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Recent Economic Developments in Italy:  
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Rodney H. Mills, Jr.

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Recent Economic Developments in Italy: July to November 1962Summary

Wage rates in Italy continued to rise through the third quarter of 1962 at a much faster pace than in other recent years. By September, hourly wages in manufacturing were 14-1/2 per cent higher than a year earlier, in contrast with yearly increases of about 4-1/2 per cent in 1960 and 1961. The heavy "wage push" in 1962, which reflected the declining structural unemployment in Italy and more aggressive labor union activity, reduced profit margins and curtailed internal funds for financing business investment.

Both wholesale and consumer prices rose further in the third quarter of 1962. In the year ended last September, wholesale prices were up 3.8 per cent and consumer prices 5.2 per cent. However, the index of export prices had not shown any upward tendency through last August.

The very rapid increase in industrial production which had been a notable feature of the Italian economy in 1959-61 came to an end in 1962. Seasonally-adjusted industrial output in the third quarter of 1962 was apparently below the level of the second quarter and no higher than in the last quarter of 1961. In part, this reflected serious strikes from June onward. On the other hand, exports gave little further stimulus to the economy in 1962, and recent statements also seem to indicate a tapering off of the rate of rise in investment outlays.

A number of important financial measures were taken in October-November. In part, these steps constitute fundamental changes in financial practices, particularly the shift from an open tap to an auction system for Treasury bills. At the same time, they attempt to give the economy

a "shot in the arm" by augmenting bank liquidity, reducing interest rates, and channelling more bank resources into long-term securities and loans to enterprises.

Italy's balance of payments in the third quarter was, as earlier in 1962, much less strong than in 1961, because of greater capital outflow and a larger trade deficit. For the first nine months of 1962, the over-all external surplus was \$216 million compared with \$455 million in the corresponding period of 1961. The surplus was reflected not in official reserves of gold and foreign exchange, but rather in the foreign investments of the Italian Exchange Office. These investments included \$150 million of U. S. Treasury borrowings of lire.

#### Marked acceleration of wage rise

Italy has now joined the ranks of those countries experiencing a significant "wage push." A definite upturn in the wage trend became apparent in early 1962, as was reported in the previous memorandum on Italy dated October 17, 1962. In contrast with earlier years, wage rates rose rapidly in the second quarter and still more so in the third. Governor Carli of the bank of Italy has reported that wages rose faster than productivity in 1962, and that profit margins were reduced.

Minimum contractual hourly wages in manufacturing, on a yearly average basis, registered annual increases of 4.7 per cent in 1960 and 4.5 per cent in 1961. In the first nine months of 1962, the increase amounted to 11.8 per cent, and in September these wage rates were 14.5 per cent above the previous year. (See Table 1.) In the year ending last September, increases in nine branches of manufacturing ranged from 7.4 to 26.8 per cent. In other sectors of the economy, wage rates last

September were up, over a year previous, by 19.7 per cent in agriculture and 18.0 per cent in construction, while civil servants' salaries were up 25 per cent. All of these figures refer to minimum contractual wages; according to the Banca Nazionale del Lavoro, actual wages paid have risen faster.

TABLE 1. Italy: Wage and Price Indexes, End of Quarter

(1953 = 100)

	Quarter			
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>
<u>Wages (manufacturing)<sup>a/</sup></u>				
1961	138	138	140	143
1962	147	150	160	n.a.
<u>Wholesale prices</u>				
1961	99.1	98.7	98.5	99.9
1962	101.4	102.0	102.2	n.a.
<u>Consumer prices</u>				
1961	116.9	117.4	118.1	119.6
1962	121.5	122.9	124.2	n.a.
<u>Exports-unit value<sup>b/</sup></u>				
1961	84	85	84	83
1962	83	82	<u>c/</u> 84	n.a.

<sup>a/</sup> Minimum contractual hourly rates.

<sup>b/</sup> Quarterly average.

<sup>c/</sup> July-August average.

Source: OECD.

There appear to be two causes--undoubtedly related to each other--of the current wage developments. For decades, Italy had been a country with high structural unemployment. But substantial migration of labor to Germany, France and Switzerland and the enormous economic progress within Italy has, since 1954, been cutting into reserves of free labor. The decline in unemployment accentuated in 1962, the drop amounting to 230,000 in the first nine months (seasonally-adjusted) as against 115,000 in the year ended December 1961. Secondly, the labor unions have this year become more aggressive in their wage demands. Strike activity was also

much more prevalent in 1962; especially beginning in June, strikes hampered production severely.

Industrial expansion falters

Seasonally-adjusted industrial production in the third quarter of 1962 (latest figure available) appears to have been 1-2 per cent below the second quarter. <sup>1/</sup> (See Table 2.) Earlier in the year, the rate of increase was considerably slower than in 1959-61, and third-quarter output appears to have been no higher than in the fourth quarter of 1961. Expectations of Italian officials last summer, reported in the previous report on Italy, <sup>2/</sup> that output would rise faster in the second half, have not been realized so far.

TABLE 2. Italy: Industrial Production, Seasonally-Adjusted, 1958-62

(quarterly average; 1953 = 100)

	Quarter			
	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>
1958	141	139	142	148
1959	152	153	157	170
1960	177	181	184	187
1961	192	196	198	213
1962	216	216	<sup>a/</sup> 213	n a.

<sup>a/</sup> FRB estimate based on unadjusted indexes.  
Source: OECD.

It is not possible to determine how much of this slowdown is the result of strikes and how much may represent a slowing of demand. Strikes, centered in the metal and engineering industries, were severe from June through September.

<sup>1/</sup> The adjustment factors for the third quarter have been estimated by staff members of the Division of International Finance.

<sup>2/</sup> See R. H. Mills, "Recent Economic Developments in Italy," October 17, 1962.

Consumer demand, bolstered by the recent wage increases, continued to rise rapidly. On the other hand, exports, seasonally-adjusted, fell 1-1/2 per cent in the third quarter. In fact, through the first nine months of 1962, export demand contributed very little to economic expansion: on a seasonally-adjusted basis, exports rose only 1.8 per cent from the last quarter of 1961 to the third quarter of 1962. By contrast, exports rose 15 per cent during the year 1961. Furthermore, according to several recent statements, investment demand apparently slowed down in 1962. In late September, Italy's leading private economic research institute stated its belief that investment was rising "moderately," whereas in 1961 gross investment in Italy was 13 per cent above 1960. In late October, Governor Carli of the Bank of Italy declared that the economic situation in Europe, while varying somewhat from country to country, was generally characterized by rising consumption and by a lack of expansion of investment and export demand. Finally, Treasury Minister Tremelloni recently told the Financial Times that the financial measures taken by Italy in November (to be discussed below) were designed to give the economy a "shot in the arm."

Internal prices continue to rise but export prices hold steady

The upward internal price tendencies noted in the previous memorandum on Italy continued through the third quarter of 1962 (latest figures available). From June to September, the consumer price index rose 1 per cent. (See Table 1.) At the wholesale level, where the recent upward movement has been less pronounced, the general index was up 0.2 per cent between June and September. Seasonal factors, however, helped to hold down the increase.

Prices began moving upward in Italy in the beginning of 1962. At that point, wholesale prices began to creep up after several years of stability. Simultaneously, the uptrend of consumer prices--previously moderate--became more pronounced.

In September, the general consumer price index was 5.2 per cent above a year earlier. The rise in consumer prices has been widespread among the various commodities and services: increases in this twelve-month period were 5 per cent for foods, 6-1/2 per cent for non-food commodities, and 4 per cent for services. The general wholesale price index recorded a 3.8 per cent increase in the year ended last September. Prices of most non-agricultural goods rose, but for this group as a whole the rise was only 2 per cent. For agricultural commodities, the increase was 10 per cent, with the foodstuffs component rising even more.

Although internal prices, including wholesale prices, have been rising since the end of 1961, the same has apparently not been true of export prices. The average value index for exports in July-August was at virtually the same level as at the beginning of 1962, and was slightly below the level for July-August 1961. (See Table 1.)

#### Four new measures of financial reform

In October and November, the Italian monetary and fiscal authorities took several measures in the financial field. The Research Department of the Banca Nazionale del Lavoro, in its monthly letter for November, observed that "As a whole these measures constitute the most important innovation in the monetary field since the great stabilization operation carried out in 1948 to arrest inflation." There were four main financial measures introduced:

a. Commercial banks permitted greater access to foreign borrowing --

The first of these financial measures, announced in mid-October and effective on November 1, had as its objective the augmentation of the lira assets of the commercial banks. To this end, the requirement imposed on the banks in January 1961 was suspended under which foreign exchange acquired by Italian banks from non-residents (mainly in the form of Euro-dollar deposits) had to be placed abroad (largely as Euro-dollar deposits with foreign banks). Under this regulation, Italian banks could not borrow funds abroad to make foreign-currency loans to domestic customers; for the latter purpose, the banks usually completed swaps with the (official) Italian Exchange Office, buying spot dollars for lire and selling forward dollars. To obtain foreign currency by this means meant that the banks had to give up lire. This restriction had the dual objectives of reducing credit availabilities within Italy and of retarding the growth in official Italian holdings of dollars. At the end of September (1962), outstanding swaps aggregated \$939 million, constituting a substantial volume of the resources of the commercial banks to be employed in foreign-currency assets rather than in Italian securities or other lira assets.

Suspension of the regulation requiring them to balance their foreign exchange transactions with foreigners has enabled the banks to increase their borrowing abroad, use such resources to finance foreign exchange loans to Italian customers, and thereby allow some of their swaps with the Italian Exchange Office to run off. In turn, the decline in these swaps provides lira resources to the Italian banking system for other uses.

b. Reduction in reserve requirements -- Italian banks have been required to keep at least 22.5 per cent of their deposit liabilities either



in Treasury bills or in cash on deposit with the Bank of Italy.<sup>1/</sup> The "mix" between bills and cash had been left to the discretion of the banks which had to weigh a slightly higher return on bills against certain conveniences of holding cash. Last October, 29 per cent of the required reserve was held in cash; since 1958, all additions to the required reserves have gone into Treasury bills.

Effective November 1, the banks must keep about 44 per cent of their total required reserves in cash under a new regulation which provided that the cash portion of these reserves must be at least close to 10 per cent of deposit liabilities.<sup>2/</sup> This step will reduce the "automatic" employment of bank funds in Treasury bills, as has been the case in the recent past.

Two changes in the computation of required reserves, also introduced on November 1, have the effect of substantially reducing required reserves. On the one hand, interbank deposits are no longer to be included in computing required reserves; on the other, foreign-owned deposits in foreign currency, formerly exempt, are now to be included. Since interbank deposits aggregate about \$2.2 billion and non-resident foreign-currency deposits were \$1.0 billion last September, the change may have freed about 7 per cent of required reserves. The freed reserves could support a credit expansion roughly equivalent to 5 per cent of outstanding bank loans.

c. Adoption of auction system for Treasury bills -- On November 1, the Italian Treasury switched from a tap to an auction system

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<sup>1/</sup> The regulation, which is highly complicated in its technical details, is not stated in this form but this is thought to be the effective result for most banks.

<sup>2/</sup> Actually, the regulation provides for 10 per cent of the difference between deposit liabilities and net worth; the net worth for the banks is very small.

for marketing Treasury bills. Under the old system, bills were on tap in unlimited amount at a fixed rate of interest and purchases, mainly by commercial banks, have been substantially in excess of the Treasury's current cash needs. As a result, the Treasury's balance at the Bank of Italy climbed from \$233 million at the end of 1959 to more than \$1.0 billion at the end of October 1962.

Under the new arrangement, Treasury bills of 12 months maturity are to be auctioned periodically (usually monthly) to the banks in amounts based on the Treasury's needs. Except for the Treasury bills needed to satisfy their reserve requirement which will continue to be issued at a fixed yield (currently 3.5 per cent), the banks will be free to make their own bidding price for bills in the auction.

The first auction in November resulted in a yield of 3.3 per cent compared with the former fixed yield of 3.5 per cent.

d. Limitation on interbank deposit rates -- In mid-November it was announced that, beginning January 1, 1963, interest rates on interbank deposits cannot be higher than the current auction rate on Treasury bills for free investment.

In the past, small banks have kept substantial funds on deposit with large banks, which competed actively for such deposits and bid up rates above levels which the monetary authorities thought desirable.

The new financial measures: reform and a "shot in the arm"

These broad-gauged measures of financial reform have both the long-run objective of integrating Italian money rates more closely to those prevailing in foreign financial centers and the short-run objective of giving the domestic economy a "shot in the arm" through greater credit

availabilities. The effect of these measures is to augment the liquid resources of the Italian banks, to lower interest rates within Italy, to add support to the prices of securities and to add to credit availabilities for productive investment.

Since last spring, tendencies in Italian securities markets have been adverse and business trends have not been as favorable as they previously had been. Securities markets have been weak since early in 1962. Prices of government bonds declined from a peak of 128.9 (1953=100) in April to 116.0 by September and stock prices continued to fall after the sell-off of last May-June: the stock index fell from 415.4 (1953=100) in March to 355.6 in September. (See Table 3.)

TABLE 3. Italy: Security Price Indexes and Yields, 1962

(Monthly average; for price indexes, 1953 = 100)

	<u>Gov't bonds</u>		<u>Other bonds <sup>a/</sup></u>		<u>Stocks <sup>b/</sup></u>	
	<u>Price</u>	<u>Yield</u>	<u>Price</u>	<u>Yield</u>	<u>Price</u>	<u>Yield</u>
January	127.0	4.85	128.3	5.44	411.6	2.82
February	127.8	4.82	126.2	5.33	407.6	2.82
March	128.1	4.81	124.9	5.59	415.4	2.84
April	128.9	4.78	124.4	5.61	399.5	2.99
May	125.5	4.91	122.0	5.72	403.0	3.05
June	113.7	5.42	118.9	5.87	374.6	3.32
July	115.8	5.32	120.1	5.79	368.9	3.44
August	117.8	5.23	119.1	5.86	370.4	3.42
September	116.0	5.31	116.5	5.99	355.6	3.57

<sup>a/</sup> Government agencies and industrials.

<sup>b/</sup> All stocks traded on Milan Exchange.

Source: Bank of Italy.

Investor fears about the political and economic orientation of the present center-left government have been an important cause of weakness in Italian security markets since mid-1962. Measures taken by the government to nationalize the electric power industry, to impose a withholding tax on dividend income, and to explore steps to widen the

scope of government planning of the economy, help to account for the feeling of uncertainty pervading financial markets.

At the same time, business investment expenditure in Italy has apparently lost much of its former buoyancy. In addition, business firms have been finding that they no longer have as ample internal resources to finance spending on plant and equipment and have come to depend more heavily on the banks for funds.

The Italian authorities hope that the easing of credit availabilities within Italy, through lower required reserves and Treasury cash balances and through heavier borrowing abroad, will achieve the dual objectives of adding support to uncertain financial markets and of facilitating bank financing of business investment projects.

The reform in Treasury bill marketing is designed to bring more flexibility in Italian bill rates and to give the monetary authorities an additional means to influence bank liquidity and interest rates, consistent with the Treasury's needs. At the moment, the desire is to increase liquidity and lower interest rates. Over the longer run, the authorities hope to be able to integrate Italian markets more closely with financial markets abroad.

#### Payments surplus continues well below 1961 levels

Italy's balance of payments in the third quarter of 1962 (latest data available) was again much less strong than a year earlier. The capital account once more registered a deficit, in contrast with large surpluses in 1961. Although receipts from tourism and emigrant remittances continued to run substantially higher than a year before, the trade deficit was larger. Allowing for seasonal influences, the trade deficit widened sharply in the third quarter.

For the first nine months of 1962, the over-all surplus was \$216 million, compared with \$455 million in January-September 1961. (See Table 4.) The third quarter -- which is seasonally very strong -- yielded a surplus of \$390 million, or \$55 million less than in the third quarter of 1961. In the first half of 1962 there was a deficit of \$119 million, as against a surplus of \$65 million the year before, marking a deterioration of \$184 million between those two periods. Thus, the third quarter results were less unfavorable, relative to a year previous, than had been the results for January to June, due primarily to some improvement in two capital account items -- repatriation of Italian banknotes, and foreign investment in Italy.

TABLE 4. Italy: Balance of Payments, 1961-62  
(In millions of dollars)

	First Half		Third Quarter		Jan.-Sept.	
	1961	1962	1961	1962	1961	1962
<u>Trade (payments basis):</u>						
Imports c.i.f.	-2472	-2825	-1181	-1398	-3653	-4223
Exports	1830	2186	1003	1149	2833	3335
<u>Trade balance</u>	- 642	- 638	- 178	- 250	- 820	- 888
<u>Foreign travel</u>	237	263	275	311	512	574
<u>Emigrant remittances</u>	165	209	126	158	291	367
<u>Other services</u>	197	151	105	108	302	259
<u>Total current account</u>	- 44	- 16	329	328	285	312
<u>Private capital</u>						
<u>Italian capital:</u>						
Loans	- 4	- 41	- 26	- 42	- 30	- 83
Investments <u>a/</u>	- 42	- 55	- 13	- 87	- 55	- 142
<u>Foreign capital:</u>						
Loans	60	- 12	8	8	68	- 4
Investments <u>a/</u>	293	403	117	212	410	615
Repatriation of Italian banknotes	- 200	- 454	- 43	- 105	- 243	- 559
<u>Other</u>	- 1	11	- 3	2	- 4	13
<u>Official capital</u>	24	6	- 2	3	22	9
<u>Total capital account</u>	131	- 143	37	- 8	168	- 151
<u>Unclassified items</u>	- 21	40	23	16	2	56
<u>Surplus or deficit</u>	65	- 119	390	335	455	216
<u>Monetary movements <u>b/</u></u>	- 65	119	- 390	- 335	- 455	- 216
<u>Exchange office:</u>						
Official reserves	- 28	180	- 262	- 13	- 290	167
Investments	- 12	- 116	- 2	- 250	- 14	- 366
Other	28	- 8	- 3	- 6	25	- 9
<u>Commercial banks</u>	7	- 27	- 17	- 45	- 10	- 72
<u>Bank of Italy <u>c/</u></u>	- 53	90	- 113	- 25	- 166	65

a/ All capital movements except loans.

b/ Change in net foreign assets (-=increase).

c/ Includes change in IMF position. Not part of official reserves.

Source: Istituto Nazionale per il Commercio Estero, Movimento Valutario.

As was reported in the earlier memorandum on Italy, the main reason for the change in Italy's external position has been a big increase in private capital outflow, much of it in the form of clandestine export of Italian banknotes. Recorded Italian loans and investments abroad in the third quarter showed an even greater increase than they had in the first half, and the nine-month figures were \$225 million in 1962 compared with \$85 million in 1961. Repatriation of Italian banknotes exported abroad continued in large volume in the third quarter, although the increase over a year earlier was relatively less than in the first half. Again taking the first nine months, the figures for note repatriation are \$559 million in 1962 and \$243 million in 1961.

Since it is believed that a good part of this capital export via banknotes eventually returns to Italy as (bogus) foreign investment in Italian securities, it is difficult to know how much of the rise in recorded foreign investment in Italy between 1961 and 1962 -- from \$410 million to \$615 million in the two nine-month periods -- was genuine. It may be noted, however, that the rise in foreign investment (all foreign capital flow other than loans) was \$111 million less than the increase in banknote repatriation. This indicates that either (1) genuine foreign investment declined, or (2) in 1962 a larger part of the clandestine capital export failed to return to Italy than in 1961.

The balance of payments has also been effected by a widening trade deficit since the end of 1961. The trade deficit widened with particular abruptness in the third quarter of 1962, when the deficit on actual trade shipments was \$342 million compared with \$192 million in the same period of 1961. Favorable leads and lags in trade payments held

down the third-quarter-1962 deficit on a payments basis to the \$250 million shown in the balance of payments in Table 4.

The markedly less favorable trade performance in 1962 is better brought out by the seasonally-adjusted figures in Table 5. Exports, which had risen with remarkable rapidity in 1961, increased less than 2 per cent from the last quarter of 1961 to the third quarter of 1962, and were lower in the third quarter than in the second. Imports, on the other hand, accelerated in 1962. In the third quarter they were up 16 per cent over the last quarter of 1961, and were up especially sharply over the second quarter.

TABLE 5. Italy: Seasonally-Adjusted Foreign Trade, 1961-62

(in millions of dollars; monthly average or month)

	<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
<u>1961</u>			
Quarter I	430	327	-103
II	432	341	- 91
III	443	362	- 81
IV	453	384	- 69
<u>1962</u>			
<u>By quarter:</u>			
Quarter I	479	381	- 98
II	481	397	- 84
III	525	391	-134
<u>By month:</u>			
June	483	408	- 75
July	555	398	-157
August	506	368	-138
September	515	408	-107

Source: OECD.

Official reserves did not reflect 1962 payments surplus

Changes in Italy's official reserves (gold together with the foreign exchange held by the Italian Exchange Office) no longer mirror by



themselves the state of Italy's balance of payments. Whereas the balance of payments was in surplus by \$216 million in January-September 1962, official reserves declined \$167 million, as shown in Table 4. Official reserves were reduced by a \$179 million debt prepayment to the United States, but did not reflect the other transactions.

Most of the payments surplus was to be found in the "net foreign investments" of the Italian Exchange Office. The \$366 million rise in this item includes \$179 million of Italian debts to the United States that were taken over from the U. S. creditors when the debts were prepaid. Other investments thus increased by \$187 million. Included among these other investments are the notes representing loans of lire to the U. S. Treasury in the amount of \$150 million in the first nine months of 1962. A \$72 million increase in the net foreign assets of the commercial banks was nearly offset by a decrease in the net foreign assets of the Bank of Italy. The latter, which are relatively small, are not part of the official reserves, and reflect changes in Italy's IMF position.

Partial data indicate that in October Italy's balance of payments was in surplus. In October, official reserves rose \$30 million and the other net foreign assets of the Italian Exchange Office and the Bank of Italy rose \$12 million. At the end of October, official reserves amounted to \$3,282 million.

Lira weakens slightly but remains near upper limit

From the first week of October through December 24, the rate for the lira fluctuated around the level of .16105 U. S. cents, and was thus generally slightly below the rate of .16110 U. S. cents which was

maintained steadily during the months July-September. However, the October-December quotations were still near the upper limit of .16120 U. S. cents, and were more than 0.6 per cent above the lira parity of .16000 U. S. cents.

### Public Debt in Foreign Currencies

#### I. Dollar Obligations

A. Italy owed \$268 million to the IBRD on November 30, 1962 and \$4 million to the Eximbank on October 31, 1962.

B. Debts to the U. S. Government other than the Eximbank are currently about \$37 million. These debts were \$219 million on June 30, 1962, but in July \$179 million were prepaid.

C. Dollar bonds outstanding on April 30, 1961 totalled \$137 million.

D. In June 1959 a \$25 million 6-year loan was placed with three New York banks.

#### II. Non-Dollar Obligations

A. At the end of 1960, Italy owed \$46 million equivalent to the Swiss Government on a long-term Swiss-franc loan for that amount raised in 1955.

B. Other known non-dollar obligations are small and consist partly of bonds denominated in Swiss francs and sterling.

#### III. Other Obligations

At the end of 1961, Italy had outstanding loans of \$86 million equivalent from the European Investment Bank and \$42 million equivalent from the European Coal and Steel Community. The currency composition of these debts is not known, but they must be repaid in currencies which at present are all externally convertible.