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Economic Developments in Italy: January-August 1965

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Summary

A further recovery of economic activity and a moderation of price and wage pressures were favorable developments in the Italian economy in the period under review.[1/] Monthly balance of payments surpluses increased during the year, partly for seasonal reasons, and totalled about $1.1 billion through August; the large size of this surplus chiefly reflects spectacular increases in Italian exports, together with lagging imports and heavier earnings on invisibles account. Easy monetary policies have allowed the money supply to increase, but bond yields have been nearly stable since January and stock prices have moved irregularly.

After months of lagging domestic recovery, industrial production (excluding construction) advanced to new record levels in May and June. Because of these gains and output increases in agriculture and services, seasonally-adjusted real GNP in the second quarter was estimated at 3.8 per cent above its recession low in July-September 1964. Sharply rising exports appear to have accounted for most of the increase in output since recovery began, but consumption is believed to have increased this year and the decline in outlays on equipment goods probably halted in the spring. Falling activity continued to characterize the construction industry: to aid this sector, the government in March reduced taxes and made provisions for new public spending programs. To help profit margins

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1/ For earlier developments, see Recent Economic Developments in Italy, October 1964 to February 1965, March 15, 1965.

and spur investment by industry, a shift in social security charges from employers to the State budget estimated to be equal to about 1-1/2 per cent of total labor costs was made in March; this followed a similar shift in August 1964.

A 2.1 per cent rise in consumer prices from December to July was substantially less than the 3.5 per cent increase in the same period last year, and wholesale prices were nearly stable. The first clear indication of a slowing of wage rate increases emerged in 1965: in the six months from November to May, contractual wage rates in industry rose only 2.5 per cent, compared with a 17.3 per cent rise in the 12 months up to last November. This change is to be interpreted as favorable to the prospects for further recovery. At the annual Bank of Italy stockholders' meeting last May, Governor Carli stressed that wage increases far in excess of productivity gains had greatly impaired the incentive and capacity of business to invest, and were the major cause of the recession.

The external surplus of around $1.1 billion in the first eight months included about $600 million of foreign exchange accruals in July-August, when tourist receipts and remittances from Italian workers abroad reached a seasonal peak. The surpluses this year have reflected abnormally low trade deficits. Italian exports in April-May were 36 per cent more than in the last quarter of 1963, partly because of the unexpected growth in German purchases. Imports in April-May had recovered 12 per cent from last summer's low, but were still 11 per cent below their pre-recession peak, in large degree because of depressed imports of equipment goods.

The money supply rose seven per cent in the first half of this year, and in June was up nearly 13 per cent from a year earlier. The authorities have allowed the external surpluses to serve as a base for an expansion of bank assets that has taken the form largely of additions to bond portfolios. Loans have increased very little, and the banks have further reduced their net borrowings from both the Bank of Italy and foreign creditors.

Industrial production surpasses earlier peaks

During the first half of 1965, continued recovery from last year's recession brought Italian industrial production (excluding construction) to new record levels in May and June. The upturn, which began in September 1964, seemed to lose momentum in the period January-April when the output gain was very small; but production jumped sharply in May, and is believed to have advanced further in June. (See Table 1.) In May, the seasonally-adjusted index virtually equalled the previous high set in January 1964; a new production series developed by ISCO (the Institute for Business Cycle Studies), which further adjusts the index for accidental factors, places May output 0.8 per cent in excess of the earlier peak established in October 1963. As measured from the recession low in August 1964, the gain in production over the nine months through May was 7.3 per cent, or at a rate of 0.8 per cent per month, after adjustment for accidental factors.

Table 1. Italy: Selected Economic Indicators, 1963-65

	Industrial Production (seasonally adjusted) (1953=100)	Building Construction 1/ (million cubic meters) 2/ (1) Permits issued	(2) Completions	(3) (1) + (2)
Quarters				
1963-I	231.1	48.4	24.4	72.8
II	240.5	53.4	24.2	77.6
III	245.0	48.4	23.4	71.8
IV	248.3	48.9	33.5	82.4
1964-I	248.5	43.2	25.9	69.1
II	242.0	40.4	27.5	67.9
III	236.4	33.1	29.2	62.3
IV	241.1	40.5	31.5	72.0
1965-I	242.9	24.6	28.9	53.5
Months-1965				
January	241.9	7.6	9.4	17.0
February	246.3	7.5	8.7	16.2
March	241.2	9.6	10.9	20.5
April	243.9	n.a.	n.a.	n.a.
May	251.5	n.a.	n.a.	n.a.
June	3/	n.a.	n.a.	n.a.

1/ Residential and non-residential buildings in county seats and in towns of over 20,000 population.
2/ This series presumably gives an approximate indication of quarterly changes in building construction activity. However, nothing is known about time lags between issue of permits and actual starts.
3/ Production is believed to have increased in June.
Sources: ISCO (Istituto Nazionale per lo Studio della Congiuntura) and Istituto Centrale di Statistica.

In its latest semi-annual report to the government last July, ISCO estimated that the seasonally-adjusted quarterly rate of gain in Italy's real GNP dropped from 1.4 per cent in the last quarter of 1964 to 0.5 per cent in this year's initial quarter, but then rose to 1.7 per cent in the April-June period. Increases in agricultural production and in output of services, like those in industrial production (excluding construction), slowed in the first quarter but picked up in the second. (See Table 2.) The pace of recovery was held back by further declines in construction activity.

Table 2. Italy: Gross National Product at Factor Cost, 1963-65
(quarterly percentage changes, seasonally-adjusted)

	1963	1964				1965	
	IV	I	II	III	IV	I1/	II2/
At constant prices							
Agriculture	+0.4	+1.5	+1.3	+0.5	+0.4	+0.5	+1.0
Industry, excluding construction	+1.5	+0.7	-2.2	-2.0	+2.1	+0.8	+2.6
Construction	+2.2	+1.5	+0.6	-0.6	-0.9	-1.2	-0.5
Services	+1.5	+0.7	-0.6	-0.2	+1.4	+0.6	+1.8
Total, private sector	+1.3	+0.8	-0.9	-0.8	+1.4	+0.6	+1.8
Total GNP	+1.3	+0.7	-0.6	-0.5	+1.4	+0.5	+1.7
At current prices							
Total GNP	+3.7	+2.5	+0.9	+1.0	+2.5	+1.0	+2.2
Implicit price change	+2.4	+1.8	+1.5	+1.5	+1.1	+0.5	+0.5

1/ Provisional
2/ Estimate
Source: ISCO, report submitted to the National Economic and Labor Council on the business situation in the first half of 1965.

Even so, real GNP in the second quarter was estimated at 3.8 per cent above its recession low in July-September, and at 2.6 per cent above the first quarter of 1964, the last period before over-all output turned downward.

Recovery is aided by exports and Treasury spending

During the recovery period, exports have been by far the most dynamic element in the economy, and the data suggest that exports alone have accounted for the better part of the total increase in output. The upward course of exports, already rapid in 1964, accelerated still further this year. Seasonally-adjusted exports rose 15 per cent from the third quarter of last year, when GNP was in its recession trough, to April-May of this year. This export gain by itself lifted GNP at current prices by almost 3 per cent, exports having equalled about 18 per cent of GNP in mid-1964. By comparison, the estimated total gain in GNP over about the same time period (III '64 to II '65) was 5.8 per cent at current prices and 3.8 per cent at constant prices.

A second factor adding to total demand has been increased State (i.e., national government) expenditures. The 1965 budget provided for substantial increases in outlays. Although it is impossible to quantify precisely the total amount of the State's effective cash expenditures this year, a significant rise in disbursements has occurred: in January-May, budget expenditures and the net extra-budgetary expenditures of the Treasury and the Cassa Depositi e Prestiti appear to have been between 15 and 20 per cent greater than in the same months of last year.

As regards other demand forces, total private consumption is thought to have increased slowly in the first half of the year, but two sectors were exceptions to the rule. There was a very strong revival of demand for automobiles: new car registrations began to pick up sharply last November, and seasonally-adjusted auto production rose 40 per cent from December (its cyclical low point) to April. Revival in the auto sector was aided by the abolition in November of the special tax levied on new car purchases in February 1964 as an anti-inflationary device. (However, the consumer credit controls instituted at that time have been maintained.) On the other hand, textile production, which slumped badly last year, continued to drop.

ISCO believes that internal demand for equipment goods softened further during the winter, but that the decline was arrested in the spring. Although the output of equipment goods rose 9 per cent from August 1964 (its recession low) to April, this gain resulted from increasing exports.

Government acts to aid construction industry

Activity in the construction industry decreased further in 1965, and the outlook for this sector is not bright because the severe drop in housing starts will have adverse repercussions over an extended period of time. (See Tables 1 and 2.) This prospect led the government to promulgate a decree law on March 15 affecting taxation and public spending in the construction field. The major tax provisions were: (1) a 25-year suspension of taxes on income from non-luxury residences completed in the years 1962-68; and (2) reductions in taxes on property transfers and consumption of building materials. The Credit Consortium for Public Works, a government lending agency, was authorized to issue 250 billion lire of long-term bonds and relend the proceeds to local authorities, housing institutes, and other institutions for various specified construction projects--agricultural improvements, schools, hospitals, housing, roads, and ports. However, it is not possible to foresee by how much the new law will raise the total lending of the Consortium: in 1964, it loaned a total of 345 billion lire for agricultural improvements, public works, housing, and coverage of local authority deficits, all financed by bond issues.

The March 15 law also made it easier for local authorities to obtain loans from the Cassa Depositi e Prestiti (in essence, an arm of the Treasury) to finance public works. In 1964, the Cassa's loans to local authorities came to 334 billion lire. Some sources report that the new law will enable the local authorities to initiate 400 billion lire of public works in 1965.

Price and wage indexes move more favorably

Moderation of price inflation and a marked slowing of wage rate increases constituted a major favorable development in the Italian economy in the first seven months of this year. Consumer prices advanced 2.1 per cent from December to July, compared with 3.5 per cent in the year-earlier period, and the year-to-year gain was reduced from 5.8 per cent in December to 4.4 per cent in July. (See Table 3.) Wholesale prices continued to exhibit the fairly high degree of stability they have shown since early in 1964; in May, they were 1.6 per cent above a year earlier and this rise was caused entirely by higher prices of agricultural products. Implicit price increases in the ISCO seasonally adjusted GNP series were 0.5 per cent in each of the two first quarters of 1965, compared with quarterly increases ranging from 1.1 to 1.8 per cent in 1964. (See Table 2.)

For the first time since the Italian "wage explosion" began in 1962, the upward trend of wage rates has shown a clear tendency to moderate. In the year ended last November, contractual wage rates in Italian industry rose 17.3 per cent, or at an average rate of about 4-1/4 per cent every three months. (See Table 4.) The rate of

Table 3. Italy: Price Indexes, 1963-65
(1953=100)

	Consumer prices	Wholesale prices: General index	Wholesale prices: Agricultural products	Wholesale prices: Non-agric. products
1963 - Dec.	136.2	110.2	122.1	107.0
1964 - Mar.	137.8	110.7	118.9	108.5
May	139.2	110.3	117.9	108.3
Dec.	144.1	112.2	123.0	109.3
1965 - Mar.	145.4	111.9	122.2	109.1
May	145.9	112.4	124.1	n.a.
July	147.1	111.9	n.a.	n.a.

Source: Istituto Centrale di Statistica

Table 4. Italy: Contractual Wage Rates in Industry, 1961-65
(percentage increases)

Period	Increase
November 1961 to November 1962	13.6
November 1962 to November 1963	15.3
November 1963 to November 1964	17.3
November 1964 to February 1965	1.7
February to May, 1965	0.8

Source: Istituto Centrale di Statistica

increase dropped to 1.7 per cent in the three months from November to February, and to 0.8 per cent in the period February-May. (The choice of these three-month periods is dictated by the fact that the sliding scale wage adjustments are made in February, May, August, and November.) The slowing of the rise seems attributable mainly to changed labor market conditions, affected by last year's declines in employment and working hours, and in much lesser degree to the effects, via the sliding scale, of the smaller increase in consumer prices. It has in turn helped to mitigate inflationary pressures and to slow down or reverse the previous erosion of profit margins.

State action reduces industrial labor costs

In a move to aid a recovery of profits and investment in industry, the government acted in March to reduce industrial labor costs. A provision of the March 15 decree law lowered employers' contributions to social security by an amount equal to 3 per cent of the wages on which the contributions are based, and transferred the relevant financing costs to the State budget. Because the wages on which social security contributions are based appear to equal between 50 and 55 per cent of total labor costs, this action appears to have had the effect of reducing such costs by around 1-1/2 per cent. In August of 1964, a reduction of similar proportions in industry's social security contributions was made, so that the State has now assumed about 3 per cent of industrial labor costs by "fiscalization" of part of the social security charges.

Contractual wage rates in industry rose 5-1/4 per cent from August 1964 to May 1965. Because of the shifting of social security charges, the rise in total labor costs paid by employers appears to have been about 2 per cent.

Balance of payments surpluses become very large

Italy's balance of payments surpluses have become extremely large this year, totalling nearly $800 million through July and probably around $1.1 billion through August.

The surpluses increased during the course of the year: $68 million in the first quarter, $443 million in the second quarter, $284 million in July alone, and, in all probability, something like $300 million in August. The growth during the year was in part seasonal, in reflection of rising tourist receipts and emigrant remittances.

But in addition, the trade deficit (payments basis) was smaller in the second quarter than in the first, and private capital flows shifted from a small outflow in January-March to a modest inflow in April-June. (See Table 5.)

Table 5. Italy: Balance of Payments, 1963-65
(In millions of dollars)

	1963		1964		1965	
	III	IV	I	II	I	II
I. Current Account	-76	-329	-427	53	114	403
A. Imports c.i.f.	1829	1967	1932	1727	1709	1713
B. Exports	1206	1249	1254	1331	1513	1609
C. Trade balance	-624	-720	-679	-396	-196	-103
D. Gross foreign travel receipts	395	183	128	236	151	299
E. Emigrant remittances	154	141	100	138	113	176
F. Other (net)	-1	67	24	75	46	31
II. Capital Account	-36	-124	-9	173	-46	40
A. Private capital	-17	-136	-5	207	-48	40
B. Public capital	-19	12	-4	-34	2	--
III. Surplus or Deficit	-113	-452	-436	227	68	443
IV. Monetary Movements	113	452	436	-227	-68	-443
A. Gold	-2	-52	200	-5	13	-291
B. Official foreign exchange	-110	462	35	-26	183	163
C. IMF and GAB positions	-15	-8	225	--	-33	-164
D. Other official net foreign assets	37	140	173	-49	-179	70
E. Commercial banks' net foreign position	203	-90	-197	-147	-52	-221

Considering the year (to date) as a whole, the exceptional size of the surplus is to be explained largely in terms of trade developments over the past two years. As regards exports, the Italian performance has been unexpectedly impressive. The rate of increase picked up last year and again this year; as a result, seasonally-adjusted exports (shipments basis) in April-May 1965 were 36 per cent more than in the last quarter of 1963. (See Table 6.) Foreign demand has of course risen, especially in Germany; but Italian exporters have also greatly increased their share of foreign markets. Total imports of the European OECD countries (except Italy) rose 15 per cent from IV '63 to April-May 1965 (unadjusted), but those countries' imports from Italy increased 39 per cent.

Table 6. Italy: Seasonally-Adjusted Foreign Trade, 1963-65
(In millions of dollars; monthly average or month)

	Imports c.i.f.	Exports	Balance
Quarters			
1963-III	683	431	-252
IV	663	433	-231
1964- I	679	456	-222
II	627	489	-138
III	536	512	-24
IV	560	512	-48
1965- I	571	568	-3
Months, 1965			
January	559	536	-23
February	583	574	-9
March	572	595	22
April	597	606	9
May	572	572	0

Source: OECD

On the import side, Italian imports continue to lag; they have been substantially below earlier levels, even though they have moved up since last summer. From their peak in the third quarter of 1963 to their recession low in the third quarter of 1964, seasonally-adjusted imports declined 22 per cent. By April-May of this year they had recovered by only 12 per cent. In the spring, all major commodity groups (except crude oil) were below late 1963 peaks, according to seasonally-adjusted ISCO calculations, but by far the most depressed group was equipment goods. In April, seasonally-adjusted imports of equipment goods, which comprised some 30 per cent of total imports last year, were 50 per cent under their high. All other import groups began to move up again after September or October, but imports of equipment goods continued to decline until March.

Also contributing to this year's surpluses have been sizeable year-to-year increases in receipts from tourism and emigrant remittances. The months January-June recorded $450 million of gross foreign travel earnings and $289 million of emigrant remittances, compared with $364 million and $237 million, respectively, in the same months last year.

Capital movements were practically in balance in the first half of 1965, a result which contrasted strongly with both a $442 million net inflow in the full year 1964 and a $355 million net outflow in 1963. In late June the Cassa per il Mezzogiorno (the government agency for developing Southern Italy) obtained a $100 million loan from the World Bank, but no drawings appear to have occurred to date. A significant event for Italian foreign borrowing and for international capital movements in general was the flotation in mid-July of a $60 million equivalent "parallel" bond loan by ENEL, the Italian mational electricity authority. ENEL issued bonds in local currency in France ($25 million equivalent), Germany ($25 million eauivalent), Belgium, Netherlands, and Luxembourg. The bonds reportedly have a maturity of 15 years, a 6 per cent coupon, and were sold at a price of 95; the effective yield to maturity, including cash lottery premiums, is reported to be 6.8 per cent.

The Italian surpluses in January-July were not used to increase official gold and foreign exchange reserves, which in fact were $9 million less at the end of July than at the end of December. However. the gold portion of official reserves rose $281 million, most of this increase coming in April. Other official net foreign assets were increased $418 million, principally reflecting a $396 million increase in Italy's combined IMF and GAB position. (See Table 7.) The United Kingdom drew $182.5 million equivalent of lire from the IMF in May, of which $85 million was obtained from Fund holdings, $65 million from borrowing under the GAB, and $32.5 million from a Fund gold sale to Italy. In July, the United States drew $180 million equivalent of lire from the IMF.

Table 7. Italy: Official Net Foreign Assets, 1964-65
(In millions of dollars; end of month)

	Gold	Foreign Exchange	IMF and GAB positions	Other (net)	Total
1964 - December	2,107	1,571	146	538	4,362
1965 - January	2,107	1,561	146	592	4,406
February	2,101	1,630	151	605	4,487
March	2,093	1,388	179	716	4,376
April	2,351	1,173	183	706	4,413
May	2,384	1,107	329	682	4,502
June	2,384	1,225	343	650	4,602
July	2,388	1,281	542	604	4,815

Sources: Bank of Italy and IMF.

The Italian banks' net foreign liabilities were further reduced each month this year, except for January, by a total of $338 million in the first seven months.

"Easy money" policy allows liquidity to expand

This year the Italian monetary authorities have continued the "easy money" policy adopted in the summer of 1964 to aid a recovery of economic activity. At the end of June, the money supply was 7.1 per cent more than the average level in November and January 1/, compared with a 2.8 per cent rise in the same period of 1964 when the authorities were actively restraining credit. The money supply increase in the 12 months through June was 12.6 per cent.

Monetary expansion has not necessitated any increase in Bank of Italy rediscounts, advances, and other credit in favor of the banking system. The banks have in fact contracted their net credit from the Bank of Italy (gross borrowings less free reserves), as well as their net foreign borrowings. The basis for monetary expansion has been the balance of payments surpluses: besides adding directly to the money supply, these have provided the banks with reserves for a secondary expansion. Apart from increases in required reserves (held partly in cash and partly in Treasury bills), bank asset expansion has taken the form largely of additions to bond portfolios. Net purchases of Treasury bonds, bonds issued by the various public medium- and long-term credit institutes, bonds of the nationalized enterprises, and corporate bonds raised the banks' total bond holdings by 17 per cent from December to June. By contrast, loans increased relatively little;

1/ Comparison with the figure for end-December is distorted by the end-of-year seasonal "bulge."

in June, outstanding loans were only 2-1/2 per cent above their average level in November and January (December showed a seasonal bulge), and 3.2 per cent more than a year earlier. It appears that a good part of the liquidity necessary to finance the recovery to date was built up last year: despite the sharp fall in output in the first eight months of 1964, there was virtually no contraction of bank loans.

Bond yields stabilize at reduced levels

Since the end of January, yields on outstanding bonds have not, as a whole, shown much variation. As compared with January, yields on Treasury bonds in July were up 10 basis points to 5.45 per cent. (See Table 8.) But a decrease of 3 basis points, to 6.73 per cent, occurred in the composite yield on other bonds which, in terms of the floating supply, have more than six times the importance of Treasury bonds.

These recent yields have been much lower than those reached last year at the height of the "credit squeeze." Italian bond yields began to rise sharply when the Bank of Italy tightened credit in the summer of 1963. From 5.98 per cent in June 1963, yields on non-Treasury bonds rose to a peak of 7.62 per cent in June 1964. In spite of the subsequent decline, however, bond yields in July were still considerably above their levels of two years earlier.

Stock prices move irregularly

Italian stock prices showed a small net gain of 3 per cent from December to July. The period was marked by a sharp rise in March, after the cut in business enterprises' social security contributions and the announcement of the measures to aid the construction industry, but nearly all of this gain was subsequently lost.

Table 8. Italy: Bond Yields, 1963-65
(monthly averages)

	Treasury bonds	Other bonds: Group A 1/	Group B 2/	Group C 3/	Combined
1963 - June	5.19	6.07	5.69	6.13	5.98
December	5.62	6.61	5.85	6.79	6.42
1964 - June	6.05	8.12	6.25	8.57	7.62
December	5.62	7.15	6.18	7.63	6.90
1965 - January	5.35	6.96	6.17	7.45	6.76
February	5.35	6.96	6.16	7.36	6.76
March	5.35	6.88	6.16	7.30	6.71
April	5.44	6.88	6.17	7.23	6.70
May	5.49	6.89	6.18	7.26	6.71
June	5.46	6.90	6.19	7.25	6.72
July	5.45	6.92	6.19	7.27	6.73

1/ National enterprises and public credit institutions which lend to industry.
2/ Public credit institutions which extend agricultural and real estate credit.
3/ Corporations.
Source: Bank of Italy.

Wide swings and a lack of a well-defined trend have characterized Italian stock prices since July of last year. The expectation of improved business conditions caused a notable recovery of stock prices in August-September of 1964, which was then followed by a drop of similar magnitude later in the year. The succession of ups and downsover 12 months left prices in July 1965, 4 per cent higher than a year earlier.

However, in a relative sense this irregularity constitutes an improvement in stock price behavior. Until July 1964, stocks had been following a declining trend for three years during which time prices fell 50 per cent.