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Italy—Background Economic Developments and Issues

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INTERNATIONAL MONETARY FUND

ITALY

Background Economic Developments and Issues

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Approved by the European I Department

March 7, 1995

Contents

Tables

Charts

Table 1. Italy: Selected Economic Indicators, 1987-95

(Percentage changes, except as otherwise indicated)

	1987	1988	1989	1990	1991	1992	1993	1994 1/	1995 1/
Domestic economy									
GDP	3.1	4.1	2.9	2.1	1.2	0.7	-0.7	2.5	3.0
Domestic demand	4.1	4.4	2.8	2.5	1.9	0.8	-5.0	2.3	3.0
Consumption (households)	4.2	4.2	3.5	2.5	2.7	1.4	-2.1	2.0	3.2
Public consumption	3.4	2.8	0.8	1.2	1.6	1.0	0.8	0.2	-1.9
Gross fixed investment	5.0	6.9	4.3	3.8	0.6	-2.0	-11.1	--	5.1
Machinery and equipment	11.5	11.6	4.9	4.1	-0.1	-1.9	-15.6	4.3	10.0
Construction	-0.7	2.3	3.6	3.5	1.4	-2.1	-6.2	-4.2	--
Inventories (contribution)	--	--	-0.4	--	-0.1	0.3	-1.6	1.0	0.3
Foreign sector (contribution)	-1.1	-0.5	--	-0.5	-0.8	-0.1	4.6	0.2	--
Exports	4.7	5.4	8.8	7.0	0.5	5.0	10.0	10.4	8.5
Imports	9.1	6.8	7.6	8.0	3.4	4.6	-7.3	9.6	8.5
Employment 2/	-0.3	0.6	-0.1	1.3	0.8	-0.9	-2.9	-2.7	0.4
Unemployment rate 2/ 3/	10.5	10.7	10.5	9.4	8.8	10.7	10.4	11.5	11.2
Industrial production 4/	3.9	6.0	3.1	0.2	-0.9	-1.3	-2.1	5.1	3.0
Labor cost in manufacturing	7.6	7.5	9.7	8.6	9.4	7.0	4.5	3.1	3.3
Unit labor costs in manufacturing	2.4	1.8	6.7	6.9	7.5	3.1	1.4	-1.6	0.3
Consumer prices	4.7	5.0	6.3	6.5	6.3	5.3	4.4	3.9	4.8
GDP deflator	6.0	6.7	6.2	7.7	7.7	4.5	4.4	3.8	4.4
External accounts 5/									
Export volume	3.3	4.9	9.0	3.5	0.1	3.8	8.5	10.4	8.5
Import volume	11.3	6.4	8.3	4.5	4.5	3.4	-10.4	10.1	8.5
Export unit value	1.0	5.2	6.3	2.1	2.9	0.7	11.4	3.9	6.0
Import unit value	-1.5	4.2	7.6	-0.7	-0.8	-0.6	11.7	3.9	6.2
Trade balance (in percent of GDP)	--	-0.1	-0.2	0.1	--	0.3	3.3	3.4	3.6
Current account (in percent of GDP)	-0.3	-0.8	-1.4	-1.6	-2.1	-2.3	1.2	1.5	1.9
Nominal effective exchange rate	1.6	-3.6	-0.2	4.7	-2.4	-2.4	-18.7	-4.7	...
Real effective exchange rate	0.6	-2.6	4.3	5.6	0.6	0.1	-16.1	-4.1	...
Public finances (in percent of GDP)									
General government									
Balance	-11.0	-10.7	-9.9	-10.9	-10.2	-9.5	-9.5	-9.2	-8.1
Primary balance	-3.0	-2.6	-1.0	-1.3	--	1.9	2.5	1.6	3.1
Debt	94.4	96.6	99.8	102.3	105.8	113.3	122.4	123.9	123.2
State sector									
Revenues	29.4	29.5	30.8	31.4	32.1	33.7	34.3	32.0	32.8
Expenditures	40.7	40.5	41.5	41.5	42.4	44.1	44.2	41.4	40.1
Balance	-11.2	-11.0	-10.7	-10.1	-10.3	-10.4	-9.9	-9.3	-7.4
Incl. interest on tax refund liabilities	-11.6	-11.4	-11.1	-10.6	-10.7	-10.9	-10.3	-9.6	-7.5
Primary balance	-3.7	-3.2	-2.0	-0.7	-0.3	0.8	1.8	1.1	3.4
Debt	93.8	96.6	100.2	103.3	106.3	113.9	119.9	122.6	121.6
Financial variables									
Money (M2) 6/	8.7	8.0	7.6	9.6	8.3	6.0	7.9	2.8	...
Total domestic credit 7/	12.8	14.6	14.9	13.1	12.6	9.8	6.4	5.6	...
Of which: To nonstate sector	10.2	15.6	18.7	16.0	14.0	7.0	1.7	0.3	
Six-month rate on Treasury bills 8/	10.7	11.1	12.6	12.3	12.5	14.4	10.5	9.1	9.8
Minimum lending rate 8/	12.1	12.1	12.9	12.7	12.3	13.6	11.1	9.0	...

Sources: Data provided by the Italian authorities, and Fund staff estimates.

1/ Staff estimates and projections, unless otherwise indicated.
2/ In 1992, break in the series due to methodological revisions in the survey; before 1992 the series is reconstructed by the Bank of Italy.
3/ Excluding workers in the Wage Supplementation Fund.
4/ New series since 1991.
5/ Volumes and unit values are customs basis; trade balance and current account are balance of payments basis.
6/ Growth rate used for target monitoring, i.e., moving average of last three months.
7/ End-of-period.
8/ Period average.

I. Introduction

During 1994, the Italian economic recovery entered gathered pace as well as breadth, as the effects of strong export growth were reinforced by a revival of domestic demand. Inflation reached a 25-year low in July, but signs of inflationary pressures began to re-emerge with the recovery and continuing weakness of the lira. Despite the recovery, there is as yet no sign of a decline in unemployment from its recent high levels.

The fiscal situation continued to be problematic, with the level of public debt approaching 125 percent of GDP. The pause in adjustment envisaged in the 1993-95 medium-term plan turned into a reversal, due mainly to the effects of the recession. The 1994-96 plan, implemented in the 1995 budget, reaffirmed the goal of debt stabilization by 1996, but considerable uncertainty remains: the outturn for the primary balance may be better than anticipated due to the stronger-than-expected recovery, but higher-than-expected interest rates have also hindered plans to stabilize and reduce the debt. Structural issues, notably pension reform, as well as tax reform and expenditure control, remain important elements of the policy agenda. Privatization is another key policy priority, with the goal of reducing state involvement in economic life.

Financial markets continued to be troubled by uncertainties with regard to fiscal as well as political developments, and market interest rates reversed the downward course they had followed since the fall of 1992. Long-term rates declined in April to a spread of 250 basis points over German rates in April; this spread widened with mounting political anxieties, reaching over 550 basis points in February 1995. Money and credit growth decelerated. The Bank of Italy began to place increased emphasis on inflation targets as a criterion for policy, as money demand displayed continued signs of greater unpredictability. The banking system continued to undergo important structural changes, also experiencing cyclically adverse results with regard to volume of intermediation, spreads, problem loans, and capital losses on bank portfolios.

International trade reflected competitiveness gains as well as cyclical developments with a widening current account surplus. Capital movements were dominated by portfolio investment, which was influenced both by international interest rate trends and domestic political factors.

This background paper reviews developments in the Italian economy during 1994 with some special attention to some specific issues. Chapter II describes trends in the real economy, with special annexes focusing on the outlook for inflation and the response of employment to cyclical and structural factors. Chapter III discusses fiscal developments. Chapter IV summarizes developments in the monetary sector; annexes review empirical evidence on money demand in Italy, and the combination of cyclical and structural factors impinging on the banking system. Chapter V covers the external sector, including recent developments and trade policy, with notes on the exchange rate and capital flows.

II. The Domestic Economy

1. Aggregate demand, supply, and prices

a. Aggregate demand

The economic recovery began toward end-1993 and accelerated in the course of 1994. As the recovery proceeded, the composition of growth shifted from net exports to domestic demand. In the first three quarters of 1994, GDP grew by 2.2 percent over the corresponding period of the previous year: 0.5 percent of the increase was due to net exports and 1.7 percent to domestic demand. Exports continued to grow at record rates with the expansion of demand in partner countries, but imports also picked up as domestic demand revived. The recovery of domestic spending was driven by the rise in private consumption and inventory accumulation.

In the first three quarters of 1994, private consumption grew by 1.9 percent, as a result of improved consumer confidence and some expansion of disposable income. The latter was due to a substantial increase in nonwage income and reduced tax pressure, which offset the moderate growth of wages and salaries resulting from wage restraint and the decline in employment.

Gross fixed investment recovered only slowly and in the first three quarters of 1994 was still 0.6 percent below its level in the corresponding period of 1993. Investment in machinery, equipment and means of transportation grew by 3.3 percent. The accelerator effect was limited, due to uncertain demand prospects, especially on the domestic side, as domestic orders increased at a relatively slow pace and capacity utilization remained below pre-crisis levels. While profit margins grew very rapidly, their effect on investment has tended to operate with long lags--although, by the same token, the similarly long lags in the effects of credit conditions would suggest that high real interest rates and slow growth of credit are likely to have had a limited impact on investment activity to date, especially given enterprises' greater recourse to self-financing. Surveys indicate a continued cautious attitude on the part of firms.

Construction investment declined by 4.2 percent. This was due mainly to the public works component (accounting for more than 50 percent of the total), which has been weak for some time because of delays related to the shift of responsibilities from the *Cassa per il Mezzogiorno* to the government and the drop of investment by local authorities as well as the continued effect of corruption scandals. There was also little sign of recovery in the residential component, which may have been due to fall of housing prices as well as the increased supply of rental apartments following the abolition of rent control.

In the first three quarters of 1994, inventories made a large positive contribution to growth (0.6 percent), in contrast to their large negative contribution in 1993 (-1.6 percent). In the same period, stocks of finished goods in manufacturing fell below their normal level for the first time since mid-1990.

National savings are estimated to have increased in 1994. This reflects both the recovery of private savings after their decline in 1993 and slightly lower public dissaving as a result of fiscal adjustment. The ratio of gross investment to GDP is expected to have remained at around the 1993 level, as the expansion of private investment (including inventories) was compensated by the contraction of public works. Correspondingly, the external current account surplus widened to an estimated 1 1/2 percent of GDP.

b. Supply

In 1994, the recovery was clearly dominated by the industrial sector and specifically manufacturing production, which grew by 5.3 percent in the first three quarters of 1994; at the same time, the output of the energy sector increased by 0.9 percent, and construction output dropped by 4.5 percent. The performance of the service sector was mixed, with market services increasing by 2.2 percent and nonmarket services dropping by 0.3 percent. Output in agriculture was unchanged from the same period of 1993.

Within manufacturing, industrial production rose by 2.7 percent in the year to the third quarter. Export-oriented sectors grew faster than domestic sectors. Although there has been no clear evidence of bottlenecks so far, these could soon arise in export-oriented sectors, where capacity utilization rates appear to have increased rapidly. 1/

Regional data show that North-Western and Southern regions were those most affected by the 1993 recession; the recovery was concentrated in the export-intensive North-Central region. Given the small number of export-oriented industries in the South, the export-led pattern of the recovery--at least in its initial stages--has exacerbated Italy's traditional regional duality.

c. Prices

Italian inflation performance has been extraordinarily favorable in view of a nominal effective depreciation of the lira of close to 30 percent since the September 1992 ERM crisis. Cost-of-living inflation reached a 25-year low of 3.9 percent on average for 1994, down from 5.3 percent in 1992. This was largely the result of the sharp deceleration of wages in the context of a widespread adherence to the July 1993 framework agreement, which--accompanied by impressive productivity gains--lead to a decline in unit labor costs, compensating for increases in nonlabor input costs and profit margins. 2/

1/ As mentioned, capacity utilization rates are still below the pre-crisis levels in all sectors, but available statistics should be interpreted with caution, as they are likely to overlook the effect of the tremendous drop of net investment in 1993 (about 30 percent) and thus to overestimate capacity.

2/ The agreement on the cost of labor is described in Italy - Background Developments and Issues (SM/94/39, 2/11/94).

For 1995, the government set a target of 2.5 percent inflation. This has recently been recognized to be beyond reach, in view of the latest trends in consumer and producer prices, the pickup in inflation expectations, the recent increase in indirect taxes and the persistent weakness of the exchange rate.

Inflation developments and prospects are discussed in more detail in Annex I.

2. Labor market developments

Employment continued falling through 1994, on a seasonally adjusted basis, despite the recovery. This was the case in both the Center-North and the South. Nevertheless, there are signs of recovery of employment in the industrial sector. Surveys of large industrial firms show increases in employment and in the use of overtime. The estimated number of workers on temporary layoff, covered by the wage supplementation fund, is also declining.

Two structural features are expected to begin to play an important role in the near future: (a) the ongoing structural reorganization of public industry, concentrated in the South, and of the retail and transportation sectors; and (b) the flexibility of the labor market, which increased over the last decade and should have an effect as recovery proceeds.

The divergence between employment patterns in the North and South may widen in the years ahead, as a result of demographic trends. While the total working age population in Italy as a whole is projected to be stable or falling, it is projected to fall in the North and rise in the South. 1/ The new framework for wage bargaining agreed upon in July 1993 will allow for an increase of wage differentiation through second tier negotiations at the firm level, which are to start at the end of 1995. This process would, however, take time to differentiate salaries sufficiently across regions to the attenuate regional unemployment. Unemployment prospects are analyzed in more detail in Annex II.

In July 1994, the government introduced some measures aimed at creating incentives for employment, targeted at disadvantaged groups in the labor market; there is little evidence of whether these have had a significant effect on employment so far. A draft law to facilitate temporary and part-time employment was prepared in August, but remains to be discussed by Parliament; it is thought that it could have a relatively important affect.

1/ An additional problem is created by the recent EC guidelines, which mandate a removal of employment subsidies--particularly in the form of subsidization of social contributions ("*fiscalizzazione oneri sociali*")--in the South over a three-year period. The removal of these subsidies may lead to a 20-25 percent increase of labor costs in the region. However, EC funds for less developed regions may compensate for this.

Inflation Experience and Prospects 1/

1. Inflation performance since the ERM crisis

Cost of living inflation fell from 5.3 percent in August 1992, just prior to the lira's exit from the ERM, to a 25-year low of 3.6 percent in July 1994, even while the lira depreciated in nominal effective terms by almost 30 percent. This inflation performance was largely due to the sharp deceleration of unit labor costs, brought about by the recession and a remarkable wage moderation. 2/ The inflationary impact of the depreciation was also attenuated by the pricing behavior of foreign suppliers, who lowered profit margins to maintain market shares in the presence of an unprecedented fall in domestic demand.

a. Wages and labor costs

Nominal contractual wage growth remained well below cost of living inflation since 1992 and fell to about 2 percent in 1994 (Chart 1). Such moderate growth was the result both of the recession and of a marked shift in wage setting behavior. A persistent output gap led to record layoffs and put downward pressure on wages. Two agreements--in 1992 and 1993--between government, industry, and unions abolished wage indexation and linked wage increases to targeted inflation and sectoral productivity gains. Incomes policy contributed to breaking the previously strong link between wages in manufacturing and the rest of the economy: the latter, which were also affected by budget cuts and restructuring in the services sector, increased noticeably less than the former which were boosted by the lira's depreciation (Chart 1).

Labor productivity growth accelerated from 1991 onward, largely as a result of an unprecedented drop in employment (see Annex II on unemployment). Although the largest gains took place in the manufacturing sector, labor productivity also increased in nontradable sectors such as market services (Chart 2, middle panel). The combined effect of wage moderation and productivity increases brought about a rapid deceleration of unit labor costs (Chart 2, bottom panel).

To maintain market shares in Italy during a European-wide recession, foreign suppliers of manufactured goods reduced profit margins and increased import prices in lire by less than the exchange rate depreciation. "Pricing to market" behavior reduced the initial inflationary impact of the depreciation, but, by October 1994, foreign input prices in manufacturing had increased by the full amount of the lira depreciation (Chart 3). The

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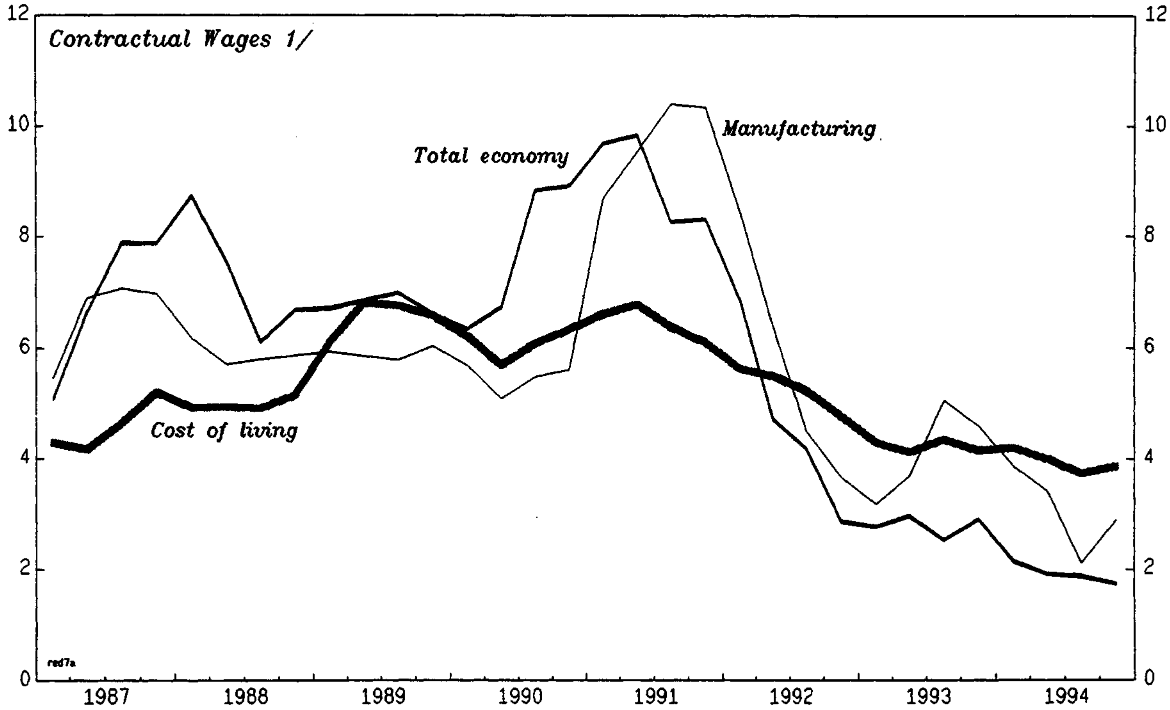
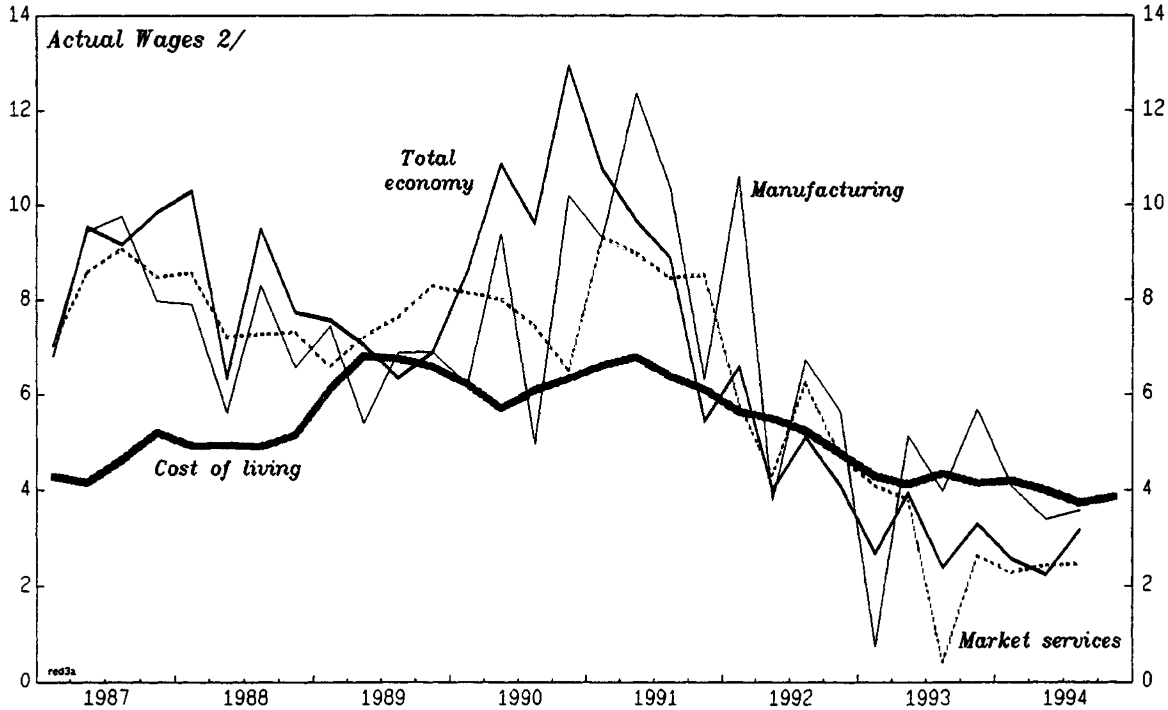
1/ Prepared by Alessandro Prati.

2/ A counterfactual simulation of the Bank of Italy quarterly econometric model shows that, in the absence of the depreciation, the 1993 deflator of private consumption would have grown by less than 1 percent as opposed to the actual 4.7 percent.

CHART 1
ITALY

Wages and Inflation
(Year-on-year percentage change)





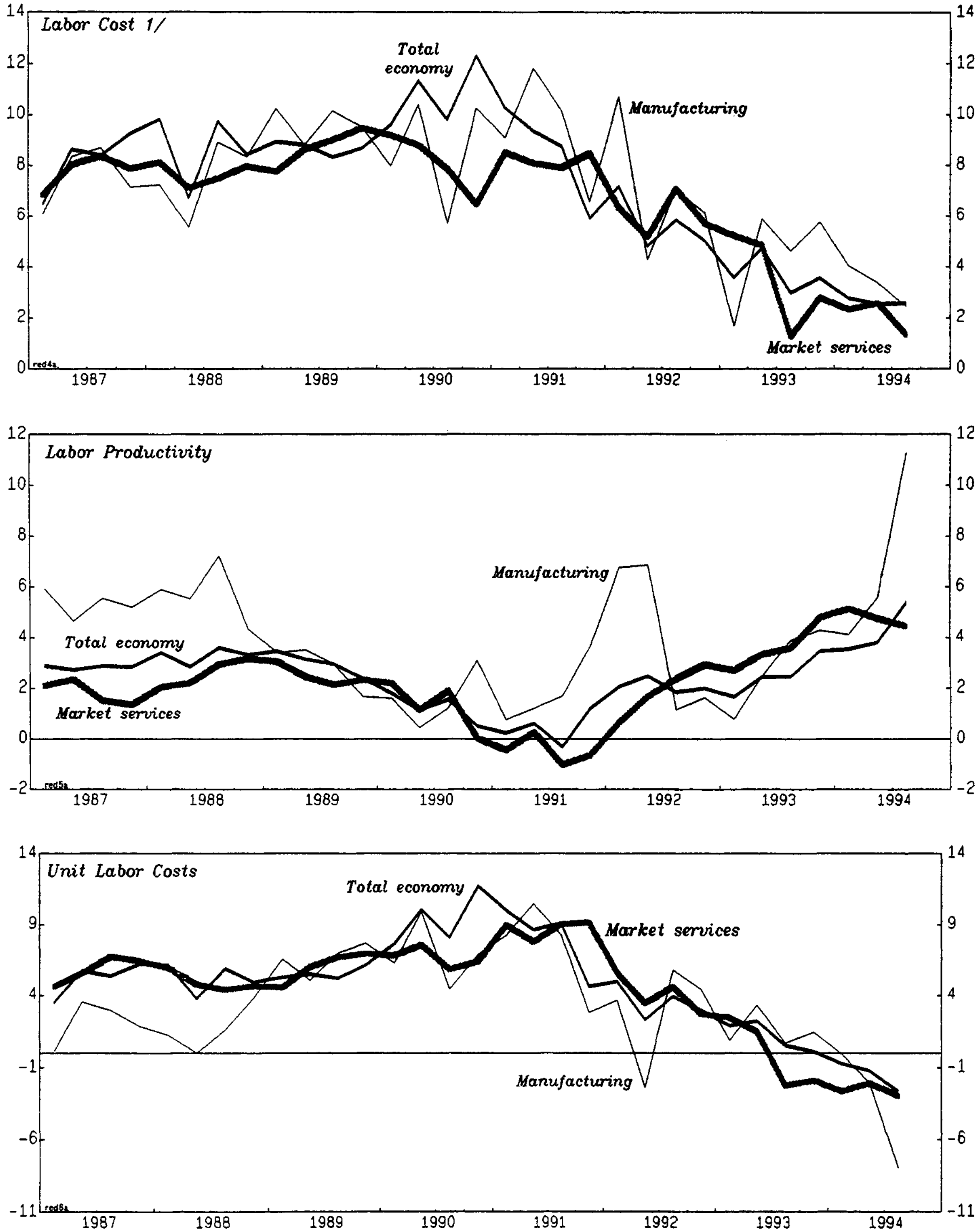
Source: Bank of Italy.

1/ Average monthly contractual wage per dependent worker.
2/ Compensation of employees = contractual wages plus wage increases at firm level and overtime compensation, including taxes and social security contributions paid by the employee.

CHART 2

ITALY

Wages, Productivity and Unit Labor Cost
(Year-on-year percentage change)



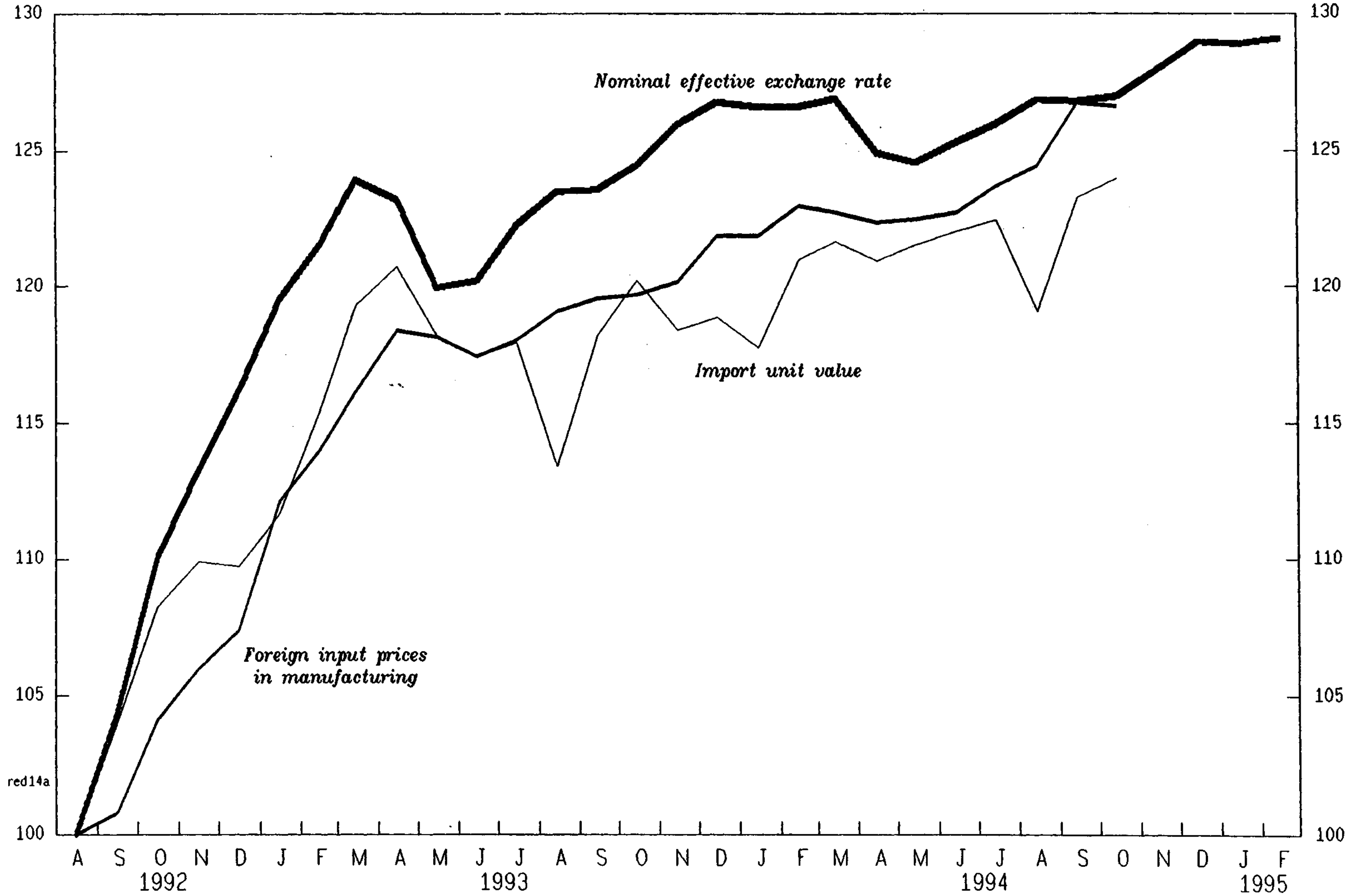
Source: ISTAT.

1/ Includes social security contributions paid by the employee.

CHART 3

ITALY

Import Prices and Exchange Rate
(August 92 = 100)



Source: Bank of Italy.

impact on nonlabor input costs was significant, but largely offset by declining unit labor costs. In the end, the growth of unit variable costs slowed down to zero or even negative figures in both tradable and nontradable sectors (Chart 4).

b. Profit margins and prices

Profit margins increased in all sectors of the economy since 1992. In the manufacturing sector, cost moderation and higher export prices following the lira depreciation allowed margins to return almost to their 1987 level by the third quarter of 1994 (Chart 5). In the market services sector, the expansion of profit margins began earlier and was larger: unit variable costs dropped more and price inflation remained higher than in the manufacturing sector (Chart 6).

In the early 1990s, CPI inflation declined while the prices of domestic output accelerated, possibly indicating a compression of trade margins due to the restructuring in the distribution sector (Chart 7, top panel). 1/ In spite of the different trends, output and CPI inflation were closely related in the short-run, with output prices playing a leading-indicator role, as shown by annualized monthly inflation rates calculated on seasonally adjusted data (Chart 7, bottom panel).

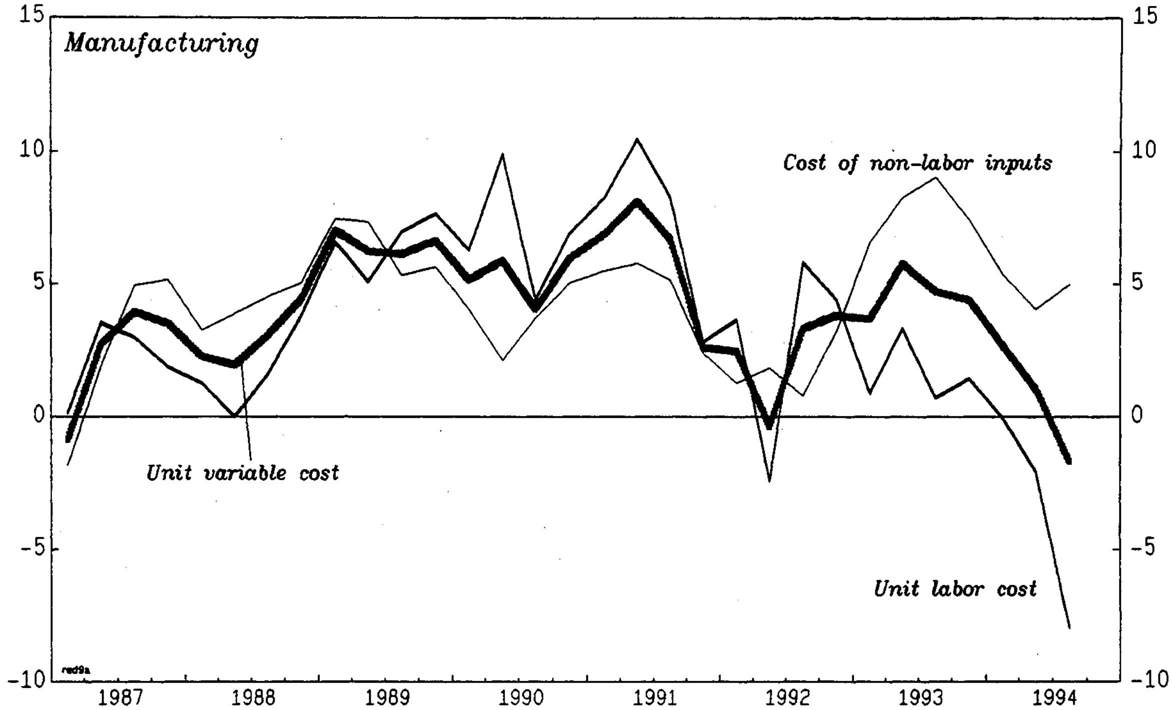
2. Outlook

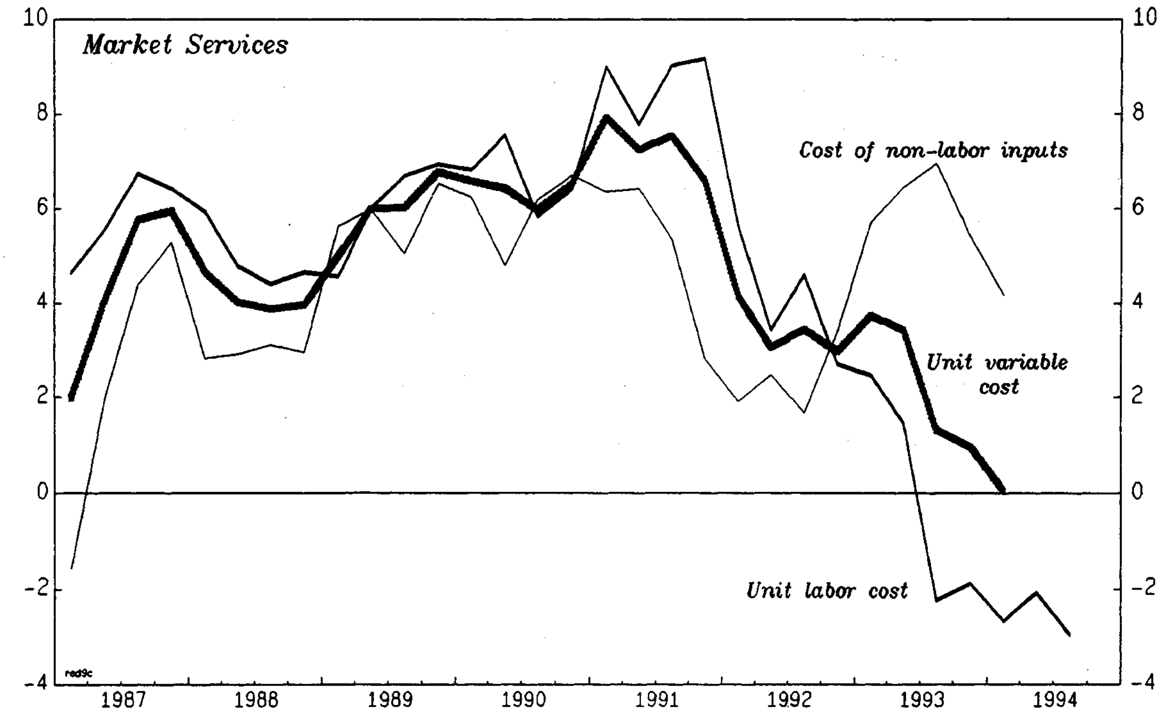
In view of the latest trends, continued exchange rate weakness, and the recent increase in indirect taxes, the 2.5 percent target for average inflation in 1995 is recognized to be beyond reach. The main source of inflationary pressure remains the continuously depreciating exchange rate, which reached record lows against the deutsche mark in early March 1995. The most recent inflation figures and indicators of expectations show evidence of inflationary pressures, and underlie the Bank of Italy's decision to raise official rates in late February 1995. Cost of living inflation accelerated to 4.3 percent in February 1995, and both output price and CPI monthly inflation figures show a strong acceleration in the second half of 1994 (Chart 6). In the December monthly survey of manufacturing firms, the percentage of those likely to increase prices over the following three to four months exceeded the percentage of those likely to reduce them by 44 points against a difference of 29 points in November; the revisions were particularly strong in the intermediate and consumption goods sectors (Chart 8). Large increases also characterized CPI inflation a year ahead, as reported in the December quarterly survey, as well as medium-term inflation expectations implicit in forward interest rate differentials.

1/ The data should be interpreted with caution since the two indices do not refer to the prices of the same basket of goods. The basket of goods of the CPI is larger than the one of the cost-of-living index, but the former is available only with a lag.

CHART 4
ITALY

Costs and Prices
(Year-on-year percentage change)

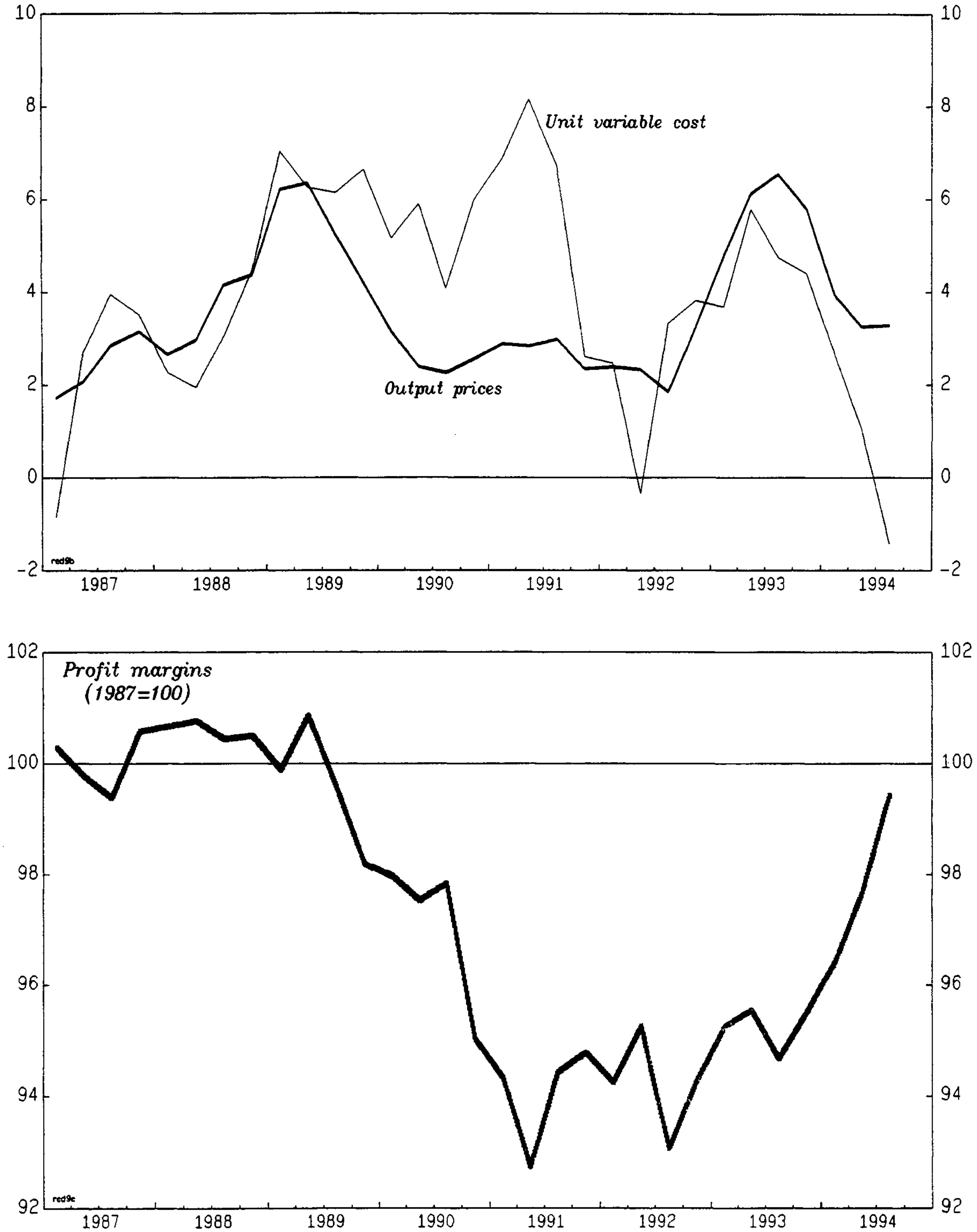




Sources: ISTAT; and Bank of Italy.

CHART 5
ITALY

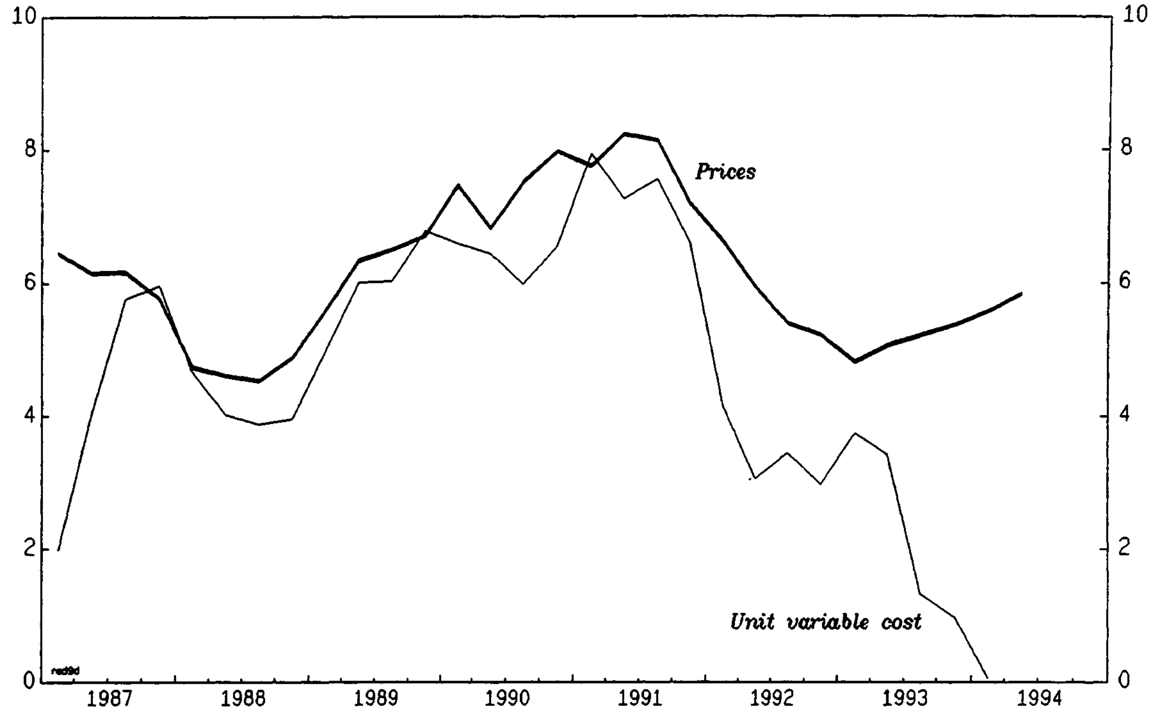
Profit Margins - Manufacturing
(Year-on-year percentage change)

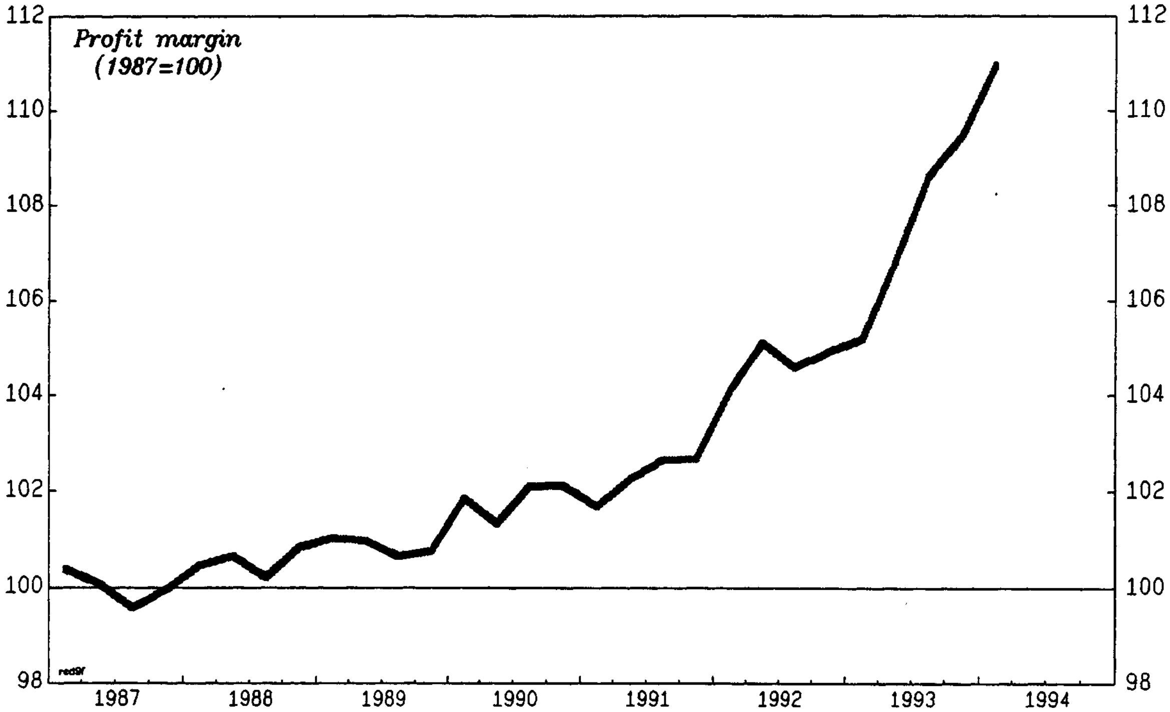


Sources: Staff estimates based on ISTAT; and Bank of Italy data.

CHART 6
ITALY

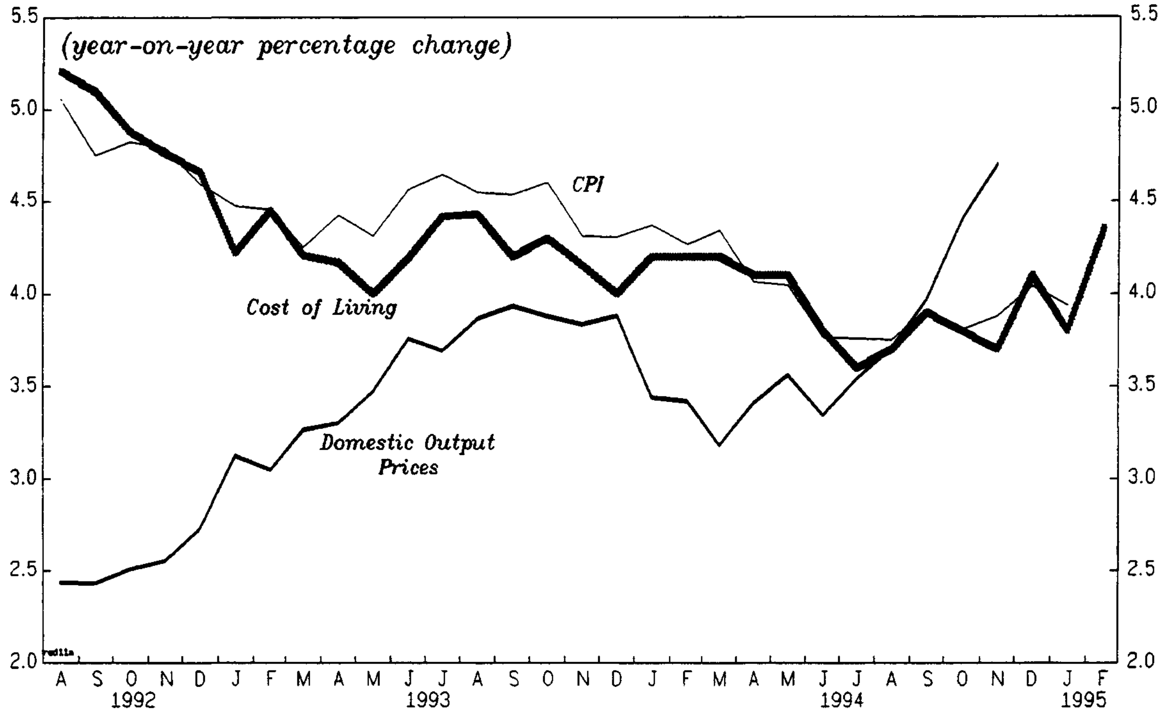
Profit Margins - Market Services
(Year-on-year percentage change)

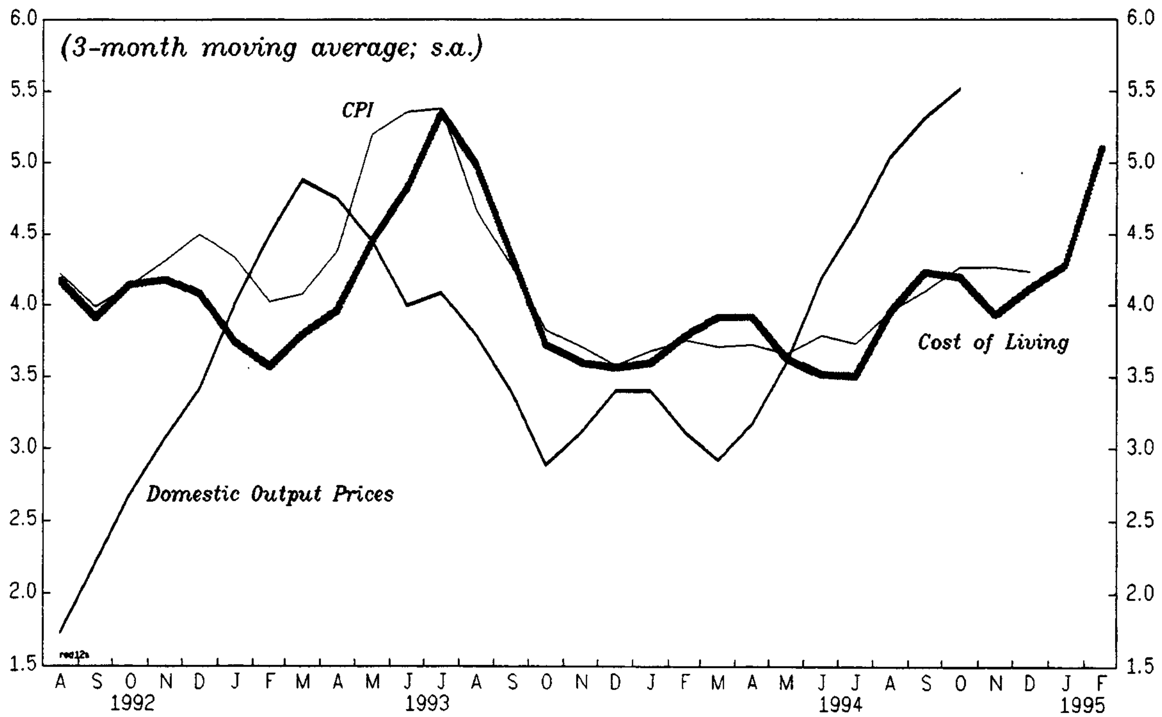




Sources: Staff estimates based on ISTAT; and Bank of Italy data.

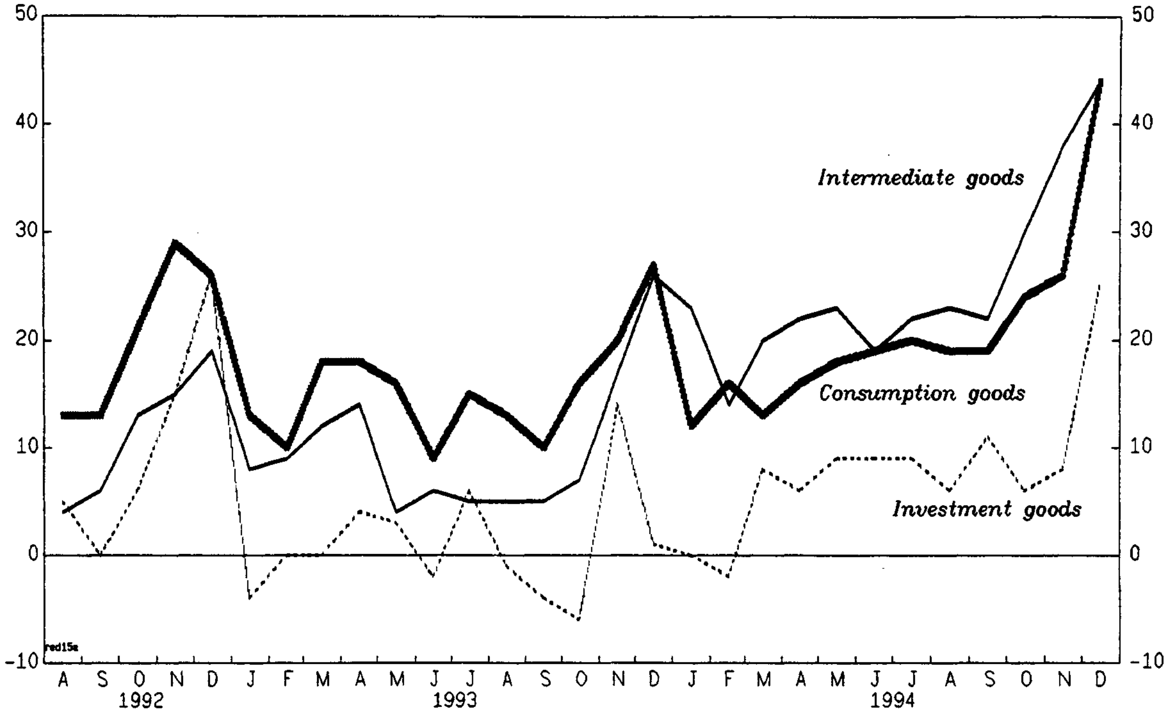
CHART 7
ITALY
Inflation

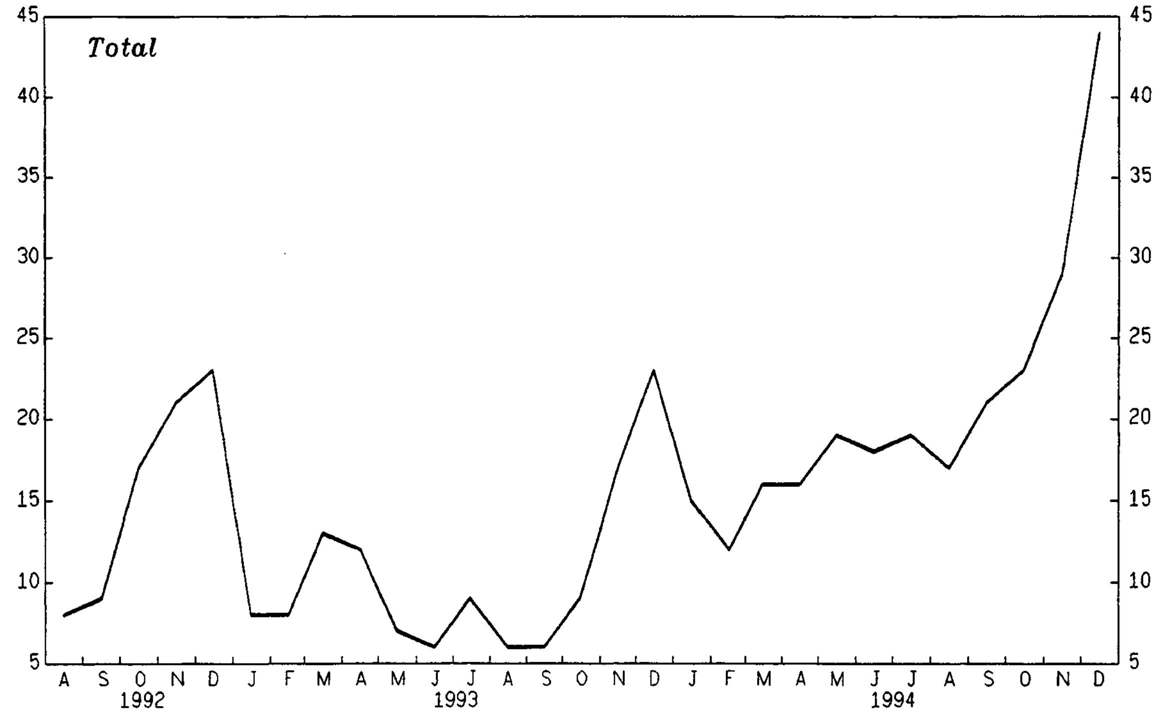




Source: Bank of Italy.

CHART 8
ITALY
Survey of Price Expectations 1/





Source: Isco-Mondo Economico, December 1994.

1/ Difference between the percentage of Firms that would increase prices over the following 3 to 4 months and the percentage of Firms that would reduce them.

In 1995, wage growth is likely to remain moderate (all contract renewals have been in line with the targeted 2.5 percent inflation, and no further contracts are up for renewal) and further productivity gains are expected. However, the resulting decline in unit labor costs risks being more than offset, at the current level of the exchange rate, by increasing costs of nonlabor inputs and growing profit margins. Given the worldwide recovery, importers might likely increase their prices in lire to compensate past reductions in profit margins and the recent growth of raw material prices in dollar terms. As a result, the cost of nonlabor inputs could rise and the pressure of foreign competitors on the pricing behavior of domestic producers diminish. In addition, bottlenecks in the most export-oriented sectors may soon arise.

Additional risks for the medium-term outlook could come from possible difficulties on the incomes policy front, if actual inflation in 1995 turned out to be substantially in excess of the 2.5 percent inflation target on which all wage contracts were based. As the economy recovers and the output gap shrinks, wage demands may well increase. Within the framework of the July 1993 wage agreement, second-tier negotiations at the firm level are scheduled to begin toward end-1995 and a second round of national contracts will start in 1996.

Unemployment 1/

The 1992-94 recession had a much stronger impact on employment and real wages than the recessions of the 1970s and the 1980s. The drop in employment was unprecedented, and was particularly surprising in light of the limited length and depth of the downturn. In addition, for the first time, real wages stopped growing (Chart 9). Two main factors account for these deviations from past behavior. First, in contrast to previous recessions, employment fell in the service sector as well as in the rest of the economy. Second, employment and real wages became more responsive to the cycle as a result of labor market reform.

The outlook for employment is uncertain. If the increased sensitivity of employment to output observed in the downturn were confirmed in the upswing, employment could rebound rapidly as the recovery gathers pace. However, reforms to increase the flexibility of the labor market have not yet been completed, and most were introduced in a piecemeal fashion. As a result, the lack of a credible comprehensive plan and the risk of backtracking could make firms more cautious in expanding employment during the upturn.

1. The 1992-94 recession

During the last recession, about a million and a half jobs were lost, twice the number created during the boom of the 1980s (Chart 10, top panel). Unlike in the 1980-83 recession, employment fell not only in the Center-North, but also--and very markedly so--in the South (Chart 10, middle and bottom panels). In a similar pattern, the labor force shrank (Chart 11), although not enough to compensate the employment reduction. As a result, the unemployment rate increased from less than 9 to about 12 percent, reaching 8 percent in the Center-North and 20 percent in the South (Chart 12).

Econometric analysis confirms that labor market behavior during the last recession was radically different from that observed in the past. An econometric model of the Italian labor market was estimated for the period 1977-91 and then simulated up to 1994; simulated values are compared with actual in Charts 13 and 14. 2/ The differences are striking: simulated employment declines slightly until mid-1994 and recovers afterwards; the unemployment rate increases in 1992-93, but then falls in 1994; the labor force diminishes less than in reality and real wages remain marginally higher. This structural break in the econometric relationships is apparently attributable to the employment crisis in the service sector and to the effects of transition from a highly rigid to a more flexible labor market.

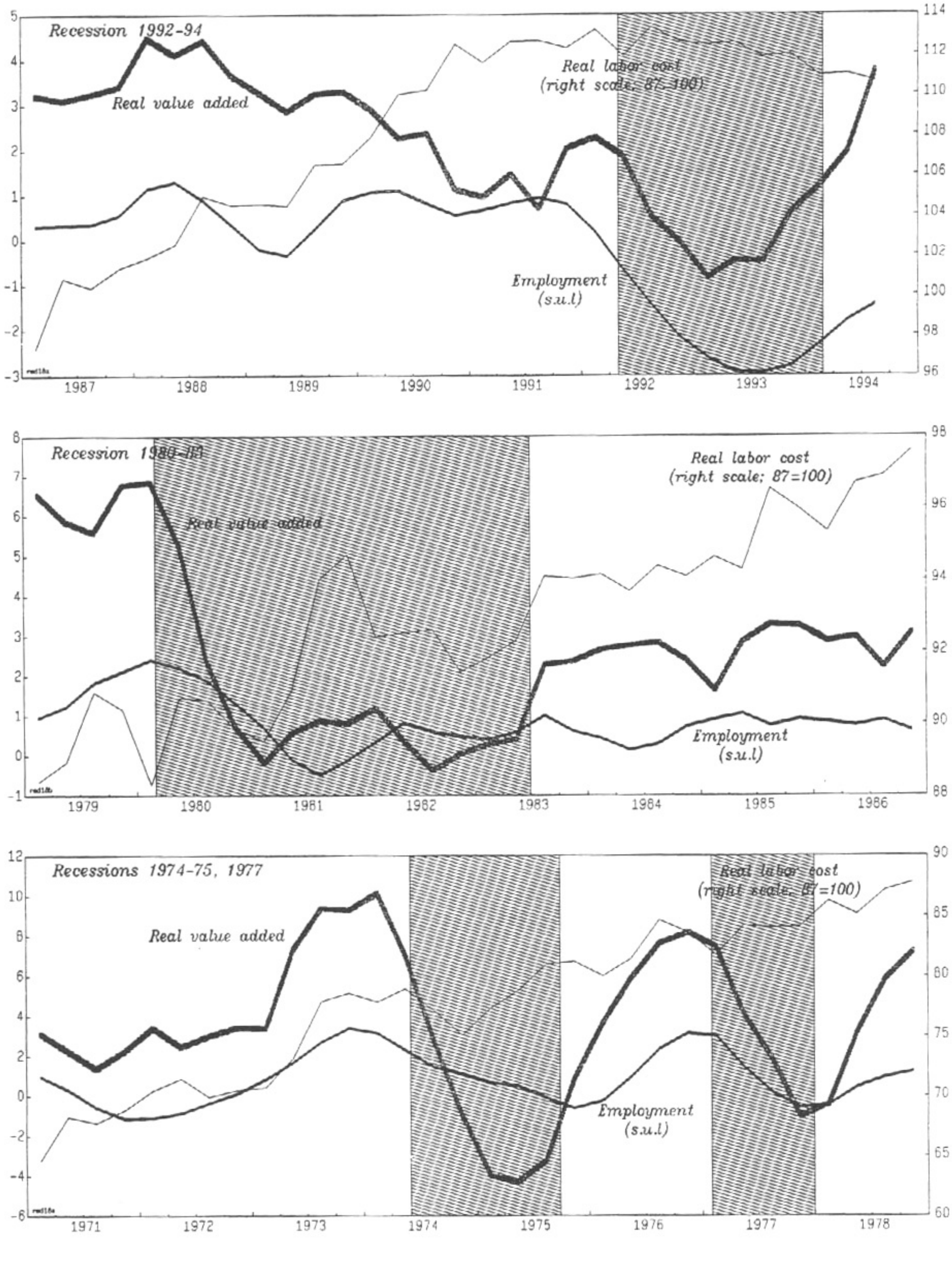
1/ Prepared by Charis Christofides and Alessandro Prati.

2/ The actual variables do not correspond to those plotted in the previous charts, since employment and unemployment are corrected for an estimate of the number of people on wage supplementation fund, not included in the official unemployment statistics.

CHART 9

ITALY

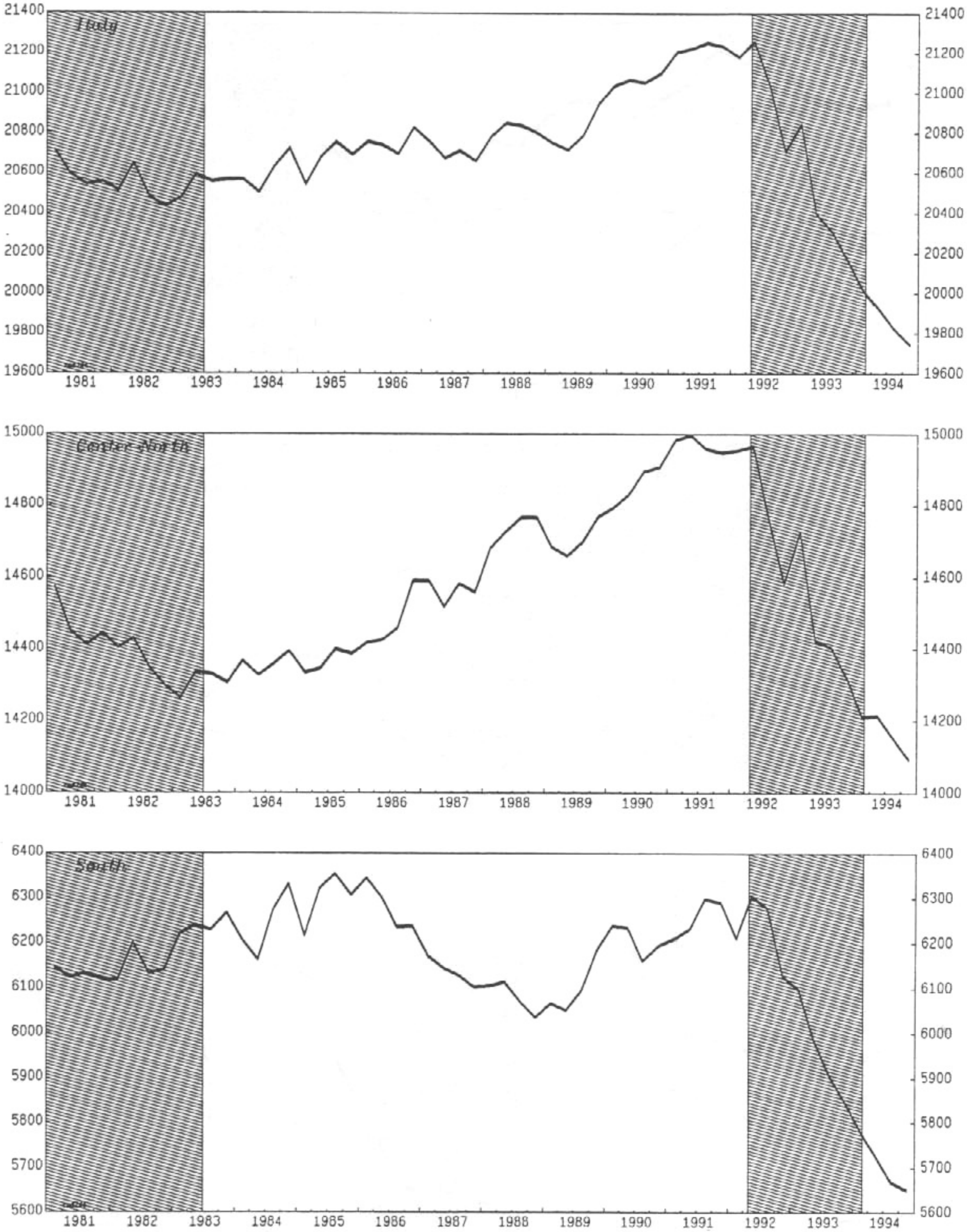
Cycle, Employment and Real Wages
(Year-on-year percentage change)



Source: ISTAT.

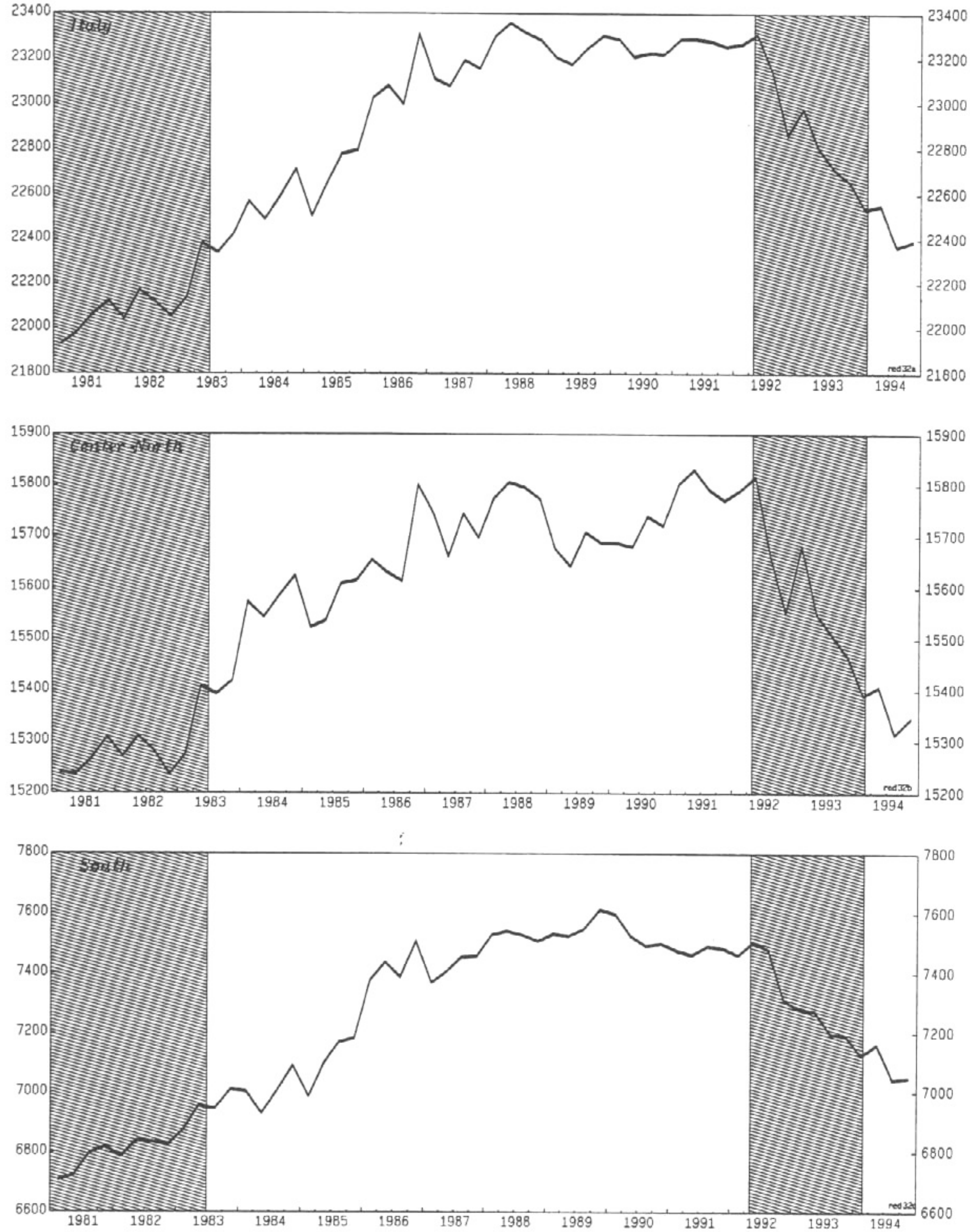
CHART 10
ITALY

Employment
(s.a.; thousands of people)



Source: Bank of Italy.

CHART 11
ITALY
Labor Force
(s.a.; thousands of people)



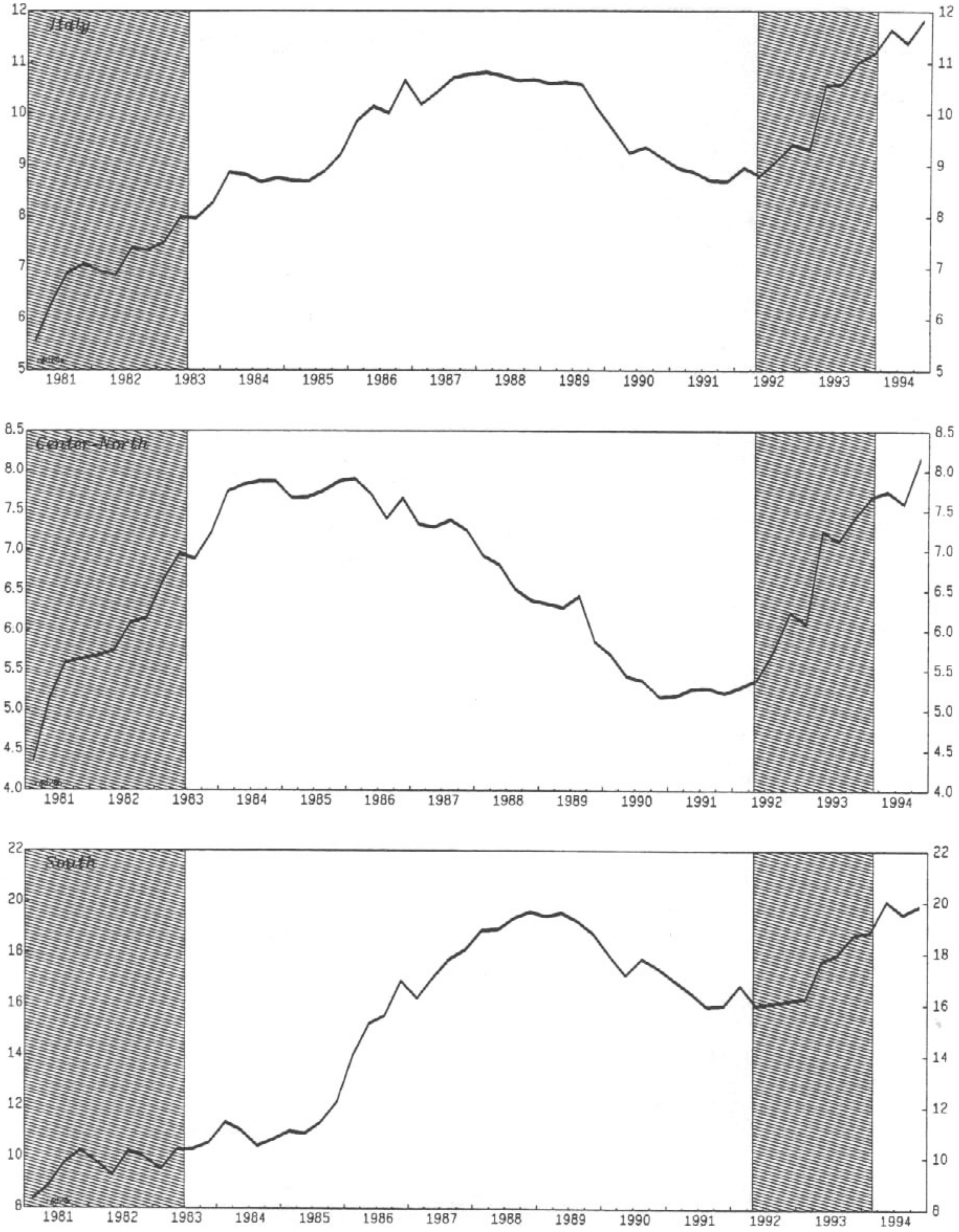
Source: Bank of Italy.

CHART 12

ITALY

Unemployment Rate

(s.a.; percentage)

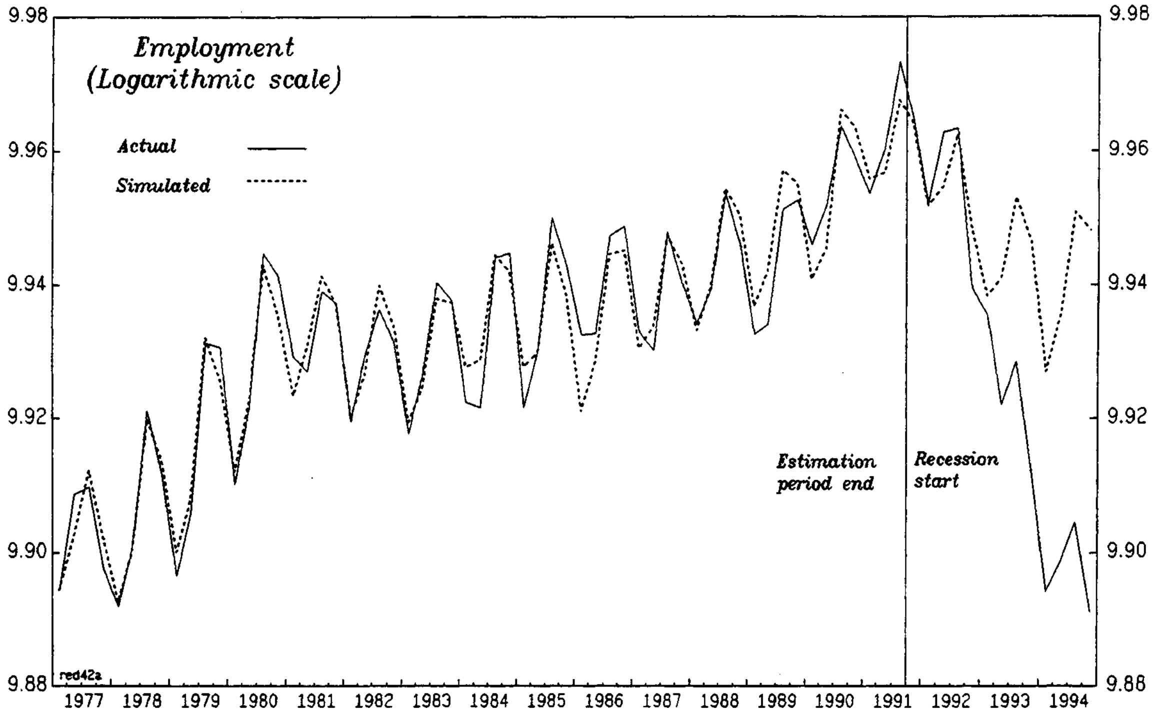


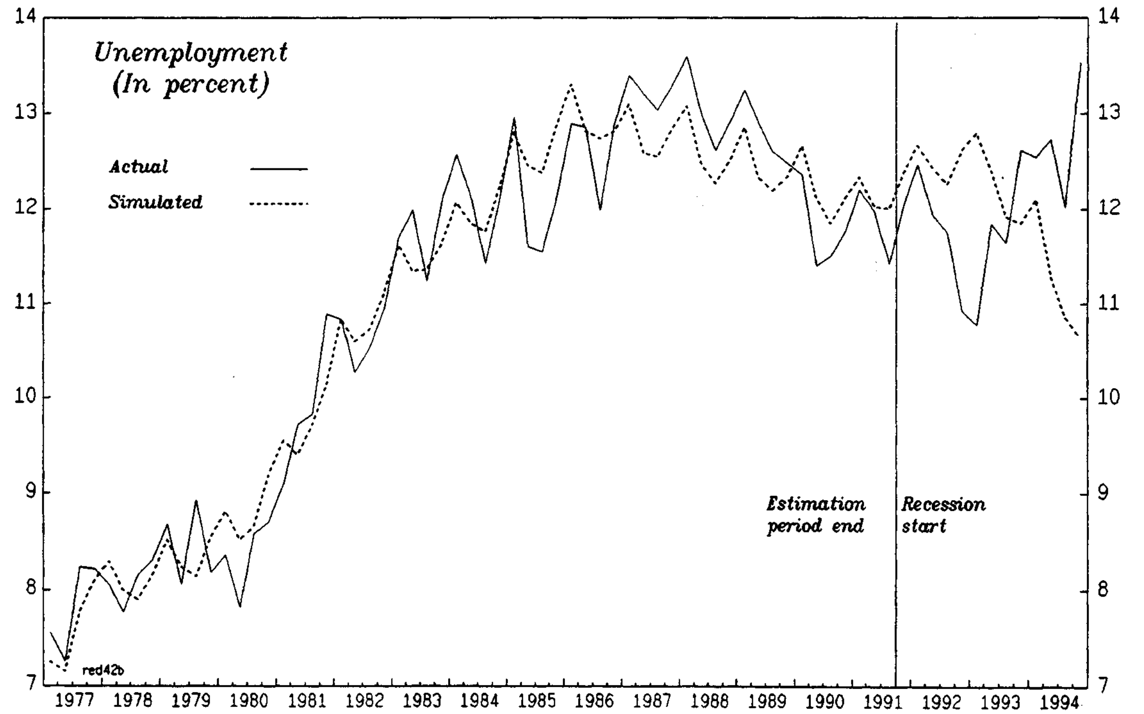
Source: Bank of Italy.

CHART 13

ITALY

Employment and Unemployment



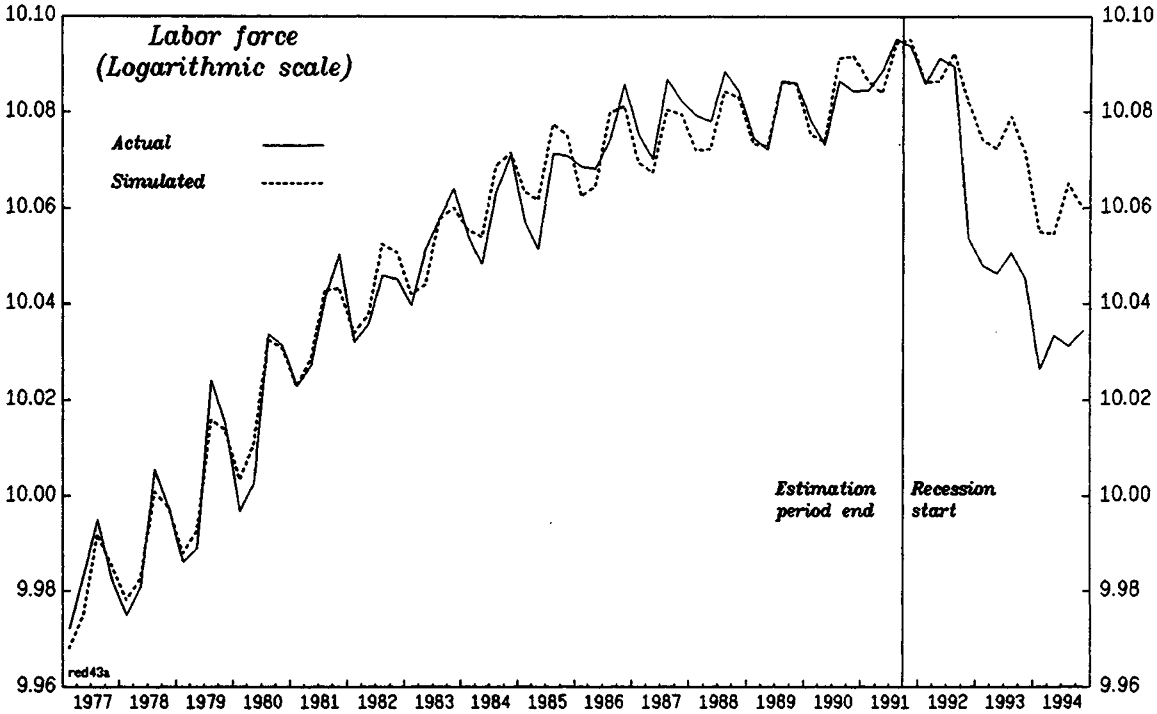


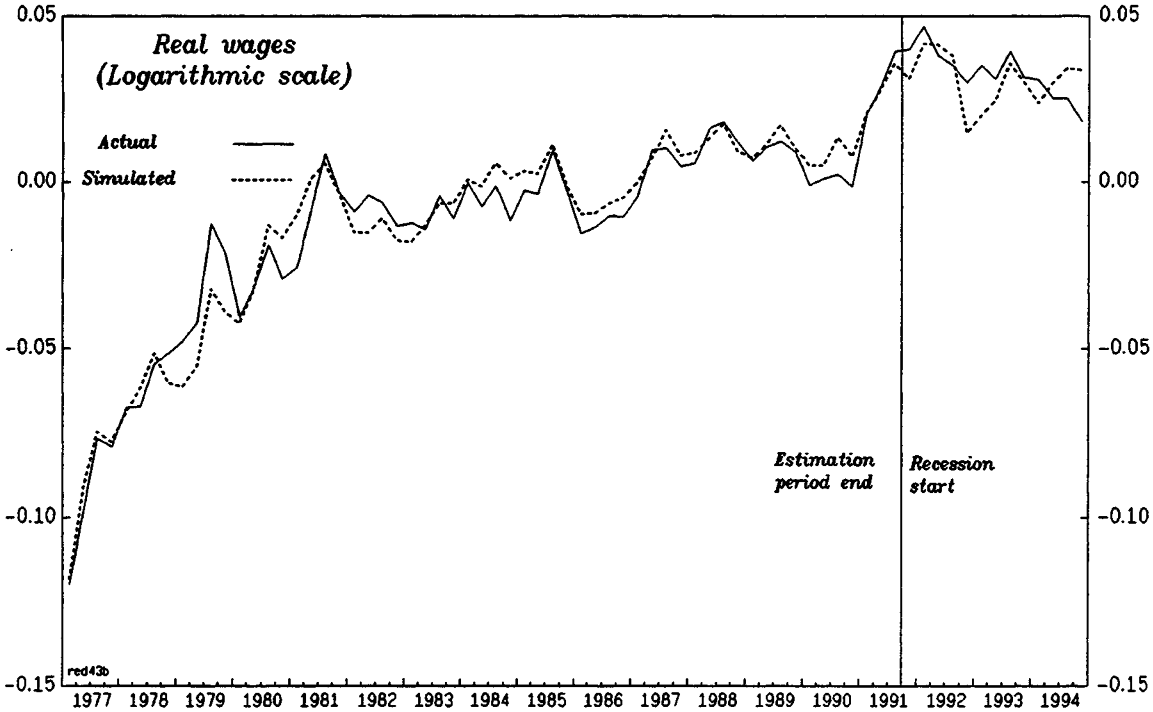
Sources: Italian authorities and Fund staff estimates.

CHART 14

ITALY

Labor Force and Real Wages





Sources: Italian authorities and Fund staff estimates.

a. The employment crisis in the service sector

In contrast to previous recessions, the number of service sector jobs declined together with those in the industrial sector (Chart 15b). Two factors account for the reversal, at the beginning of the 1990s, of the trend of growing employment in services. First, the public finance situation did not allow the public administration to act as "employer of last resort" of the economy, as in the past (Chart 16, bottom panel). Secondly, restructuring was under way in the market services sector (Chart 16, top panel). Within the latter, the largest reductions took place in the transportation sector, characterized by a large weight of public enterprises; and in the trade sector, marked by a significant process of restructuring and concentration in distribution with a declining number of small enterprises and a rising share of sales accounted for by large stores (Chart 17). This process of concentration in the trade sector was also the main factor responsible for the unprecedented drop in the number of self-employed during the recession (Chart 18).

b. The transition to a more flexible labor market

Although significant restrictions and distortions remain in the Italian labor market, far reaching changes have been introduced in recent years. New instruments of redundancy reduced firing costs; less-restrictive employment protection legislation reduced hiring costs; the abolition of wage indexation and a new wage bargaining system reduced wage rigidity. 1/

Until 1991, firms facing a reduction in activity or restructuring could lay off workers temporarily, taking advantage of the wage supplementation fund. In 1991, a new law (223/1991) introduced the mobility procedure, which allowed firms to formally terminate the employment relationship. As a result, fewer hours of wage supplementation fund were requested and authorized in this recession than in the 1980-83 one (Chart 19), while firms took advantage of the mobility procedure to reduce the number of workers and the overmanning stemming from years of firing restrictions. 2/

The reduced use of the wage supplementation fund was not the only sign of increased elasticity of employment to output. Data for large firms indicate that in the most recent recession any evidence of labor hoarding disappeared: the crisis was marked not only by a fall of the hiring rate, as in past recessions (especially in the 1970s), but also by a very large increase of the exit rate. Similarly, during the last recession, the fraction of the unemployed with a previous job increased relative to the share of first-job seekers.

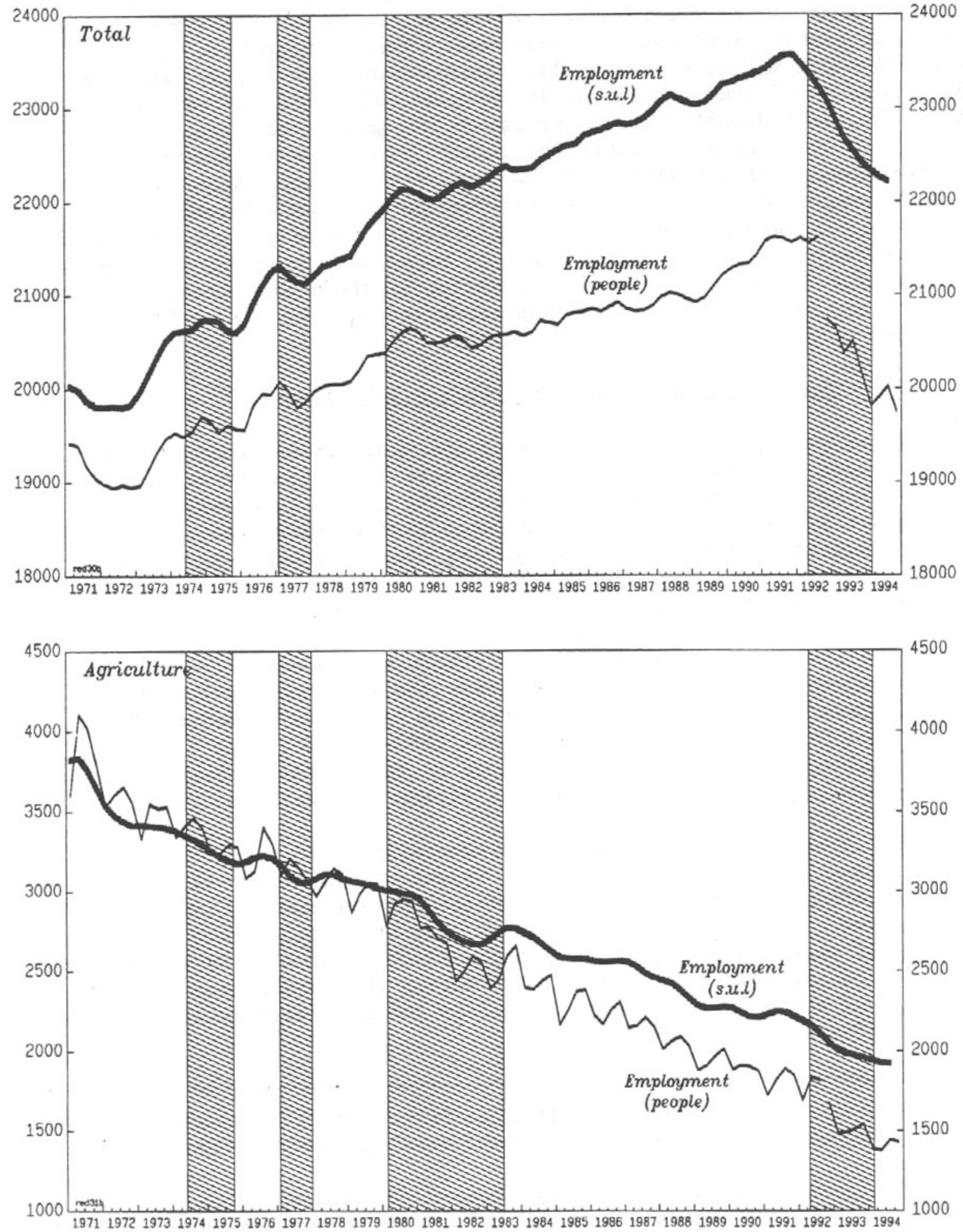
1/ A critical presentation of Italian labor market institutions can be found in Chapter 5 of Italy - Background Developments and Issues, (SM/94/39, 2/11/94).

2/ In light of the theoretically "temporary" nature of the layoff, workers on the wage supplementation fund are not considered unemployed and not classified as such in the labor force surveys.

CHART 15a

ITALY

Employment
(Thousands)

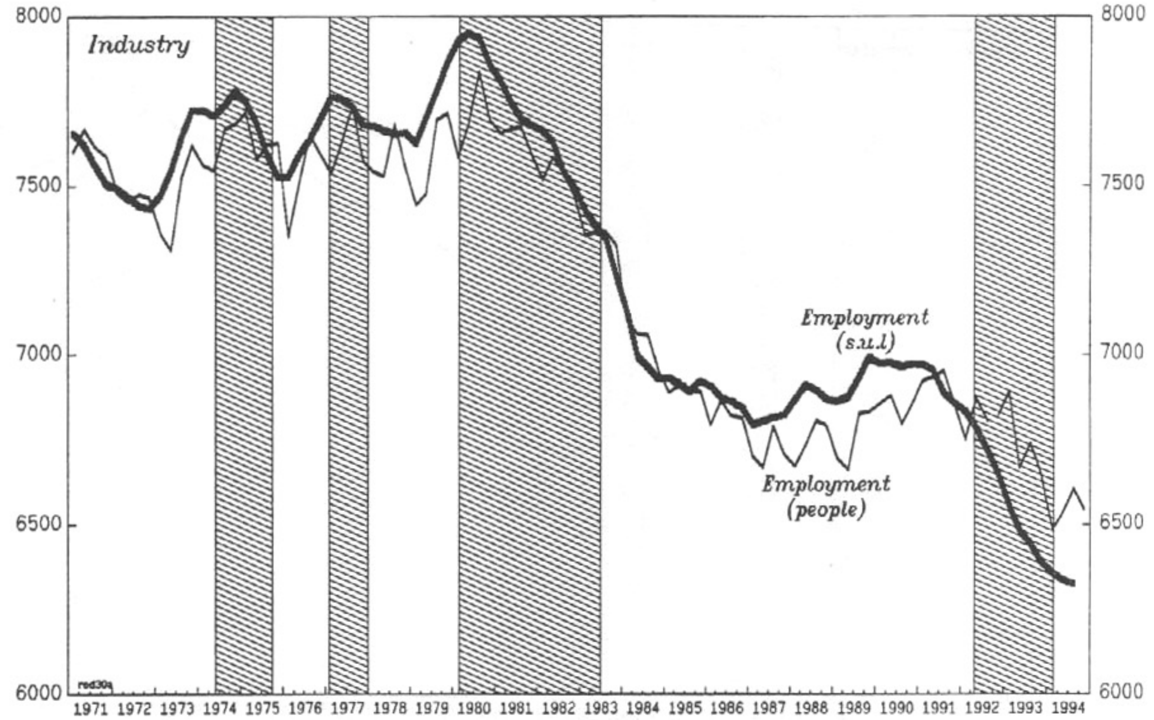


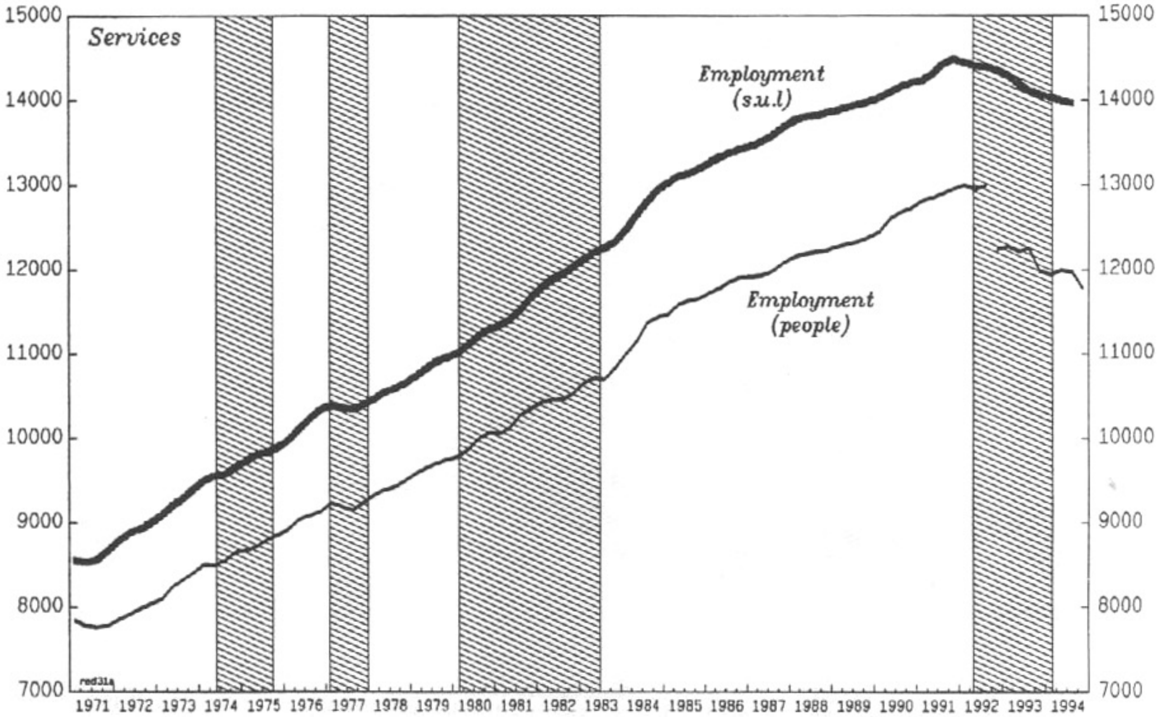
Sources: Bank of Italy; and ISTAT.

CHART 15b

ITALY

Employment
(Thousands)





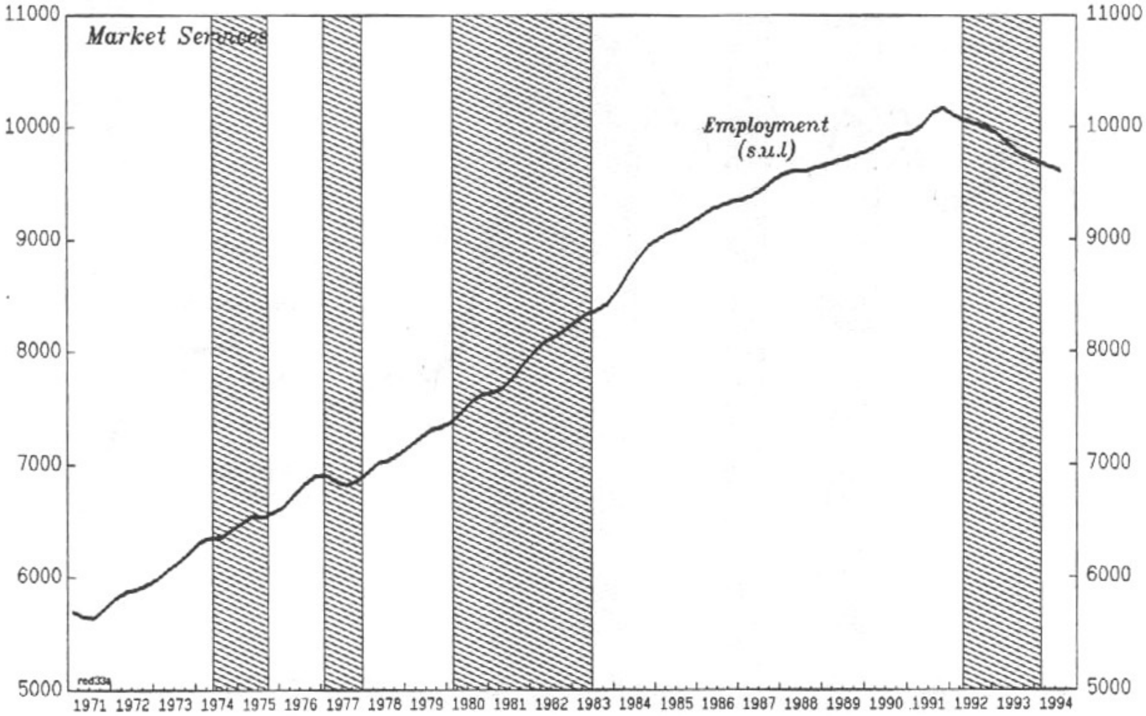
Sources: Bank of Italy; and ISTAT.

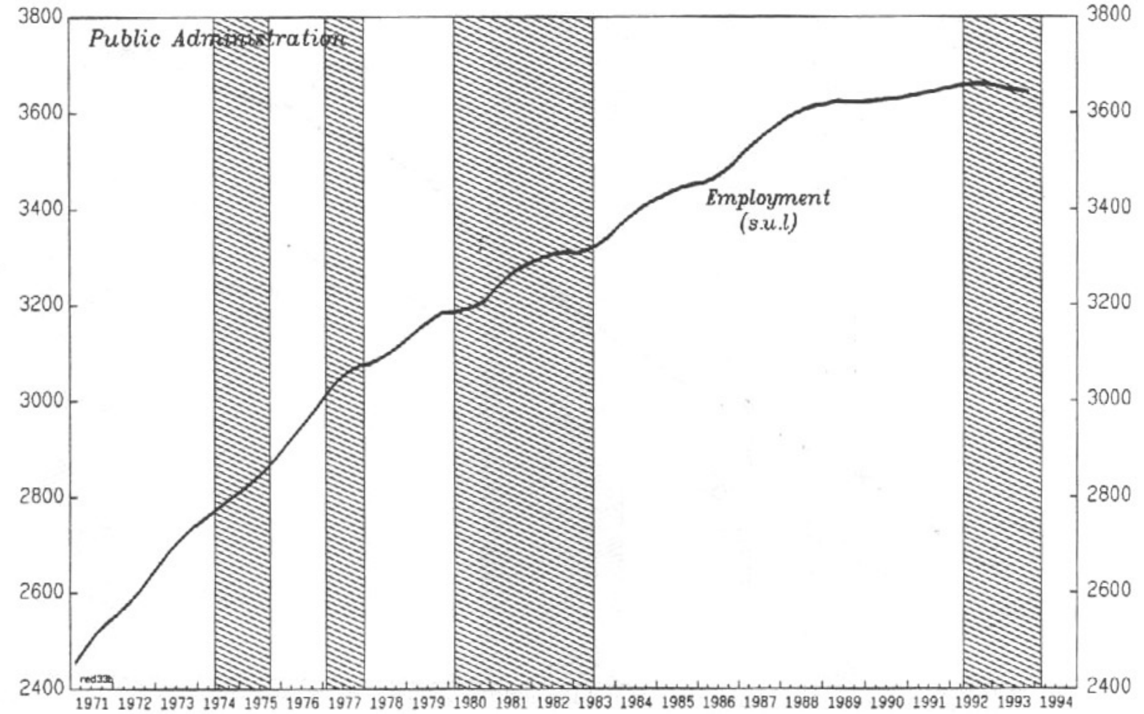
CHART 16

ITALY

Services

(s.a.; thousands of people)





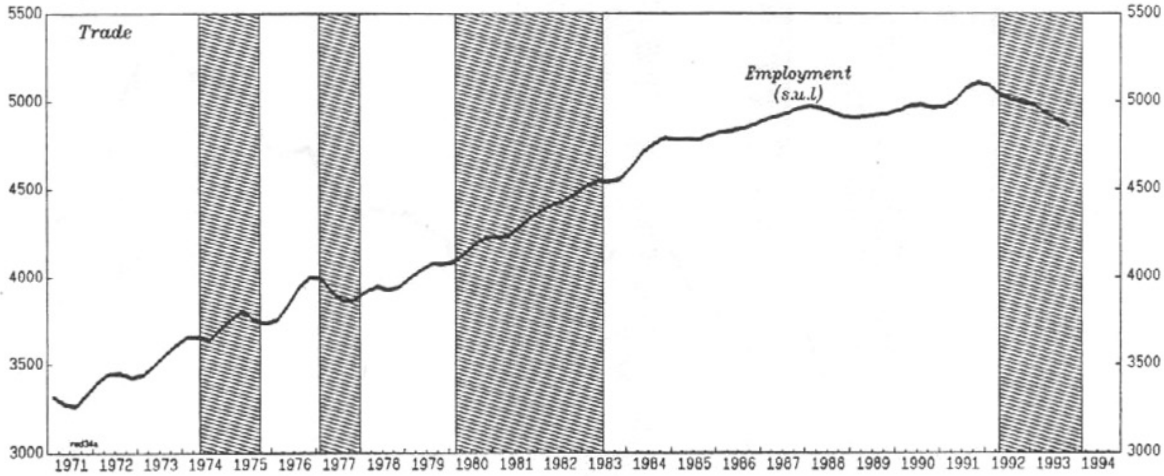
Sources: Bank of Italy; and ISTAT.

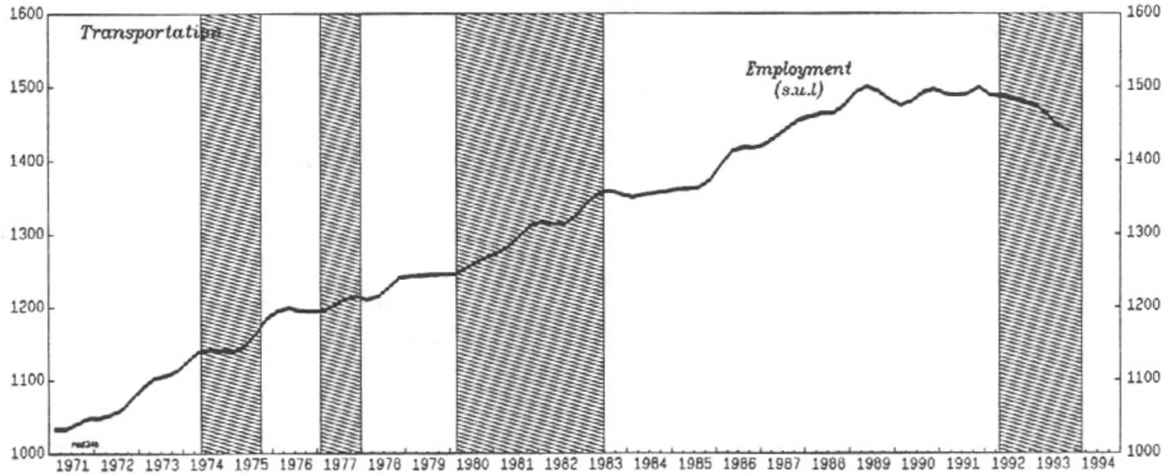
CHART 17

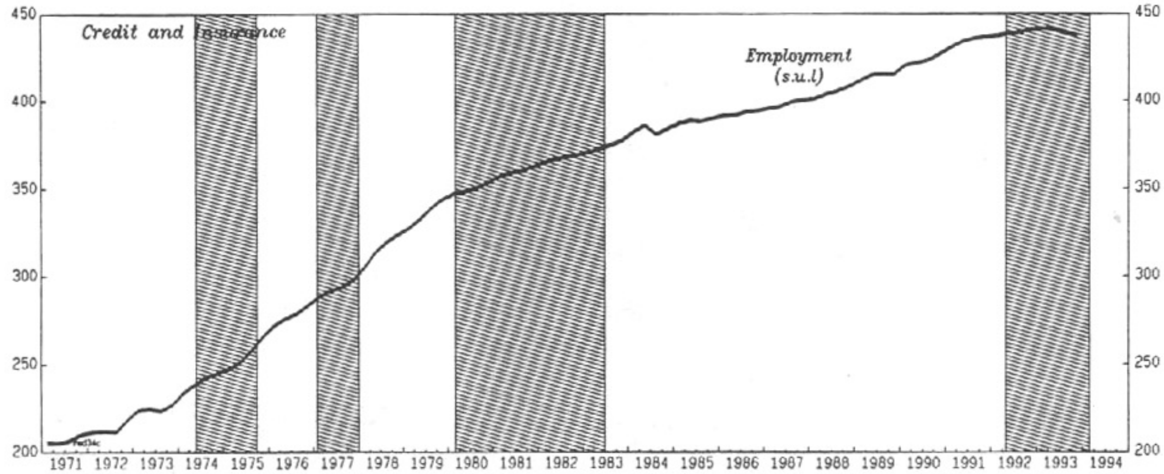
ITALY

Market Services

(s.a.; thousands of people)





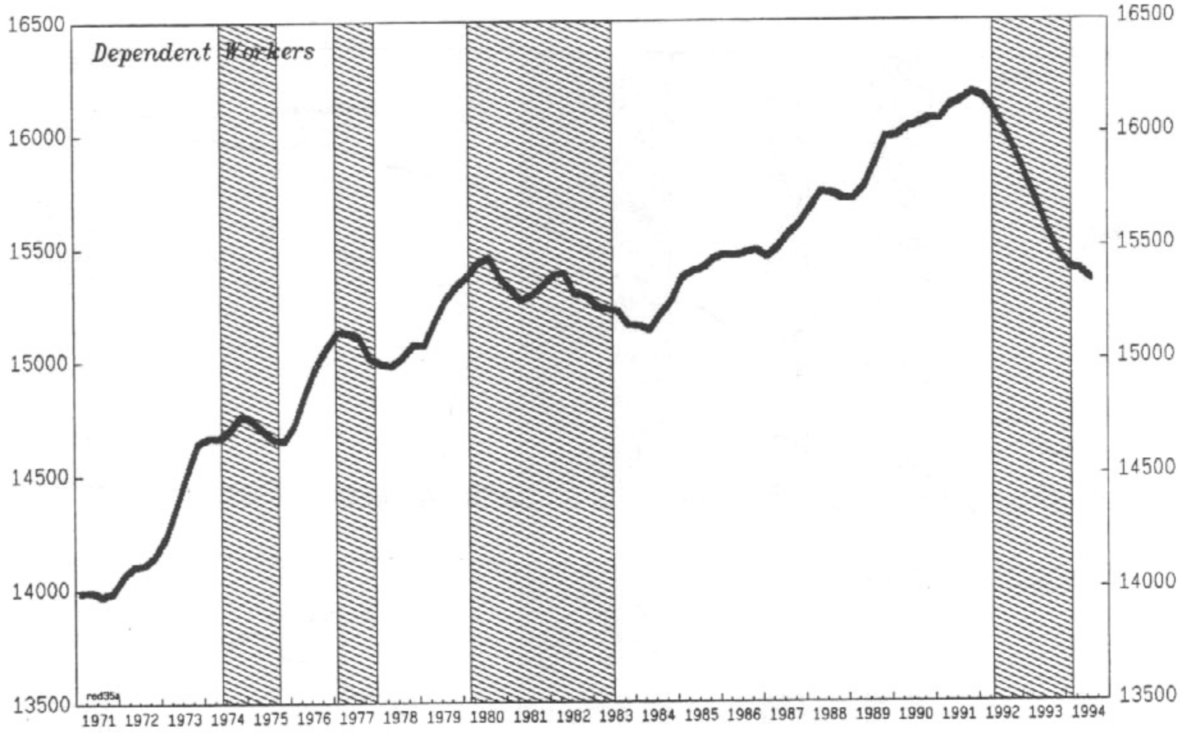


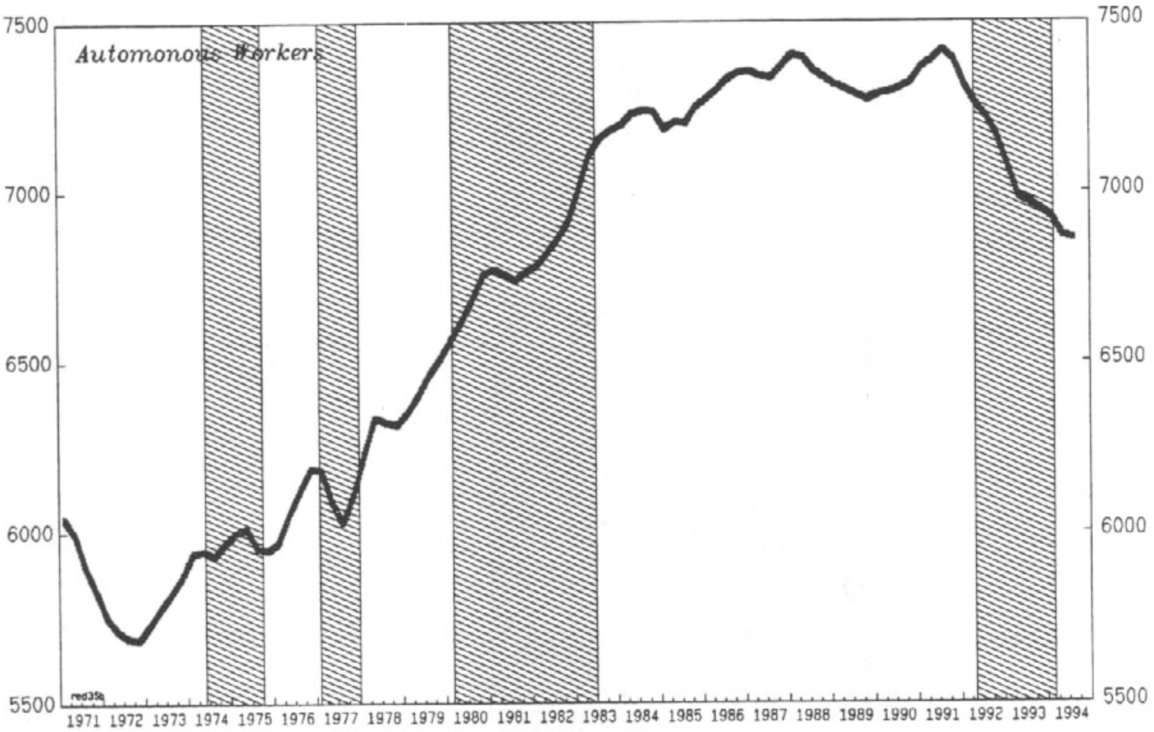
Sources: Bank of Italy; and ISTAT.

CHART 18

ITALY

Dependent and Automonous Employment Trends
(standard unit of labor)

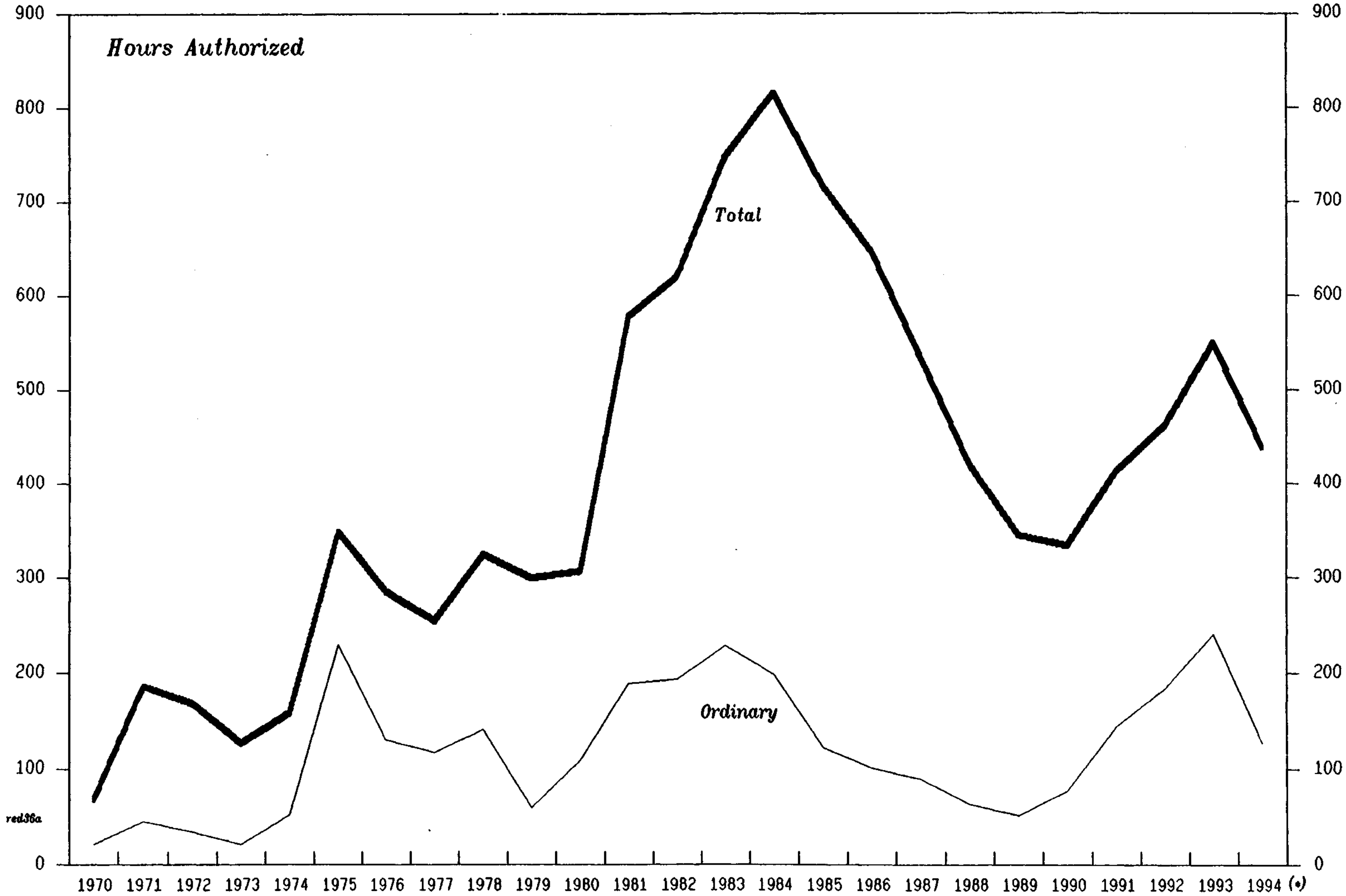




Source: ISTAT.

CHART 19
ITALY

Wage Supplementation Fund (CIG)
(In millions of manhours)



Sources: INPS (1993); and Cuchiarelli & Tronti (1993).

(*) Estimate based on data for the first ten months.

Entering--not only exiting--employment became easier in the second half of the 1980s and early 1990s, as the power of "insiders" diminished. In 1993, the share of young people unemployed was smaller than it was in the early 1980s--in relation to both total unemployment and the demographic age group. Fiscal incentives provided for trainee contracts (1984), as well as increased wage differentiation following the abolition of wage indexation (1992), account for this progress. Nevertheless, in 1993 the share of young unemployed was far the largest among the G7 countries.

Another important element of labor market reform in the early 1990s was increased wage flexibility following the elimination of wage indexation in 1992 and the agreement on a framework for collective bargaining in 1993. For 1993-95, wage increases are tied to officially targeted inflation. This agreement has been adhered to all national contracts concluded so far; as a result, real wages declined as actual inflation turned out to be above the target. Beginning at the end of 1995, the collective bargaining agreement envisions two levels of collective bargaining: a national industry-wide agreement would revise minimum contractual wages every two years with reference to targeted inflation rates; then bargaining at the firm or regional level would determine specific wage increases linked to productivity and profitability developments.

2. Outlook

To identify possible signs of recovery in the labor market, recent trends of employment, real value added and real wages are broken down by sector. Chart 20 considers separately agriculture, industry, market services and nonmarket services. With the exception of the market services sector, there is a strong correlation between employment (measured in standard units of labor) and real value added growth. In addition, since the latter systematically exceeded the former, the charts reflect large productivity gains in all sectors, while real labor costs declined or stabilized.

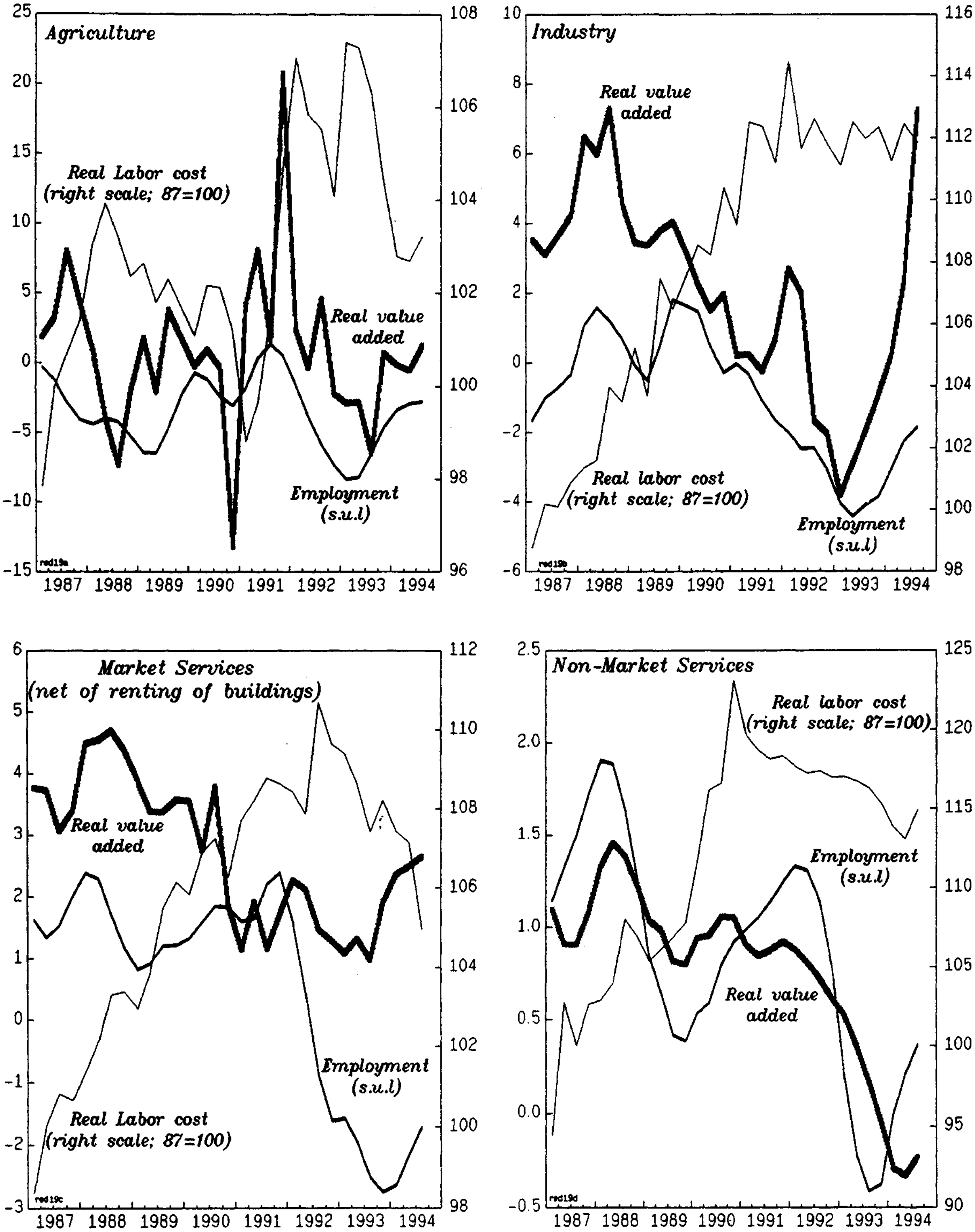
By the third quarter of 1994, the recovery had slowed down the decline of employment. Chart 21 presents the behavior of the same variables in three industry sub-sectors: energy, manufacturing and construction. In the energy and manufacturing sectors, employment was still declining but at lower rates; instead, in the construction sector, severely hit by the contraction of public works, employment and real value added showed no sign of recovery. This evidence should be interpreted with caution: since employment is measured in standard units of labor, an increase does not necessarily imply a larger number of people employed, but could simply correspond to an increase in overtime--which constantly increased in large firms since the beginning of 1994--or to a reduction in the number of people benefitting from the wage supplementation fund (who are treated statistically as employed).

To assess the employment outlook, the labor market model presented in Charts 13 and 14 has been re-estimated using all data available until the end of 1994, and simulated up to 1999 using the last World Economic Outlook

CHART 20

ITALY

Agriculture, Industry, Services
(Year-on year percentage change)

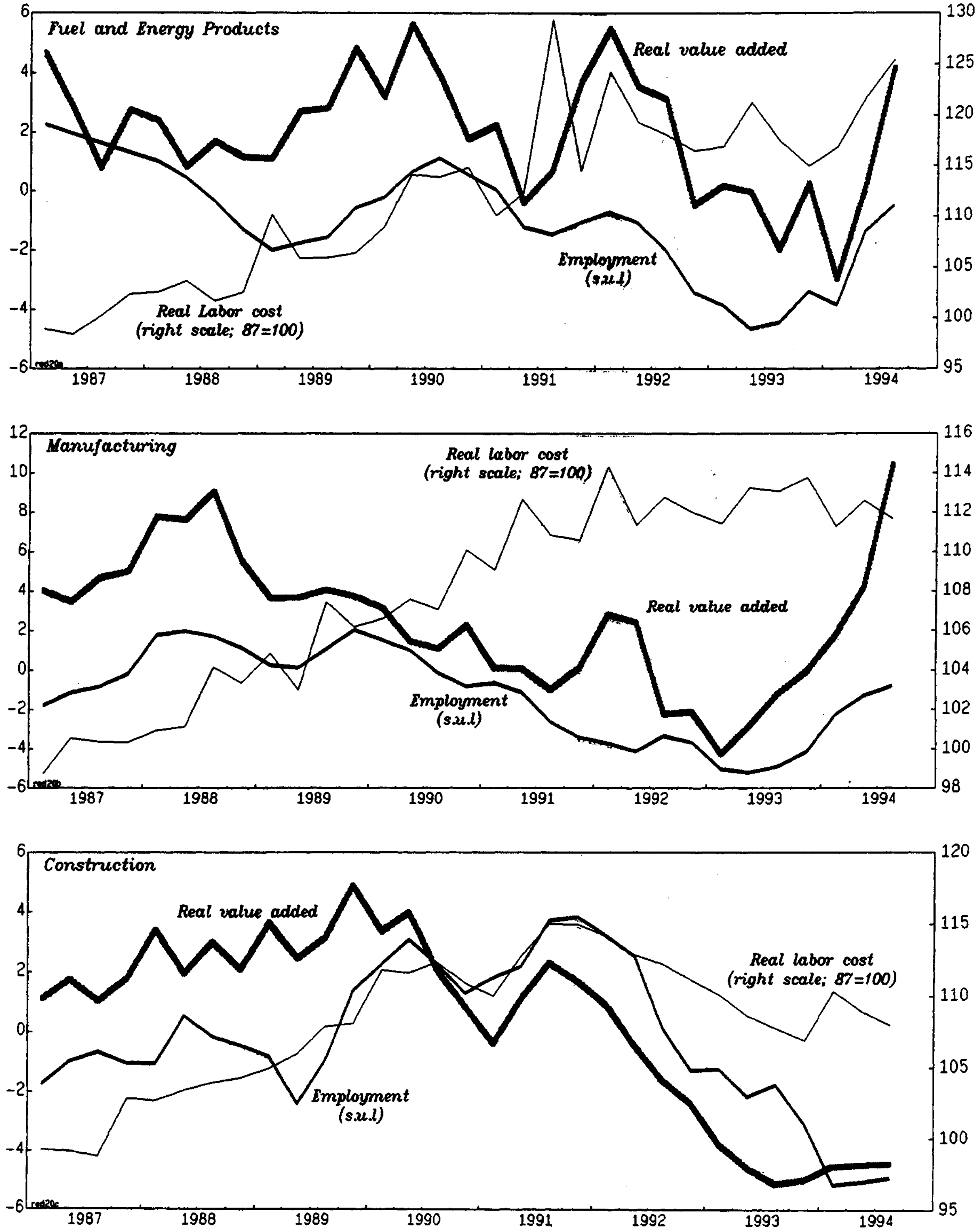


Source: ISTAT.

CHART 21

ITALY

Industry (sub-sectors)
(Year-on-year percentage change)



Source: ISTAT.

(WEO) projections for the exogenous variables (Charts 22 and 23). The longer estimation period makes it possible to take into account the higher elasticity of employment to output that characterizes the most recent observations. If a structural break took place in the early 1990s, the actual elasticity should be estimated only using the most recent observations--but those are unfortunately insufficient for estimation purposes. As a result, the new estimated elasticity--though higher than the one estimated with data until 1991--is still likely to be lower than the actual one, since old observations are still taken into account. The simulations predict that employment would bottom out in 1995-96 and increase in later years. Similarly, unemployment would stabilize around its end-1994 level for the next two years and then fall, while the labor force would gradually rebound. Real wages would decline until 1997 and recover thereafter.

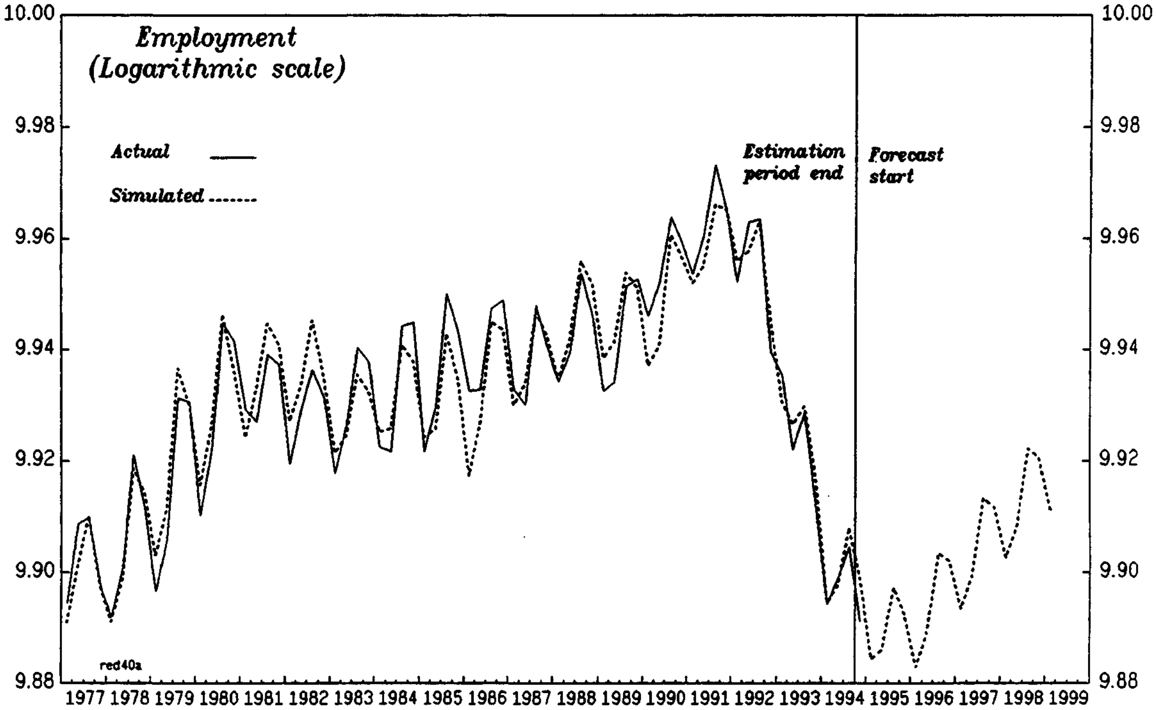
Projections for the WEO are more optimistic than the above simulations, with the unemployment rate falling by 2000 to the NAIRU 1/ in line with a closing output gap. This projection requires that the recovery phase would be characterized by the higher elasticity of employment to output observed during the latest recession. The strong recovery of employment implied by this projections would require credible prospects for labor market reform with immediate reassuring signals, such as rapid approval of recent proposals to facilitate temporary and part-time employment and greater wage differentiation introduced through second-tier negotiations at the firm level.

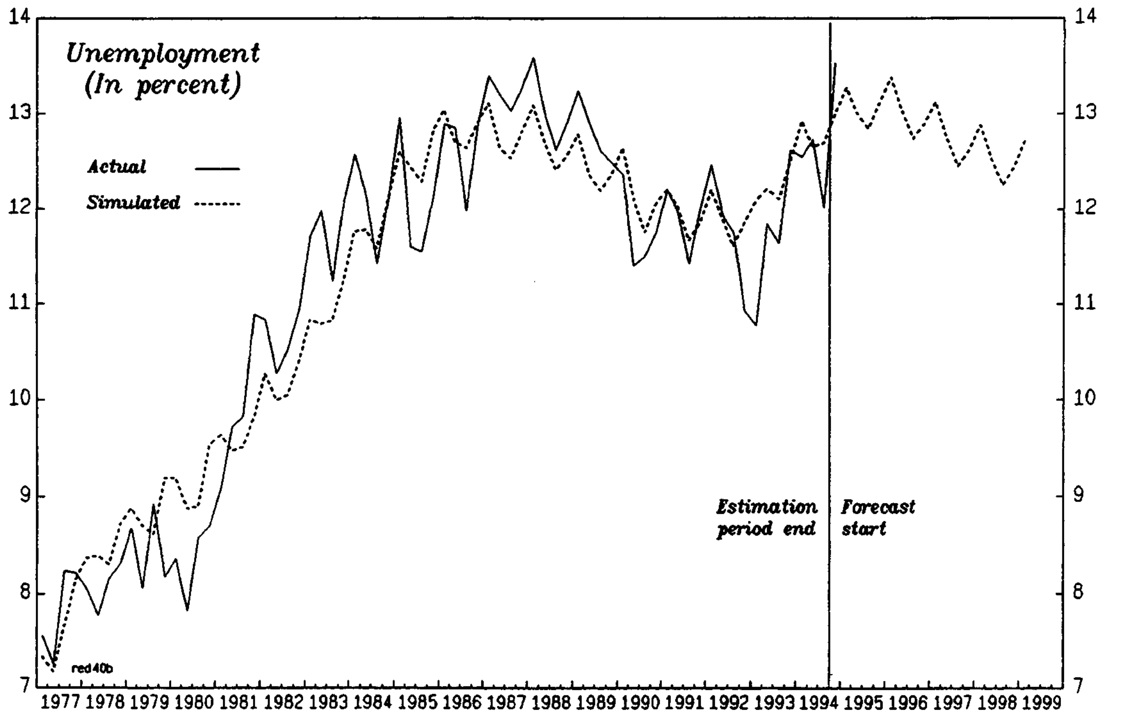
1/ In 2000, the NAIRU is projected to be 9.2 percent, equivalent to about 10.7 percent in the definition used for the simulations, which includes workers on wage supplementation fund among the unemployed.

CHART 22

ITALY

Employment and Unemployment



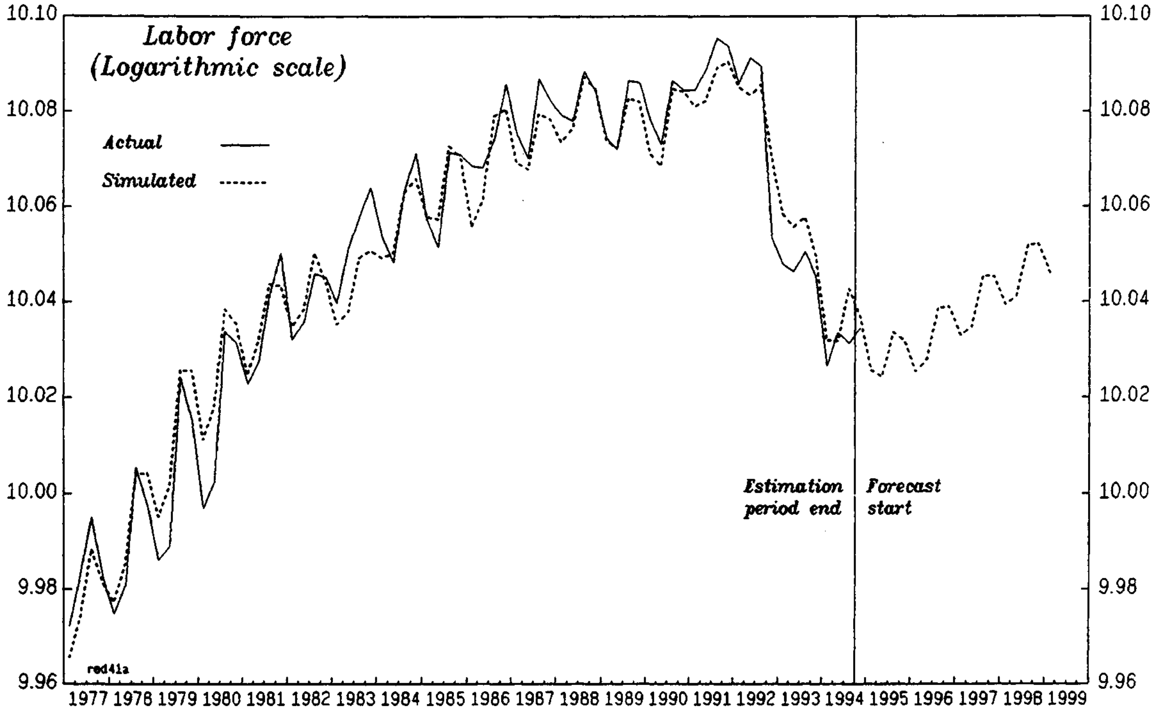


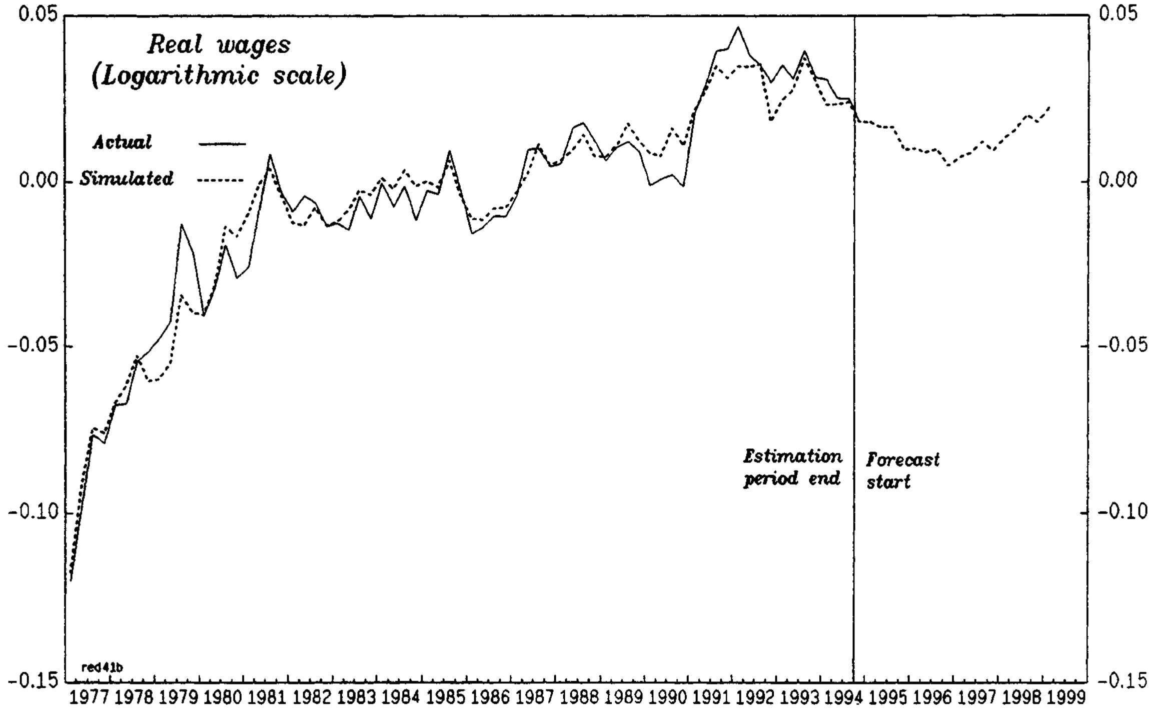
Sources: Italian authorities and Fund staff estimates.

CHART 23

ITALY

Labor Force and Real Wages





Sources: Italian authorities and Fund staff estimates.

III. Public Finances

1. The 1994 budget and outcome

The 1994 budget was based on the three-year plan for 1994-96. That plan had been approved in July 1993, in the midst of the recession. In these conditions, the authorities had decided to accept a "pause" in the process of primary adjustment: the central government (*settore statale*) primary surplus in 1994 was targeted to remain at about its 1993 level (Lit 32 trillion, just under 2 percent of GDP). At the same time, because interest rates were falling at the time, the overall deficit was projected to decline from Lit 154 trillion, or 9.9 percent of GDP in 1993 to Lit 144 trillion, or 8.7 percent of GDP in 1994. 1/ The target date for debt stabilization was postponed from 1995--as earlier planned--to 1996.

To achieve the objective for the primary surplus, given that the underlying "no-measures" (*tendenziale*) fiscal position was projected to deteriorate as a result of the expiration of the one-off measures taken in 1993 and of the economic cycle, the 1994 budget included new measures (*manovra*) relative to baseline equivalent to Lit 31 trillion (about 1.9 percent of GDP) on both revenues and primary expenditures. The emphasis was put on expenditure savings, which were supposed to contribute the bulk (about Lit 26 trillion) of the total. 2/

In early 1994, as the full extent of the 1993 downturn became evident while the signs of recovery were still weak, the authorities took the view that the 1994 central government targets could not be achieved without additional measures. According to the March 1994 quarterly budget report, in the absence of additional measures, the primary surplus in 1994 would reach only Lit 9.9 trillion and the overall deficit Lit 159 trillion, compared with the targeted Lit 32 trillion and Lit 144 trillion, respectively. The new government that came to office in May 1994 decided to take Lit 5 trillion of measures to offset this shortfall only partly, and the revised target was set at Lit 154 trillion (9.4 percent of GDP). This implied a reversal of the process of primary adjustment, instead of the "pause" envisaged in the 1994-96 plan.

1/ The official definition of interest payments (and hence the overall deficit) does not include interest accruing on outstanding tax refund liabilities not yet replaced by government bonds (the process of issuing bonds to gradually replace these liabilities started in 1993). This accrued interest is estimated by the staff at about 0.3-0.4 percent of GDP annually, and is projected to decline rapidly in the coming years as these liabilities are replaced by bonds. Thus, if the government accounts figures were to be corrected by this amount, the overall deficit would be 10.3 percent of GDP in 1993, and the 1994 target would be 9.0 percent of GDP. In what follows, the official presentation of interest payments and the overall balance is used, unless otherwise indicated.

2/ The 1994 budget was described in SM/94/39, 2/11/94.

Developments in the course of the year affected the fiscal accounts in opposite directions. On the positive side, the economic recovery revealed itself to be much stronger than expected early in the year. However, interest rates stopped declining and then--especially after August--increased substantially. Furthermore, floods hit the North-west of the country in October, causing considerable damage to private and public property. The government's immediate response to the floods was a postponement by six months of the direct and indirect tax payment due in November 1994 by business and professionals in the affected regions (an amount estimated at about Lit 4.5 trillion, including social security contributions); and an extension of a line of credit of Lit 3 trillion for reconstruction (of which only about Lit 1.2 trillion was expected to be drawn in 1994). Additional relief measures were to be taken in 1995 (see below).

In addition to these exogenous factors, the government delayed taking the supplementary measures intended to partly offset the shortfall from the original budget target, and when these measures were finally taken in September their yields amounted to less than the Lit 5 trillion originally announced: when implemented, the measures, consisting of summary procedures for the closing of outstanding tax court cases, and an amnesty on illegal construction, were designed to yield only Lit 3.5 trillion.

Nonetheless, the government left the revised 1994 budget target unchanged at Lit 154 trillion. The cost of higher interest rates (which would anyway be contained in 1994) and of the floods, as well as the smaller size of the corrective measures, were expected to be broadly offset by lower-than-budgeted VAT refunds and the positive effects of the stronger economic cycle on the primary balance--although these effects would be muted as the recovery had not yet resulted in higher employment. The latest staff estimates show the central government overall deficit close to the government's revised target at about Lit 157 trillion (9.5 percent of GDP), 1/ and the primary surplus at Lit 15.4 trillion (0.9 percent of GDP). These estimates are still subject to some uncertainty arising primarily from the possible impact on the central government's cash financing need of transactions among government agencies (such as transfers to public sector entities, deposits of local authorities in the Treasury account, etc.). They are, however, broadly in line with the authorities' own estimates. After privatization receipts accruing to the Treasury of Lit 7.2 trillion, the central government debt is estimated at 123.1 percent of GDP at end-1994.

The main reason for the difference between the estimated outcome and the original budget was a significant shortfall in revenues: instead of the budgeted decrease of 1 percentage point of GDP, central government revenue fell by almost 2 percentage points relative to 1993 (despite the corrective measures taken in September) to reach an estimated 32.5 percent of GDP in

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1/ About Lit 162 trillion (9.8 percent of GDP) including estimated interest accruing on tax refund liabilities not yet replaced by bonds.

1994. This shortfall, which affected both direct and indirect tax revenue, was only partly due to the cycle. Pending the official data on the budget outcome, it appears that the shortfall was also partly due to the ineffectiveness of the revenue measures included in the 1994 budget. Expenditures, on the other hand, were kept broadly in line with the target: small overruns in primary current spending (an estimated 27.7 percent of GDP instead of an original budget target of 27.3 percent) and interest payments were offset by lower capital (an estimated 2.5 percent of GDP instead of an original budget target of 3.1 percent). The latter was due to the decision to renegotiate existing suppliers' contracts, as well as the effects on public investment of the corruption investigations of recent years; although these factors had been taken into account in the 1994 budget, their effects went beyond the budget estimates.

2. <u>The 1995-97 three-year plan and the 1995 budget</u>

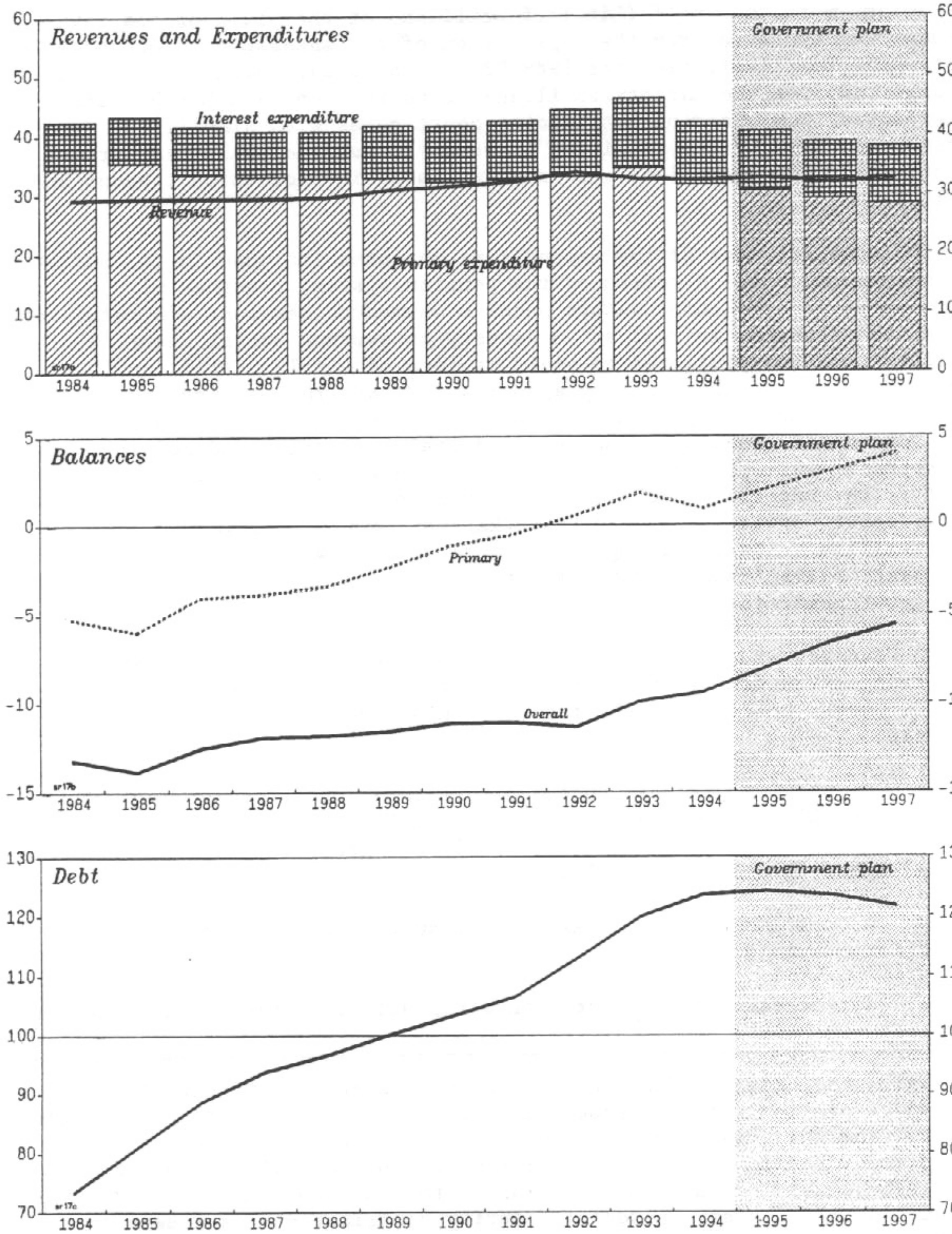
In July 1994, the government presented its new three-year plan for the period 1995-97. Although this plan was based on a projected 1994 outcome that was considerably worse than envisaged in the previous three-year plan, it maintained that plan's key objective of stabilizing the central government debt-to-GDP ratio in 1996. In addition, it spelled out the broad strategy to achieve this objective: the budgets for 1995-97 would be designed so as to keep the tax pressure at about its 1994 level, while primary current expenditure would increase every year by the rate of projected inflation.

The plan targeted an increase of the central government's primary surplus to 2 percent of GDP in 1995, and to a further 3 percent and 4 percent of GDP, respectively, in 1996 and 1997. Relative to a baseline "no-measures" projection, this implied a cumulative primary adjustment of some 4½ percentage points of GDP over the three-year period, to compensate for the expiration of one-off measures taken in the past. The plan was front-loaded: about half of the planned primary adjustment relative to the baseline (Lit 45 trillion, or 2½ percent of GDP) was targeted for 1995. These primary surpluses were expected, according to the plan, to enhance confidence and thereby bring about a substantial reduction in interest rates, with the benchmark interest rate on 12-month Treasury bills declining from over 9 percent at the time of the plan to 8 percent by end-1994 and remaining there through the end of the three-year period. This would facilitate fiscal adjustment and debt reduction. The overall central government deficit was projected to decline to 8 percent of GDP in 1995, 6.6 percent in 1996, and 5.6 percent in 1997. With the contribution of privatization receipts (expected to amount to Lit 10 trillion per year during 1995-97), the debt-to-GDP ratio was projected to start declining in 1996, and reach 121.6 percent at end-1997 (Chart 24).

The 1995 budget, approved by Parliament in December 1995, reflected these targets. Because interest rates and hence interest payments at the time of budget preparation were projected to be higher than at the time of the plan, the budget included a slightly larger primary adjustment than the plan (Lit 48 trillion) to achieve the same overall deficit target.

CHART 24
ITALY

State Sector Finances and Debt 1/
(In percent of GDP)



Source: Data provided by the authorities.

1/ Starting in 1986, data exclude operations of the Railways, Tobacco Monopolies, and Telephone Agencies.

The budget included measures on both revenues (Lit 21 trillion) and expenditures (Lit 27 trillion). The bulk of the revenue measures were one-off and, although they would raise the revenue-to-GDP ratio slightly to 32.6 percent, were not interpreted as increasing tax pressure. In particular, more than half (Lit 11.5 trillion) of the yield of the revenue measures was expected from the application of new assessment procedures for outstanding tax liabilities for 1989-93 (*concordato*); another Lit 7 trillion was expected from the amnesty on illegal construction; and Lit 0.6 trillion was expected from clearing outstanding court cases with simplified procedures. Most of the remaining increase in revenue would come from reductions in tax exemptions and from increases in excises on tobacco and spirits.

In contrast, most of the expenditure measures included in the budget were permanent cuts. A reform of the pension system, together with a postponement of some compensatory pension payments (*pensioni d'annata*) and indexation payments, as well as an amnesty on overdue social security contributions, was projected to yield savings of Lit 12.5 trillion in transfers to the social security agencies. 1/ Health spending cuts, including ceilings on spending by local health agencies, the closure of small uneconomic hospitals (subject to certain criteria) and ceilings on drug spending were projected to generate Lit 6 trillion in savings. Finally, the budget included cuts to transfers to local authorities, wider public sector entities, and the State Railway Company equivalent to almost Lit 7 trillion. The remaining expenditure savings would come from a central government hiring freeze for the first nine months of 1995 and reductions in other government consumption.

On December 19, 1994, the government passed decree-law 691/1994 specifying extraordinary measures (in addition to those taken earlier in 1994) to cover the costs of the floods. This decree-law includes three measures:

- a one-time personal income tax (*Irpef*) surcharge for medium and high incomes (Lit 100,000 for incomes between Lit 100-200 million; Lit 300,000 for incomes between Lit 200-500 million; and Lit 1 million for incomes higher than Lit 500 million);

- a one-time corporate tax (*Irpeg*) surcharge equal to 1 percent of taxable corporate income; and

- an increase of 50 percent in stamp duty on financial transactions.

1/ While the original draft budget included specific standard measures in the area of pension reform, trade union protests led to the removal of these measures from the budget law, and to a negotiated agreement on the principles of pension reform to be implemented by June 1995. Instead, the final 1995 budget included--in addition to the postponement of compensatory payments and the amnesty on social security contributions--a freeze on seniority pensions until June 1995.

The one-time personal and corporate income tax surcharges would not apply to taxpayers in the areas affected by floods.

These measures are expected to generate about Lit 1.3 trillion of resources in 1995. Together with another Lit 1 trillion of diverted budgetary resources (from the *Cassa dei Depositi e Prestiti*), they would cover the expected additional financial burden on the central government for flood relief and rehabilitation in 1995. Nonetheless, other overruns--notably on interest payments--remained. The program of the new government that took office in January 1995 included the early implementation of corrective measures (which it estimated at about 1 percent of GDP) to safeguard the overall budget target. The package of measures was still in the process of definition at the time of writing.

IV. Monetary Developments

During 1994, Italy's financial markets were influenced by a combination of global financial market trends and domestic economic and political factors. For the second year, monetary policy was formulated in the absence of an exchange rate anchor. In the continued pursuit of disinflation, the Bank of Italy relied on a number of forward-looking indicators of inflationary pressures, among which monetary and credit aggregates were assigned a decreasing emphasis. While embodying some of its elements, this approach differs in important respects from a formal inflation-targeting framework, however. 1/ In the period under review, there were also important structural changes associated with the increasing competition and progressive liberalization of the financial system.

1. Interest rates

In the first part of 1994, the Bank of Italy continued the sequential reduction of official interest rates that it had pursued since the crisis of the fall of 1992 (Chart 25). The discount rate was lowered in February and then in May in conjunction with similar moves by the Bundesbank; another downward move of German official rates, in April, was not followed in Italy.

During this period, long-term interest rates were driven by both international and domestic factors. As occurred in a number of other countries with weak fiscal positions, Italian bond markets amplified the effects of the U.S. Federal Reserve's first increase in interest rates in February, with a widening differential against deutsche mark interest rates. Then, following March elections, interest differentials narrowed, reaching a low of 250 basis points in April.

During the summer, with adverse news on fiscal and political fronts, long-term interest rate spreads widened, concomitant with downward pressure

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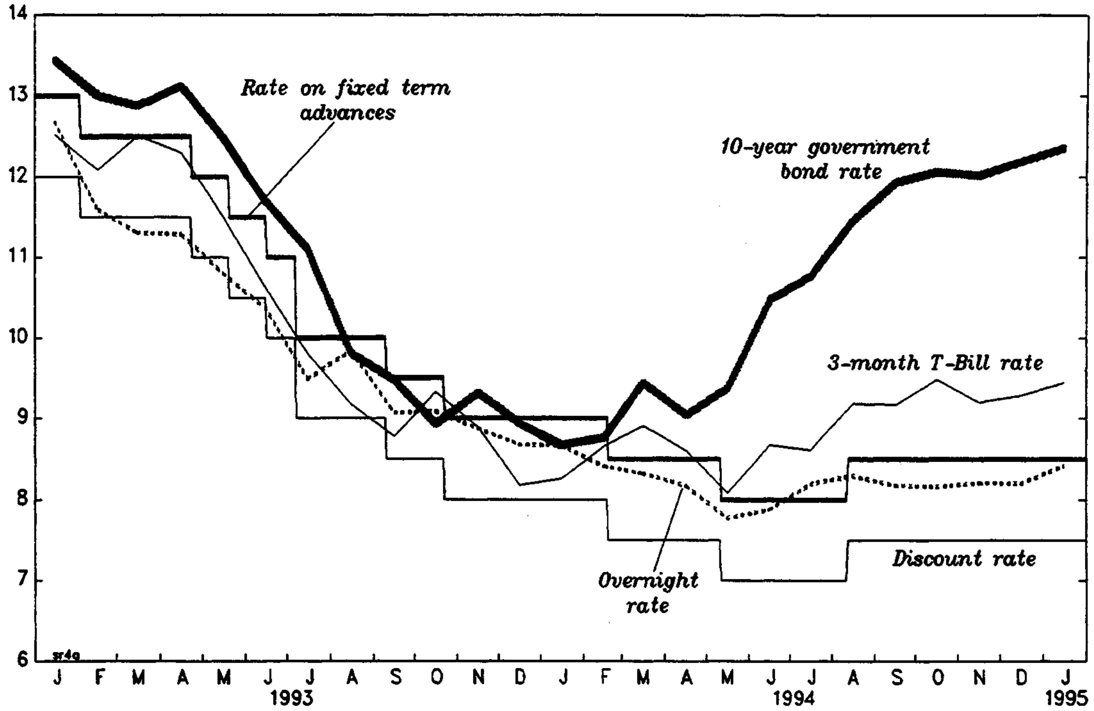
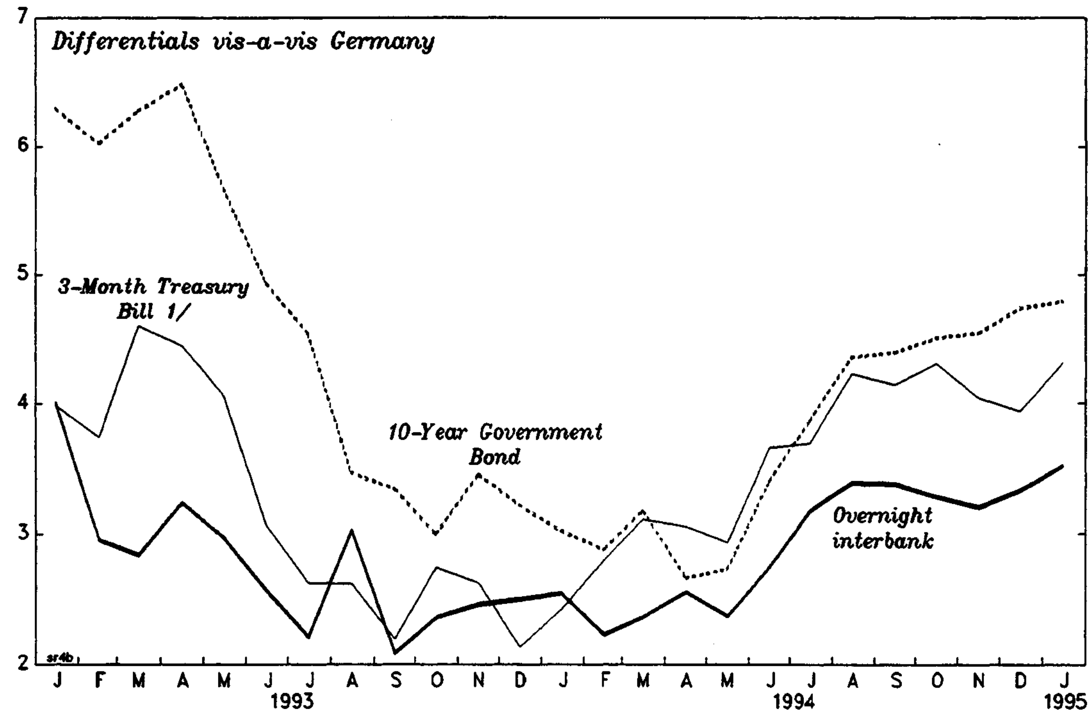
1/ See Lane, Timothy, Alessandro Prati, and Mark Griffiths, An Inflation Targeting Framework for Italy, forthcoming in the PPAA series.

CHART 25

ITALY

Selected Interest Rates





Sources: IMF, Research Department; International Financial Statistics; and Bank of Italy.

1/ German 3-month interbank discount rate.

on the lira. At the same time, other indicators, including surveys of inflationary expectations, suggested heightened inflationary pressures. The Bank of Italy initially responded by tightening liquidity conditions and pushing up market interest rates. Money market rates on repurchase agreements rose above the rate on fixed-term advances, thus out of their notional band. 1/ In mid-August, the Bank of Italy raised official interest rates by 50 basis points. The initial market response was unfavorable: the long-term interest rate spread vis-à-vis German rates widened to over 450 basis points, and the lira dropped to record lows against the deutsche mark. The widening long-term rate spread apparently reflected market expectations of further increases in interest rates. Some observers attributed the markets' reactions to a perceived conflict between monetary and fiscal policy.

During the autumn of 1994, official interest rates were held steady, while market interest rates fluctuated with shifting prospects for political stability and for parliamentary approval of the 1995 budget. The differential between short and long rates narrowed in September, as did the premium on German long-term rates, as these prospects improved, and then widened in late November with difficulties over the parliamentary budget process and further in December with the political events leading up to the fall of the Berlusconi Government.

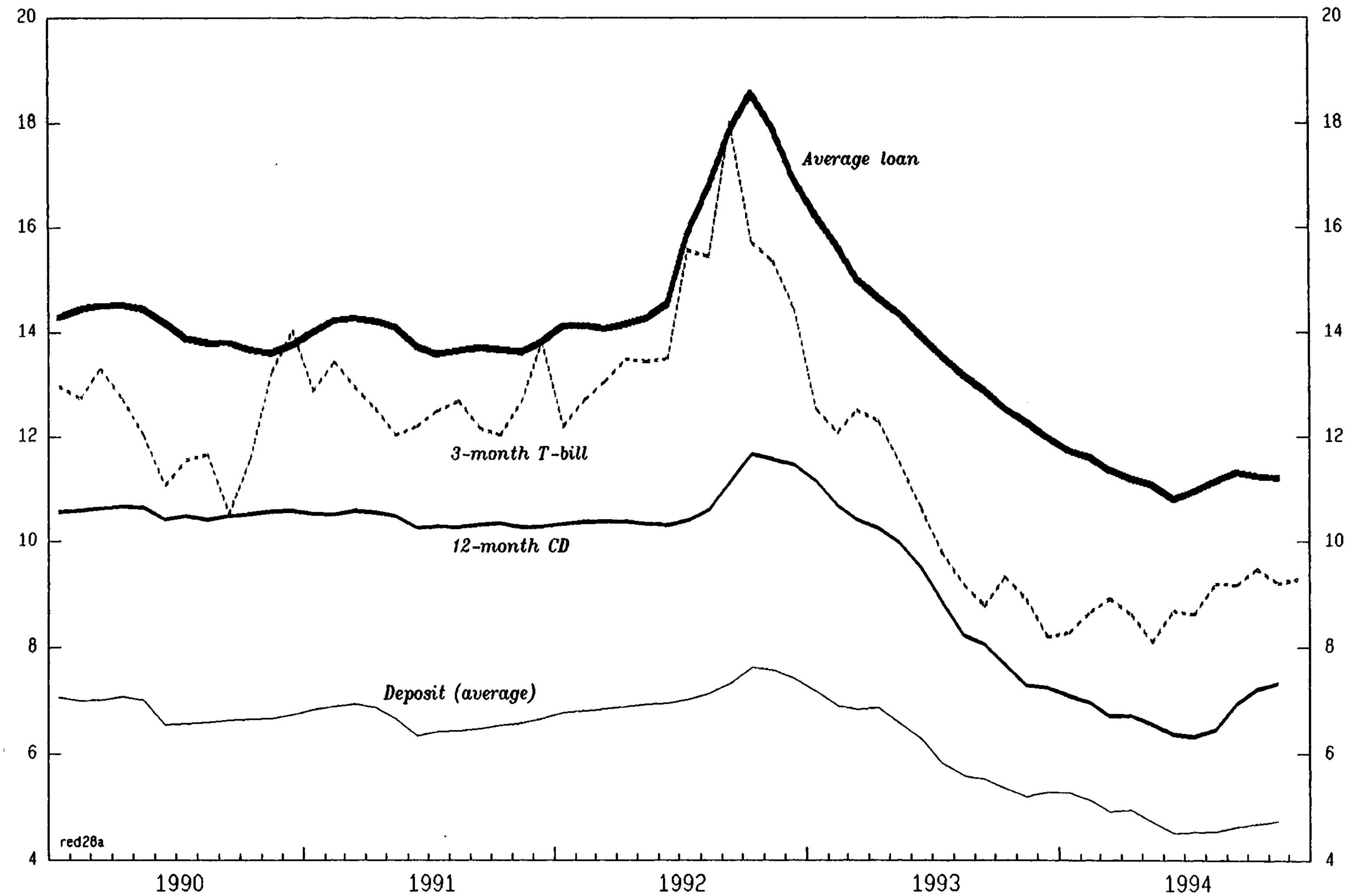
Associated with these changes in the overall level of interest rates was the maintenance of the relatively low spread between average deposit and loan rates (Chart 26) which had emerged toward end-1993 (6.5 percent versus, for example, 9.5 percent at end-1992). This reflected in part the greater responsiveness of loan rates than deposit rates to movements in market interest rates. A more competitive banking environment associated with liberalization may also have played a role (see Annex IV).

1/ The rate on fixed-term advances does not in practice put an actual ceiling on repo rates, since arbitrage between the two rates is not riskless due to asynchronous timing: the fixed-term advances are not allocated until the end of the day, when the repo market is closed, so a bank that wants to use a fixed-term advance to finance the purchase of a repo would have to purchase the repo first and then, at the end of the day, apply for a fixed-term advance to cover the resulting liquidity shortfall (taking the risk that the Bank of Italy would not give the advance).

CHART 26

ITALY

Bank Interest Rates



Source: Bank of Italy.

2. Money and credit

Monetary aggregates showed considerable short-term variability during 1994. Early in the year, growth of broad money (M2) was above the Bank of Italy's 5-7 percent target range (Chart 27). This pattern was apparently in considerable part due to the continuing decline in short-term interest rates. Growth of M2 began to decelerate in April, however, with an increasingly large component of growth coming from the more liquid instruments comprised in narrow money M1. For the year as a whole, M2 growth (at 2.8 percent, on the 3-month moving average basis used for target monitoring) was significantly below its target range, also making a notable deceleration from 1993. This may have reflected the widening spread between bank deposit rates and yields on public debt instruments, associated with less aggressive liability management on the part of the banks, which in many cases were flush with cash due to weak loan demand. The deceleration of growth of certificates of deposit (CDs) occurred despite a lowering of reserve requirements, which would normally have been expected to make CDs more attractive relative to alternative assets. Both narrow and broad money continued to account for a declining share of total domestic financial assets, associated with continued growth in the importance of repurchase agreements, bonds, and mutual fund shares. In particular, medium- and long-term government bonds accounted for the lion's share of growth in domestic financial assets.

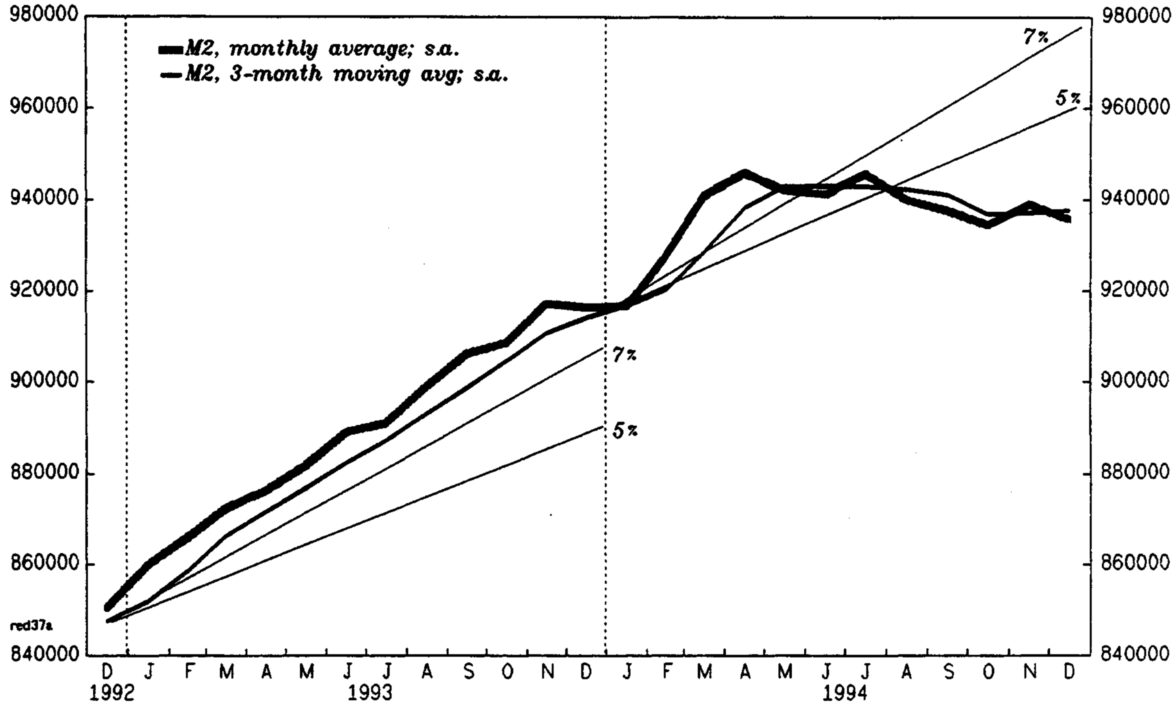
Money demand in Italy has recently shown some indications of, at the least, greater short-run variability around its predicted value. In late 1992, there was an underprediction of money demand, which continued through 1993; then, in mid-1994 this switched to an overprediction (see Annex III).

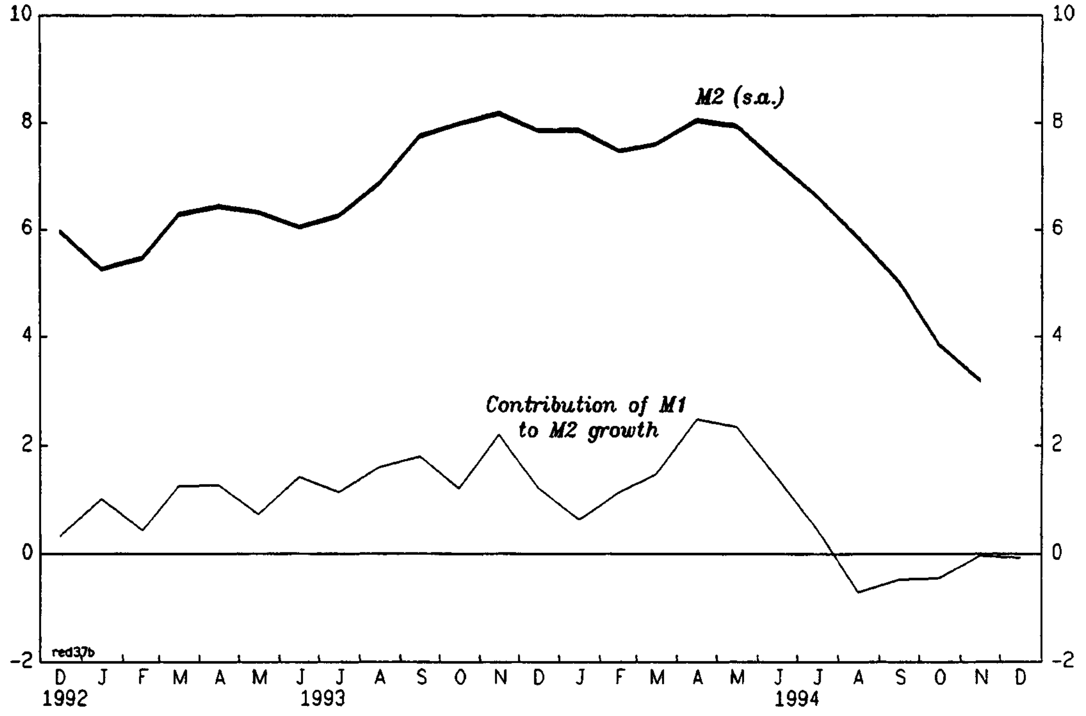
Credit meanwhile grew quite slowly with credit to the nonstate sector, in particular, remaining essentially flat. This was largely due to cyclically weak loan demand and greater recourse to self-financing by enterprises; banks' caution in lending in the face of high loan losses may also have played a role. The share of foreign-currency-denominated loans in total credit declined to 13 percent in September 1994 compared with 17 percent a year earlier; this reflected borrowers' increasing unwillingness to expose themselves to exchange-rate risk in order to obtain a lower interest rate. The counterpart of slow credit growth was increased bank holdings of securities, and in particular of medium- and long-term government bonds. As in the previous two years, a substantial part of these bond holdings was financed through repurchase agreements.

The monetary base rose by 5.7 percent during 1994 when adjusted for changes in reserve requirements. On an unadjusted basis, it declined by 3.4 percent in the first 11 months of 1994, mainly due to the reduction in reserve requirements which are discussed below. The major part of the reduction in the monetary base came from the Treasury, associated with the abolition of the Treasury's overdraft facility at the Bank of Italy. In addition, the Treasury overfunded itself during 1994, in anticipation of large redemptions of medium- and long-term bonds during 1995. The Bank of Italy offset the effect of these Treasury operation on the monetary base through open market operations.

CHART 27
ITALY

M2 Money Supply





Source: Bank of Italy.

3. Monetary policy instruments

This was the second year that Italy's monetary policy was without an exchange-rate anchor. An official target range of 5 to 7 percent had been announced for growth of broad money M2 during 1994. There were also official forecasts of growth of credit to the nonstate sector of 6 to 7 percent, and 7 to 8 percent for both total domestic credit and total financial assets. These targets or ranges were rarely mentioned in official statements explaining interest rate changes, however, and in the event, they were all undershot during 1994.

For 1995, the Bank of Italy discontinued the practice of announcing a target range for M2. Instead, it indicated point figures in the context of "the programming framework for financial flows," of 5 percent for money growth, as well as 5 percent for growth of total financing and 6 percent for growth of total financial assets.

Important changes in Italy's system of reserve requirements were introduced in June 1994, associated with a new banking law that eliminated the former legal distinction between banks (which were confined to short-term deposit-taking and lending) and special credit institutions (confined to medium- and long-term activities). With the new law, reserve requirements apply equally to banks with short and with medium- and long-term deposit bases. However, CDs with maturities over 18 months, which can now be issued by all institutions, are not subject to reserve requirements, and there is an exemption for deposits in amounts over Lit 200 billion. Reserve requirements were also lowered to 15 percent (on the monthly change in deposits) from 17.5 percent. 1/ The rate of remuneration on required reserves was changed to a uniform 5.5 percent from a system under which a higher rate was paid on required reserves held against CDs. Finally, a system was phased in under which a bank could mobilize up to 10 percent of its required reserves to meet its liquidity needs, provided that it satisfied its required average level of reserves over the month; previously, the fraction that could be mobilized was 5 percent. These changes move in the direction of establishing a level playing field between institutions differing in their maturity specialization, reducing the tendency toward market segmentation by maturity. They also end a situation where reserve requirements and other regulations contributed to distort the maturity composition of assets and liabilities.

In November 1993, a law was passed abolishing the Treasury's overdraft account with the Bank of Italy, in compliance with the Maastricht Treaty's prohibition of direct central bank lending to the Treasury. In its place, a new interest-bearing account, called the Treasury payments account (*conto disponibilità*) was established to effect Treasury payments and receipts and enable the Treasury to ride out fluctuations in its net payments needs. The

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1/ The ratio was lowered in February 1993 to 17.5 percent from 22.5 percent. From March 1993 through May 1994, a lower ratio of 10 percent applied to CDs with maturities under 18 months.

use of the account is subject to thresholds to ensure that the balance remains at a safe level. If the balance at the end of any month is less than Lit 15 trillion, the Treasury must bring it back to that level within the following three months. If any end-month balance is less than Lit 15 trillion, or if the balance is below Lit 30 trillion for three successive months, the Treasury must report the reasons to Parliament and describe any corrective measures planned; in the first case, this must be done by the fifth day of the following month.

4. Financial markets

The structure of Italy's financial markets underwent some important changes in 1994. One was the introduction in late 1993 of a streamlined procedure for refunding withholding tax to nonresidents. This reduced the segmentation between resident and nonresident investors, and stimulated the involvement of the latter in Italy's domestic bond markets. However, because tax refunds were not available to residents of all countries, some distortions remain, creating opportunities for tax arbitrage. 1/ Another important change was the December 1993 abolition of stamp duty on securities transactions on regulated markets.

Some notable steps were also taken in early 1994 to reform the electronic market for government securities. Nonresident operators were given direct access to the screen market, although they were not allowed to operate as primary dealers. A new category of primary dealers, called specialists, was established subject to a minimum capital requirement and minimum participation in both primary and secondary markets. 2/ Another reform was to improve the procedures on the electronic market for processing large orders, eliminating an anomaly whereby large transactions had to be split up into several smaller ones, resulting in wider spreads for large transactions and encouraging large transactors to use the over-the-counter market instead. Provisions for the establishment of inter-dealer brokers were promulgated, to enable anonymous trading of lots between specialists. Settlement procedures were improved, linking them directly to execution of transactions. Another innovation was the introduction of screen-based auctions for Treasury securities, whereby bids can be submitted electronically; this has been accompanied by speeding up the period between when bids are submitted and auction results announced. The thrust of these reforms is to increase the efficiency, liquidity, and depth of the government securities market, with a view to ensuring a smooth issuing activity and reducing the costs of financing the public debt.

1/ Notably, U.S. residents were still subject to Italian withholding tax.

2/ The latter requirement, however, led some institutions to undertake artificial transactions to boost their trading activity--so-called "whipped cream"--apparently wishing to become specialists more for the status than with the intention of participating as actively in the securities markets as this status implies.

Stability of Money Demand 1/

Beginning in 1984, the Bank of Italy each year announced a target range for broad money (M2). Until September 1992, these targets were subordinated to the exchange rate bands associated with the exchange rate mechanism (ERM) of the European Monetary System. The importance of money supply targets did not apparently increase with the lira's departure from the ERM, however: during 1993 through the spring of 1994, the Bank of Italy continued to lower official interest rates despite the fact that money supply was growing above the target range; in August 1994, in contrast, official rates were raised despite the fact that growth of M2 was decelerating below the target range. Official communiques announcing official interest rate changes also did not refer to M2 growth in their explanations. For 1995, the Bank of Italy did not announce an explicit target range, but indicated that, consistent with the programming framework for financial flows, "the money supply will continue to expand at a moderate rate, currently estimated at around 5 percent." 2/

A key empirical question underlying the use of monetary targets is whether there exists a stable demand for money function. 3/ Stability of money demand is needed if a target for money supply growth is to bear a predictable relationship to output and inflation that are of more fundamental interest to policy-makers. Moreover, instability of money demand would vitiate the controllability of the money supply through the interest rate control mechanism typically employed by central banks. Empirical work addressing the stability of money demand in Italy has generated ambiguous conclusions. In addition, there is reason to believe that, with further financial innovations, the predictability of money demand will deteriorate further in the future.

Some Italian empirical work published in the early 1980s (e.g., Caranza, Micossi, and Villani (1983)) produced encouraging results on money demand, and supported the case for money supply targeting. Several subsequent papers found indications of instability in money demand, apparently associated with changes in monetary policy regime or with financial innovation; these papers sought to account for apparent structural shifts empirically with a view to finding a specification that would remain stable over a long period.

1/ Prepared by Timothy Lane.

2/ Bank of Italy, *Bolletino Economico*, October 1994, p. 76.

3/ Notwithstanding the mixed empirical evidence on stability of money demand, it is conceivable that money would perform better than alternative monetary indicators. Angeloni and Cividini (1990) examine the informational value of alternative financial indicators, and find that M2 out-performs other variables examined. Their analysis, however, is in the context of the Bank of Italy quarterly model, whose structure may favor M2 over other financial variables.

There are several factors that have been identified in the literature as possibly leading to structural changes. These include:

(1) the change in policy regime in 1969, when the Bank of Italy ended its commitment to supporting bond prices (Bagliano and Favero (1992));

(2) the change in the behavior of inflation in the mid-1970s, when inflation accelerated into the double-digit range and its variability increased (Bagliano and Favero (1992));

(3) financial innovation, associated with disintermediation of government borrowing from the non-bank public in the 1970s and 1980s. This involved the easing of portfolio restrictions on banks which had been used to induce them to hold government bonds; as well as the introduction of new government financial instruments such as BOT and CCT (Muscatelli and Papi (1990); Mastromatteo (1991)); and the liberalization of the market for certificates of deposit (CDs) (Dooley and Spinelli (1989));

(4) the greater financial market volatility (and possibly the large volume of capital flows) following the lira's departure from the ERM in September 1992 (Angelini, Hendry, and Rinaldi (1994)); and

(5) the reduction of reserve requirements on CDs in 1993, which might have led to a portfolio shift into CDs (included in M2) and out of other liquid assets that are not included in M2.

The resulting possible structural shifts in money demand have been addressed in several ways. One approach is to include additional variables in the money demand equation capturing the financial innovations. For instance, Dooley and Spinelli (1989) and Muscatelli and Papi (1990) included variables incorporating the public's holdings of BOT and CCT; the former found that money demand was still unstable even when these variables were incorporated, while the latter found that the inclusion of these variables, in their specification was sufficient to achieve stability. Mastromatteo (1991) used the deposit-loan rate spread and the ratio of liquid assets to GDP as measures characterizing financial system development; he found that with this specification there was no structural shift in the early 1980s. 1/

A second general approach is to capture possible changes in monetary regime through a more appropriate dynamic specification. Some researchers have followed a buffer stock approach, in which money holdings act as a temporary abode of purchasing power before funds are allocated among

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1/ These studies vary in their dynamic specifications. Muscatelli and Papi (1990) use the Johansen approach to test the order of integration of the variables and estimate cointegrating equations. Mastromatteo (1991) uses the traditional lagged-dependent-variable approach, which may result in inconsistent estimates when (as is typical) the variables are nonstationary. Dooley and Spinelli (1989) use the traditional permanent income formulation.

alternative assets, so shocks to money supply and income initially impinge on money demand (Papi (1989)). At a more formal level, Bagliano and Favero (1992) investigate the empirical properties of a money demand equation explicitly incorporating costly portfolio adjustment with forward-looking expectations. This approach generated plausible coefficient estimates using instrumental variables; the forward-looking specification--unlike a backward-looking specification which the authors also estimated--did not show a structural break in 1969 (when the Bank of Italy stopped supporting bond prices), but both specifications nonetheless had a structural break in 1974 (when inflation accelerated and became more variable).

A third approach involves examining the behavior of alternative monetary aggregates, weighting each component of a broad monetary aggregate by a measure of its "moneyness" rather than taking the simple sum of each component. The construction of a Divisia index assigns to each component of broad money a weight based on the interest that must be sacrificed to hold it rather than alternative assets. Gaiotti (1994) constructed a Divisia index of money for Italy, and found that it had desirable properties as an indicator--in particular, that it experienced slower growth than conventional M2 in 1993, a period when conventional money demand equations were subject to underprediction.

A fourth approach is to use a deterministic trend to model the structural break, rather than attempting to account for the break in terms of economic variables. This is the approach taken in the Bank of Italy quarterly model, which specifies a money demand equation over the 1974-84 period spanning different states of the financial system (Bank of Italy, 1986). The model assumes that demand for money up until the early 1980s incorporated a large portfolio element, implying that wealth was an important scale variable for money demand; following the financial liberalization of the early 1980s, demand for money was largely transactions-related, and thus mainly related to current income. Money demand is assumed to adjust from one specification to the other according to a logistic trend--a rather ad hoc exercise, but one that yields a stable specification. 1/ Angelini, Hendry, and Rinaldi (1994) incorporate this transition model into a more sophisticated dynamic specification, using the error correction approach; their specification is stable over the 1983-1992 period, and its forecasting performance is satisfactory through the first half of 1992.

Existing money demand equations have performed less well in explaining the behavior of money demand since 1992. In the period of high interest rates and volatile financial flows in the latter part of 1992 and early 1993, most equations underpredicted money demand: essentially, the high interest rates of that period did not choke off money demand as much as was predicted by the equations. A possible interpretation is that, because the magnitude of the shocks exceeded those found in the data used to estimate

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1/ In the Bank of Italy's monthly model, estimated over a shorter period (1981-85), only the transactions-based specification is assumed.

the equations, the estimated dynamics did not stand up well. Most equations continued to underpredict through much of 1993, which may also have been partly attributable to the lowering of reserve requirements which may have made certificates of deposit closer substitutes for alternative assets not included in M2. Some preliminary work at the Bank of Italy also suggests that the poor performance of money demand equations in 1992-93 may be explained, in part, by an increase in the riskiness of alternative assets, and by movements in long-term interest rates (Grande and Rinaldi (1994)). In 1994, in contrast, money demand turned out below predicted levels; this appears to have been at least partly attributable to liability management on the part of banks, reflected in a widening spread between CD rates and money market interest rates. Some degree of persistent overprediction of money demand in 1993, and underprediction in the second half of 1994, is found even with relatively sophisticated money demand specifications (Chart 28). 1/

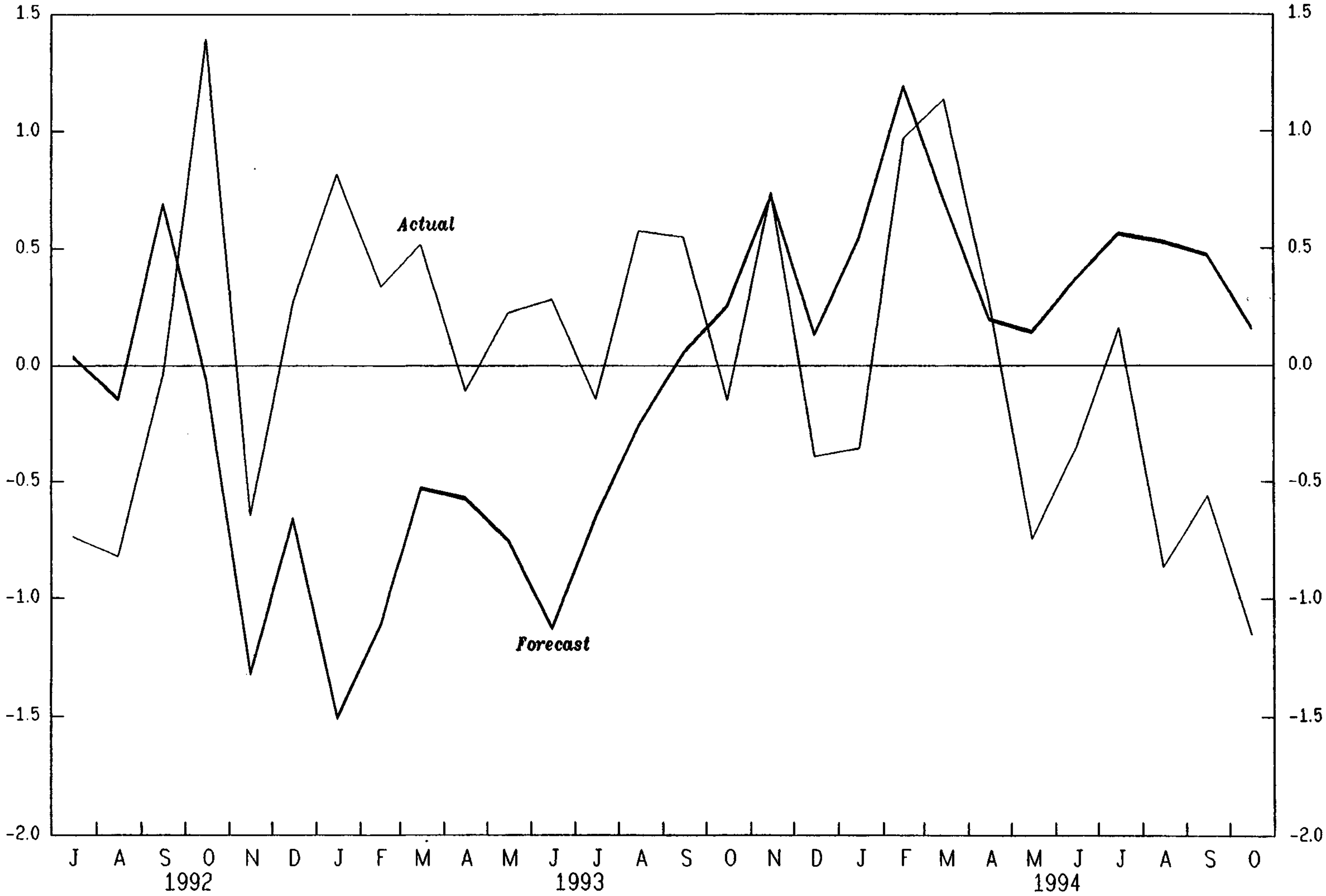
Looking to the future, further financial innovation is in store in Italy, and it is to be expected that this may be associated with further increases in the volatility of money demand. The reductions in reserve requirements, particularly on CDs in 1993 and 1994, and their abolition on CDs with maturities exceeding 18 months, as well as the 1993 elimination of the prohibition on banks' issuing CDs with maturities exceeding 18 months, have not yet had their full effect. The restructuring of the banking system, and increased public access to equity markets associated with the privatization program, may also change the range of assets that are substitutes for money, thereby altering the influence of interest rates on money demand. When these changes have progressed further, they may make the money stock less reliable as a monetary target or indicator than at present.

1/ Chart 28, based on Grande and Rinaldi (1994), plots actual month-to-month real M2 growth against the predictions of an equation in which explanatory variables include real GDP, interest rates (the own return on money, Treasury bill, and Treasury bond rates), a measure of variability of the T-bond rate, and total financial wealth.

CHART 28

ITALY

Money Demand: Predictions and Outturn
(Monthly percent changes; in real terms)



Source: Bank of Italy.

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The Banking Industry: Liberalization and Performance 1/

The past year has been characterized by many observers as a "black year" for the Italian banking industry, with a confluence of narrowing spreads, exceptionally slow growth of deposits and loans, record high nonperforming loans, and capital losses on bond portfolios--in contrast to previous years, when losses in one area were offset by unusually high returns in others (Chart 29). As a result, commercial banks' gross profits fell to an estimated 0.35 percent of total assets in the first half of 1994, following a steady decline from 1.08 percent in 1990. 2/

The banking industry's adverse circumstances were mainly the result of the recession and the turning of the interest rate cycle. However, they have also drawn attention to longer-term issues associated with liberalization and structural change of the banking system in the first half of the 1990s.

1. Liberalization and restructuring

The liberalization of the Italian banking system received much of its impetus from the move toward the single European financial market, including both the liberalization of capital movements in 1990 and the Second Banking Directive which came into effect in 1993. These developments posed a potential threat of competition from banks and financial markets in other EU countries, as well as leading to the establishment of uniform minimum standards of prudential regulation throughout the EU. The response was a major departure from the existing framework. The existing banking environment was founded on the 1936 banking law, which prescribed a rigid differentiation of institutions according to maturity and function, with banks engaging in short-term deposit-taking and lending and special credit institutions dealing in longer maturities. Most of the largest institutions were state-owned, in two main categories: "public law banks" mainly owned by charitable foundations; and "banks of national interest" owned by state holding companies. Banks' functions were also differentiated, with some institutions (especially the banks of national interest) slanted heavily toward commercial activities and others (especially the savings banks) relying heavily on the household sector. These arrangements, together with tight regulation of bank branching and mergers, resulted in a situation where Italy was "overbanked and underbranched." Italian banks' performance also typically varied according to size: the medium-size banks, with strong regional ties and close customer relations, have in many cases been very profitable, while the large banks have often spread themselves too thin and in some cases incurred substantial losses on their international activities.

Under the Amato Banking Law of 1990, banks were permitted to form universal banking groups, which combined banks, special credit institutions, and other institutions; they were also given special tax concessions

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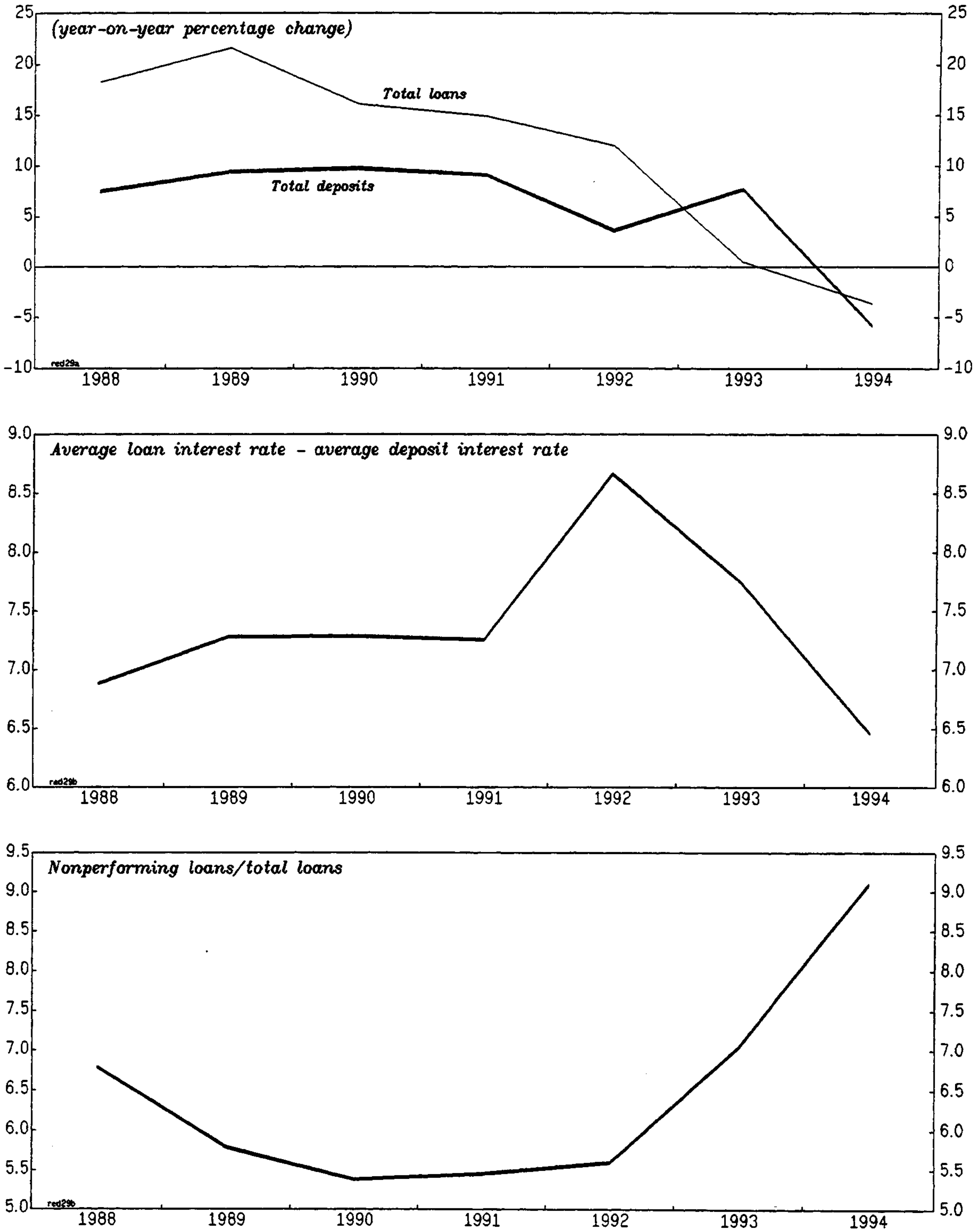
1/ Prepared by Timothy Lane.
2/ Data refer to banks taking short-term deposits.

CHART 29

ITALY

Variables Affecting Bank Performance



Source: Bank of Italy.

covering their reorganization. An element in this reorganization was that public law banks were legally separated from the charitable foundations that owned them, with the foundation owning a holding company which in turn owned the bank. In this connection, banks were given tax exemptions for the revaluation of assets valued at low historic cost. The separation of foundations from their holdings, and the associated revaluations, were needed to prepare for the coming into effect of the EU's Solvency Ratio Directive at the beginning of 1993. The law also provided tax incentives for mergers, with a view to encouraging some degree of consolidation of the banking industry. These tax incentives were extended in successive years, and have now been extended into 1995. In addition to the general provisions of the law, the Treasury also provided support to recapitalize a few problem banks in anticipation of the implementation of the EU's capital adequacy standards. 1/

In the early 1990s, the Bank of Italy also liberalized its regulation of branch expansion: as a result, over 4,000 new branches were established in 1990-92 alone. 2/ In addition, some regulations governing banks' activities were liberalized: for instance, the percent of residential property that could be financed by mortgage was raised from 50 to 75.

With these changes, Italian banks are likely to face an increasing degree of competition. Competition may already have begun to intensify, as a result of the branch expansion, the openness of capital markets, and increasingly efficient financial markets of which both savers and borrowers made greater use. Competition may help explain the modest decline in average interest spreads between assets and liabilities from 700-725 basis points in 1988-1991 to less than 650 basis points in 1994 (Chart 29); however, the more dramatic drop in spreads from 1992 to 1994 mainly reflects unusually wide spreads in 1992.

The legally-enforced maturity segmentation of the financial system was also finally abolished with the 1994 banking law, which eliminated the legal distinction between banks and special credit institutions. This followed the 1993 law, under which banks were allowed to issue longer-maturity deposits and loans, and uniform reserve requirements were imposed on similar deposits issued by all deposit-taking institutions. This would be expected to increase further the degree of competition among different types of financial institutions. The goal of the reform is that Italy should move toward the universal banking model, dominated by large banks spanning the maturity spectrum as well as offering a wide range of assets, liabilities and services.

It is also intended that many of the banks will be privatized. In the case of the banks of national interest, this involves their sale by state holding companies. In late 1993 and early 1994, Credito Italiano and Banca Commerciale Italiana, two of the ten largest Italian banks, were privatized through public share offerings. The government also publicly sold a

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1/ In some cases this was done by assuming pension liabilities.
2/ These included many so-called "light branches", small banking outlets specialized in deposit-taking.

minority interest in Istituto Mobiliare Italiano (IMI), one of the largest medium- and long-term credit institutions. A decree law promulgated in December 1994 provides fiscal incentives for the foundations owning the public law banks to sell part or all of these banks, so that they would hold a diversified portfolio of assets. Many observers view the privatization of banks as a precondition for the efficient functioning of the banking system.

The tax incentives for mergers under the Amato Banking Law, together with a more tolerant regulatory attitude, were associated with an unprecedented level of merger activity. Some 125 mergers took place during 1991-93, compared with only 75 in the previous 5 years. In 1994, there were also the first attempted hostile takeovers (one already successful) of important regional banks by newly-privatized national banks. There were also several smaller acquisitions designed to expand branch networks, as well as purchases of small banks in difficulties. Bank mergers are subject to approval by the Bank of Italy with regard to their banking aspects; by the Anti-Trust Authority (*Autorità Garante della Concorrenza e dei Mercati*) with regard to their implications for competition; and by the CONSOB (*Commissione Nazionale per le Società e la Borsa*) with respect to their implications for securities trading and corporate governance. The authorities have viewed some consolidation of the banking system through mergers as inevitable, and conducive to enhancing the system's competitiveness in a European setting. The result envisaged is a system dominated by large universal banks which carry out banking activity on a national and international scale.

2. Problem loans and capital losses

There was some concern that the increased branching and more liberal regulations would lead to a decline in loan quality as banks entered unfamiliar markets and competed for marginal loan customers previously unable to obtain credit--although much of the branch expansion was defensive, with banks opening additional branches to consolidate already-dominant market positions. In the event, loans expanded rapidly in the early 1990s, but decelerated in each year from 1989 through 1994 (Chart 29); there was also an increase in problem loans. Loan losses as a share of total bank loans rose by some 27 percent in the 12 months to September 1994, reaching 9 1/2 percent of total loans outstanding. Nonperforming loans, together with the other factors, resulted in a valuation adjustment of about 1 percent of banks' total assets, a substantial amount but not enough to generate losses for the system as a whole. 1/ About one-fifth of the banks are estimated to have incurred losses in 1994.

1/ By way of comparison, in 1991 the adjustment for non-performing loans reached 0.93 percent of commercial bank assets in Finland, 4.14 percent in Norway, and 1.83 percent in Sweden. (In Sweden, the losses of the savings banks were proportionately larger.) In all these Nordic countries unlike in Italy, however, the nonperforming loans resulted in losses for the banking system as a whole. For further discussion, see Burkhard Drees and Ceyla Pazargasioglu, "The Nordic Banking Crises: Pitfalls in Financial Liberalization?" (mimeo, IMF, 1995).

Although total nonperforming loans were high in 1994, the flow of new bad loans started to decline in the latter part of the year; bank analysts have estimated, based on past experience, that it would likely take 2-4 years to overcome the problems. Substandard assets (loans to borrowers in temporary difficulties--*partite incagliate*) declined for some major banks in 1994, partly because some large corporate restructurings had moved the affected loans back out of the substandard category. Consumer lending, including for housing, played some, although not a dominant role in the mounting loan losses: the incidence of nonperforming consumer loans on total consumer loans rose from 10.8 percent in 1991 to 12.1 percent in 1993, raising their share in total nonperforming loans from 15.8 to 16.8 percent over the same period. Unlike in the Nordic countries' banking crisis, problem loans were not concentrated in any one sector such as real estate.

Capital losses on bond portfolios emerged in 1994 mainly because banks had deliberately maintained maturity mismatches between predominantly short-term deposits and assets that included a long-term component. Much of the bond portfolio was normally hedged, but early in 1994, many had decided not to cover, due to expectations that interest rates would continue to decline. More recently, banks had decided to hedge their duration exposure, in at least one case by issuing bonds with similar duration to that of the bond portfolio. Some banks' true portfolio losses may turn out to be somewhat larger than reported, due to the use of repurchase agreements for "window dressing." Banks are only required to mark-to-market the portion of their bond portfolio that is actively traded, but the Bank of Italy has established a monitoring system that requires banks to report changes in the value of all assets and liabilities.

3. Disintermediation

Another development affecting the banking system is the slow growth of bank assets and liabilities. Bank lending fell off sharply in 1993 and the first part of 1994, but began to recover moderately in the second half of the year with the recovery of investment spending, especially by medium-size enterprises. The slow growth of lending was largely attributable to weak loan demand. In part, this was due to an increased role of retained earnings and other means of finance: especially, some export-driven companies were cash-rich, and some also launched successful equity issues earlier in the year. Bank lending was also characterized as more cautious, but there was no indication of a credit crunch induced by capital requirements, which were not a constraint on lending, at least for large banks. The fact that supply as well as demand was at work was reflected in the decrease in credit lines granted (*credit accorded*) as well as in credit used; a decrease in the ratio of credit drawn to credit granted and narrowing in spreads between lending rates and market interest rates are consistent with the view that the decline in loan demand played the dominant role.

The prevalence of foreign or offshore financing of bank lending decreased during 1994. Previously, there had been a substantial amount of funding of domestic loans through the Eurolira market, but this essentially ended with the abolition as of June 1994 of the reserve requirement on CDs

with maturity over 18 months. 1/ Foreign-currency domestic credit also declined: prior to September 1992, many domestic borrowers had chosen to accept the exchange rate risk in order to obtain a lower interest rate, but such loans gradually declined as experience highlighted the magnitude of these risks.

At the same time, bank deposits grew relatively slowly. Particularly striking was the slow growth of CDs, despite the easing of maturity restrictions which allowed banks to issue CDs of any maturity. This was widely attributed to banks' reluctance to compete for funds given the slow growth of lending. The spread between CD and Treasury bill rates widened by some 2 percentage points during the course of 1994, inducing the public to shift into Treasury bills. At the same time, the market for repurchase agreements with customers grew rapidly, enabling banks to finance their bond portfolios; the market had previously been restrained by a size limit, but this limit was lowered in 1994 to 1 billion lire (about $625,000) per transaction.

In conclusion, the slow growth of bank lending and deposits, which helped depress bank profits in 1994, is to a certain extent a temporary phenomenon associated with cyclical developments affecting investment and the mode by which this investment is financed. However, it also reflects, to a significant extent, the longer-term trend toward disintermediation and securitization also experienced in other countries, as developing financial markets offer firms more advantageous means of financing their activities as well as offering households a more diversified array of assets.

Some 20 percent of the banks made losses in 1994. The banks' losses have not brought banks' capital adequacy down to dangerously low levels: at end-1993, average bank capital adequacy reached 11 percent, and as of late 1994 was expected to remain significantly above the 8 percent minimum required by the EU. Within the average there was of course some variation of individual banks' performance, and about a dozen had inadequate capital by late 1994. The problem of loss-making banks had a particular regional dimension, associated with the regional bifurcation of the Italian economy: on the whole, banks in the South experienced much greater loan losses and had weaker capital positions than those in the Center-North. The problems of banks in difficulties, particularly in the South, were addressed in two ways: for some small banks, takeovers were arranged with larger and solvent banks. For two large banks, some direct Treasury support was provided in connection with the Amato Law, and a further infusion may be needed, together with restructuring of the banks, to restore their capital to adequate levels.

1/ This followed two previous changes in reserve requirements: in February 1993, all reserve requirements were lowered to 17.5 percent; in March 1993, the rate on CDs with maturities in excess of 18 months was lowered to 10 percent.

V. The External Sector

1. The balance of payments

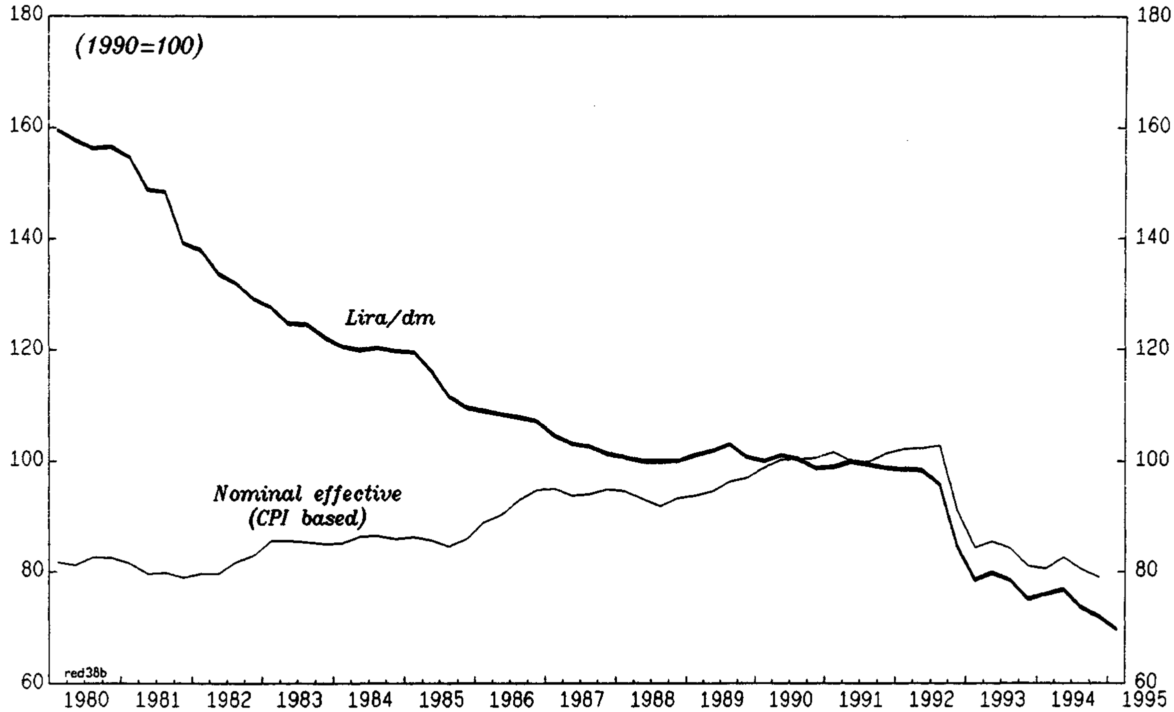
Developments in the external sector in 1994 have been conditioned by the prolonged weakness of the exchange rate. The depreciation of the lira that began following Italy's exit from the ERM in September 1992 continued through most of 1994, albeit with a temporary recovery in March and April 1994 associated with optimism surrounding the new government (Chart 30). Pressure on the exchange rate resumed during the summer and fall, with mounting uncertainties over the timing of fiscal adjustment. Exchange market pressures intensified further with the events leading to the fall of the Berlusconi Government in December, and continued in January and February of 1995 (after a brief reprieve with the formation of the Dini Government in late January); the lira plunged to new lows around Lit 1,150 per deutsche mark in late February, with uncertainties regarding the Parliamentary ratification of supplementary fiscal measures.

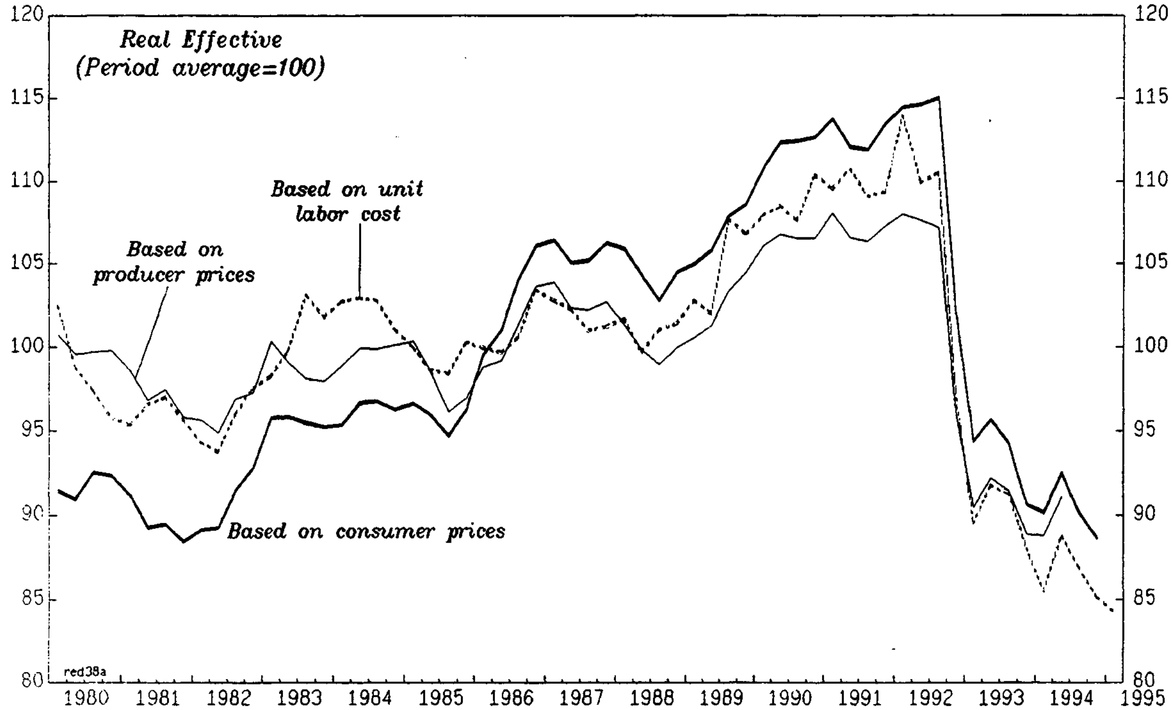
The depreciation of the nominal effective exchange rate was attenuated, relative to these bilateral exchange rate movements, by the appreciation of the deutsche mark vis-à-vis the dollar and other currencies. Most of the depreciation of the nominal effective exchange rate has been reflected in a depreciation of the real effective exchange rate, as the recent period has been characterized by relatively slow growth of domestic wages and prices. By end-1994, the real effective depreciation of the Lira amounted to 25 percent from its pre-September 1992 level and to 2 1/2 percent from the beginning of the year. The real effective exchange rate based on normalized unit labor costs suggests an improvement in competitiveness of over 20 percent between August 1992 and the end of 1994. Most measures of competitiveness show significant gains over the past two years, although measures based on producer prices or on export prices show somewhat smaller improvements (see Annex V). Moreover, among Italy's major European trading partners, only Sweden has experienced similar gains in competitiveness.

As a result of these competitiveness gains, together with the recovery of demand in some important export markets ahead of the recovery of domestic demand in Italy, there has been a marked improvement in the trade balance, which moved from a small surplus of just over Lit 3 trillion (0.2 percent of GDP) in 1992 to a surplus of over Lit 50 trillion (3.2 percent of GDP) in 1993. Nevertheless, demand for Italian exports continued to rise in 1994, helped by the stronger recovery in world trade than had generally been anticipated, especially in continental Europe, but also among developing countries. In the first half of 1994, the trade balance registered a surplus of around Lit 25 trillion; the improvement in the trade balance that resulted from competitiveness gains could be diminished as imports rose reflecting domestic demand growth.

Much of the recent export expansion has been vis-à-vis European countries which represent traditional markets for Italian exports. But, there have also been gains in market share in some of the faster growing markets outside Europe, especially North America; in the first six months of

CHART 30
ITALY
Nominal and Real Exchange Rates





Sources: International Financial Statistics; and Bank of Italy.

1994 exports to the United States increased by over 20 percent compared to the same period in 1993 although their share of the total remains small (Chart 31). There has also been a marked increase in the trade surplus with developing countries in Asia, with exports growing at over 40 percent and market growth in the latter group of countries expected to remain strong over the medium term.

Recent exports growth has been strongest in traditional sectors, where the decline in the exchange rate is likely to have been the most important factor, although these account for a relatively small share of total exports. Since the early 1990s, there has been considerable reorganization of firms and an increase in investment spending, especially on research and innovations, partly financed by increased profitability resulting from the exchange rate depreciation; these changes could, in principle, enable Italian firms to preserve their gains in market share even if the real exchange rate returns toward typical historical levels.

The strengthening of the trade balance accounts for most of the substantial improvement in the current account that occurred in 1993 and 1994. There has been little change in the contribution of invisibles and of the services account. Between 1992 and 1993 the invisibles balance improved by about Lit 3 trillion (8 percent), whereas over the same period the current account moved from a deficit of Lit 34 trillion to a surplus of almost Lit 18 trillion (around 1.2 percent of GDP). The current account surplus for 1994 is estimated at around 1.5 percent of GDP, largely reflecting the surplus on trade.

The capital account has been characterized by increasing capital outflows which largely mirror the surplus on the current account. Underlying the overall net outflow of capital, there have been significant changes in the composition of capital flows, with a large capital inflow by nonresidents--largely offset by an outflow of bank capital--in 1993. In 1994, the pattern became more complex: beginning in February, foreign investors unwound their positions in Italian government securities, which had largely been predicated on continuing interest rate declines. In addition, there were substantial outflows of portfolio capital of domestic residents due to political uncertainty in the early part of the year, inflows during the "honeymoon" period of the new government, and a resumption of outflows beginning in July. The outflows intensified during the fall, mainly reflecting increased political uncertainty. 1/ With the emerging current account surpluses, and associated net capital outflows, Italy's net external debt position improved.

For most of 1994, foreign currency reserves were stable, although there was intervention to support the lira during the early part of the year the Lira had required support. Toward the end of 1994, as foreign exchange

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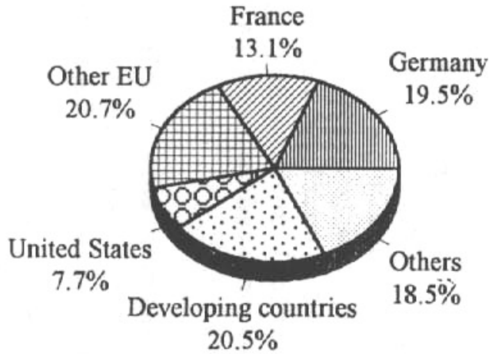
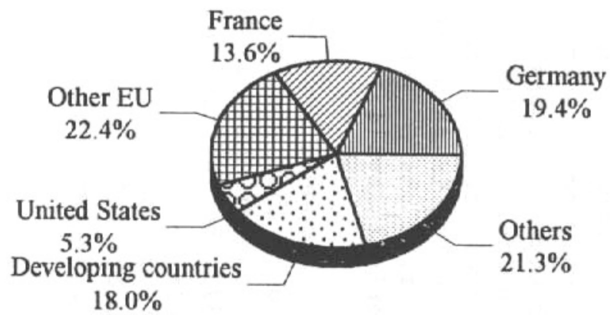
1/ A detailed discussion of the factors influencing recent capital flows and the effect of expectations of future interest rates is contained in Annex VI.

Chart 31
Italy
Direction and Composition of Trade, 1993

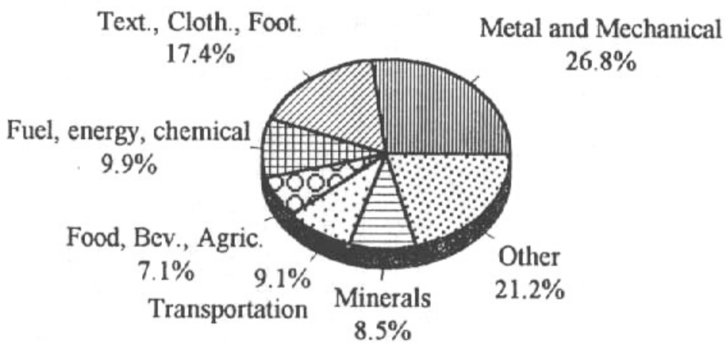
EXPORTS



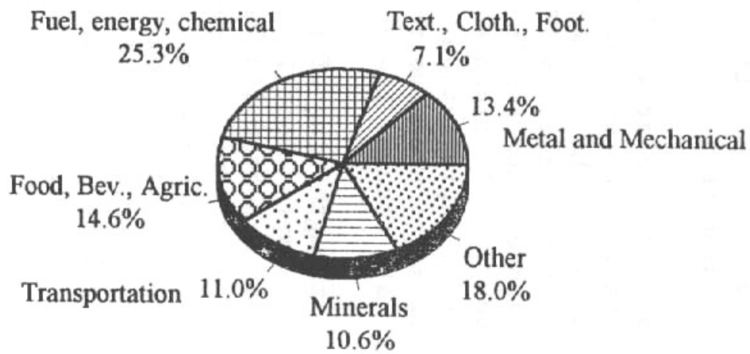
IMPORTS



EXPORTS



IMPORTS



Source: Bank of Italy.

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market pressures intensified central bank reserves were used, in part to support the currency; there also substantial month-to-month fluctuations associated with large international loans and bond issues, and with the use of reserves for repayment of the central government's foreign currency loans.

2. Trade policy

The Uruguay Round trade agreement was ratified by the Italian parliament in December 1994, meeting the January 1, 1995 deadline. Official studies of its impact have shown significant advantages for the Italian economy, although there are some concerns about the impact on agriculture and on the textiles and clothing sector.

The agreement will necessitate major reform of the European Union's Common Agricultural Policy (CAP), which in the short term is likely to have an adverse effect on Italian agriculture, but over the longer term the outcome will depend largely on the extent of improvements in efficiency. Italy's interest in agricultural trade is somewhat different from those of many of its EU partners, as it is the EU's largest food importer and a large component of its own production consists of "Mediterranean products," which have tended to be less heavily supported than "continental products." The Uruguay Round trade agreement will require important changes in the CAP, including the removal of price supports, export subsidies and price controls, partly compensated by income support schemes which are still permitted. The agreement and the proposed changes to the CAP also leave room for discretionary support at the regional and national levels, especially in areas that are not directly related to agriculture but nevertheless have a bearing on its development, such as domestic aid to research and development, market research, incentives for rural development, and general infrastructure in rural areas. Under the Marrakesh Agreement, the EU had agreed to raise food imports to at least 5 percent of internal consumption within a six-year phase-in period, through more flexible tariffs and quotas; there remains however, the issue of how additional imports would be allocated among member countries.

Some other aspects of the Uruguay Round agreement are also quite important for Italy. Protection of intellectual property rights is important to many Italian products--including, for example, to the clothing and textiles industries, where design is a key element. Italy also has a particular interest in liberalization of trade in services; it is, for instance, the world's third largest exporter and fifth largest importer of commercial services. The changes made in the Uruguay Round, moving from a system of reciprocity to a multilateral framework, is viewed as important both in liberalizing the Italian market and opening up foreign markets.

The phased elimination of the Multifiber Agreement under the Uruguay Round agreement is likely to have a significant impact on the Italian textiles and clothing sector, although Italy's clothing exports, which amount to around Lit 20 trillion per anum and consist largely of finished quality products, occupy a different sector of the market than products from

many other exporting countries. The current Multifiber Agreement, including both the general agreement and a series of bilateral agreements between the EU and the exporting countries, will expire in 1995. These agreements will be replaced with a new set of agreements, consisting largely of export restraints rather than quotas, that will run through 2005 and are permitted under a derogation of the GATT.

Some special limitations have also been placed on the application of the most-favored-nation clause of GATT, notably the exclusion from GATT of bilateral agreements with Eastern European and Mediterranean countries with regard to the movement of physical persons, especially seasonal workers. Relations with San Marino and Vatican City are also excluded.

The voluntary export restrictions agreement on Japanese automobiles applies to all EU countries, with a further agreement within the EU on how the fixed number of imports are allocated among member countries. This agreement is due to expire at the end of 1999, with export limits that will increase each year until then.

Another issue of particular interest to Italy is trade relations with the Maghreb countries. Italy has been active in promoting initiatives in this direction; it has, for instance, been fully supportive of the EU's partnership agreement with Algeria which will provide export credits and technical assistance.

The Exchange Rate and Competitiveness 1/

The substantial depreciation of the lira since September 1992 has led to a sizable gain in competitiveness, leading to a situation where the lira may now be undervalued. This note reviews some evidence of undervaluation, also discussing how this evidence may be reconciled with indications of market exchange-rate expectations.

The appropriateness of the exchange rate can only be assessed conditionally, given uncertainty about the fiscal outlook, and in particular the implementation of the authorities' fiscal plans. The sense in which the lira is currently undervalued is that it would have to appreciate if announced policies are pursued i.e., if the authorities succeeded in pursuing fiscal adjustment and making it credible, as well as in maintaining moderate inflation. If the authorities were not to succeed in these goals, further depreciation would be likely.

Chart 32 shows the behavior of some measures of the lira's real effective exchange rate during the 1980s and 1990s, permitting a comparison of current exchange rates with recent historical experience. 2/ Overall, various real exchange rate indicators show the lira recently between 8 and 15 percent below the average of the 1980s and 1990s. The historical average does not necessarily correspond to equilibrium. In particular, it is possible that the lira may have been overvalued over a significant part of the period, namely the latter part of the period of ERM membership during which the exchange rate was used as a tool of disinflation.

For comparison, Chart 33 shows real effective exchange rates, based on unit labor costs, for Italy, Spain, Sweden, and the United Kingdom for 1985-1994. As the chart shows, Italy, Spain, and Sweden had somewhat similar experience, with a significant real appreciation especially from 1988-1992 and a significant depreciation thereafter, although the depreciation is larger in the case of Sweden, and smaller and later in the case of Spain. The pound sterling depreciated by about 10 percent in real effective terms over the period, as did the lira, but the United Kingdom neither experienced as large a real appreciation up until 1992, nor as sharp a depreciation thereafter. The similarity of Italian and Swedish experience may be relevant, since in both countries uncertainties of the fiscal outlook may have depressed the real exchange rate below its average historical level.

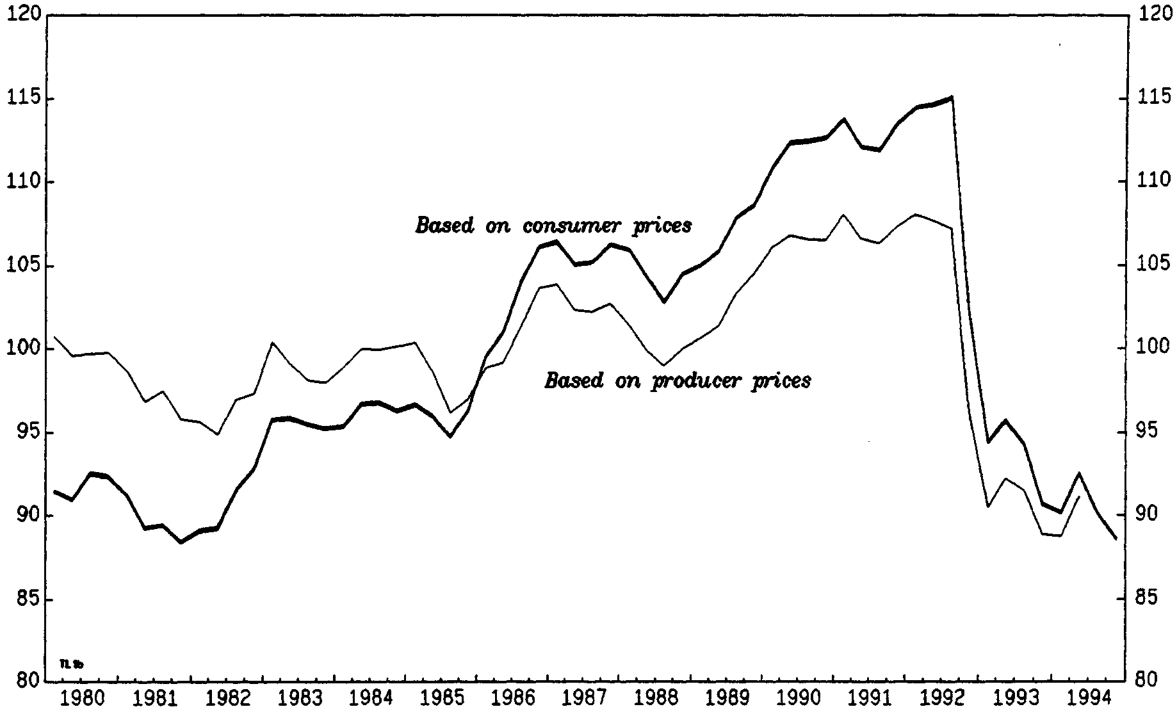
1/ Prepared by Timothy Lane.

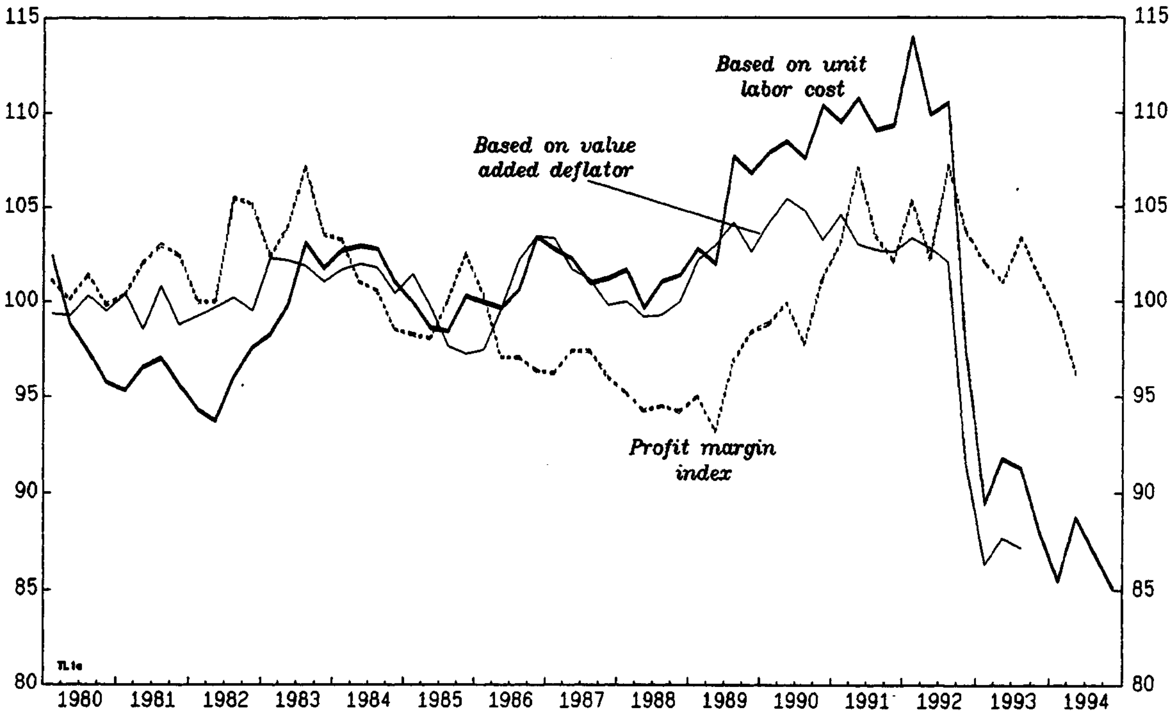
2/ The (inverse) profit margin index is the ratio of indices of unit labor cost in manufacturing to the manufacturing value added deflator. Here, the manufacturing sector is used as a proxy for tradable goods. It is based on the idea that an increase in profitability provides an incentive for increased production of tradables. This measure of competitiveness is not directly comparable with the real exchange rate measures.

CHART 32

ITALY

Real Effective Exchange Rates
(Period Average=100)





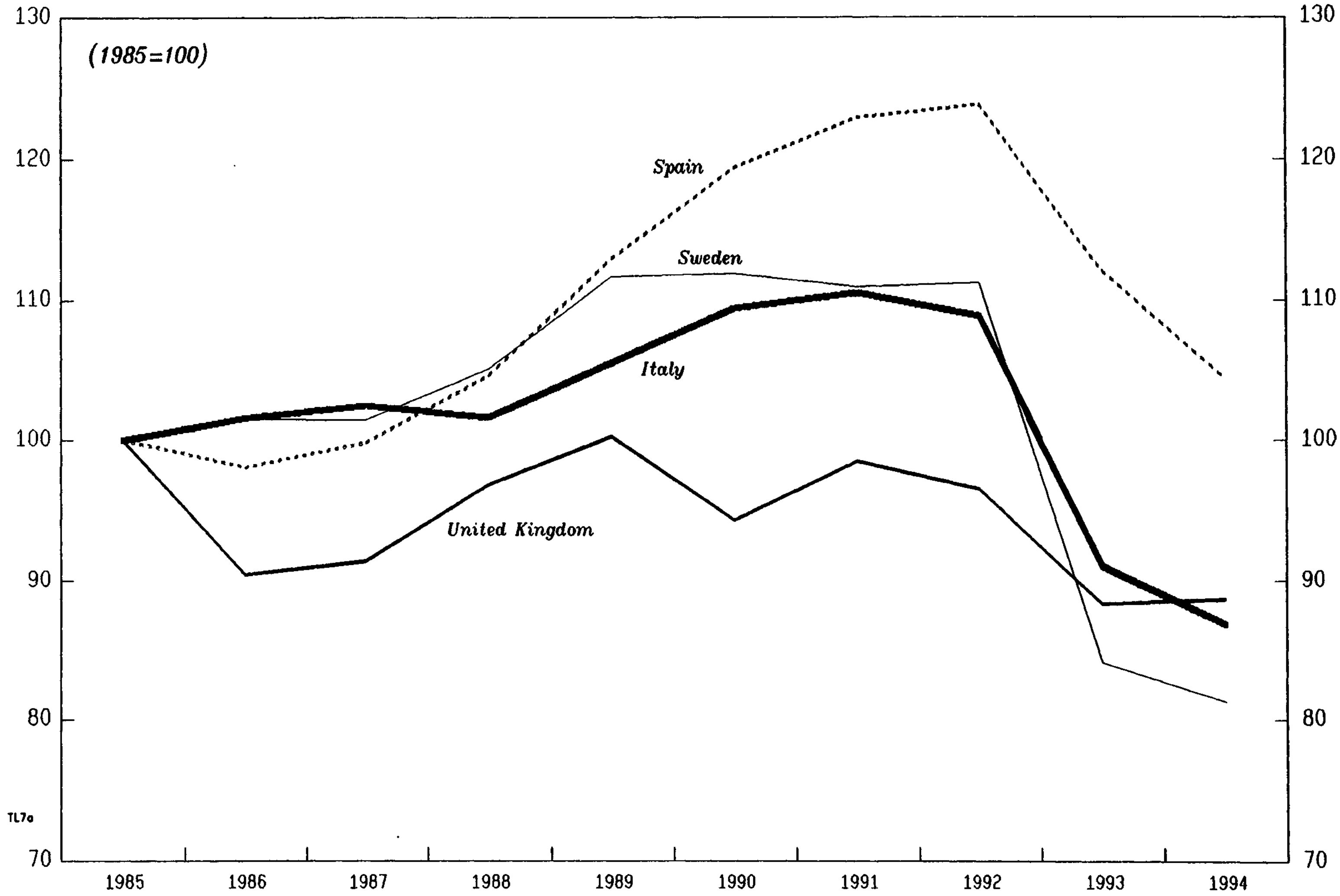
Sources: IMF, Research Department; International Financial Statistics; and Bank of Italy.

CHART 33

ITALY

Real Effective Exchange Rates Based on Normalized Unit Labor Costs

(Selected countries)



Source: IMF, Research department.

The response of trade flows to recent real exchange rate movements is shown in Chart 34. Exports surged in both volume and unit value following the real depreciation of the lira, despite the effects of the recession on external demand. At the same time, there was a sharp increase in import unit value and decrease in volume, although this was partly due to the severe contraction of domestic demand. The result was a substantial improvement in the trade balance and the current account.

The appropriateness of the real exchange rate can be assessed with reference to the past and projected behavior of the current account, as shown in Chart 35. For 1994 and future years, staff projections for the WEO are presented, showing a current account surplus of 1 1/2 percentage points of GDP for 1994 and over 2 percent in 1995. 1/ There is no reason to believe that surpluses of the magnitude implied by those projections are appropriate for Italy at this time; indeed, the aging population would, *prima facie*, suggest that a small deficit, as typical of the 1980s, might be appropriate. The projections suggest that there may be some scope for appreciation of the lira, beyond the unchanged real rates assumed, consistent with reducing the current account to levels more consistent with historical experience. Projections are based on the assumption of a continuation of current announced policies, including the implementation of the authorities' medium-term fiscal plan and a gradual decrease in inflation. 2/

The latter point is relevant in examining indicators of market expectations, which suggest that market participants anticipate a substantial depreciation of the lira. These indicators include Eurocurrency interest rate differentials (equivalent to forward exchange rates) over the short term, and forward interest rate differentials from the swap market

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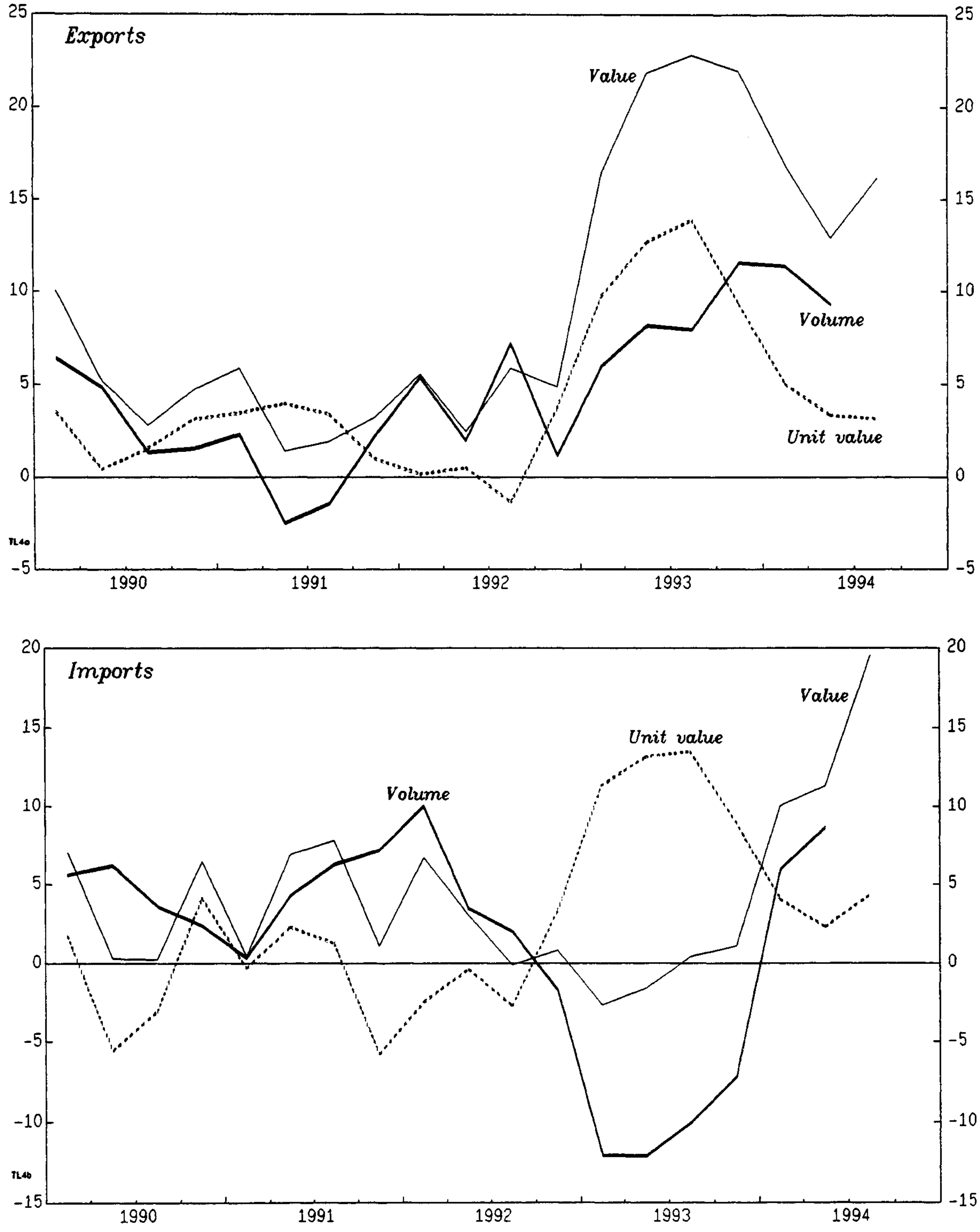
1/ This is consistent with convergence to 2.6 percentage points of GDP at the end of the projection period, 2000 (at which point the cyclical position is assumed to be neutral). The WEO projections do not explicitly model the price elasticity of trade flows and the lag structure of these effects, but involve a judgmental upward adjustment of exports in relation to market growth in 1994, 1995, and 1996. These adjustments implicitly take account of the lagged effects of the exchange rate, but an explicit model-based treatment might give a more precise estimate of these effects.

2/ One can go beyond these observations on the current account to calculate a fundamental equilibrium exchange rate, i.e. an exchange rate consistent with an appropriate current account balance over the medium term. This requires judgements with regard to the equilibrium current account balance, any continuing effects of past exchange rate changes, the effects of the cycle and of projected fiscal adjustment, and the exchange rate elasticities of imports and exports. Such calculations also suggest, for a range of assumptions, that the lira is undervalued with respect to its fundamental equilibrium level.

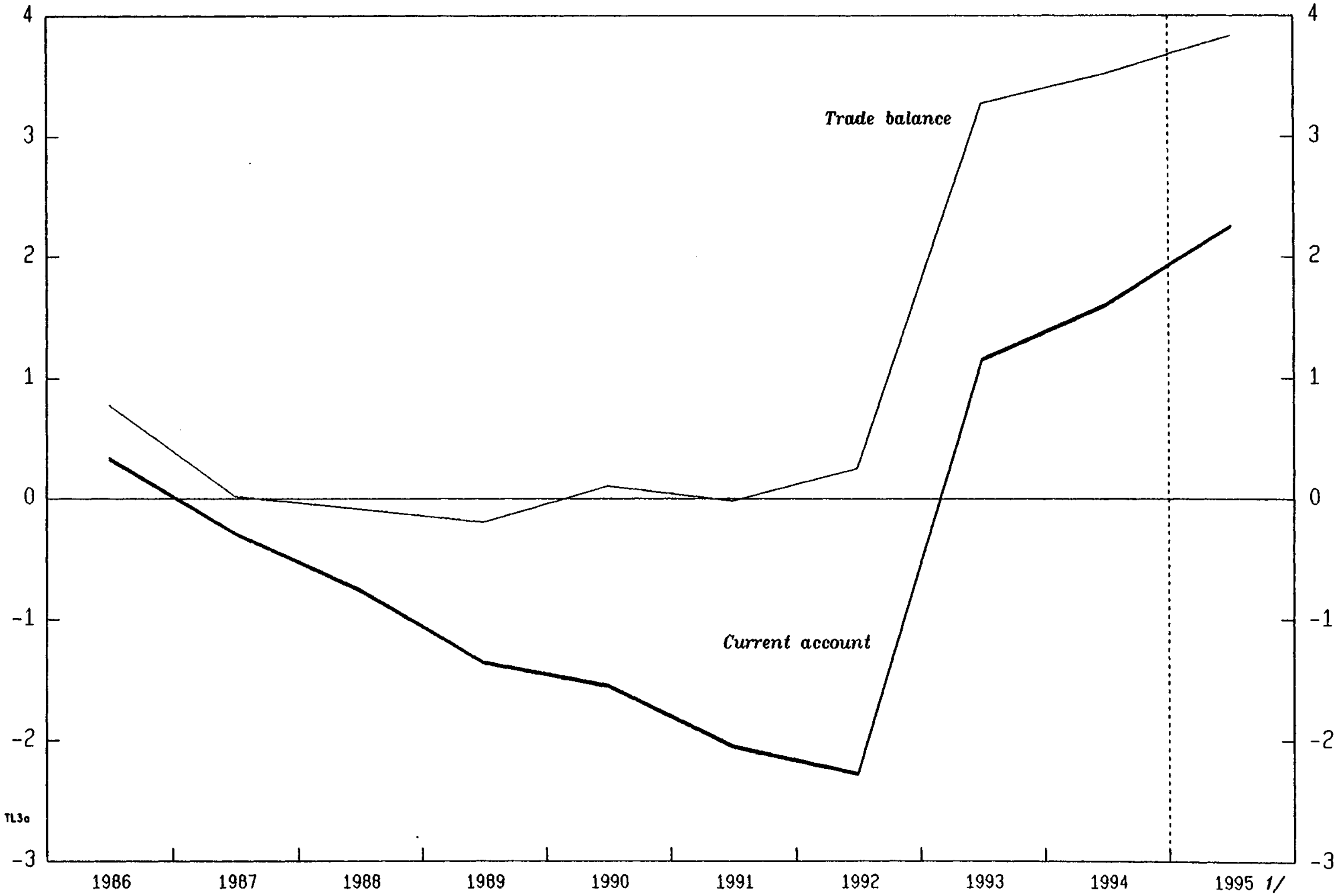
CHART 34
ITALY

Recent Trade Performance
(Year-on-year percentage change)



Source: Bank of Italy.

CHART 35
ITALY
Current Account
(In percent of GDP)



Sources: Bank of Italy; and IMF, World Economic Outlook.

1/ Projections.

over the longer term. 1/ The top panel of Chart 36 shows the structure of lira forward interest rate differentials with respect to the deutsche mark, French franc, pound sterling, and United States dollar in early November 1994. These differentials suggest that market participants expect the lira to depreciate against all of the other currencies, over both a long and a short horizon. The bottom panel, showing the evolution of forward rate differentials against the deutsche mark, indicates that market's expectation of further lira depreciation (against the deutsche mark) heightened in the latter part of 1994, despite the depreciation that had already occurred.

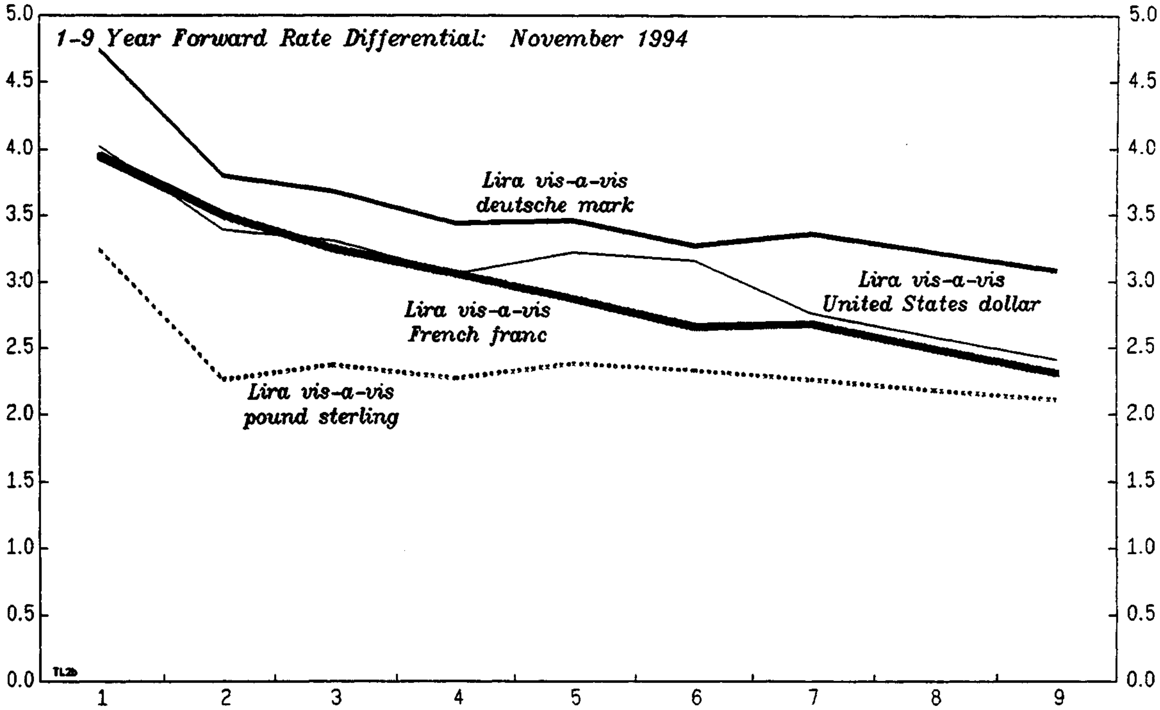
These financial market indicators of expected lira depreciation do not necessarily contradict real effective exchange rate data, discussed earlier, that suggest that the lira is currently below its equilibrium level. Taken together, this evidence implies that Italy's inflation rate is expected to exceed that of its partner countries by more than the exchange rate is expected to depreciate. The recent evolution of Italy's consumer price inflation rate, compared with Germany and the United Kingdom, is shown in Chart 37. If the expected forward rates shown in Chart 36 indeed correspond to market expectations of exchange rate movements, and if exchange rate movements correspond to expected inflation differentials in the long run, the expected inflation differential with respect to Germany would have to be an average of some 4 1/2 percent per year over the next 9 years to bring about the real appreciation of 8 percent to return the (CPI) real exchange rate to its historical average level. It is one of the tasks of policy to ensure that this pessimistic scenario implicit in the forward interest rates does not come to pass.

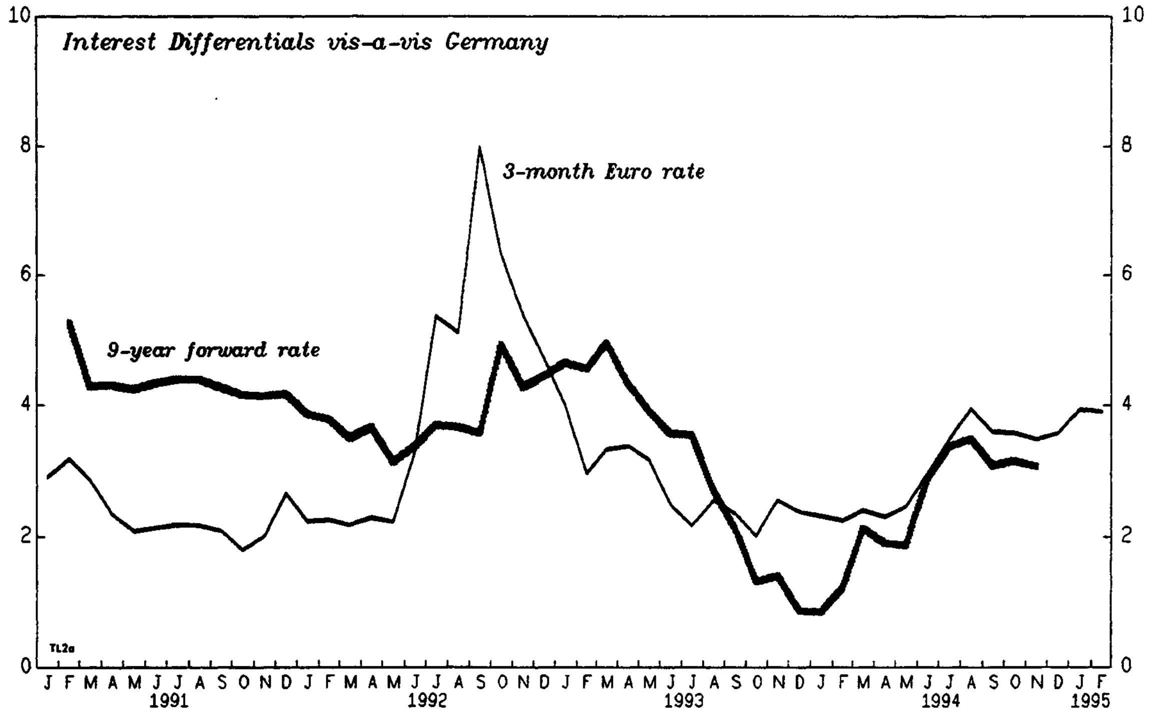
1/ Implicit forward rates may also be derived from the bond market. The advantage of the swap market data is that they are comparable in terms of creditworthiness and tax treatment; a possible disadvantage is that swap markets may be less liquid than national bond markets.

CHART 36

ITALY

Forward Rate Differentials and 3-Month Eurolira Differentials



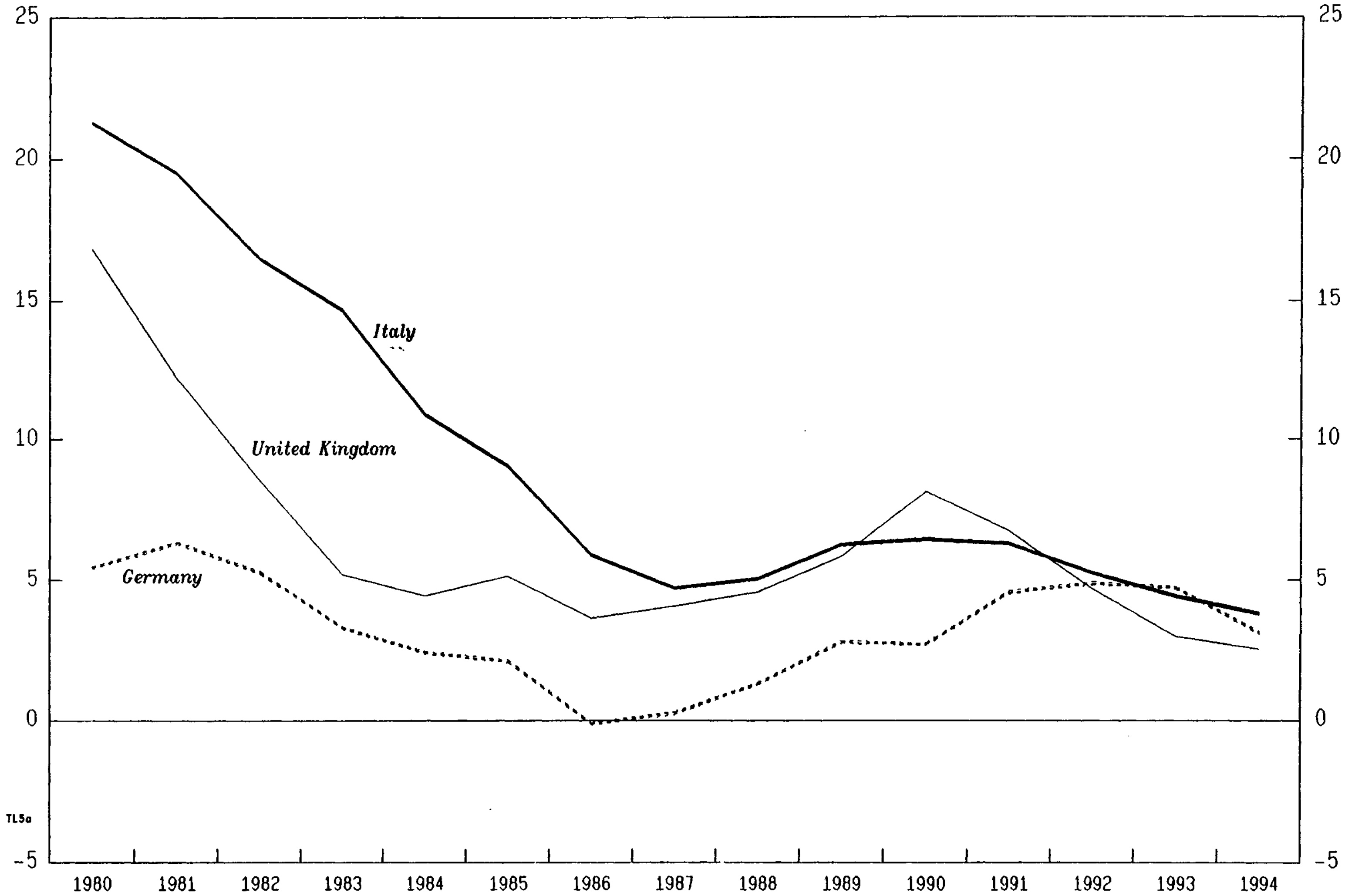


Source: IMF, Research Department.

CHART 37

ITALY

Consumer Price Inflation, (Selected countries)
(Year-on-year percentage change)



Source: IMF, World Economic Outlook.

Capital Flows 1/

With the completion in 1990 of the process of liberalization of capital movements, Italy became more open to international capital flows, with an expansion in the volume of gross flows. Heightened capital mobility made the domestic financial system increasingly vulnerable to shifts in market confidence; to the extent that such shifts were triggered by changing prospects for fiscal adjustment, this also implied heightened exposure to market discipline.

Under an essentially floating exchange rate, net capital movements merely correspond to the current account balance (minus any intervention), and thus convey little information about investor behavior. If a change in market opinion is nearly universal, it is reflected mainly in changes in asset prices rather than in capital movements. The composition of capital flows may, however, shed light on the divergent opinions and behavior of different groups of transactors, as well as the institutional constraints under which they operate.

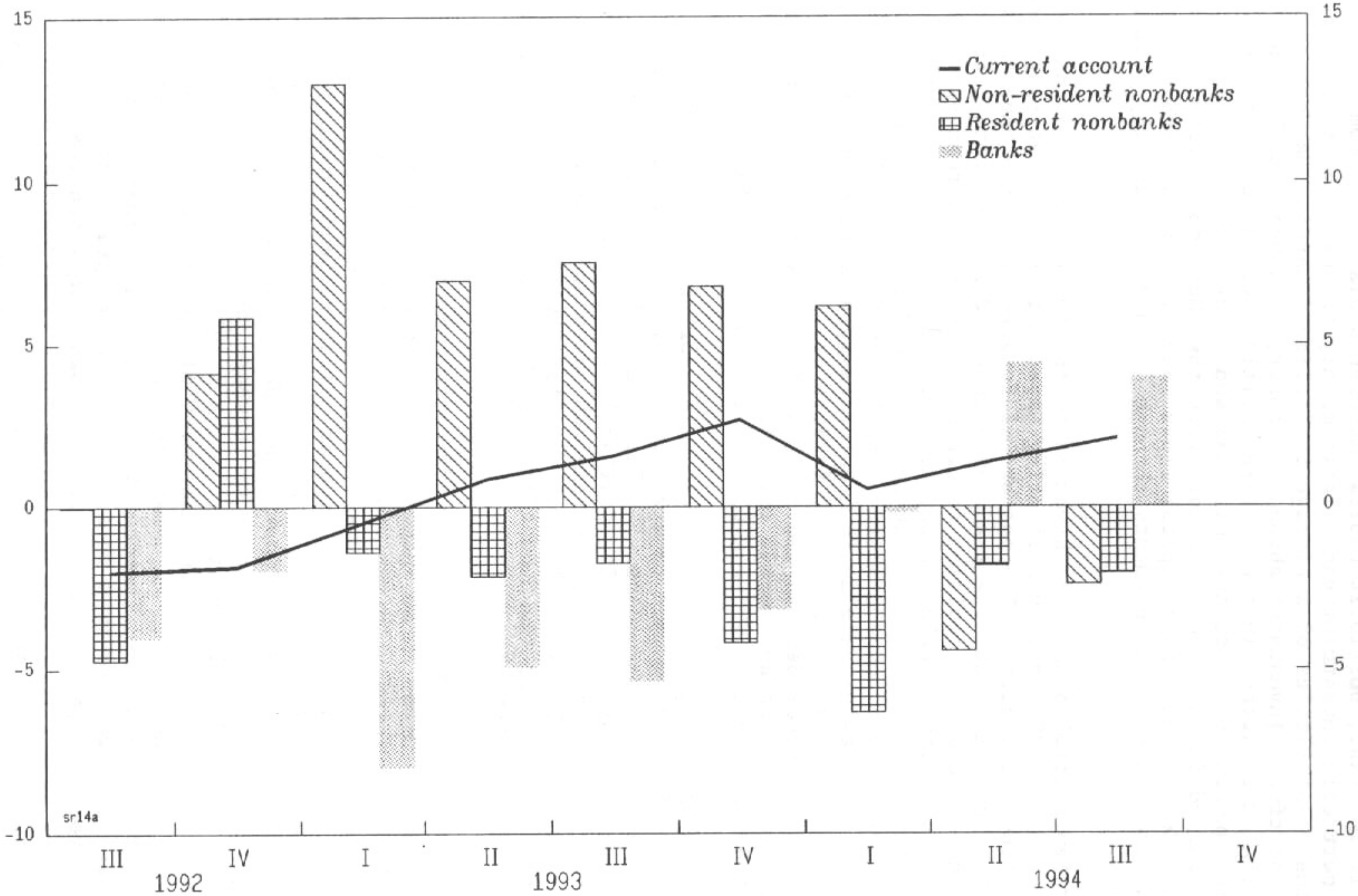
This can be illustrated with reference to the experience of 1994. Against the background of an overall net capital outflow associated with a swelling current account surplus, Chart 38 and the following table show significant changes in the composition of capital flows as between regard to banks and nonbanks and between residents and nonresidents.

Capital Movements
(Trillions of lire)

	1993	1994-I	1994-II	1994-III	1994 Oct-Nov
Nonbank capital	96.0	-0.6	-25.8	-21.0	0.3
Foreign	133.4	24.8	-18.3	-11.3	...
Investment	132.8	26.9	-18.5	-5.7	9.4
of which: portfolio	126.9	25.6	-20.3	-5.9	7.6
Lending	0.6	-4.3	-2.6	-3.3	-3.7
Trade credit and other	--	2.2	2.8	-2.3	...
Italian	-37.3	-25.4	-7.4	-9.7	...
Investment	-26.5	-19.0	-0.7	-8.2	-1.5
of which: portfolio	-15.1	-18.2	1.7	-6.8	-0.4
Lending	-5.1	-3.7	-3.4	-3.0	-3.8
Trade credit and other	-5.7	-2.7	-3.4	1.5	...
Bank capital	-83.2	-0.7	18.1	14.4	-7.5
Total	12.9	-1.3	-7.7	-6.6	-7.1

1/ Prepared by Timothy Lane.

CHART 38
ITALY
Balance of Payments



Source: Bank of Italy.

As in the past, portfolio capital movements played the dominant role. Foreign portfolio investment was related mainly to the interest rate cycle and to the possibilities of arbitrage in Italian financial markets. Domestic portfolio investment abroad, in contrast, appears to have been more closely linked to swings in the Italian political situation, with outflows reflecting uncertainties of the political and fiscal outlook; a small net inflow occurred in the second quarter, with the "honeymoon period" of the Berlusconi Government. Bank capital flows largely mirrored nonbank flows, as banks financed capital movements through loans and especially repurchase agreements.

Foreign portfolio capital showed large inflows during 1993 and the first quarter of 1994, mainly reflecting expectations that interest rates would continue to decline. The pattern of foreign portfolio investment shifted in connection with the sea change in world bond markets precipitated by the Federal Reserve's decision to begin increasing interest rates in February 1994. With changing perceptions of the interest rate outlook, foreign capital started to flow out in the second quarter, tapering off in the third quarter and into October. Finally, in November, foreign capital flowed back into Italy, as wide interest rate spreads made Italian investments attractive. Outflows of foreign capital during some periods of 1994 made only a small dent in the inflows that had occurred during the rest of the period, leaving an overall net inflow of Lit 133.9 trillion (some 8 percent of GDP) during 1993 and the first 11 months of 1994.

Inflows of foreign portfolio investment during 1993 through the first quarter of 1994 in large part involved the acquisition of government securities by foreign investors. 1/ These acquisitions brought the foreign-held share of outstanding Italian Treasury securities to 13 percent in mid-1994, more than 3 times its end-1989 share and nearly double its level at end-1992. The volatility of this foreign investment is illustrated, however, by the fact that this share had declined again to 9.3 percent by end-November.

1/ The inflow in the first quarter of 1994 is exaggerated due to an error in the data, associated with the transition to a new system of accounting for repurchase agreements. The new system, consistent with international conventions, essentially treats a repo as collateralized lending; thus a bond purchase financed by a repo with an Italian bank would be treated as foreign portfolio investment offset by a bank capital outflow. In contrast, the same transaction would not show up anywhere under the old system: the purchase of the bond would be offset by the sale associated with the first half of the repo, while the repurchase half of the transaction would be recorded off-balance sheet. In cases where bond purchases made prior to the beginning of 1994 had been financed with repos with resident nonbanks, and where these repos were renewed in early 1994, these pre-existing purchases would incorrectly appear as new capital inflows. This problem has been corrected in the existing data as regards repos with resident banks (which constitute the majority of repos), but an error remains with regard to resident nonbanks. It should be emphasized that this is not a series break, since the historical data have been revised in line with the new system; rather, it is an error in the data in the first quarter only, associated with the transition to the new accounting system.

Foreign Holdings of Government Debt

(In percent of stock; November 1994)

Treasury bills (BOT)	0.8
Floating-rate (CCT)	6.5
Fixed-rate (BTP)	16.0
Total	9.3

Foreign purchases of Treasury securities have been dominated by medium- and long-term fixed rate bonds, BTPs. Foreigners held 16 percent of outstanding BTPs in November 1994, compared with their 9 percent share of all government debt. Purchases of BTPs were particularly prominent in 1993, accounting for 63 percent of foreign portfolio investment; to a large extent, the foreign investors were speculating on the continued downward trend in Italian interest rates. 1/ Their positions were often covered against exchange rate risk, in any of several ways. In many cases, they were financed by lira borrowing from or repurchase agreements with Italian banks, either of which appears as an outflow of bank capital. Alternatively, they could hedge their exposure offshore in the currency futures market or using over-the-counter currency swaps, or finance their positions through Eurolira loans or repurchase agreements with nonresident banks; in any of these latter cases, the financing and/or hedging would not occasion a capital flow directly, but the foreign banks and other institutions that are counterparties to such transactions customarily proceed to cover their resulting exposures in ways that show up as offsetting capital movements. 2/

The inflows of foreign capital to purchase BTPs through 1993 and early 1994 had the effect of pushing down long-term interest rates and contributing to the flattening of the yield curve. The subsequent outflows, associated with net sales of BTPs, pushed long-term rates up again, contributing to the steepening of the yield curve after August (Chart 25).

Another significant development is the increase in foreign holdings of floating-rate Treasury securities, CCTs, which amounted to 2/3 of foreign portfolio investment in the first half of 1994. By end-November, foreigners held 6.5 percent of the outstanding stock of CCTs. Some foreign investors in CCTs may have been looking for high-yield bonds without exposure to risks associated with interest rate movements. More important, according to market observers, was arbitrage between CCT and Eurolira rates--collecting an interest spread that might be over 100 basis points. The key elements in

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1/ Data are not available on what share of this activity is attributable to hedge funds, other institutional investors, and individual investors.

2/ These methods are discussed in International Capital Markets Part I, April 1993.

this spread are the 30 basis point spread of CCT over the Treasury bills to which they are indexed (BOT), and the spread of BOT over Eurolira rates. Such strategies in effect cover against currency risk and risk associated with general interest rate movements, leaving some other risks: the basis risk associated with the indexation mechanism according to which CCT rates are reset semiannually based on Treasury bill rates in the previous three auctions; as well as any element of pure country risk associated with possible default or debt consolidation affecting the CCT. An alternative strategy is to purchase CCT and use cross-currency swaps to lay off the exchange-rate and interest-rate risks, yielding a deutsche mark denominated asset. At least one company has been set up in Luxembourg to institutionalize this strategy, offering investors an asset offering a spread of 30 basis points over deutsche mark LIBOR. 1/

Another important aspect of foreign portfolio investment concerned Republic of Italy bonds, reflecting in part the success of the Treasury's global bond issues (which market observers have characterized as innovative and successful). These issues in foreign currency offered attractive interest rates, maturities, and market liquidity in relation to other issues in the same currencies. In the first half of 1994, these issues accounted for 80 percent of total foreign portfolio investment.

Foreign purchases of listed equity shares amounted to some 5 percent of foreign portfolio investment in 1993. Then, in the first half of 1994, there were virtually no net foreign share purchases. The small role of foreign share purchases in the capital account, despite the much-publicized privatization issues during the winter, may in part reflect the still small size and lack of transparency of Italy's stock market.

Patterns in resident portfolio capital movements are somewhat different. Italian capital flowed out with the political uncertainties of 1993 and the first few months of 1994. 2/ Then, in the second quarter of 1994 this flow was reversed, with increasing confidence in the new government. With the renewed and intensified political uncertainties in

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1/ One such operation is reported in the leading Italian financial newspaper, Il Sole-24 Ore, December 8, 1994.

2/ The portfolio outflow shown for the first quarter of 1994 is exaggerated by an error in the data similar to that discussed in the footnote on page 78. Repos on foreign bonds with nonresident nonbanks were previously recorded as foreign nonbank portfolio disinvestment (a nonbank capital inflow) and bank investment, with the corresponding agreed repurchases recorded off-balance sheet. Under the new system, these repos are essentially treated as credit extended by a domestic resident to a domestic bank, which does not enter the balance of payments anywhere. In the first quarter under the new system, when these repos were renewed they were recorded as new nonbank capital outflows, partly accounting for the large volume of outflows recorded in 1994-I. The counterpart to this error is that the true outflow of bank capital in the first quarter of 1994 was larger than the number recorded here.

July and August, as well as the tightening of monetary policy, this situation was reversed again, and there was a further outflow of investment by Italian nonbank residents. The outflow continued, albeit at a slower rate, into the fourth quarter of 1994.

Another noteworthy development is with regard to borrowing and lending. Italian residents had been borrowing substantial amounts abroad prior to September 1992, given the attractiveness of the lower interest rates and the hope that the exchange rate would not depreciate--a form of convergence play. Large sums of these loans were repaid during 1993 and 1994, as borrowers became increasingly unwilling to accept the exchange rate risk for the sake of the lower interest rate. At the same time, there was increasing lending to foreign residents by Italian lenders, which may have reflected soft credit demand in the Italian market.

Flows of trade credit were also important. During the whole of 1993 and the first half of 1994, there were outflows of credit by Italian firms to finance the surging volume of Italian exports; in the third quarter of 1994, there was a net repayment of such credit. Credit in the other direction, provided by nonresident firms, picked up in 1994 as Italian imports began to expand, but a net amount of this credit was repaid in the third quarter.

Table 1. Italy: Nominal Demand and Output

(In trillions of lire; at current prices)

	1993	1993 I	1993 II	1993 III	1993 IV	1994 I	1994 II	1994 III
Private consumption	973.2	238.8	241.0	244.6	248.8	252.4	256.2	260.2
Public consumption	279.8	68.9	69.6	70.4	70.9	71.1	71.4	73.3
Gross fixed investment	266.6	68.0	66.6	65.7	66.4	68.4	68.7	68.9
Of which:								
Construction	147.5	37.3	37.0	36.6	36.6	37.0	36.8	36.4
Machinery, equipment and means of transport	119.1	30.7	29.5	29.1	29.8	31.4	31.9	32.4
Change in stocks	-3.2	-1.1	1.8	-1.7	-2.1	-5.4	2.1	4.1
Total domestic demand	1516.4	374.5	379.0	378.9	384.0	386.5	398.5	406.5
Exports of goods and services	333.2	80.2	81.8	84.7	86.5	92.7	92.0	97.0
Imports of goods and services	289.5	71.7	71.7	72.9	73.2	77.7	79.9	85.5
Foreign balance	43.7	8.6	10.1	11.7	13.3	15.0	12.1	11.5
Gross domestic product	1560.1	383.1	389.1	390.7	397.3	401.5	410.5	417.9
Memorandum items:								
Percentage change in:								
GDP at current prices	3.7	2.6	3.5	4.0	4.7	4.8	5.5	7.0
GDP deflator	4.4	3.9	4.5	4.8	4.3	3.8	3.5	3.2

Source: ISTAT.

Table 2. Italy: Demand and Output

(Percent change over corresponding period; at constant prices)

	1993	1994 1st three quarters	1993 I	1993 II	1993 III	1993 IV	1994 I	1994 II	1994 III
Private consumption	-2.1	1.9	-2.4	-3.1	-2.4	-0.6	1.2	2.0	2.4
Public consumption	0.8	0.2	1.0	0.9	0.7	0.5	0.0	--	0.6
Gross fixed investment	-11.1	-0.5	-10.1	-12.5	-12.7	-9.0	-3.3	0.0	1.7
Of which:									
Construction	-6.2	-4.2	-5.8	-6.4	-6.7	-5.9	-4.4	-4.0	-4.1
Machinery, equipment and means of transport	-15.6	3.3	-14.1	-18.0	-18.2	-11.9	-2.2	4.2	7.7
Change in stocks 1/	-1.6	0.6	-2.4	-1.4	-1.1	-1.4	-0.5	0.4	1.8
Total domestic demand	-6.4	1.7	-8.0	-6.8	-6.0	-4.8	-0.8	2.1	5.7
Exports of goods and services	10.0	10.3	10.4	11.0	9.0	9.8	10.1	9.0	11.9
Imports of goods and services	-7.3	8.6	-7.9	-8.3	-7.4	-5.4	5.0	8.2	12.6
Foreign balance 1/	4.6	0.5	4.8	5.0	4.4	4.0	1.4	0.2	-0.2
Gross domestic product	-0.7	2.2	-1.3	-1.0	-0.8	0.4	1.0	1.9	3.7
Memorandum items:									
Percentage change in:									
GDP at current prices	3.7	5.8	2.6	3.5	4.0	4.7	4.8	5.5	7.0
GDP deflator	4.4	3.5	3.9	4.5	4.8	4.3	3.8	3.5	3.2

Source: ISTAT.

1/ Changes in the stockbuilding and foreign balance are expresssed as contributions to GDP growth (in percent).

Table 3. Italy: Selected Indicators of Foreign Demand and Prices 1/

(Annual changes, in percent)

	1988	1989	1990	1991	1992	1993	1994 2/
Demand and output in partner countries (export weighted) 3/							
Real GDP (or GNP) 4/	4.1	3.6	3.3	1.2	0.9	0.1	2.4
Real total domestic demand 5/	4.5	3.8	3.2	1.9	1.3	-0.6	2.5
Volume of merchandise imports 4/	8.6	7.4	6.8	5.4	3.6	-0.3	5.3
Of which:							
Non-oil imports	9.1	8.2	7.7	5.5	3.8	-0.3	5.6
Costs and prices of partner suppliers (import weighted) 6/							
Unadjusted for exchange rate changes 7/							
GDP (or GNP) deflators 5/	2.9	3.8	3.7	4.4	3.8	3.1	2.2
Consumer prices 5/	2.5	3.7	4.3	4.5	3.8	3.4	2.5
In U.S. dollars terms							
GDP (or GNP) deflators 5/	5.9	-2.6	17.9	2.1	8.4	-4.1	4.3
Consumer prices 5/	5.5	-2.7	18.5	2.2	8.4	-3.7	4.6
Export unit values 4/	4.0	-0.1	12.4	-1.9	2.9	-7.0	3.4
Of which:							
Non-oil trade	5.7	-1.1	11.1	-1.3	3.3	-6.9	3.9
Nonfuel commodity prices (in U.S. dollars)							
Export weighted 8/	21.0	1.8	-5.7	-0.6	-3.6	-3.7	15.5
Import weighted 9/	18.4	-1.6	-6.2	-4.7	0.1	-1.7	9.3

Source: IMF, Research Department.

1/ With the exception of nonfuel prices, the composites are averages of percentage changes for individual trading partners (as defined in footnotes 3 and 4 below) weighted by the distribution of exports or sources of imports, as appropriate.
2/ Estimates by Fund staff.
3/ Weights proportional to the geographic distribution of 1986-88 average exports.
4/ Composite based on data for those countries that together accounted for about 90 percent of trade.
5/ Composite based on data for each industrial country.
6/ Weights are proportional to the 1986-88 average imports.
7/ That is, weighted average of percentage changes in indices expressed in national currencies of industrial partner countries.
8/ Based on averages of world market price quotations for component nonfuel commodities weighted by the 1979-81 composition commodity exports.
9/ Based on averages of world market price quotations for component nonfuel commodities weighted by the 1979-81 composition commodity imports.

Table 4. Italy: Origin of Gross Domestic Product

(Percent change over corresponding period; at constant prices)

	1993	1994 1st three quarters	1993 I	1993 II	1993 III	1993 IV	1994 I	1994 II	1994 III
Services	1.1	1.9	1.0	1.1	0.8	1.4	1.8	1.9	2.1
Market	1.3	2.2	1.1	1.2	0.9	1.8	2.3	2.4	2.6
Nonmarket	0.2	-0.3	0.5	0.4	0.2	-0.0	-0.3	-0.3	-0.2
Industry	-2.4	3.3	-3.8	-2.9	-2.0	-0.9	0.2	2.3	7.3
Manufacturing	-2.1	5.2	-4.3	-2.8	-1.2	-0.0	1.8	4.2	10.4
Energy	-0.4	0.9	0.2	-0.0	-2.0	0.2	-3.0	0.1	4.2
Construction and public works	-4.6	-4.5	-3.8	-4.6	-5.1	-5.0	-4.5	-4.5	-4.5
Agriculture, forestry and fishing	-2.9	--	-2.9	-2.8	-6.5	0.7	-0.2	-0.5	1.2
Total value added at factor cost	-0.3	2.3	-0.8	-0.5	-0.5	0.6	1.2	1.9	3.7

Source: ISTAT.

Table 5. Italy: Industrial Production

(Changes in percent over same period of previous year)

	1988	1989	1990	1991	1992	1993	1994
Industrial Production 1/	6.0	3.1	0.1	-2.1	-0.5	-2.9	4.9
By economic use:							
Final consumption goods	5.4	2.7	0.9	0.1	1.5	-0.7	5.2
Final investment goods	8.5	2.9	1.9	-5.9	-5.0	-5.1	3.1
Intermediate goods	5.5	3.4	-0.8	-1.9	-0.1	-3.2	5.1
By sector:							
Fuel and energy products	3.2	2.8	3.7	1.2	1.7	1.3	...
Basic industry 2/	7.2	3.1	1.8	-1.2	-1.3	-5.3	...
Mechanical industry 3/	7.7	3.7	-1.2	-6.1	-3.8	-5.7	...
Light industry 4/	4.5	2.6	-0.3	0.7	2.2	-0.3	...

Sources: ISTAT; and Bank of Italy.

1/ New series since 1994.
2/ Mining and processing of nonenergy minerals, chemical products.
3/ Machinery, tools and equipment, vehicles, other means of transport, electrical and electronic products.
4/ Food processing, textiles, clothing, footwear, furniture, and other items.

Table 6. Italy: Prices

(Percentage change)

	1988	1989	1990	1991	1992	1993	1994
Consumer prices	5.1	6.3	6.5	6.3	5.2	4.5	3.8 1/
Food products	3.9	6.3	6.2	6.7	4.9	2.2	3.9 1/
Other goods	4.8	5.0	5.9	5.2	3.4	4.7	3.6 1/
Services	6.4	7.7	7.3	7.2	7.6	5.6	4.1 1/
Wholesale prices 2/	4.7	6.4	7.4	5.2	2.1	5.1	4.6 3/
Consumer goods	4.7	6.7	5.7	7.0	4.3	3.3	3.9 3/
Investment goods	5.4	6.4	5.5	4.1	3.3	3.6	3.4 3/
Raw and intermediate materials	4.5	6.2	8.3	4.5	1.1	6.1	5.1 3/
Cost of living	5.0	6.6	6.1	6.5	5.3	4.2	3.9
GDP deflator	6.7	6.2	7.6	7.7	4.5	4.4	3.1
Private consumption deflator	5.7	6.3	6.2	6.8	5.3	4.8	3.6

Sources: Bank of Italy.

1/ October.

2/ The methodology used for the computation of wholesale price index was revised in 1990.

3/ November.

Table 7. Italy: Consumer Prices, by Regulated and Nonregulated Components

(Year-on-year percent change)

	Weights 1/	1988	1989	1990	1991	1992	1993	1994 1st qtr.	1994 2nd qtr.	1994 3rd qtr.
Total administered goods and services	27.2	3.6	4.4	5.8	6.9	4.9	3.7	4.3	4.0	3.9
Public tariffs	7.0	3.7	4.7	6.6	8.1	6.0	2.5	3.7	3.2	3.4
Administered price products	9.7	2.0	0.9	1.4	4.8	-0.6	3.2	0.6	0.7	0.5
Rents	3.7	4.3	5.6	6.1	5.9	6.5	7.6	9.2	8.8	8.2
Nonregulated goods and services	66.1	5.4	6.5	6.6	6.1	5.3	4.6	4.3	4.0	3.8
Consumer prices	100.0	5.0	6.6	6.1	6.5	5.3	4.2	4.2	4.0	3.7

Source: Bank of Italy.

1/ 1980 basis.

Table 8. Italy: Sectoral Wage and Cost Developments
Per Unit of Dependent Labor

(Changes in percent)

	1988	1989	1990	1991	1992	1993	1994 1/
Total economy							
Gross wages	8.4	7.0	10.5	8.6	4.9	3.1	3.2
Labor costs	8.6	8.7	10.7	8.5	5.7	3.7	2.6
Productivity	3.3	3.0	1.3	0.4	2.1	2.5	5.4
Unit labor costs	5.2	5.5	9.4	8.0	3.5	1.2	-2.6
Agriculture							
Gross wages	6.9	5.5	5.0	6.4	9.8	5.1	-0.1
Labor costs	8.3	5.5	5.6	6.0	9.9	4.9	0.7
Productivity	1.3	6.6	-1.5	8.2	6.1	4.3	4.1
Unit labor costs	6.9	-1.0	7.5	-2.3	3.6	0.6	-2.7
Industry							
Gross wages	7.4	7.1	8.2	9.3	6.2	3.1	4.6
Labor costs	7.7	9.8	9.1	9.0	6.5	3.6	3.6
Productivity	4.9	3.2	1.4	1.0	2.8	1.8	9.3
Unit labor costs	2.7	6.4	7.6	8.0	3.6	1.8	-5.4
Market Services							
Gross wages	7.6	7.4	7.5	8.8	5.2	2.7	2.5
Labor costs	7.7	8.7	8.0	8.2	6.1	3.5	1.4
Productivity	2.6	2.5	1.3	-0.5	1.9	3.6	4.4
Unit labor costs	4.9	6.1	6.6	8.8	4.1	-0.1	-3.0

Source: ISTAT.

1/ Third quarter.

Table 9. Italy: Labor Force, Employment, and Unemployment

(In millions, unless otherwise indicated)

	1988	1989	1990	1991	1992	1993	1994
Labor force	23,852	23,870	23,926	24,244	23,915	22,786	22,460
Employment	20,984	21,004	21,304	21,592	21,360	20,427	19,874
Agriculture	2,052	1,946	1,895	1,823	1,756	1,508	1,410
Industry	6,750	6,753	6,845	6,916	6,812	6,736	6,542
Services	12,181	12,305	12,564	12,854	12,793	12,183	11,922
Dependent employment	14,861	14,937	15,222	15,479	15,296	14,540	14,174
Agriculture	778	788	790	744	754	606	559
Industry	5,596	5,594	5,679	5,726	5,623	5,515	5,358
Services	8,487	8,555	8,753	9,009	8,920	8,418	8,257
Unemployed	2,868	2,866	2,621	2,652	2,555	2,360	2,586
Of which: first-time job seekers	1,398	1,404	1,266	1,285	1,250	1,030	1,080
Memorandum items:							
Unemployment rate 1/	12.0	12.0	11.0	10.9	10.7	10.4	11.5 2/
Including Wage Supplementation Fund	13.0	12.8	11.8	11.9	11.8	11.6	...
Participation rate (in percent)	41.6	41.5	41.5	41.5	41.3	40.6	40.0

Source: ISTAT.

1/ In percent of labor force.

2/ New methodology starting in 1993; data not comparable to those in previous years.

Table 10. Italy: Unemployment Rates by Sex and Region

(*In percent, seasonally adjusted data*) 1/

	Northern Italy			Central Italy			Southern Italy and Islands			Italy		
	Women	Men	Total	Women	Men	Total	Women	Men	Total	Women	Men	Total
1980	9.2	2.9	5.1	12.9	4.8	7.5	20.3	7.5	11.5	13.1	4.8	7.6
1981	10.6	3.5	6.1	14.2	5.3	8.3	21.6	8.1	12.4	14.4	5.4	8.5
1982	11.3	4.1	6.7	14.1	5.8	8.6	22.0	9.0	13.2	14.9	6.1	9.1
1983	12.4	4.9	7.7	15.1	5.8	9.1	23.4	9.4	14.0	16.2	6.6	9.9
1984	13.4	4.9	8.1	14.9	5.8	9.0	23.2	9.3	13.8	16.5	6.6	10.0
1985	13.1	5.0	8.0	15.0	5.9	9.1	24.3	9.8	14.6	16.7	6.8	10.3
1986	13.1	4.9	8.0	15.9	6.1	9.7	27.2	11.4	16.8	17.8	7.4	11.1
1987	12.7	4.8	7.8	15.7	6.2	9.7	30.6	13.6	19.7	18.7	8.1	12.0
1988	11.3	4.1	6.9	16.2	6.1	9.9	32.8	14.6	21.2	18.8	8.1	12.0
1989	10.2	3.4	6.0	17.4	6.5	10.6	33.2	15.0	21.7	18.7	8.1	12.0
1990	8.6	2.9	5.1	15.7	6.2	9.8	31.8	13.6	20.4	17.1	7.3	11.0
1991	8.4	3.0	5.1	15.4	5.9	9.6	31.5	14.1	20.4	16.8	7.5	10.9
1992	8.9	3.4	5.6	13.9	6.0	9.1	29.2	13.8	19.3	16.0	7.5	10.7
1993	9.4	4.2	6.2	13.4	5.9	8.8	25.7	13.8	17.7	14.8	7.8	10.4
1994	10.2	4.9	7.0	14.5	6.8	9.8	27.2	15.9	19.6	15.8	9.0	11.5
1991												
January	8.7	3.0	5.2	15.7	6.1	9.8	31.9	15.1	21.1	17.1	7.9	11.3
April	8.3	2.8	4.9	15.0	6.0	9.5	32.0	13.9	20.5	16.8	7.3	10.9
July	8.0	3.0	4.9	14.7	5.8	9.3	31.4	13.2	20.0	16.4	7.2	10.6
October	8.6	3.4	5.4	16.2	5.9	9.9	30.9	14.0	20.2	16.8	7.6	11.0
1992												
January	8.6	3.2	5.3	15.4	6.6	10.0	31.5	15.0	20.8	16.8	8.0	11.3
April	8.6	3.3	5.3	14.0	5.9	9.0	30.3	13.9	20.0	16.2	7.5	10.8
July	9.1	3.4	5.6	14.3	6.3	9.4	30.5	13.8	20.1	16.6	7.6	11.0
October	9.4	3.8	6.0	12.0	5.1	7.8	24.6	12.4	16.4	14.2	7.0	9.7
1993 2/												
January	8.6	3.7	5.7	11.7	5.1	7.6	23.9	12.5	16.1	13.5	7.0	9.4
April	9.1	4.5	6.3	13.8	6.1	9.0	26.4	13.6	17.7	15.0	7.9	10.5
July	9.1	4.0	6.0	12.8	6.1	8.6	26.3	13.7	17.9	14.7	7.7	10.3
October	10.6	4.5	6.9	15.2	6.4	9.8	26.3	15.3	18.9	15.9	8.5	11.3
1994 2/												
January	10.5	5.0	7.2	14.4	6.5	9.5	26.5	15.2	18.7	15.7	8.7	11.3
April	9.9	4.9	6.9	13.9	6.6	9.4	27.6	16.5	20.1	15.7	9.2	11.6
July	9.4	4.5	6.5	13.2	6.6	9.1	27.2	15.5	19.5	15.1	8.6	11.0
October	11.0	5.1	7.5	16.5	7.5	11.0	27.5	16.5	20.1	16.7	9.4	12.1

Source: ISTAT, *Indagine Sulle Forze Lavoro*.

1/ Quarterly data refer to the first month of the quarter. Annual data are averages of the quarterly unemployment rates.
2/ Due to the revisions in methodology, the numbers for 1993 and 1994 are not directly comparable with previous years.

Table 11. Italy: General Government Finances

	1988	1989	1990	1991	1992	1993	1994 Prelim.off. estimates
				(In trillions of lire)			
Revenue	435.6	498.6	557.7	623.7	696.3	744.2	757.7
Current	432.5	494.1	554.3	618.5	662.5	728.7	745.0
Tax 1/	404.1	462.0	517.9	576.0	614.5	676.3	689.8
Nontax	28.3	32.1	36.4	42.5	48.0	53.4	55.2
Capital	3.2	4.5	3.4	5.2	33.7	15.5	12.7
Expenditures	552.5	616.8	701.2	770.0	839.7	892.5	913.0
Current	499.2	559.4	635.3	705.1	775.4	820.8	840.7
Wages and salaries	132.2	142.3	167.1	181.8	190.4	196.0	201.6
Goods and services	54.4	58.6	63.3	70.0	75.6	81.0	83.8
Social security	189.1	210.0	238.6	261.3	290.5	301.6	320.8
Subsidies 2/	26.6	29.8	29.6	32.6	31.2	34.5	38.0
Interest payments	88.9	106.6	126.3	145.9	172.1	186.9	175.0
Other current 3/	8.1	12.0	10.4	13.5	15.5	20.8	21.5
Capital	53.2	57.4	65.9	64.9	64.3	71.6	72.3
Fixed investment	36.8	39.8	43.1	46.6	45.1	41.2	41.3
Other	16.5	17.6	22.8	18.3	19.2	30.4	31.0
Primary expenditure	463.5	510.2	574.9	624.1	667.5	705.5	738.0
Primary balance	-27.9	-11.6	-17.2	-0.4	28.7	38.7	19.7
Overall balance	-116.8	-118.2	-143.5	-146.3	-143.4	-148.2	-155.3
Debt; end of period 4/	1,054.4	1,191.2	1,341.7	1,512.8	1,704.6	1,909.4	2,058.2
Memorandum item:							
Interest accruing on tax refund liabilities not yet replaced by government bonds 5/	3.6	4.5	5.4	6.3	7.6	7.0	4.6
				(In percent of GDP)			
Revenue	39.9	41.8	42.5	43.6	46.3	47.7	46.2
Current	39.6	41.4	42.2	43.3	44.0	46.7	45.4
Tax 1/	37.0	38.7	39.5	40.3	40.9	43.3	42.1
Nontax	2.6	2.7	2.8	3.0	3.2	3.4	3.4
Capital	0.3	0.4	0.3	0.4	2.2	1.0	0.8
Expenditures	50.6	51.7	53.4	53.9	55.8	57.2	55.7
Current	45.7	46.9	48.4	49.3	51.5	52.6	51.3
Wages and salaries	12.1	11.9	12.7	12.7	12.7	12.6	12.3
Goods and services	5.0	4.9	4.8	4.9	5.0	5.2	5.1
Social security	17.3	17.6	18.2	18.3	19.3	19.3	19.6
Subsidies 2/	2.4	2.5	2.3	2.3	2.1	2.2	2.3
Interest payments	8.1	8.9	9.6	10.2	11.4	12.0	10.7
Other current 3/	0.7	1.0	0.8	0.9	1.0	1.3	1.3
Capital	4.9	4.8	5.0	4.5	4.3	4.6	4.4
Fixed investment	3.4	3.3	3.3	3.3	3.0	2.6	2.5
Other	1.5	1.5	1.7	1.3	1.3	2.0	1.9
Primary expenditure	42.5	42.7	43.8	43.7	44.4	45.2	45.0
Primary balance	-2.6	-1.0	-1.3	--	1.9	2.5	1.2
Overall balance	-10.7	-9.9	-10.9	-10.2	-9.5	-9.5	-9.5
Debt; end of period 4/	96.6	99.8	102.3	105.8	113.3	122.4	125.5
Memorandum item:							
Interest accruing on tax refund liabilities not yet replaced by government bonds 5/	0.3	0.4	0.4	0.4	0.5	0.4	0.3

Sources: Ministry of Budget, Relazione Generale sulla Situazione Economica del Paese, 1993; and Relazione Previsionale e Programmatica per 1995.

1/ Including social security contributions.
2/ To producers.
3/ Including the issuance of bonds to replace outstanding tax refund liabilities.
4/ Including the stock of outstanding tax refund liabilities not yet replaced by government bonds; 1994 estimates are unofficial and provisional.
5/ Staff estimate.

Table 12. Italy: State Sector Finances

(In trillions of lire)

	1988	1989	1990	1991	1992	1993	1994 Budget	1994 Prelim. off. est.
Revenue	322.5	367.8	411.5	459.0	507.7	535.4	549.8	532.4
Tax	246.9	283.4	316.9	353.0	403.0	424.3	425.8	412.0
Direct	137.4	159.6	176.2	189.9	230.8	249.8	238.7	228.0
Indirect	109.6	123.7	140.7	163.1	172.2	174.5	187.1	184.0
Social security contributions 1/	10.5	11.4	11.3	14.8	14.2	23.5	24.5	23.7
Other current	59.2	66.2	73.4	79.8	81.7	73.6	85.9	83.4
Capital	1.9	2.5	3.0	3.3	3.3	3.8	4.8	3.9
Financial operations	3.9	4.4	7.0	8.2	5.6	10.2	8.8	9.4
Expenditures	443.0	495.9	544.7	606.0	663.6	689.8	694.0	689.5
Primary current	310.3	336.6	363.3	409.1	441.6	445.9	452.0	454.7
Wages and salaries	62.1	66.3	77.4	83.1	86.0	89.3	99.9	88.0
Pensions	16.8	18.8	21.8	24.7	28.2	30.2	36.0	34.5
Goods and services	20.3	20.5	20.8	21.1	23.4	26.2	25.4	25.6
Transfers	206.9	226.3	238.1	274.2	296.6	291.9	280.4	297.6
Of which: to public entities	162.3	178.8	194.5	218.9	232.0	217.2	213.7	227.0
Other current	4.3	4.6	5.2	6.0	7.4	8.3	10.3	8.9
Interest payments	85.7	104.4	124.3	142.6	168.3	182.1	176.0	172.7
Capital	31.6	36.8	38.1	39.9	41.0	43.5	51.1	40.6
Fixed investment	6.4	7.2	7.9	8.2	7.0	8.0	15.2	4.2
Capital transfers and other	25.3	29.6	30.2	31.7	34.1	35.5	34.9	36.4
Financial operations	15.4	18.1	19.0	14.4	12.7	18.3	14.9	21.5
Primary expenditure	357.3	391.5	420.4	463.4	495.3	507.7	518.0	516.7
Primary balance	-34.8	-23.7	-8.8	-4.4	12.3	27.7	31.8	15.4
Overall balance	-120.5	-128.0	-133.2	-147.0	-155.9	-154.4	-144.2	-157.0
Debt; end of period 2/	1,055.0	1.195.5	1,354.8	1,519.4	1,713.0	1,870.7	2,008.3	2,028.6
Memorandum item:								
Interest accruing on tax refund liabilities not yet replaced by government bonds 3/	3.6	4.5	5.4	6.3	7.6	7.0	...	4.6

Sources: Ministry of Budget, Documento di Programmazione Economico-Finanziaria 1995-97; and data provided by the authorities.

1/ Paid directly to the Treasury.
2/ Including the stock of tax refund liabilities not yet replaced by government bonds.
3/ Staff estimate.

Table 13. Italy: State Sector Finances

(In percent of GDP)

	1988	1989	1990	1991	1992	1993	1994	
							Budget	Prelim. off.est.
Revenue	29.5	30.8	31.4	32.1	33.7	34.3	33.3	32.5
Tax	22.6	23.7	24.2	24.7	26.8	27.2	25.8	25.1
Direct	12.6	13.4	13.4	13.3	15.3	16.0	14.4	13.9
Indirect	10.0	10.4	10.7	11.4	11.4	11.2	11.3	11.2
Social security contributions 1/	1.0	1.0	0.9	1.0	0.9	1.5	1.5	1.4
Other current	5.4	5.5	5.6	5.6	5.4	4.7	5.2	5.2
Capital	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.2
Financial operations	0.4	0.4	0.5	0.6	0.4	0.7	0.5	0.6
Expenditures	40.6	41.5	41.5	42.4	44.1	44.2	42.0	42.0
Primary current	28.4	28.2	27.7	28.6	29.4	28.6	27.3	27.7
Wages and salaries	5.7	5.6	5.9	5.8	5.7	5.7	6.0	5.4
Pensions	1.5	1.6	1.7	1.7	1.9	1.9	2.2	2.1
Goods and services	1.9	1.7	1.6	1.5	1.6	1.7	1.5	1.6
Transfers	19.0	19.0	18.1	19.2	19.7	18.7	17.0	18.1
Of which: To public entities	14.9	15.0	14.8	15.3	15.4	13.9	12.9	13.8
Other current	0.4	0.4	0.4	0.4	0.5	0.5	0.6	0.5
Interest	7.8	8.7	9.5	10.0	11.2	11.7	10.6	10.5
Capital	2.9	3.1	2.9	2.8	2.7	2.8	3.1	2.5
Fixed investment	0.6	0.6	0.6	0.6	0.5	0.5	0.9	0.3
Capital transfers and other	2.3	2.5	2.3	2.2	2.3	2.3	2.1	2.2
Financial operations	1.4	1.5	1.4	1.0	0.8	1.2	0.9	1.3
Primary expenditure	32.7	32.8	32.0	32.4	32.9	32.5	31.3	31.5
Primary balance	-3.2	-2.0	-0.7	-0.3	0.8	1.8	1.9	0.9
Overall balance	-11.0	-10.7	-10.1	-10.3	-10.4	-9.9	-8.7	-9.5
Debt; end of period 2/	96.6	100.2	103.3	106.3	113.9	119.9	121.5	123.1
Memorandum item:								
Interest accruing on tax refund liabilities not yet replaced by government bonds 3/	0.3	0.4	0.4	0.4	0.5	0.4	...	0.3

Sources: Ministry of Budget, Documento di Programmazione Economico-Finanzaria 1995-97; and data provided by the authorities.

1/ Paid directly to the Treasury.
2/ Including the stock of tax refund liabilities not yet replaced by government bonds.
3/ Staff estimate.

Table 14. Italy: Financing of the Central Government Borrowing Requirement

	1988	1989	1990	1991	1992	1993	1994 Jan.-Oct.
				(In trillions of lire)			
Central government cash deficit 1/	125.1	133.4	140.6	152.2	163.2	153.6	127.4
Debt settlements 2/	0.5	0.5	4.6	--	--	9.6	--
Privatization receipts 3/	--	--	--	--	--	--	-6.1
Central government borrowing requirement	125.6	133.9	145.2	152.2	163.2	163.1	121.3
Domestic financing	121.7	125.5	130.3	146.7	163.0	148.7	119.0
Medium- and long-term	61.0	59.2	73.2	119.7	97.9	164.2	121.0
Of which: net purchases by Bank of Italy	4.2	8.1	-9.6	-4.2	-4.4	30.6 4/	-1.8
Short-term	60.7	66.3	57.1	27.0	65.1	-15.5	-2.0
Treasury bills	42.0	43.1	40.5	11.6	46.5	5.6	8.1
Of which: net purchases by Bank of Italy	-5.3	-3.0	5.3	-7.8	-5.5	0.5	-14.3
Post Office deposits	11.0	15.4	12.7	11.7	11.4	13.9	5.6
Account at the Bank of Italy 5/	4.3	1.8	2.8	2.0	7.7	-35.2	-14.3
Other	3.2	6.0	1.0	1.7	-0.5	0.2	-2.0
Foreign financing	4.0	8.4	14.9	5.5	0.2	14.4	2.3
Memorandum item:							
Monetary financing	2.6	8.5	-1.4	-9.5	-2.7	-3.4	-30.5
				(In percent of total)			
Central government borrowing requirement	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Domestic financing	96.9	93.7	89.7	96.4	99.9	91.2	98.1
Medium- and long-term	48.6	44.2	50.4	78.6	60.0	100.7	99.8
Short-term	48.3	49.5	39.3	17.7	39.9	-9.5	-1.6
Of which: Treasury bills	33.4	32.2	27.9	7.6	28.5	3.4	6.7
Foreign financing	3.1	6.3	10.3	3.6	0.1	8.8	1.9
Memorandum item:							
Monetary financing	2.1	6.3	-1.0	-6.2	-1.7	-2.1	-25.1

Sources: Bank of Italy Annual Report 1994; and Supplementi al Bollettino Statistico.

1/ Old definition prior to 1993 (i.e., including the Railways, telephone company, and government monopolies).
2/ Issues of central government debt to replace liabilities of wider public sector entities (notably local health authorities).
3/ Only those accruing to the Treasury.
4/ Including the special security issue at end-1993 to fund the new Treasury payments account at the Bank of Italy (see footnote 5).
5/ In 1994, monetary financing of the government budget deficit was prohibited; the Treasury's current account with the central bank was accordingly replaced by a Treasury payments account, whose balance must be kept at a certain level.

Table 15. Italy: Issues of Government Securities

	1988	1989	1990	1991	1992	1993	1994 Jan.-Sept.
			(Stocks, end of period, in billions of lire)				
Total	810,092	918,680	1,039,255	1,157,138	1,299,366	1,468,771	1,583,267
Treasury bills (BOT)	244,835	284,613	329,253	343,147	387,819	394,358	407,013
ECU-denominated bills (BTE)	8,049	11,313	7,241	4,988	6,960	7,145	2,240
Floating-rate bonds (CCT)	346,649	367,565	423,086	433,811	495,924	517,537	541,609
Fixed-rate bonds (BTP)	147,038	174,044	162,788	250,952	287,072	426,003	515,934
Fixed-rate renewable bonds (CTO)	14,332	29,668	57,185	78,787	75,883	75,640	67,465
ECU-denominated bonds (CTE)	23,566	31,000	38,194	39,866	40,323	41,862	46,577
Other	25,623	20,477	21,508	5,587	5,325	6,226	2,430
			(Net issues, in billions of lire)				
Total	103,850	108,588	116,753	127,114	137,606	168,303	109,210
Treasury bills (BOT)	36,275	39,778	44,641	13,894	44,731	6,480	12,654
ECU-denominated bills (BTE)	5,738	3,264	-4,072	-2,253	1,943	219	-4,905
Floating-rate bonds (CCT)	-7,848	20,916	54,214	9,268	60,024	20,698	23,602
Fixed-rate bonds (BTP)	59,781	27,006	-13,347	85,774	33,576	138,485	85,638
Fixed-rate renewable bonds (CTO)	564	15,336	26,678	22,923	3,847	-7,041	--
ECU-denominated bonds (CTE)	11,167	7,434	7,262	1,775	520	1,763	4,194
Other	-1,032	-2,968	-14	-4,267	-7,035	7,699	-11,973
			(Net issues, in percent of total)				
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Treasury bills (BOT)	34.9	36.6	38.2	10.9	32.5	3.9	11.6
ECU-denominated bills (BTE)	5.5	3.0	-3.5	-1.8	1.4	0.1	-4.5
Floating-rate bonds (CCT)	-7.6	19.3	46.4	7.3	43.6	12.3	21.6
Fixed-rate bonds (BTP)	57.6	24.9	-11.4	67.5	24.4	82.3	78.4
Fixed-rate renewable bonds (CTO)	0.5	14.1	22.8	18.0	2.8	-4.2	--
ECU-denominated bonds (CTE)	10.8	6.8	6.2	1.4	0.4	1.0	3.8
Other	-1.0	-2.7	--	-3.4	-5.1	4.6	-10.9

Source: Bank of Italy, Supplementi al Bollettino Statistico.

Table 16. Italy: Official Development Assistance

(In millions of U.S. dollars)

	1988	1989	1990	1991	1992	1993 1/
Official development assistance,						
net disbursements	3,193	3,613	3,395	3,352	4,121	2,909
In percent of GDP	0.29	0.30	0.26	0.23	0.27	0.19
Bilateral loans and grants	2,408	2,189	2,112	2,245	2,430	1,638
Multilateral contributions	785	1,424	1,283	1,107	1,691	1,271
Aid through EU	329	407	435	632	593	706
Capital subscriptions to IDBs	186	745	490	34	616	237
Contributions to other multilateral institutions	270	272	358	441	481	328
Memorandum item:						
Official development assistance,						
commitments	4,586	3,544	3,607	4,882	4,405	2,584
In percent of GDP	0.42	0.29	0.27	0.34	0.29	0.17

Sources: OECD, Development Co-operation, 1993 Report; and Ministry of Foreign Affairs.

1/ Provisional.

Table 17. Italy: International Comparison of General Government Balance and Debt

(In percent of GDP)

	1988	1989	1990	1991	1992	1993	1994 1/
Overall balance							
United States	-2.0	-1.5	-2.5	-3.4	-4.4	-3.5	-2.6
Japan	1.5	2.5	2.9	2.9	1.8	0.3	-1.8
EU	-3.5	-2.7	-4.1	-4.6	-5.1	-6.0	-5.6
Germany	-2.1	0.1	-2.1	-3.2	-2.6	-3.3	-3.1
France	-1.8	-1.3	-1.5	-2.1	-3.9	-5.7	-5.6
United Kingdom	1.1	0.9	-1.5	-2.8	-6.4	-7.7	-6.0
Italy	-10.7	-9.9	-10.9	-10.2	-9.5	-9.5	-9.5
Primary balance							
United States	-0.1	-0.5	-0.4	-1.1	-2.3	-1.6	-0.5
Japan	5.7	6.6	6.9	6.8	5.7	4.2	2.2
EU	1.1	2.0	0.9	0.4	0.3	-0.5	-0.1
Germany	0.3	2.8	0.5	-0.5	0.7	0.1	0.8
France	1.0	1.4	1.4	1.0	-0.5	-2.0	-1.7
United Kingdom	5.0	4.6	1.9	0.2	-3.5	-4.8	-2.8
Italy	-2.6	-1.0	-1.3	--	1.9	2.5	1.2
Debt							
United States	53.2	54.0	55.4	58.9	62.0	63.9	64.2
Japan	72.8	70.6	69.8	67.7	71.1	74.7	79.4
EU	53.5	52.0	51.3	57.0	60.8	66.0	69.8
Germany	44.4	43.2	43.8	42.1	44.8	48.9	53.6
France	...	...	35.4	35.5	39.4	43.9	48.1
United Kingdom	49.5	43.2	39.8	35.8	41.7	48.2	50.5
Italy 2/	92.6	95.6	97.9	101.3	108.4	118.6	122.6

Source: Ministry of Budget, Relazione Previsionale e Programmatica per l'anno 1994.

1/ Preliminary official estimates.

2/ Excluding tax refund liabilities.

Table 18. Italy: International Comparison of General Government Revenue and Expenditure

(In percent of GDP)

	1988	1989	1990	1991	1992	1993	1994 1/
Tax revenue 2/							
United States	30.5	30.9	30.8	30.7	30.6	30.9	31.9
Japan	29.8	30.1	31.2	30.7	30.4	30.5	29.7
EU	41.1	40.8	40.4	41.3	41.6	42.3	42.5
Germany	42.0	42.4	40.6	42.7	43.5	43.9	44.5
France	45.2	44.9	45.0	45.2	44.6	45.0	45.8
United Kingdom	36.2	35.8	36.1	35.7	34.7	33.5	34.5
Italy 3/	37.0	38.9	39.6	40.5	42.9	44.0	42.8
Total expenditures 4/							
United States	32.5	32.4	33.3	34.1	35.1	34.4	33.8
Japan	32.2	31.5	32.4	31.4	33.0	34.8	36.3
EU	47.8	46.8	47.8	49.1	50.2	51.7	51.5
Germany	47.0	45.6	45.4	48.8	49.4	50.4	50.8
France	50.8	49.9	50.5	51.2	52.5	54.7	55.3
United Kingdom	38.1	37.8	40.2	41.0	43.4	43.5	42.6
Italy	50.3	51.3	53.1	53.5	53.6	56.2	55.0

Source: Ministry of Budget, *Relazione Previsonale e Programmatica per l'anno 1994*.

1/ Preliminary official estimates.
2/ Including social security contributions.
3/ Including capital revenue.
4/ Net of capital revenue.

Table 19. Italy: Medium-Term Fiscal Plan

(In percent of GDP)

	1993 Act.	1994 Off. est.	1995		1996		1997	
Macroeconomic indicators (percent change; unless otherwise indicated)								
Real GDP growth	-0.7	1.6	2.7		2.8		3.1	
Inflation	4.2	3.5	2.5		2.0		2.0	
Employment growth	-2.8	-0.8	0.4		0.5		0.8	
Unemployment rate (in percent)	10.4	11.1	10.7		10.3		9.6	
State sector			No Measures	Plan	No Measures	Plan	No Measures	Plan
Revenue	34.3	32.4	31.4	32.6	30.8	32.1	30.8	32.3
Current	33.4	31.6	30.6	...	30.2	...	30.0	...
Capital and other	0.9	0.8	0.8	...	0.6	...	0.8	...
Expenditure	44.2	42.0	42.1	40.5	41.4	38.7	41.2	37.9
Primary	32.5	31.5	32.1	30.5	31.5	29.1	31.2	28.3
Interest 1/	11.7	10.5	10.1	10.0	9.9	9.6	10.0	9.6
Primary balance	1.8	1.0	-0.6	2.0	-0.7	3.0	-0.4	4.0
Overall balance 1/	-9.9	-9.4	-10.7	-8.0	-10.6	-6.6	-10.5	-5.6
Privatization proceeds	--	0.6	--	0.6	--	0.5	--	0.5
Debt	119.9	123.6	127.8	124.2	131.4	123.5	134.5	121.6

Source: Ministry of Budget, *Documento di Programmazione Economico-Finanziaria*, 1995-97.

1/ Excluding capitalized interest on outstanding tax refund liabilities not replaced by government bonds.

Table 20. Italy: Measures in the 1995 State Sector Budget

	In Lit trillions	In percent of GDP
Revenue	20.4	1.18
Tax	12.9	0.75
New tax assessment procedures for 1989-93 incomes	11.5	0.66
Clearing of outstanding tax court cases	0.6	0.03
Presumptive taxation of small holding companies 1/	1.0	0.05
Impact of revaluation of land incomes 1/	0.3	0.02
Special tax on cooperatives	0.6	0.03
Impact of tax-neutral treatment of business mergers and splits	0.5	0.03
Reduction in fiscal drag compensation	0.6	0.03
Excise tax increase in tobacco products and spirits 2/	0.7	0.04
VAT reduction on drugs 2/	-0.7	-0.04
Increase in tax deductions for low income families 2/	-0.5	-0.03
Other measures to reduce tax avoidance and evasion 1/	0.4	0.02
VAT rate reduction on building maintenance	-0.9	-0.05
Revenue losses from expenditure cuts 1/	-1.1	-0.06
Nontax	7.5	0.43
Tax amnesty on illegal construction 1/	6.9	0.40
Increase in withholding on civil servants' pensions 1/	1.1	0.06
Increases in public rents and fees 1/	0.1	--
Other (including revenue losses from expenditure cuts)	-0.5	-0.03
Primary expenditure	27.6	1.60
Pensions 3/	12.5	0.72
Of which:		
Freeze on seniority retirement 1/	5.5	0.32
Postponement of compensatory pension payments (pensioni d'annata) 1/	1.8	0.10
Postponement of pension indexation payments	1.3	0.08
Amnesty and new assessment procedures for social security contributions due 1/	2.9	0.17
Health	5.9	0.34
Ceilings on spending on goods and services by local health units 1/	3.2	0.19
Ceiling on total drug spending 1/	1.5	0.09
Closure of underutilized hospitals	0.9	0.05
Other	0.3	0.02
Personnel spending	0.3	0.02
Hiring freeze through September 1, 1995, and restrictions on turnover	0.4	0.02
Restrictions on utilization of supplementary teachers	0.7	0.04
Cost of wage increases	-0.9	-0.05
Other	0.1	--
Goods and services	1.6	0.09
Reductions on spending for goods and services by central government agencies 1/	1.6	0.09
Transfers	7.4	0.43
Reduction in transfers to special status regions	1.7	0.10
Reduction in transfers to other regions and local authorities	0.9	0.05
Reduction in transfers to enterprises 1/	3.4	0.20
Of which: To State Railway Company	3.0	0.17
Reduction in transfers to other public entities 1/ 4/	1.3	0.09
Other	0.2	0.01
Other expenditure measures	-0.3	-0.02
Primary balance	48.0	2.8

Source: Data provided by the Italian authorities.

1/ As amended by Parliament.
2/ Provisions introduced by Parliament.
3/ As amended following an agreement between government and trade unions on November 30, 1994.
4/ Excluding social security agencies.

Table 21. Italy: Selected Interest Rates

(Period average, except when indicated otherwise)

	1994												1995
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.
Central bank rate													
Discount rate	8.0	7.8	7.5	7.5	7.2	7.0	7.0	7.3	7.5	7.5	7.5	7.5	7.5
Fixed term advance	9.0	8.5	8.5	8.5	8.0	8.0	8.0	8.5	8.5	8.5	8.5	8.5	8.5
Repurchase agreements	8.6	8.5	8.4	8.2	7.7	7.9	8.1	8.3	8.2	8.4	8.3	8.4	8.5
Comercial bank rate													
12 month CDs	7.1	7.0	6.7	6.7	6.6	6.4	6.3	6.5	6.9	7.2	7.3	7.3	...
Interbank rate--overnight	8.7	8.4	8.3	8.2	7.8	7.9	8.2	8.3	8.2	8.2	8.2	8.2	8.4
Average loan rate	11.7	11.6	11.4	11.2	11.1	10.8	11.0	11.2	11.3	11.2	11.2	11.1	...
Government securities market													
3 month (gross)	8.3	8.7	8.9	8.6	8.1	8.7	8.6	9.2	9.2	9.5	9.2	9.3	9.4
6 month (gross)	8.7	8.8	9.0	8.8	8.0	8.6	8.9	9.8	9.7	9.9	9.6	9.3	9.9
12 month (gross)	8.7	8.8	9.0	8.8	8.2	9.1	9.4	10.4	10.3	10.7	10.3	10.4	10.6
12 month (net of taxes)	7.5	7.6	7.8	7.6	7.1	7.9	8.1	9.0	8.9	9.2	8.9	9.1	9.2
Treasury bonds--average (net)	7.2	7.4	8.0	7.8	8.0	8.5	9.3	10.1	10.4	10.3	10.1	10.3	10.4
Treasury bonds--10 year (gross)	8.7	8.8	9.4	9.0	9.4	10.5	10.8	11.5	11.9	12.1	12.0	12.1	12.4
Treasury certificate in ECU (net)	4.7	5.0	4.9	6.0	6.2	6.3	7.1	7.7	7.4	7.5	7.1	7.6	8.1
Germany:													
Money market	6.2	6.2	6.0	5.7	5.4	5.1	5.0	4.9	4.8	4.9	5.0	4.9	...
Interbank deposit rate (3 month)	5.8	5.9	5.8	5.6	5.2	5.0	4.9	5.0	5.0	5.2	5.2	5.4	5.1
Treasury bill (12 month)	5.1	5.1	5.1	5.1	4.8	5.0	4.9	5.0	5.1	5.1	5.2	5.5	5.1
Government bond yield	5.5	5.8	6.2	6.3	6.4	6.9	6.7	6.9	7.3	7.4	7.4	7.4	7.6

	1988	1989	1990	1991	1992	1993	1994
Central bank rate							
Discount rate	12.2	13.3	12.8	11.9	12.8	9.9	7.4
Fixed term advance	11.6	11.5	11.2	11.0	13.8	10.8	8.5
Repurchase agreements	4.1	6.6	8.9	10.9	13.6	10.1	8.3
Comercial bank rate							
12 month CDs	10.0	10.3	10.6	10.4	10.7	9.1	6.8
Interbank rate--overnight	10.4	13.4	14.5	11.9	14.4	10.3	8.2
Average loan rate	13.6	14.2	14.1	13.9	15.8	13.9	11.2
Government securities market							
3 month (gross)	11.2	12.7	12.3	12.7	14.4	10.5	8.8
6 month (gross)	11.1	12.6	12.3	12.5	14.4	10.5	9.1
12 month (gross)	11.2	12.6	12.5	12.4	14.0	10.7	9.5
12 month (net of taxes)	9.6	10.8	10.8	10.7	12.1	9.3	8.3
Treasury bonds--average (net)	10.5	11.6	11.9	11.4	11.9	9.6	9.0
Treasury bonds--10 year (gross)	...	...	...	13.3	13.3	11.2	10.6
Treasury certificate in ECU (net)	8.1	9.3	10.0	9.0	9.0	6.6	6.5
Germany:							
Money market	4.0	6.6	7.9	8.8	9.4	7.5	5.4
Interbank deposit rate (3 month)	4.2	7.1	8.4	9.2	9.5	7.2	5.3
Treasury bill (12 month)	3.6	6.3	8.1	8.3	8.4	6.2	5.1
Government bond yield	6.1	7.1	8.9	8.6	6.6	6.3	6.7

Sources: Bank of Italy; IMF, International Financial Statistics; and Treasurer's Department.

Table 22. Italy: Selected Monetary Indicators

	1988	1989	1990	1991	1992	1993	1994
				(In trillions of lire)			
Narrow money (M1)							
Period average	358.9	384.8	420.2	450.7	481.7	504.2	538.0
End of period	361.7	388.8	422.7	457.6	490.2	516.8	551.1 1/
Broad money (M2)							
Period average	606.0	655.7	715.5	772.4	830.9	890.4	941.3
End of period	609.2	660.4	719.3	781.0	841.8	907.1	959.4 1/
Of which: Certificates of deposit (CDs), end of period	47.4	77.9	107.0	137.6	178.9	223.9	241.1 2/
Domestic credit, end of period	1,452.5	1,653.2	1,876.1	2,129.5	2,403.9	2,636.0	2,759.1 1/
				(In percent of GDP)			
Narrow money (M1)							
Period average	32.9	32.2	32.0	31.5	32.0	32.3	32.6
End of year	33.1	32.6	32.2	32.0	32.6	33.1	33.4
Broad money (M2)							
Period average	55.5	54.9	54.5	54.0	55.2	57.1	57.1
End of year	55.8	55.3	54.8	54.6	56.0	58.1	58.2
Of which: Certificates of deposit (CDs)	4.3	6.5	8.2	9.6	11.9	14.4	14.6
Domestic credit	133.0	138.5	143.0	149.0	159.8	169.0	167.3
				(In percent per annum)			
Average deposit rate	6.7	7.0	6.7	6.7	7.4	5.2	4.7 2/
Six-month CD rate	9.9	10.4	10.6	10.4	11.2	9.3	6.9 1/
Six-month Treasury bill rate	11.1	12.5	12.3	12.5	14.4	10.5	9.1
After-tax rate of return on:							
Ordinary deposits	4.7	4.9	4.7	4.7	5.2	3.6	3.3
Six-month CDs	7.4	7.8	8.0	7.7	7.8	6.5	4.8
Six-month Treasury bills	9.6	10.9	10.7	10.8	12.4	9.1	7.9
Real after-tax rate of return on:							
Ordinary deposits	-0.3	-1.6	-1.3	-1.7	-0.1	-0.6	-0.6
Six-month CDs	2.3	1.1	1.8	1.1	2.4	2.2	0.8
Six-month Treasury bills	4.4	4.0	4.3	4.1	6.8	4.7	3.8
Memorandum items:							
Rate of inflation	5.0	6.6	6.1	6.5	5.3	4.2	3.9
Withholding tax rate on:							
Ordinary deposits	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Six-month CDs	25.0	25.0	25.0	26.3	30.0	30.0	30.0
Treasury securities	12.5	12.5	12.5	12.5	12.5	12.5	12.5

Source: Bank of Italy.

1/ November 1994.
2/ October 1994.

Table 23. Italy: Selected Monetary and Credit Aggregates

(End-of-period; percentage changes)

	1988	1989	1990	1991	1992	1993	1994
Monetary aggregates 1/							
Base money, adjusted	7.9	9.5	10.1	9.7	8.3	7.7	5.7
Base money	8.5	12.4	7.4	5.6	4.0	-7.7	-2.7 2/
M1	7.3	7.8	9.1	10.5	1.0	7.4	3.4
M2	7.5	8.4	9.6	9.1	4.7	7.8	2.5
M2 + REPOS	7.7	11.3	9.0	14.2	8.9	6.7	-4.1
Total liquid assets	14.4	13.6	9.0	10.2	11.9	8.7	1.3
Total financial assets	14.3	14.0	12.4	13.4	10.7	7.3	6.7 3/
Total credit	13.5	14.6	14.9	14.1	11.5	7.9	5.4 3/
Total domestic credit	14.2	15.0	13.3	12.9	11.1	7.5	5.1 3/
Credit to the state sector	14.2	12.9	12.2	12.2	12.4	7.8	2.3 3/
Credit to the nonstate sector	14.0	18.6	15.2	14.0	10.2	7.0	0.6
Special credit institutions lending to nonstate sector 4/	14.8	15.5	16.2	12.7	9.0	16.1	1.1 2/
Bank lending to nonstate sector 5/	17.9	21.7	16.1	15.0	12.0	0.5	-3.5 2/

Source: Bank of Italy.

1/ Adjusted base money excludes the effect of discretionary changes in reserve requirements and penalties for nonobservance of credit ceilings. The definition of M1 consists of currency in circulation and sight deposits held with commercial banks and the post office; M2 is defined as M1 plus savings deposits held with commercial banks and the post office plus CDs; and total liquid assets is made up of M2 plus treasury bills, banks' repurchase agreements with customer postal deposits, and bankers' acceptancess, and SCI CDs.

2/ Twelve months through November 1994.

3/ Twelve months through October 1994.

4/ Beginning in 1994, denotes banks collecting medium- and long-term funds.

5/ Beginning in 1994, denotes banks collecting short-term funds.

Table 24. Italy: Domestic Financial Assets Held by the Nonstate Sector

	1988	1989	1990	1991	1992	1993	1994 October
				(End-of-period stocks, in billions of lire)			
M1	400,381	451,785	482,358	537,534	545,158	578,472	544,852
Bank certificates of deposit	55,866	86,014	119,333	153,433	200,945	234,845	234,018
M2	663,850	738,395	801,992	878,136	921,030	986,268	945,108
Repos	4,267	5,065	8,199	46,942	86,904	89,566	101,178
Postal deposits	70,426	80,659	91,011	100,367	107,210	117,683	123,300
Treasury bills (BOT)	212,480	256,434	284,887	298,362	355,364	313,161	317,116
Bankers' acceptances	2,121	1,612	1,540	2,104	1,925	1,554	1,639
SCI certificates of deposit	40,015	49,893	62,678	69,457	73,923	80,977	73,079
Total liquid assets	993,159	1,132,057	1,250,306	1,395,368	1,546,356	1,589,209	1,561,420
Medium- and long-term government bonds	313,454	380,309	451,876	496,080	490,033	566,017	621,889
Other bonds	69,002	79,874	94,642	120,516	129,990	166,267	183,501
Shares in mutual funds	51,565	49,165	47,379	56,191	60,663	110,093	131,600
Other financial assets	2,232	2,936	5,649	4,857	3,158	3,309	3,633
Domestic financial assets	1,429,412	1,644,341	1,849,852	2,073,012	2,230,201	2,434,895	2,502,044
				(End-of-period stocks, in percent of total)			
M1	28.0	27.5	26.1	25.9	24.4	23.8	21.8
Bank certificates of deposit	3.9	5.2	6.5	7.4	9.0	9.6	9.4
M2	46.4	44.9	43.4	42.4	41.3	40.5	37.8
Repos	0.3	0.3	0.4	2.3	3.9	3.7	4.0
Postal deposits	4.9	4.9	4.9	4.8	4.8	4.8	4.9
Treasury bills (BOT)	14.9	15.6	15.4	14.4	15.9	12.9	12.7
Bankers' acceptances	0.1	0.1	0.1	0.1	0.1	0.1	0.1
SCI certificates of deposit	2.8	3.0	3.4	3.4	3.3	3.3	2.9
Total liquid assets	69.5	68.8	67.6	67.3	69.3	65.3	62.4
Medium- and long-term government bonds	21.9	23.1	24.4	23.9	22.0	23.2	24.9
Other bonds	4.8	4.9	5.1	5.8	5.8	6.8	7.3
Shares in mutual funds	3.6	3.0	2.6	2.7	2.7	4.5	5.3
Other financial assets	0.2	0.2	0.3	0.2	0.1	0.1	0.1
Domestic financial assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0
				(Changes, in percent of GDP)			
M1	2.6	4.3	2.3	3.9	0.5	2.1	-2.0
Bank certificates of deposit	2.2	2.5	2.5	2.4	3.2	2.2	-0.1
M2	4.2	6.2	4.8	5.3	2.9	4.2	-2.5
Repos	0.1	0.1	0.2	2.7	2.7	0.2	0.7
Postal deposits	1.0	0.9	0.8	0.7	0.5	0.7	0.3
Treasury bills (BOT)	4.6	3.7	2.2	0.9	3.8	-2.7	0.2
Bankers' acceptances	--	--	--	--	--	-0.0	0.0
SCI certificates of deposit	1.2	0.8	1.0	0.5	0.3	0.5	-0.5
Total liquid assets	11.1	11.6	9.0	10.1	10.0	2.7	-1.7
Medium- and long-term government bonds	5.5	5.6	5.5	3.1	-0.4	4.9	3.4
Other bonds	0.7	0.9	1.1	1.8	0.6	2.3	1.0
Shares in mutual funds	-0.7	-0.2	-0.1	0.6	0.3	3.2	1.3
Other financial assets	--	0.1	0.2	-0.1	-0.1	0.0	0.0
Domestic financial assets	16.6	18.0	15.7	15.6	10.4	13.1	4.1

Source: Bank of Italy.

Table 25. Italy: Selected Balance Sheet Items of the Commercial Banks

(End-of-period stocks; in billions of lire)

	1988	1989	1990	1991	1992	1993	1994 October
Assets							
Reserves	106,721	116,814	128,781	132,952	132,003	108,616	99,372
Loans	351,417	427,183	495,922	569,693	637,807	641,287	617,622
In lire	307,815	374,248	437,406	500,199	521,645	546,863	535,329
In foreign currency	43,602	52,935	58,516	69,494	116,162	94,423	82,293
Securities	217,764	212,448	207,555	260,530	316,636	325,711	362,759
Government securities	139,481	134,829	146,679	201,261	255,292	274,632	308,771
Treasury bills	20,939	22,171	28,768	31,196	31,129	72,999	66,010
Medium- and long-term bonds	118,542	112,658	117,204	168,969	222,447	200,305	241,234
Other securities	78,283	77,619	60,875	59,266	61,344	51,076	53,988
Repurchase agreements	472	1,230	1,326	9,314	11,091	20,182	11,398
Shares and participation	14,641	19,547	21,480	32,124	36,687	38,520	43,646
Liabilities and capital account							
Deposits	571,564	625,348	686,279	748,800	775,946	835,874	796,449
Demand deposits	324,769	358,420	390,416	435,469	431,273	461,250	432,922
Certificates of deposit	55,929	86,093	119,397	153,493	200,998	234,851	233,968
Savings deposits	190,866	180,835	176,466	159,838	143,676	139,773	129,559
Repurchase agreements	5,673	10,543	18,059	75,170	136,615	132,776	136,541
Net foreign liabilities	42,731	52,295	52,704	76,321	107,683	42,399	91,306
Borrowings from BI	5,730	6,298	7,563	8,826	8,870	2,454	2,251
Capital	77,740	87,468	95,695	126,499	153,592	166,292	178,695
Memorandum items:							
Loans by foreign subsidiaries	9,466	16,327	30,053	26,446	32,182	28,360	21,790
In lire	1,306	3,741	12,633	14,928	18,008	18,265	14,611
In foreign exchange	8,160	12,586	17,420	11,518	14,174	10,095	7,179

Source: Bank of Italy.

Table 26. Italy: Sources and Uses of Base Money

	1988	1989	1990	1991	1992	1993	1994 Jan-Nov
				(Changes in billions of lire)			
Sources							
External sector	10,947	14,971	15,458	-8,674	-32,591	2,564	-3,146
Treasury	13,349	8,450	-1,383	-9,458	-2,696	-3,378	-25,246
Open market operations	-10,601	-2,106	2,393	27,172	42,781	-14,098	33,052
Refinancing	-30	1,203	1,260	2,664	108	-6,451	-161
Other sources	-708	-2,043	-4,027	-583	858	1,903	-11,278
Total	12,957	20,475	13,700	11,121	8,460	-19,460	-6,778
Uses							
Currency in circulation	4,450	10,477	1,805	6,906	9,263	4,152	1,484
Bank reserves	8,507	9,998	11,895	4,215	-802	-23,612	-8,262
Deposits with Bank of Italy	8,770	9,746	10,745	3,646	113	-23,594	-7,754
Of which: required reserves	9,444	9,567	13,026	3,424	1,012	-24,131	-12,317
Other items	-263	252	1,150	570	-916	-18	-509
				(Percentage change relative to total base money)			
Sources							
External sector	7.20	9.07	8.33	-4.35	-14.89	1.30	-1.58
Treasury	8.78	5.12	-0.75	-4.75	-1.23	-1.71	-12.66
Open market operations	-6.97	-1.28	1.29	13.64	19.55	-7.12	16.58
Refinancing	-0.02	0.73	0.68	1.34	0.05	-3.26	-0.08
Other sources	-0.47	-1.24	-2.17	-0.29	0.39	0.96	-5.66
Total	8.52	12.41	7.38	5.58	3.87	-9.83	-3.40
Uses							
Currency in circulation	2.93	6.35	0.97	3.47	4.23	2.10	0.74
Bank reserves	5.59	6.06	6.41	2.12	-0.37	-11.93	-4.14
Deposits with Bank of Italy	5.77	5.90	5.79	1.83	0.05	-11.92	-3.89
Of which: required reserves	6.21	5.80	7.02	1.72	0.46	-12.19	-6.18
Other items	-0.17	0.15	0.62	0.29	-0.42	-0.01	-0.26
Memorandum item:							
Monetary base (end-of-period)	165,047	185,522	199,222	210,343	216,803	199,343	192,565

Source: Bank of Italy.

Table 27. Italy: Exchange Rate Developments

	1988	1989	1990	1991	1992	1993	1993				1994			
							I	II	III	IV	I	II	III	IV
							(In lire per unit of foreign currency)							
Exchange rate of the Italian lira vis-a-vis														
U.S. dollar														
Average	1,301.6	1,372.1	1,198.1	1,240.6	1,232.4	1,573.7	1,544.2	1,503.9	1,585.3	1,661.2	1,684.8	1,604.3	1,571.5	1,589.2
End of period	1,305.8	1,270.5	1,130.1	1,151.1	1,470.9	1,704.0	1,598.2	1,543.5	1,582.1	1,704.0	1,611.3	1,586.0	1,556.5	1,629.7
Deutsche mark														
Average	741.2	729.8	741.5	747.6	789.2	951.8	944.5	929.4	945.0	987.3	977.1	965.5	1,006.0	1,029.9
End of period	733.5	748.3	756.5	759.3	911.3	987.1	990.0	914.3	976.7	987.1	963.7	994.1	1,005.3	1,052.3
ECU														
Average	1,537.3	1,510.7	1,521.9	1,533.3	1,587.5	1,841.6	1,842.3	1,818.2	1,823.1	1,883.0	1,894.5	1,864.6	1,928.1	1,968.4
End of period	1,531.1	1,517.5	1,540.3	1,542.4	1,787.4	1,908.4	1,919.9	1,781.5	1,860.6	1,908.4	1,860.4	1,909.8	1,931.7	1,997.4
Exchange rate indices (period averages) 1/														
Nonimal effective exchange rate														
MERM (1985=100)	101.8	101.6	106.4	103.9	101.4	82.5	83.8	84.4	82.3	79.4	78.4	80.3	78.6	77.0
Real effective exchange rate														
Producer prices 2/	97.3	99.6	103.6	104.1	101.9	88.3	88.0	89.7	89.0	86.4	86.3	88.5	86.5	...
Normalized unit labor costs 3/	92.9	96.5	100.0	101.0	99.4	83.0	82.4	84.5	84.1	81.1	78.7	81.7	80.0	78.4
							(Year-on-year percent changes)							
Exchange rate of the Italian lira vis-a-vis														
U.S. dollar														
Average	0.4	5.4	-12.7	3.5	-0.7	27.7	26.7	23.5	39.9	22.2	9.1	6.7	-0.9	-4.3
End of period	11.7	-2.7	-11.0	1.9	27.8	15.8	29.0	33.6	28.3	15.8	0.8	2.8	-1.6	-4.4
Deutsche mark														
Average	2.8	-1.5	1.6	0.8	5.6	20.6	25.5	23.2	22.0	12.5	3.4	3.9	6.5	4.3
End of period	-0.8	2.0	1.1	0.4	20.0	8.3	31.3	20.9	11.6	8.3	-2.7	8.7	2.9	6.6
ECU														
Average	2.9	-1.7	0.7	0.7	3.5	16.0	19.9	17.6	16.0	11.0	2.8	2.6	5.8	4.5
End of period	0.6	-0.9	1.5	0.1	15.9	6.8	24.6	14.9	7.5	6.8	-3.1	7.2	3.8	4.7
Exchange rate indices (period averages)														
Nonimal effective exchange rate														
MERM (1985=100)	-3.6	-0.2	4.7	-2.4	-2.4	-18.7	-19.4	-18.7	-21.7	-14.4	-6.4	-4.8	-4.5	-3.0
Real effective exchange rate														
Producer prices 2/	-2.7	2.4	4.0	0.5	-2.2	-13.4	-16.2	-14.3	-14.6	-7.6	-1.9	-1.3	-2.7	...
Normalized unit labor costs 3/	-0.8	3.8	3.6	1.0	-1.6	-16.5	-21.5	-16.5	-17.4	-9.6	-4.5	-3.3	-4.8	-3.3

Sources: Bank of Italy; IMF, International Financial Statisitics; IMF, Research Department.

1/ Foreign currency per Italian lira.
2/ Bank of Italy index for manufacturing goods in 14 countries.
3/ Manufacturing sector.

Table 28. Italy: Summary Balance of Payments

(In billions of lire unless otherwise noted; on a transaction basis)

	1988	1989	1990	1991	1992	1993	1994 I	1994 II	1994 III
Trade balance	-939	-2,308	1,406	-238	3,852	51,106	11,671	13,955	16,486
Imports (f.o.b.)	-167,318	-195,105	-202,109	-209,969	-215,583	-213,980	-59,943	-62,244	-56,951
Exports (f.o.b.)	166,379	192,797	203,515	209,731	219,435	265,086	71,614	76,199	73,437
Net invisibles	-7,321	-13,897	-21,784	-29,099	-38,077	-33,121	-9,548	-8,372	-7,797
Services balance	1,762	-256	-1,551	-330	-5,715	980	1,472	1,550	930
Transfers, net	-3,740	-4,394	-5,752	-7,370	-6,892	-8,466	-1,617	-3,512	-3,073
Current account	-8,260	-16,205	-20,378	-29,337	-34,225	17,985	2,123	5,583	8,689
(In percent of GDP)	-0.8	-1.4	-1.6	-2.1	-2.3	1.2	0.5	1.4	2.1
Capital account	21,636	34,085	52,165	29,059	10,712	12,863	-1,325	-7,703	-6,630
Errors and omissions	-2,470	-2,494	-16,631	-8,284	-9,035	-28,642	3,392	3,050	-3,085
Overall balance	-10,906	-15,386	-15,156	8,571	32,548	-2,206	-4,190	-930	1,026

Sources: Bank of Italy, Annual Report for 1992; and Supplementi al Bollettino Statistico.

Table 29. Italy: Foreign Trade and Selected Factors Affecting the Trade Balance

(Year-on-year percent change, unless otherwise indicated)

	1988	1989	1990	1991	1992	1993	1994		
							I	II	III
Exports (in billions of lire) 1/	166,380	192,797	203,515	209,731	219,436	265,086	71,614	76,199	73,437
Changes in:									
Value	10.3	15.9	5.6	3.1	4.6	20.8	16.9	12.9	16.2
Unit value	5.2	6.3	2.1	2.9	0.7	11.4	5.0	3.3	3.1
Volume	4.9	9.0	3.5	0.1	3.8	8.5	11.4	9.3	...
Imports (in billions of lire) 1/	180,013	209,910	217,703	225,748	232,111	232,297	65,233	67,395	61,635
Changes in:									
Value	10.9	16.6	3.7	3.7	2.8	0.1	10.1	11.1	19.1
Unit value	4.2	7.6	-0.7	-0.8	-0.6	11.7	4.0	2.3	4.3
Volume	6.4	8.3	4.5	4.4	3.4	-10.4	6.0	8.7	...
Trade deficit (in billIons of lire)	-13,633	-17,113	-14,188	-16,017	-12,674	32,789	6,381	8,804	11,802
(in percent of GDP)	-1.2	-1.4	-1.1	-1.1	-0.8	2.1	1.6	2.1	2.8
Factors affecting trade balance									
Real GDP in Italy	4.1	2.9	2.1	1.2	0.7	-0.7	1.0	1.9	3.7
Real GDP in partner countries 2/	4.1	3.6	3.3	1.2	0.9	0.1	...	...	...
Real total domestic demand in Italy	4.4	2.8	2.5	1.9	0.8	-5.0	-0.3	1.7	3.8
Real total domestic demand in partner countries 3/	4.5	3.8	3.2	1.9	1.3	-0.6	...	...	...
Export market growth, non-oil 2/	9.1	8.2	7.7	5.5	3.8	-0.3	...	...	...
Terms of trade	0.9	-1.2	3.0	3.6	1.3	-0.3	0.9	1.0	...
Real total domestic demand growth differentials	-0.1	-1.0	-0.6	0.0	-0.5	-4.4	...	...	...
Performance indicators									
Cover ratio 4/	92.4	91.8	93.5	92.9	94.5	114.1	...	...	...
Gains (+) or losses (-) in market shares In volume terms 5/	-4.2	0.9	-4.2	-5.4	-0.0	8.8	...	...	...
Real GDP differential	-0.0	-0.7	-1.2	0.0	-0.2	-0.8	...	...	...

Sources: Bank of Italy; and IMF, Research Department.

1/ Customs basis.
2/ Composite based on data for countries that together accounted of at least 90 percent of Italy's trade, with weights proportional to the geographical distribution of 1986-88 average exports.
3/ Based on data for industrial countries only.
4/ Ratio of exports, f.o.b. to imports, c.i.f.
5/ Difference between Italy's export volume growth and non-oil export market growth.

Table 30. Italy: Commodity Composition of External Trade 1/

	1988	1989	1990	1991	1992	1993
	(In percent of total exports)					
Exports						
Agricultural products	2.7	2.6	2.6	2.9	2.6	2.5
Food and beverages	4.2	4.0	4.0	4.3	4.7	4.6
Fuel and energy products	1.9	1.8	2.1	2.2	2.1	2.1
Chemical products	8.6	8.1	7.5	7.4	7.8	7.8
Minerals	8.9	9.2	8.6	8.2	8.1	8.5
Metal and mechanical industries	25.3	26.4	26.2	26.4	26.2	26.8
Transportation equipment	9.6	9.9	10.6	10.6	10.0	9.1
Textile and clothing	12.6	12.0	12.3	12.2	12.2	11.9
Leather and footwear	6.3	6.1	6.2	5.7	5.5	5.5
Other	20.1	19.9	19.7	20.3	20.6	21.2
Total	100.0	100.0	100.0	100.0	100.0	100.0
	(In percent of total imports)					
Imports						
Agricultural products	7.8	7.2	6.6	7.0	6.4	6.5
Food and beverages	7.9	7.6	7.2	7.5	7.5	8.1
Fuel and energy products	10.2	11.1	12.1	11.4	10.2	11.6
Chemical products	13.0	12.6	12.6	12.3	12.7	13.7
Minerals	11.7	12.8	11.4	10.6	10.4	10.6
Metal and mechanical industries	14.2	13.4	13.7	13.9	13.9	13.4
Transportation equipment	10.3	10.9	11.9	12.8	14.1	11.0
Textile and clothing	5.3	5.1	4.9	5.1	5.3	5.4
Leather and footwear	1.5	1.5	1.5	1.4	1.5	1.7
Other	18.2	17.8	18.1	18.0	17.9	18.0
Total	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Bank of Italy, Annual Report, 1993.

1/ Customs data.

Table 31. Italy: Geographical Distribution of Trade 1/

	1988	1989	1990	1991	1992	1993
	(In percent of total exports)					
Exports						
Industrial countries	80.2	79.4	80.1	79.3	77.2	74.1
EEC 12	57.1	56.4	58.2	59.0	57.7	53.3
Of which:						
France	16.6	16.3	16.4	15.2	14.6	13.1
Germany	18.1	17.0	19.0	21.0	20.4	19.5
United Kingdom	8.0	7.9	7.1	6.7	6.6	6.4
Spain	4.1	4.7	4.9	5.1	5.1	4.3
Switzerland	4.7	4.5	4.5	4.2	4.0	3.9
United States	8.9	8.6	7.6	6.9	7.0	7.7
Oil-exporting countries (OPEC)	4.7	4.8	4.1	4.8	5.2	4.9
Non-oil developing countries	11.3	11.8	12.3	12.3	13.1	15.6
Other countries	3.9	4.0	3.5	3.6	4.5	5.5
	(In percent of total imports)					
Imports						
Industrial countries	77.0	75.9	76.3	76.6	77.3	75.0
EEC 12	57.5	56.7	57.4	57.7	58.8	55.4
Of which:						
France	14.8	14.7	14.2	14.2	14.5	13.6
Germany	21.8	21.2	21.2	20.9	21.6	19.4
United Kingdom	5.1	4.8	5.2	5.7	5.7	5.8
Spain	2.4	2.4	3.0	3.5	3.4	3.3
Switzerland	4.5	4.3	4.6	4.4	4.5	5.1
United States	5.6	5.5	5.1	5.6	5.2	5.3
Oil-exporting countries (OPEC)	5.8	6.4	7.1	7.1	6.2	6.5
Non-oil developing countries	12.1	12.5	11.9	11.1	11.0	11.5
Other countries	5.1	5.2	4.7	5.1	5.6	7.0
	(In percent of GDP)					
Trade balance	-1.2	-1.4	-1.1	-1.1	-0.8	2.1
Industrial countries	-0.5	-0.5	-0.2	-0.5	-0.7	1.4
EEC 12	-0.8	-0.9	-0.5	-0.5	-0.7	0.8
Of which:						
France	0.1	0.0	0.2	-0.0	-0.1	0.2
Germany	-0.8	-1.0	-0.6	-0.2	-0.4	0.4
United Kingdom	0.4	0.4	0.2	0.1	0.1	0.2
Spain	0.2	0.3	0.3	0.2	0.2	0.2
Switzerland	-0.0	-0.0	-0.1	-0.1	-0.1	5.9
United States	0.4	0.4	0.3	0.1	0.2	0.5
Oil-exporting countries (OPEC)	-0.2	-0.3	-0.5	-0.4	-0.2	-0.1
Non-oil developing countries	-0.3	-0.3	-0.1	0.0	0.2	0.9
Other countries	-0.2	-0.3	-0.2	-0.3	-0.2	-0.1

Source: Bank of Italy.

1/ Customs basis.

Table 32. Italy: Services and Transfers

(In billions of lire)

	1988	1989	1990	1991	1992	1993
Total Receipts	69,324	81,296	97,830	105,232	128,436	160,111
Services	54,814	64,990	82,533	88,578	111,520	138,393
Travel	16,144	16,442	19,442	22,853	28,236	34,625
Transportation 1/	9,950	11,633	11,543	13,668	13,815	18,707
Investment income	10,306	15,062	17,782	22,996	31,251	44,723
Labor income	4,062	4,903	4,507	3,347	2,713	3,096
Other	14,352	16,950	29,259	25,714	35,505	37,242
Transfers	14,510	16,306	15,297	16,654	16,916	21,718
Private	4,910	4,843	4,761	3,866	3,692	5,106
Government	9,600	11,463	10,536	12,788	13,224	16,612
Total Expenditures	76,645	95,193	119,614	134,331	166,513	193,232
Services	60,189	75,325	101,527	110,307	142,705	163,048
Travel	7,795	9,291	11,858	14,451	22,313	22,070
Transportation 1/	13,690	16,027	17,295	18,406	21,093	24,308
Investment income	19,514	26,423	35,361	44,665	56,815	70,247
Labor income	1,991	3,621	4,371	3,077	2,619	3,207
Other	17,199	19,963	32,642	29,708	39,865	43,216
Transfers	16,456	19,868	18,087	24,024	23,808	30,184
Private	2,802	3,345	3,360	4,210	4,248	4,382
Government	13,654	16,523	14,727	19,814	19,560	25,802
Total Balance	145,969	176,489	217,444	239,563	294,949	353,343
Services	-5,375	-10,335	-18,994	-21,729	-31,185	-24,655
Travel	8,349	7,151	7,584	8,402	5,923	12,555
Transportation 1/	-3,740	-4,394	-5,752	-4,738	-7,278	-5,601
Investment income	-9,208	-11,361	-17,579	-21,669	-25,564	-25,524
Labor income	2,071	1,282	136	270	94	-111
Other	-2,847	-3,013	-3,383	-3,994	-4,360	-5,974
Transfers	-1,946	-3,562	-2,790	-7,370	-6,892	-8,466
Private	2,108	1,498	1,401	-344	-556	724
Government	-4,054	-5,060	-4,191	-7,026	-6,336	-9,190

Sources: Bank of Italy, Annual Report, 1993; and Supplementi al Bolletino Statistico.

1/ Including insurance.

Table 33. Italy: Capital Movements

(In billions of lire)

	1988	1989	1990	1991	1992	1993	1994 1/
Total capital inflows (nonbank)	339,032	445,077	600,573	901,822	1,370,373	2,781,869	1,822,941
Direct investment	15,929	21,040	30,654	38,212	25,545	22,722	20,756
Portfolio investment	56,276	107,600	174,347	427,913	884,679	2,313,938	1,303,513
Private long-term loans	27,948	54,699	136,521	165,720	166,677	129,363	...
Public sector long-term loans	11,665	11,492	13,620	2,554	4,914	8,629	...
Medium- and long-term loans	2,712	2,400	1,950	3,200	4,606	4,553	...
Short-term trade credit	224,502	247,846	243,481	264,223	283,952	302,664	...
Total capital outflows (nonbank)	327,602	425,919	571,228	911,742	1,385,024	2,717,628	1,870,399
Direct investment	14,200	20,977	32,174	44,223	28,918	28,191	22,138
Portfolio investment	55,845	102,872	174,555	435,187	896,088	2,231,920	1,327,401
Private long-term loans	21,903	37,875	110,769	158,265	163,876	133,378	...
Public sector long-term loans	8,796	10,189	7,929	4,296	4,783	9,059	...
Medium- and long-term loans	3,503	3,850	4,150	4,980	7,795	7,906	...
Short-term trade credit	223,355	250,156	241,651	264,791	283,564	307,174	...
Net capital movements (bank and nonbank)	-15,692	-30,735	-34,279	10,409	5,461	-104,692	-15,658
Bank capital	10,224	14,979	22,976	39,369	25,303	-53,486	31,800
Direct investment	-1,729	-63	1,520	6,011	3,373	5,469	-1,382
Portfolio investment	-413	-4,658	258	7,689	-718	-111,756	-23,888
Private long-term loans	-6,045	-16,824	-25,752	-7,455	-2,801	4,015	...
Public sector long-term loans	-8,162	-7,642	-9,470	2,426	2,881	-723	...
Medium- and long-term loans	791	1,450	2,200	1,780	3,189	3,353	...
Short-term trade credit	-134	-2,998	-3,035	-42	-463	-5,050	...

Sources: Bank of Italy, Annual Report for 1993; and Supplemnti al Bolletino Statistico.

1/ Data for first three quarters.

Table 34. Italy: External Debt Outstanding

(In billions of U.S. dollars, end of period)

	1988	1989	1990	1991	1992	1993
Nonbank medium and long-term debt	55.3	77.8	122.5	112.0	134.3	94.5
Public and publicly guaranteed debt	30.7	37.7	47.2	25.5	25.2	24.1
Nonfinancial private sector	20.9	36.4	71.1	82.4	78.4	67.4
Trade credits	3.7	3.7	4.2	4.1	30.7	3.1
Commercial bank debt	129.3	161.9	202.9	239.8	243.7	214.1
Central bank and UIC	1.1	1.2	1.4	1.4	6.3	1.5
Total debt	185.7	240.9	326.8	353.2	384.3	310.1
(In percent of GDP)	22.2	25.6	28.1	28.5	37.5	33.7
Memorandum items:						
Short-term trade credit	18.6	19.6	26.3	25.4	20.8	18.3
Total external assets	210.0	270.3	353.7	398.9	377.6	415.7
Net external assets	-67.2	-92.9	-139.1	-157.9	-160.2	-127.7
(In percent of GDP)	-8.0	-9.9	-12.0	-12.7	-15.6	-13.9

Source: Bank of Italy, Annual Report, 1993.

Table 35. Italy: Foreign Position of the Bank of Italy
and the Commercial Banks 1/

(End of period values)

	1988	1989	1990	1991	1992	1993	1994
			(In millions of SDRs) 2/				
Total gross official reserves	46,992	55,713	61,744	50,271	36,959	37,230	39,176
Gold 3/	21,194	20,162	17,512	16,240	16,854	17,177	18,044
SDRs	705	759	729	650	173	175	86
Reserve position in the Fund	941	1,099	1,205	1,576	1,774	1,575	1,393
Foreign exchange	24,151	33,693	42,298	31,805	18,157	18,303	19,653
Memorandum items:							
Net foreign reserve position of the Bank of Italy 3/	47,107	55,845	64,310	57,296	33,276	35,863	...
			(In millions of U.S. dollars)				
Total gross official reserves 3/	63,236	73,216	87,840	71,909	50,818	51,138	57,190
Short-term official liabilities, net	-147	-315	-354	-363	-5,316	-578	...
Medium- and long-term position net	258	488	1,859	8,240	1,815	550	...
Net foreign position of the Bank of Italy 3/	63,392	73,389	91,491	81,958	45,755	49,260	...
Net foreign position of commercial banks	-35,358	-40,565	-50,127	-70,360	-86,052	-52,025	...
Memoradum items:							
ECU	1,531	1,518	1,540	1,542	1,787	1,908	1,997
Gold at national valuation	28,521	26,496	24,913	23,230	23,175	23,593	26,342

Sources: Bank of Italy; IMF, International Financial Statistics.

1/ Including the Foreign Exchange Office.
2/ The conversion into SDR values has been done using end-of-period exchange rates, as reported by IFS.
3/ Gold at national valuation.