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Recent Economic Developments in Italy,
July-December 1963 — 15 pages

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Summary

The new coalition government formed in December with Socialist support has formally outlined its economic objectives: financial stability, together with reforms and national planning. These declarations, and the brighter prospects for stable government, raise hopes for concerted action to combat inflation and improve the balance of payments. The monetary authorities have been restricting credit expansion since last summer, but Italy's external position has deteriorated further in recent months.1/

The Socialist Party, despite its own internal dissensions, agreed in late November to participate actively in a four-party government under Christian Democrat Aldo Moro.2/ No other grouping of forces can obtain a majority in the present Parliament. The Socialists, who since 1956 have increasingly disassociated themselves from their former Communist allies, are in the government for the first time since 1947. Their actions in the past have had an unsettling influence on the economy. As their price for passive support of the Fanfani government in 1962-63, they demanded and won the nationalization of the electric power industry and the withholding tax on dividends. These measures, together with the general political uncertainty this year, are held responsible for the large clandestine capital flight (via export of Italian banknotes).

1/ For a review of previous developments, see Recent Economic Developments in Italy, April-September 1963, dated September 25, 1963.

2/ The new Cabinet was sworn in December 6. Besides the Christian Democrats and Socialists it includes two small left-of-center parties, the Social Democrats and the Republicans. The new government received its final vote of confidence in Parliament on December 21.

However, the economic program to which they have now agreed is reassuring from several standpoints. In the first place, no further nationalization is contemplated, and private enterprise has been assured that despite national planning it will not be subject to more than "normal" risks. Second, the Socialists have agreed that wage rates should not outpace productivity, and that government spending should not be inflationary. Finally, while many reforms are envisaged, the long-range goals do not appear unduly radical. The conservative press, while harboring reservations on some aspects, has approved the program as a whole.

Almost the only anti-inflationary action up till now has been in the monetary field, where the Bank of Italy could operate with considerable autonomy. Since the summer the Bank has restricted its lending to the commercial banks, and in September it effectively enjoined the banks from further net foreign borrowing, so that the external deficit became deflationary. The caretaker government of Mr. Leone took some limited measures in the autumn, including a reduction in the planned budget deficit for the current fiscal year.

The $113 million balance of payments deficit in the third quarter indicates a further worsening, after allowance for seasonal factors. In October, seasonal factors increased the deficit, and with the banks no longer increasing their net foreign indebtedness heavy drawdowns of officials reserves set in.

Internally, prices continued to rise in the third quarter. But a favorable development was a slowing--for the second successive quarter--of the advance of wage rates. A moderation in the rate of rise of overall demand during the summer is indicated.

New government's economic program is announced

In late November the four parties of the new government agreed on a comprehensive economic program which includes action to stop inflation and improve the balance of payments. It also commits Italy to adoption next year of long-range national economic planning, pending which various interim measures will be proposed to help achieve long-run goals. Although the program is couched in general terms, the inclusion--for the first time since 1947--of Socialist members in the Italian Cabinet suggests that the reform features of the program should be regarded seriously.

A. Stabilization program. To reduce inflationary pressures, the government will:

(1) Apply a temporary "freeze" on government expenditures and reassess the priorities of public investment outlays. (The meaning of this "freeze" has yet to be spelled out.);

(2) Strive to keep wage rates from rising faster than productivity;

(3) Restrict consumption of "nonessential" goods, especially through taxation;

(4) Reduce tax evasion and tax exemptions;

(5) Stimulate investment in areas where quick returns can be realized and where demand pressures are greatest, e.g., milk, meat, fats, and sugar.

(6) Encourage food imports; and

(7) Place curbs on nonearned and nonlabor incomes, particularly from real estate.

B. Long-run objectives. The long-run goals of the program are (1) the reduction of income disparities between Northern and Southern Italy and between agrarian and other incomes; (2) more public aid for housing and urban development;

(3) modernization of the social security system and of hospital and health facilities; and (4) improvement of the educational system and of scientific, professional, and cultural training. These objectives are to be reached under a series of five-year national plans, the first of which will be drafted in 1964. The long-range program reaffirms the need for monetary stability, for containment of wage increases within productivity limits, and avoidance of substitution of money creation for "real" savings, while maintaining labor's freedom of action. No further nationalization is contemplated, and private enterprise will not be subjected to more than normal risks.

C. Interim measures. Between now and the time when the first five-year plan is ready, the new government will lay down lines of action on certain priority issues. The principal measures proposed are:

(1) Urban redevelopment plans, providing for possible expropriation of land, and the curbing of real estate speculation;

(2) Tax reforms to simplify the tax system, to improve collections, and to replace the turnover tax with a value-added tax;

(3) An anti-monopoly law;

(4) Reform of company laws to provide more adequate financial reporting to shareholders and the public;

(5) Elimination of sharecropping by gradual means; and

(6) Tax relief and social assistance for farmers.

Monetary policy is tightened

In the third quarter the Bank of Italy adopted a general policy of keeping monetary expansion within the limits of the rise in real output, resulting in a distinct slowing of the increase in the money supply. This policy was continued in October-December, with allowance for seasonally higher needs for liquid funds.

The Bank employed two instruments of control to implement this line of action:

1. First, it reduced its accommodation to the commercial banks by 84 billion lire in the third quarter, compared with a reduction of only 11 billion lire in the same period of 1962, despite the banking system's increased need for such funds. (See Table 1.) This accommodation, which takes the form of rediscounts, advances, and deposits with banks of the Italian Exchange Office, is carefully controlled by the authorities at all times and is the main tool for influencing credit expansion over short periods of time.

2. Second, in early September the Bank requested the commercial banks not to increase their net foreign borrowings beyond the level of the end of August, and this request was complied with. The banks' net foreign indebtedness had continued to soar by 142 million lire in July-August, but it fell 15 billion lire in September. This change in policy caused Italian external transactions to exert a strong deflationary effect from September on. Official reserves and other official net foreign assets dropped 46 billion lire in September in order to cover the balance of payments deficit and the decline in the banks' foreign indebtedness.

These actions helped to hold down the third quarter rise in the money supply to 3.5 per cent, or 20 per cent less than the 4.3 per cent rise in July-September 1962. (See Table 1.) Bank credit to the economy increased 4.3 per cent,

Table 1. Italy: Selected Monetary Statistics, 1962-63
(In billions of lire; end of month)

	1962			1963		
	June	Sept.	Change	June	Sept.	Change
BANK OF ITALY CREDIT TO COMMERCIAL BANKS	607	596	- 11	938	854	- 84
COMMERCIAL BANKS' NET FOREIGN BORROWING	92	64	- 28	713	840	+127
MONEY SUPPLY	8,906	9,287	+381	10,496	10,862	+366
COUNTERPARTS OF MONEY SUPPLY						
A. Credit to economy						
1. Commercial banks	9,482	9,952	+470	11,851	12,374	+523
2. Bank of Italy	239	247	+ 8	298	295	- 3
B. Credit to Treasury						
1. Commercial banks	2,522	2,553	+ 31	2,430	2,457	+ 27
2. Bank of Italy	858	853	- 5	939	879	- 60
C. Official net foreign assets	2,509	2,685	+176	2,802	2,864	+ 62
D. Savings deposits 1/	-6,719	-6,992	-273	-7,821	-8,030	-209
E. Treasury balance with Bank of Italy 1/	- 540	- 461	+ 79	- 135	47	-182
F. All other (net)	555	450	-105	132	- 24	-156

1/ Because these are offsets, minus sign = positive balance.
Source: Data assembled from Bank of Italy *Bolletino* and *Supplemento al Bollettino*.

down from 4.9 per cent in a year earlier. Official net foreign assets rose only 62 billion lire compared with 176 billion lire a year before;1/ this contrast reflected both the shift in the balance of payments from surplus to deficit, and the September directive to the banks. On the other hand, two developments in particular tended to increase the rate of money supply expansion relative to 1962. These were a smaller increase in savings deposits, and a greater drawdown of Treasury cash balances.

Additional economic measures taken in September-October.

On September 25 and October 1 the Italian Cabinet announced a number of economic measures designed either to reduce inflationary pressures or to spur production. However, because of its caretaker status, the government in office at that time felt itself unable to adopt a strong anti-inflationary program.

The anti-inflationary moves were in the fiscal field, and the major provision was a reduction in the forecast budget deficit for the fiscal year ending June 30, 1964. Budget receipts in July-September ran 80 billion lire above initial estimates, and the excess was applied to reduce the deficit from 502 to 422 billion lire. This compares with an administrative deficit in the previous year that was 389 billion lire in the initial budget presentation but which in the course of the year increased sharply to a figure that was probably in excess of 650 billion lire. Whether this year's deficit will be similarly inflated by supplementary expenditures is impossible to predict. However, in recent pronouncements, both Governor Carli of the Bank of Italy and Premier Aldo Moro have warned against continuation of the upward trend of budget deficits in the past two years.

1/ These assets rose 108 billion lire in July-August, because the increase in the bank's net foreign borrowings exceeded the over-all payments deficit.

A second fiscal step was an increase in turnover taxes on a number of "luxury" products to discourage their consumption, an action believed to have been taken mainly for psychological purposes. To increase its revenue the government also made proposals to speed up tax litigations.

To encourage production in general, it was decided to grant special accelerated depreciation allowances on investment in new plant and equipment, and regular depreciation coefficients were revised in favor of industry. Also, numerous regulations and programs were promulgated to increase low-cost housing construction and output of several agricultural products, two areas where inflationary pressures have been strongest.

External position weakens further; heavy reserve losses begin

Italy's balance of payments difficulties became more acute in the third quarter, if allowance is made for seasonal influences. Foreign borrowing by Italian commercial banks more than covered the deficit in July-August, but with the halt in such (net) borrowings in September Italy's official foreign assets registered the full brunt of the imbalance. The loss of reserves was heavily accentuated in October.

The deficit of $113 million in the third quarter was smaller than the $412 million in the second quarter because of the seasonal rise in tourism in Italy and favorable seasonal factors on trade account. But the deficit deteriorated by $448 million from the third quarter of 1962 (when a surplus of $335 million was recorded), compared with a year-to-year worsening of $387 million in the second quarter.

The trade position once again worsened rapidly, although seasonal factors caused some improvement in the actual figures. The deficit on trade payments of

Table 2. Italy: Balance of Payments, 1962 - 63
(in millions of dollars)

	1962	1963	
	III	II	III
A. CURRENT ACCOUNT	+328	-275	- 82
Trade deficit (payments basis, imports, c.i.f.) 1/	-249	-644	-623
Invisibles	+577	+368	+541
B. CAPITAL ACCOUNT	+ 9	-136	- 30
Italian banknotes returned for credit by foreign banks	-105	-473	-169 2/
All other transaction (net)	+114	+337	+139 2/
C. UNCLASSIFIED TRANSACTIONS	+ 16	--	--
D. OVER-ALL BALANCE (A+B+C)	+335	-412	-113
E. MONETARY MOVEMENTS	-335	412	113
Official reserves	- 13	8	-115
Other official net foreign assets	-277	22	24
Commercial banks' net foreign position	- 45	383	202

1/ Excluding freight and insurance paid to residents
2/ Estimated.
Sources: I.N.C.E., Movimento Valutario; Bank of Italy, Supplemento al Bollettino; U.S. Embassy, Rome.

$623 million was $21 million less than in the second quarter. (See Table 2.) (Import and export figures are not yet available.) However, the seasonally adjusted shipments through customs showed a rise in the deficit from $604 million in April-June to $771 million in July-September, an increase of $165 million in the space of three months. (See Table 3.) Imports (seasonally adjusted) continued to soar, rising 9.6 per cent from the second to the third quarter, to a level 31 per cent above a year ago. In the main this rise reflects increased demand for consumer goods imports caused by the excessive expansion of money incomes, although generally poor crops for two successive years have also added to over-all import demand. Adjusted exports were up 1.2 per cent in the third quarter, when they exceeded the year-ago rate by 9.7 per cent.

The position on current invisibles has also been slipping continuously in the past year, and net receipts of $541 million in the third quarter were $36 million less than a year earlier. Although gross receipts from tourism were up 11 per cent from July-September 1962, other items weakened, including expenditures by Italians on foreign travel (up nearly 50 per cent).

While the capital account deficit shrank from $136 million in the second quarter to only $30 million in the third quarter, here again seasonal factors were highly important. As the number of tourists to Italy increases in the summer months, much more of the exported Italian banknotes are bought up abroad to cover travel expenses. This is one reason why the amount of banknotes remitted for credit by foreign banks (mostly Swiss) fell from $467 million to an estimated $169 million. To what extent the initial outflow of notes may itself have slackened is not known. If the remittances of banknotes are deducted from the total net capital flow, the net inflow on all the remaining items (the only other available figure) drops from

Table 3. Italy: Foreign Trade, 1962-63
(In millions of dollars)

	Imports c.i.f.	Exports	Balance
Unadjusted			
1962 - Quarter I	1,452	1,128	-324
II	1,470	1,152	-318
III	1,517	1,166	-351
IV	1,680	1,258	-422
1963 - Quarter I	1,707	1,188	-519
II	1,908	1,249	-659
III	1,949	1,289	-660
Seasonally-adjusted			
1962 - Quarter I	1,425	1,149	-216
II	1,458	1,185	-135
III	1,578	1,176	-402
IV	1,678	1,208	-461
1963 - Quarter I	1,673	1,220	-454
II	1,881	1,275	-604
III	2,061	1,290	-771
April	625	404	-220
May	636	444	-191
June	620	427	-193
July	639	414	-225
August	688	426	-262
September	734	450	-284

Source: OECD

$331 million to $139 million. But this change cannot be interpreted for many reasons, including absence of knowledge of (1) the true dimensions of the gross banknote outflow; and (2) the proportion of such funds that is reimported through the intermediary of the foreign banks. The latter is believed to be high, but is of course subject to quarterly variation.

In the coverage of the deficit, Italian commercial banks increased their net foreign borrowing $227 million in July-August. Since this greatly exceeded the over-all deficit, official reserves and other official net foreign assets rose $175 million. With the subsequent abrupt halt (in fact, slight contraction) of the banks' recourse to foreign funds, official holdings dropped $74 million in September, of which $54 million was in gross gold and foreign exchange reserves.

Official reserves fell $180 million in October and other official net foreign assets declined $86 million. This reflected a pick-up in the rate of deficit (mostly seasonal) and continued absence of further net foreign borrowing by the banks.

Exchange rate is maintained

Following its sharp decline in September,[1] the lira has not been allowed to depreciate further on the exchange markets and has been kept well above parity with the dollar. The lira has been maintained by the authorities since the last week of September at about 0.1607 U. S. cents per lira, which is 0.4 per cent above the parity rate.

Price rise continues

Consumer prices continued their rise over the summer. The increase from June to September was 1 per cent, despite favorable seasonal influences on food prices. Wholesale prices dipped in July, but rose in September to 1/2 of 1 per cent above the June level. In both instances the quarterly increases were greater than in the April-June quarter. (See Table 4.).

Wage rise moderates

A recent favorable development on the Italian scene has been a slowing in the rate of rise of wage rates. In manufacturing, rates rose 1.7 per cent from June to September, and for the third quarter averaged 2.3 per cent above the second quarter. This quarter-to-quarter increase compares with increases of 4.1 per cent in the second quarter and 5.0 per cent in the first. The third quarter rise was also the smallest, save one, of any of the quarterly increases since the final three months of 1961, when the recent big "wage push" first began. While the reasons for this slowing are not clear, the movements of the industrial production index and of unemployment since last spring suggest a decline, or at least a moderation in the rate of rise, in the demand for labor.

1/ See Recent Economic Developments in Italy, April-September 1963, dated September 25, 1963.

Table 4. Italy: Selected Economic Indicators, 1962-63
(1953=100)

		Consumer prices	Wholesale prices	Hourly wages (manufacturing)	Seas. adj. industrial production
1962 - Quarter	I	120.8	100.7	147	219
	II	122.6	101.8	150	219
	III	123.9	101.9	157	219
	IV	125.9	103.7	161	229
1963 - Quarter	I	130.1	106.0	169	232
	II	131.9	106.7	176	243
	III	132.5	107.0	180	n.a.
April		131.8	106.4	172	244
May		131.8	106.6	178	244
June		132.0	107.0	178	243
July		131.9	106.5	178	238
August		132.4	106.8	181	226
September		133.3	107.8	181	n.a.

Source: OECD

Industrial production declines sharply

The seasonally-adjusted level of industrial production dipped fractionally in June, fell 2 per cent in July, and sank 5 per cent in August (latest data available). Earlier, output had failed to gain in May, so that August production was 7.4 per cent below April. From April to July, production of investment goods declined 3 per cent and consumer goods production fell nearly 4 per cent. Details for August are not yet available.

This downward movement in statistics of industrial production conflicts somewhat with qualitative reports on economic activity in this period. The Institute for Business Cycle Studies, Italy's leading economic research institute, has reported that throughout the spring and summer over-all demand--especially consumer demand--continued to increase, though not quite so vigorously as earlier in the year. Moreover, the Institute's periodic surveys of business sentiment showed a pick-up in August in business leaders' optimism over the outlook for production increases in the next few months.