal GDP. The net effect of the discretionary measures introduced from 2011 on was virtually nil.

The ratio of tax revenue and social contributions to GDP, which had increased by 1.5 percentage points in 2012, diminished by almost 0.2 points, to 43.8 per cent (Table 13.4), but was still some 2.1 points over the average for the other euro area countries.

While social security contributions (-0.5 per cent) generally followed the performance of GDP, current tax revenue fell by 1.5 per cent. This was partly due to the sharp fall of 3.6 per cent in indirect taxes, associated above all with the decrease in VAT receipts and revenue from the municipal property tax (IMU). The latter contracted by €3.6 billion (to €20.2 billion) as a result of its abolition for non-luxury owner-occupied houses and other minor items.

The increase of 0.6 per cent in direct taxes came primarily from the growth in the revenue from corporate income tax and from some withholding taxes on income from financial assets. Capital revenue rose sharply (by 57.3 per cent or €3.4 billion), boosted mainly by the revenue from the withholding tax on the alignment of fiscal and book values.

Table 13.4

General government revenue (1)
(per cent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Direct taxes	13.3	13.2	14.3	15.0	15.2	14.6	14.6	14.3	15.1	15.3
Indirect taxes	14.0	14.1	14.8	14.6	13.7	13.6	14.0	14.0	15.0	14.5
Capital taxes	0.6	0.1	0.0	0.0	0.0	0.8	0.2	0.4	0.1	0.3
Tax revenue	**27.8**	**27.5**	**29.1**	**29.6**	**28.9**	**29.0**	**28.8**	**28.8**	**30.2**	**30.0**
Social security contributions	12.6	12.6	12.6	13.1	13.7	14.0	13.8	13.7	13.8	13.8
Tax revenue and social security contributions	**40.4**	**40.1**	**41.7**	**42.7**	**42.6**	**43.0**	**42.6**	**42.5**	**44.0**	**43.8**
Other current revenue	3.6	3.5	3.6	3.5	3.6	3.8	3.9	3.8	3.8	4.0
Other capital revenue	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.3	0.3
Total revenue	**44.3**	**43.9**	**45.5**	**46.5**	**46.5**	**47.1**	**46.7**	**46.5**	**48.1**	**48.2**

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

Expenditure. – In 2013 general government expenditure decreased in nominal terms by 0.2 per cent (Table 13.5), due to the decline in interest payments and to the further drop in capital expenditure. Primary expenditure and primary current expenditure began to increase again, after falling for respectively three and two consecutive years.

Table 13.5

General government expenditure (1)
(per cent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Compensation of employees	10.7	10.9	10.9	10.6	10.8	11.3	11.1	10.7	10.5	10.5
Intermediate consumption	5.3	5.4	5.1	5.1	5.4	5.9	5.8	5.8	5.6	5.6
Social benefits in kind	2.7	2.8	2.8	2.7	2.7	2.9	2.9	2.8	2.8	2.8
Social benefits in cash	16.8	16.9	16.9	17.0	17.6	19.2	19.2	19.3	19.9	20.5
Interest payments	4.7	4.6	4.6	5.0	5.2	4.7	4.6	5.0	5.5	5.3
of which: swap and forward rate agreements	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.1*	*0.1*	*0.1*	*0.1*	*0.2*
Other current expenditure	3.6	3.7	3.6	3.7	3.8	4.2	4.1	3.7	3.7	3.9
Total current expenditure	**43.9**	**44.2**	**44.0**	**44.1**	**45.4**	**48.1**	**47.8**	**47.2**	**48.0**	**48.5**
of which: expenditure net of interest payments	*39.1*	*39.6*	*39.3*	*39.1*	*40.3*	*43.5*	*43.2*	*42.2*	*42.5*	*43.2*
Gross fixed investment (2)	2.4	2.4	2.4	2.3	2.2	2.5	2.2	2.0	1.9	1.7
Other capital expenditure	1.5	1.7	2.7	1.7	1.5	1.9	1.3	1.1	1.2	1.0
Total capital expenditure (2)	**3.9**	**4.1**	**5.0**	**4.0**	**3.8**	**4.4**	**3.4**	**3.1**	**3.1**	**2.7**
Total expenditure (2)	**47.8**	**48.3**	**49.0**	**48.2**	**49.2**	**52.5**	**51.2**	**50.3**	**51.1**	**51.2**
of which: expenditure net of interest payments (2)	*43.1*	*43.7*	*44.3*	*43.2*	*44.0*	*47.9*	*46.6*	*45.3*	*45.6*	*46.0*

Source: Based on Istat data.
(1) Rounding may cause discrepancies. – (2) The proceeds of sales of public assets are recorded as a deduction from this item.

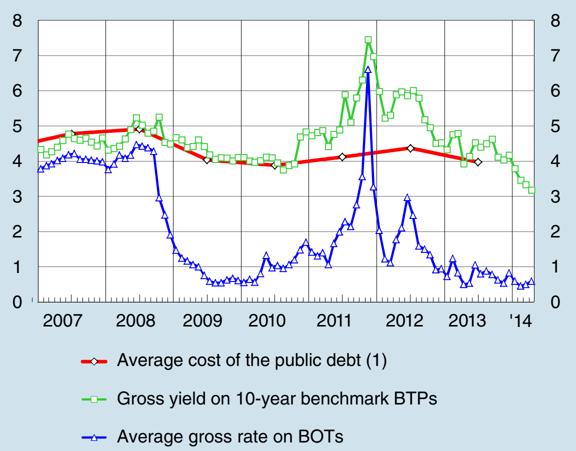
The 1.3 per cent increase in primary current expenditure was due above all to the rise in social benefits in cash, up by 2.7 per cent. Among the latter, outlays on pensions rose by 2.2 per cent, while the non-pension component grew by 6.3 per cent as a result of outlays on unemployment and welfare benefits.

Compensation of employees, which had been falling since 2011, decreased by 0.7 per cent. Contributory factors were the further fall of 0.7 per cent in employment (down by 0.7 per cent and by 8.3 per cent from the peak reached in 2006), which was affected by the tight limits on hiring, and the freeze on wage negotiations.

Expenditure on social benefits in kind, 90 per cent of which consists of healthcare outlays, diminished by 0.6 per cent (-5.1 per cent since 2010). Intermediate

Figure 13.2

Gross yield on 10-year BTPs, average gross rate on BOTs and average cost of the public debt
(per cent)



(1) The average cost of the debt is calculated as the ratio of interest payments to the average size of the debt during the year.

consumption decreased by 1.7 per cent (-3.2 per cent in 2012) reflecting the measures to curb spending introduced in the second half of 2011.

After falling sharply in the previous three years, capital expenditure, not including receipts from property disposals (which are entered as a reduction to investment), contracted by 12.9 per cent. Expenditure on investment also diminished, by 9.5 per cent compared with 2012 and by 29.0 per cent over the last four years, despite the funds allocated under the 2013 measures to accelerate the payment of arrears.

Interest payments decreased by 5.1 per cent owing to the reduction in the average cost of the debt from 4.4 to 4.0 per cent (Figure 13.2), which more than offset the increase in liabilities.

General government borrowing requirement and debt

The borrowing requirement. – The general government borrowing requirement grew from €66.7 billion in 2012 to €77.0 billion, or from 4.3 to 4.9 per cent of GDP (Table 13.6). This was mainly due to the use of resources to accelerate the payment of commercial debts and for tax refunds (respectively €19.1 billion and €2.5 billion, according to the Ministry for the Economy and Finance) and to the decrease in privatization receipts, to €1.9 billion compared with €7.9 billion in 2012. The reduction in financial support to EMU countries, from €29.5 billion in 2012 to €13 billion, produced an opposite effect.

Table 13.6

General government balances and debt (1)
(millions of euros)

	2009	2010	2011	2012	2013
Net borrowing	83,413	69,919	59,112	47,356	47,345
Total borrowing requirement	86,892	69,837	63,771	66,675	76,991
Privatization receipts (2)	1,208	8	1,525	7,874	1,877
Borrowing requirement net of privatization receipts (2)	88,100	69,846	65,296	74,550	78,868
Debt	1,769,250	1,851,141	1,907,369	1,989,584	2,069,365
Memorandum items:					
Treasury deposits with the Bank of Italy (3)	31,731	43,249	24,255	34,394	37,640
Other deposits	35,466	35,688	35,385	27,210	24,681
Financial support to EMU countries (4)	–	3,909	13,118	42,665	55,621
bilateral loans	–	*3,909*	*10,007*	*10,007*	*10,007*
EFSF	–	–	*3,110*	*26,925*	*34,148*
ESM	–	–	–	*5,732*	*11,465*
Average residual maturity of the debt (years)	7.7	7.8	7.5	7.1	6.9

Source: For net borrowing, Istat.
(1) Rounding may cause discrepancies. – (2) The privatization receipts are those of central government. – (3) Treasury deposits with the Bank of Italy and liquid balances deposited with the banking system. – (4) Loans granted to EMU countries both bilaterally and via the EFSF and Italy's contribution to the capital of the ESM.

The disparity between the borrowing requirement and net borrowing. – The general government borrowing requirement exceeded net borrowing by 1.9 percentage points of GDP, compared with 1.3 points in 2012 (Table 13.7). The gap was due in part (1.1 points) to the accumulation of financial assets and in part (1.0 points) to the different method of entering transactions in the accounts, on a cash basis for the borrowing requirement and on an accrual basis for net borrowing, while the statistical discrepancies caused by the differences in the methods used by the Bank of Italy and the Ministry for the Economy and Finance to measure the borrowing requirement reduced the gap by 0.2 percentage points

Table 13.7

Reconciliation between net borrowing and the change in the debt (1)
(per cent of GDP)

		2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
(a)	**Net borrowing (Istat)**	**3.5**	**4.4**	**3.4**	**1.6**	**2.7**	**5.5**	**4.5**	**3.7**	**3.0**	**3.0**
(b)	Balance of financial items (2)	0.4	1.0	0.6	0.3	0.2	0.6	0.5	0.7	1.3	1.1
	of which: support to EMU countries (3)	–	–	–	–	–	–	*0.3*	*0.6*	*1.9*	*0.8*
	Privatization receipts	0.6	0.3	0.0	0.2	0.0	0.1	0.0	0.1	0.5	0.1
(c)	Cash basis minus accrual basis	-0.4	-0.6	0.0	-0.1	0.4	-0.3	-0.6	-0.4	0.0	1.0
(c1)	*primary balance* (4)	*-0.3*	*-0.4*	*-0.2*	*0.2*	*0.2*	*-0.5*	*-0.7*	*-0.3*	*0.2*	*0.9*
(c2)	*interest payments*	*-0.2*	*-0.1*	*0.3*	*-0.2*	*0.2*	*0.2*	*0.0*	*0.0*	*-0.2*	*0.1*
(d)=(a)+(b)+(c)	**Public sector borrowing requirement (MEF) including privatization receipts + EFSF loans**	**3.5**	**4.9**	**4.0**	**1.8**	**3.2**	**5.8**	**4.4**	**4.1**	**4.3**	**5.1**
(e)=(f)-(d)	Difference between general government and public sector borrowing requirements	0.1	0.1	-0.1	-0.1	0.0	0.0	0.1	-0.1	-0.1	-0.2
(f)	**General government borrowing requirement (BI)**	**3.6**	**5.0**	**3.9**	**1.7**	**3.2**	**5.7**	**4.5**	**4.0**	**4.3**	**4.9**
(g)	Change in the Treasury's deposits at BI (5)	0.2	-0.1	0.6	-0.8	0.7	0.8	0.7	-1.2	0.6	0.2
(h)	Issue discounts	0.0	-0.2	0.2	0.3	0.3	0.0	0.0	0.7	0.4	0.0
(i)	Change in the euro value of foreign currency liabilities	-0.1	0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(l)=(f)+(g)+(h)+(i)	**Change in the debt (BI)**	**3.7**	**4.8**	**4.6**	**1.1**	**4.2**	**6.5**	**5.3**	**3.6**	**5.2**	**5.1**
(m)=(a)-(l)	Difference between net borrowing and change in debt	-0.2	-0.4	-1.2	0.5	-1.5	-1.0	-0.8	0.2	-2.2	-2.1
(n)=(f)-(l)	Difference between general government borrowing requirement and change in debt	-0.1	0.2	-0.7	0.6	-1.0	-0.7	-0.8	0.5	-1.0	-0.2

Sources: For net borrowing and interest payments on an accrual basis, Istat; for the public sector borrowing requirement and interest payments on a cash basis, the Ministry for the Economy and Finance (MEF), Quarterly Report on the Borrowing Requirement, Combined Report on the Economy and Public Finances, and the Economic and Financial Document (EFD), various years; for loans to Greece and EMU countries via the EFSF, Eurostat; for the general government borrowing requirement and debt, change in the Treasury's deposit at the Bank of Italy, issue discounts and the change in the euro value of foreign currency liabilities, Bank of Italy; for the balance on financial asset items, based on financial accounts data, Bank of Italy.
(1) Rounding may cause discrepancies. – (2) Includes changes in holdings of the following financial assets: cash and deposits (net of Treasury deposits at the Bank of Italy), securities, shares and other equity (net of privatization receipts) and loans. – (3) Loans granted to EMU countries both bilaterally and via the EFSF and Italy's contribution to the capital of the ESM. – (4) Calculated as the remainder: (c1)=(d)-(a)-(b)-(c2). – (5) Treasury deposits with the Bank of Italy and liquid balances deposited with the banking system.

The debt. – The ratio of general government debt to GDP rose from 127.0 to 132.6 per cent (Table 13.8). About one sixth of the increase in liabilities financed the reduction in general government commercial debts, which are not included in the public debt unless assigned without recourse to financial intermediaries. Excluding the financial support provided to EMU countries, the increase was 4.8 percentage points and reflected above all the gap between the average cost of the debt and the growth in nominal GDP (5.7 points) and between the cash basis and accrual basis methods of accounting (1.0 points); these factors were only partly offset by the primary surplus of 2.2 percentage points.

Table 13.8

Composition of the public debt by issuer (1)
(per cent of GDP)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
General government	**103.7**	**105.7**	**106.3**	**103.3**	**106.1**	**116.4**	**119.3**	**120.7**	**127.0**	**132.6**
Memorandum item: Unconsolidated debt	106.0	108.0	108.2	105.0	108.3	118.1	120.9	122.4	128.6	135.2
Central government	**98.2**	**99.6**	**99.2**	**96.1**	**99.1**	**108.8**	**111.8**	**113.3**	**119.6**	**125.7**
Memorandum item: Unconsolidated debt	99.1	100.5	100.1	97.0	100.0	109.3	112.2	113.8	120.2	126.3
Local government	**5.4**	**6.2**	**7.2**	**7.2**	**7.0**	**7.6**	**7.5**	**7.4**	**7.3**	**7.0**
Memorandum item: Unconsolidated debt	6.9	7.5	8.1	8.0	8.3	8.8	8.6	8.5	8.4	8.8
Social security institutions	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum item: Unconsolidated debt	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

(1) Debt consolidated among and within issuers. Rounding may cause discrepancies.

In 2013, with tension on the sovereign debt market gradually easing, the proportion of medium- and long-term securities in the total increased by 1.1 percentage points to about 92 per cent. The proportion of inflation-linked securities rose from 9.2 to 11.7 per cent, partly as a result of the issues of BTP Italia bonds in April and November. The average residual maturity of government securities was unchanged at 6.3 years; that of the debt shortened slightly, from 7.1 to 6.9 years.

The share of the debt held by non-residents decreased for the third consecutive year, falling from 32.4 to 31.8 per cent. After contracting to 31.4 per cent in the first half of the year it picked up in the second half, reaching 32.8 per cent in February this year. Excluding the securities purchased under the Securities Markets Programme and those held on behalf of Italian investors in managed portfolios and investment funds based abroad, the share of government securities held by non-residents at the end of 2013 was close to 27 per cent, compared with 27.8 per cent at the end of 2012.

Commercial debts. – On the basis of the Bank of Italy's supervisory reports and sample surveys of firms, total general government commercial debts are estimated to have fallen in 2013 from about €90 billion to just over €75 billion (in relation to an annual outlay of the order of €150 billion).

The above figure is a rough estimate based on samples only and was obtained by summing the commercial debts entered in firms' annual accounts – including those assigned without recourse to financial intermediaries – and the commercial debts assigned with recourse. The latter are part of the public debt and decreased from €10.8 billion in December 2012 to €8.4 billion a year later.

Estimates of European countries' commercial debts were released by Eurostat in April. The figure given for Italy (€51.3 billion in 2013) refers exclusively to current expenditure and does not include debts acquired with recourse by financial intermediaries. It was equal to 3.3 per cent of GDP, compared with 3.9 per cent in 2012, the highest figure among the European countries that submitted data.

The estimates made by Istat and transmitted to Eurostat only consider current expenditure, insofar as capital expenditure (which should also be accounted for on an accrual basis) is proxied by the data on a cash basis, so that it does not give rise to discrepancies between payments and the registration of disbursements in the public accounts.

In 2013 more than €40 billion was appropriated (nearly €25 billion for 2013 and €16 billion for 2014) to accelerate the payment of certain, liquid and collectable general government commercial debts outstanding at the end of 2012 (a further €6.5 billion was allocated to accelerate tax refunds). In particular, for current liabilities, the Ministry for the Economy and Finance disbursed in 2013 (and will disburse again in 2014) cash advances to debtor entities (regional governments and local authorities); for capital debts, financial space will be granted within the Domestic Stability Pact for 2013 only. It is officially estimated that the increased disbursements for capital debts raised net borrowing by 0.5 percentage points of GDP (see the box "General government commercial debts", *Economic Bulletin*, No. 2, 2014).

According to data collected by the Ministry for the Economy and Finance during 2013, firms received €19.1 billion (with a further €2.5 billion disbursed for additional tax refunds) out of €22.0 billion of funds made available to the debtor entities. The last update, published on 28 March this year, indicates that a further €1.8 billion of debts were paid in the early months of this year, bringing the total to €21.0 billion, out of €22.5 billion of available resources.

It is estimated on the basis of sample surveys that the average payment time of general government in 2013 was about 180 days, slightly less than in 2012. The acceleration was due in part to the reduction in agreed payment times to about 75 days. For contracts concluded in 2013, after the European directive on combating late payment (Legislative Decree 192/2012) entered into force, average contracted payment times were just over 60 days.

Decree Law 66/2014 increases the funds available to pay commercial debts, including those outstanding at the end of 2013, by roughly €9 billion. Furthermore, a system of computerized monitoring at pre-set intervals has been put in place to bring payment times into line with the European directive. Finally, some measures have been introduced to help supplier firms transfer their claims to the banking system.

Local government

The local government consolidated accounts were basically in balance in 2013. Revenue and expenditure amounted to 15 per cent of GDP.

Revenue decreased by 1.4 per cent to €233.8 billion. This was due to transfers from other government entities and the tax component, both of which contracted by about 2 per cent, to €93.6 billion and €104.7 billion respectively.

Local government expenditure, excluding transfers to other public bodies, decreased by 1.2 per cent, to €230.9 billion. Primary current expenditure diminished for the third consecutive year, by 0.7 per cent. Employee compensation contracted by 1.9 per cent (by 7.4 per cent with respect to 2010) and social benefits in kind by 0.5 per cent (5.3 per cent with respect to 2010). For the first time intermediate consumption also diminished, by 1.2 per cent.

Capital expenditure, excluding transfers to public bodies and property disposals, fell by 5.0 per cent, owing to the further contraction of 6.0 per cent in investment. Disbursements to firms in the form of investment grants and transfers instead increased by 4.2 per cent.

Changes in local property taxes. – Property taxes play a leading role in local finance. Homes are an excellent tax base to provide local government with revenue according to the benefit principle, i.e. the quantity and quality of services provided. In Italy, it is estimated that in 2012 the property taxes pertaining to local authorities yielded total revenue equal to about a quarter of their current expenditure.

In the last three years local taxes on residential property and related services (specifically, waste collection) have been changed repeatedly. The tax on first homes was re-introduced in 2012 when the municipal property tax (IMU) entered into force; it was virtually eliminated for all but luxury homes in 2013 and then reinstated de facto in 2014 with the advent of the tax on communal services (TASI).

Unlike the IMU, the TASI does not envisage basic deductions (i.e. standard throughout the country) for owner-occupied housing. Some measures have recently been passed to make it less likely that the changeover to the new tax will cause redistribution effects to the disadvantage of principal residences with the lowest land registry values.

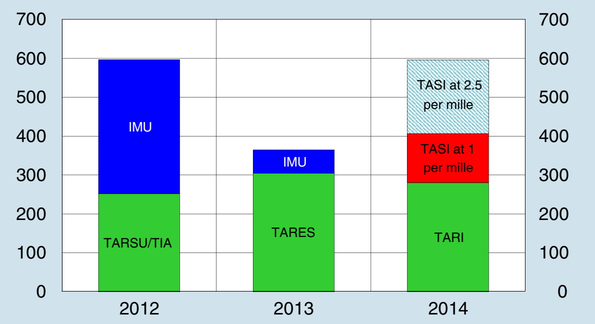
Local taxes on waste collection have also undergone changes in recent years. The TARES was introduced in 2013 and replaced by the TASI at the beginning of 2014.

Since 2012 part of the revenue from local property taxes is allocated to the State. The criteria for distributing resources between State and local authorities have also changed.

An analysis of property taxes by regional capital shows that the amount levied locally on non-luxury owner-occupied dwellings diminished sharply in 2013 (Figure 13.3). The total amount of taxation will increase in 2014; if the authorities raised the tax rate to 2.5 per mille, local property taxes would return to their 2012 level.

Figure 13.3

Local taxation on principal residences (1)
(euros)



Sources: Based on Revenue Agency data (*Statistiche catastali 2012, catasto edilizio urbano*) and resolutions approved by local authorities.
(1) Analysis based on the taxes paid by a family of 3 people (including one child under 26 living at home) in owner-occupied property with surface area and land registry value equal to the average of estimated values for the regional capitals. The average land registry value and surface area in each regional capital are calculated by summing the land registry statistics for properties in categories from A2 (average property) to A7 (whole or part of house with outside area). Taxes are calculated taking account of the resolutions approved by local authorities.

BUDGETARY POLICY FOR 2014 AND THE MEDIUM TERM

Budgetary policy for 2014

In the April 2013 EFD the Government projected net borrowing for 2014 at 1.8 per cent of GDP and a primary surplus of 3.8 per cent (Table 13.9).

In the autumn, the EFD Update revised the objective for the deficit upwards to 2.5 per cent of GDP and that for the primary surplus down to 2.9 per cent. The revisions took account, among other things, of a baseline estimate for net borrowing in 2013 that was 0.2 percentage points of GDP higher (due to the deterioration in economic conditions during the year); the worsening of the macroeconomic outlook for 2014 (GDP growth was reduced to 1.0 per cent, from 1.3 per cent projected in April); an upward revision of 0.3 percentage points in the trend growth of capital expenditure; and the decision to increase capital outlays in 2014 by about 0.2 percentage points.

A structural deficit of 0.3 per cent was projected. However, at the time the Government, invoking the investment clause, deemed the deviation from a balanced position to be consistent with European rules, and thus also with the provisions introduced as part of the Constitutional reform of 2012. In November, the European Commission, in its opinion on the draft budget, announced that the clause was not applicable to Italy because it was unlikely to respect the debt rule in 2014.

Table 13.9

Public finance objectives and estimates for the year 2014
(billions of euros and per cent of GDP)

	General government				*Memorandum items:*				
	Net borrowing	Primary surplus	Structural deficit	Debt (1)	Real GDP growth rate (%)	Nominal GDP	Structural deficit 2013	Net borrowing 2013	Debt 2013
Objectives									
EFD 2012 Update (September 2012)	….	….	….	….	1.1	1,629.1	….	….	….
per cent of GDP	*1.5*	*4.4*	*0.2*	*123.1*			*0.0*	*1.8*	*126.1*
EFD 2013 (April 2013) (2)	28.5	61.9	….	2,094.3	1.3	1,624.0	….	45.4	2,051.4
per cent of GDP	*1.8*	*3.8*	*-0.4*	*129.0*			*0.0*	*2.9*	*130.4*
EFD 2013 Update (September 2013)	….	….	….	2,128.8	1.0	1,602.9	….	….	2,069.5
per cent of GDP	*2.5*	*2.9*	*0.3*	*132.8*			*0.4*	*3.0*	*132.9*
Estimates									
Draft budgetary plan 2014 (October 2013)	….	….	….	….	1.1	….	….	….	….
per cent of GDP	*2.5*	*2.9*	*0.3*	*132.7*			*0.5*	*3.0*	*132.9*
EFD 2014 (April 2014) (2)	41.9	40.7	….	2,141.5	0.8	1,587.1	….	47.3	2,069.0
per cent of GDP	*2.6*	*2.6*	*0.6*	*134.9*			*0.8*	*3.0*	*132.6*

(1) The estimates and objectives given in the official documents are not fully consistent, as the treatment of the effects of financial support to EMU countries in difficulty and Italy's contribution to the ESM is not uniform. – (2) The EFD includes the Stability Programme.

In line with the EFD Update, the 2014 Stability Law passed by Parliament in December introduced measures approving €3.2 billion of additional net capital expenditure this year. Furthermore, total current expenditure was raised by €1.5 billion and revenue by €2.2 billion (Table 13.10). The principal measures on the revenue side include changes to property taxes, some amendments to the taxation of financial and insurance companies, the raising of stamp duty and an increase in the tax allowance for corporate equity.

Table 13.10

Effects of the 2014 Stability Law and measures passed in 2014 on the general government consolidated accounts (1)
(millions of euros)

	2014	2015	2016
PROCUREMENT OF RESOURCES	**21,410**	**22,027**	**27,592**
Measures that increase revenue (A)	**13,419**	**11,490**	**15,184**
Changes in tax rates and reduction of incentives and tax credits	0	3,000	7,000
Deductibility of write-downs and losses on financial intermediaries' claims	2,634	0	0
Increase in stamp duty on financial instruments	1,118	627	627
Revaluation of corporate assets and realignment of equity interests	1,662	350	350
Increase in taxation of financial assets	720	2,306	2,987
Withholding tax on Bank of Italy shares	1,794	0	0
Registry fee on assignment of contracts	621	621	621
Reduction of offsetting of direct taxes and IRAP (approval stamp)	460	460	460
Reduction of incentives in the agricultural sector	384	395	395
Measures to combat tax evasion	300	300	300
Other measures	3,727	3,431	2,444
Measures that reduce expenditure (B)	**-7,991**	**-10,538**	**-12,408**
Rationalization of outlays on goods and services	-4,540	-5,188	-5,551
Changes to pension indexation	-580	-1,380	-2,160
Severance payments for public employees	-380	-443	-905
Employee compensation	-18	-1,154	-1,477
Property disposals	-500	-500	-500
Other measures	-1,973	-1,873	-1,815
USE OF RESOURCES	**23,813**	**18,450**	**20,275**
Measures that reduce revenue (C)	**-14,024**	**-12,284**	**-12,501**
Measures to reduce the tax wedge	-9,939	-5,900	-4,556
Abolition of increase in TARES	-1,000	-1,000	-1,000
Measures affecting the tax allowance for corporate equity (ACE)	0	-659	-717
Deductibility of write-downs and losses on financial intermediaries' claims	-410	-635	-1,719
Measures affecting pensions (fiscal effects)	-200	-476	-745
Measures relating to leasing contracts	0	-222	-347
Other measures	-2,475	-3,392	-3,418
Measures that increase expenditure (D)	**9,789**	**6,167**	**7,774**
Easing of local authorities' Domestic Stability Pact	1,500	0	0
Railways (Ferrovie dello Stato) and roads (ANAS)	1,226	656	470
Other investments	1,484	1,095	1,084
Local solidarity fund for TASI deductions	625	0	0
Fund to reduce the tax wedge	0	2,685	4,680
Peace missions	614	0	0
Subsidies for road haulage firms	330	0	0
Other measures	4,009	1,731	1,540
Net change in revenue (E=A+C)	**-605**	**-794**	**2,683**
Net change in expenditure (F=D+B)	**1,798**	**-4,371**	**-4,634**
Change in net borrowing (G=F-E)	**2,403**	**-3,577**	**-7,317**
of which: 2014 Stability Law	*2,458*	*-3,515*	*-7,304*
Per cent of GDP			
Net change in revenue (E=A+C)	**-0.0**	**-0.0**	**0.2**
Net change in expenditure (F=D+B)	**0.1**	**-0.3**	**-0.2**
Change in net borrowing (G=F-E)	0.2	-0.2	-0.4
of which: 2014 Stability Law	*0.2*	*-0.2*	*-0.4*

Sources: Based on official estimates contained in the EFD 2014 for the 2014 Stability Law (Law 147/2013), Decree Law 4/2014, Decree Law 16/2014 and Decree Law 47/2014, and on official estimates contained in the bill converting Decree Law 66/2014 (A.S. 1465).
(1) Rounding may cause discrepancies.

In the April EFD the estimate for net borrowing was raised with respect to the autumn predictions, from 2.5 to 2.6 per cent of GDP; this was despite the reduction in interest expense, which declined by 0.2 percentage points to 5.2 per cent of GDP. In structural terms the deficit was projected to amount to 0.6 per cent of GDP, compared with 0.3 per cent in the September EFD; this represents a reduction of 0.2 percentage points on 2013, although the improvement is less than that required under EU budget rules and Italian legislation.

The debt is expected to rise by a further 2.3 percentage points, to 134.9 per cent of GDP, owing to the measures to accelerate the payment of commercial debts (1.0 points) and additional outlays for financial support to EMU countries (0.4 points). An opposite effect should come from the revenue from disposals of assets (about 0.7 points).

In April the Government passed a decree introducing tax relief measures worth €7.4 billion and €0.2 billion of additional expenditure in 2014. Some 60 per cent of this will be financed by measures to increase revenue, more than two thirds of which will be one-off, and the remainder by expenditure cuts. Most of the tax relief (€6.7 billion) will consist of a reduction of the tax wedge for average-to-low-income payroll workers, valid from May until the end of 2014 only. The decree allocates €2.7 billion for 2015 (and €4.7 billion for 2016) which, together with the resources to be provided by the 2015 Stability Law, will be used to reduce the tax wedge definitively. A permanent reduction of 10 per cent in IRAP tax rates will also be introduced.

According to EFD estimates and official assessments of the effects of the decree, the fiscal burden will remain unchanged in 2014 at 43.8 per cent, while primary expenditure is expected to decrease by over 0.3 percentage points, to 45.6 per cent of GDP.

The latest estimates for 2014. – The European Commission's recent projections converge on the figure for net borrowing of 2.6 per cent of GDP in 2014, despite forecasts that economic growth will be 0.2 percentage points less than indicated in the EFD, at 0.6 per cent of GDP. The structural deficit is expected to diminish by just 0.1 percentage points. The debt should be only slightly above the value indicated in the EFD (135.2 per cent of GDP).

The performance of the public finances in the first four months of the year appears consistent with a small decline in net borrowing with respect to 2013. It is estimated that the borrowing requirement amounted to about €42 billion, a decrease of some €5 billion on the corresponding period in 2013, less if some operations that do not effect net borrowing for the year are excluded.

Programmes and prospects for 2015-18

The Government's programme envisages an improvement in the public finances in the next four years as well. Net borrowing is forecast to fall to 1.8 per cent of GDP in 2015 and to progress to a surplus of 0.3 per cent in 2018. The primary surplus should increase to 3.3 per cent in 2015 and to 5 per cent in 2018. The structural deficit is expected to decrease by 0.5 percentage points in 2015 and balance to be achieved in 2016 and to be maintained in the following years.

To achieve these objectives the EFD calls for an adjustment of 0.3 per cent of GDP in 2015 with respect to the estimates based on current legislation. From 2016 the gap between the objectives and the baseline estimates for net borrowing will be 0.6 percentage points. According to these estimates, to achieve the planned outturn for 2015 – while avoiding the €3.0 billion increase in revenue planned in the 2014 Stability Law – at least €7 billion must be found. The Government has undertaken to make the reduction in the tax wedge for 2014 introduced in April a permanent feature; this will require a further €7.3 billion, on top of the €2.7 billion already allocated under the same measure and set aside in an ad hoc fund. Finally, some of the increased outlays indicated in the EFD scenario on an unchanged-policy basis could be considered unavoidable compared with the scenario based on current legislation.

According to the programmes, the ratio of debt to GDP will begin to diminish in 2015 for the first time since 2007, after increasing by 30 percentage points. In the period 2015-17, in which the forward-looking rule will apply for the first time, it is expected to decrease by about 10 points, to 125.1 per cent. In 2018 the debt-to-GDP ratio is projected to return to a level close to that of 2011 (120.5 per cent).

The European Commission's recent forecasts are that net borrowing will decrease by 0.4 percentage points in 2015, to 2.2 per cent of GDP. The structural deficit is expected to improve by 0.1 points to 0.7 per cent of GDP. The Commission also projects that the debt-to-GDP ratio will turn around in 2015, decreasing by 1.3 percentage points.

The compliance of programmes with budget rules

The European budget rules, which were transposed into Italian legislation with the Constitutional reform of 2012, cover net borrowing, expenditure and the debt.

For net borrowing, the Stability and Growth Pact not only sets a threshold of 3 per cent of GDP but also calls for structural adjustments of the order of at least 0.5 percentage points a year until the medium-term objective has been achieved (which in Italy's case is a structurally balanced budget). The reduction of the structural deficit by 0.2 per cent of GDP programmed for 2014 is therefore less than the amount required under the rules. However, the Government has decided not to plan any adjustment measures and, based on the existing margins of flexibility, has requested the European Commission and the Italian Parliament for authorization to deviate temporarily from the rules. The latter granted the authorization by an absolute majority of both chambers in accordance with the new procedures. The admissibility of the deviation will be evaluated in June by the European Commission and later by the EU Council.

Regarding curbs on expenditure, the European Commission has set an upper limit on the annual growth in outlays (excluding some components not controlled directly by the Government) of -1.07 per cent in real terms for the period 2014-16, assuming no discretionary increases in revenue. According to the baseline estimates contained in the EFD the growth in outlays will exceed this level. However, if the Government achieves all the savings it hopes to make as a result of the spending review, it will be able to comply with the limit on expenditure in 2016; the deviations in 2014-15 are expected to be small.

In terms of the debt, the 2011 Stability and Growth Pact reform implemented by means of the six-pack required countries with a debt-to-GDP ratio in excess of 60 per cent to reduce the difference by one twentieth a year on average over a three-year period. Member states with an excessive deficit procedure open in November 2011 would be granted a three-year transitional period from the year of closure of the procedure. During that period they will be considered to comply with the debt rule if they make the minimum linear structural adjustment to net borrowing (MLSA) calculated yearly by the Commission for each country.

In November last year, the Commission calculated for Italy, which entered the transitional period in 2013, an MLSA of 1.32 percentage points of GDP overall in 2014-15. The reduction programmed in the EFD is 0.7 points over the same two years. In the coming months the Commission and the Council will assess whether this complies with the rules on the basis of their May forecasts and any other relevant factors.

The planning scenario for 2015-17 complies with the debt reduction rules, but there is no safety margin in the event of even the smallest deterioration in the macroeconomic situation or lower than expected privatization receipts.

14. THE FINANCIAL CONDITION OF HOUSEHOLDS AND FIRMS

Italian households' total net wealth shrank in 2013 owing to the fall in house prices. The increase in saving and in the value of securities resulted in growth in households' financial assets. Debt diminished, but disbursements of loans for house purchase turned upwards in the first few months of 2014. The indicators of the risk on lending to households worsened slightly in 2013, although low interest rates and the measures to support borrowers in difficulty buffered the impact of the crisis on the solvency of indebted households.

Despite a slight improvement, firms' financial conditions are still fragile. Profitability and investment are at very low levels. Deteriorating balance sheets led banks to maintain prudent lending standards: the rates on bank loans, not high by historical standards, remained above those in other euro-area countries and bank lending contracted for the second consecutive year. The unfavourable credit market conditions were mitigated by measures to facilitate access to credit for small and medium-sized firms. More firms raised funds on the bond and equity markets than in the past.

Italian companies have large debt burdens. To bring their level of capitalization into line with the euro-area average, Italian firms would have to increase their equity by an estimated €200 billion and reduce their debt by the same amount. With the aim of rebalancing the financial structure of firms, the tax incentives introduced under the allowance for corporate equity were recently strengthened.

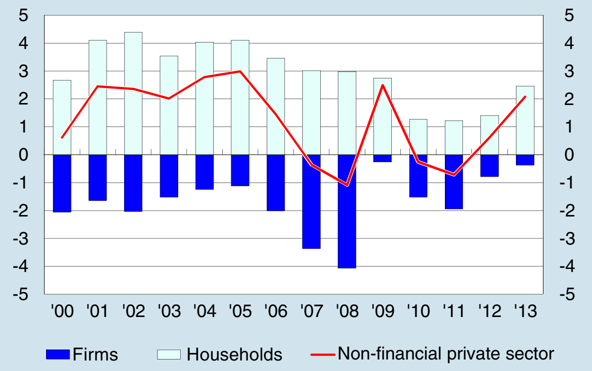
HOUSEHOLDS

Financial saving and wealth

In 2013 households' total net wealth fell from 8.0 to 7.9 times disposable income, owing to the fall in house prices. The value of financial assets rose, instead, by 2.1 per cent, to 3.6 times disposable income, surpassing the 2007 level; the increase reflected the gain in security prices and the rise in saving (11 per cent in nominal terms). The household sector's financial surplus reached 2.5 per cent of GDP (Figure 14.1)

Figure 14.1

Financial balances of the non-financial private sector
(per cent of GDP)



Source: Istat.

Table 14.1

Households' financial assets and liabilities (1)
(millions of euros and per cent)

	End-of-period stocks			Flows	
	2013	Percentage composition		2012	2013
		2012	2013		
ASSETS (2)					
Bank deposits (3)	1,047,346	27.0	26.9	55,230	16,027
Italian	1,016,945	26.2	26.1	54,367	16,216
sight deposits	*500,444*	*12.8*	*12.8*	*-8,694*	*10,648*
other deposits	*516,501*	*13.4*	*13.3*	*63,061*	*5,568*
Foreign	30,401	0.8	0.8	863	-189
Debt securities	624,988	18.6	16.0	-61,109	-72,800
Italian	511,180	15.2	13.1	-36,344	-57,568
issued by the public sector	*184,423*	*5.4*	*4.7*	*-24,146*	*-22,881*
issued by banks	*326,454*	*9.8*	*8.4*	*-5,335*	*-34,972*
Foreign	113,809	3.4	2.9	-24,765	-15,233
Investment fund units	308,093	7.1	7.9	20,217	27,532
Italian	161,078	3.9	4.1	-2,303	8,962
Foreign	147,015	3.2	3.8	22,520	18,570
Shares and other equity	916,371	22.1	23.5	1,906	29,416
Italian	873,216	21.2	22.4	3,624	27,489
Foreign	43,155	1.0	1.1	-1,718	1,927
Insurance, pension fund reserves and severance pay entitlements	726,842	18.2	18.7	-1,631	22,047
of which: life insurance reserves	*457,143*	*11.2*	*11.7*	*-5,226*	*18,625*
Other assets (4)	273,157	7.0	7.0	3,687	8,206
Total assets	**3,896,796**	**100.0**	**100.0**	**18,299**	**30,428**
LIABILITIES					
Short-term debt	58,739	6.4	6.4	857	-529
of which: granted by banks	*57,338*	*6.3*	*6.2*	*905*	*-230*
Medium - and long-term debt	639,474	69.7	69.4	-7,677	-10,425
of which: granted by banks	*544,950*	*59.2*	*59.2*	*-7,434*	*-7,235*
Other liabilities (5)	223,048	23.8	24.2	3,946	1,178
Other liabilities	**921,261**	**100.0**	**100.0**	**-2,874**	**-9,776**
BALANCE	**2,975,535**			**21,173**	**40,204**

Source: Bank of Italy, financial accounts.
(1) Consumer households, producer households and non-profit institutions serving households. Rounding may cause discrepancies in totals. – (2) Individually managed portfolios are not shown. Their assets are included in the individual investment instruments. – (3) Includes those of Cassa Depositi e Prestiti. – (4) Accounts receivable, Bancoposta current accounts, banknotes, coins and other minor items. – (5) Accounts payable, severance pay and pension provisions, and other minor items.

Investment in financial assets. – Net purchases of financial assets rose sharply, from €18 billion in 2012 to €30 billion in 2013 (Table 14.1). Households increased their net purchases of shares and other equity and of asset management products (insurance policies and investment fund units), while they made very substantial net disposals of government securities and bank bonds. The substitution of insurance products and investment funds for bank bonds partly reflects the change in banks' supply policies in response to diminished funding needs and the positive impact of placement fees on profitability.

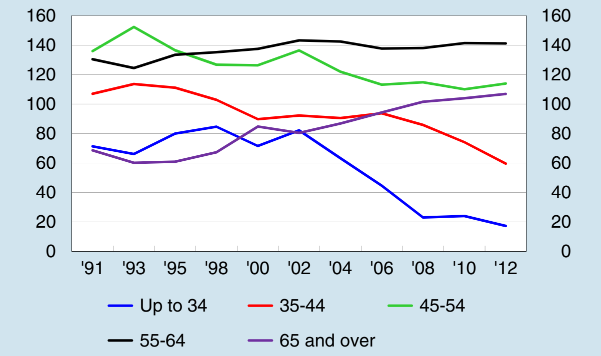
As in the other main advanced countries, the effects of the crisis are still apparent in the composition of households' portfolios: the portion invested in liquid assets (cash and deposits), which best satisfy precautionary motives, was 30.9 per cent in 2013, greater than in 2007 (27.3 per cent).

Distribution of wealth. – According to the database of the Bank of Italy's Survey on Household Income and Wealth, in 2012 the richest 10 per cent of households possessed 46.6 per cent of total net wealth, up from 45.7 per cent in 2010. The most affluent households are the main investors in risky assets and hold more than two thirds of all the equities, private sector bonds, asset management products and foreign securities in households' portfolios. The median net wealth of households whose head is over 64 years old has shown a more favourable long-term dynamic than that of households whose head is under 35 (Figure 14.2); this gap widened between 2010 and 2012. The share of young households whose income was less than half the median and whose net wealth (excluding their home equity) was insufficient, in case of loss of income, to maintain their living standard for at least six months rose from 15 per cent in 2010 to 20 per cent in 2012. By contrast, for the whole sample the share remained stable between the two periods at 9 per cent.

Figure 14.2

Household net wealth by age group of head of household (1)

(indices, Italy=100)



Source: Bank of Italy, based on the *Survey on Household Income and Wealth* historical database.
(1) Median values.

Debt

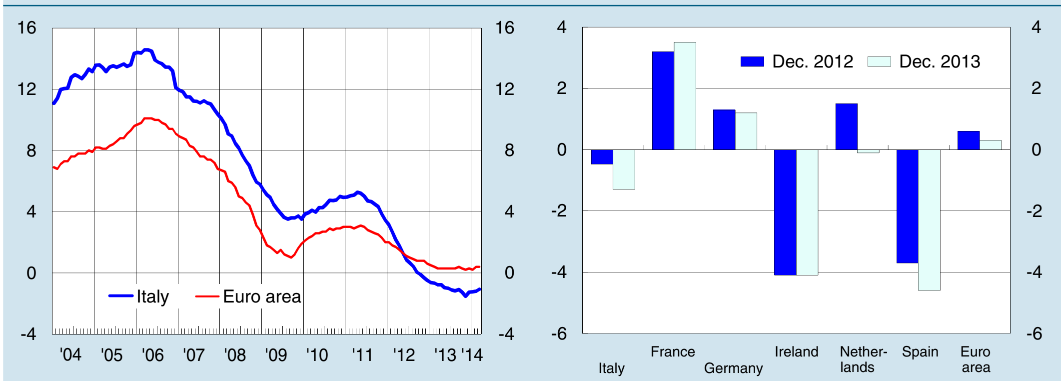
Households' debt to banks and other financial corporations diminished by 1.6 per cent in 2013 after decreasing by 1.1 per cent in 2012. Financial debt fell to 65 per cent of disposable income.

Bank loans declined by 1.3 per cent; in the first quarter of 2014 the contraction eased to 1.1 per cent on an annual basis (Figure 14.3). In the euro area, the annual

Figure 14.3

Bank lending to households (1)

(12-month percentage change)



Sources: Based on supervisory reports and ECB data.
(1) Consumer households, producer households and non-profit institutions serving households. Loans include repos and bad debts. The percentage changes are calculated net of the effects of securitizations, reclassifications, exchange rate variations, value adjustments and other variations not due to transactions.

growth in lending moderated from 0.6 per cent in 2012 to 0.3 per cent in 2013, with country-to-country variations.

Loans for house purchase. – Loans for house purchase contracted by 1.2 per cent in 2013 (Table 14.2). New home mortgages fell to €21 billion, from €25 billion in 2012, owing to slack demand and still restrictive supply conditions. The quarterly bank lending survey registered signs of improvement in the second half of the year in relation to the performance of the economy.

Table 14.2

Lending to consumer households (1)
(end-of-period data; millions of euros and per cent)

	12-month percentage change					Stocks March 2014 (2)
	December 2011	December 2012	June 2013	December 2013	March 2014	
			Loans for house purchase			
Banks	4.5	0.1	-0.6	-1.2	-1.2	341,890
			Consumer credit			
Banks	1.5	-0.9	-1.9	-1.9	-1.2	56,238
Financial companies	1.9	-1.5	-1.3	-1.9	-1.9	58,581
Banks and financial companies	**1.7**	**-1.2**	**-1.5**	**-1.9**	**-1.5**	**114,819**
			Other loans (3)			
Banks	2.7	0.4	0.4	0.2	0.8	108,287
			Total loans			
Banks and financial companies	**3.5**	**-0.1**	**-0.6**	**-1.0**	**-0.9**	**564,996**

Source: Supervisory reports.
(1) Loans include repos and bad debts. The data for March 2014 are provisional. – (2) Includes securitized loans. – (3) Other loans consist mainly of lines of credit and mortgage loans for purposes other than the purchase, construction or restructuring of residential property.

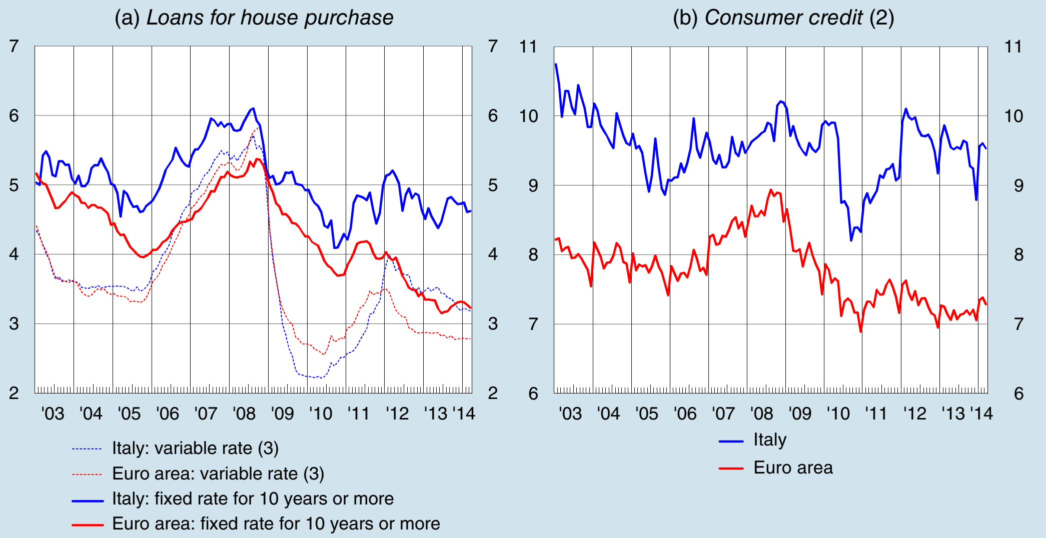
These signs were followed by an upturn in new lending in the first quarter of 2014 (8.4 per cent with respect to the same period of the previous year), fuelled in part by the completion of transactions that had been postponed in the last quarter of 2013 pending the reduction in real estate transfer taxes that took effect on 1 January 2014.

On the basis of the regional bank lending survey conducted by the Bank of Italy's branches, in 2013 the average loan-to-value ratio stabilized at around 58 per cent; the share of new mortgages with a loan-to-value ratio exceeding 80 per cent rose by 1.3 percentage points to 6.3 per cent. The average length of new mortgage loans remained stable at 22 years, even though the share with a maturity of 30 years or longer grew by 1.0 percentage points to 27.2 per cent. The share of new contracts that allow the maturity to be extended or payments to be temporarily suspended at no additional cost reached almost 20 per cent of the volume disbursed.

In 2013 the share of variable rate loans for house purchase rose from 73 to 78 per cent, compared with a euro-area average of 27 per cent. The cost of new variable rate loans declined from 3.4 to 3.2 per cent; that of new fixed rate loans with a maturity beyond ten years rose during the summer before falling back to 4.7 per cent in the last two months of the year (Figure 14.4.a). For variable rate loans, the differential with respect to the euro area, which had reached a historically high 0.7 percentage points at

Figure 14.4

Interest rates on bank loans to households (1)
(monthly data referring to new transactions; per cent)



Source: Based on ECB data.
(1) Consumer households, producer households and non-profit institutions serving households. Contracts concluded during the reference period or which constitute a renegotiation of previous terms and conditions. – (2) Annual percentage rate of charge on new loans. The APRC includes ancillary expenses (administrative expenses, loan examination fees and insurance). From June 2010 interest rates on credit cards are no longer included. – (3) Variable rate or renegotiable within one year.

the end of 2012, declined by 0.3 percentage points; for fixed rate loans, the differential remained large, exceeding 1 percentage point.

After the sharp increase recorded from mid-2011 onwards, the spreads with respect to the reference rates (Euribor and IRS) have diminished somewhat, but for fixed-rate mortgages in particular they remain quite considerable (2.8 percentage points in March 2014, double the euro-area average).

Consumer credit. – Consumer credit contracted by 1.9 per cent in 2013 (Table 14.2); in the first quarter of 2014 the rate of decline moderated to 1.5 per cent. The reduction regarded both earmarked and non-earmarked loans; loans secured by a pledge of one fifth of salary or pension, which involve less risk for lenders, were the only form of consumer credit to expand.

The annual percentage rate of charge on new consumer credit business came down by 0.4 percentage points to 8.8 per cent in 2013, but jumped to 9.5 per cent in the early months of 2014 (Figure 14.4.b). The difference with respect to the euro-area average remained considerable (about 2 percentage points).

Indebted households' vulnerability

On the basis of the Survey on Household Income and Wealth, in 2012 vulnerable households, i.e. those with debt servicing costs exceeding 30 per cent of disposable income and an income below the median, were 2.9 per cent of the total. Using a microsimulation model and macroeconomic data that are available more promptly and with greater frequency, it can be estimated that in a scenario of gradually growing income, with low and stable interest rates, the percentage of vulnerable households would be broadly unchanged in the three years 2013-15. It would fall to 2.5 per cent in 2015 if measures to support borrowers of the same magnitude as those adopted in 2009-12 were in place.

According to the regional survey on bank lending, the payment of instalments of about 3 per cent of outstanding loans was suspended in 2013. More than 40 per cent of these suspensions were agreed directly with the bank or decided by the customer under a loan contract allowing payments to be temporarily suspended or the maturity of the loan to be extended at no additional cost (more than 10 per cent of outstanding loans grant this option). The remaining suspensions came under the moratorium agreed between the Italian Banking Association and consumer associations (which lapsed in March 2013) or tapped the Solidarity Fund for First-Home Mortgages, which was refinanced in 2013 with a further €20 million a year for 2014 and 2015. From the beginning of 2013 through April 2014 some 16,000 borrowers benefited from the Fund; the remaining resources for 2014 should cover an estimated more 12,000 suspensions, bringing the total number of beneficiaries in 2013-14 to 28,000, about the same as the average number of households that have benefited each year from the moratorium.

The share of loans to households past due by more than 90 days plus restructured loans, which stood at 1.2 per cent at the end of 2013 (1.1 per cent in 2012), decreased to 0.9 per cent in the first three months of 2014 (Table 14.3). The share of substandard loans (for which banks report temporary repayment difficulty) grew from 2.4 per cent at the end of 2012 to 2.8 per cent in the first quarter of 2014, that of bad debts from 5.8 to 6.6 per cent over the same period. The share of non-performing loans (overdue, substandard and restructured loans and bad debts), equal to 10.3 per cent in December 2013, remained stable in the first quarter of 2014; it is higher (24.2 per cent) for the aggregate including loans taken out for business purposes (classified as *other loans*).

Table 14.3

Non-performing loans to consumer households (1)
(per cent of total loans)

	Loans for house purchase			Consumer credit			Other loans (2)			Total loans		
	Dec. 2012	Dec. 2013	Mar. 2014	Dec. 2012	Dec. 2013	Mar. 2014	Dec. 2012	Dec. 2013	Mar. 2014	Dec. 2012	Dec. 2013	Mar. 2014
Non-performing	5.4	6.2	6.2	10.3	10.7	10.3	21.4	24.0	24.2	9.3	10.3	10.3
Past-due (3)	*0.8*	*0.9*	*0.7*	*1.5*	*1.5*	*1.4*	*1.7*	*1.7*	*1.4*	*1.1*	*1.2*	*0.9*
Substandard	*1.8*	*1.9*	*2.1*	*2.6*	*3.0*	*2.8*	*4.3*	*4.8*	*5.0*	*2.4*	*2.7*	*2.8*
Bad debts	*2.9*	*3.4*	*3.4*	*6.2*	*6.2*	*6.0*	*15.4*	*17.5*	*17.8*	*5.8*	*6.5*	*6.6*

Source: Supervisory reports.
(1) Loans include repos but not securitized loans cancelled from balance sheets. – (2) Other loans mainly comprise current account overdraft facilities and mortgages to build or buy non-residential properties, to consolidate other loans or for other non-specific purposes. – (3) Past-due loans include restructured loans.

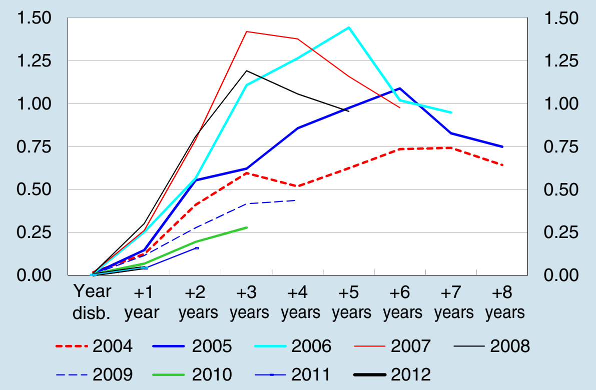
The ratio of the annual flow of adjusted new bad debts to performing loans decreased from 1.4 per cent in the first quarter of 2013 to 1.2 per cent in March 2014.

Banks' selectiveness in granting mortgage loans during the crisis helped to limit the ratio of new bad debts to outstanding mortgages. The ratio for loans granted in the years 2009-12 is lower than that for those granted before the crisis for the same cohorts (2006-08; Figure 14.5). The findings are similar for consumer loans.

Figure 14.5

New bad mortgage loans by year of disbursement (1)

(per cent of the number of contracts)



Source: Central Credit Register, analytical survey of interest rates.
(1) Consumer households.

FIRMS

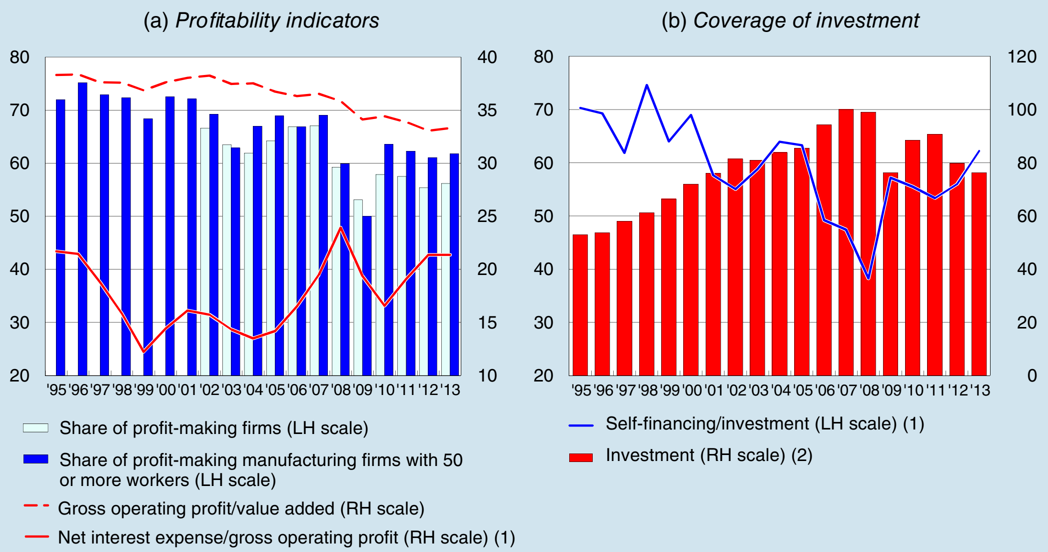
Profitability and financial balance

According to national accounts data, the gross operating profit of non-financial corporations remained stable in 2013 at a level more than a tenth lower than in 2007. Its ratio to value added was unchanged with respect to 2012 at 33 per cent (Figure 14.6.a).

Figure 14.6

Profitability and coverage of investment

(per cent; indices)



Sources: Banca d'Italia, *Survey of Industrial and Service Firms,* and calculations based on Istat data.
(1) Net interest expense and self-financing are estimated on the basis of the national economic accounts of the non-financial corporations sector, 1995-2013. – (2) Indices, 2007=100.

Firms had very limited need for external resources owing to the small volume of investment, which was covered with self-financing to a greater extent than in the past (Figure 14.6.b). The sector's financial deficit continued to shrink, reaching 0.4 per cent of GDP (Figure 14.1).

In the last two years the reduction of the deficit has been associated with a considerable increase of €33 billion in liquid assets (cash and deposits), largely held with banks (Table 14.4).

Table 14.4

Financial assets and liabilities of firms (1)
(millions of euros and per cent)

	End-of-period stocks			Flows	
	2013	Percentage composition		2012	2013
		2012	2013		
ASSETS					
Cash and sight deposits	251,903	15.2	16.0	7,467	18,861
Other deposits	27,426	1.9	1.7	9,092	-2,062
Short-term securities	854	0.1	0.1	-620	312
Medium- and long-term securities	59,836	4.0	3.8	-9,221	-5,051
of which: Italian government	*44,644*	*2.7*	*2.8*	*-2,373*	*-3,972*
Italian corporate	*2,622*	*0.1*	*0.2*	*239*	*1,925*
foreign issuers	*9,034*	*0.8*	*0.6*	*-4,337*	*-1,755*
Shares and other equity	509,150	31.2	32.4	-16,414	329
of which: foreign	*282,743*	*17.0*	*18.0*	*20,691*	*18,625*
Investment fund units	9,316	0.5	0.6	84	1,962
Accounts receivable	597,746	39.3	38.0	-87,643	-7,661
Financial credits (2)	58,795	3.9	3.7	-431	-977
Other financial assets (3)	56,301	3.9	3.6	-426	-4,612
Total assets	**1,571,326**	**100.0**	**100.0**	**-98,111**	**1,101**
of which: external	*442,622*	*27.5*	*28.2*	*19,977*	*19,847*
LIABILITIES					
Total financial debt	1,268,964	37.3	35.6	-8,213	-38,901
of which: external	*170,232*	*4.3*	*4.8*	*13,586*	*14,510*
Short-term debt (4)	370,900	11.5	10.4	-829	-24,390
of which: to Italian banks	*305,367*	*9.5*	*8.6*	*-3,610*	*-21,853*
Medium- and long-term debt (5)	752,644	22.5	21.1	-20,959	-36,940
of which: to Italian banks	*508,547*	*15.3*	*14.3*	*-18,791*	*-23,842*
Securities	145,420	3.4	4.1	13,576	22,429
Shares and other equity	1,591,266	42.7	44.7	3,310	35,233
of which: held abroad	*279,491*	*7.4*	*7.8*	*11,421*	*16,215*
Accounts payable	527,881	15.0	14.8	-85,560	3,670
Other financial liabilities (6)	173,984	5.0	4.9	-381	523
Total liabilities	**3,562,094**	**100.0**	**100.0**	**-90,844**	**526**
of which: external	*489,328*	*12.7*	*13.7*	*25,499*	*31,874*
BALANCE	**-1,990,768**			**-7,268**	**575**

Source: Bank of Italy, financial accounts.
(1) The data refer to the non-financial corporations sector. Rounding may cause discrepancies in totals. – (2) Short-term foreign claims and intra-group claims. – (3) Insurance technical provisions, domestic derivatives and other minor items. – (4) Includes finance provided by factoring companies. – (5) Includes securitized loans, finance provided by leasing companies and intra-group liabilities. – (6) Postal current accounts, severance pay and pension provisions, domestic derivatives and other minor items.

Debt and financial structure

In 2013 firms' financial debt decreased by €39 billion and fell from 187 to 182 per cent in relation to value added (Table 14.4 and Figure 14.7). Leverage, defined as the ratio of financial debt to the sum of financial debt and shareholders' equity at market prices, declined from 46.7 to 44.4 per cent; this was still more than 5 percentage points above the euro-area average and the gap increased slightly from the previous year.

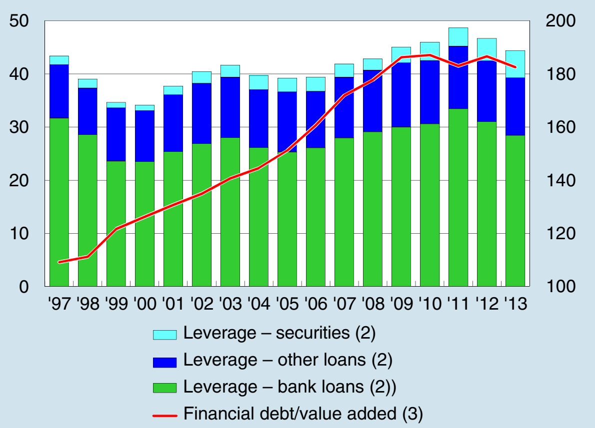
An econometric analysis based on the annual accounts data of some 900,000 indebted euro-area corporations confirm that in the period 2005-10 the average leverage of Italian companies was systematically higher than in the other countries, even controlling for a number of firm characteristics (profitability, tangible fixed assets, liquidity, turnover growth, age, size and product sector). At the end of the period, the difference amounted to 11 percentage points; the gap decreases as firm size increases, becoming nil for companies with more than €300 million of assets. On the basis of these results and financial account data, it can be estimated that, total resources remaining unchanged, it would be necessary to replace close to €200 billion of financial debt with equity in order to bring Italian companies' leverage into line with that of their euro-area peers.

Bonds. – Gross bond issues by Italian companies and their foreign subsidiaries totalled €39 billion in 2013, with a further €10 billion of issues in the first quarter of 2014. Placements have averaged €32 billion a year since 2009, some €9 billion more than in the period 2002-07; during the crisis large companies have dominated bond issuance, using part of the funds to replace bank debt (see *Financial Stability Report*, No. 1, 2014). In 2013 the improved conditions on the financial markets allowed firms to lengthen the average maturity of new issues to 11 years, compared with 6 in 2012; interest rates and the portion of fixed rate issues (85 per cent) were about the same as in the previous year.

A contribution to the expansion of bond issues in 2013 came from so-called mini-bonds issued by unlisted companies. Under the legislation that entered into force in 2012 (Decree Law 83/2012, converted into Law 134/2012), mini-bonds traded in regulated markets or held by professional investors are subject to the same tax treatment as the bonds of listed companies, as regards both the tax deductibility of interest payments and exemption from withholding tax for some categories of investor. From November 2012 to December 2013, 19 firms issued mini-bonds amounting to €5.9 billion (12 per cent of the total value of bonds issued in the same period); almost all of the issuers were large companies, half of them operating in the service sector. In the first three months

Figure 14.7

Corporate debt (1)
(per cent)



Sources: Bank of Italy and Istat.
(1) The data refer to the non-financial corporations sector. – (2) Left-hand scale. Leverage is calculated as the ratio of financial debt to the sum of financial debt and shareholders' equity at market prices. – (3) Right-hand scale.

of 2014 five issues of modest size (€16 million on average) were made by small and medium-sized businesses.

Credit

Bank credit to Italian firms contracted by 5.0 per cent in 2013; the twelve-month rate of decline eased to 4.2 per cent in March of this year (Table 14.5). The fall in credit from non-bank financial companies was more pronounced (5.4 per cent in March from a year earlier) and was particularly sharp in the factoring sector, which was affected by reduction in general government commercial debts.

Table 14.5

Lending to firms (1)
(end-of-period data; per cent)

	12-month percentage changes				Percentage composition
	2011	2012	2013	March 2014	March 2014
			Banks		
Branch of economic activity					
Manufacturing	-0.3	-5.9	-6.1	-3.8	20.9
Construction	-0.5	-2.4	-4.5	-4.3	15.6
Services	3.6	-2.4	-6.8	-6.2	32.9
Real estate	0.8	-1.1	-3.2	-3.9	11.8
Other	9.0	1.1	-5.2	-3.5	9.1
Size of firms					
Small firms (2)	-0.2	-2.9	-4.0	-3.1	17.2
Medium-sized and large firms	3.2	-2.0	-5.3	-4.5	73.1
Length of loan					
Up to 1 year	4.2	-0.3	-6.2	-3.4	31.5
More than 1 year	1.6	-3.2	-4.4	-4.7	58.8
Total	**2.5**	**-2.2**	**-5.0**	**-4.2**	**90.3**
			Financial companies		
Leasing	1.8	-2.6	-4.3	-3.9	6.3
Factoring	15.3	3.9	-6.2	-11.1	2.6
Altri finanziamenti	-5.9	-9.4	2.6	-0.4	0.8
Total	**4.2**	**-1.5**	**-4.4**	**-5.4**	**9.7**
			Banks and financial companies		
Total	**2.7**	**-2.1**	**-5.0**	**-4.4**	**100.0**

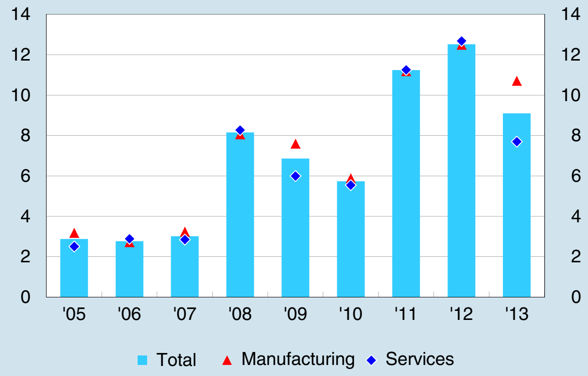
Sources: Supervisory reports.
(1) The data refer to non-financial corporations and producer households. Loans include repos and bad debts. The data for financial companies refer to intermediaries under Article 107 of the Consolidated Law on Banking. The data by sector of economic activity for December 2011 are partially estimated. The data for March 2014 are provisional. - (2) Limited partnerships, general partnerships, informal partnerships, de facto companies and sole proprietorships with up to 19 workers.

Firms' demand for credit reflected the fall in investment and production. In the Bank of Italy's Survey of Industrial and Service Firms with at least 20 employees, the balance between companies that increased their demand for loans and those that reduced it in the second half of 2013 – 12 percentage points – remained at about the same low levels of the last six years.

On the supply side, the Italian banks participating in the Eurosystem's bank lending survey have reported from the fourth quarter of 2013 onwards an attenuation of the severity of their lending standards, which nonetheless remain restrictive. In the Bank of Italy's Survey of Industrial and Service Firms, the share of companies reporting that they had not obtained the amount of bank credit requested fell by about 3 percentage points compared with 2012, to 9 per cent, which was still higher than in the period 2005-07; for service firms the improvement was very substantial (Figure 14.8).

Figure 14.8

Share of credit-rationed firms (1)
(per cent)



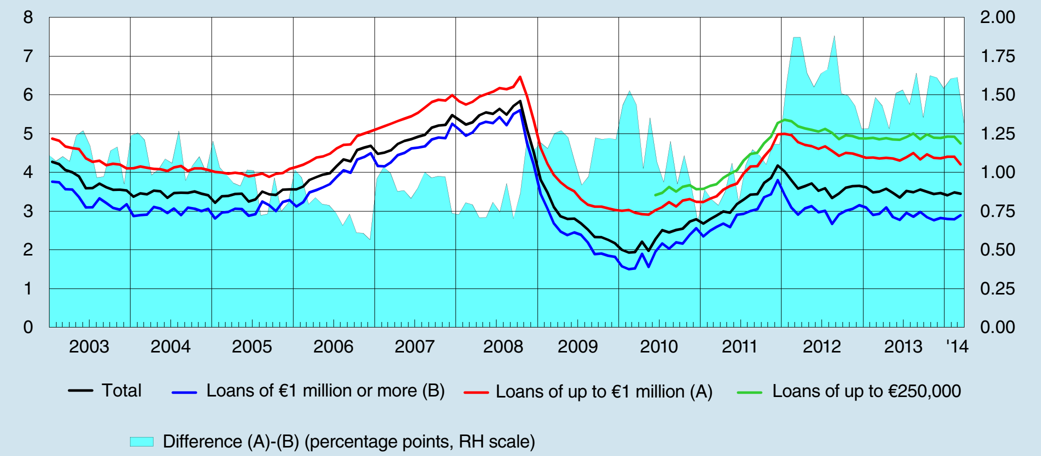
Source: Banca d'Italia, *Survey of Industrial and Service Firms.*
(1) Firms declaring they had not obtained the entire amount of credit requested. Before 2010 the questions on difficulties in accessing credit referred to the time of the interview; from 2010 onwards data refer to the entire year.

In Italy, the rise in credit risk has led to an expansion in the share of secured loans during the crisis (from 63 per cent in 2007 to 69 per cent in 2013). The largest increase involved collateral and guarantees provided by entities that manage public resources, which offer banks a higher probability of credit recovery in case of default. While the total value of collateral and guarantees grew by about 10 per cent, the value of collateral increased by 16 per cent, that of guarantees provided by mutual loan guarantee consortiums rose by 26 per cent and that of guarantees provided by the Guarantee Fund for small and medium-sized enterprises (SMEs) and by regional finance companies expanded more than tenfold. On the basis of the Survey of Industrial and Service Firms, in 2013 some 14 per cent of firms received a guarantee from the Fund, from a mutual loan guarantee consortium or from a public entity; nearly half of these businesses reported that without guarantees they would have received no loans.

From March 2012 interest rates on new bank loans remained stable at around 3.5 per cent, slightly below the average for the period between 2003 and 2007 (Figure 14.9).

Figure 14.9

Interest rates on new bank loans to firms (1)
(monthly data; per cent)



Source: Harmonized ESCB reports.
(1) Does not include drawings on current account overdraft facilities.

Given a low expected inflation rate, the real cost of bank credit, close to 2 per cent, was a little higher than in the period 2003-07, though lower than in the second half of the 1990s (5.1 per cent).

In 2013 the difference between the interest rates on new loans of less than €1 million and those on loans of a larger amount averaged 150 basis points (compared with 130 in March 2014 and about 100 between 2003 and 2007). The spread between the interest rates on short-term loans to financially less solid businesses and sounder firms remains substantial (240 basis points); from 2008 onwards the spread had widened across all size classes, signalling more careful customer screening for creditworthiness.

Financial fragility and debt repayment difficulties

The ratio of net interest expense to gross operating profit, a gauge of firms' ability to repay debt, held steady in 2013 at 21.4 per cent, which was high compared with the first half of the 2000s (Figure 14.6). On the basis of 2012 company accounts data, the ratio for construction and real estate firms was about double the average of the other sectors.

The financial strains besetting firms were confirmed by the large number of corporations, some 57,000, that went out of business in 2013 either voluntarily or following the start of bankruptcy proceedings (18,000 more than the average for the years 2004-08).

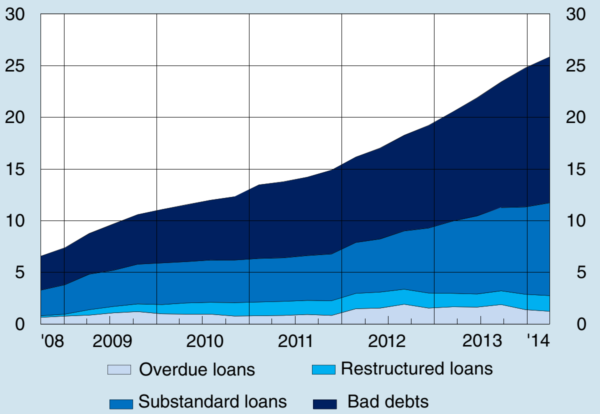
Bank loan repayment difficulties continued to be acute. However, there were signs of improvement in the opening months of 2014: in March the annualized flow of adjusted new bad debts fell to 4.1 per cent of the start of period stock of performing loans, from the September 2013 peak of 4.8 per cent. In March 2014 non-performing loans amounted to €239 billion, 25.9 per cent of the total (Figure 14.10); the share of overdue loans, the least problematic of these items, declined in the last two quarters.

Modest signs of improvement are also found in business-to-business transactions among firms. According to the Survey of Industrial and Service Firms, for domestic sales the percentage of claims settled after the agreed due date fell by 2 percentage points in 2013 to 31 per cent. The average length of delay remained stable at 44 days, while that of payment deferrals, which takes account of both contractual due dates and delays, decreased from 92 to 84 days.

Figure 14.10

Loans with repayment difficulties

(per cent of total loans)



Source: Supervisory reports.

The main measures to support firms' credit access and liquidity

The Guarantee Fund for SMEs, in operation for more than a decade, continued to be the main instrument supporting the financing of businesses. In 2013 the Fund guaranteed loans for €11 billion, with a record high of 77,000 applications (compared with a total of €41 billion of guarantees and 270,000 applications between 2009 and 2013). Recent legislative measures added other categories of potential beneficiary, including members of the liberal professions, and increased the Fund's resources considerably for the three years 2014-16; however, some of these resources have been allocated to purposes other than the original ones, including the capital strengthening of mutual loan guarantee consortiums and the granting of guarantees to large corporations for industrial research and innovation projects.

In July 2013 the Italian Banking Association (ABI) and the main trade associations signed a third accord that, like previous agreements, allowed SMEs in temporary financial difficulty to suspend the repayment of principal on loans or to lengthen loan maturities. Since 2009 the three moratoria have made it possible to suspend repayments of principal amounting to some €23 billion (€3 billion in 2013).

Cassa Depositi e Prestiti (CDP), by means of various agreements entered into with the ABI since 2009, has made €18 billion available to banks at low interest rates for the financing of SMEs. The participating banks have disbursed some €12 billion to date (€3 billion in 2013); in the last two years, as the liquidity strains in banks' balance sheets subsided, recourse to this programme diminished.

Between 2009 and 2013 the financial resources assigned to SMEs thanks to the loan moratoria and to the interventions of the Guarantee Fund and CDP amounted to €76 billion, equal to about 16 per cent of the disbursements of loans below €250,000 (a proxy for lending to smaller companies).

In 2013 firms' financial condition also benefited from the speeding up of general government commercial debt payments and tax refunds. At the end of March 2014 the debtor entities had disbursed about half of the €47 billion allocated for the two years 2013-14. According to the Survey of Industrial and Service Firms, the beneficiaries of general government commercial debt payments used the funds mainly to pay down debts to banks or suppliers.

Equity capital

The shareholders' equity of non-financial corporations grew by €35 billion in 2013, compared with €3 billion in 2012 (Table 14.6), thanks in part to more favourable financial market conditions and the adoption of several measures to support equity capital strengthening.

The recovery of share prices facilitated equity capital raising on the market, with transactions reaching a four-year high of €1.4 billion in 2013. Eleven initial public offerings (IPOs) were made, about double the yearly average between 2008 and 2012, and another four were carried out in the first four months of this year. Most of the

IPOs were made on the Alternative Investment Market, a segment reserved to small firms with streamlined procedures for admission to listing.

According to data published by the Italian Private Equity and Venture Capital Association (AIFI), investment by firms of the sector amounted to €3.4 billion and involved 281 target businesses, some 15 per cent above the average figures for the previous four years. Over half of the resources went into leveraged buyouts. Early stage investments are modest in the international comparison: in 2013 they accounted for just 2.4 per cent of the total, less than a third of the share in France and Germany.

As of the end of February 2014 Fondo Italiano di Investimenti, set up at the end of 2012, had approved direct acquisitions of 37 equity stakes totalling €360 million and investments amounting to €425 million in 21 private equity and venture capital vehicles. Especially through the latter activity, it is helping to make equity investment in Italian firms more attractive for foreign as well as domestic institutional investors.

The Stability Law for 2014 strengthened the allowance for corporate equity (ACE), the most important measure issued in recent years to support firms' capitalization. The rate to be applied to capital increases for the deductions from taxable income, initially set at 3 per cent, is set to be progressively raised from 4 per cent in 2014 to 4.75 per cent in 2016.

15. THE MONEY AND FINANCIAL MARKETS AND THEIR INFRASTRUCTURE

In 2013 the improvement in conditions in the Italian financial markets that had begun in the second half of 2012 continued. Uncertainty diminished markedly, risk premiums on government securities went down, and stock and corporate bond prices went up.

These positive developments are mainly due to the subsidence of fears of a break-up of monetary union and to the progress made by Italy on fiscal and structural adjustment. Investors' confidence in the irreversibility of the single currency was further reinforced by the ECB's introduction of Outright Monetary Transactions (OMTs) in August 2012 and further economic and institutional integration at EU level, a fundamental component of which is the project for Banking Union. The Italian financial markets were also supported by the gradual strengthening of the prospects for economic recovery and, from the autumn onwards, the shift in the composition of investors' portfolios from the emerging to the advanced economies.

Last year Italy's financial markets suffered the temporary effects of tensions on the international front, such as the financial crisis in Cyprus, the conflict in Syria, fears about the way in which the United States would exit from its non-conventional monetary policies and the attendant turbulence in the markets of the emerging economies. At the beginning of the year, the markets also suffered as a result of the uncertainty that followed Italy's general elections. All in all, however, the tensions had a limited impact.

While still significant, the fragmentation of the euro area's financial markets diminished. The gap narrowed between the risk premiums on Italian bank and corporate equity and bonds and those on securities issued in the other euro-area countries.

The volume of bond placements made by Italian companies on the international markets was higher overall than in 2012, while the share of issuances by smaller companies increased.

In the first few months of 2014 conditions in the financial markets continued to improve. Risk premiums on Italian government securities fell further; yields on ten-year bonds were the lowest since their introduction at the start of the 1990s. Moreover, the prices of shares and bonds of Italian firms made strong gains, surpassing those recorded in the other euro-area countries.

The money market

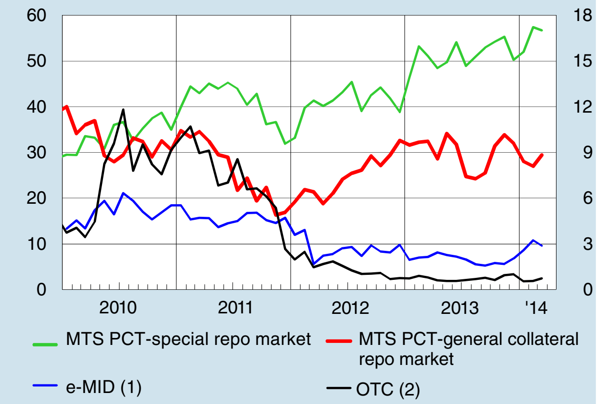
Trading in unsecured deposits on the e-MID market contracted in 2013, with average daily turnover below €2 billion, as against €2.7 billion in 2012 (Figure 15.1).

One factor in the thin trading was banks' liquidity, which remains abundant notwithstanding the early repayment of a portion of the funds obtained by euro-area banks in the three-year refinancing operations with the ECB. According to estimates based on the information provided by the TARGET2 system, trading in over-the-counter deposits (net of intra-group transactions) also declined.

Figure 15.1

Trading on Italy's electronic markets and on the OTC market

(monthly averages of daily data; billions of euros)



Sources: Based on e-MID SIM S.p.A. and TARGET2-Banca d'Italia data.
(1) Right-hand scale. (2) Right-hand scale; uncollateralized trading on the money market between Italian banks belonging to different groups with maturities of up to one week; estimates based on TARGET2-Banca d'Italia data.

The preference for collateralized trading fuelled the further growth in volume on the MTS general collateral repo market (up by 21 per cent with respect to 2012) and in secured interbank deposits on the New MIC collateralized segment of the e-MID market.

In the early months of 2014 there were signs of a recovery in unsecured funding. On the e-Mid market in particular, average daily trading in unsecured interbank deposits exceeded €3 billion in February.

Last year the rate on overnight deposits traded on the Italian market averaged 2 basis points lower than the benchmark Euro OverNight Index Average (Eonia).

Public sector securities

Supply and demand. – Net issues of Italian public sector securities climbed from €46 billion in 2012 to €81 billion in 2013, reflecting the increase in the general government borrowing requirement. At the end of the year the stock of public sector securities outstanding came to 111.2 per cent of GDP (105.5 per cent in 2012), and total public debt reached 132.6 per cent of GDP.

In a context of strong demand and falling yields the Treasury made regular new issues of government securities. The cover ratio remained well above 1 throughout 2013, averaging 1.4 for ten-year BTPs.

At the end of 2013 the average residual maturity of government securities remained long, although it did decrease slightly (falling by two months to six years and four months). The average duration instead remained unchanged at five years.

In 2013 Italy's banks made net purchases of Italian public sector securities amounting to €46 billion. Purchasing was concentrated in the first half of the year, whereas from July onwards the banks were net sellers.

Following three years of heavy disinvestment, in 2013 foreign investors made €13 billion worth of net purchases of Italian public sector securities. At the end of the year their holdings amounted to 36 per cent of the total outstanding, slightly down from

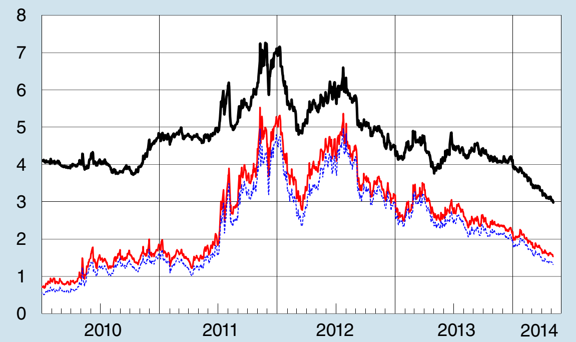
37 per cent at the end of 2012. Residents of the other euro-area countries made net purchases, as did investors residing outside the area, albeit to a lesser extent.

On the basis of preliminary data, in the first three months of 2014 net foreign investment in Italian public sector securities was considerable (€37 billion, as against €11 billion in the first quarter of 2013).

Figure 15.2

Gross yield on 10-year BTPs and main interest rate spreads (1)

(daily data; per cent and percentage points)



Source: Based on Bloomberg data.
(1) Yields on benchmark bonds. – (2) Spread between the yield on 10-year BTPs and that on the corresponding Bunds. – (3) Spread between the yield on 10-year BTPs and the simple average of the yields on the corresponding government securities of the euro-area countries that were rated AAA by at least two of the main rating agencies at the end of 2012 (Austria, Finland, Germany and the Netherlands).

Interest rates. – In 2013 rates on Italian government securities fell across the board, thanks to the significant reduction in sovereign risk premiums. Yields on Italian ten-year securities fell from 4.5 to 4.1 per cent (Figure 15.2), while those on the corresponding German bunds rose from 1.3 to 1.9 per cent. This year the rate on ten-year BTPs has fallen further, to 2.9 per cent in mid-May, the lowest on record in nominal terms since these securities were introduced in the early 1990s.

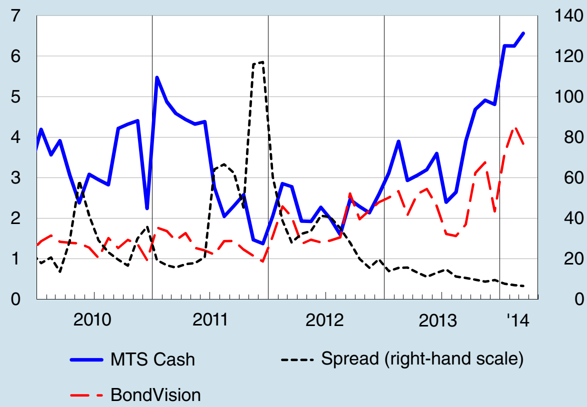
The narrowing of interest rate spreads with respect to Germany mostly reflected the dissipation of fears of a break-up of monetary union. Other contributory factors were the introduction of Outright Monetary Transactions (OMTs) by the ECB, further economic and institutional integration at EU level (including the rapid advancement of the project for Banking Union), and the progress made on national policies in Italy and the other EU countries most exposed to the sovereign debt tensions. In the second half of 2013 Italian government securities also benefited from the improved prospects for cyclical recovery in the euro area and strengthening demand from investors disposing of assets in the emerging economies. During 2013 the spreads between Italian and German government securities narrowed by 0.9, 1.2 and 1.0 percentage points for three-, five-, and ten-year bonds respectively. The narrowing was accompanied by a sharp drop in the volatility of the rates on Italian government securities.

The tensions that emerged in some phases were mostly connected with international factors. On more than one occasion the markets were affected by the turbulence in emerging country markets and uncertainty about how and when the US Federal Reserve would begin tapering its bond purchases and the consequences. Spreads were temporarily pushed upward by the financial crisis in Cyprus in March and by the violent clashes in Syria in August. There were also transient increases in the risk premiums on Italian government securities due to political uncertainties, such as that which followed February's general elections. Even when there were tensions, however, the level and volatility of Italian sovereign spreads remained well below the peaks recorded at end-2011.

The pace of the reduction in the spreads on Italian government securities accelerated in the early months of 2014, in part owing to portfolio reallocations between the emerging and advanced economies. In mid-May the spread on ten-year maturities hit a low of 1.5 percentage points, not seen since June 2011.

Figure 15.3

Turnover in Italian government securities and bid-ask spread on BTPs
(monthly averages of daily data; billions of euros and basis points)



Source: Based on MTS S.p.A data.

The secondary market in government securities. – Liquidity conditions in the MTS Cash secondary market in government securities improved. In 2013 daily volume exceeded that of 2012 by around 60 per cent (Figure 15.3). The average bid-ask spread for BTPs diminished significantly, from 33 to 12 basis points. The ratio of foreign operators to total market members increased (from 59 to 62 per cent), as did the share of transactions attributable to them (from 78 to 80 per cent).

Average daily volume on BondVision, the market designed for institutional investors and smaller banks, increased markedly (to €2.4 billion, from €1.9 billion in 2012).

The average daily volume of special repo trading increased from €38 billion to €49 billion, representing more than 60 per cent of the volume of repo trading on MTS. Last year the average difference between interest rates on the general collateral repo market and those on the special repo market fell from 11 to 7 basis points, in part indicating an easing of speculative pressure on Italian government securities.

Corporate bonds and bank bonds

Issuance. – Italian companies made net bond redemptions worth €75 billion in 2013, compared with net issues of €90 billion in 2012 (Table 15.1). Banks redeemed a large volume of securities falling due, but issuance proceeded constantly, with a greater propensity to place new securities in the market; there was a negative balance of €80 billion between banks' bond issues and redemptions. Other financial corporations also made net redemptions worth €17 billion, while non-financial corporations increased their net issues to €22 billion.

Table 15.1

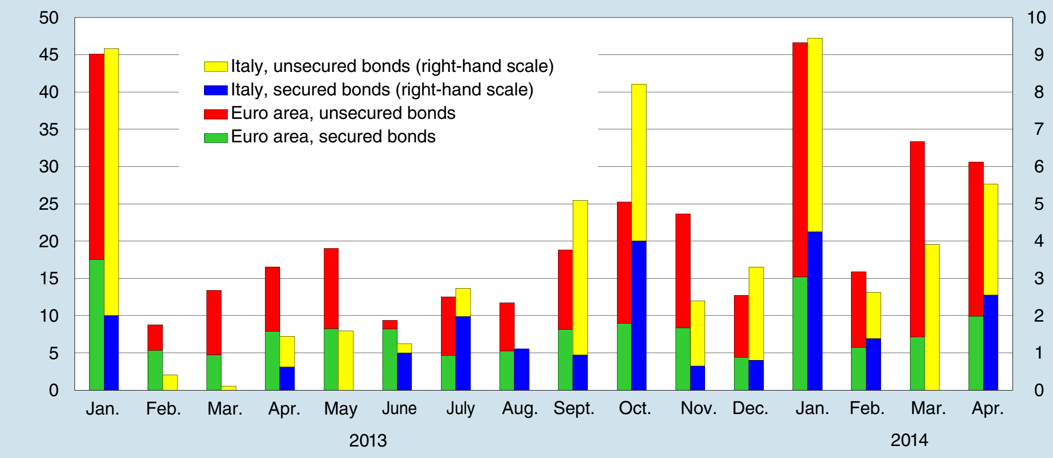
Medium- and long-term bonds of Italian banks and firms (1)
(nominal values; millions of euro)

	Net issues (2)			Stocks			*Per cent of GDP*
	2011	2012	2013	2011	2012	2013	2013
Banks	66,330	83,153	-80,297	873,618	956,739	875,792	*56*
Other financial corporations	-4,260	-5,606	-16,663	238,953	233,376	216,665	*14*
Non-financial corporations	-129	12,715	22,429	90,320	103,056	125,169	*8*
Total	**61,941**	**90,261**	**-74,531**	**1,202,891**	**1,293,171**	**1,217,626**	***78***

(1) The nationality and sector refer to the issuer and not to its parent company. Refers only to securities with a maturity at issue of more than one year. – (2) Difference between the nominal values of issues and redemptions.

Figure 15.4

Gross issues of secured and unsecured bank bonds in Italy and in the euro area (1)
(monthly data; billions of euros)



Source: Dealogic.
(1) Bonds issued by private banks classified according to the location and sector of the parent company. Does not include private placements, government-backed bonds, retained bonds and self-funded bonds.

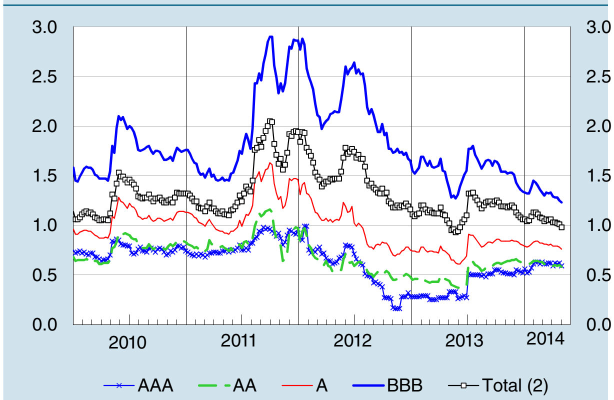
According to Dealogic data, gross issues of securities placed in the international markets by Italian banking groups, including through foreign subsidiaries, amounted to €36 billion in 2013 (€19 billion in 2012), while the portion of bond issues retained on banks' balance sheets, which in 2012 had represented around 60 per cent of the total, was virtually nil. More than half of the issues were not backed by collateral or government guarantees (Figure 15.4). As the year drew to a close there was an intensification of placement activity, in concomitance with a significant reduction in yields.

Again according to Dealogic data, firms in non-financial corporations issued bonds worth €21 billion (compared with €26 billion in 2012). The number of issuers rose again (from 16 to 22) and the share of placements attributable to the biggest six issuers (Enel, Eni, Fiat, Mediaset, Snam and Telecom Italia) fell from 80 to 60 per cent.

Yields. – In the early months of 2013, the average yield on investment-grade corporate bonds denominated in euros both in Italy and abroad fell again, reaching a historic low of 1.7 per cent in April; yields subsequently increased, reaching 2.1 per cent at the end of the year, as against 1.8 per cent at the end 2012. The returns on high-yield securities diminished further, from 5.6 to 4.9 per cent.

Figure 15.5

Yield spreads between euro-denominated corporate bonds and government securities (1)
(end-of-week 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 debt bears a rating not lower than BBB- or Baa3. The spreads are calculated with reference to French and German government securities of corresponding maturity. – (2) Includes all investment-grade bonds (i.e. rated at least BBB- or Baa3).

The Italian non-financial corporations that issued bonds benefited from the easing of the tensions on Italian sovereign debt. The risk premiums on their securities diminished more than those of firms in the other euro-area countries. For a sample of investment grade securities with a large float (Figure 15.5), in 2013 the yield differential with respect to AAA-rated bonds fell by an average of 0.7 percentage points for Italian firms and by 0.1 percentage points for firms in the other euro-area countries. Despite this, the risk premiums on bonds issued by Italian corporations are still around 0.3 percentage points higher than the average in the rest of the euro area.

The yield spreads on the bonds of the main Italian banks also benefited from the easing of the financial market tensions, narrowing by around 1 percentage point, a greater fall than that recorded by the banks in the other euro-area countries. At the end of 2013, however, the average yield differential for Italian bank bonds was 0.9 points higher than that of French banks and 1.4 points higher than that of German banks.

The equity market

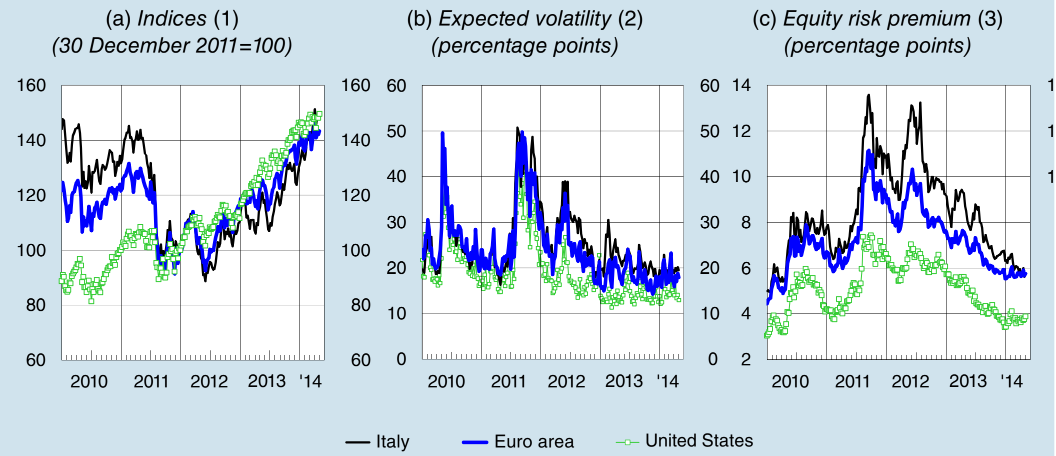
Share prices and trading. – In 2013 the Italian stock exchange index gained 19 per cent (Figure 15.6.a), in line with the average gain of 21 per cent recorded in the share prices of the main listed euro-area corporations.

In the first half of the year share prices fluctuated widely, reflecting tensions on the international and domestic fronts. From the end of June onwards, prices made progressive gains, driven by the strengthening signs of economic recovery and the maintenance of expansionary monetary conditions both in the euro area and in the United States.

The rise in share prices can be attributed to the marked reduction in the risk premiums demanded by investors (Figure 15.6.c), which more than offset the negative effects of the lowering of the expected earnings of listed companies and the rise in yields on the securities reputed to be safest, such as the German Bund.

Figure 15.6

Share markets
(end-of-week data)



Source: Based on Bloomberg data.
(1) Indices: FTSE Italia MIB storico for Italy, Dow Jones Euro Stoxx for the euro area, Standard & Poor's 500 for the United States. – (2) Volatility implied by options on the stock indices of the main stock markets. – (3) The risk premium is calculated as the difference between the expected earnings/price ratio for the subsequent 12 months and the nominal yield on 10-year government bonds (German Bunds are used for Italy and the euro area).

In 2013 the implied volatility of the Italian stock exchange index was lower on average than in the previous year; at the end of February it increased temporarily, affected by the uncertainty over the result of Italy's general elections, before subsiding again and ending the year at very modest levels, comparable to those recorded prior to the outbreak of the financial crisis in 2008 (Figure 15.6.b).

The ratio of current earnings to the market capitalization of Italian listed companies fell by over 2 percentage points to 5 per cent, dipping below the average calculated since the middle of the 1980s. Based on estimates that also factor in earnings expectations, at the end of 2013 the return demanded by investors to hold Italian shares was around 6.3 percentage points higher than that for risk-free investments (compared with 4.4 points on average for the past 15 years and 5.5 points for the euro area as a whole; Figure 15.6.c).

In the first four months of 2014 the Italian stock exchange index gained 14 per cent, a much larger increase than the 3 per cent recorded for the euro area as a whole.

Supply and demand. – There were 17 initial public offerings in 2013 (6 in 2012); 15 were in the segment for small and medium-sized firms (the AIM Italia-MAC alternative capital market). The value of the shares placed in these IPOs came to €1.2 billion, as against €0.2 billion in 2012. In the first four months of 2014 five more companies joined the segment for SMEs, bringing the total number listed to 41.

Last year the funds raised through capital increases by listed companies dropped sharply, coming to just €1 billion compared with €10 billion in 2012 (Table 15.2). The funding activity, which in previous years was mainly linked to recapitalizations of banks and insurance companies, was mostly carried out by non-financial corporations.

Table 15.2

Main indicators of the Italian stock exchange
(millions of euros, unless indicated otherwise)

	2009	2010	2011	2012	2013
Change in prices (1)	20.7	-8.7	-24.0	10.2	18.8
Listed companies *(number at end of year)*	332	332	328	323	326
of which: Italian	*291*	*291*	*287*	*282*	*285*
Market capitalization of Italian companies (2)	457,126	425,099	332,374	365,466	446,641
per cent of GDP	*30.1*	*27.4*	*21.0*	*23.3*	*28.6*
Percentage composition: (2)					
industrials	*37*	*41*	*45*	*47*	*40*
insurance	*9*	*7*	*7*	*8*	*9*
banking	*26*	*20*	*17*	*18*	*19*
financials	*2*	*3*	*3*	*3*	*3*
services	*26*	*28*	*29*	*25*	*28*
Total	**100**	**100**	**100**	**100**	**100**
Capital increases by Italian companies	18,562	6,810	12,544	10,085	949
Market value of newly-listed companies (3)	561	8,060	12,743	802	5,267
of which: Italian	*510*	*8,060*	*12,743*	*802*	*5,267*
Dividends distributed by Italian companies (4)	21,309	16,036	17,009	13,207	13,813
Earnings/price ratio (5)	5.3	7.6	9.0	7.2	5.0
Dividend yield (5)	5.0	3.8	5.1	4.2	3.1
Turnover					
spot market (6)	*645,993*	*715,147*	*683,630*	*487,301*	*526,411*
FTSE MIB index futures (7)	*418,714*	*560,207*	*561,798*	*442,990*	*553,626*
FTSE MIB index options (7)	*140,345*	*174,918*	*162,684*	*107,232*	*139,278*
Turnover ratio of Italian companies (8)	155	162	181	140	130

Sources: Borsa Italiana, Thomson Reuters Datastream and World Federation of Exchanges.
(1) Percentage change in the FTSE Italia MIB storico index over the year. — (2) End-of-period data. – (3) Sum of the market values of the various companies on the placement date. – (4) Sources: up to 2009, World Federation of Exchanges data; from 2010 onwards, Borsa Italiana data. – (5) End-of-period data. Per cent. Current earnings and dividends. – (6) Italian companies. – (7) Starting June 2009, replaces the contract on the S&P MIB index. – (8) Turnover as a percentage of average market capitalization for the year.

Italian corporations' total capitalization went from €365 to €447 billion; as a share of GDP, it rose from 23 to 29 per cent. At the end of 2013, in the other main advanced economies this share was much larger: 54 per cent in Germany, 75 per cent in France, 133 per cent in the United States and 160 per cent in the United Kingdom.

Market infrastructure

In 2013 the volume of transactions handled by the central depository Monte Titoli and the central counterparty Cassa di Compensazione e Garanzia S.p.A. (CC&G) increased.

The average daily volume of transactions entered into the Express II securities settlement system operated by Monte Titoli went from €136 billion to €155 billion, owing to the large increase in trading in Italian government securities. The percentage of fails (transactions not settled owing to non-delivery of the securities within the prescribed time limit) remained unchanged at 2.1 per cent of transactions entered.

At the end of last year the nominal value of the financial instruments deposited with Monte Titoli amounted to €2,945 billion, comparable to the previous year. The government securities component increased from €1,594 to €1,682 billion, while that of other bonds decreased from €1,073 to €963 billion. The number of members of the system slipped from 2,416 to 2,392.

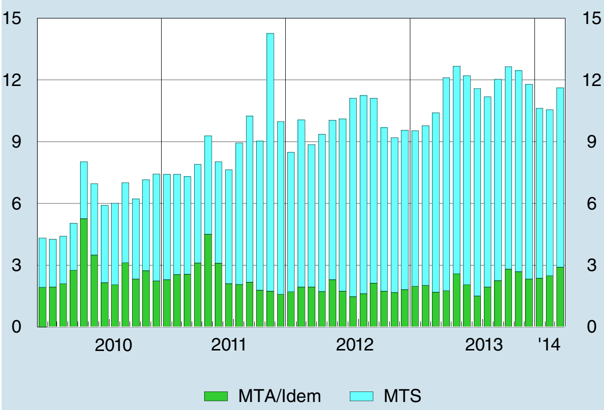
The value of the operations cleared by CC&G grew, on the government bond market (34 per cent) and on the equity market (7 per cent) and the Idem derivatives market (22 per cent). The increased business influenced the amount of guarantees demanded of members by the CC&G (Figure 15.7).

At the end of January 2014 the improved conditions in the sovereign debt markets allowed the margins required by CC&G on Italian government bonds to be cut; for ten-year bonds the reduction was of the order of 140 basis points.

CC&G increased the amount of the default fund for both the bond segment and the equity segment (to €2.7 and €1.2 billion respectively).

Figure 15.7

Initial margins deposited with Cassa di Compensazione e Garanzia S.p.A.
(monthly averages of daily data; billions of euros)



Source: Based on Cassa di Compensazione e Garanzia S.p.A. data.

16. THE ACTIVITY OF BANKS AND FINANCIAL INTERMEDIARIES

In 2013 the weakness of demand, coupled with supply side policies that were still prudent towards firms, especially the riskiest ones, led to a 3.7 per cent contraction of credit. The decrease in lending reduced the need for banks operating in Italy to raise funds. The improvement in market conditions from the middle of the year onwards nonetheless allowed the leading Italian banks to increase their international bond issues; some banks also began to repay the funds they had obtained through three-year refinancing operations with the European Central Bank.

The revenues of the Italian banking industry diminished. The fall in operating profit was curbed by the reduction in operating expenses. The result for the year was negative owing to the provisions for loan losses and the large volume of goodwill impairments, most of which involved the leading groups. The system's capital ratios nonetheless remained in line with those recorded in 2012. In the early months of 2014 several banks completed or announced increases in capital totalling nearly €11 billion.

The structure of the Italian banking system

The Italian banking system is highly diversified in terms of bank size and legal form. At the end of 2013 five large banking groups, of which two of a size on a par with the leading European banks, were flanked by another 72 groups and 524 banks not belonging to a group (Table 16.1). The latter included 375 mutual banks, 19 cooperative banks and 79 branches of foreign banks. A significant proportion of non-bank financial intermediaries also belonged to banking groups.

Last year 47 per cent of the assets of the banking system, excluding the foreign component, were held by the five largest groups; 24 per cent were held by another 15 groups and large and medium-sized banks. Small and minor banks, mainly mutual banks, accounted for more than 20 per cent of the total, the branches of foreign banks for about 8 per cent. Twenty-three subsidiaries of foreign companies and banks held 9 per cent of the total assets of banks operating in Italy

Italian banks are marked by their focus on traditional business, which consists mainly in raising funds from customers and granting loans to firms and households. On the basis of consolidated financial statements data collected by the ECB, in 2012 loans were 68 per cent of the assets of the Italian banking system, compared with a euro-area average of 58 per cent.

Table 16.1

Banks and non-bank intermediaries

	31 December 2012			31 December 2013		
	Number of intermediaries			Number of intermediaries		
	Members of banking groups (1)	Not members of banking groups (2)	Total	Members of banking groups (1)	Not members of banking groups (2)	Total
Banking groups	–	–	75	–	–	77
Investment firm groups	–	–	19	–	–	18
Banks	169	537	706	160	524	684
of which: limited company banks	*141*	*56*	*197*	*131*	*51*	*182*
cooperative banks (banche popolari)	*18*	*19*	*37*	*18*	*19*	*37*
mutual banks (banche di credito cooperativo)	*9*	*385*	*394*	*10*	*375*	*385*
branches of foreign banks	*1*	*77*	*78*	*1*	*79*	*80*
Investment firms	9	92	101	10	84	94
Asset management companies	26	146	172	21	131	152
Financial companies entered in the special register under Article 107 of the Consolidated Law on Banking	58	128	186	53	127	180
Financial companies entered in the general register under Article 106 of the Consolidated Law on Banking	33	625	658	27	518	545
Electronic money institutions	–	3	3	1	3	4
Payment institutions	8	36	44	7	36	43
Other supervised intermediaries (3)	–	2	2	–	2	2

Sources: Supervisory registers and lists.
(1) Includes parent banks. The limited company banks include those belonging to groups headed by a cooperative bank (41 in 2012 and 34 in 2013). – (2) Includes investment firms (24 in 2012 and 23 in 2013), 7 asset management companies and one financial company entered in the register under Article 106 of the Consolidated Law on Banking belonging to investment firm groups. – (3) Bancoposta and Cassa Depositi e Prestiti.

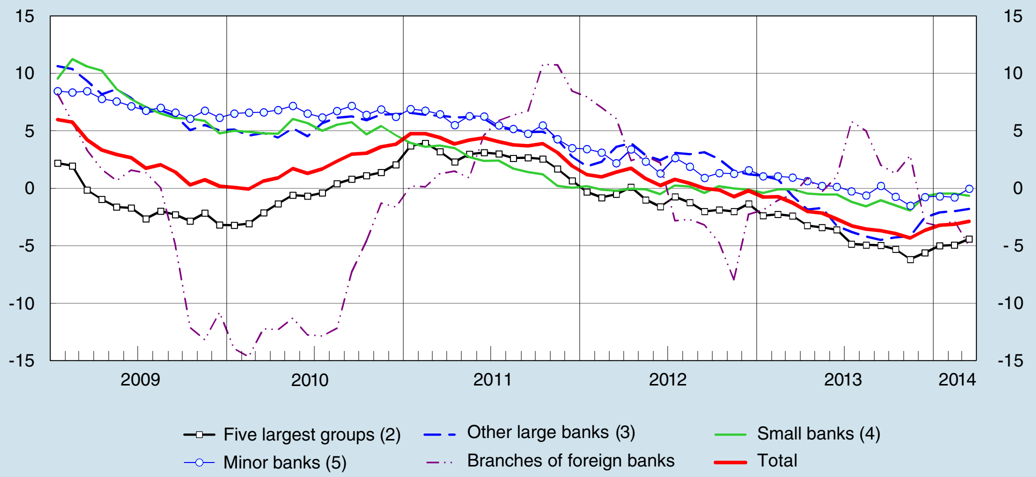
The ratio of operating expenses to total assets of the Italian banking industry was higher than the euro-area average (1.8 per cent, as against 1.3 per cent). The difference was largely due to the greater relative importance of labour-intensive, branch-based retail business, including for the largest Italian banks. Even though financial statement data are not perfectly comparable across borders, the information drawn from a sample of large European banks shows that there is a correlation between the ratio of operating expenses to total assets and the share of loans in total assets. Moreover, in the countries where investment and securities trading business is more important, banks generally have a larger volume of assets. On the other hand, the Italian banking system's cost/income ratio was in line with the euro-area average.

Lending and other asset items

Lending. – In 2013 loans disbursed to residents by banks operating in Italy decreased by 3.7 per cent after declining by 0.2 per cent in 2012 (Figure 16.1 and Table 16.2). The reduction in lending primarily concerned that to firms, which decreased by 5.0 per cent, while mortgage loans and other lending to consumer households decreased by much less (0.9 per cent). The contraction slowed in the early months of 2014. Qualitative surveys of banks show that the contraction in lending in Italy was due not only to the weakness of demand but also to banks' supply policies. These remained prudent towards firms, especially the riskiest ones. For households, borrowing conditions became progressively less restrictive; for loans for house purchase a slight easing began in the fourth quarter of 2013.

Figure 16.1

Bank lending by size class of bank (1)
(monthly data; 12-month percentage changes)



Source: Supervisory reports.
(1) Data for March 2014 are provisional. Loans include repos and bad debts. Banks are classified according to the composition of banking groups at March 2014 and to unconsolidated total assets at December 2008. Percentage changes are calculated net of the effects of securitizations, reclassifications and other variations not due to transactions. – (2) Banks belonging to the groups Banco Popolare, Intesa Sanpaolo, Banca Monte dei Paschi di Siena, Unione di Banche Italiane and UniCredit. – (3) Banks belonging to a group and independent banks with total assets amounting to between €21,532 million and €182,052 million. – (4) Banks belonging to a group and independent banks with total assets amounting to between €3,626 million and €21,531 million. – (5) Banks belonging to a group and independent banks with total assets amounting to less than €3,626 million.

The contraction in lending involved all the size classes of banks; it was most pronounced for the five largest groups (5.6 per cent) and for the branches of foreign banks (3.0 per cent), owing in part to the lower demand of firms that issued bonds. The lending of the other large banks and of the smaller banks decreased by 2.5 and 0.7 per cent respectively.

Securities and other assets. – In 2013 banks' proprietary holdings of debt securities, excluding those deriving from uncancelled securitized loans and those issued by other banks, increased by 12.0 per cent, as against 39.2 per cent in 2012. The growth, which occurred mainly in the first half of the year, came from securities issued by the Italian public sector, especially the central government. Between January and June 2013 banks made net purchases of Italian public sector securities amounting to more than €71 billion,

Table 16.2

Italian banks' lending by geographical area and economic sector (1)
(12-month percentage changes)

	General government	Financial and insurance companies	Firms: total	Firms: medium-sized, large	Firms: small (2)	Firms: small – producer households (3)	Consumer households	Non-profit institutions serving households and units n.e.c.	Total
Centre and North									
2011 – Dec.	-0.9	-2.4	2.3	3.0	-0.6	1.3	3.7	9.8	1.7
2012 – Mar.	2.6	4.8	-0.3	0.2	-2.4	-0.5	2.8	5.7	1.4
June	0.9	6.6	-1.6	-1.2	-3.5	-1.7	1.4	5.9	0.3
Sept.	5.7	8.9	-3.3	-3.1	-4.2	-2.6	0.7	3.7	0.2
Dec.	4.6	4.4	-2.2	-2.0	-2.9	-2.4	0.2	-1.6	0.0
2013 – Mar.	0.3	1.3	-2.6	-2.5	-3.2	-2.6	-0.2	-1.3	-1.2
June	-0.7	-4.2	-4.2	-4.3	-3.8	-2.9	-0.3	-3.1	-2.8
Sept.	-4.6	-8.6	-4.2	-4.5	-3.2	-2.7	-0.6	-3.5	-3.5
Dec.	-2.5	-4.9	-5.4	-5.7	-4.1	-3.1	-0.8	-3.4	-3.8
2014 – Mar.	0.3	-5.5	-4.5	-4.8	-3.1	-2.6	-0.6	-3.2	-3.0
South and Islands									
2011 – Dec.	3.0	-10.4	3.5	4.4	1.0	1.2	3.9	3.2	3.4
2012 – Mar.	0.7	-9.0	1.1	1.9	-1.0	-1.0	2.5	-3.4	1.5
June	-2.3	-7.6	-0.7	-0.2	-2.0	-1.9	1.0	-3.0	-0.2
Sept.	-3.8	-8.5	-1.7	-1.3	-2.7	-2.9	0.4	-1.4	-1.1
Dec.	-1.7	-4.5	-2.1	-1.8	-2.9	-3.2	-0.4	-0.8	-1.4
2013 – Mar.	-2.5	-4.3	-2.1	-1.8	-2.8	-3.0	-0.8	1.9	-1.6
June	-2.8	-0.5	-2.9	-2.7	-3.4	-3.4	-1.1	1.1	-2.1
Sept.	-2.6	0.2	-3.2	-3.2	-3.3	-3.2	-1.6	-1.5	-2.5
Dec.	-5.4	-2.9	-3.0	-2.9	-3.4	-3.0	-1.5	-3.0	-2.6
2014 – Mar.	-5.0	-1.3	-2.8	-2.7	-2.9	-2.8	-1.4	-5.0	-2.4
Italy									
2011 – Dec.	-0.5	-2.6	2.5	3.2	-0.2	1.3	3.7	9.1	1.9
2012 – Mar.	2.4	4.5	-0.1	0.4	-2.1	-0.6	2.7	4.7	1.4
June	0.5	6.3	-1.4	-1.0	-3.2	-1.8	1.3	4.9	0.3
Sept.	4.7	8.5	-3.0	-2.8	-3.9	-2.7	0.6	3.2	0.0
Dec.	4.0	4.2	-2.2	-2.0	-2.9	-2.6	0.0	-1.5	-0.2
2013 – Mar.	0.0	1.2	-2.5	-2.4	-3.2	-2.7	-0.3	-1.0	-1.3
June	-0.9	-4.1	-4.0	-4.1	-3.7	-3.0	-0.5	-2.7	-2.7
Sept.	-4.4	-8.4	-4.1	-4.3	-3.2	-2.8	-0.8	-3.3	-3.7
Dec.	-2.8	-4.9	-5.0	-5.3	-4.0	-3.1	-0.9	-3.4	-3.7
2014 – Mar.	-0.2	-5.5	-4.2	-4.5	-3.1	-2.6	-0.7	-3.4	-2.9

Source: Supervisory reports.
(1) Data for March 2014 are provisional. Loans include repos and bad debts. The allocation by geographical area is based on the customer's residence. The percentage changes are calculated net of the effect of securitizations, reclassifications and other variations not due to transactions. – (2) Limited partnerships and general partnerships with fewer than 20 workers; partnerships, de facto companies and sole proprietorships with fewer than 20 workers. – (3) Partnerships, de facto companies and sole proprietorships with up to 5 workers.

owing in part to the widening differential between the risk-adjusted yields on securities and loans to resident customers. In the second half of the year, with the easing of sovereign debt tensions, the fall in the yields on government securities made investments of this kind less advantageous and banks' exposure to the Italian public sector began to diminish; between July and December their net disposals amounted to €25 billion.

In December 2013 banks held €398 billion of public sector securities; the twelve-month increase of €53 billion was affected by an estimated net revaluation gain of €7 billion. The ratio of public sector securities to total assets rose by 1.6 percentage points to 9.8 per cent (on the basis of unconsolidated data). In the twelve months to March 2014 government securities increased by 3.8 per cent.

External assets contracted by 12.3 per cent (about €43 billion), as against 4.7 per cent in 2012 (Table 16.3). The decrease was primarily in deposits with other banks and was more pronounced for the five largest banking groups, which reduced their external liabilities by a similar amount, and for the branches of foreign banks.

Table 16.3

Banks' main assets and liabilities (1)
(*monthly data; 12-month percentage changes and millions of euros*)

	12-month flows				12-month percentage changes				Stocks at March 2014
	December 2011	December 2012	December 2013	March 2014	December 2011	December 2012	December 2013	March 2014	
					Assets				
Cash	361	1,845	-336	-605	3.2	16.0	-2.5	-5.7	9,924
Debt securities (2)	28,525	96,455	42,065	5,144	8.2	25.4	8.5	1.0	546,255
of which: government securities	*25,148*	*99,555*	*45,927*	*14,415*	*12.2*	*43.3*	*13.3*	*3.8*	*405,827*
Loans	39,235	-10,624	-68,932	-56,381	2.1	-0.5	-3.6	-3.0	1,851,104
Claims on central counterparties	-17,040	41,342	14,756	13,552	-44.6	195.0	23.6	22.3	74,318
Claims on the Eurosystem (3)	11,138	-6,214	-6,875	-14,794	49.0	-18.3	-24.9	-47.4	16,401
External assets	31,499	-17,076	-42,614	-35,560	9.4	-4.7	-12.3	-10.4	287,557
Claims on resident MFIs									
Loans	*39,838*	*12,498*	*7,716*	*8,325*	*11.5*	*3.5*	*2.2*	*2.3*	*381,152*
Securities	*89,641*	*86,943*	*-29,958*	*-53,072*	*43.6*	*29.5*	*-7.8*	*-14.4*	*317,005*
Shares and other equity	1,501	14,329	3,780	1,090	1.0	11.7	2.8	0.8	133,722
Other assets (4)	91,348	10,245	-82,925	-47,501	23.7	2.1	-16.9	-9.9	437,979
					Liabilities				
Deposits of residents in Italy (a)	-6,527	68,297	34,338	19,532	-0.6	5.9	2.8	1.6	1,261,678
Deposits of non-residents (b)	-41,816	-46,721	-24,254	-24,151	-9.6	-11.8	-6.9	-7.0	307,783
Bonds (5) (c)	16,395	-42,745	-49,528	-45,428	2.7	-6.9	-8.6	-8.1	512,880
Liabilities to central counterparties	-47,292	48,412	1,700	-10,049	-40.8	70.6	1.5	-7.7	121,103
Liabilities to the Eurosystem (3) (d)	162,360	61,789	-35,915	-57,114	340.8	29.4	-13.2	-21.3	211,046
Liabilities associated with sales of claims	-2,129	-6,499	-6,820	-14,654	-1.2	-4.1	-4.5	-9.5	143,226
Liabilities to resident MFIs									
Deposits	*37,337*	*15,142*	*4,613*	*8,829*	*10.6*	*4.2*	*1.3*	*2.4*	*382,878*
Bonds	*89,641*	*86,943*	*-29,958*	*-53,072*	*43.6*	*29.5*	*-7.8*	*-14.4*	*317,005*
Capital and reserves	26,658	-4,342	18,963	35,402	7.4	-1.1	5.1	9.2	420,990
Other liabilities	83,263	49,081	-76,776	-39,608	26.2	12.8	-17.7	-9.4	376,827
Memorandum items:									
Net liabilities to central counterparties (e)	-30,252	7,070	-13,056	-23,601	-39.0	14.9	-24.0	-33.5	46,785
Total funding (f=a+b+c+d+e)	100,159	47,689	-88,415	-130,762	4.3	2.0	-3.6	-5.3	2,340,172

Source: Supervisory reports.
(1) The percentage changes are calculated net of the effects of reclassifications, exchange rate variations, value adjustments and other variations not due to transactions. – (2) Includes securities deriving from uncancelled securitized loans; excludes bonds issued by resident MFIs. – (3) Includes the positions vis-à-vis the Eurosystem for monetary policy operations; see Monetary and Financial Indicators, Money and Banking, in Supplements to the Statistical Bulletin, Tables 1.4a and 1.4b. – (4) Money market fund units, movable and immovable assets, and other minor items. – (5) Excludes bonds held by MFIs resident in Italy.

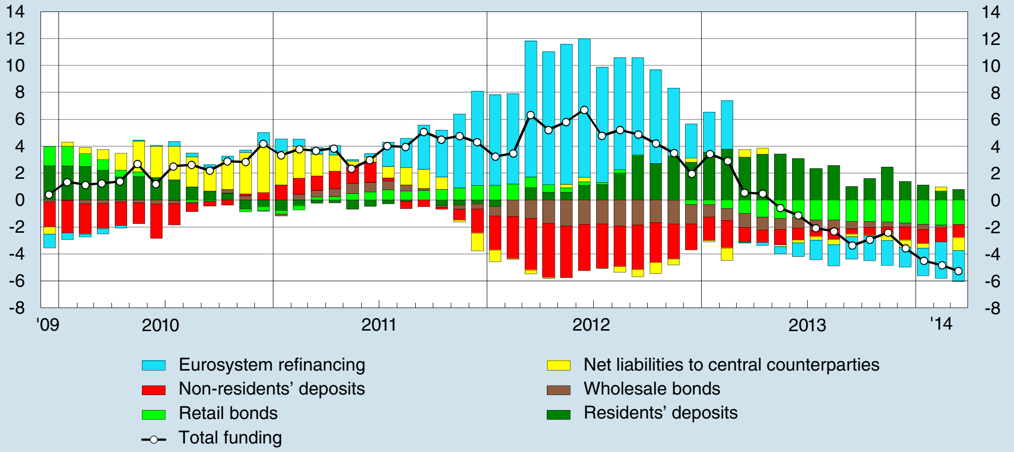
Funding and liquidity management

In 2013 total funding decreased by 3.6 per cent (Figure 16.2). More than 40 per cent of the contraction was due to the liabilities to the Eurosystem, whose share of total funding fell by more than one percentage point to 9.9 per cent. Wholesale funding also shrank, although much more slowly than in 2012 thanks to the recovery in international bond issues. This component's share of total funding fell by 1 percentage point to 23.4 per cent. Retail funding remained virtually unchanged.

Figure 16.2

Growth in bank funding by component (1)

(monthly data; percentage points)



Source: Supervisory reports.

(1) The sum of the contributions is equal to the 12-month percentage change in total funding. The percentage changes in the individual components are calculated net of the effects of reclassifications, exchange rate variations, value adjustments and other variations not due to transactions.

The average cost of funds (calculated on the stock of liabilities outstanding at the end of 2013, including funding from other banks resident in Italy) declined by 15 basis points to 1.2 per cent, owing to the reductions in the ECB official rates and the easing of sovereign debt tensions.

The funding gap – the share of loans not financed by deposits or by bonds held by households – narrowed from 13.7 per cent in 2012 to 11.2 per cent in 2013, the lowest value since 2005. The reduction involved banks of all size classes, but was most pronounced for small and minor banks (7.0 percentage points), whose retail funding comfortably exceeds their lending (in fact their funding gap is equal to -11.9 per cent).

Eurosystem refinancing. – In 2013 the Italian banking system's liabilities to the Eurosystem decreased by €36 billion as a result of the €55 billion partial repayment of funds obtained through three-year refinancing operations, which was accompanied by a €19 billion increase in main refinancing operations. The reduction involved some of the major banks, which, following the easing of the tensions on financial markets, benefited from a large reduction in the refinancing risk of wholesale liabilities (see *Financial Stability Report*, No. 1, 2014). In the first four months of this year the liabilities to the Eurosystem decreased by €25 billion, the early repayments of longer-term refinancing operations amounted to €27 billion.

Wholesale funding. – In 2013 wholesale funding (non-residents' deposits, bonds not held by households and net liabilities to central counterparties) contracted by 7.4 per cent, after falling by 11.0 per cent in 2012. The bond component contracted by €8 billion (3.7 per cent) after falling by €34 billion in 2012. The bulk of the reduction occurred in the first eight months of the year, while from the autumn onwards net issues turned positive in response to the improved market conditions. The banks belonging to the five largest groups were able to keep their stocks at the same levels as in 2012 thanks to very substantial issues on international markets, including of unsecured bonds. These issues amounted to €30 billion (of which €19 billion in the second half of the year), compared with a total of €17 billion in 2012. Although three quarters of the new issues were made by the five largest banking groups, medium-sized banks also placed a substantial volume of medium- and long-term bonds. The cost of funds from this source continued to decline, following the trend of the yields on government securities: in 2013 the differential between bond yields at issue and the swap rate, a measure of the issuer's credit risk, narrowed by 93 basis points to 1.9 per cent.

In the first quarter of 2014 Italian banks' wholesale bond issues net of redemptions increased: net placements on international markets amounted to €3.5 billion; the differential between the yields on the bonds and the swap rate narrowed to 1.6 per cent.

Non-residents' deposits also diminished in 2013, although the decrease (6.9 per cent) was smaller than in 2012 (11.8 per cent). An important contribution came from the inflow of funds to the subsidiaries of foreign banks operating in Italy, as against a large outflow in 2012. The improvement in market conditions allowed banks to reduce their external repo funding through central counterparties.

Retail funding. – Retail funding (deposits from residents and bank bonds held by households) remained virtually unchanged, declining by 0.5 per cent over the twelve months to December 2013.

Deposits grew by 2.8 per cent. Those of the banks belonging to the five largest groups, which benefited to a greater extent from the easing of tensions on wholesale markets and recorded a sharper reduction in loans, remained basically unchanged, declining by 0.4 per cent. The deposits of the other banks grew by 4.7 per cent.

The volume of bonds held by households decreased by 11.2 per cent, compared with a decline of 2.1 per cent in 2012, in response to a variety of factors. There was a continuation, although at a slower pace than in 2012, of the replacement of this form of funding with fixed-term deposits following the elimination at the beginning of 2012 of the advantageous tax treatment of bond interest. In addition, some banks carried out bond buybacks amounting to more than €10 billion in order to benefit from the fall in interest rates. Lastly, some banks gave priority at their branches to the sale of insurance products and investment fund shares/units in order to increase fee income.

In the first quarter of 2014 retail funding contracted by 1.6 per cent compared with the year-earlier period.

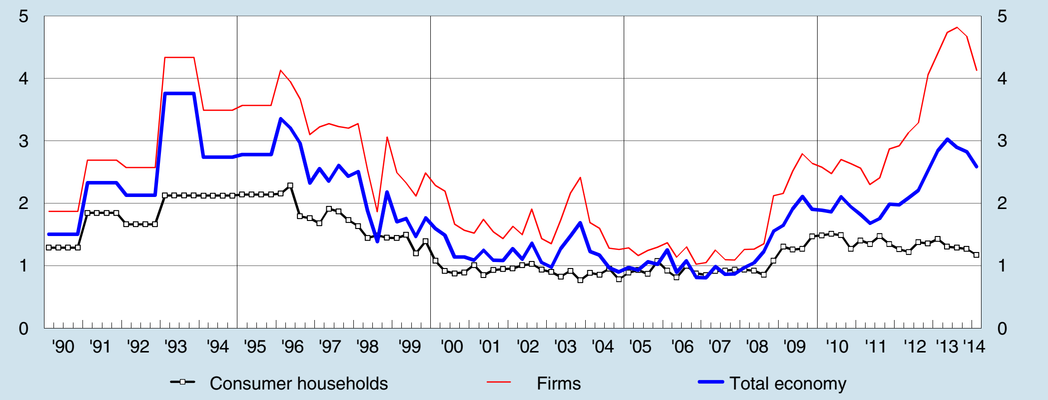
The liquidity position. – The data collected weekly by the Bank of Italy from 31 banking groups show that the net liquidity position, given by the difference between their expected cash flows and the liquidity available within a period of one month as a percentage of total assets, rose from 8.0 per cent on average in 2012 to 10.5 per cent in 2013, the highest value since the end of 2008. In April 2014 the indicator stood close to 12 per cent.

Credit risk and country risk

Loan quality. – In 2013 credit quality deteriorated, although at a rate that slowed in the second half of the year. The flow of new bad debts of banks and financial companies operating in Italy amounted to €50 billion, as against €39 billion in 2012 and €32 billion in 2011. After peaking in the second quarter of 2013, the ratio of new bad debts to outstanding loans declined slightly (Figure 16.3); in the fourth quarter the ratio on an annualized seasonally adjusted basis was 2.8 per cent, as against 2.5 per cent in the year-earlier period.

Figure 16.3

New bad debts as a percentage of outstanding loans (1)



Sources: Supervisory reports and Central Credit Register.
(1) Annualized quarterly flow of adjusted bad debts in relation to the stock of loans excluding adjusted bad debts at the end of the previous quarter. Data seasonally adjusted where necessary.

The flow of new bad debts was almost entirely related to loans to firms, whose default rate was 4.7 per cent in the fourth quarter; for households the default rate was 1.3 per cent, slightly lower than in the year-earlier period.

In the first quarter of 2014 the default rate for the economy as a whole recorded a further decrease, falling to 2.6 per cent; the main contribution to this result came from loans to firms, for which the indicator fell to 4.1 per cent.

At the end of 2013 the ratio of non-performing loans (bad debts, substandard loans, restructured loans and loans overdue or breaches of overdraft limits) to total loans to customers was 16.0 per cent, 2.5 percentage points higher than a year earlier (Table 16.4). More than half of non-performing loans were backed by collateral or personal guarantees (64.4 per cent). Bad debts alone were equal to 8.7 per cent of total loans, as against 7.2 per cent in 2012; net of provisions, bad debts amounted to about one third of regulatory capital, as against 29 per cent in 2012.

The non-performing-loan coverage ratio. – The ratio of loan loss provisions to gross non-performing exposures increased by nearly 3 percentage points from 39.0 per cent at the end of 2012 to 41.7 per cent at the end of 2013. One contributory factor was the valuation policies adopted by banks, partly in response to the Bank of Italy's supervisory activity involving targeted inspections. Provisions increased over the year by 17.3 per cent.

Table 16.4

Credit quality of Italian banks and banking groups (1)
(end-of-period data; millions of euros and per cent)

	Loans (2)	Share of total loans		Coverage ratio (3)		Share of total loans net of provisions	
	2013 (4)	2012	2013 (4)	2012	2013 (4)	2012	2013 (4)
	Banking system (5)						
Loans to customers	1,998,936	100.0	100.0	5.8	7.2	100.0	100.0
Performing	1,679,907	86.5	84.0	0.6	0.7	91.3	90.0
Non-performing	319,029	13.5	16.0	39.0	41.7	8.7	10.0
Bad debts	*174,637*	*7.2*	*8.7*	*55.1*	*57.1*	*3.4*	*4.0*
Substandard loans	*105,474*	*4.2*	*5.3*	*23.4*	*25.5*	*3.4*	*4.2*
Restructured loans	*19,325*	*1.0*	*1.0*	*22.4*	*21.1*	*0.8*	*1.0*
Loans overdue or breaches of overdraft limits	*19,594*	*1.1*	*1.0*	*9.2*	*10.9*	*1.1*	*0.9*

Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for banks not belonging to groups.
(1) Rounding may cause discrepancies in totals. – (2) Loans are gross of provisions. – (3) Provisions in relation to the corresponding gross exposure. – (4) Provisional data. – (5) Includes banking groups and the subsidiaries of foreign banks.

The coverage ratio of Italian banks' non-performing loans is influenced by the high proportion of such loans backed by collateral or personal guarantees, whose loss rates are significantly lower than those of unsecured loans. The coverage ratio of non-performing unsecured loans rose from 52.5 per cent at the end of 2012 to 55.4 per cent at the end of 2013.

The coverage ratio rose by 3.3 percentage points to 44.4 per cent for the five largest banking groups, by 2.0 points to 40.2 per cent for small banks, and by 4.5 points to 31.6 per cent for minor banks. It remained basically unchanged at 37.5 per cent for large banks, which have a lower ratio of bad debts to non-performing loans than the rest of the banking system.

The lower coverage ratio for minor banks is due partly to their lower proportion of bad debts and partly to their larger share of non-performing loans backed by collateral or personal guarantees (79.2 per cent).

Country risk. – The balance-sheet exposure to non-residents of Italian banks and their foreign subsidiaries diminished by 3.9 per cent in 2013. At the end of the year it amounted to €610 billion, or 23.3 per cent of the total exposure to residents and non-residents. The five largest groups' claims on non-residents accounted for 93.1 per cent of the total foreign exposure and were equal to 33.5 per cent of their total exposures.

The countries to which Italian banks were most exposed were Germany (€168 billion), Austria (€72 billion), Poland (€37 billion) and the United Kingdom (€33 billion).

At the end of 2013 the balance-sheet exposure to residents of central and eastern European countries, most of which was accounted for by the largest groups, amounted to €171 billion (€42 billion to households and €73 billion to firms). The ratio of non-performing loans to performing loans was just below 10 per cent.

Profitability

Italian banks and banking groups recorded a loss of €20.6 billion in 2013 owing both to the very large provisions made for loan losses and to goodwill impairments (Table 16.5); 15 per cent of the loss affected regulatory capital. Net of the extraordinary items connected with goodwill impairments, ROE fell by two percentage points and turned negative (-0.8 per cent).

Table 16.5

Consolidated income statement of Italian banks and banking groups (1)
(millions of euros and percentage changes)

	Banking system			Largest groups (2)		
	2012	2013 (3)	Percentage change	2012	2013 (3)	Percentage change
Net interest income (a)	50,896	46,345	-8.9	29,458	25,813	-12.4
Non-interest income (b)	43,197	46,358	7.3	25,385	27,230	7.3
of which: fees	*29,188*	*29,923*	*2.5*	*17,406*	*18,095*	*4.0*
Gross income (c=a+b)	94,093	92,703	-1.5	54,842	53,043	-3.3
Operating expenses (d) (4)	58,724	57,577	-2.0	34,785	33,593	-3.4
of which: *staff costs*	*32,373*	*31,025*	*-4.2*	*19,739*	*18,610*	*-5.7*
Operating profit (e=c-d)	35,370	35,127	-0.7	20,058	19,450	-3.0
Allocations to provisions and net value adjustments (f)	34,708	60,115	73.2	21,834	43,837	100.8
of which: for loan impairment	*28,610*	*38,587*	*34.9*	*18,105*	*25,748*	*42.2*
of which: for goodwill impairments	*2,531*	*17,954*	*::*	*1,685*	*16,094*	*::*
Ordinary profit (g=e-f)	661	-24,989	::	-1,776	-24,387	::
Non-recurring profit (h)	-381	2,614	::	-583	2,444	::
Gross profit (i=g+h)	280	-22,374	::	-2,359	-21,943	::
Taxes (l)	202	-3,178	::	-989	-3,714	::
Profit from groups of assets undergoing disposal (after tax) (m)	-201	-827	::	-201	-841	::
Minority interest profit (n)	488	554	13.6	384	383	-0.3
Parent company profit (o=i-l+m-n) (5)	-610	-20,577	::	-1,955	-19,452	::
Indicators *(per cent)*						
Ratio of non-interest income to gross income	45.9	50.0		46.3	51.3	
Cost/income ratio (6)	62.4	62.1		63.4	63.3	
Value adjustments to loans/operating profit	80.9	109.9		90.3	132.4	
ROE	0.0	-8.0		-1.1	-13.5	
ROE net of goodwill impairments	1.0	-0.8		0.1	-2.1	

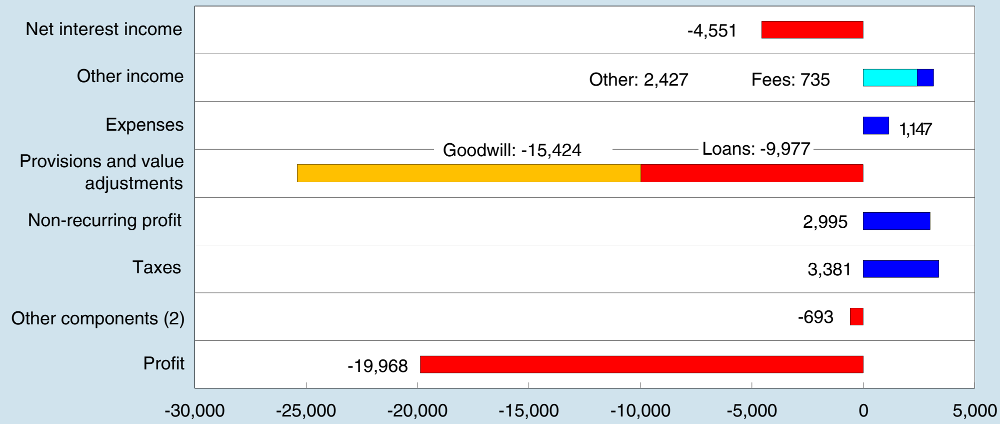
Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for banks not belonging to groups.
(1) Rounding may cause discrepancies in totals. For the sake of comparison, the composition of the banking groups is that at the end of 2013. – (2) Five largest groups by total assets at December 2013. – (3) Provisional data. – (4) Excludes value adjustments to intangible assets connected with goodwill, reclassified among the provisions. – (5) Includes the net profit of banks not belonging to groups. – (6) Ratio of operating expenses to gross income.

Net interest income contracted by 8.9 per cent (Figure 16.4), primarily as a result of a fall in the volume of business. The increase of 7.3 per cent in income from fees and trading partly offset the decline in interest income. Gross income contracted by 1.5 per cent.

Further progress was made in curbing operating expenses, which fell by almost 2.0 per cent in total and by 4.2 per cent for staff costs alone. The fall in operating expenses

Figure 16.4

Change in profits between 2012 and 2013: contribution of the main income statement items (1)
(millions of euros)



Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for banks not belonging to groups.
(1) Provisional data. – (2) Profit/loss from groups of assets undergoing disposal (after tax) and minority interest profit/loss.

mainly concerned the five largest banking groups, which cut their branch networks by 3.6 per cent and reduced their staff numbers by 1.1 per cent. The ratio of operating expenses to gross income was virtually unchanged at 62.1 per cent.

Some of the largest groups have announced new plans for rationalizing their distribution networks in the coming years.

For the banking system as a whole, the operating profit was not large enough to cover all the provisions for loan losses. In addition, very substantial goodwill impairments, seven times as large as in 2012, recorded primarily by the largest groups, caused significant losses for the year (one bank in four closed with a loss).

International comparison based on a sample made up of the 15 largest European banking groups shows that the profitability of the two leading Italian banks was less than that of the other 13 banks in the sample; net of goodwill impairments, their ROE was negative (-1.5 per cent), while that of the other banks was positive (4.6 per cent). The result was affected by the provisions for loan losses, equal to 118.7 per cent of the operating profit, as against 60 per cent for the other banks. Net interest income contracted to a comparable extent for all the banks in the sample; as regards the growth in other income, the two Italian groups outpaced the other banks (18.9 per cent as against 5.2 per cent). The operating efficiency of these two Italian banks remains high: their cost/income ratio was significantly lower than the average for the rest of the sample (60.5 per cent as against 71.5 per cent).

Capital

In 2013 both regulatory capital and risk-weighted assets decreased, leaving the capital adequacy of the banking system virtually unchanged.

Capital and risk-weighted assets. – At the end of 2013 regulatory capital calculated on a consolidated basis amounted to €223 billion, down by €12 billion (5.1 per cent) on the end of 2012 (Table 16.6). Tier 1 capital decreased by more than €13 billion, primarily in connection with the losses for the year. The goodwill impairments had no effect on the capital adequacy of the system because goodwill is deducted from capital for prudential purposes. Supplementary capital decreased by more than €4 billion, mainly with regard to hybrid and subordinate instruments. The deductions from total capital decreased by €5 billion and this partially offset the fall in the other capital items.

Table 16.6

Capital adequacy of Italian banks and banking groups (1)
(end-of-period data in millions of euros)

	Banking system		Largest groups (2)	
	2012	2013	2012	2013
Allocations to regulatory capital	2,737	1,885	1,235	192
Regulatory capital	234,932	222,945	137,643	129,556
Core tier 1 capital ratio *(%)*	10.6	10.5	10.9	10.4
Tier 1 capital ratio *(%)*	11.1	11.0	11.6	11.1
Total 1 capital ratio *(%)*	13.8	13.9	14.5	14.5
Financial leverage (3)	18	18	19	19
Excess capital	98,703	95,337	61,677	57,965

Sources: Consolidated supervisory reports for banking groups and individual supervisory reports for banks not belonging to a group.
(1) Excludes the Italian branches of foreign banks. The data for December 2012 take account of the debt securities issued in February 2013 by the Monte dei Paschi di Siena group and subscribed by the Ministry for the Economy and Finance. – (2) Five largest groups by total assets at December 2013. – (3) Ratio of total balance-sheet assets to tier 1 capital. Provisional data.

Risk-weighted assets continued to contract, falling by more than €100 billion or 6.2 per cent in 2013, above all owing to the 7.0 per cent decrease in assets. By contrast, the average weighting (the ratio of risk-weighted assets to unweighted assets) increased slightly.

Capital ratios. – In 2013 the banking system's capital ratios remained in line with those of the previous year. At the end of the year the core tier 1 ratio was 10.5 per cent and the tier 1 ratio 11.0 per cent; the total capital ratio rose slightly from 13.8 per cent in 2012 to 13.9 per cent in 2013.

Comparing the capital ratios of the five largest Italian banking groups with a set of large European banks that are part of the sample observed by the EBA for the publication of the key risk indicators, at the end of 2013 the Italian banks' core tier 1 ratio was below the European average (10.4 as against 11.6 per cent). The gap reflects the lower profitability of the Italian groups in 2013; in fact at the end of 2012 the capital ratios of the two groups of banks were basically in line. Financial leverage (the ratio of total assets, except intangible assets, to tier 1 capital) remained low by international standards, 18.5 as against 19.6 for the European banks.

The outlook for capital strengthening. – The new rules on banks' capital (Basel III), as set out in EU legislation (CRD4-CRR), have been in force since 1 January 2014; in Italy they will become fully effective in 2018. On the basis of Italian transitional provisions it is estimated that for the 15 largest Italian banking groups that participate in the comprehensive assessment the common equity tier 1 (CETI) ratio at the end of 2013 would have been 9.9 per cent, as against a core tier 1 ratio of 10.0 per cent.

On the basis of published balance-sheet data, at 31 March 2014 the CETI ratio of the five largest banking groups was 10.8 per cent, their tier 1 ratio was 11.1 per cent and their total capital ratio 14.6 per cent.

Italian banks continued their progress towards meeting the new capital requirements that will apply under Basel III when it is fully operational.

In the early months of 2014 ten banks, nine of which involved in the SSM comprehensive assessment, completed or announced capital increases amounting to nearly €11 billion. The consequent average improvement in the core tier 1 capital ratio of the 15 banks subject to the comprehensive assessment will be about one percentage point.

NON-BANK INTERMEDIARIES

The activity of non-bank intermediaries

The reorganization of the non-bank intermediaries sector continued in 2013. The economy's weakness, mergers aimed at improving operational efficiency and changes in the legislative framework led to a reduction in the number of firms providing investment and asset management services and loans (Table 16.1).

The profitability of asset management companies and investment firms improved, except for asset management companies specializing in real estate and private equity funds. The riskiness of the loans of financial companies entered in the special register continued to worsen, leading to a reduction in their profitability that was most pronounced for mutual loan guarantee consortiums (*confidi*).

Asset management companies. – In 2013 the sector's total net profit amounted to €605 million, an increase of 18.7 per cent on 2012 (Table 16.7) that was driven by the growth in net fee income deriving from that in assets under management (to €770 billion

Table 16.7

Asset management companies: income statement data
(millions of euros; per cent and percentage changes)

	2012		2013		Percentage change
	Amount	Per cent (1)	Amount	Per cent (1)	
Fees and commission income	4,021	225.9	4,793	246.6	19.2
Fees and commission expense	2,241	125.9	2,850	146.6	27.2
Gross operating profit (2)	**1,780**	**100.0**	**1,943**	**100.0**	**9.2**
Administrative expenses	1,083	60.9	1,056	54.3	-2.5
of which: staff costs	*589*	*33.1*	*571*	*29.4*	*-3.0*
Other operating expenses	42	2.4	45	2.3	6.8
Total operating expenses (3)	**1,178**	**66.2**	**1,157**	**59.5**	**-1.8**
Other operating income	89	5.0	95	4.9	6.7
Net operating profit	**690**	**38.8**	**881**	**45.3**	**27.5**
Result on financial operations	103	5.8	113	5.8	9.5
Result on ordinary activities	**794**	**44.6**	**994**	**51.1**	**25.2**
Taxes	284	15.9	389	20.0	36.8
Net profit (loss) for the year	**510**	**28.7**	**605**	**31.1**	**18.7**

Source: Supervisory reports.
(1) Amount as a percentage of gross operating profit. – (2) Individual and collective portfolio management. – (3) Includes value adjustments to tangible and intangible fixed assets.

at the end of 2013); operating expenses declined by 1.8 per cent. The number of companies that closed the year with a loss rose from 35 to 38, corresponding to 25 per cent of those entered in the register. Of the total loss €30 million (75 per cent) was accounted for by five companies. For asset management companies as a whole regulatory capital increased; the ratio of regulatory capital to the minimum capital required by law rose from 4.6 to 6.0.

Investment firms. – In 2013 investment firms' net profit increased by 31 per cent to €163 million. The cost/income ratio declined from 68 to 60 per cent.

Investment firms' own funds, consisting almost entirely of capital and reserves, increased by 11 per cent compared with the previous year, thanks in part to their profit allocation policies. Accordingly there was an increase in the coverage of the mainly operational risks assumed (the ratio of regulatory capital to the minimum capital required by law rose from 4.8 to 5.1).

Financial companies entered in the special register under Article 107 of the Consolidated Law on Banking. – In 2013 the flow of new loans granted by non-bank intermediaries (mainly companies engaged in leasing, factoring and consumer credit) remained basically unchanged compared with 2012 (-0.2 per cent). At the end of the year outstanding loans amounted to €195 billion. New disbursements fell by 29.1 per cent in the leasing sector, grew by 2.7 per cent in the consumer credit sector and rose by 2.2 per cent in the factoring sector.

Credit quality continued to deteriorate. The ratio of non-performing loans (bad debts, substandard loans, restructured loans and loans overdue or breaches of overdraft limits) to total loans rose by 2 percentage points to 15.8 per cent. The ratio was higher for leasing (21.8 per cent) than for factoring (6.5 per cent) and consumer credit (11.6 per cent).

Gross income fell by 9.8 per cent as a result of the contraction in fee income; there was also an increase of 32 per cent in net losses on loans. The number of loss-making intermediaries rose from 82 to 92. Regulatory capital increased by €0.7 billion, raising the coverage of the prudential requirements provided for by law (the ratio of regulatory capital to the minimum capital required by law rose slightly, to 1.6).

In 2013 the profitability of mutual loan-guarantee consortiums (*confidi*) entered in the special register was again affected by the difficulties of member firms. At the end of the year the guarantees granted amounted to €15.9 billion, those on non-performing loans were 27.6 per cent of the total (8.9 percentage points more than in 2012). Losses rose to €143 million, as against €73 million in 2012. Of the 60 *confidi* entered in the register 18 made a profit. The ratio of regulatory capital to risk-weighted assets for all the *confidi* was 15.1 per cent, a value that was in line with the risks to which the sector as a whole is exposed. There were nonetheless wide divergences between individual intermediaries and in some cases, especially among the intermediaries significantly dependent on public subsidies, capital was not adequate.

17. INSTITUTIONAL INVESTORS

Italian institutional investors raised fresh funds worth €52 billion in 2013, largely recouping the resources lost over the previous two years (Table 17.1), thanks in part to the increase in household savings in nominal terms. Funding through the banking channel expanded significantly. Assets under management grew by 5 per cent to €1.1 trillion, helped by the rise in the prices of portfolio assets. The proportion of Italian households' total financial assets under professional management, while edging up from 24 to 25 per cent, remains low by international standards.

For the first time since 2004, subscriptions of open-end Italian investment funds exceeded redemptions. Open-end foreign funds and closed-end funds continued to grow. Individually managed portfolios and life insurance products registered a net inflow of funds, after the outflow in 2012. The net flow of resources to the retirement saving sector – pension funds and individual retirement plans – remained stable. An increase in the number of members was offset by a reduction in the average amount of contributions paid in, owing to a further increase in the number of members who have suspended payments.

Table 17.1

Italian institutional investors: net funding and assets under management
(millions of euros and per cent)

	Net flows		End-of-period stocks			
	2012	2013 (1)	2012	2013 (1)	Percentage composition	
					2012	2013 (1)
Investment funds (2)	-10,744	16,337	189,391	205,818	13.8	14.3
Insurance companies (3)	4,313	29,593	486,299	514,362	35.5	35.8
Pension funds (4)	4,953	6,771	69,029	76,094	5.1	5.3
Individually managed portfolios	-11,473	22,935	624,190	640,004	45.6	44.6
Total	**-12,951**	**75,636**	**1,368,909**	**1,436,278**	**100.0**	**100.0**
Consolidated total (5)	**-16,717**	**51,946**	**1,040,249**	**1,096,160**	**–**	**–**
per cent of GDP	*-1.1*	*3.3*	*66.4*	*70.3*	–	–

Sources: Based on Bank of Italy, Covip and Ivass data.
(1) Provisional. – (2) Italian investment funds and SICAVs. – (3) For end-of-period stocks, technical provisions net of reinsurance reserves. Excludes Italian branches of EU insurance companies and includes Italian branches of non-EU insurance companies. – (4) For end-of-period stocks, balance-sheet assets. – (5) Net of investments in Italian collective investment undertakings by the other categories of intermediary, investments of insurance companies and pension funds in portfolios managed on an individual basis by asset management companies, and the technical provisions of insurance companies deriving from the management of open pension funds.

By comparison with the other main euro-area countries, the assets of Italian institutional investors are weighted more heavily towards public sector securities, while the proportion of private sector bonds, especially non-financial corporate issues, is modest. In fact, government securities made up 66 per cent of Italian insurance and pension fund portfolio assets in 2013, securities issued by resident banks and corporations accounted for 7 per cent, and the rest consisted of investment fund units, equities and foreign bonds (Table 17.2). According to ECB data, at the end of 2013 public sector securities accounted for 19 per cent of euro-area insurance and pension fund assets, while the portion consisting of securities of resident private sector issuers could be estimated at 14 per cent.

Table 17.2

Institutional investors' main financial assets (1)
(percentage shares)

	2012				2013			
	Investment funds (2)	Pension funds (3)	Insurance companies	Individually managed portfolios	Investment funds (2)	Pension funds (3)	Insurance companies	Individually managed portfolios
Government securities	49	55	66	41	47	55	67	41
of which: Italian	*72*	*50*	*92*	*81*	*72*	*50*	*92*	*80*
Bonds	17	11	24	26	18	11	23	25
of which: Italian	*26*	*20*	*34*	*20*	*28*	*14*	*35*	*20*
Shares	16	17	4	7	14	18	3	9
of which: Italian	*13*	*6*	*66*	*38*	*15*	*5*	*60*	*44*
Investment fund units	6	15	5	22	9	15	6	22
Other financial assets	12	1	1	5	12	1	1	3
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
in millions of euros	*129,483*	*60,025*	*362,665*	*624,190*	*143,290*	*67,519*	*394,053*	*640,004*

Sources: Bank of Italy, Covip and Ivass.
(1) Balance-sheet values. For insurance companies, investments covering the technical provisions of the non-life sector and of traditional products of the life sector (class C); for investment funds, individually managed portfolios and pension funds, assets under management. – (2) Italian harmonized funds. – (3) Occupational and open pension funds and funds instituted prior to the 1993 reform, including independent funds and employer-managed funds for which data on asset composition are available. For 2013, provisional data.

Investment funds

Funding and total assets. – The net assets of open-end investment funds distributed in Italy increased by 15 per cent in 2013 to €555 billion (Table 17.3). Net subscriptions of Italian funds turned positive (by €11 billion) after nearly a decade of uninterrupted outflows. Net funding by foreign funds increased to €36 billion, €16 billion of it accounted for by funds set up by Italian intermediaries. The increase in funding can be ascribed largely to placements via the banking network, whose share of the total increased by 9 percentage points to 70 per cent.

The flow of resources into open-end funds went to bond, equity and flexible funds, while money market funds registered net redemptions owing to the low yields of short-term securities. Nearly 45 per cent of gross funding during the year was accounted for by fixed maturity plans, paying regular coupons to investors and front loading sales commissions.

Table 17.3

Investment funds distributed in Italy: market structure (1)
(number of funds and millions of euros)

	Number of funds (2)		Net assets		Net funding (3)	
	2012	2013	2012	2013	2012	2013
			Italian open-end funds			
Harmonized open-end funds	555	637	129,483	143,290	-11,632	12,083
Equity	129	117	17,943	16,756	-2,749	-2,297
Balanced	36	41	8,079	7,591	-1,968	-619
Bond	196	237	71,566	78,555	-243	7,353
Money market	20	18	13,899	11,297	-3,779	-2,187
Flexible	174	224	17,997	29,091	-2,893	9,833
Non-harmonized open-end funds	188	150	20,310	20,733	-2,842	-884
Hedge funds (4)	99	81	6,225	5,077	-1,805	-1,782
of which: funds of funds	*80*	*64*	*5,079*	*4,119*	*-1,439*	*-1,141*
Other	89	69	14,085	15,656	-1,037	898
of which: funds of funds	*48*	*31*	*6,241*	*6,195*	*-701*	*83*
Total (a)	**743**	**787**	**149,793**	**164,023**	**-14,474**	**11,199**
			Foreign open-end funds (5)			
Foreign funds set up by Italian ntermediaries (6)	1,003	1,094	209,357	233,246	4,617	16,073
Foreign funds set up by foreign intermediaries	2,162	2,222	123,632	157,820	10,513	19,722
Total (b)	**3,165**	**3,316**	**333,989**	**391,066**	**15,130**	**35,795**
			Italian closed-end funds			
Closed-end securities funds	139	145	8,121	8,689	781	1,012
of which: reserved to qualified investors	*134*	*141*	*7,959*	*8,579*	*794*	*1,034*
Closed-end real estate funds	353	364	31,457	33,106	2,951	4,126
of which: reserved to qualified investors	*326*	*338*	*26,098*	*28,179*	*2,800*	*4,178*
Total (c)	**492**	**509**	**39,578**	**41,795**	**3,732**	**5,138**
Memorandum items:						
Total open-end funds (a+b)	3,908	4,103	482,802	555,089	655	46,993
Total Italian funds (a+c)	1,235	1,296	189,391	205,818	-10,744	16,337

Sources: Assogestioni and Bank of Italy.
(1) Includes SICAVs. – (2) For Italian funds, those in operation at the end of the year indicated. For foreign funds, those in which Italian investors purchased units. – (3) For closed-end funds, net funding is calculated as the difference between new subscription commitments received and redemptions made by asset management companies, as shown in supervisory reports. – (4) Side-pocket accounts are included in net assets and net funding; they are not included in the number of funds. – (5) Net assets and net funding refer to the value of units held and subscribed, respectively, by Italian investors. – (6) Funds run by management companies resident in Luxembourg or Ireland.

According to the European Fund and Asset Management Association, net funding by harmonized funds was also positive in the euro area overall. Counting funds set up in Luxembourg by companies belonging to foreign groups, it is estimated that at the end of the year assets under management by Italian, German and French intermediaries were equal to 7, 14 and 28 per cent, respectively, of those of all euro-area funds. The remainder consisted mostly of funds set up in Luxembourg by American, British and Swiss financial groups.

The total assets of closed-end Italian funds grew by 6 per cent to €42 billion, with real estate funds raising €4.1 billion of fresh resources and securities funds, mostly private equity funds, raising about €1 billion (Table 17.3).

Yields and fees. – The average yield of Italian harmonized funds, while remaining positive, declined from 8.2 per cent in 2012 to 4.9 per cent last year. Especially large gains were scored by equity funds specializing in advanced economies and by balanced funds; bond fund yields were more modest, reflecting lower yields on Italian government securities and losses on foreign bonds. Funds investing in emerging country equities lost 7.9 per cent.

Figure 17.1

Italian investment funds: total fees (1)
(per cent)

(1) Italian harmonized investment funds and SICAVs. Comprises charges debited to the fund for fees and commissions paid to management companies, depositary banks and other intermediaries. Simple average, calculated as the percentage ratio of total annual fees to average net assets for the year. For continuity with the data for 2001-02, securities brokerage commissions are excluded. The data for the last two years are provisional.

As a proportion of the average annual net assets of Italian harmonized investment funds, total fees (management and incentive fees, depositary bank fees, securities brokerage commissions and other, minor items) declined from 1.8 to 1.6 per cent (Figure 17.1), due to the fall in management fees. The incidence of incentive fees was practically unchanged from 2012. According to Borsa Italiana data, for exchange traded funds the average annual ratio of total fees to net assets remained virtually the same, at 0.4 per cent.

The Italian investment fund industry. – According to data supplied by the asset management trade association Assogestioni, the share of the total assets of open-end funds distributed in Italy attributable to funds controlled by Italian groups fell further, from 71 to 69 per cent.

The first three closed-end credit funds specializing in SME debt instruments started operations during the year, with total assets of about €50 million. Four funds specializing in purchasing properties serving as collateral for distressed bank loans were operational at the end of the year, with assets of €133 million.

In July Directive 2011/61/EU was transposed into Italian law. The directive lays down harmonized rules for alternative investment fund managers not governed by the UCITS4 directive (Directive 2009/65/EU) on open-end funds. Also in July, Regulations (EU) 345/2013 and 346/2013 went into effect, introducing common rules on venture capital and social entrepreneurship funds.

Individually managed portfolios

Funding and total assets. – In 2013 the individually managed portfolios of Italian banks, asset management companies and investment firms received net new resources of €23 billion, following a net outflow of €11 billion in 2012 (Table 17.1). The total value of assets under management rose from €624 billion to €640 billion, as the inflow of new resources and the rise in prices were partially offset by the transfer of the assets of the Allianz group to one of its foreign asset management affiliates.

Individually managed portfolios ascribable to Italian banking groups, either directly or through asset management subsidiaries, raised funds worth €8 billion. Those managed by non-bank intermediaries raised €16 billion. Banking groups' share of the total increased from 41 to 43 per cent.

According to Assogestioni data, net funding in Italy by foreign groups was also positive (€4 billion). Foreign groups' share of the total assets managed rose from 13 to 14 per cent.

Investments and yields. – In 2013 individually managed portfolios made substantial net purchases of Italian government securities (€12 billion) and foreign assets (€23 billion), chiefly bonds and investment fund units, while making net disposals of equities and Italian investment funds. At the end of the year government securities and investment fund units made up respectively 41 and 22 per cent of the total holdings, corporate bonds 25 per cent, and equities 8 per cent.

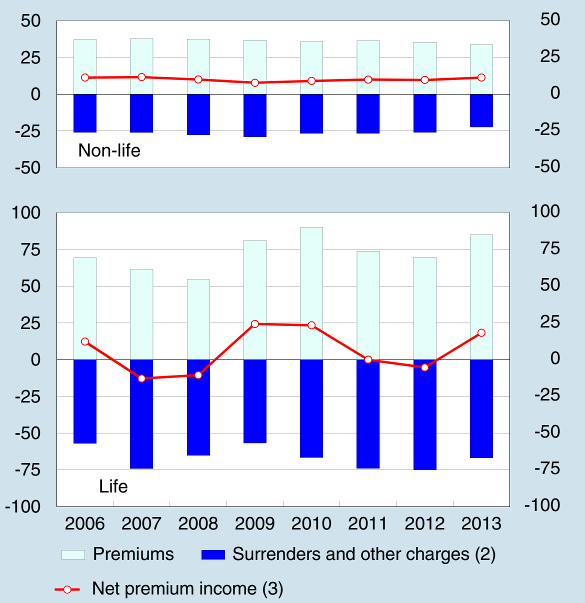
Italian portfolios' yield, measured by the percentage increase of net assets less funding and adjusted for the effects of the reorganization of the portfolios managed by the Allianz group, declined from 6.3 to 3.5 per cent, mostly because of lower bond market yields.

Insurance companies

Premiums and technical provisions. – Insurance technical provisions expanded by 6 per cent in 2013 to €514 billion (Table 17.1). Total premium income amounted to €30 billion, net of surrenders and other charges. The life sector had a positive net inflow of resources (€18 billion) after the outflow registered in 2012 (Figure 17.2). The gain was accounted for exclusively by traditional insurance products, such as with-profits policies (€23 billion), while unit- and index-linked policies suffered a net outflow of €5 billion. In the life sector, premiums expanded by 22 per cent while surrenders and other charges diminished by 11 per cent, reducing liquidity risk. Throughout the year the ratio of these costs to premiums stayed below 100 per cent, significantly lower than in the previous two years (see *Financial Stability Report,* No. 1, 2014). In the non-life sector net premium income increased from €10 billion to €11 billion, thanks for the most part to lower claims costs.

Figure 17.2

Insurance premium income (1)
(billions of euros)



Source: Ivass.
(1) In Italy. – (2) Charges in respect of claims, surrenders and payments falling due. – (3) Premiums net of surrenders and other charges.

Like investment funds, life insurance companies benefited from increased funding via the banking channel. The share of premium income deriving from policies distributed by bank and post office branches rose from 49 to 59 per cent, while the portions accounted for by agencies and financial salesmen declined. In the non-life sector, by contrast, the preponderant role of insurance agencies was confirmed (81 per cent of total premiums), while the share of bank and post office branches remained below 4 per cent.

Investments. – The composition of insurance companies' assets did not undergo significant variation compared with the previous year. Securities continue to account for the overwhelming majority of the assets held to cover technical provisions. Some 67 per cent of the financial portfolio was invested in government securities (mostly Italian); corporate bonds, investment funds and equities accounted for 23, 5 and 3 per cent respectively (Table 17.2).

At the end of the year Italian insurance companies' investments in unlisted securities, non-harmonized open-end investment funds and closed-end securities funds accounted for about 3 per cent of reserves, well within the regulatory ceiling.

Profitability. – ROE in the non-life sector jumped from 2 per cent in 2012 to 8 per cent last year, thanks to the positive contribution from the overall technical account. In the life sector, while diminishing, ROE remained positive (8 per cent), thanks partly to capital gains on portfolio securities. The solvency ratio in both sectors continued to be well above the regulatory minimum. The main market indicators highlight the progressive improvement in the outlook for the insurance industry, buoyed by the signs of economic recovery (see *Financial Stability Report,* No. 1, 2014).

Italy's insurance industry. – The number of Italian insurance companies remained practically unchanged in 2013 at 134, of which 41 operating exclusively in life insurance, 70 in non-life insurance and 23 in both sectors. At the end of the year 48 companies controlled by foreign groups, mostly German and French, were operating in Italy; they accounted for 24 per cent of total premiums, compared with 23 per cent in 2012. In addition, companies resident in another EU country had 93 units in Italy, while 963 foreign companies operated in Italy under the freedom to provide services.

The top five groups accounted for 73 per cent of non-life premiums and 65 per cent of life premiums, compared with 73 and 66 per cent in 2012. The Italian insurance industry remains concentrated by European standards.

According to data released by the European Insurance and Occupational Pensions Authority, Italy made up 11 per cent of the European insurance market in 2012. Units of foreign companies accounted for 7 per cent of the premiums written in Italy. The premium income of insurance subsidiaries resident in other European countries, most of them part of Italy's leading insurance group, amounted to 30 per cent of the total in 2013, about the same as the average over the past five years (31 per cent).

The presence of banks in the ownership structures of Italian insurance companies remained stable, while agreements for the distribution of insurance products via bank branches increased. At the end of the year 18 per cent of life insurance assets were ascribable to banking groups, whose presence in the non-life insurance sector is negligible.

Pension funds

Funding, assets and enrolments. – Net funding of the various supplementary pension schemes – pension funds and individual retirement plans – remained virtually unchanged at €7 billion. Resources under management grew by 12 per cent to €96 billion, thanks mostly to the good performance of the financial markets. Occupational pension funds accounted for 36 per cent of the total, pension funds set up before the 1993 reform for 31 per cent, individual retirement plans for 20 per cent, and open pension funds for 13 per cent (Table 17.4).

Last year the number of members of supplementary pension schemes rose by 6 per cent, to 6.2 million (Table 17.4). Enrolments in open pension funds and individual plans grew by 8 and 13 per cent respectively, while the number of participants in occupational pension funds declined by 1 per cent. Open funds and individual plans benefited from an increase in funding through agencies and bank branches. The enrolment rate for the entire work force rose from 22.7 to 24.3 per cent, but the number of members who temporarily suspended contributions increased further.

Returns and costs. – In 2013 the returns on pension funds were positive, thanks to the rising prices of financial assets. According to Covip data, the average return, net of management expenses and taxes, was 5.4 per cent for occupational funds and 8.1 per cent for open funds. Individual pension plans yielded around 12.2 per cent for unit-linked products and 3.8 per cent for products based on separate portfolios.

The costs borne by subscribers remained broadly unchanged. For a 35-year holding period, the synthetic cost indicator, which measures the reduction in the annual return due to the costs borne by the subscriber (except incentive fees), averaged 0.2 per cent for occupational pension funds, 1.0 per cent for open pension funds and 1.6 per cent for individual retirement plans.

Table 17.4

Supplementary pension schemes: market structure
(amounts in millions of euros)

	Number of funds (1)		Persons enrolled (2)		Total assets (3)	
	2012	2013 (4)	2012	2013 (4)	2012	2013 (4)
Pension schemes set up after the 1993 reform	98	98	2,883,684	2,935,136	40,499	46,782
Occupational pension funds	39	39	1,969,771	1,950,552	30,421	34,792
Open pension funds	59	59	913,913	984,584	10,078	11,990
Pension funds set up before the 1993 reform	361	330	662,162	654,627	28,530	29,312
Individual pension plans	76	81	2,329,651	2,639,148	16,086	19,513
Total	**535**	**509**	**5,828,727**	**6,203,763**	**85,115**	**95,607**

Sources: Based on Bank of Italy and Covip data.
(1) The data for individual pension plans and the total only include plans compliant with the requirements of Legislative Decree 252/2005. – (2) Includes Fondinps. Total is gross of possible double-counting except for that due to persons being enrolled simultaneously in individual pension plans compliant with Legislative Decree 252/2005 and in other individual pension plans. For funds set up before the 1993 reform, estimates. – (3) Includes Bank of Italy staff pension fund. Data on funds instituted prior to the 1993 reform comprise independent funds and employer-managed funds for which data on asset composition are available. – (4) Provisional data.

Investments. – At the end of 2013, more than half of pension fund portfolio assets (55 per cent) consisted of government securities. Corporate bonds accounted for 11 per cent, shares for 19 per cent and investment funds for 15 per cent, with the remainder in money market instruments and other financial assets (Table 17.2).

According to reports from the company set up to develop the market for pension funds (Mefop), 80 per cent of open pension funds and individual retirement plans and 30 per cent of occupational funds allow members to specify how their contributions are to be allotted among the various sub-funds. This option enables savers to achieve a portfolio allocation more in line with their own needs, but at the same time it requires the ability to make relatively complex financial choices. The Bank of Italy's 2012 survey of household income and wealth found that only 25 per cent of members of supplementary pension and retirement plans actually did subdivide their contributions.

THE GOVERNOR'S CONCLUDING REMARKS

Since last autumn, monetary policy in the euro area has been faced with a scenario of very low inflation inconsistent with the objective of price stability, in a setting of persistently modest and uneven economic growth. Work directed to the launch of the Single Supervisory Mechanism in November has been stepped up and the advance towards the completion of Banking Union has continued. Substantial headway has been made in the full operation of the single euro payments area. In Italy, the road out of the most acute phase of recession has been rocky at times owing to political uncertainty. The recovery has not found a firm footing, making it all the more urgent to proceed with reform action.

For the Bank of Italy, the most important change has been in ownership structure. Our commitment to modernizing the Bank's organization and management systems has been strengthened, and operating costs have been further curbed. The results for 2013 permit us to submit to this Shareholders' Meeting a proposal for the distribution of profits which, in addition to the allocation to the provision for general risks, calls for the assignment of adequate resources to reserves against the risks connected with the crisis. Taking market conditions into account, the proposal is for the distribution to shareholders of dividends amounting to €380 million, with the remaining €1.9 billion going to the State, in addition to taxes of €1.6 billion for the year.

The reform of the Bank of Italy's ownership structure, enacted by Parliament, involves technical complexities that have distracted public attention from the objectives that have been attained. The new arrangements maintain the model of shareholding centred on the financial industry, a feature shared with other major central banks. They reaffirm that shareholders have no power to influence the Bank in fulfilling its institutional functions. They supersede anachronistic and anomalous features that had developed over the decades. They make the process of profit distribution more transparent. And they clarify, circumscribing them, the shareholders' economic and equity rights. Shareholders continue to have no claim on the Bank's foreign exchange and gold reserves, whose public function is beyond question.

The value of the Bank's capital, which the law now sets at €7.5 billion (against 300 million lire established in 1936) is consistent with the estimate made by the Bank at the behest of the Government. This valuation, which had specified both a minimum and a maximum value, was endorsed by experts of undisputed competence and independence. The methods and the results were made public. The increase was accomplished by means of the transfer to capital of a portion of the statutory reserves, without affecting the Bank's own funds and at no cost to the public finances.

The reform avoids undue transfers of wealth to the benefit or detriment of the shareholders. Under the previous arrangement, in addition to dividends shareholders also received an amount proportional to the Bank's statutory reserves, which were bound to increase indefinitely owing to the automatic reinvestment of the return on them and the allocation to reserves of a part of each year's profits. Eliminating any claim to the statutory reserves, the new rules entitle the shareholders solely to a dividend drawn from net profits, up to a maximum of 6 per cent of the Bank's capital, hence not more than €450 million. Amounts increasing over time with no limit have been replaced by a dividend that is higher initially but subject to a fixed ceiling.

The concentration of shareholdings in the hands of the main banking groups fuelled the erroneous but persistent perception of possible interference in the Bank's performance of our institutional functions. The reform has broadened the potential shareholder base, capped single institutions' stakes at 3 per cent and instituted effective measures to foster a redistribution of shares to bring holdings down within that ceiling. We expect shareholders to act swiftly and on their own to dispose of their excess holdings. The rights associated with shareholding have now been defined with certainty, which favours trading in the shares and permits transparent price formation. We shall act to facilitate this process.

The actual amount of dividends will be decided, each year, subject to the results for the year and the Bank's capital needs. In order to foster compliance with the limit on shareholdings, the Bank may purchase its own shares temporarily; we shall avail ourselves of this option only if necessary and in such a way as in no case to entail any risk of loss.

The newly acquired clarity concerning the amount realizable from sales of Bank of Italy shares and the prospect of market transactions make it possible to include them in the regulatory capital of banks and insurance companies, which could have a modest positive effect on the supply of credit. The shares do not form part of the banks' initial capital for the asset quality review that the ECB is currently conducting together with national supervisors.

The Bank of Italy: an institution open to change

In performing its functions the Bank manages resources entrusted to it in the national and European interest, pursuing the express objective of efficiency. For some time now we have been engaged in an operation of reorganization and rationalization. The initiatives undertaken in this regard are described at length in our *Relazione sulla gestione e sulle attività* (report on operations and activities), which has a specific section dedicated to cost trends in the last few years.

Relying on new technology, we have imparted impetus to the modernization of the payment system and made a sizeable investment in the computerization of our branches. Since the mid-1990s this has resulted in a steady diminution in the resources allocated to cashier and state treasury services. The reorganization carried out between 2008 and 2010 reduced the number of branches from 97 to 58, of which 31 have been converted into more streamlined, specialized units. The yearly cost of the branch network has been cut by about 25 per cent in real terms. A reassessment, open to the contribution of representatives of the staff, is now under way on the best way to guarantee the Bank's efficient presence throughout the national territory.

At the start of this year our head office was reorganized. In place of the old functional areas, we now have eight directorates general, with autonomous management responsibilities. The directorates with responsibilities for human resources have been unified. Procurement has been assigned to a single specialized unit. The number of units assigned to administrative tasks has been reduced.

The total staff of the Bank of Italy, including the Italian Foreign Exchange Office personnel taken on by the Bank in 2008, has come down from a peak of over 10,000 in the early 1990s to 7,850 on the eve of the branch reform and to some 7,000 at present. Operating costs have been lowered by 14 per cent in real terms over the past four years.

We will continue along these lines, carefully reviewing every expenditure item. Our ongoing reform action has lowered costs and improved efficiency, maintaining high quality service and capitalizing on staff skills.

The reduction in resources employed and costs incurred has been achieved despite an increase in the number and complexity of the tasks performed. European integration, with the creation of the European Central Bank, has not resulted in any diminution of the responsibilities of the national authorities in the field of monetary policy or banking supervision; nor will it in the future with Banking Union.

The ECB's monetary policy decisions are taken collegially by the Governing Council, which consists of the governors of all the national central banks of the Eurosystem, acting in the European common interest and using for this purpose the research and analysis of their own institutions. The ECB's own preparatory analytical work is conducted through the intense activity of committees and working groups that bring together experts from the various national central banks.

Our capability for economic, statistical and legal research and analysis is also placed directly at the service of the nation, with advisory services and operational support to Parliament, the Government and other institutions, and with activity in international forums.

The implementation of monetary policy is delegated wholly to the national central banks: open market operations, the refinancing of banks, and the acquisition, management and valuation of the collateral they provide in exchange for liquidity.

The central banking function includes the production and distribution of banknotes. Our works print about 18 per cent of the euro area's paper money, with a peak last year of 1.36 billion notes. The Bank of Italy regulates and controls the activities of banks and other cash handlers, with off-site analysis and on-site inspections involving its branch network.

Our institution develops and manages the technological platforms and infrastructure for the clearing and settlement of domestic financial transactions. Together with the Bundesbank, we are entrusted with operating the euro area's TARGET2 gross settlement system, to be flanked by the TARGET2 Securities system for the settlement of securities trades in the euro area, now under development. The Bank of Italy is the Italian national authority competent for the realization of the single euro payments area for retail transactions. The Bank and its branch network also manage the state treasury service. We exercise oversight of the payment system and financial market infrastructure in cooperation with our European counterparts. Together with Consob, we oversee wholesale trading in government securities and post-trading activities in financial markets.

In November, with the launch of Banking Union, the Single Supervisory Mechanism created by the ECB and the national competent authorities of the participating EU member states will be operational. With the decisive contribution of the national authorities, the ECB will supervise banks identified as systemically important according to specific criteria, such as size. For Italy, this group should include nearly all the fifteen intermediaries currently subjected to the comprehensive assessment. The national authorities will maintain direct supervision over all the other banks – in Italy they number around 600 – according to common standards and methodologies to ensure uniform supervisory action.

The Supervisory Board, which is charged with preparing decisions to submit to the ECB Governing Council, is already operational. It consists of representatives of the ECB and of the national supervisory authorities, including the Bank of Italy. Committees in which experts from individual countries can deal with issues of common interest are already active.

The quality of European banking supervision will depend strictly on the contribution of the authorities that have had the most experience in this field. We are now actively working to ensure the adoption of best practices in the Single Supervisory Mechanism, collaborating within the European Banking Authority on the design of a Single Rulebook to ensure a level playing field. In order to participate effectively in the decision-making process of European banking supervision, we shall extend our analysis to the banking industry and the major banks in other countries.

The launch of the Single Supervisory Mechanism will affect the daily activities of all the authorities involved. Off-site controls on systemically important banks will now be carried out by teams consisting of both ECB and national personnel. Inspections will be conducted by groups in which national staff may be flanked by members from other countries.

The Bank of Italy is also entrusted with the prudential supervision of securities firms and asset management companies, financial companies, payment institutions and electronic money institutions. The Bank has full jurisdiction over all intermediaries, including banks, in matters of consumer protection and transparency. It is engaged in the promotion of better financial awareness on the part of the general public, in particular in schools. It will continue to provide assistance to the panels of the Banking Ombudsman for dispute resolution. Our branches contribute significantly to these activities.

Financial stability requires a macroprudential commitment. In this context the Bank is a member of the European Systemic Risk Board and participates in the work of the Financial Stability Board and the G20 to complete a series of reforms to make the financial system sounder and more resilient.

We have intensified our efforts to combat money laundering and terrorist financing, both within our directorate general for financial supervision and through the Financial Intelligence Unit, an autonomously managed body instituted within the Bank of Italy, which regulates the Unit's operation and provides the necessary human, financial and technological resources.

In January 2013 the new insurance supervisory authority (Ivass) was constituted, in close relation with banking and financial supervision. It is chaired ex officio by the Senior Deputy Governor of the Bank of Italy, who runs it together with two Councillors. Measures with significant external implications are decided on and issued by the Governing Board of the Bank enlarged to include the two Councillors. Cooperation between the operational structures of the two institutions is extensive and growing.

The public functions assigned to us, which I felt it was appropriate to recall here today, require adequate technology and, even more, high quality human resources. The competence, motivation and commitment of individual staff members are essential to effective action and to the Bank's reputation. We are taking steps to ensure that the Bank of Italy maintains its ability to attract talented young people who have successfully completed rigorous courses of study. We are well aware that we can still improve the organization of work, through reconsideration of the assignments and the professional development of individual employees, in fruitful dialogue with the trade unions. I join the Board of Directors and the Governing Board in thanking the staff of the Bank for the capability, spirit and dedication with which they perform their duties.

The exit from the sovereign debt crisis: monetary policy, Europe, Italy

Financial conditions have improved greatly in the euro area since last year. After Ireland, Greece and Portugal too are once again issuing government securities. Yields on Italy's ten-year BTPs have fallen to 3.0 per cent, less than half the peak figure recorded in November 2011. The yield spread with German securities is now around 160 basis points; it had hit 550 points in November 2011 and was still 470 points in July 2012.

The contribution of monetary policy has been crucial: during the most acute stages of the crisis it prevented the situation from precipitating; it helped allay investors' fears for the integrity of the Economic and Monetary Union; it accompanied the implementation of important reforms at national level and in European governance.

Since last summer there have been large inflows of capital from the emerging economies, mainly following the announcement by the Federal Reserve of its plan for tapering monetary accommodation. The resulting downward pressure on long-term euro interest rates could be transient; less expansionary monetary policy in the United States could provoke a rebound in global yields. Volatility on the financial markets in the advanced economies has subsided to well below the historical norm, reaching levels that in the past sometimes preceded rapid changes in the orientation of investors. The fluctuations in government securities yields in recent weeks remind us just how sensitive the markets can be to any signs of uncertainty.

The consolidation of the public finances in the countries hit by the crisis, necessary per se and imperative to eliminate any doubts about debt sustainability, constitutes a guarantee against the rekindling of tensions on the sovereign debt markets in the euro area. However, the combined costs of the recession and restrictive budgetary policies have been high. The economy and, in particular, the labour market remain fragile.

Structural reforms make our economies more resilient to future shocks, but it will take time for them to yield their full fruits. Income support for those worst hit by the crisis and re-employment mechanisms for workers forced out of traditional production work can make a contribution. In addition to expansionary policies in the countries where the public finances allow it, concerted action at European level could help to boost investment and consumption demand. The opportunities provided by favourable external conditions must not be missed; the conditions for transforming the capital now available into lasting productive investment have to be guaranteed.

Monetary policy and Europe

Monetary policy in the euro area now faces challenges somewhat different from those addressed over the last two years. Economic activity returned to growth in 2013, but only in part of the euro area and at very uneven speeds. The most recent data confirm this. Credit market conditions remain difficult. Financial fragmentation along national lines has diminished but it has not disappeared. Above all, there has been a sharp reduction in consumer price inflation; since the middle of last year the rate of inflation has been well below the ECB Governing Council's definition of price stability.

During 2013 we lowered the official interest rates twice, in May and in November, bringing the cost of the main refinancing operations to an all-time low of 0.25 per cent. In July we began to provide explicit indications of our monetary policy stance, announcing that the official interest rates would remain at or below the then current level for an extended period, in consideration of the outlook for inflation, the weakness of the real economy, and monetary and credit dynamics. This forward guidance attenuated the volatility of short-term interest rates.

The rapidity of the fall in inflation has surprised the main forecasters, who have revised their short- and medium-term expectations downwards. This pattern has been more pronounced in the countries directly hit by the sovereign debt crisis, but it is common to the entire euro area. It reflects not only the fall in energy prices, compounded by the appreciation of the euro, but also the persistent weakness of the economy. Core inflation has fallen to its lowest levels since the introduction of the single currency.

Just like excessively high rates of inflation – and we can still well remember how difficult it was to overcome that problem more than twenty years ago – prices that are growing too slowly are also detrimental to financial stability, especially when public and private debt is high and growth is weak. Excessively low inflation must be countered with equal firmness, also to prevent it from being incorporated into medium-term expectations. The formation of expectations is not a linear process: even large changes can materialize very quickly, discontinuously.

Since July 2012 the euro has appreciated by an average of 9 per cent against a basket of other currencies; against the dollar it has gained 12 per cent. The appreciation began following the announcement of Outright Monetary Transactions, which allayed fears about the reversibility of the single currency that had turned investors away from financial assets issued in some euro-area countries. The exchange rate is not in itself a monetary policy target, but at this stage the euro's appreciation has compressed consumer price inflation, both directly, by reducing the prices of imported goods, and indirectly, by increasing competitive pressure on domestic products.

Eurosystem inflation projections will be made public on 5 June. According to those published in March by the ECB, inflation is expected to remain well below 2 per cent over the next two years. This is not consistent with our definition of price stability. If this pattern is confirmed, the Governing Council is determined to act, even with unconventional policies, to ensure that in the medium term price developments do not diverge from the desired path.

Albeit in a situation of emergency, and not without some hesitancy, European policies have achieved significant progress during the crisis: the strengthening of fiscal rules, the extension of multilateral surveillance to macroeconomic imbalances other than those of public finances, the establishment of common funds for financial assistance to countries in difficulty, and the launch of the Single Supervisory Mechanism.

As I have observed on other occasions, the euro is a currency without a state and suffers from this deficiency. To complete the journey towards integration other essential elements of sovereignty need to be shared; Banking Union, now being implemented, should be followed by the creation of a true common budget. Designing instruments that will make it possible to intervene in support of economic growth and better public welfare would help the European Union to regain the consensus that has been partially lost.

In the shorter term, the central bank can support domestic demand through the pursuit of monetary stability. But the return to sustained and balanced growth requires broader economic policy action at European level. Measures must be taken immediately to speed up the creation of infrastructure, both tangible and intangible, indispensable to the formation of a true single market. Joint intervention would help to give market expectations a positive orientation.

The Italian economy

In Italy, the long recession in progress since 2008 with only a brief interruption came to a halt at the end of last year, mainly thanks to foreign demand and to the reduced need for fiscal adjustment. A contribution came from the accelerated payment of general government commercial debts. A real recovery is struggling to get under way, however. The gradual improvement in expectations has been slow to translate into a solid upturn in economic activity.

The recession has left a burdensome legacy. Many Italian companies have managed to safeguard their shares of foreign markets and some have increased them; the current account is back in surplus, even on a cyclically adjusted basis. But the contraction in domestic activity has been dramatic: industrial production has shrunk by 25 per cent overall. In the last quarter of 2013, while exports were almost back to the same level as at the end of 2007, household consumption was still down by about 8 per cent and investment by 26 per cent, with a capacity loss in manufacturing of approximately 15 per cent. Although there are signs that confidence is picking up, the need to compensate for the erosion of accumulated savings and uncertainty about prospective income in the medium to long term will continue to weigh on household consumption. Household spending can benefit from the recently approved tax cuts, but it will not become the driving force of the recovery without an enduring increase in employment.

The recession has had a heavy impact on the number of persons in employment and hence on household income. Between 2007 and 2013 employment fell by more than a million, with almost all of the contraction in industry; the average number of hours worked also decreased. The unemployment rate has more than doubled compared with the low point of 2007, reaching 12.7 per cent in March. The supply of jobs will only begin to rise slowly; usually the first variable to react to an increase in output is the number of hours worked per employee.

We must not underestimate the risk that a further lengthening of the duration of unemployment – and there are signs of this particularly in the South and among the younger population – may erode individual skills and know-how and distance them from those that firms require. In the past, deep recessions have been associated with extensive restructuring of the productive system that has resulted in the introduction of new labour-saving technologies and organizational models. But the crisis can be the occasion for our firms to carry out and extend what up to now has often been missing: a profound renewal of the mode of production in connection with the digital revolution, which can give life to new forms of enterprise and employment in new fields of activity.

Productivity gains and employment growth can go hand in hand if domestic demand revives. The key is the growth of fixed investment, which forms the linkage between demand and supply. On the one hand, given the right external conditions, investment is the demand component that reacts most promptly to changes in expectations, while on the other it bolsters supply capacity by exploiting technical progress and responding to the globalization of markets and production processes.

The ratio of gross investment to GDP has fallen by 4 percentage points since 2007, reaching a post-war low of 17 per cent in 2013. The difficulty of many firms in accessing bank credit has been a factor. But it is above all the widespread uncertainty over the prospects for demand growth and the orientation of economic policies that is responsible for postponements and cutbacks of plant restructuring and expansion plans.

Towards the end of 2013 opinions of the conditions for investment became more favourable, especially among the largest companies. In manufacturing industry, spending plans suggest a stabilization this year, thanks to the support of the capital goods component. These first positive signs can strengthen if the business environment improves.

Economic policy measures that act on both the demand and the supply side in a comprehensive, consistent framework can support economic activity in the short term and lend strength to the reform project. If that project is vast, vigorous and credible, it can alter the course of expectations, reinforcing the growth of investment, employment and consumption. The response to the acute phase of the crisis was notable, but the results have suffered from the fragmentary nature of the interventions and from the incomplete implementation of many of the measures adopted, in some cases owing to successive, at times substantial revisions made to them soon after.

It is important to build on the foundation of what has already been done. For example, thanks to the measures in the service sector, the OECD indicators show that Italy is now more open to competition. But at the end of last year only half of the implementing measures envisaged by the 69 reform laws passed between November 2011 and April 2013 had been issued. In the field of taxation, the rapid implementation of the enabling act can ensure greater certainty in the application of rules and sanctions and make the fight against tax evasion and avoidance more effective and closely targeted.

The main shortcomings of our economic system and the prospects for reform, which are also the subject of the National Programme that the Government presented in April, are examined in a chapter of this year's Report. The list of areas requiring action is long; among the most urgent interventions are those to safeguard legality and efficiency in the public administration.

Corruption, criminal activity and tax evasion not only undermine the community but also distort the behaviour of economic agents and market prices, reduce the effectiveness of governmental action, increase the tax burden on those who do their duty, and compress productive investment and job creation. A well-functioning public administration improves the operation of markets and competition, reduces firms' costs, and is reflected in the quality and cost of public services and thus on the tax burden. The efficacy of the reforms depends on it.

Restrictive regulation and a legal and institutional environment that is unfriendly to entrepreneurial activity hamper the transfer of resources towards the more efficient firms and sectors and the growth of productivity. The same elements also affect the Italian economy's ability to attract investment from abroad, which is very poor compared with other economies, ultimately curbing the diffusion of innovative technologies and managerial practices. For potential investors, both Italian and foreign, the lengthiness and complexity of administrative procedures pose the most significant obstacle.

In many cases the benefits of reforms are inevitably deferred. This is true, for example, of interventions on the education and training system, a subject to which we have dedicated another chapter of the Report. But this is no reason to postpone action. The level of education and skills on which the Italian productive economy can count is inadequate: a recent OECD survey ranks Italy last for functional literacy and next to last for numeracy; the gap with the average of the other countries is also found among the younger age groups and increases with the level of educational qualification.

Important progress has been made in adjusting the public finances. The deficit is equal to 3 per cent of GDP, below the European average. With Germany, Italy has the highest primary surplus in Europe, and Italy is close to achieving structural budget balance. The reforms of the past years have reduced the pressure of demographic trends on public expenditure, pressure which instead remains strong in many other countries of the Union.

The lowering of the ratio of debt to GDP remains the ineluctable challenge for our country; its speed depends on a return to stable, rapid growth. Economic growth and budgetary balance can only be pursued in tandem.

The results won with so much sacrifice must not be squandered. They make it possible to undertake actions in support of growth, for example by continuing to shorten the payment times of general government entities and to reduce the tax wedge on labour. The budgetary rules that we have agreed in Europe and transposed into our national law are aimed at ensuring the long-term sustainability of the public finances. The margins of flexibility that they afford can be exploited as part of a cogent strategy of structural reforms directed at clear and credible objectives.

Careful action to recoup efficiency in the public administration, conducted as part of the spending review, can assist a reallocation of expenditure to the benefit of the more productive items. This objective should be accompanied on the revenue side by greater reliance on the less distortionary items at both central and local level.

The endowment of infrastructure, in which Italy is inferior to the other main European countries, influences firms' productivity, their choices of where to locate and the quality of life of the population. The delays accumulated in the past decades reflect not so much insufficient resources as inefficiency in their use, but in the last four years public investment expenditure has diminished by nearly 30 per cent. European resources and private capital can contribute in greater measure to the financing of infrastructure and territorial protection, with benefits for the building industry, which has been hit especially hard by the recession.

Banks, credit, supervision

In Italy, more than in other countries, the banks play a central role in financing the economy. Their business is concentrated in the traditional intermediation of savings, mostly within the country. This is one reason why they withstood the initial impact of the crisis, which originated in foreign markets and speculative financial products. In recent years, however, they have been badly hit by the protracted recession and the sovereign debt crisis. Our Annual Report details the role of the banks in the intermediation of Italians' savings; the Report on Operations and Activities describes the supervisory action of the Bank of Italy.

Bank loans to households and firms at the end of 2013 exceeded €1.4 trillion and 90 per cent of gross domestic product. Credit accounts for almost two thirds of firms' financial debt. More than one third of households' financial wealth is invested in bank deposits and bonds.

In recent years the exceptional decline in GDP has undermined the soundness of many firms, increasing their debt-service burden. The repercussions for banks have been very serious: loan losses accumulated since 2008 amount to €130 billion; those in the past two years have absorbed almost all of banks' operating profits.

Banks have stemmed the deterioration of profitability by curbing costs. Between 2008 and 2013 the number of employees in banking was reduced by 30,000 and 2,400 branches were closed. The cost-to-income ratio was lowered from 66.7 to 62.1 per cent.

Following the collapse of funding on the international markets in autumn 2011, extensive resort to the Eurosystem's three-year refinancing operations enabled Italian banks to sustain a volume of lending to the economy that exceeded domestic funding and to meet the future redemption of bonds previously placed in foreign markets.

With large-scale purchases of government securities the banks built up resources to withstand new liquidity crises, at a time when the increase in sovereign risk was driving foreign investors away from Italian markets. Interest income and capital gains on these securities partly offset the heavy losses on loans to households and firms. In mid-2013, with the return to orderly market conditions, banks began to sell off government debt.

The financing of the economy

Total credit to the Italian economy is shrinking. But the aggregate data mask different trends for the various categories of borrower. Given the persistent uncertainty about the timing and strength of the recovery, businesses have lowered their demand for credit. The largest firms have increased their recourse to the bond market. In 2013 gross placements by Italian issuers were close to €40 billion, almost twice the amount recorded in the years preceding the crisis.

Credit supply restrictions are hardest on small and medium-sized firms, generally more risky and now especially weakened by the recession. In this setting the funding difficulties of firms with good growth opportunities but no direct access to the capital markets are a cause for concern.

In the coming weeks the Bank of Italy will adopt measures to improve banks' liquidity further, thereby facilitating lending to small and medium-sized firms. The range of loans eligible as collateral for Eurosystem refinancing will be extended. Innovations in the characteristics of contracts will enable banks to pledge new types of loan such as credit lines that are widespread among small firms. Banks will be allowed to use loan portfolios with more flexible collateral management and with lower haircuts; it will be possible to include mortgage loans to households.

The chief obstacle to the supply of financing continues to be credit risk. Non-performing bank loans, net of provisions, have risen to 10.0 per cent of total lending; bad debts alone account for 4.0 per cent. At a time when banks are deeply concerned about borrowers' soundness and prospects, the dearth of credit has been alleviated by the granting of government guarantees.

In 2013 the Central Guarantee Fund accepted more than 77,000 applications to guarantee loans amounting to almost €11 billion. Recent measures have expanded the range of potential beneficiaries of the Fund and more than doubled, compared with the previous period, the resources allocated for the three years 2014-16. A portion of these resources has nevertheless been earmarked for purposes other than those originally envisaged. They must not be dispersed: the piecemeal nature of the interventions risks reducing the effectiveness of an instrument whose purpose must continue to be to facilitate access to credit for small and medium-sized firms that have been weakened by the recession but are fundamentally sound.

A recovery in the securitizations market could help reactivate the flow of credit to the economy. Enabling investors to make an informed assessment of these transactions requires rules that increase their transparency and standardization, and distinguish between complex and simple products in favour of the latter. The European Commission recently announced initiatives that move in this direction.

Italian firms' indebtedness and dependence on bank credit are signs of their financial vulnerability. With almost €1.3 trillion in financial debt and €1.6 trillion in net equity, Italian firms' overall leverage is 44 per cent; bank loans account for 64 per cent of the total debt. For the euro area these ratios are considerably lower, averaging 39 and 46 per cent respectively.

A larger endowment of equity capital could facilitate firms' access to credit. This, together with greater diversification of the sources of external funding, would make them stronger. Bringing financial leverage into line with the European average would require a capital increase of around €200 billion and an equal reduction in debt: this is an ambitious objective but one within the reach of Italian firms in the medium term. Structural reforms to kick-start growth would attract equity-type funds from external investors and encourage entrepreneurs to invest their own resources, thereby being the first to show confidence in their firms' prospects.

Firms' funding model reflects the structural traits of Italy's economy, such as the modest size and family-based ownership of businesses. Entrepreneurs are reluctant to admit new partners or to raise funds directly on the market, partly owing to a taxation system that has long done little to favour equity capital.

The capital-building incentive introduced by Decree Law 201/2011 (the Allowance for Corporate Equity), reinforced by the 2014 Stability Law, corrects the tax disadvantage of equity with respect to debt. It represents an important opportunity for all firms; it is estimated that almost 40 per cent of firms with 20 or more workers increased their capital in 2012-13.

Supervisory action

In 2013 the Bank of Italy continued the verification of the adequacy of loan loss provisions that we initiated in mid-2012. The supervisory authority continued to call on banks to strengthen their capital in order to ensure their solidity.

At times our interventions have been harshly criticized. We believe that they were decisive first to preserve and then to reinforce investors' confidence in the banking system's ability to withstand the impact of the crisis. Thanks in part to this action, in 2013, notwithstanding the sharp increase in non-performing loans, the coverage ratio on them went up from 39 to 42 per cent.

Core tier 1 capital rose from 7.1 per cent of risk-weighted assets in 2008 to 10.5 per cent in 2013; substantial issues of new equity and retained profits contributed nearly €60 billion to the increase in capital. Capital strengthening proceeds: in the first five months of this year ten banking groups made or announced capital increases amounting to €11 billion; for the banks subject to the comprehensive assessment carried out at European level this will raise capital ratios by around one percentage point.

Capital strengthening has been achieved almost entirely with private capital. The Italian State's contribution has been minimal; it reached €4.8 billion in the first quarter of 2013 (0.3 per cent of GDP), a level far below those of most of the other European countries; it will be wiped out by the repayment of the State's loan to Monte dei Paschi di Siena, of which €3 billion has already been authorized by the Bank of Italy. Overall, public support for the banks has generated substantial net gains for the Italian State.

The banking foundations have participated in capital-raising operations, thereby contributing to the solidity of the banking system in the most difficult phase; sometimes, as a matter of choice or out of necessity, they have reduced the share of capital they owned. The inflows of resources connected with investors' renewed confidence in Italy's prospects provide an opportunity for banks to strengthen their capital bases and for foundations to further diversify their assets. At the same time it is necessary, as I have indicated on several occasions, to reinforce the separation between foundations and banks by prohibiting persons from moving between the governing bodies of foundations and banks and extending the ban on control to cases in which it is exercised de facto, even jointly with other shareholders.

For many small and medium-sized banks close relationships with their home territory are a source of stability, which has a beneficial effect on the local economy. However, a misguided interpretation of these relationships can distort the disbursement of credit, thereby jeopardizing the soundness of banks' balance sheets and the efficient allocation of resources. Cases of this kind become more likely during prolonged recessions, such as the one we have passed through. We are working to persuade banks to strengthen their operational, organizational and corporate governance safeguards in order to prevent credit relationships with customers from degenerating and to take remedial action when they do.

Taking account of the numerous suggestions deriving from public consultation, the Bank of Italy has recently issued regulations on bank governance. The rules foster the correct exercise of the functions of strategic guidance, management and control, enhance the functionality of decision-making chains, exert downward pressure on costs, and make directors more accountable. Some of the rules are immediately applicable, others could require banks to make changes to their bylaws, to be implemented without delay. The innovations introduced for cooperative banks encourage shareholders to attend shareholders' meetings, foster internal debate and facilitate the raising of equity capital.

Bank crises are often associated with weaknesses in corporate governance systems, which sometimes breed episodes of malfeasance. The Bank of Italy tackled 11 new cases of intermediaries in difficulty in 2013 and another six in the first four months of this year. The banks currently under special administration are small or medium-sized; they account for about 1 per cent of the total assets of the banking system. Since 2009, ten intermediaries have been placed directly in liquidation and 55 under special administration; about half the crisis procedures that have been completed saw the banks return to ordinary operations, including by way of takeovers. The continuity of customer services was guaranteed together with the protection of depositors.

In the last two years 340 inspections were carried out at banks that accounted for 80 per cent of the banking system's total assets. In 63 cases serious shortcomings were found in banks' corporate governance. In 45 of these there were irregularities of a possibly criminal nature that were promptly reported to the judicial authorities. With the proper distinction of functions and instruments, cooperation with the magistracy is intense.

Where necessary the Bank of Italy requests banks to radically renew their board of directors, strengthen their organizational structure and capital base, and draw up new business plans. This makes it possible to avoid recourse to crisis procedures, which might be required if the problems found persisted. Our action would become even more effective with the attribution of the power to remove a bank's directors when necessary and on the basis of convincing evidence, as is envisaged in the draft law for the transposition of the European Capital Requirements Directive.

Italy's large banks, as well as granting loans, often hold equity interests in non-financial firms. Such shareholdings must not distort lending decisions or delay the emergence of borrowers' difficulties. The risks associated with these relationships, in the same way as for those deriving from dealings with counterparties closely related to banks, must be carefully monitored by the latter's governing bodies. The Bank of Italy cannot and must not assess individual lending decisions in advance, but lays down rules for related-party transactions and checks that they are complied with. The rules are intended to prevent allocative distortions and minimize conflicts of interest; they establish quantitative limits to risk, strengthened decision-making procedures, organizational safeguards and obligations to inform the supervisory authority.

Banking Union and the implementation of the Single Supervisory Mechanism

The ongoing construction of the Single Supervisory Mechanism is driving forward the Banking Union project, one aim of which is to counter the fragmentation of the euro area's financial markets. The new European supervisory system shares the basic principles of the approach followed in Italy: emphasis on close integration of on- and off-site controls, quantitative and qualitative assessment of risks, and close linkage between the results of analyses and remedial action.

The Single Resolution Mechanism for crises will come into operation in 2015. The handling of banking crises will involve numerous national and European institutions participating in the context of a Single Resolution Board. Provision is made for recourse to a fund made up of contributions paid in by the banks themselves. Even though the decision-making process appears complex and the pooled resources limited, the compromise reached is a further step towards the completion of Banking Union.

Together with the ECB and the other national supervisory authorities, we are now conducting the comprehensive assessment of the most important euro-area banks. The aim of the exercise is to increase the transparency and reliability of banks' balance sheets and increase the market's confidence in the soundness of the European banking system, thereby contributing to the recovery of lending to the economy. The key aspects of the comprehensive assessment are an asset quality review and a stress test of the banks' balance sheets.

The exercise under way is of unprecedented complexity, both in terms of the volume of activities to be carried out and for their concentration in time. It considers a wide range of bank assets, going from loans to households and firms, to government securities and complex financial instruments, so-called third-level assets.

In the cases where the assessment shows that a bank needs to raise its capital ratios, this can be done in several ways, ranging from not distributing profits to the disposal of non-strategic assets, the cutting of costs and the issue of new equity. The manner of carrying out these interventions and their timing will be determined in relation to the nature of the capital weakness and according to whether it derived from value adjustments to balance-sheet items or from the results of stress tests. Capital-raising measures will have to be agreed with the national supervisory authorities.

The credibility of the exercise and its success in restoring confidence in the soundness of the European banking system require that instruments of public intervention be available to act as financial backstops, as established by the European Council in June 2013 and reaffirmed by the Ecofin Council in November. They will have to conform with the basic principles of national and European law, with the ultimate objective of ensuring financial stability.

The results of the comprehensive assessment of banks' balance sheets will be published in October. The exercise is already making a contribution to the strengthening of banks' capital bases. The effects on the supply of credit in the short term will need to be carefully monitored. In the longer run, the positive relationship between banks' capital and growth in lending will be reinforced.

The challenges immediately ahead

In the closing months of last year the flow of new bad debts began to diminish. However, historical experience teaches that economic recovery will improve credit quality only gradually, and with a lag. To cope with the additional loan loss provisions that will be necessary, the banking system will have to increase its efficiency further.

The rationalization of the branch network is beginning to make a dent in operating costs, but there is still ample room for improvement in the use of technology. The European-wide intensification of competition in the banking market that will stem from the shift to single supervision will stimulate a rethinking of banks' business models, organization and distribution methods. The structural measures on banking now under discussion at European level can work in the same direction, with effects circumscribed to a limited number of banks. Mergers based on solid economic foundations and market logic can facilitate the recouping of efficiency. In considering proposed mergers, the Bank of Italy weighs their compliance with the regulations and with the standards of sound and prudent management.

Banks must reduce the volume of non-performing loans in order to free up the resources needed to finance the economy. There is growing interest in these assets on the part of specialized investors, who are now willing to pay higher prices than in the past thanks to the easing of the sovereign debt crisis and the reduction in risk premiums. The revival of this market also benefits from the increase in provisioning, which translates into a decline in the prices at which banks are prepared to dispose of these loans. The market is also gaining from the recent changes in the tax treatment of loan losses, which have reduced – but not eliminated – Italy's strong fiscal disincentives to the prudent valuation of risk.

Some disposals of non-performing assets have already taken place, and others may be well-received by national and international investors. Several large banks are acting to rationalize their management of non-performing loans by creating special units for the purpose. The need to shrink the stock of impaired loans arises also for smaller banks, which could find it hard to develop autonomous strategies for dealing with them.

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The year 2013 was another trying one for Europe and for the Italian economy, harder than had been predicted twelve months back. The exit from the recession remains laborious, the recovery fragile and uncertain. In Italy, as elsewhere, there is no lack of positive signs: capital inflows are growing, consumer confidence is strengthening, manufacturing orders are rising. In order to consolidate these gains, it is necessary to build on what has been done so far, moving vigorously ahead on the path of reform and promoting the drive for efficiency in public services as in the private sector. We also know that gains in productivity, stagnant for too long, must be accompanied by the expansion of demand, and hence the growth of household income, which has to be sustained by the formation of new jobs. Investment – private and public, Italian and European – is essential.

The union of the nations of Europe, whose fullest expression to date is the euro, is a work in progress that the peoples of the continent must be able to believe in, to recognize as the source of peace and prosperity. What is asked of the institutions is policies to make the European construction robust but that also respond to the challenges of our time. We are all citizens of this Europe, and together we must make it grow – and not only in economic terms. In the face of public opinion that is divided, not always well informed, the need is for profoundly European policies, implemented within the limits of national responsibilities but in the spirit of cooperation. Monetary policy and Banking Union are two key areas in which the Bank of Italy is intensely engaged.

In monetary management the primary objective is price stability. Monetary policy as such cannot stimulate productivity or determine growth paths. But these are premised upon stable monetary conditions, which the Governing Council of the ECB is striving to ensure. As for banks, which are now subject to common rules and single supervision, in Italy they remain the fundamental pillar for financing the economy. For them to continue raising capital and borrowing in the markets, which is indispensable to the performance in full of their intermediation function, their governance must be strengthened, integrity of conduct must be guaranteed, and profitability must be increased. The possible repercussions of taxation and other burdens on their ability to compete in an integrated financial market must be weighed carefully.

The recovery of the economy and renewed creation of jobs depend on the ability to finance deserving investment projects. Even in the present difficult phase, this is the fundamental task to be performed by bank credit, with the crucial support of capital invested directly in firms and resources procured in the market. Compliance with the rules and transparent conduct are essential conditions, and we shall continue to monitor them.

The path to recovery – economic and beyond – will be neither short nor easy. Uncertainty is intrinsic to the rapid transition towards a radically different world, more open and mobile, in which protections for the vulnerable must go hand-in-hand with opportunities for young people. Ambitious policies need to be embodied in a clear, comprehensive set of actions. Investors, workers and consumers must be presented with a programme that takes due account of all the aspects of society and the economy that need to be reformed, fosters innovation, inculcates observance of the law, adheres to the principles of efficiency and equity, and rewards merit and responsibility. Although single measures may come at different times, not just for budgetary reasons, the visibility of such a coherent design will reassure citizens and bolster faith in the future, without which all progress is inconceivable.

THE BANK OF ITALY'S ANNUAL ACCOUNTS

18. MANAGEMENT REPORT AND ANNUAL ACCOUNTS [1]

The Bank of Italy's annual accounts consist of the balance sheet, the profit and loss account and the notes to the accounts. Amounts are presented in euros in the official accounts and in thousand euros in the tables of the notes. The accounts are accompanied by the management report.

In February, the Bank sends the balance sheet to the European Central Bank for consolidation with those of the other Eurosystem central banks.

The draft annual accounts are transmitted to the Ministry for the Economy and Finance under Article 117 of Royal Decree 204/1910 (Consolidated Law on the Bank of Issue).

The annual accounts are audited by an independent auditing company, which certifies their conformity with accounting rules in accordance with Article 27 of the Statute of the European System of Central Banks. The auditing company appointed for the years 2010-15 is PricewaterhouseCoopers, which won the public tender announced by the Bank in 2009.

Information on the functions and governance of the Bank can be found on its website (www.bancaditalia.it).

[1] This abridged English version of the Bank's annual accounts does not contain all the information required by law in the Italian version, nor is it accompanied by the audit report issued by PricewaterhouseCoopers. The full Italian version can be found on the Bank of Italy's website (www.bancaditalia.it).

MANAGEMENT REPORT

The Bank of Italy's new Statute

Decree Law 133/2013, converted with amendments into Law 5/2014, introduced new provisions regarding the ownership structure of the Bank of Italy and authorized it to increase its capital to €7.5 billion by drawing on the statutory reserves. The extraordinary general meeting of 23 December 2013 approved the changes to the Statute and the increase in capital, taking account of the provisions of the decree law. The new Statute was approved by Presidential Decree of 27 December 2013 and entered into force on 31 December 2013.

The most important changes concern the property and economic rights of the shareholders, the institutions eligible to hold shares in the Bank's capital, the introduction of an individual ceiling on shareholdings, the sterilization of the governance and economic rights pertaining to the portion in excess of the limit, and the possibility for the Bank to buy back shares temporarily in order to facilitate compliance with the shareholding limit.

The reform has also changed the method of calculating shareholders' annual dividends, which are now based on net profit only and cannot exceed 6 per cent of the capital. Compared with the previous rules it is now no longer possible to pay shareholders an additional dividend out of the income earned from the investment of the statutory reserves. The provision of Article 40 of the previous Statute attributing the income from their investment to the statutory reserves has also been abolished.

Summary of the annual accounts

The year 2013 closed with a net profit of €3,035 million. In 2012 the net profit was €2,501 million and did not include the income earned from the investment of ordinary and extraordinary reserves, amounting to €478 million, which had been attributed to these reserves under the previous Statute. The gross profit before tax and transfers to the provision for general risks was equal to €6,862 million in 2013 (€7,551 in 2012, including, for the purposes of comparison, the return on the investment of the statutory reserves).

The size and composition of the balance sheet items reflected mainly the unconventional monetary policy operations undertaken by the Eurosystem during the worst period of the financial crisis.

The balance sheet total amounted to €554,399 million, €55,574 million less than in 2012 (Table 18.1).

Table 18.1

Main balance sheet aggregates (1)
(millions of euros)

	31.12.2013	%	31.12.2012	%	31.12.2011	%	31.12.2010	%	31.12.2009	%
Gold	68,677	12.4	99,417	16.3	95,924	17.8	83,197	25.0	60,410	20.1
Foreign currency assets	37,720	6.8	41,185	6.7	40,911	7.6	37,789	11.3	33,440	11.1
Lending to euro-area credit institutions	235,869	42.5	271,784	44.6	209,995	39.0	47,635	14.3	27,156	9.0
Securities held for monetary policy purposes	37,572	6.8	44,525	7.3	43,056	8.0	18,079	5.4	5,015	1.7
Portfolio of financial assets	140,289	25.3	128,601	21.1	129,455	24.0	123,047	37.0	99,432	33.0
Intra-Eurosystem position	20,086	3.6	10,804	1.8	7,199	1.3	10,898	3.3	62,475	20.7
Other assets	14,186	2.6	13,657	2.2	12,438	2.3	12,316	3.7	13,328	4.4
Total assets	**554,399**		**609,973**		**538,978**		**332,961**		**301,256**	
Banknotes in circulation	157,541	28.4	149,948	24.6	146,010	27.1	138,324	41.5	132,840	44.1
Liabilities to euro-area credit institutions	20,789	3.7	27,665	4.5	33,878	6.3	22,741	6.8	34,313	11.4
General government deposits	27,117	4.9	33,802	5.5	23,529	4.4	42,488	12.8	31,027	10.3
Intra-Eurosystem position	228,382	41.2	253,799	41.6	198,453	36.8	7,093	2.1	10,358	3.4
Foreign currency liabilities	7,758	1.4	8,047	1.3	8,355	1.5	8,236	2.5	7,580	2.5
Other liabilities	8,697	1.6	3,386	0.6	4,652	0.9	4,958	1.5	2,621	0.9
Provisions	23,351	4.2	21,317	3.5	18,223	3.4	16,913	5.1	15,802	5.3
Revaluation accounts	54,191	9.8	86,900	14.3	83,004	15.4	70,206	21.1	44,968	14.9
Capital, reserves and net profit	26,573	4.8	25,109	4.1	22,874	4.2	22,002	6.6	21,747	7.2
Total liabilities	**554,399**		**609,973**		**538,978**		**332,961**		**301,256**	

Main profit and loss account aggregates (2)
(millions of euros)

	2013	2012	2011	2010	2009
Net interest income	6,728	6,962	4,832	4,152	3,893
Net result of the pooling of monetary income	557	1,315	590	613	692
Income from equity shares and participating interests	552	352	409	534	439
Realized gains/losses arising from financial operations	1,095	758	522	426	571
Write-downs	-357	-71	-664	-271	-102
Other net income	102	73	119	57	131
Operating expense and other costs	-1,815	-1,838	-1,862	-1,921	-2,005
Gross profit	**6,862**	**7,551**	**3,946**	**3,590**	**3,619**
Transfer of investment income to the statutory reserves (ex Art. 40 previous Statute)	–	-478	-316	-463	-445
Transfer to the provision for general risks	-2,183	-2,645	-1,400	-1,350	-700
Taxes on income for the year and productive activities	-1,644	-1,927	-1,101	-925	-805
Net profit	**3,035**	**2,501**	**1,129**	**852**	**1,669**

(1) The balance sheet is reclassified as follows: *Foreign currency assets* include the securities and other assets denominated in foreign currency (Items 2 and 3 on the asset side); the *Portfolio of financial assets* includes bonds, equity shares and other participating interests, and other assets denominated in euros and foreign currency allocated to Items 4, 6, 7.2, 8 and 11.2 on the asset side. It also includes the participating interest in the ECB (Item 9.1); the *Intra-Eurosystem position* includes net claims (liabilities) vis-à-vis the Eurosystem (Items 9.2, 9.3 and 9.4 on the asset side; 9.1, 9.2 and 9.3 on the liability side). *Liabilities to euro-area credit institutions* refers to those related to monetary policy operations (Item 2 on the liability side). *Foreign currency liabilities* include the liabilities denominated in foreign currency (Items 6, 7 and 8 on the liability side). The *Provisions* include the provisions for general risks, the provisions for specific risks and the staff-related provisions (Items 12 and 14 on the liability side). – (2) For the sake of comparison, the data for previous years have been reclassified to take account of the amendment to the Bank's Statute and eliminating the transfer of investment income to the ordinary and extraordinary reserves. The profit and loss account is reclassified as follows: *Net interest income* includes interest income and interest expense under Items 1 and 6.1 of the profit and loss account. *Income from equity shares and participating interests* includes dividends and income from ETFs and shares/units of UCITS (Items 4, 6.2 and 6.4). *Realized gains/losses arising from financial operations* and *Write-downs* include income and expense under Items 2.1, 2.2, 6.3 and 6.4. *Other net income* includes the amounts under Items 3, 7, 8 and 12. *Operating expense and other costs* include the costs under Item 10, while *Transfer to the provision for general risks* refers to the allocations under Item 2.3.

On the asset side, the value of refinancing operations remained high, although decreasing overall by €35,915 million. Longer-term refinancing operations (LTROs) declined mainly owing to the early repayment of the three-year LTROs conducted at the end of 2011 and the beginning of 2012. A contribution to the decrease in the Bank's balance sheet assets also came from the redemption of €6,953 million of securities held for monetary policy purposes.

At the end of 2013 assets held for monetary policy operations amounted to 49 per cent of the Bank's total balance sheet assets, against 52 per cent at the end of 2012.

A further factor in the reduction of the Bank's assets was the €30,740 million decrease in the value of the gold reserves due entirely to the drop in the metal's price.

A positive contribution came instead from the increase of €11,688 million in the Bank's portfolio of mainly euro-denominated financial assets and of €9,282 million in its net position with the Eurosystem as a result of the rise in claims related to the allocation of euro banknotes.

On the liability side, there was a substantial reduction in the Bank's debit balance with the TARGET2 payment system, part of its intra-Eurosystem liabilities (-€25,417 million). At the end of 2013 the latter amounted to €228,382 million, equal to 41 per cent of total liabilities (42 per cent at the end of 2012).

Apart from the reduction in the debit balance resulting from TARGET2 transactions, there was a decrease in the revaluation accounts (-€32.709 million) owing to the decline in the value of gold and foreign currency assets, in the deposits of banks (-€6.876 million) and in those of general government (-€6.685 million). The Bank's share of banknotes in circulation rose by €7,593 million and capital funds by €3,113 million, including the provision for general risks.

The shift in the composition of balance sheet assets and liabilities has affected, together with the trend in interest rates, the Bank's profit and loss account.

The net result for the Bank of the pooling of monetary income decreased from €1,315 to €557 million, reflecting the lower amount of monetary income generated in the whole Eurosystem.

Gross profit was negatively affected by the increase of €286 million in write-downs, chiefly associated with the depreciation of foreign currency assets. Net interest income declined by €234 million, owing above all to the smaller average stock of securities held for monetary policy purposes as part of the Securities Markets Programme. The contraction in interest income from refinancing operations was more than offset by that in interest expense on intra-ESCB balances.

A positive contribution came instead from the €337 million increase in the profit on trading, for the most part from the sale of shares, and the €200 million additional dividend from shareholdings due to the increase in those allocated by the ECB, including from 2012 profits.

Operating expense and other costs decreased by €23 million, continuing the downward trend under way in recent years as a result of the measures taken to improve efficiency. In particular, personnel costs declined by €8 million, outlays for pensions and severance pay by €6 million, allocations to the severance pay fund by €3 million and depreciation of tangible and intangible assets by another €3 million.

The provision for general risks, which covers the Bank's overall exposure to risk, was funded to the tune of €2,183 million, bringing it to a total of €15,374 million at the end of 2013, compared with €13,191 in 2012.

Taxes for the year amounted to €1,644 million (€1,927 million in 2012).

After allocations to the statutory reserves and payment of a dividend to shareholders, €1,896 million of the net profit of €3,035 million was transferred to the State. A total of €759 million was allocated to the ordinary and extraordinary reserves and the shareholders were assigned a dividend of €380 million.

Post-balance-sheet events

As of 1 January 2014, following the five-year adjustment and Latvia's entry into the euro area, the Bank of Italy's share in the ECB's capital, considering only the Eurosystem countries, decreased from 17.91 to 17.59 per cent. This capital key is used to settle financial transactions between the Bank and the other Eurosystem central banks, such as the distribution of the ECB's net profit.

With legal effect from 1 January 2014, the Bank transferred its portfolio of mainly residential rental properties to the wholly-owned company Società Italiana di Iniziative Edilizie e Fondiarie SpA (SIDIEF). The purpose was to introduce a more flexible and dynamic style of property management.

In May 2014 an agreement was reached with a group of entrepreneurs and institutional investors on the sale of the Bank's controlling interest in Bonifiche Ferraresi SpA. Accordingly, 60.37 per cent of the capital will be transferred at a price of €30.50 per share, net of the dividend for 2014, to a special purpose vehicle to be set up by the consortium; the sum paid will amount to about €104 million. The Bank of Italy will keep an interest of less than 2 per cent in Bonifiche Ferraresi SpA purely as a financial investment. The operation will depend on the outcome of the due diligence on the company and the completion of the financing agreements for the mandatory public tender offer to be launched on the other shares in circulation.

Monetary policy operations

In 2013 as well, all the monetary policy auctions were conducted at fixed rates with full allotment. In November 2013 the Governing Council of the ECB announced that this system would remain in place as long as necessary and in any case until July 2015.

On two occasions, in May and November, the Governing Council reduced the interest rates on monetary policy operations. At the end of the year the rates on main and marginal refinancing operations reached 0.25 and 0.75 per cent respectively, the lowest levels on record. The rate on the deposit facility was left unchanged at zero per cent.

In July, the Governing Council issued for the first time forward guidance on interest rates, communicating that it expected to keep them at the same or at a lower level than at present for an extended period of time, given the prospect of low inflation, generally weak economic situation and limited monetary growth. The guidance was repeated at subsequent meetings.

On 10 October 2013, the ECB announced that it had signed a currency swap agreement with the People's Bank of China. The agreement will last three years and the facility will be for a maximum of RMB 350 billion; it will allow short-term liquidity to be provided to all Eurosystem counterparties through the national central banks.

During 2013, the volume of funds provided by the Eurosystem through its refinancing operations fell from €1,126 billion to €752 billion. This trend continued in the early months of 2014.

The average maturity of refinancing operations also diminished following the decision to allow counterparties of euro-area monetary policy operations to repay, as of January 2013, all or part of the funds received from the three-year refinancing operations conducted at the end of 2011 and the beginning of 2012 (for a total of €1,019 billion, €255 billion of which pertaining to Italy). Of the €474 billion repayments made at Eurosystem level (€63 billion nationally), the share of LTROs fell from 92 per cent at the end of 2012 to 78 per cent a year later.

Marginal refinancing operations conducted by the Eurosystem also diminished.

The Bank's total exposure to the counterparties financed amounted to €236 billion at the end of 2013, some €36 billion less than a year earlier. The reduction was proportionally less than for other euro-area banking systems and therefore Italian counterparties' share of funds rose from 24 to 31 per cent of the euro-area total.

Partly owing to the early repayment of the three-year auctions, the amount of banks' deposits with the euro-area NCBs decreased progressively at both national and Eurosystem level.

On 17 December 2013, in accordance with the decisions of the ECB's Governing Council, the Bank of Italy took part, alongside the other euro-area central banks, in the Irish Government's buyback of a government bond held by the Eurosystem in the SMP programme for a total of €3.6 billion. The Bank of Italy sold all the bonds in its possession for a nominal value of €457 million.

The OMT programme of securities purchases for monetary policy purposes was not activated in 2013; its characteristics had been determined by the Governing Council in September 2012 to alleviate tensions on the government securities markets and safeguard the monetary policy transmission mechanism. The SMP and the second Covered Bond Purchase Programme (CBPP2) came to a close in 2012, while the first CBPP had ended in 2010. The change in the Bank's portfolio was due to repayments at maturity and the buyback of bonds by the Irish Government.

Table 18.2

Securities held for monetary policy purposes
(millions of euros)

	31.12.2013	31.12.2012
Government securities (SMP)	28,621	33,599
CBPP (1st programme)	6,693	8,455
CBPP (2nd programme)	2,258	2,471
Total	**37,572**	**44,525**

In accordance with the decisions of the Governing Council of the ECB, the securities acquired under the two Covered Bond Purchase Programmes and the Securities Markets Programme were classified as being held to maturity and therefore valued at amortized cost subject to impairment.

The annual impairment tests conducted at the level of the Eurosystem did not show any evidence of losses.

Financial resources

Ownership of the country's official reserves (gold and claims on non-euro-area residents in foreign currency) is assigned by law to the Bank of Italy. Management of the reserves makes it possible to service the Italian Republic's foreign currency debt and meet its commitments to international organizations such as the International Monetary Fund. In addition, since the nation's official reserves are an integral part of the Eurosystem's reserves, their overall level and proper management help to safeguard the credibility of the ESCB. The foreign currency reserves are managed with the aim of guaranteeing high levels of liquidity and security, while also seeking to maximize the long-term expected yield. The Bank also manages a part of the reserves transferred to the ECB following the guidelines laid down by the Governing Council.

The item *Gold and net foreign currency assets*, the composition of which is shown in Table 18.3, includes the official reserves plus other claims on euro-area residents denominated in foreign currency held by the Bank, net of foreign currency liabilities.

Table 18.3

Gold and net foreign currency assets (1)
(millions of euros)

	31.12.2013	31.12.2012
Gold	68,677	99,417
US dollars	16,932 (2)	19,780
Pounds sterling	3,045	3,106
Japanese yen	4,200	5,212
Australian dollars	1,246	1
Other currencies	5	6
Net assets vis-à-vis the IMF (including SDRs)	4,534	5,034
Total	**98,639**	**132,556**

(1) Valued at market exchange rates and prices. The reserves do not include financial assets (ETFs and shares/units of UCITS) denominated in foreign currency representing the investment of ordinary and extraordinary reserves, provisions and other capital funds, as they constitute a separate foreign currency position– (2) Includes €73 million (€2,088 million in 2012) of temporary operations in dollars as part of an agreement between the ECB and the Federal Reserve to offer short-term liquidity in dollars to the banking system.

At 31 December 2013, gold and net foreign currency assets were worth €98.6 billion, compared with €132.6 billion a year earlier. The decrease was due above all to the fall in the price of gold (down by 30.92 per cent, leading to a reduction of €30.7 billion in the value of the stock, which was stationary in volume). The decline in net foreign currency assets reflected the overall movements in exchange rates and the decrease in temporary operations in dollars conducted as part of the refinancing programme agreed between the ECB and the Federal Reserve. In 2013 the Bank began to manage a new portfolio denominated in Australian dollars and outsourced the management of fairly small euro- and dollar-denominated portfolios of corporate bonds to specialist intermediaries.

The Bank also holds a financial portfolio containing, among other things, investments of provisions, reserves and the pension and severance pay provision. In compliance with the ban on the monetary financing of member states and euro-area public institutions, securities of such issuers are not acquired at issue. Investments in shares of banks and insurance companies are excluded.

Table 18.4

Composition of the financial portfolio
(millions of euros)

	31.12.2013	31.12.2012
Government securities	117,380	116,698
Shares and other participating interests	6,246	5,304
Other bonds	2,953	1,040
ETFs and shares/units of UCITS	3,302	2,658
Total	**129,881**	**125,700**

At the end of 2013, the book value of the portfolio was €129.9 billion (€125.7 billion in 2012). The portfolio was invested mainly in bonds, especially Italian and other euro-area-country government securities. The part invested in equities consisted primarily of shares listed in the euro area. Further progress was made in 2013 in diversifying the portfolio of Italian listed shares, progressively bringing it into line with the market benchmark and improving the risk/return ratio.

The bulk of the portfolio (86 per cent) consists of securities held to maturity and is therefore valued at amortized cost subject to impairment. If all listed financial instruments were valued at market prices, the portfolio would be worth €136.9 billion.

The Bank also manages the investments of the defined-contribution pension fund for staff hired since 28 April 1993. Its investments and earmarked estate are included in the Bank's balance sheet. The fund constitutes a separate estate for administrative and accounting purposes. Investments are made observing benchmarks. At 31 December 2013 the fund's total assets and liabilities in the Bank's balance sheet amounted to €299 million. Returns on assets and exposure to risk are measured daily.

Financial risks

Monetary policy operations. – The national central banks share the risks attached to the securities acquired under the Securities Markets Programme and, generally, to refinancing operations with the whole of the Eurosystem according to their share in the ECB's capital key.

According to the ESCB Statute, lending operations with banks conducted by the Eurosystem must be backed by adequate collateral in the form of the transfer of ownership or pledging of eligible financial assets. The measures to control risk introduced by the ECB Governing Council are designed to protect the Eurosystem NCBs from the risk of financial loss when such assets are realized following a counterparty's default.

These risks are mitigated and managed according to rules laid down by the Eurosystem, which set out the requirements for counterparty eligibility and the credit rating of assets used as collateral and provide for the daily evaluation of collateral and the adoption of appropriate control measures, such as haircuts and variation margins.

In 2013, decisions regarding the assets eligible in Eurosystem lending operations remained directed at increasing available collateral in order to meet the banks' demand for liquidity and at limiting the risk exposure of the Eurosystem, by reviewing the risk control measures.

The Eurosystem's risk exposure was affected by the decrease in outstanding loans and by the shorter average duration of financing as credit institutions took up the option to make early repayments of three-year LTROs.

Foreign currency reserves and the financial portfolio. – The Bank of Italy manages on an integrated basis the financial risks (market and credit risks) attached to monetary policy operations and to other financial assets and liabilities, consisting in particular of the foreign currency reserves and the financial portfolio. It also monitors the liquidity risk of the foreign currency reserves and the operational risks associated with its overall activities.

For the control of overall risks the Bank uses a prudential measure of risk exposure based on an estimate of low-probability high-impact losses, i.e. entailing a large expected shortfall.

The risks for the foreign currency reserves and the financial portfolio derive above all from the fluctuations in the price of gold, exchange rates and share prices, as well as in interest rates on the various markets.

As well as controlling aggregate risk exposure, the Bank also monitors individual positions, including the component held to maturity. The exposure to market risk is monitored on the basis of several indicators. For the bond component, the duration is taken into account. In addition, the maximum potential loss is estimated, separately for the various classes of financial assets and market segments, using the long-term and short-term VaR indicator.

The exchange rate risk for non-euro-denominated assets included in the financial portfolio is hedged through foreign exchange forward sales.

Credit risk is kept in check by means of a rigorous selection of investment instruments and a prior assessment of the soundness of issuers and eligible counterparties. Category and individual exposure limits are also set and monitored daily.

The liquidity of the financial instruments invested in is normally very high. The liquidity risk of the foreign currency reserves is managed by applying extremely prudent criteria in the selection of financial instruments and counterparties, by placing tight restrictions on the maturity of bank deposits, bank paper, and commercial paper as well as on acquisitions of individual issues, and by limiting the financial duration of the portfolios.

At the end of 2013 the overall riskiness (of gold, the foreign currency reserves and the financial portfolio) was assessed as less than at the end of 2012. The overall duration of the bond component was basically unchanged for both Italian government securities and those of other euro-area countries, but declined for securities indexed to euro-area inflation and the portfolio of supranational securities. Over the year the duration of foreign currency reserves in dollars and sterling decreased, while the duration of those in yen lengthened.

Seigniorage and monetary circulation

Seigniorage is the aggregate income that the central banks earn from the issue of banknotes.

In the Eurosystem, seigniorage is included in the broad definition of monetary income, i.e. the net revenue that the national central banks obtain from the assets held against monetary liabilities, mainly consisting of banknotes and credit institutions' deposits. With the adoption of the euro and the single monetary policy the total monetary income generated by the Eurosystem NCBs is distributed among them according to their share in the ECB's capital. Consequently, every year each of the NCBs calculates its monetary income as laid down in the rules established by the Governing Council; this is then pooled with the ECB for redistribution among NCBs according to the capital key (see "Comments on the items of the profit and loss account" – *Net result of the pooling of monetary income*).

The monetary income of the Bank of Italy contributes, together with the other income from its investments (including of capital and provisions) to the net profit for the year.

At the end of the year the total value of banknotes put into circulation by the Bank was €144.7 billion (15.1 per cent of the Eurosystem total), down 1 per cent from the end of 2012 (€146.3 billion). The amount recorded in the accounts (€157.5 billion) represented the 16.5 per cent share of total Eurosystem circulation notionally assigned to the Bank of Italy.

The Bank contributes to meeting the Eurosystem's demand for banknotes and participates in the development of the new series. It is also involved in drafting common guidelines for the quality of the notes in circulation and measures against counterfeiting.

The production volume of the Bank's printing facility was particularly high last year. A total of 1.36 billion banknotes of both the first and second series were produced (1.14 billion in 2012), the largest amount since the single currency was introduced in 2002. Although production is expected to remain high in 2014, according to the ECB the impact of the launch of the second series will ease from 2015 and Eurosystem requirements will diminish.

The Bank's branches put 2.8 billion banknotes into circulation for a total value of €93 billion. The return flow to the Bank amounted to 2.6 billion banknotes, worth €94.7 billion. Some 2.6 billion banknotes were checked and 1.1 billion were withdrawn from circulation.

Human, logistical and IT resources

Human resources. – At 31 December 2013 the Bank had 7,027 employees: 4,431 working at Head Office and 2,596 at branch offices. Managers and officers accounted for respectively 8.6 and 20.9 per cent of the personnel. The staff's average age was 48.6 years and 35.7 per cent of the Bank's employees were women.

The total number of staff decreased by 42 compared with the end of 2012. In 2013 there were 152 new appointments, of which about 40 per cent to positions requiring a university degree. Terminations, which decreased further owing to the introduction of new legislation on retirement, totalled 194 and were down 7 per cent compared with 2012 and 59 per cent compared with 2011.

Table 18.5

Composition of the Bank's staff

	At 31.12.2013					At 31.12.2012				
	Men	Women	**Total**	At branches	At Head Office (1)	Men	Women	**Total**	At branches	At Head Office (1)
Managers	460	146	**606**	137	469	467	139	**606**	137	469
Officers	933	537	**1,470**	394	1,076	921	528	**1,449**	398	1,051
Coadjutors	804	525	**1,329**	492	837	791	526	**1,317**	485	832
Other	2,324	1,298	**3,622**	1,573	2,049	2,380	1,317	**3,697**	1,614	2,083
Total	**4,521**	**2,506**	**7,027**	**2,596**	**4,431**	**4,559**	**2,510**	**7,069**	**2,634**	**4,435**

(1) Includes members of the staff assigned to the Financial Intelligence Unit, the representative offices abroad, and those seconded to other organizations.

IT and logistics resources. – The Bank's information and communication technology resources play a major role in guaranteeing the innovativeness, quality and reliability of the services provided. In 2013 further progress was made within the ESCB in building the new platform for the settlement of securities transactions, TARGET2-Securities, improving the TARGET2 system, and strengthening the communications network between the NCBs (CoreNet). In 2014 the IT department will continue to work on the development programmes under way at national and European level.

The objective of the Bank's property administration is to ensure the efficient functioning of its premises and security systems and to preserve the value of its real estate holdings, as well as to support plans for organizational reform. In 2013 efforts to ensure the business continuity of the Bank's "critical" functions were stepped up.

Management control system

The control of expenditure also makes use of management tools such as budgets and cost accounting. The latter is based on principles agreed among the national central banks of the Eurosystem with the aim of making their costs comparable, facilitating assessments of relative efficiency and contributing to the determination of charges for the services offered.

The outcome of the spending commitments in 2013 was in line with the Bank's objectives for cost containment and improved performance in terms of the efficiency and the quality of the services provided. Reductions in expenditure were made at the level of the Head Office and of the network of branches and foreign representative offices.

From a longer term perspective, expenditure diminished steadily during the period 2009-2013, thanks to investments in technology in the preceding years together with an overall reduction in staff numbers (down 8 per cent since 2009) as terminations were only partially offset by recruitment of new personnel. The containment of labour costs and the rationalization of procurement procedures contributed to the improvement in efficiency.

Internal audit and operational risk

The Bank of Italy's internal audit system uses a function-based approach in which each organizational unit is responsible for the management of its own risk exposure, controls, effectiveness and efficiency. The units apply operational control procedures within their own spheres of responsibility. The Bank also has in place a system for the integrated management of operational risk, which includes an ad hoc committee to assist the Governing Board in drafting policy guidelines and monitoring their implementation.

An advisory committee on internal auditing has been set up with the aim of strengthening the system of controls and the independence and objectiveness of the internal audit function. The purpose of the committee is to provide advice and support to the Board of the Directors and the Governor on matters concerning the oversight of the internal audit function; the committee is also required to provide opinions on audit policy and the annual audit plan.

For legal questions the Bank of Italy has its own team of lawyers who are listed in a special annex to the professional register. The risk of non-compliance with tax law and expenditure rules is overseen by ad hoc units.

The Board of Auditors is responsible for monitoring the administration of the Bank as regards compliance with the law, the Statute and the General Regulations and for checking the accounts.

Environmental policy and workplace safety

As part of the Strategic Plan for 2011-13 the Bank has reinforced its commitment to social responsibility, among other things by reducing the environmental impact of its activities. To this end it has drafted and put into effect a series of measures that include: (a) as of 2013, purchasing electricity for all the Bank's institutional premises only from renewable sources; (b) installing a photovoltaic system for electricity generation at the banknote production facility; (c) optimizing the data centre with a view to reducing energy consumption; (d) dematerializing internal and external documents; and (e) incorporating environmental and social clauses into the main tenders for the supply of goods and services.

The Bank monitors the success of these measures and its carbon footprint by means of specific quantitative indicators published in the annual Environment Report, available on the Bank's website.

ANNUAL ACCOUNTS
for the year ending 31 December 2013

BALANCE SHEET

ASSETS	NOTES	Amounts in euros 31.12.2013	31.12.2012
1 GOLD AND GOLD RECEIVABLES	[1]	**68,677,223,308**	**99,417,221,610**
2 CLAIMS ON NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	[1]	**36,833,904,316**	**38,282,563,781**
2.1 Claims on the IMF		11,888,283,997	12,699,771,877
2.2 Securities		23,108,784,786	24,270,672,007
2.3 Current accounts and deposits		1,378,219,855	768,929,570
2.4 Reverse operations		454,665,413	538,310,210
2.5 Other claims		3,950,265	4,880,117
3 CLAIMS ON EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	[1]	**885,693,946**	**2,902,815,448**
3.1 Financial counterparties		885,693,946	2,902,815,448
3.1.1 Securities		*263,573,477*	*180,029,434*
3.1.2 Reverse operations		*72,511,058*	*2,088,070,335*
3.1.3 Other claims		*549,609,411*	*634,715,679*
3.2 General government		–	–
3.3 Other counterparties		–	–
4 CLAIMS ON NON-EURO-AREA RESIDENTS		**1,405,092,784**	**629,205,358**
4.1 Claims on EU central banks		–	–
4.2 Securities	[4]	1,405,057,331	629,205,358
4.3 Other claims		35,453	–
5 LENDING TO EURO-AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS	[2]	**235,869,200,000**	**271,783,800,000**
5.1 Main refinancing operations		22,160,000,000	3,488,000,000
5.2 Longer-term refinancing operations		213,709,200,000	268,295,800,000
5.3 Fine-tuning reverse operations		–	–
5.4 Structural reverse operations		–	–
5.5 Marginal lending facility		–	–
5.6 Credits related to margin calls		–	–
6 OTHER CLAIMS ON EURO-AREA CREDIT INSTITUTIONS	[3]	**9,030,360,601**	**1,539,972,286**
7 SECURITIES OF EURO-AREA RESIDENTS		**111,529,531,677**	**116,430,534,449**
7.1 Securities held for monetary policy purposes	[2]	37,571,581,510	44,524,997,190
7.2 Other securities	[4]	73,957,950,167	71,905,537,259
8 GENERAL GOVERNMENT DEBT	[4]	**14,484,463,862**	**14,620,151,540**
9 INTRA-EUROSYSTEM CLAIMS	[5]	**21,463,585,337**	**12,164,717,030**
9.1 Participating interest in the ECB		1,377,337,333	1,361,271,704
9.2 Claims arising from the transfer of foreign reserves to the ECB		7,218,961,424	7,198,856,881
9.3 Net claims related to the allocation of euro banknotes within the Eurosystem		12,867,286,580	3,604,588,445
9.4 Other claims within the Eurosystem (net)		–	–
10 ITEMS IN COURSE OF SETTLEMENT		**12,714,869**	**8,294,390**
11 OTHER ASSETS	[6]	**54,207,620,183**	**52,194,123,616**
11.1 Euro-area coins		94,590,561	62,281,159
11.2 Securities related to the investment of reserves and provisions	[4]	40,033,818,971	38,544,663,225
11.3 Intangible fixed assets		65,423,437	67,735,449
11.4 Tangible fixed assets		2,962,900,887	3,078,877,072
11.5 Accruals and prepaid expenses		5,218,965,124	4,895,684,878
11.6 Deferred tax assets		3,687,649,388	4,291,486,395
11.7 Sundry		2,144,271,815	1,253,395,438
TOTAL		**554,399,390,883**	**609,973,399,508**

THE ACCOUNTANT GENERAL: Paolo Marullo Reedtz

THE GOVERNOR: Ignazio Visco

Audited and found correct - 27 March 2014

THE BOARD OF AUDITORS: Lorenzo De Angelis, Giovanni Fiori, Gian Domenico Mosco, Sandro Sandri, Dario Velo

BALANCE SHEET

LIABILITIES	NOTES	Amounts in euros 31.12.2013	31.12.2012
1 BANKNOTES IN CIRCULATION	[7]	**157,541,040,600**	**149,947,991,520**
2 LIABILITIES TO EURO-AREA CREDIT INSTITUTIONS RELATED TO MONETARY POLICY OPERATIONS	[2]	**20,789,249,743**	**27,664,560,871**
2.1 Current accounts (covering the minimum reserve system)		18,392,290,699	24,592,970,178
2.2 Deposit facility		2,376,959,044	3,039,590,693
2.3 Fixed-term deposits		20,000,000	32,000,000
2.4 Fine-tuning reverse operations		–	–
2.5 Deposits related to margin calls		–	–
3 OTHER LIABILITIES TO EURO-AREA CREDIT INSTITUTIONS		**8,161,000**	**–**
4 LIABILITIES TO OTHER EURO-AREA RESIDENTS	[8]	**33,888,202,906**	**34,495,553,304**
4.1 General government		27,116,969,782	33,802,015,193
4.1.1 Treasury payments account		*7,973,293,376*	*8,501,827,482*
4.1.2 Sinking fund for the redemption of government securities		*20,377,620*	*170,531,105*
4.1.3 Other liabilities		*19,123,298,786*	*25,129,656,606*
4.2 Other counterparties		6,771,233,124	693,538,111
5 LIABILITIES TO NON-EURO-AREA RESIDENTS	[9]	**555,342,893**	**1,000,215,366**
5.1 To EU central banks		–	–
5.2 Other liabilities		555,342,893	1,000,215,366
6 LIABILITIES TO EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	[1]	**401,829,300**	**378,443,094**
6.1 Financial counterparties		–	–
6.2 General government		401,829,300	378,443,094
6.3 Other liabilities		–	–
7 LIABILITIES TO NON-EURO-AREA RESIDENTS DENOMINATED IN FOREIGN CURRENCY	[1]	**1,992,549**	**2,301,777**
7.1 Current accounts and deposits		1,992,549	2,081,670
7.2 Other liabilities		–	220,107
8 COUNTERPART OF SDRs ALLOCATED BY THE IMF	[1]	**7,354,065,166**	**7,665,772,838**
9 INTRA-EUROSYSTEM LIABILITIES	[5]	**228,381,753,593**	**253,799,438,019**
9.1 Liabilities in respect of debt certificates issued by the ECB		–	–
9.2 Net liabilities related to the allocation of euro banknotes within the Eurosystem		–	–
9.3 Other liabilities within the Eurosystem (net)		228,381,753,593	253,799,438,019
10 ITEMS IN COURSE OF SETTLEMENT		**27,146,453**	**40,493,764**
11 OTHER LIABILITIES	[10]	**1,334,868,589**	**1,652,952,050**
11.1 Bank of Italy drafts		104,547,106	219,490,566
11.2 Accruals and income collected in advance		7,014,220	14,209,029
11.3 Sundry		1,223,307,263	1,419,252,455
12 PROVISIONS	[11]	**7,977,566,284**	**8,125,980,240**
12.1 Provisions for specific risks		1,364,011,759	1,516,754,934
12.2 Staff-related provisions		6,613,554,525	6,609,225,306
13 REVALUATION ACCOUNTS	[12]	**54,191,327,073**	**86,900,466,265**
14 PROVISION FOR GENERAL RISKS	[11]	**15,373,675,075**	**13,190,675,075**
15 CAPITAL AND RESERVES	[13]	**23,537,853,745**	**22,607,429,359**
15.1 Capital		7,500,000,000	156,000
15.2 Statutory reserves		8,298,342,824	14,867,762,438
15.3 Other reserves		7,739,510,921	7,739,510,921
16 NET PROFIT FOR THE YEAR		**3,035,315,914**	**2,501,125,966**
TOTAL		**554,399,390,883**	**609,973,399,508**

OFF-BALANCE-SHEET ACCOUNTS at 31 December 2013 amounted to **615,442,986,483** euros.

THE ACCOUNTANT GENERAL: Paolo Marullo Reedtz

THE GOVERNOR: Ignazio Visco

Audited and found correct - 27 March 2013

THE BOARD OF AUDITORS: Lorenzo De Angelis, Giovanni Fiori, Gian Domenico Mosco, Sandro Sandri, Dario Velo

PROFIT AND LOSS ACCOUNT

	NOTES	Amounts in euros 2013	2012
1.1 Interest income		7,151,707,496	8,344,083,871
1.2 Interest expense		-1,542,634,228	-2,548,766,113
1 Net interest income	[14]	**5,609,073,268**	**5,795,317,758**
2.1 Realized gains/losses arising from financial operations		300,573,762	747,528,081
2.2 Write-downs on financial assets and positions		-347,053,063	-4,623,615
2.3 Transfers to/from the provisions for general risks for exchange rate, price and credit risks		-2,183,000,000	-2,645,000,000
2 Net result of financial operations, write-downs and transfers to/from risk provisions	[15]	**-2,229,479,301**	**-1,902,095,534**
3.1 Fee and commission income		29,506,266	29,599,664
3.2 Fee and commission expense		-13,132,549	-13,434,424
3 Net income from fees and commissions	[16]	**16,373,717**	**16,165,240**
4 Income from participating interests	[17]	**320,913,773**	**116,225,144**
5 Net result of the pooling of monetary income	[18]	**556,532,173**	**1,314,730,473**
6.1 Interest income		1,118,720,784	1,166,931,258
6.2 Dividends from equity shares and participating interests		197,916,661	203,771,243
6.3 Gains and losses on financial operations (1)		794,532,333	10,386,720
6.4 Write-downs 0n financial operations (1)		-9,408,502	-65,818,107
6.5 Other components		32,839,623	32,025,319
6 Net income from financial assets related to the investment of reserves and provisions	[19]	**2,134,600,899**	**1,347,296,433**
7 Other transfers from provisions		**831**	**1,918**
8 Other income	[20]	**77,376,636**	**87,181,377**
TOTAL NET INCOME		**6,485,391,996**	**6,774,822,809**
9 Transfer of investment income to statutory reserves (2)	[21]	**–**	**-478,230,955**
10.1 Staff wages and salaries		-599,069,445	-603,296,510
10.2 Social security and insurance		-155,171,228	-155,905,061
10.3 Other staff costs		-47,146,455	-49,951,320
10.4 Pensions and severance payments		-293,348,495	-299,143,196
10.5 Transfers to provisions for accrued expense and staff severance pay and pensions		-63,496,495	-66,122,131
10.6 Emoluments paid to head and branch office collegial bodies		-3,009,269	-2,878,677
10.7 Administrative expenses		-441,264,460	-442,629,205
10.8 Depreciation of tangible and intangible fixed assets		-170,354,962	-173,080,819
10.9 Banknote production services		–	–
10.10 Other expenses		-42,222,442	-45,105,957
10 Expenses and charges (1)	[22]	**-1,815,083,251**	**-1,838,112,876**
11 Other transfers to provisions		**–**	**–**
12.1 Extraordinary income		20,854,405	33,186,470
12.2 Extraordinary expense		-12,245,218	-63,420,395
12 Extraordinary income and expense	[23]	**8,609,187**	**-30,233,925**
PROFIT BEFORE TAX		**4,678,917,932**	**4,428,245,053**
13 Taxes on income for the year and on productive activities	[24]	**-1,643,602,018**	**-1,927,119,087**
NET PROFIT FOR THE YEAR		**3,035,315,914**	**2,501,125,966**

(1) Amounts for 2012 are reclassified. – (2) Made in 2012 in accordance with Article 40 of the previous Statute, which allocated the income from their investment to the statutory reserves.

THE ACCOUNTANT GENERAL: Paolo Marullo Reedtz — **THE GOVERNOR:** Ignazio Visco

Audited and found correct - 27 March 2014

THE BOARD OF AUDITORS: Lorenzo De Angelis, Giovanni Fiori, Gian Domenico Mosco, Sandro Sandri, Dario Velo

NOTES TO THE ACCOUNTS

Legal basis, method of preparation and layout of the annual accounts

Legal basis of the annual accounts. – The annual accounts of the Bank of Italy are drawn up in compliance with special statutory provisions and, where these do not provide any guidance, the Bank applies the rules laid down in the Civil Code, taking generally accepted accounting principles into account where necessary.

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, shall also be valid for tax purposes". This validity is recognized by Article 114 of Presidential Decree 917/1986 (Consolidated Income Tax Law) as amended by Legislative Decree 247/2005.

  The rules adopted by the ECB are contained in Guideline ECB/2010/20 (published in OJ, L35 of 9 February 2011), as amended, which contains provisions referring mainly to items of the annual accounts concerning the institutional activities of the ESCB and non-binding recommendations for the other items of the annual accounts.

  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 profit and loss account 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;

– the Bank's Statute (approved by a Presidential Decree of 27 December 2013), which lays down the principles and rules for the allocation of the net profit for the year and the creation of reserves and provisions.

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"), as amended;

– 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"), as amended;

– Article 65 (transactions involving government bonds) of Law 289/2002, as amended by Decree Law 203/2005, ratified by Law 248/2005.

Accounting policies. – The accounting policies regarding the main balance-sheet items and applied in preparing the annual accounts for 2013 are described below. Where provided for by law, they were agreed with the Board of Auditors.

GOLD, FOREIGN CURRENCY ASSETS/LIABILITIES, SECURITIES

Gold and foreign currency assets/liabilities

– *stocks, including those represented by foreign currency securities, are valued by applying, for each currency and for gold, the method of the "average daily net cost", determined in the manner established by the ECB, which requires account also to be taken of purchases of foreign currency with a trade date in the year and a settlement date in the next year;*

– *gold and foreign currency assets/liabilities are valued on the basis of the year-end gold price and exchange rates communicated by the ECB. Unrealized gains are included in the corresponding revaluation account, while unrealized losses are covered first by earlier unrealized gains, and any amount in excess thereof is included in the profit and loss account.*

Securities and participating interests

– *each type of security is valued by applying the method of the "average daily cost", determined in the manner established by the ECB. In the case of bonds, account is taken of the amount of the amortization of the premium/discount, which is recorded daily for those denominated in foreign currency;*

– *the year-end valuation is effected:*

1. *for securities held to maturity, at amortized cost subject to impairment (verification of lasting reduction in value related to the position of the issuer);*
2. *for securities other than those held to maturity:*
   a) *shares, ETFs and marketable bonds, at the market price available at the end of the year; units of collective investment undertakings at the year-end value published by the management company. Unrealized gains are included in the corresponding revaluation accounts; unrealized losses are covered first by earlier unrealized gains for the relevant security and any amount in excess thereof is included in the profit and loss account;*
   b) *non-marketable bonds, at amortized cost subject to impairment;*
   c) *non-marketable shares and equity interests not represented by shares, at cost subject to impairment;*
3. *participating interests in subsidiary and associated companies that constitute permanent investments are valued at cost subject to impairment. The participating interest in the capital of the ECB is valued at cost. The Bank's accounts are not consolidated with those of investee companies insofar as the Bank is not among the entities mentioned in Article 25 of Legislative Decree 127/1991.*

Securities denominated in foreign currencies, including ETFs and units of collective investment undertakings, stated in the balance-sheet item Financial assets related to investments of reserves and provisions *are not included in the net foreign exchange position but shown as a separate item.*

Dividends are recognized on a cash basis.

TANGIBLE FIXED ASSETS

Buildings

– *are stated at cost, including improvement expenditure, plus revaluations effected pursuant to specific laws. The depreciation of "instrumental" buildings used in the Bank's institutional activities and of those that are "objectively instrumental" in that they cannot be used for other purposes without radical restructuring – included among the investments of the provision for staff severance pay and pensions – is on a straight line basis using the annual rate of 4 per cent established by the ECB. Land is not depreciated.*

Plant and equipment

– *are stated at cost, including improvement expenditure. They are depreciated on a straight line basis using the rates established by the ECB (plant, furniture and equipment, 10 per cent; computers and related hardware and basic software and motor vehicles, 25 per cent).*

Depreciation begins in the quarter subsequent to that of acquisition both for buildings and for plant and equipment.

INTANGIBLE FIXED ASSETS

Procedures, studies and designs completed are valued at purchase or directly allocable production cost and amortized on the basis of allowances deemed congruent with the assets' remaining useful lives.

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.

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 are not capitalized, except for those incurred for software licences.

ACCRUALS AND DEFERRALS

Include accrued income and prepaid expenses and accrued expenses and income collected in advance. Interest accrued on foreign exchange assets and liabilities is recorded on a daily basis and included in the net foreign exchange position.

BANKNOTES IN CIRCULATION

The ECB and the euro-area NCBs, which together comprise the Eurosystem, issue the euro banknotes (ECB Decision No. 29 of 13 December 2010 on the issue of euro banknotes, in OJ, *L35 of 9 February 2011, as amended).*

The total value of euro banknotes in circulation is allocated within the Eurosystem on the last working day of each month on the basis of the criteria set out hereinafter.

The ECB is allocated 8 per cent of the total value of euro banknotes in circulation, while the remaining 92 per cent is allocated to the NCBs according to the weighting of each 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. *On the basis of the banknote allocation key, the difference between the value of the banknotes allocated to each NCB and that of the banknotes it actually puts into circulation gives rise to remunerated intra-Eurosystem balances. From the year of the cash changeover of each member state that has adopted the euro and for the five subsequent years the intra-system balances arising from the allocation of euro banknotes will be adjusted in order to avoid significant changes in NCBs' relative income positions as compared with previous years. The adjustments are effected by taking into account the differences between the average value of banknotes in circulation of each NCB in the reference period established by law and the average value of banknotes that would have been allocated to them during that period under the ECB's capital key. The adjustments are reduced in annual steps for five years starting from the year of the cash changeover, after which income on banknotes is allocated fully in* *proportion to the NCBs' paid-up shares in the ECB's capital (ECB Decision No. 23 of 25 November 2010 on the allocation of monetary income of the national central banks of member states whose currency is the euro, in* OJ, *L35 of 9 February 2011, as amended). The adjustments recorded in 2013 arise from the entry into the Eurosystem of the central banks of Slovakia in 2009 and Estonia in 2011; they will terminate at the end of 2014 and 2016 respectively. The adjustments arising from the entry of the central bank of Malta and Cyprus in 2008 terminated in 2013.*

The interest income and expense on intra-Eurosystem balances are cleared through the accounts of the ECB and 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 banknotes allocated to the ECB and the income deriving from the securities held in connection with the Securities Markets Programme (SMP) shall be recognized to the NCBs in full with reference to the financial year in which it accrued and was distributed, as a rule, in January of the following year in the form of an interim distribution of profit (ECB Decision No. 24 of 25 November 2010, in OJ, *L6 of 11 January 2011, as amended). The interim distribution of ECB profit is recorded on an accrual basis in the year to which the income refers, by way of derogation from the cash basis applied in general to dividends and profits from participating interests. All of the seigniorage income and the income arising from SMP securities is distributed, unless it exceeds the ECB's net profit for that year or the Council decides to transfer all or part of it to a provision for foreign exchange rate, interest rate, credit and gold price risks.*

The Governing Council of the ECB may also decide to reduce seigniorage income to be distributed by the amount of expenses incurred in connection with the issue and handling of banknotes.

INTRA-EUROSYSTEM ASSETS AND LIABILITIES

Intra-Eurosystem balances arise mainly from cross-border payments in euros within the EU that are settled in central bank money. Most of these transactions are ordered by private individuals and settled in TARGET2 (Trans-European Automated Real-time Gross Settlement Express Transfer System), giving rise to bilateral balances in the TARGET2 accounts of the EU member states' central banks. These balances are netted out and then assigned to the ECB on a daily basis, leaving each NCB with a single net bilateral position vis-à-vis the ECB. The intra-Eurosystem balance with the ECB arising from TARGET2 and the other intra-Eurosystem balances denominated in euros, including the provisional distribution of the ECB's profit to the NCBs and the result of the pooling of monetary income, are entered in the accounts as a single net position, appearing on the asset side under Other claims within the Eurosystem (net) *or on the liability side under* Other liabilities within the Eurosystem (net).

The intra-Eurosystem balance arising from the allocation of euro banknotes is included under Net claims/liabilities related to the allocation of euro banknotes within the Eurosystem.

The intra-Eurosystem claims arising from the subscription of the ECB's capital and the transfer of official reserves to the ECB are included under Participating interest in the ECB *and* Claims arising from the transfer of foreign reserves to the ECB.

PROVISIONS FOR RISKS

In determining the provisions for risks, the riskiness of each sector of the Bank's operations is taken into account in an overall evaluation of adequacy.

The provision for general risks (Article 41.2 of the Statute) is also for risks in connection with the Bank's overall activity that cannot be determined individually or allocated objectively.

The riskiness of the foreign exchange position and that of the securities portfolio are evaluated on a value-at-risk basis, with consideration also given to the size of the revaluation accounts.

TAX PROVISION

The provision for taxation is equal to the amount of taxes to be paid, determined on the basis of a realistic estimate of the foreseeable liability under the tax rules in force; it includes deferred tax liabilities for Irap and amounts arising from possible fiscal checks and disputes with the tax authorities.

PROVISION FOR MONETARY POLICY OPERATIONS

This provision corresponds to the Bank's share of the provision set up by the Eurosystem for credit and counterparty risks deriving from monetary policy operations.

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 mathematical 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 but not been paid at year-end;*
- *transfers to the provision for early retirement incentives connected with the reorganization of the Bank's branch network are entered for the amounts determined on the basis of the expected costs;*
- *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 or who pay only a part of the contributions for retirement benefits, 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 (see below Other assets and liabilities*).*

OTHER ASSETS AND LIABILITIES

Receivables are stated at their nominal value, except in the case of diminutions in value connected with particular situations concerning the counterparty.

Pursuant to Recommendation NP7/1999 of the Governing Council of the ECB, the costs incurred in the production of banknotes are not included in the valuation of stocks.

Deferred tax assets and liabilities are included in the financial statements on the basis of their presumable tax effect in future years. Deferred tax assets include those deriving from the application of Article 65.2 of Law 289/2002, as amended by Decree Law 203/2005, ratified by Law 248/2005. Deferred tax liabilities for Ires are entered with a minus sign under Deferred tax assets.

The items Other assets *and* Other liabilities *include the investments and separate 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.*

Securities lending transactions are entered in the balance sheet only if collateral is in the form of a cash deposit in an account of the central bank.

The other components are stated at their nominal value.

OFF-BALANCE-SHEET TRANSACTIONS AND MEMORANDUM ACCOUNTS

Forward foreign currency operations, which represent the forward component of foreign currency swaps and other financial instruments involving a swap of currencies at a future date, are included in the net outstanding foreign currency positions at the spot settlement date.

Forward purchases and sales of foreign currency

- *forward purchases and sales are recorded in the memorandum accounts from the trade date to the settlement date at the spot exchange rate of the transaction. The difference between the values at the spot and forward exchange rates is recorded, on a* pro rata temporis *basis, under interest in the profit and loss account;*
- *forward sales of the currencies included in the SDR basket to cover the SDR position are valued in conjunction with the latter and therefore do not affect the net positions in the single currencies.*

Foreign currency swaps

- *forward and spot purchases and sales are recorded in the memorandum accounts from the trade date to the settlement date at the spot exchange rate of the transaction. The difference between the values at the spot and forward exchange rates is recorded, on a* pro rata temporis *basis, under interest in the profit and loss account.*

At the time of the settlement of forward purchases and sales of foreign currency and foreign currency swaps, the entries in the memorandum accounts are transferred to the appropriate items of the balance sheet.

Interest rate futures denominated in foreign currency

– *are recorded in the memorandum accounts at the trade date at their notional value and translated at the end of the year at the exchange rate communicated by the ECB. Initial margins in cash are recorded in the balance sheet among foreign currency claims, those in securities are recorded in the memorandum accounts. Positive and negative daily variation margins are communicated by the clearer and taken to the profit and loss account, converted at the exchange rate of the day.*

Other cases with the amount entered in the memorandum accounts

– *securities denominated in euros held on deposit are stated at their nominal value; shares are stated on a quantity basis; other kinds, at face value or at conventional value;*
– *commitments in respect of foreign currency transactions are shown at the contractually agreed exchange rate. The entries are reversed at the time the commitments are settled;*
– *other foreign currency amounts are converted at the year-end exchange rates communicated by the ECB.*

Comments on the items of the balance sheet

The items *Gold, assets and liabilities denominated in foreign currency*, *Monetary policy operations* and *Securities portfolio* are aggregated according to their purposes or type. The other items are commented on following the layout of the balance sheet.

[1] Gold and assets and liabilities denominated in foreign currency

Table 18.6

Gold and assets and liabilities denominated in foreign currency
(thousands of euros)

	31.12.2013	31.12.2012	Changes
Gold (item 1)	**68,677,223**	**99,417,222**	**-30,739,999**
Net assets denominated in foreign currency	**29,961,710**	**33,138,861**	**-3,177,151**
Assets denominated in foreign currency	**37,719,597**	**41,185,379**	**-3,465,782**
Claims on the IMF (sub-item 2.1)	11,888,284	12,699,772	-811,488
Securities (sub-items 2.2 and 3.1.1)	23,372,358	24,450,701	-1,078,343
Current accounts and deposits (sub-items 2.3 and 3.1.3)	1,927,829	1,403,645	524,184
Reverse operations (sub-items 2.4 and 3.1.2)	527,176	2,626,381	-2,099,205
Other assets (sub-item 2.5)	3,950	4,880	-930
Liabilities denominated in foreign currency	**7,757,887**	**8,046,518**	**-288,631**
Counterpart of SDRs allocated by the IMF (item 8)	7,354,065	7,665,773	-311,708
Advances of general government departments (sub-item 6.2)	401,829	378,443	23,386
Current accounts and deposits (sub-item 7.1)	1,993	2,082	-89
Other liabilities (sub-item 7.2)	–	220	-220

At the end of 2013, the value of gold amounted to €68,677 million, down by €30,740 million on the previous year. The decline was entirely due to the fall in the metal's price. The volume remained unchanged at 79 million ounces or 2,452 tons.

The amount of net assets denominated in foreign currency also declined, from €33,139 million to €29,962 million. The change reflected the fall in the exchange rate and the overall decline in stocks, particularly that related to reverse operations associated with the dollar refinancing programme agreed between the ECB and the Federal Reserve (see below).

Gold reserves are valued at the year-end market price in euros per fine ounce. This price was obtained by converting the dollar price of gold at the London fixing on 31 December 2013 using that day's exchange rate of the euro against the dollar. Compared with end-2012, gold depreciated by 30.92 per cent (from 1,261.179 to 871.22 euros per ounce).

Compared with the end of the previous year, the main foreign currencies showed substantial depreciations against the euro. The US dollar fell from 1.3194 to 1.3791 dollars per euro, the yen from 113.61 to 144.72, the pound sterling from 0.8161 to 0.8337, the Australian dollar from 1.2712 to 1.5423 and the special drawing rights from 1.1657 to 1.1183 euros per SDR.

Compared with the end of 2012 there were unrealized losses at the end of the year that were entirely covered by the corresponding revaluation accounts for gold (€30,740 million), yen (€1,027 million), dollars (€873 million), SDRs (€89 million) and pounds sterling (€68 million). After the above mentioned write-downs, at the end of 2013 the exchange rate revaluation accounts amounted to €50,618 million, of which €49,256 million was in respect of gold, €533 million the dollar, €416 million the yen, €351 million the pound sterling and €62 million the SDR, including the valuation of the relative hedging operations (see *Revaluation accounts*). The unrealized losses on Australian dollars were instead entered in the profit and loss account (€266 million).

Table 18.7

Accounts with the International Monetary Fund
(thousands of euros)

	31.12.2013	31.12.2012	Changes
Assets			
Claims on the IMF (sub-item 2.1)	**11,888,284**	**12,699,772**	**-811,488**
a) Reserve Tranche Position in the IMF	2,252,202	2,827,176	-574,974
Quota in the IMF	*8,814,756*	*9,189,177*	*-374,421*
IMF holdings	*-6,562,554*	*-6,362,001*	*-200,553*
b) Participation in the PRGF	807,677	804,854	2,823
c) Participation in the NAB	1,977,853	1,894,510	83,343
d) Special Drawing Rights	6,850,552	7,173,232	-322,680
Liabilities			
Counterpart of SDRs allocated by the IMF (item 8)	**7,354,065**	**7,665,773**	**-311,708**

The decrease in claims on the IMF was the result not only of the lower exchange rate applied to their end-year valuation, but also of the Fund's withdrawals from its holdings. Loans to the IMF on behalf of the Italian Government under the New Arrangements to Borrow increased.

The portfolio of securities denominated in foreign currency classified as not held to maturity was made up almost entirely of bonds, issued primarily by foreign government bodies and international organizations. Of the total portfolio 66 per cent was denominated in US dollars, 18 per cent in yen, 11 per cent in pounds sterling and 5 per cent in Australian dollars.

The other foreign currency assets (sub-items 2.3, 2.4, 2.5, 3.1.2, 3.1.3), denominated primarily in US dollars, consisted mainly of fixed-term deposits (€1,144 million), current accounts (€784 million), reverse operations (€527 million) and foreign banknotes (€4 million).

Reverse operations are transactions whereby the Bank purchases or sells assets under a repurchase agreement. They are recorded in the balance sheet respectively on the asset side and the liability side. Sub-item 3.1.2 (*Claims on euro-area residents denominated in foreign currency: reverse operations*) includes claims (€73 million) in respect of reverse operations with Eurosystem counterparties associated with the short-term dollar refinancing programme (€2,088 million at the end of 2012). According to this programme the Federal Reserve supplies the ECB with dollars within the context of a foreign currency swap line aimed at providing short-term funding in dollars to euro-area counterparties. At the same time the ECB enters into back-to-back swaps with the Eurosystem NCBs, which use the dollar funds to provide liquidity to euro-area counterparties through reverse operations or foreign currency swaps. Transactions involving back-to-back swaps with the ECB are settled on intra-Eurosystem accounts.

Among the liabilities denominated in foreign currency, primarily in dollars, the most important are the liabilities to general government (€402 million, sub-item 6.2) in respect of advances received for the management of foreign currency cross-border payments and collections.

[2] Monetary policy operations

The operations outstanding at 31 December 2013 carried out by the Bank of Italy within the framework of the single monetary policy of the Eurosystem are shown in Table 18.8.

Table 18.8

Monetary policy operations
(thousands of euros)

	31.12.2013	31.12.2012	Changes
Lending to euro-area credit institutions (item 5)			
5.1 Main refinancing operations	22,160,000	3,488,000	18,672,000
5.2 Longer-term refinancing operations	213,709,200	268,295,800	-54,586,600
5.3 Fine-tuning operations	–	–	–
5.4 Structural reverse operations	–	–	–
5.5 Marginal lending facility	–	–	–
5.6 Credits related to margin calls	–	–	–
Total	**235,869,200**	**271,783,800**	**-35,914,600**
Securities held for monetary policy purposes (sub-item 7.1)	**37,571,582**	**44,524,997**	**-6,953,415**
Liabilities to euro-area credit institutions (item 2)			
2.1 Current accounts(covering the minimum reserve system)	18,392,291	24,592,970	-6,200,679
2.2 Deposit facility	2,376,959	3,039,591	-662,632
2.3 Fixed-term deposits	20,000	32,000	-12,000
2.4 Fine-tuning reverse operations	–	–	–
2.5 Deposits related to margin calls	–	–	–
Total	**20,789,250**	**27,664,561**	**-6,875,311**

In 2013 refinancing operations were again influenced by the unconventional measures adopted by the Eurosystem to counter the adverse effects of the financial crisis. In particular, longer-term refinancing operations predominated after the two three-year auctions at the end of 2011 and beginning of 2012 totalling €255 billion.

The year-end value of the stock of *Main refinancing operations* increased, but the average value declined from €11,549 million to €5,250 million. Owing to early repayments of the amounts allocated at the two three-year auctions, there was a decrease in both the year-end value of *longer-term refinancing operations* and, to a smaller extent, the average value, down from €250,113 million to €247,078 million. *Marginal lending facility*, for which the value was zero at the end of the two years considered, also recorded a decrease in the annual average figures, from €46 million to €27 million. No recourse was made in 2013 to either *Fine-tuning reverse operations* or *Structural reverse operations*.

The *Securities held for monetary policy purposes* consisted of covered bonds acquired under the two programmes approved by the Governing Council of the ECB in the decisions adopted in May 2009 and October 2011, as well as of government securities issued by some euro-area countries and purchased under the Securities Markets Programme approved in May 2010. The first Covered Bond Purchase Programme closed in June 2010 and the second in October 2012. In September 2012 the Governing Council of the ECB brought the Securities Markets Programme to a close.

Table 18.9

Movements in securities held for monetary policy purposes (sub-item 7.1)
(thousands of euros)

	Bonds held to maturity			Total
	Covered bond (1st programme)	Covered bond (2nd programme)	Government securities (Securities Markets Programme)	
Opening balance	**8,454,666**	**2,471,489**	**33,598,842**	**44,524,997**
Increases	**–**	**751**	**361,479**	**362,230**
Net profits	–	–	1,709	1,709
Net premiums and discounts	–	751	359,770	360,521
Decreases	**-1,761,477**	**-214,800**	**-5,339,368**	**-7,315,645**
Sales and redemptions	-1,734,870	-214,800	-5,339,368	-7,289,038
Net premiums and discounts	-26,607	–	–	-26,607
Closing balance	**6,693,189**	**2,257,440**	**28,620,953**	**37,571,582**

In 2013 covered bonds amounting to €1,950 million and government securities amounting to €4,881 million reached maturity. A further €458 million of government securities were reimbursed in advance.

Securities held for monetary policy purposes under the above programmes are classified as held to maturity, in accordance with the decision of the Governing Council of the ECB, and are valued under Eurosystem accounting rules at amortized cost subject to impairment. The impairment tests conducted at year-end by the Eurosystem on securities held for monetary policy purposes did not indicate any long-lasting decrease in value.

Under Article 32.4 of the ESCB Statute losses associated with refinancing operations, should they materialize, may be shared, on the basis of a decision adopted by the Governing Council of the ECB, among the Eurosystem NCBs in proportion to their shares of the ECB's capital. However, the Governing Council has decided to waive the principle of risk sharing where certain types of collateral are accepted by NCBs at their own discretion. As regards securities purchased under the SMP, the Governing Council has decided that any losses will be shared among the Eurosystem NCBs.

At the end of 2013, the Eurosystem's total refinancing operations amounted to €752,288 million (€1,126,019 million in 2012). The securities purchased by the NCBs under the Securities Markets Programme amounted to €165,845 million, against €192,608 million in 2012.

On the liability side the deposits held by credit institutions, including their minimum reserve requirements, decreased in value at year-end but increased in terms of average stock (from €22,173 million to €25,804 million). Credit institutions' holdings in the *Deposit facility* decreased at year-end and even more in terms of average stock (from €8,084 million to €1,280 million). The year-end value of *fixed-term deposits* showed no change, but the average stock rose from €227 million to €2,271 million. No recourse was made to *Fine-tuning reverse operations*.

[3] Other claims on euro-area credit institutions

These claims amounted to €9,030 million at the end of 2013 (€1,540 million in 2012) and consisted in large part of reverse repos on securities denominated in euros amounting to €5,414 million mainly associated with the provision of Eurosystem Reserve Management Services (ERMS) and liquidity-providing operations with national counterparties outside the Eurosystem operations for monetary policy purposes. The latter amounted to €3,470 million and are fully collateralized. The item also includes claims in connection with the management of cross-border euro payments and collections for general government (€137 million) and other claims denominated in euros (€9 million).

With a view to increasing the transparency of its role in liquidity-providing operations carried out by the NCBs, on 16 October 2013 the ECB Governing Council decided to publish the rules of procedure governing such operations. They can be consulted on the ECB's website.

[4] Securities portfolio

In addition to the securities making up part of the foreign exchange reserves (€23,372 million, sub-items 2.2 and 3.1.1), commented under *Gold, assets and liabilities denominated in foreign currency*, and those held for monetary policy purposes (€37,572 million, sub-item 7.1), commented under *Monetary policy operations*, the Bank's securities portfolio amounted to €129,881 million, of which €40,034 million relating to investments of reserves and provisions.

The items in Table 18.10 are detailed as follows:

A) securities denominated in euros consist exclusively of bonds and are stated in:
   - Sub-item 4.2 (*Claims on non-euro-area residents – securities*). This item consists mostly of bonds issued by international organizations;
   - Sub-item 7.2 (*Securities of euro-area residents – other securities*). This item consists mainly of bonds issued by the Italian government and by other euro-area governments;
   - Item 8 (*General government debt*). This item contains the Italian government securities assigned to the Bank following the bond conversion under Law 289/2002 and the termination of the management of mandatory stockpiling. Of the €136 million decrease, €86 million corresponded to the annual accrued premium/discount on the bonds converted and €50 million to the amount of the annual redemption of securities deriving from the termination of the management of mandatory stockpiling.

Table 18.10

Securities portfolio
(thousands of euros)

	31.12.2013	31.12.2012	Changes
A. SECURITIES DENOMINATED IN EUROS (sub-items 4.2 and 7.2 and item 8)			
1. Securities held to maturity	**81,260,623**	**77,461,607**	**3,799,016**
a) Government securities (sub-item 7.2)	65,111,088	61,925,019	3,186,069
b) Other bonds (sub-items 4.2 and 7.2)	1,665,071	916,436	748,635
c) Government securities assigned to Bank of Italy (item 8)	14,484,464	14,620,152	-135,688
2. Securities other than those held to maturity	**8,586,848**	**9,693,287**	**-1,106,439**
a) Government securities (sub-item 7.2)	7,856,620	9,693,287	-1,836,667
b) Other bonds (sub-items 4.2 and 7.2)	730,228	–	730,228
Total A	**89,847,471**	**87,154,894**	**2,692,577**
B. SECURITIES RELATED TO THE INVESTMENT OF RESERVES AND PROVISIONS (sub-item 11.2)			
1. Securities held to maturity and other permanent investments	**30,632,207**	**30,729,443**	**-97,236**
a) Government securities	29,911,468	30,443,176	-531,708
b) Other bonds	558,181	123,709	434,472
c) Shares and other equity	162,558	162,558	–
of subsidiary companies and entities	*105,600*	*105,600*	–
of other companies and entities	*2,410*	*2,410*	–
of other companies and entities denominated in foreign currency	*54,548*	*54,548*	–
2. Securities other than those held to maturity and other permanent investments	**9,401,612**	**7,815,220**	**1,586,392**
a) Government securities	16,230	15,803	427
b) Shares and other equity	6,083,472	5,141,584	941,888
of subsidiary companies and entities	*122,343*	*127,360*	*-5,017*
of other companies and entities	*5,961,129*	*5,014,224*	*946,905*
c) ETFs and shares/units of UCITS	3,301,910	2,657,833	644,077
of which: denominated in foreign currency	*962,560*	*775,073*	*187,487*
Total B	**40,033,819**	**38,544,663**	**1,489,156**
Total (A+B)	**129,881,290**	**125,699,557**	**4,181,733**

B) securities related to investments of reserves and provisions (sub-item 11.2 – *Securities related to the investment of reserves and provisions*) are denominated in euros and to a very small extent in foreign currency. At year-end, 76 per cent of the portfolio consisted of bonds and 24 per cent of shares, other equity, ETFs and shares/units of UCITS. Most of the investments in shares consisted of listed securities.

As regards the issuers of these securities, the majority were Italian and the bulk of the remainder from other euro-area countries. Most of the purchases during 2013 consisted of government securities.

The Bank of Italy has controlling interests in two companies, Bonifiche Ferraresi SpA and Società Italiana di Iniziative Edilizie e Fondiarie SpA (SIDIEF). The interest in Bonifiche Ferraresi SpA, previously held as a permanent investment, was classified in 2012 under marketable securities following the Board of Directors' decision to sell the holding.

In 2013, following the transfer of its interest in Assicurazioni Generali SpA (Generali), the Bank became a shareholder in Fondo Strategico Italiano (FSI). The agreement with FSI and its parent company Cassa depositi e prestiti was signed on 19 December 2012. The shares in Generali were transferred in exchange for newly issued FSI shares. The Bank's interest, which is equal to 20 per cent of FSI's capital, consists of one third of ordinary shares and two thirds of preference shares. FSI has undertaken to sell its entire interest in Generali at market prices by 31 December 2015. Once the sale of Generali has been completed, FSI will redeem the Bank's preference shares.

The other interests held as permanent investments include shares of the Bank for International Settlements, which are denominated in SDRs, valued at cost and translated at historic exchange rates. The Bank's interest is equal to 9.4 per cent of the BIS's capital.

The portfolio includes securities held to maturity whose book value (€4,167 million) was higher than the year-end valuation at market prices (€4,101 million). These securities, for which no lasting reduction in value was found relating to the position of the issuers, were stated at amortized cost.

[5] Intra-Eurosystem claims and liabilities

On the asset side:

– the *Participating interest in the ECB* increased by €16 million as a result of the recalculation of the Bank's share upon Croatia's accession to the EU. Accordingly, *Claims deriving from transfers of reserves to the ECB*, which are computed according to the Bank's subscription, also increased;

Pursuant to Article 28 of the Statute of the ESCB, the NCBs are the sole subscribers and holders of the capital of the ECB. Subscriptions depend on the shares, which are determined on the basis of the key for the subscription of the ECB's capital established in Article 29 of the Statute and adjusted every five years or when a new country joins the EU. The Bank of Italy's share of the ECB's subscribed capital was adjusted on 1 July 2013 to reflect Croatia's accession and at the end of 2013 amounted to 12.4570 per cent. Following the periodic five-year adjustment, on 1 January 2014 the Bank's share decreased to 12.3108 per cent.

Table 18.11

Positions with the ECB and the other euro-area NCBs
(thousands of euros)

		31.12.2013	31.12.2012	Changes
Assets				
9.1	Participating interest in the ECB	1,377,337	1,361,272	16,065
9.2	Claims arising from the transfer of foreign reserves to the ECB	7,218,961	7,198,857	20,104
9.3	Net claims related to the allocation of euro banknotes within the Eurosystem	12,867,287	3,604,588	9,262,699
9.4	Other claims within the Eurosystem (net)	–	–	–
Total		**21,463,585**	**12,164,717**	**9,298,868**
Liabilities				
9.3	Other liabilities within the Eurosystem (net)	228,381,754	253,799,438	-25,417,684
Total		**228,381,754**	**253,799,438**	**-25,417,684**

Considering only the NCBs belonging to the Eurosystem, at the end of 2013 the Bank's share of the ECB's capital was equal to 17.9088 per cent. This amount was reduced to 17.5923 per cent on 1 January 2014 after the five-year adjustment and the accession of Latvia.

The *Claims deriving from transfers of reserves to the ECB* represent the interest-earning claim denominated in euros recorded at the start of the Third Stage of EMU against the transfer of gold, foreign securities and foreign currencies to the ECB in proportion to the Bank's share of the ECB's capital, as in the case of the other Eurosystem NCBs (see "Comments on the items of the profit and loss account" – *Net interest income*).

– *Net claims related to the allocation of euro banknotes within the Eurosystem* amounted to €12,867 million (see "Legal basis, method of preparation and layout of the annual accounts").

On the liability side:

– *Other liabilities within the Eurosystem (net)* amounted to €228,382 million (compared with €253,799 million in 2012) and represent the Bank's net position vis-à-vis the Eurosystem, mainly deriving from the operation of the TARGET2 system. The latter gave rise to an overall debtor position of €229,128 million at the end of 2013 (compared with €255,102 million in 2012). At the end of the year the overall position was reduced by a) a claim of €245 million (€103 million in 2012) for the ECB interim profit distribution pertaining to 2013 and b) a claim of €501 million (€1,200 million in 2012) deriving from the net result of the pooling of monetary income in 2013 (€498 million) and the recalculation (€3 million) of monetary income pertaining to previous years.

[6] Other assets

This item consists mainly of investments in securities of reserves and provisions (see *Securities portfolio*).

The year-end market value of the buildings owned by the Bank was estimated to be €4,101 million for those used for its operations and €1,235 million for those related to investments of the severance pay and pension provision.

Deferred tax assets (sub-item 11.6) decreased by €604 million as a consequence of:

– the offsetting of €589 million of the deferred taxes deriving from the carry-forward of the remaining tax loss for 2002;

– the decrease of €18 million in the deferred tax assets in respect of the provision for Eurosystem monetary policy operations (see *Provisions* and *Provision for general risks*);

– the net increase of €3 million in the deferred tax assets deriving from other sources.

The amount of deferred taxes is calculated using the tax rates that are expected to be in force at the time the temporary differences that have generated them are reversed. The bulk of the deferred tax assets included in the balance sheet derive from the carry-forward of the residual tax losses from the bond conversion under Law 289/2002. The rules governing the carry-forward of these losses are laid down in Article 65 of Law 289/2002, as amended by Law 248/2005. The rules state that the losses may be utilized with no time restriction to offset up to 50 per cent of the corporate income tax liability each year. The inclusion of deferred tax assets in the balance sheet is based on the reasonable expectation – considering the outlook for the Bank's income and the applicable tax law – of offsetting the full amount of the abovementioned tax losses.

Sundry (sub-item 11.7 on the asset side) includes the balance-sheet total of €299 million of the defined-contribution supplementary pension fund for staff hired since 28 April 1993, which is matched on the liability side by an equal amount entered in sub-item 11.3 of *Other liabilities*. The other components of the sub-item are mainly payments on account of corporate income tax and Irap made in 2013.

[7] Banknotes in circulation

The total value of banknotes in circulation issued by the Eurosystem is distributed among the NCBs according to their respective shares (see "Legal basis, method of preparation and layout of the annual accounts"). The item, which represents the Bank of Italy's share (16.5 per cent), increased by €7,593 million (from €149,948 million to €157,541 million). The value of banknotes effectively put into circulation by the Bank decreased instead by €1,669 million (from €146,343 million to €144,674 million). Because this amount was lower than the notional amount assigned to the Bank, the difference of €12,867 million gave rise to a claim on the Eurosystem entered in Item 9.3 *Net claims related to the allocation of euro banknotes within the Eurosystem*. The average stock of banknotes effectively put into circulation fell from €145,545 million to €139,622 million, a decrease of 4 per cent compared with a 3 per cent increase for the euro area.

[8] Liabilities to general government and other counterparties

The item, which amounted to €33,888 million at the end of 2013, down by €607 million with respect to 2012, refers mainly to the deposits held by the Treasury with the Bank of Italy (€7,973 million) and the Treasury's fixed-term deposits (€19,000 million), which are included under the sub-item *Other liabilities*.

The year-end balance of the sinking fund for the redemption of government securities decreased, while the average balance increased from €229 million to €2,868 million. The sub-item *Other liabilities* also includes debtor positions with general government in respect of advances received for the management of cross-border euro payments and collections amounting to €116 million (compared with €130 million in 2012) and deposits amounting to €7 million.

Liabilities to other counterparties, amounting to €6,771 million (€694 million in 2012), referred mainly to customers that used the Eurosystem Reserve Management Services (see *Other claims on euro-area credit institutions*) in the amount of €5,085 million and to other deposits in the amount of €1,213 million.

[9] Liabilities to non-euro-area residents denominated in euros

The sub-item 5.2 *Other liabilities* amounted to €555 million (€1,000 million in 2012) and referred mainly to accounts held by customers that used the Eurosystem Reserve Management Services.

[10] Other liabilities

As detailed below:

Table 18.12

Other liabilities (item 11)
(thousands of euros)

	31.12.2013	31.12.2012	Changes
11.1 Cashier's cheques	104,547	219,491	-114,944
11.2 Accruals and deferrals	7,014	14,209	-7,195
11.3 Sundry	1,223,308	1,419,252	-195,944
of which: Supplementary Pension Fund	*299,302*	*249,480*	*49,822*
Total	**1,334,869**	**1,652,952**	**-318,083**

[11] Provisions and provision for general risks

The balances and movements in *Provisions* are shown in Tables 18.13 and 18.14.

The decrease in *Provisions for specific risks* (sub-item 12.1) was due to the net change in the *Tax provision* and the elimination of the provision for Eurosystem monetary policy operations. In accordance with Article 32.4 of the ESCB Statute, all the Eurosystem NCBs created provisions against the counterparty risk associated with monetary policy operations in proportion to their capital key shares in the ECB in the year in which the events occur. The Governing Council of the ECB reassessed the buffer created by the NCBs and eliminated the outstanding amount, equal to €310 million (of which €56 million pertaining to the Bank of Italy). The reduction is entered in the profit and loss accounts of the Eurosystem NCBs, apportioned in the same way as their allocations to the buffer (see "Comments on the items of the profit and loss account" – *Net result of the pooling of monetary income*).

Table 18.13

Movements in provisions for specific risks (sub-item 12.1)
(thousands of euros)

	Insurance cover	Tax provision (1)	Provision for Eurosystem monetary policy operations	Provision for charges	Total
Opening balance	**309,874**	**1,134,802**	**55,730**	**16,349**	**1,516,755**
Increases	**–**	**1,039,772**	**–**	**–**	**1,039,772**
Allocations	–	1,039,600	–	–	1,039,600
Other increases	–	172	–	–	172
Decreases	**–**	**-1,133,407**	**-55,730**	**-3,378**	**-1,192,515**
Withdrawals	–	-1,133,400	–	-3,378	-1,136,778
Other decreases	–	-7	-55,730	–	-55,737
Closing balance	**309,874**	**1,041,167**	**–**	**12,971**	**1,364,012**

(1) Other *changes include* the change in deferred tax liabilities for Irap.

The provision for charges, from which €3 million was released in 2013, refers to the costs to be incurred for the restructuring of the Bank's buildings in L'Aquila damaged by the earthquake of 6 April 2009.

Table 18.14

Movements in staff-related provisions (sub-item 12.2)
(thousands of euros)

	For staff severance pay and pensions	For staff costs	For severance pay (1)	For grants to BI pensioners and their survivors	Total
Opening balance	**6,426,770**	**177,263**	**2,913**	**2,279**	**6,609,225**
Increases	**19,550**	**78,710**	**300**	**307**	**98,867**
Allocations	19,550	78,710	157	307	98,724
Other increases	–	–	143	–	143
Decreases	**-220**	**-94,283**	**-31**	**-3**	**-94,537**
Withdrawals	-220 (2)	-93,091	-25	-3	-93,339
Other decreases	–	-1,192	-6	–	-1,198
Closing balance	**6,446,100**	**161,690**	**3,182**	**2,583**	**6,613,555**

(1) Includes severance pay accrued by contract staff and ordinary staff prior to joining the supplementary pension fund. – (2) Includes the transfer of severance pay of staff participating in the supplementary pension fund.

Staff-related provisions (sub-item 12.2) amounted to €6,614 million. They include:

– the severance pay provision, which increased by €19 million to €6,446 million. The allocation for the year reflected above all the new economic and financial parameters used to calculate actuarial reserves;

– the provision for staff costs, which decreased by €16 million to €162 million. Of this figure €49 million was in respect of early retirement measures in connection with the reorganization of the Bank's branch network.

Following an assessment of the Bank's overall risk exposure, the *Provision for general risks* (item 14) was increased by €2,183 million to €15,374 million at the end of 2013, compared with €13,191 million at the end of 2012.

[12] Revaluation accounts

These include the valuation at market prices of gold, foreign currency, securities and forward operations (see *Gold, assets and liabilities denominated in foreign currency* and *Securities portfolio*).

Table 18.15

Revaluation accounts (item 13)
(thousands of euros)

	Opening balance	Withdrawals	Net revaluations	Closing balance
Exchange rate revaluations	**83,420,789**		**-32,796,207**	**50,624,582**
of which: gold	*79,996,330*		*-30,739,999*	*49,256,331*
net foreign currency assets (1)	*3,418,495*		*-2,056,913*	*1,361,582*
financial assets related to the investment of reserves and provisions (1)	*5,964*		*705*	*6,669*
Price revaluations	**3,479,675**		**87,069**	**3,566,744**
of which: foreign currency securities	*336,949*		*-210,487*	*126,462*
securities denominated in euros	*613,692*		*-143,943*	*469,749*
financial assets related to the investment of reserves and provisions (1)	*2,529,034*		*441,499*	*2,970,533*
Revaluations at 1 January 1999	**2**	**-1**		**1**
Total	**86,900,466**	**-1**	**-32,709,138**	**54,191,327**

(1) Includes net revaluations relating to operations to hedge exchange rate risks on the Bank's SDR position and foreign currency investments related to reserves and provisions.

[13] Capital and reserves

On 23 December 2013 the extraordinary meeting of shareholders approved some amendments to the Bank of Italy's Statute taking into account the provisions of Decree Law 133/2013, converted into Law 5/2014. The new Statute entered into force on 31 December 2013. The meeting approved an increase in the Bank's capital from €156,000 to €7,500,000,000 by drawing on the statutory reserves (Tables 18.15 and 18.16).

Unlike the previous Statute, the new one does not provide for shareholders to receive a dividend drawing on the revenue from the investment of ordinary and extraordinary reserves in addition to the dividend distributed from net profits.

Unlike the previous Statute, the new one does not provide for shareholders to receive a dividend drawing on the revenue from the investment of ordinary and extraordinary reserves in addition to the dividend distributed from net profits.

Table 18.16

Capital and reserves (item 15) *(thousands of euros)*			
	31.12.2013	31.12.2012	Changes
15.1 Capital	**7,500,000**	**156**	**7,499,844**
15.2 Statutory reserves	**8,298,343**	**14,867,762**	**-6,569,419**
Ordinary	3,989,220	7,273,198	-3,283,978
Extraordinary	4,309,123	7,594,564	-3,285,441
15.3 Other reserves	**7,739,511**	**7,739,511**	**–**
Revaluation reserve under Law 72/1983	694,502	694,502	–
Revaluation reserve under Law 408/1990	683,274	683,274	–
Revaluation reserve under Law 413/1991	16,943	16,943	–
Revaluation reserve under Law 342/2000	896,577	896,577	–
Revaluation reserve under Law 266/2005	1,521,240	1,521,240	–
Fund for the renewal of tangible fixed assets	1,805,044	1,805,044	–
Surplus from the merger of UIC (Law 231/2007)	2,121,931	2,121,931	–
Total	**23,537,854**	**22,607,429**	**930,425**

As a result of the amendments to the Statute, the previous registered shares with a face value of €0.52 have been cancelled and new registered shares issued in their place with a legally established face value of €25,000.

Table 18.17

Movements in ordinary and extraordinary reserves (sub-item 15.2) *(thousands of euros)*					
	Balance at 31.12.2012	Allocation of 2012 profit (1)	Distribution to shareholders (2)	Withdrawal for capital increase	Balance at 31.12.2013
Ordinary	7,273,198	500,225	-34,281	-3,749,922	3,989,220
Extraordinary	7,594,564	500,225	-35,744	-3,749,922	4,309,123
Total	**14,867,762**	**1,000,450**	**-70,025**	**-7,499,844**	**8,298,343**

(1) Under Article 39 of the previous Statute and Article 40 of the new Statute. – (2) For the whole of 2012 under Article 40 of the old Statute, now eliminated in the new Statute.

The distribution of the shareholdings in the Bank of Italy's capital at 31 December 2013 is detailed in Table 18.18.

Table 18.18

Shareholders in the Bank of Italy				
	At end-2013		At end-2012	
	Number	Shares	Number	Shares
SpAs engaged in banking, including companies referred to in ex Article 1, Legislative Decree 356/1990	*53*	*253,500*	*57*	*253,500*
Social security institutions	*1*	*15,000*	*1*	*15,000*
Insurance companies	*6*	*31,500*	*6*	*31,500*
Total	**60**	**300,000**	**64**	**300,000**

Off-balance-sheet accounts

Forward sales of foreign currency include:

– the commitment to the ECB in respect of reverse operations with Eurosystem counterparties associated with the short-term dollar refinancing programme (see *Gold and assets and liabilities denominated in foreign currency*);

– the commitment arising from operations to hedge the exchange rate risk on the Bank's SDR position and foreign currency investments related to reserves and provisions (see *Securities portfolio*).

Commitments to the IMF for loans granted relate to existing IMF initiatives with Italy for financing to be disbursed.

The Bank participates in the automatic securities lending programmes managed by specialized intermediaries both for securities included among its foreign currency assets and for covered bonds purchased as part of monetary policy operations. At the end of 2013, the Bank's lending under these programmes amounted to €379 million for foreign currency securities and €6,990 million for covered bonds.

Table 18.19

Off-balance-sheet accounts
(thousands of euros)

	31.12.2013	31.12.2012	Changes
Orders in progress	**256,877**	**151,497**	**105,380**
Purchases	145,034	101,604	43,430
Sales	111,843	49,893	61,950
Forward operations	**2,892,047**	**4,096,013**	**-1,203,966**
Forward sales of foreign currencies	1,805,642	3,622,472	-1,816,830
Forward purchases of foreign currencies	483,390	473,541	9,849
Futures contracts purchased	551,157	–	551,157
Futures contracts sold	51,858	–	51,858
Commitments	**38,249,729**	**39,063,697**	**-813,968**
To the IMF for loans granted	38,249,729	39,063,685	-813,956
Other	–	12	-12
Collateral received	**435,447,192**	**473,612,319**	**-38,165,127**
For refinancing operations (1)	421,806,580	469,178,040	-47,371,460
Other	13,640,612	4,434,279	9,206,333
Collateral granted	**11,060**	**11,574**	**-514**
Third-party securities and valuables on deposit with the Bank	**138,326,257**	**142,059,082**	**-3,732,825**
Memorandum accounts of the supplementary pension fund	**259,824**	**171,709**	**88,115**
Total	**615,442,986**	**659,165,891**	**-43,722,905**

(1) Includes securities and bank loans used as collateral.

[14] Net interest income

Net interest income (item 1) amounted to €5,609 million in 2013, showing a decrease of €186 million with respect to 2012.

Total interest income amounted to €7,152 million, down €1,192 million on the previous year. Of the total decrease, €1,140 million was due to interest on assets denominated in euros (Table 18.20).

Table 18.20

Interest income (sub-item 1.1) (1)
(thousands of euros)

	2013	2012	Changes
On assets denominated in euros	6,930,503	8,070,017	-1,139,514
Securities	*5,357,283*	*5,662,645*	*-305,362*
Lending operations	*1,446,114*	*2,328,447*	*-882,333*
Intra-ESCB balances	*86,073*	*70,917*	*15,156*
Other	*41,033*	*8,008*	*33,025*
On assets denominated in foreign currency	221,204	274,067	-52,863
Receivables from the IMF	*10,341*	*15,477*	*-5,136*
Securities	*201,374*	*238,880*	*-37,506*
Other assets	*9,489*	*19,710*	*-10,221*
Total	**7,151,707**	**8,344,084**	**-1,192,377**

(1) Interest earned on financial assets related to the investment of reserves and provisions is shown as a separate income item (see *Net income from financial assets related to the investment of reserves and provisions*).

Interest expense totalled €1,543 million (Table 18.21). This represents a decrease of €1,006 million overall with respect to 2012, of which €992 million for interest on liabilities denominated in euros.

Table 18.21

Interest expense (sub-item 1.2)
(thousands of euros)

	2013	2012	Changes
On liabilities denominated in euros	1,533,009	2,525,389	-992,380
Treasury payments account	*76,089*	*76,071*	*18*
Sinking fund for the redemption of government securities	*16,356*	*1,875*	*14,481*
Treasury fixed-term deposits	*9,350*	*17,818*	*-8,468*
Current accounts (covering the minimum reserve system)	*71,595*	*118,252*	*-46,657*
Intra-ESCB balances	*1,355,386*	*2,286,748*	*-931,362*
Other	*4,233*	*24,625*	*-20,392*
On liabilities denominated in foreign currency	9,625	23,377	-13,752
Counterpart of SDRs allocated by the IMF	*6,017*	*8,277*	*-2,260*
Other	*3,608*	*15,100*	*-11,492*
Total	**1,542,634**	**2,548,766**	**-1,006,132**

[15] Net result of financial operations, write-downs and transfers to/from risk provisions

As detailed below:

Table 18.22

Net result of financial operations, write-downs and transfers to/from risk provisions (item 2) (thousands of euros)	2013	2012	Changes (1)
Profits (+) and losses (-) on financial operations	300,574	747,528	-446,954
Foreign exchange trading	*90,879*	*180,675*	*-89,796*
Trading in securities denominated in euros	*168,183*	*395,917*	*-227,734*
Trading in securities denominate in foreign currency	*41,779*	*164,127*	*-122,348*
Derivative contracts denominated in foreign currency	*-1,096*	*-141*	*-955*
Other transactions	*829*	*6,950*	*-6,121*
Write-downs (-) of financial assets and positions	-347,053	-4,624	-342,429
Due to exchange rate changes	*-266,558*	*-4*	*-266,554*
Due to price changes			
– securities denominated in euros	*-8,472*	*-81*	*-8,391*
– securities denominated in foreign currency	*-72,023*	*-4,539*	*-67,484*
Transfers to (-) the provision for general risks for exchange rate, price and credit risks	-2,183,000	-2,645,000	462,000
Total	**-2,229,479**	**-1,902,096**	**-327,383**

(1) Negative changes indicate smaller profits or larger losses/write-downs; positive changes indicate larger profits or smaller losses/write-downs.

[16] Net income from fees and commissions

The net result for the year was virtually unchanged (€16 million). *Fee and commission income* (sub-item 3.1) included the charges payable by the participants in TARGET2 (€7 million), the charge payable for the management of securities used as collateral for monetary policy operations (€6 million), fees for financial services on behalf of general government (€5 million), substitute protest declarations (€3 million), fees for Correspondent Central Banking Model services (€2 million), those for the use of Central Credit Register information (€3 million) and those for the retail clearing system (€2 million). *Fee and commission expense* referred primarily to the centralized securities management service (€10 million).

[17] Income from participating interests

The item *Income from participating interests* increased by €205 million to €321 million and comprises:

– €76 million, the Bank of Italy's share of the ECB profits earned in 2012 and distributed in 2013 (€13 million in the previous year);

– €245 million, the ECB interim profit distribution for 2013 (€103 million in 2012).

In February 2014, the Bank of Italy received a further dividend of €11 million, supplementing that already paid in advance.

[18] Net result of the pooling of monetary income

The result for 2013 was €557 million (item 5), consisting of:

– the receipt of the Bank of Italy's share of the pooling of monetary income (€498 million, compared with €1,184 million in 2012). This represents the difference between the monetary income pooled by the Bank (€2,484 million) and that redistributed (€2,982 million);

– the effect, positive for €3 million, of the redetermination of the pooling of monetary income for prior years;

– the elimination of the provision in respect of monetary policy operations amounting to €56 million (see “Comments on the items of the balance sheet” – *Provisions* and *Provision for general risks*).

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 mainly of banknotes in circulation; liabilities to euro-area credit institutions related to monetary policy operations denominated in euros; net intra-Eurosystem liabilities resulting from TARGET2 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 mainly of lending to euro-area credit institutions related to monetary policy operations; securities held for monetary policy purposes; intra-Eurosystem claims equivalent to the transfer of reserve assets to the ECB; net intra-Eurosystem claims resulting from TARGET2 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 and gold receivables in proportion to each NCB’s subscribed capital key. Gold is considered to generate no income. The securities held for monetary policy purposes under the Covered Bond Purchase Programmes (Decision No. 16 of 2 July 2009 and Decision No. 17 of 3 November 2011 of the Governing Council of the ECB) are considered to bear interest at the last marginal rate applied to Eurosystem main refinancing operations. 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 last marginal rate applied to Eurosystem main refinancing operations.

The monetary income pooled by the Eurosystem is redistributed to each NCB according to its capital key. The difference between the amount pooled by each NCB and the amount, which may be larger or smaller, redistributed to it depends on two factors. The first relates to the possible differences between NCBs in the interest income from specific earmarkable assets and the interest expense for some components of the liability base. The second relates to the fact that the amounts of the above assets and liabilities in the NCBs’ balance sheets do not generally coincide with their share in the ECB’s capital.

[19] Net income from financial assets related to the investment of reserves and provisions

Item 6 of the profit and loss account amounted to €2,135 million, up €787 million on the previous year (Table 18.23). The substantial improvement was due to the increase in the net profit from trading, mainly from the disposal of the Bank’s interest in Assicurazioni Generali following its transfer to FSI (see “Comments on the items of the balance sheet” – *Securities portfolio*). The net profits from trading include those from sales effected as part of the gradual restructuring of the Bank’s portfolio of listed shares.

Table 18.23

Net income from financial assets related to the investment of reserves and provisions (item 6) *(thousands of euros)*			
	2013	2012	Changes
Interest	1,118,721	1,166,931	-48,210
Dividends on shares and participating interests	197,917	203,771	-5,854
Profits/losses from trading and disposals	794,532	10,386	784,146
Write-downs	-9,409	-65,818	56,409
Other components	32,840	32,026	814
Total	**2,134,601**	**1,347,296**	**787,305**

[20] Other income

The item *Other income* includes reimbursements by the Eurosystem NCBs in connection with the development of platforms, applications and IT infrastructures by the Bank of Italy in cooperation with the other central bank providers. In particular, in 2013 the item includes the reimbursement for the TARGET2 platform (€22 million, against €23 million in 2012).

[21] Transfer of investment income to statutory reserves

In 2012, as provided for in Article 40 of the previous Statute, €478 million was transferred to the statutory reserves from the profit for the year. No amount was appropriated in 2013 following the abrogation of the provision in the new Statute.

[22] Expenses and charges

The item amounted to €1,815 million, representing a decrease of €23 million with respect to 2012 (Table 18.24).

Table 18.24

Sundry expenses and charges (item 10) *(thousands of euros)*			
	2013	2012	Changes
Staff wages and salaries	599,069	603,297	-4,228
Social security and insurance	155,171	155,905	-734
Other staff costs	47,146	49,951	-2,805
Pensions and severance payments	293,349	299,143	-5,794
Transfers from/ to provisions for accrued expenses and staff severance pay and pensions	63,497	66,122	-2,625
Emoluments paid to head office and branch collegial bodies	3,009	2,879	130
Administrative expenses	441,265	442,629	-1,364
Depreciation of tangible and intangible fixed assets	170,355	173,081	-2,726
Banknote production services	–	–	–
Other expenses	42,222	45,106	-2,884
Total	**1,815,083**	**1,838,113**	**-23,030**

In particular, there was a reduction in staff costs and outlays for staff pensions and severance pay. Administrative expenses also declined slightly.

Gross employee compensation (including that of contract workers), comprising wages and salaries, overtime and accrued expenses not yet paid, amounted to €599 million, down from €603 million in 2012. The average number of full-time equivalent employees (taking into account overtime, part-time and unpaid absences) was 7,481. The average gross per capita wage continued to decline, amounting to €80,083, against €80,477 in 2012.

Total staff costs, i.e. gross wages and salaries plus related costs (pensions and social security contributions) and other staff costs (including per diem expenses for missions and transfers), amounted to €801 million.

Table 18.25

The Bank's staff

	Average number of persons in service		Percentage composition	
	2013	2012	2013	2012
Managerial	2,060	2,042	29.5	29.1
Non-executive	4,111	4,110	58.8	58.7
General services and security	353	376	5.0	5.4
Blue-collar	471	479	6.7	6.8
Total	**6,995**	**7,007**	**100.0**	**100.0**
Contract workers	32	32		

In 2013 annual allocations to the severance pay fund amounted to €19 million, mainly in connection with the updating of the parameters of the model used to calculate actuarial reserves (see "Comments on the items of the balance sheet" – *Provisions* and *Provision for general risks*).

The *Emoluments paid to head and branch office collegial bodies* comprised the emoluments paid to all the members of the Board of Directors (€371,020), the Board of Auditors (€137,430) and the Governing Board. By resolution of 28 June 2012, the Board of Directors fixed the emoluments paid to the members of the Governing Board as of 1 January 2013 at €550,000 to the Governor, €500,000 to the Director General and €350,000 to each Deputy Director General. The amounts paid as emolument continued to be decreased by 10 per cent in accordance with the criteria laid down in Decree Law 78/2010, converted into Law 122/2010 and confirmed by Decree Law 150/2013, converted into Law 15/2014. Accordingly, the gross emoluments effectively paid were €495,000 to the Governor, €450,000 to the Director General and €315,000 to each Deputy Director General.

Administrative expenses amounted overall to €441 million (€443 million in 2012). Spending on systems assistance rose by €2 million (from €34 million to €36 million) as did the cost of external software leasing and maintenance (from €35 million to €37 million). By contrast, the cost of raw materials and subsidiary materials for banknote production decreased by €8 million (from €44 million to €36 million). The costs of security services and banknote escort (€74 million), building maintenance (€58 million), utilities (€29 million), electronic transmission (€16 million), equipment rental (€13 million) and participation in TARGET2 (€9 million) were basically unchanged.

Other expenses, amounting to €42 million, comprised €37 million for taxes, of which €31 million for IMU property tax.

[23] Extraordinary income and expense

Extraordinary income and expense (item 12) showed a positive balance of €9 million. The income (€21 million) consisted, among other things, of tax credits pertaining to previous years (€8 million) pursuant to Decree Law 16/2012 converted into Law 44/2012; it also included value adjustments to costs related to previous years (€7 million). The expense (€12 million) included tax costs (€8 million) and costs related to previous years (€3 million).

[24] Taxes on income for the year and on productive activities

Taxes for the year (item 13) amounted to €1,644 million and comprised both the current taxes due and the change in deferred tax assets and liabilities. Corporate income tax for the year, including deferred taxes, amounted to €1,341 million (€1,571 million in 2012).

The regional tax on productive activities (IRAP) decreased from €356 million to €303 million.

PROPOSALS FOR THE BOARD OF DIRECTORS

Pursuant to Article 40 of the Statute, the Board of Directors, acting on a proposal from the Governing Board and after hearing the opinion of the Board of Auditors, proposes the following allocation of the net profit for approval by the Meeting of Shareholders:

	euros
– 20 per cent to the ordinary reserve	607,063,183
– to the shareholders, a dividend equal to	380,000,000
– 5 per cent to the extraordinary reserve	151,765,796
– the remaining amount to the State	1,896,486,935
Total	3,035,315,914

THE GOVERNOR
Ignazio Visco

19. DOCUMENTATION ATTACHED TO THE ANNUAL ACCOUNTS

REPORT OF THE BOARD OF AUDITORS

ON THE 120th FINANCIAL YEAR OF THE BANK OF ITALY
AND THE ACCOUNTS FOR THE YEAR ENDED 31 DECEMBER 2013

To the shareholders,

We have examined the annual accounts of the Bank of Italy for the year ended 31 December 2013, drawn up in accordance with the accounting standards and valuation methods decided by the Board of Directors and agreed by us, which are described in detail in the notes to the accounts.

We conducted our examination of the annual accounts in accordance with the rules and principles of conduct for the board of auditors issued by the Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili. We also took the same principles into account in performing the checks required by Article 20 of the Bank of Italy's Statute.

In our opinion the annual accounts of the Bank of Italy for the year ended 31 December 2013 have been prepared in accordance with the accounting standards and valuation methods indicated in the notes to the accounts. They comply with the law in force and with the harmonized accounting rules laid down by the Governing Council of the ECB and made applicable for the purposes of the annual accounts by Article 8 of Legislative Decree 43/1998.

We call attention in particular to the following matters, which are treated at length in the notes to the accounts and the management report.

a) The inclusion in the balance sheet of deferred tax assets, deriving chiefly from the carry-forward of the residual tax loss from the bond conversion under Law 289/2002, is based on the reasonable expectation, considering the outlook for the Bank's income, of offsetting the full amount thereof. In relation to the result for the year, deferred tax assets diminish by €604 million (from €4,291 million to €3,687 million).

b) The Board of Directors approved the transfer of €2,183 million to the provision for general risks, which is now expressly provided for in Article 41 of the new Statute.

c) *Transfers to the provision for staff severance pay and pensions* amount to €19 million; this sum reflects the revision of the economic and financial parameters used for calculating the mathematical reserves.

We attest that in our opinion the total amount of the Bank's general and specific risk provisions is prudent.

We have examined the management report accompanying the annual accounts and consider it to be consistent therewith.

During the financial year ended 31 December 2013 we verified compliance with the law and with the Bank's Statute and General Regulations.

We attended all the meetings of the Board of Directors and made the tests and controls within the scope of our authority, including checks on the quantities of cash and valuables belonging to the Bank and third parties. We monitored the activity of the Bank's peripheral units, in accordance with Articles 20 and 21 of the Statute, with the assistance of the examiners at the main and local branches, whom we thank warmly.

We examined the adequacy of the administrative and accounting aspects of the organizational arrangements, checking their operation and verifying that a system was in place to ensure a full and accurate accounting record of events. The accounts were kept properly in conformity with the standards and rules laid down by the law in force. The individual items of the annual accounts, which were also audited by external auditors, were compared by us with the accounting records and found to conform with them.

We monitored the legitimacy and proper execution of the formalities provided for on the occasion of the amendments to the Bank's Statute approved by the extraordinary shareholders' meeting of 23 December 2013, entailing, among other things, the increase in the capital to €7.5 billion through the transfer to capital of part of the statutory reserves.

No significant facts warranting mention in this report emerged in the course of our auditing activity, as described above, or from our discussions with the external auditors and the heads of the corporate functions.

The accounts submitted for your approval show the following results:

Assets	€	554,399,390,883
Liabilities	€	527,826,221,224
Capital and reserves	€	23,537,853,745
Net profit for the year	€	3,035,315,914

The off-balance-sheet accounts, equal to €615,442,986,483, refer to commitments, forward transactions, guarantees granted and received, and third parties' deposits of securities and sundry valuables.

Pursuant to Article 40 of the Statute, the Board of Directors proposes the following allocation of the net profit:

– 20 per cent to the ordinary reserve	€	607,063,183
– a dividend to the shareholders	€	380,000,000
– 5 per cent to the extraordinary reserve	€	151,765,796
– the remaining amount to the State	€	1,896,486,935
Total	€	3,035,315,914

To the shareholders,

Bearing in mind Article 39.2 of the Statute, we recommend that you approve the annual accounts for 2013 that have been submitted to you (the balance sheet, the profit and loss account and the notes to the accounts) and the proposed allocation of the net profit for the year pursuant to Article 40 of the Statute.

Rome, 30 April 2014

THE BOARD OF AUDITORS

Dario Velo (Chairman)
Lorenzo De Angelis
Giovanni Fiori
Gian Domenico Mosco
Sandro Sandri

LIST OF ABBREVIATIONS

ABI – *Associazione bancaria italiana*
Italian Banking 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

BOTs – *Buoni ordinari del Tesoro*
Treasury bills

BTPs – *Buoni del Tesoro poliennali*
Treasury bonds

CC&G – *Cassa di Compensazione e Garanzia S.p.A.*

CCTs – *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

Covip – *Commissione di vigilanza sui fondi pensione*
Pension fund supervisory authority

CTOs – *Certificati del Tesoro con opzione*
Treasury option certificates

CTZs – *Certificati del Tesoro zero-coupon*
Zero-coupon Treasury certificates

EFD – *Documento di economia e finanza (DEF)*
Economy and Finance Document

EFSF – European Financial Stability Facility

ESM – European Stability Mechanism

Euribor – Euro interbank offered rate

FIU – Financial Intelligence Unit

HICP – Harmonized index of consumer prices

ICI – *Imposta comunale sugli immobili*
Municipal property tax (until 2011)

IMU – *Imposta municipale unica*
Municipal property 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
IRES	–	*Imposta sul reddito delle società* Corporate income tax
IRPEF	–	*Imposta sul reddito delle persone fisiche* Personal income tax
IRS	–	*Interest Rate Swap*
Istat	–	*Istituto nazionale di statistica* National Institute of Statistics
Ivass	–	*Istituto per la vigilanza sulle assicurazioni* Insurance Supervisory Authority
MAC	–	*Mercato Alternativo del Capitale* Alternative Capital Market
MTS	–	*Mercato telematico dei titoli di Stato* Screen-based secondary market in government securities
SACE	–	*Istituto per i servizi assicurativi per il commercio estero* Foreign Trade Insurance Services Agency
SIM	–	*Società di intermediazione mobiliare* Italian investment firm
TARGET	–	Trans-European Automated Real-Time Gross Settlement Express Transfer System

ADMINISTRATION OF THE BANK OF ITALY

AT 31 DECEMBER 2013 [1]

GOVERNING BOARD - DIRECTORATE

Ignazio VISCO	Governor
Salvatore ROSSI	Director general
Fabio PANETTA	Deputy director general
Luigi Federico SIGNORINI	Deputy director general
Valeria SANNUCCI	Deputy director general

BOARD OF DIRECTORS

Franca Maria ALACEVICH
Francesco ARGIOLAS
Nicola CACUCCI
Carlo CASTELLANO
Paolo DE FEO
Giovanni FINAZZO
Andrea ILLY
Cesare MIRABELLI
Giovanni MONTANARI
Ignazio MUSU
Lodovico PASSERIN D'ENTREVES
Stefano POSSATI
Donatella SCIUTO

BOARD OF AUDITORS

Dario VELO - Chairman
Lorenzo DE ANGELIS
Giovanni FIORI
Gian Domenico MOSCO
Sandro SANDRI

ALTERNATE AUDITORS

Anna Lucia MUSERRA
Angelo RICCABONI

HEAD OFFICE
MANAGING DIRECTORS

Paolo MARULLO REEDTZ	- accountant general
Ebe BULTRINI	- managing director for it resources and statistics
Umberto PROIA	- secretary general with temporary responsibility for currency circulation
Eugenio GAIOTTI	- managing director for economic research and international relations
Marino Ottavio PERASSI	- general counsel
Nunzio MINICHIELLO	- managing director for property and purchasing
Emerico Antonio ZAUTZIK	- managing director for central banking, markets and payment systems
Carmelo BARBAGALLO	- managing director for banking and financial supervision
Daniele FRANCO	- state accountant general
Vieri CERIANI	- adviser on budget policy to the ministry for the economy and finance

* * *

Claudio CLEMENTE	- director of the financial intelligence unit

[1] *For changes made up to 30.5.2014 see the following page.*

ADMINISTRATION OF THE BANK OF ITALY

AT 30 MAY 2014

GOVERNING BOARD

Ignazio VISCO	Governor
Salvatore ROSSI	Senior deputy governor
Fabio PANETTA	Deputy governor
Luigi Federico SIGNORINI	Deputy governor
Valeria SANNUCCI	Deputy governor

BOARD OF DIRECTORS

Franca Maria ALACEVICH
Francesco ARGIOLAS
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Stefano POSSATI
Donatella SCIUTO

BOARD OF AUDITORS

Dario VELO - Chairman
Lorenzo DE ANGELIS
Giovanni FIORI
Gian Domenico MOSCO
Sandro SANDRI

ALTERNATE AUDITORS

Anna Lucia MUSERRA
Angelo RICCABONI

HEAD OFFICE

MANAGING DIRECTORS

Paolo MARULLO REEDTZ	- accountant general
Ebe BULTRINI	- director general for information technology
Umberto PROIA	- director general for human resources and organization
Eugenio GAIOTTI	- director general for economics, statistics and research
Marino Ottavio PERASSI	- general counsel
Nunzio MINICHIELLO	- director general for property and tenders
Emerico Antonio ZAUTZIK	- director general for markets and payment systems
Carmelo BARBAGALLO	- director general for financial supervision and regulation
Letizia RADONI	- director general for currency circulation
Daniele FRANCO	- state accountant general
Vieri CERIANI	- adviser on budget policy to the ministry for the economy and finance

* * *

Claudio CLEMENTE	- director of the financial intelligence unit