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Recent Economic Developments in Italy:
Annual Review

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Summary

The Italian economy has made further substantial progress during the past year in its recovery from the setback to growth sustained in 1964. Demand has been expanding in all sectors, industrial output has risen to levels well above the pre-recession peak, and wage and price movements have given no cause for concern. However, shifts in relative demand strengths over the past three years have contributed to a severe imbalance in Italy's external accounts, which have continued to register a large surplus. However, the surplus has been reduced this year.

In July 1966, Italian industrial production exceeded by 10 per cent its level of a year earlier, and by 13 per cent the peak level reached prior to the recession. This measure somewhat overstates the progress that the economy has made, since it does not include the construction industry where activity is still quite a bit below former levels.

It appears that investment spending, after a precipitous decline of a year and one-half's duration, has been reviving since the latter part of 1965, at least with regard to expenditures on equipment and nonresidential building, and an early upturn in residential building activity seemed to be heralded by the indicators available through the first five months of the year. Outlays for

consumption and inventories of consumer goods during the first five months of this year evidently were markedly above a year earlier, and central and local government expenditures were probably continuing to rise very fast. But even with aggregate internal demand on the upswing once again, export growth has remained the strongest demand factor in the economy, as is well illustrated by the 15 per cent year-to-year rise as of June-July. National accounts forecasts for 1966 presented in July, and a revised projection made in September, show the following percentage increases over 1965 in key annual expenditure totals (valued at constant prices):

	1965 <u>Actual</u>	1966 Forecast	
		<u>July</u>	<u>Sept.</u>
Private consumption	2.1	5.4	5.5
Total gross investment	-7.4	6.0	<u>1/</u> 6.0
Exports	19.9	9.0	13.0
Imports	0.9	16.0	16.0
Gross national product	3.4	4.5	5.3

1/ Purchases of equipment are expected to increase 11 per cent.

In addition to export expansion, the resumption of growth in private internal demand in Italy can be traced to the very expansionary fiscal and monetary policies being pursued since the latter part of 1964. Government spending has been increasing very

fast; last year, its increase equaled 76 per cent of the rise in gross national product, in reflection of an extraordinary rise in transfer payments. In 1965, the cash deficit of the central authorities widened sharply, and a large part was covered by borrowing from the Bank of Italy and the commercial banks. The Bank of Italy's annual report issued last May 31 stated that the deficit would probably rise sharply again, to a level equal to 6 per cent of expected gross national expenditures. This would be equivalent to a deficit in the United States close to \$50 billion.

Heavy borrowing by the Treasury and other public bodies has meant that long-term interest rates have come down only about 50 basis points since the end of 1964, even though monetary policy has remained as expansionary as possible. Italian interest rates have also been held up by some monetary "spill-over" in the form of a capital outflow attracted by tighter credit conditions abroad. The demand for bank credit, which was at first slow to revive, has lately been rising at an accelerated pace which brought the yearly expansion in outstanding loans to nearly 12 per cent as of last July. Concurrently, the banks have continued to acquire bonds in volume of such dimensions that their security portfolios have been increasing at 20-25 per cent a year since the summer of 1964. The somewhat lower level of the balance of payments surplus this year might have forced the banks to slow down their rate of asset formation, but such a possibility was forestalled by increasing

the volume of Bank of Italy credit to the commercial banks and by a Bank of Italy regulation late in 1965 that greatly reduced the amount of new lira/dollar swaps the Bank was willing to make with the commercial banks. The effect of this change was to raise the proportion of the net inflow of foreign exchange that was used to create reserves in lire for the banks.

Italy has recently enjoyed a greater degree of price stability than any other Western industrial country: in July, consumer prices were only 1.9 per cent higher than a year earlier, and the rise in wholesale prices was 1.6 per cent. The rise in wage rates has slowed down further this year, and unit labor costs have doubtless declined some more. Last year, they fell for the first time in several years.

Italy's balance of payments surplus rose to \$1.6 billion in 1965, even despite a \$450 million net outflow of capital from Italy conditioned by monetary ease in Italy while money and capital markets abroad were tightening. (U.S. efforts to restrain capital outflows from this country also helped lead to this result.) Another extraordinary export expansion, amounting to 21 per cent, occurred last year, and the net receipts on current invisibles (mainly from tourism) rose sharply to an annual total of \$1.5 billion. Imports last year totaled no more than in 1964: although they grew rapidly during the year, their level for the year as a whole still reflected the steep fall that had previously occurred. Through the first eight

months of the current year, the surplus was only two-thirds as large as during the same period of 1965, partly because the capital outflow intensified. The trade balance has also been somewhat less favorable, but the deterioration actually occurred late last year. Since the start of 1966 the Italian trade balance has in fact improved, because of a speeding up of the export rise and a slowing of the pace of imports.

The 60 per cent rise in Italian exports in the past three years has contributed very strongly to the recovery of economic activity within the country, but of course has been one reason for the disequilibrium in the external accounts. A second major reason for the external imbalance lies in the still-depressed (albeit reviving) level of private investment in Italy which has limited the recovery of total imports; the volume of imports of machinery and other equipment has yet to regain the level of three years ago.

Industrial production rises rapidly

Industrial production in Italy rose rapidly and continuously during that part of the period under review for which the relevant data are available, i.e., through July of this year. Some sectors of output were, as of early last summer, still feeling the effects of the 1964 recession. However, for the general level of production (excluding construction), the rise that has occurred since the middle of 1965 has been entirely into new high ground.

Over-all industrial production (excluding construction) in July 1966 was 10 per cent higher than a year earlier. (See Table 1.) Production had already surpassed, by May of 1965, its pre-recession peak; consequently, as of July of the present year, seasonally adjusted production was more than 13 per cent above that highest pre-recession level (set in January 1964). The rise in production that has occurred in 1966 is especially impressive given the fact that, in all the months from February through July, the incidence of labor disputes was very heavy.

Very sharp fluctuations in the production of automobiles have imparted some irregularity to the rise in total output. The quarter-to-quarter increase in seasonally-adjusted production was especially rapid in the second quarter of 1965 and again in the second quarter of 1966, in which periods seasonally-adjusted production of automobiles increased by 38 and 46 per cent, respectively, over the preceding quarter. Between these two upsurges, auto output slumped sharply--by 25 per cent--in the fourth quarter of 1965. In the year from July 1965 to July 1966, production

Table 1. Italy: Industrial Production, 1964-66
(seasonally adjusted; excluding construction)

	<u>Indices (1960 = 100)</u>				<u>Change From Previous Quarter (in per cent)</u>	
	<u>General Index</u>	<u>Consumer Goods</u>	<u>Investment Goods</u>	<u>"Immediate use" Goods</u>	<u>Auto Prod.</u>	<u>General Index</u>
<u>Quarterly averages</u>						
1964 - I	137	133	130	152	- 4.9	---
II	134	129	121	158	- 6.0	-2.2
III	131	125	116	160	-13.2	-2.2
IV	133	124	120	165	- 0.5	+1.5
1965 - I	134	121	122	170	+ 1.4	+0.8
II	139	129	130	166	+37.6	+3.7
III	142	132	133	168	- 4.9	+2.2
IV	145	131	135	179	-24.5	+2.2
1966 - I	149	137	131	189	+ 5.5	+2.8
II	155	144	139	191	+46.0	+4.0
<u>Selected months</u>						
1964 - January	138	133	133	153		
August	126	119	109	160		
1965 - May	140	129	130	170		
July	142	133	132	170		
1966 - July	156	147	139	192		

Source: OECD and ISCO.

of "consumer goods" rose 10 per cent, and production of "immediate use goods" (electricity, chemicals, petroleum products) increased 13 per cent. The rise in the production of "investment goods" was only 5-1/2 per cent, but this differential reflected, at least in part, the heavy concentration of labor disputes (and manhours of work lost) in the metal and engineering industries.^{1/}

Italian labor market developments in the year up to last July were less favorable than might be expected on the basis of production trends, but the labor developments themselves strongly suggest that the worst effects of the recession on employment are now over. As estimated from the quarterly sample surveys of the Central Statistical Institute, full-time unemployment practically stopped increasing in the first half of 1966, since the number of unemployed in both April and July was not appreciably different from a year earlier. (See Table 2.) In July, the unemployed were estimated at 719,000, compared with 701,000 in July 1965. As a percentage of the labor force, in all probability unemployment in July was very close to the 3.3 per cent level that obtained in April. Progress of a more positive nature was made with regard to underemployment, i.e., a work week averaging less than 33 hours according to the official Italian definition. The number of underemployed numbered 292,000 in April (1.5 per cent of the labor force), down sharply from 429,000 a year earlier.

^{1/} The groups of products called "consumer goods" and "investment goods" do not fully conform to the names applied to them, partly because each includes intermediate products with multiple final uses. For example, all steel production is placed with "investment goods" even though some steel is eventually used to make consumer durables. Furthermore, some products are in the wrong category for unavoidable reasons. All products of the engineering industry, including consumer durables, are in the "investment goods" category, whereas truck tires are classified with consumer goods.

Table 2. Italy: Labor Market Data, 1959-66
(in thousands of persons)

	<u>Labor Force</u>	<u>Unem- ployment</u>	<u>Underem- ployment</u>	<u>Employment</u>		
				<u>Total</u>	<u>In Industry</u>	<u>In Manu- facturing^{1/}</u>
<u>Yearly averages</u>						
1959	20,692	1,128	n. a.	19,564	7,288	n. a.
1961	20,991	724	n. a.	20,267	8,012	n. a.
1963	20,649	504	348	20,145	7,986	4,561
1964	20,560	549	397	19,645	7,996	4,428
1965	20,366	721	520	19,525	7,728	4,341
<u>Months</u>						
1964 - January	20,611	715	432	19,896	8,035	n. a.
April	20,486	483	343	20,003	8,010	n. a.
July	20,658	469	363	20,189	8,031	n. a.
October	20,485	530	451	19,954	7,909	4,404
1965 - January	20,106	834	865	19,272	7,710	4,379
April	20,198	673	441	19,525	7,760	4,397
July	20,673	701	429	19,972	7,716	4,273
October	20,484	674	344	19,810	7,728	4,311
1966 - January	19,877	1,012	435	18,865	7,401	4,258
April	19,958	665	292	19,293	7,638	4,330
July		719				^{2/} 4,368

^{1/} Payroll employees only.

^{2/} Estimated number, deduced from the OECD index number for this type of employment.

Sources: Istituto Centrale di Statistica and OECD.

During most of the period under review, the continuing rise in industrial production failed to bring about any increase in employment. In April, total employment (as estimated from the sample surveys) was 1.2 per cent less than in April of 1965, despite an 8.5 per cent rise in industrial production between those two dates. But two developments are encouraging. First, this year-to-year drop was less than the 2.1 per cent year-to-year decrease shown by the data for January. Second, by July employment in manufacturing was beginning to turn upward. According to OECD sources, the July sample survey showed a rise of 2.2 per cent, compared with a year earlier, in manufacturing employment of persons on payrolls, i. e., excluding the self-employed and family help.

Exports and consumer purchases expand

Rising exports provided the main initial impetus to the Italian recovery in late 1964 and early 1965, for they helped, along with rapidly increasing government spending, to bring about a rise in production at a time when private internal demand was still falling. Since about mid-1965, internal demands for consumer and producer goods have been on the upswing once again, but even in this period of reviving internal spending, export sales have still remained the most buoyant element in the expansion of economic activity.

Comparison of the relative rates of increase of exports and of industrial production since mid-1965 shows that the former have increased considerably more rapidly than the latter. From the first half of 1965 to the same period of 1966, industrial production rose 11 per cent while

the comparable rise in the value of exports was 14 per cent. (See Table 3.) In the cases of both consumer goods and investment goods, export gains were very large in this period (between 10 and 15 per cent) and exceeded the increases in domestic sales, whereas the reverse was true for the remaining products. The advance in exports, while large, has been quite irregular. A burst in early 1965 was followed by a slowing and then a complete halt in the third quarter of last year. Subsequently, the pace accelerated and by the spring of this year the rise had again become very rapid.

The national accounts for 1965 reveal the extremely important contribution which rising exports made toward holding up incomes and output last year when aggregate internal demand was still, for the year as a whole, quite depressed (mostly because of reduced investment spending). Merchandise exports last year totaled 21 per cent more than in 1964, while GNP rose 7.1 per cent at current prices (and 3.4 per cent at constant prices). The increase last year in exports of goods and services equaled no less than 45 per cent of the rise in expenditures on gross national product and imports. (See Table 4.) In 1966, however, this percentage will be much smaller, because consumption and investment have been rising along with exports.

Although no quarterly estimates of GNP and its components have been issued this year, the statistical evidence points to a vigorous rise in private consumption outlays in 1966. For one thing, the production of consumer goods has been moving upward swiftly, so that in the first

Table 3. Italy: Selected Production and Trade Data,
1963-66

	Years			First Half		
	1963	1964	1965	1965	1966	% Increase
<u>Industrial Production (1960 = 100)</u>						
General index, unadjusted	132	134	140	140	155	11.1
Group indices, seasonally adjusted:						
Consumer goods	129	127	128	125	141	12.8
Investment goods	130	122	130	126	135	7.1
of which: engineering products (excluding vehicles) <u>1/</u>	130	114	110	111	120	7.8
"Immediate use" goods	141	159	171	168	190	13.1
<u>Exports (billion lire)</u>						
Total	3,160	3,724	4,493	2,165	2,451	13.2
Consumer goods	1,854	2,148	2,508	1,186	1,370	15.5
Investment goods	953	1,166	1,465	722	796	10.2
of which: equipment (excluding vehicles)	729	880	1,123	548	630	15.0
Auxiliary materials	352	410	519	257	286	11.3
<u>Imports (billion lire)</u>						
Total	4,744	4,533	4,592	2,220	2,628	18.4
Consumer goods	2,047	1,983	2,080	998	1,213	21.5
Investment goods	1,795	1,571	1,443	701	817	16.5
of which: equipment (excluding vehicles)	1,404	1,211	1,095	529	633	19.7
Auxiliary materials	902	978	1,069	521	598	14.8

1/ Not seasonally adjusted.

Sources: OECD and Istituto Centrale di Statistica.

Table 4. Italy: Sources and Uses of Resources, 1963-65^{1/}
(at current prices, in billions of lire)

	Value			Increase	
	1963	1964	1965	1964	1965
<u>Sources</u>					
Gross national product	30,193	33,112	35,460	2,919	2,348
Imports of goods and services	5,438	5,293	5,406	- 145	113
Total resources	<u>35,631</u>	<u>38,405</u>	<u>40,866</u>	<u>2,774</u>	<u>2,461</u>
<u>Uses</u>					
Private consumption	19,281	20,841	22,087	1,560	1,246
Private investment	6,658	6,505	6,092	- 153	- 413
Total private sector	<u>25,939</u>	<u>27,346</u>	<u>28,179</u>	<u>1,407</u>	<u>833</u>
Public consumption	4,101	4,659	5,198	558	539
Public investment	838	914	898	76	- 16
Total public sector	<u>4,939</u>	<u>5,573</u>	<u>6,096</u>	<u>634</u>	<u>523</u>
Exports of goods and services	4,753	5,486	6,591	733	1,105
of which: merchandise	(3,160)	(3,724)	(4,493)	(564)	(769)

^{1/} These figures, published in 1966, show substantial revisions of previously-published data on Italy's national accounts.

Source: Istituto Centrale di Statistica.

half of 1966 production of such goods exceeded by 13 per cent the volume of a year before. (See Table 3.) This production rise partly reflected a 16 per cent year-over-year increase in exports of consumer goods, so that internal sales of home-produced consumer goods are seen not to have risen as much as output. But, at the same time, imports of consumer goods have risen sharply, the January-June total being 22 per cent above a year earlier. These production and trade figures suggest that in January-June, internal consumption of consumer goods, together with accumulations of consumer goods inventories, exceeded the year-earlier level by about 13 per cent.

Investment revival has probably continued

It is difficult to quantify what has been happening to investment spending in 1966, even though special interest attaches to this aspect of the economy because of the recent severe declines suffered by these expenditures. In terms of annual totals, aggregate gross investment (at constant prices) fell 8.2 per cent in 1964 and 7.4 per cent in 1965. Outlays for equipment shrank severely in each of these years (by 18 and 13 per cent, respectively), and nonresidential building also declined in both years although by much smaller proportions. (See Table 5.) The building of homes did increase in 1964, because houses and apartments already under construction were completed rather than left half-finished. But the decline in housing starts, that began about the beginning of 1964, continued through 1965, and it was also reflected in lower completions and a reduced volume of work-in-progress last year.

Table 5. Italy: National Accounts at Constant Prices, 1963-65^{1/}
(at 1963 prices, in billions of lire)

	Value			Increase	
	1963	1964	1965	1964	1965
<u>Available Resources</u>					
Gross national product	30,193	31,015	32,084	822	1,069
Imports of goods and services	5,438	5,162	5,210	-276	48
Total	35,631	36,177	37,294	546	1,117
<u>Uses of Resources</u>					
Consumption	23,382	23,988	24,559	606	571
Exports of goods and services	4,753	5,306	6,360	553	1,054
Investment:					
Equipment (including vehicles)	3,159	2,603	2,244	-556	-359
Housing	2,162	2,292	2,154	130	-138
Nonresidential buildings	1,180	1,078	1,022	-102	- 56
Public works	649	710	715	61	5
Inventories	346	200	240	-146	40
Total investment	7,496	6,883	6,360	-613	-523

^{1/} See note to Table 4.

Source: Istituto Centrale di Statistica.

Italian officials estimate that the decline in total gross investment, which lasted as long as 18 months (the entire year 1964 and the first half of 1965), began to reverse itself in the second half of last year; that gross fixed investment rose about 5 or 6 per cent in volume between the second and fourth quarters (i.e., 10 to 12 per cent at an annual rate); and that at the end of 1965 the annual rate of total investment outlays was at practically the same level as at the end of 1964. (The much lower annual total in 1965 consequently reflected the steep decline that occurred during 1964.) But the investment upturn in late 1965 is thought to have been concentrated solely in purchases of equipment, while further declines are estimated to have occurred in construction (public works, along with housing and non-residential building).

Production and trade data show clearly that investment in equipment has continued to rise this year. Production in the engineering industries (excluding vehicles) in January-June was up 7.8 per cent from a year earlier despite the labor disputes. (See Table 3.) In the same period, exports of equipment (excluding vehicles) scored a 15 per cent year-to-year gain, but a 20 per cent rise also took place in equipment imports. These figures suggest that domestic purchases of home-produced and imported equipment (excluding vehicles) during January-May rose about 11 per cent in volume from a year earlier. At the same time, new truck registrations for the first five months of this year ran some 15 per cent ahead of 1965.

The replies to the ISCO monthly surveys of business conditions show that companies producing "investment goods" still have, as a whole, been regarding the levels of their orders from domestic customers as being on the low side. But the proportion of firms taking this view shrank in the first half of this year, while the number reporting production levels to be higher than normal increased, so that the net balance in favor of below-normal output was approximately halved between the end of last year and June 1966. Producers' expectations of levels of orders and production 3 or 4 months in the future have become more optimistic in this period. The survey results thus seem to supplement the statistical data in indicating that the direction of demand for equipment this year has been upward.

It is clear that construction in Italy has still been quite depressed this year. But at the same time, signs have appeared that the corner has probably been turned and that activity is probably rising once more after a lengthy period of decline. In the area of nonresidential building construction, last year expenditures (in real terms) totaled 5 per cent less than the year before. (See Table 5.) But in the second half of last year, permits for new building rose to 30 per cent above year-earlier levels, and this trend was further reinforced in early 1966. In the first five months of this year, permits were up 45 per cent from a year earlier. (See Table 6.) Although the number of completions in January-May was down 18 per cent, this year-to-year drop was less steep than it had been earlier. It seems that total outlays for work in progress in January-May may in fact have been ahead of last year.

Table 6. Italy: Construction of Buildings, 1963-66^{1/}

	<u>Nonresidential</u> <u>(thousand cubic meters)</u>		<u>Residential</u> <u>(thousands of rooms)</u>	
	<u>Building</u> <u>Permits</u>	<u>Completions^{2/}</u>	<u>Building</u> <u>Permits</u>	<u>Completions^{2/}</u>
<u>Half-Years</u>				
1963 - 1st half	49,490	14,740	2,512	1,186
2nd half	44,113	20,041	2,457	1,773
1964 - 1st half	36,076	18,390	2,091	1,335
2nd half	26,287	22,926	1,524	1,939
1965 - 1st half	32,115	17,854	1,477	1,307
2nd half	34,158	17,435	1,456	1,537
1965 - January-May	26,746	15,333	1,211	1,086
1966 - January-May	39,835	12,512	1,498	861
<u>Percentage change from</u> <u>a year earlier</u>				
1964 - 1st half	-27.1	+24.8	-16.8	+12.5
2nd half	-40.4	+14.4	-38.0	+ 9.4
1965 - 1st half	-11.0	- 2.9	-29.4	- 2.1
2nd half	+29.9	-24.0	- 4.5	-20.7
1966 - January-May	+48.9	-18.4	+23.7	-20.7

^{1/} These figures cover all activity; the previously published data in this series referred only to data for provincial capitals and towns of over 20,000 inhabitants.

^{2/} Based on requests for occupancy permits.

Sources: The data for 1963-65 are from ISCO as published in Mondo Economico, No. 31-32 of August 6-13, 1966, pp. 14-15. The 1966 data are from Istituto Centrale di Statistica.

Expenditures for building of homes, more than twice as important to total construction expenditures as nonresidential building, were down 6 per cent in volume from 1964 to 1965. However, the long downtrend in the issuance of building permits slowed up and reversed itself in the second half, and the months January-May 1966 showed a 24 per cent year-to-year gain in permits. Completions were down 21 per cent in January-April, but this downtrend no longer seemed to be accelerating. Total activity in early 1966 would appear to have been about the same as a year earlier, but the trends of permits and completions seemed to imply an upturn would occur before the end of the year.

Fiscal policy becomes more stimulative

Italian fiscal policy became much more expansionary in 1965. Because private internal demand was still falling in the early part of the year, and throughout the year the economy was operating with a certain amount of unused resources, the authorities sought to maintain incomes by increasing government expenditures and by financing a greatly-expanded deficit largely with bank credit. In the spring of 1966, well-informed opinion in Italy was that the public finances this year would provide a still greater stimulus to total spending through another large increase in outlays and another big increase in the deficit.

The importance of government expenditures as a direct producer of incomes in Italy increased again last year, thereby continuing a trend begun several years earlier, in 1962, when the Center-Left governing coalition was formed. Consumption and investment expenditures of the central and local governments, together with transfer and interest

payments, rose from 33.2 per cent of GNP in 1964 to 36.1 per cent in 1965; earlier increases had raised the percentage from 30.8 per cent in 1961. For present purposes it is more useful, however, to consider how much of a contribution the yearly increases in government expenditures have made toward increasing total national expenditure on GNP from one year to the next. In percentage terms, this contribution already amounted to 41 per cent in 1964, and it soared to 76 per cent in 1965, i.e., in 1965 the rise in government expenditures equaled 76 per cent of the rise in gross national product. The exceptional rise in government spending last year resulted from an upsurge of transfer payments. (See Table 7.)

The most striking aspects of the central government's finances last year were the enormous increase in expenditures and the near-doubling of the deficit, which assumed very large proportions. The expenditures rise was much larger than had been expected on the basis of the budget estimates submitted to the Parliament: by the end of the year, actual expenditures obligations exceeded the initial estimates by almost 16 per cent. This placed them at a level 27 per cent above the obligations incurred in the 1964 fiscal year (ending June 1964), and 16 per cent higher than the annual rate of expenditures (not adjusted for seasonality) in the "interim" fiscal year July-December 1964 (made necessary when the fiscal year was shifted to coincide with the calendar year beginning with 1965). Expenditure obligations and assessed revenues in 1965 yielded a deficit of over 1,200 billion lire, compared with deficits of about 500 billion lire in fiscal 1964 and of 432 billion lire in

Table 7. Italy: GNP and Government Spending, 1961-65^{1/}
(at current prices, in billions of lire)

	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
<u>Value</u>					
1. Gross national product	23,363	26,330	30,193	33,112	35,460
2. Government expenditures	7,189	8,319	9,815	11,000	12,793
of which:					
for consumption	2,872	3,349	4,101	4,659	5,198
for investment	710	757	838	914	898
transfer payments	3,104	3,669	4,302	4,807	6,045
interest payments	503	544	574	620	652
3. "2" as percentage of "1"	30.8	31.6	32.5	33.2	36.1
<u>Yearly Increase</u>					
1. Gross national product		2,967	3,863	2,919	2,348
2. Government expenditures		1,030	1,496	1,185	1,793
of which:					
for consumption		477	752	558	539
for investment		97	81	76	- 16
transfer payments		565	633	505	1,238
interest payments		41	30	46	32
3. "2" as percentage of "1"		34.7	38.7	40.6	76.4

^{1/} See note to Table 4.

Source: Istituto Centrale di Statistica.

July-December 1964. Because the budget entries were reclassified with the shift in fiscal year, it is not possible to compare the separate items of expenditure.

On a cash basis, the combined deficit of the Treasury and the Cassa Depositi e Prestiti rose from 847 billion lire in 1964 to 1,560 billion lire in 1965, equal to 4.4 per cent of gross national product, the increase being caused entirely by rising outlays on budgetary account. The deficit incurred by the Cassa Depositi e Prestiti itself declined to 582 billion lire last year--the first decline in several years--because the Cassa did not engage, as it had in 1963 and 1964, in heavy purchases of new bonds issued by the national enterprises and the special credit institutions. But the Cassa continued to increase its loans, which are mainly made to the local authorities. In the 1960's, the expenditures and the budget deficits of the local authorities have soared, and some further increase in their collective deficit took place again last year. They have come to rely heavily on the Cassa for financing: their deficits aggregated 615 billion lire in 1965, of which amount 422 billion lire was covered by Cassa loans. These loans likewise made up the great bulk of the Cassa's total deficit of 582 billion lire in 1965.

Fiscal and monetary policies were coordinated last year in such fashion that the central bank and the commercial banks extended credit to cover over one-half of the 1,560 billion lire combined deficit of the Treasury and the Cassa. Bank of Italy financing (advances and purchases of Treasury bills and long-term bonds) underwent some decrease, to 283 billion lire, but the commercial bank's purchases of long-term bonds,

Treasury bills and other minor Treasury debt rose from only 81 billion lire in 1964 to 659 billion lire in 1965, of which 419 billion lire comprised new issues of long-term bonds. Such massive bank support to the Treasury was possible mainly because of the very heavy inflow of funds into the Italian banking system emanating from the balance of payments surplus; and Bank of Italy financing of the Treasury of course added further to bank reserves. The public also contributed more heavily to the financing of the deficit last year. In addition to increasing their net new deposits with the Postal Savings Administration (managed by the Cassa Depositi e Prestiti), to 406 billion lire in 1965, nonbank investors made net purchases of long-term bonds in the amount of 202 billion lire, which was 10 times more than they had bought the year before when conditions in the Italian capital market were decidedly unfavorable.

For 1966, the Italian authorities expected that deficit financing would be on a much bigger scale than hitherto. No clue to such a possible outcome is offered by the estimates of expenditure obligation and assessed revenues in the budget document, where the deficit is shown as only 424 billion lire this year. According to the Bank of Italy discussion of the public finances in its annual report issued last May 31, the 1966 expenditure estimates fail to include nearly 1,500 billion lire of outlays which almost certainly would be effected this year, so that expenditure obligations will in fact be about 9,000 billion lire instead of the 7,500 billion shown by the Budget Ministry's estimates. At the expected level, expenditures in 1966 would be 9-1/2 per cent higher than

actual expenditure obligations incurred in 1965. The Bank anticipated a budget deficit (in terms of obligated expenditures and assessed revenues) of around 1,900 billion lire, up from approximately 1,200 billion lire in 1965.

Figures for the first six months of this year imply that the results for the full year 1966 will indeed show large increases in outlays and in the deficit, relative to 1965, although perhaps not quite as large as was estimated earlier. In January-June 1966, expenditure obligations were 8.1 per cent more than in the first half of 1965. The deficit on expenditure obligations and revenue assessments was 692 billion lire, an amount 39 per cent greater than the comparable deficit in the same period last year.

The 1966 cash deficit of the Treasury, the Cassa and the autonomous agencies was foreseen by the Bank of Italy as likely to be in the neighborhood of 2,600 to 2,700 billion lire, a sharp increase over the 1,560 billion lire combined cash deficit of 1965. Mostly, this would reflect the expanded deficit on Treasury account. But, in addition, a large rise was expected in Cassa loans to local authorities, and it was thought that the State Railways and the National Highways (the State autonomous agencies) would have to seek recourse to market loans totaling perhaps as much as 250-300 billion lire.

Monetary policy remains expansionary

Promotion of economic expansion has remained the main focus of Italian monetary policy during the past year. The large balance of payments surplus has been somewhat reduced, but to prevent this from

causing any slowing of credit expansion the Bank of Italy has taken offsetting measures. The posture adopted by the monetary authorities allowed the banks not only to fulfill an accelerating demand for loans, but also to make further large additions to their holdings of securities.

Some of the major monetary developments in Italy since the inception of the "easy money" policy in the summer of 1964 are summarized by the data in Table 8 on the money stock and its counterparts and offsets. The money stock, which grew relatively slowly during most of 1964, began to rise more rapidly after that and it increased by 14, 16, and 15 per cent, respectively, in the 12-month periods ending with July 1965, December 1965, and July 1966. These rates of increase have exceeded by a wide margin the increase occurring in the production of goods and services, not only in real terms but also valued at current prices, indicating a fall in the income velocity of the money stock in this period of recovery. In the year from June 1965 to June 1966, the rate of increase in the money stock tended to be slowed up by the diminution of the external surplus (measured by the change in official and commercial bank net foreign assets) and by a faster build-up of savings deposits in relation to holdings of demand deposits and currency, but the actual slowing that took place was kept to a minimum because the rise in the loans of the commercial banks gathered considerable speed.

The volume of loans of the Italian commercial banks lagged substantially behind the volume and value of production, in respect of their relative speeds of recovery from the events of 1963-64. In the

Table 8. Italy: The Money Stock and Its Counterparts
and Offsets, 1964-66
(in billions of lire)

	<u>Outstanding, July 31</u>			<u>Increase</u>	
	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1965</u>	<u>1966</u>
<u>Money stock</u>	11,308	12,885	14,850	1,577	1,965
<u>Counterparts:</u>					
Commercial bank loans	12,675	13,282	14,872	607	1,590
Commercial bank securities of which:	4,501	5,708	6,930	1,207	1,222
Treasury bills	1,859	2,081	2,167	222	86
Treasury bonds	578	722	861	144	139
CCOP bonds issued for Treasury account	134	206	487	72	281
Bonds of the special credit institutions	1,385	1,707	2,012	322	305
Bonds of the national enterprises (IRI, ENI, ENEL)	) 476	761	1,132	) 448	371
Corporate bonds	) 70	163	169	) 6	6
Shares		69	103	-1	34
Bank of Italy credit:					
To Treasury	2,246	2,455	2,619	209	164
To special credit institutions	34	44	36	10	- 8
Net foreign assets	1,696	2,708	3,386	1,012	678
of which:					
Official institutions	2,213	3,009	3,343	796	334
Commercial banks	-518	-301	43	217	344
<u>Offsets:</u> ^{1/}					
Savings deposits with commercial banks	8,610	9,785	11,407	1,175	1,622
Other (net)	1,234	1,527	1,587	293	60

^{1/} Increases in these quantities have the effect of decreasing the money stock.

Source: Bank of Italy.

twelve months to July 1965, for example, loans outstanding rose less than 5 per cent, whereas the increase in GNP over the same period has been estimated at about 8-1/2 per cent in money terms. But the rate of rise in loans was picking up throughout last year, and it accelerated in 1966, so that by the end of July loans were almost 12 per cent more than a year earlier. This pick-up of course reflected an accelerating demand for bank credit rather than any change in the banking system's ability to supply funds to its customers.

In reviewing banking developments in 1964 and 1965, the Bank of Italy has pointed out the wide divergence between large corporations and other borrowers in the rate at which these two groups changed their bank loan indebtedness in those years. In 1964, when credit was tight most of the year and banks remained cautious lenders even after monetary policy was eased, large private corporations increased their bank borrowings by 17.3 per cent (from end-December to end-December) while other private borrowers reduced them by 2.4 per cent. Last year, however, the same large corporations actually reduced their loans by 0.2 per cent as the other borrowers were increasing theirs by 7.8 per cent.

Italian banks began to buy bonds on a very large scale in the closing months of 1964, and they have continued for nearly two years to increase their security portfolios at a rapid rate; the banks have had increasing resources for profitable employment, while at the same time the public sector's demands for long-term funds has swelled. Total security holdings of the banks (including a small portfolio of shares) increased by 1,207 billion lire (27 per cent) in the 12 months to July 1965.

In the more recent year-long period ending in July 1966, the additions were slightly larger in absolute terms--1,222 billion lire--although the percentage increase was somewhat lower, at 21 per cent. The heavy net purchases of bonds in the last two years, coupled with a loan demand that, for the period as a whole, was weak, have meant that the composition of the Italian banking system's assets has undergone considerable change. Considering only their loans and securities, in July 1964 securities made up 26.2 per cent of total loans and securities, but this percentage increased to 31.8 per cent by July of 1966.

Treasury bills, Treasury bonds, and bonds issued on behalf of the Treasury by the Credit Consortium for Public Works accounted for 43 per cent of new security acquisitions in the period August 1965 to July 1966, a percentage somewhat higher than the 39 per cent applicable to the previous 12 months. Within this group of Treasury obligations, the relative importance of the different types of acquisitions showed a large change, because purchases of Treasury bills were much smaller in the second of these two periods while bond purchases were enlarged. It appears that this shift reflected in part the changes in reserve requirement regulations, issued in the fall of 1964 and in the latter part of 1965, which allowed some banks to invest a certain part of their required reserves in long-term bonds instead of Treasury bills. Bonds issued by the national enterprises--IRI, ENI, and ENEL--comprised another 31 per cent of the bond acquisitions in the year to July 1966; thus, three-fourths of all the net bond purchases involved issues of the public sector.

Because of a reduced external surplus, the rise in the net foreign assets of the monetary authorities and the commercial banks has been slowed down in the past year, especially since the beginning of 1966; in January-July of this year, the surplus was 337 billion lire compared with 590 billion lire in the comparable year-earlier period. This development might have had a detrimental effect on the rate of formation of lira reserves necessary for the continued rapid expansion of bank loans and investments, but two actions by the Bank of Italy have prevented such an effect from materializing. In the first place, since the summer of 1965 Bank of Italy advances and rediscounts in favor of the commercial banks have once again been increasing, following a lengthy period in which the liquidity originating from the external surplus and the subdued demand for bank loans induced the banks to pay off much of their indebtedness to the central bank. Second, towards the end of 1965, the Bank of Italy acted to cut down drastically the use by the banks of the facility by which they have been able to make new swaps of lire for dollars. Such swaps tend to reduce the banks' lira reserves, and although some of the dollars have been used for internal loans to Italian customers a large part has been employed in the Euro-dollar market and other markets outside Italy.

In the autumn of last year, the Bank of Italy began restricting new lira-dollar swaps solely to those banks which still had a net debtor position vis-à-vis foreigners, and in consequence those banks with a net creditor position could not add further to their net assets in foreign exchange. (The already-existing swaps could, however, be renewed at maturity.)

Consequently, new swaps have since been on a small scale, and this fact has importantly affected the uses to which the Italian surplus has been put. This is seen from the following changes, during two recent periods, in the net foreign assets of the monetary authorities and the commercial banks (in billions of lire):

	<u>November 1964 to July 1965</u>	<u>November 1965 to July 1966</u>
Monetary authorities	+ 485	+ 463
Commercial banks	<u>+ 197</u>	<u>- 33</u>
Total	+ 682	+ 430

In the nine months November 1965 through July 1966, the overall balance of payments surplus was reduced by more than one-third from its year-earlier level. But there was very little diminution in the rise of official foreign assets and the lira counterpart thereof, i.e., the commercial banks' liquidity in lire as determined by Italy's balance of payments.

Bond yield decline is limited by heavy government borrowing

During the year 1965 the Italian banks increased their security portfolios by 1,361 billion lire, or 28 per cent, compared with 517 billion (or 12 per cent) in 1964; most of the purchases in 1964 were made towards the end of the year, with the return of monetary ease. The movement of the banks into the bond market on this large a scale was an important reason for the decline in Italian bond yields from the peak levels attained in June of 1964. The composite market yield on all outstanding bonds except

Treasury bonds averaged 6.67 per cent in 1965, down from an average of 6.97 per cent in 1964 and a peak of 7.62 per cent in that year. The trend of market yields was gradually downward throughout 1965 and into the early months of 1966, before flattening out since last February. The yield on these bonds was 6.37 per cent in August of this year, at which time the yield on long-term governments (which are tax-free) was 5.55 per cent. The yields on the major new bonds at time of issue fell from an average of 6.85 per cent in 1964 to 6.65 per cent in 1965.

The decline in bond yields since the end of 1964, amounting to about 50 basis points, has been limited, however, because of the large increase that has occurred in borrowings on the capital market by the Treasury and other entities within the public sector. Total net new issues of securities, including shares, increased 17.1 per cent in 1965 over 1964, but new bond issues rose much more, by 36.0 per cent. The public sector dominated the new issues market last year even more so than in former years. Of total bond issues of 1,971 billion lire in 1965, the Treasury issued 34 per cent, a share well in excess of the 16 per cent issued by the Treasury in 1964; in absolute terms, Treasury bond issues (including bonds issued for Treasury account by the Credit Consortium for Public Works) increased almost three-fold, in reflection of the widening of the Treasury's cash deficit last year. In both 1964 and 1965, the issues of the national enterprises were about one-third of the total, and they increased in 1965 by 17 per cent. The special credit institutions, in contrast, issued fewer bonds last year than in 1964. Industrial borrowers

Table 9. Italy: Net New Security Issues, 1964-65^{1/}
(in billions of lire)

	<u>1964</u>	<u>1965</u>
<u>By issuer</u>		
<u>Bonds</u>		
Treasury ^{2/}	228.6	662.3
Special credit institutions	714.4	646.5
National enterprises (IRI, ENI, and ENEL)	474.4	554.9
Corporations	32.5	^{3/} 93.7
International institutions	----	<u>13.9</u>
Total bonds	1,449.9	1,971.3
<u>Shares</u>	<u>554.8</u>	<u>376.1</u>
Total securities issued	2,004.7	2,347.4
<u>By subscriber</u>		
Bank of Italy (and UIC)	180.9	37.9
Commercial banks	458.1	1,125.9
Cassa Depositi e Prestiti, and social security institutions	513.3	6.7
Insurance companies, corporations and individuals	<u>852.4</u>	<u>1,176.9</u>
Total subscriptions	2,004.7	2,347.4

^{1/} Excluding Treasury bills.

^{2/} Including bonds issued for Treasury account by the Consorzio di Credito per le Opere Pubbliche.

^{3/} Including 101.3 billion lire by the Highway Corporation (Società Autostrade).

Source: Bank of Italy.

again issued only a very small volume of bonds, and stock issues fell quite sharply in reflection of the reduced level of investment by Italian industry last year.

The subscriptions to new issues by category of subscriber showed three developments of particular interest last year. First, the commercial banks increased their absolute takings from 458 billion lire in 1964 to 1,126 billion lire in 1965. Thus, last year the banks' subscriptions to new bonds comprised no less than 84 per cent of their net long-term bond purchases, and a relatively small fraction of the bond acquisitions involved outstanding issues. This comparison makes it easier to understand why the drop in yields was not larger than it was. Second, with investor confidence improved since the previous year, non-bank investors substantially increased their total subscriptions last year, and because share issues were in fact reduced there was an increase of two and one-half times in bond subscriptions by insurance companies, corporations and individuals. Finally, in 1965 the Bank of Italy and the Cassa Depositi e Prestiti made only a very small amount of subscriptions in contrast to 1964 when they subscribed to more than one-third of all new issues. The Cassa's subscriptions in 1964 were really a round-about way of mobilizing additional Bank of Italy support of the capital market, since the Cassa's deficit was largely financed by Bank of Italy advances channeled through the Treasury.

External surplus expands and contracts

Italy's international transactions have been in heavy surplus continuously (allowing for seasonal influences) since the summer of 1964, while considerable variation has occurred during that time in the size of the overall surplus and, in more pronounced degree, in the balances shown by the separate component parts. Through the first eight months of 1966 the surplus ran at a lower level than last year, but there was no clear tendency for the decline from last year's level to grow wider.

The rise in the annual external surplus from \$774 million in 1964 to \$1,594 million in 1965 occurred because the balance on goods and services improved very greatly. (See Table 10.) Net capital flows, on the other hand, shifted sharply in the other direction, and if that had not occurred the overall surplus last year would have exceeded \$2 billion. Both the trade balance and invisible transactions contributed to the current account improvement last year.

Exports in 1965 as measured by the customs figures (and not by money receipts) were 21 per cent greater than in 1964, the second successive year in which their rise was extraordinarily large. Aggregate demand rose vigorously in the other Continental countries and in the United States, while at home the level of investment demand was depressed. These conditions were reflected not only in the rise in the value of Italian exports but also in divergent export price movements; export prices of manufactures moved down in Italy in 1965

Table 10. Italy: Balance of Payments, 1964-65
(transactions basis; in millions of dollars)

	<u>1964</u>	<u>1965</u>
Imports, f.o.b.	6,508	6,427
Exports	<u>5,863</u>	<u>7,095</u>
Trade balance	- 645	668
Services	895	1,151
Military orders	59	70
Unilateral transfers	<u>311</u>	<u>346</u>
Total current account	620	2,234
Capital movements	110	- 458
Errors and omissions	<u>44</u>	<u>- 182</u>
<u>Overall surplus</u>	<u><u>774</u></u>	<u><u>1,594</u></u>

Monetary movements (minus = increase)	- 774	-1,594
of which:		
official net foreign assets	- 332	- 635
commercial banks' net foreign position	- 442	- 960

Source: Bank of Italy.

(after two years of increase) while they rose more rapidly in the other industrialized countries (considered as a whole) than they had in quite some years. Imports f.o.b. last year (also as measured by movements through the customs) totaled 1 per cent more than in 1964. During the course of 1965, imports as a whole were in fact rising, and in the fourth quarter they were up a solid 17 per cent from a year earlier; this upturn was already under way in the final quarter of 1964. The virtual absence of import growth last year, in terms of annual totals, was rather a reflection of the steep slide suffered by imports in 1964.

The trade balance improvement was supplemented by a substantial rise in the surplus on current invisible transactions which last year reached the figure of \$1.5 billion, an improvement largely caused by a 25 per cent rise in earnings from foreign travel. (Italy's gross earnings from foreign travel exceed those of any other country and last year totaled \$1,288 million.)

Private capital movements underwent a large shift, from a \$110 million net inflow in 1964 to a \$458 million net outflow in 1965, according to the capital accounts in the balance of payments constructed on the so-called transactions basis. This shift was in large measure a reflection, at bottom, of the easing of credit conditions in Italy. The net inflow of foreign capital into Italy decreased from \$1,270 million to \$691 million, the biggest declines occurring in direct investment and in loans. (See Table 11.) The U.S. balance of payments

Table 11. Italy: Balance of Payments Capital Account,
1964-65
(transactions basis; in millions of dollars)

	<u>1964</u>	<u>1965</u>
<u>Foreign Capital</u>		
Direct investment	535	286
Portfolio investment	3	27
Loans:		
received by private sector	523	129
received by public sector	64	120
Commercial credits	133	157
Miscellaneous investments	<u>13</u>	<u>25</u>
Total foreign capital	1,270	691
<u>Italian capital</u>		
Direct investment	-136	-178
Portfolio investment	- 14	- 12
Loans:		
made by private sector	- 10	- 65
made by public sector	- 45	- 22
Remittances of Italian banknotes	-577	-313
Commercial credits	-380	-533
Miscellaneous investments	<u>3</u>	<u>- 26</u>
Total Italian capital	-1,160	-1,149
<u>Total capital</u>	110	-458

Source: Bank of Italy.

program initiated in February 1965 was, in the opinion of the Bank of Italy, a significant cause of this decline. But in addition, Italian companies did not seek foreign capital as actively as in 1964 when credit was tight much of the time, and in 1965 Italian companies also began repaying some of the large volume of medium-term foreign loans they had contracted in the three preceding years. The decline in the

total flow of foreign capital to Italy would have been larger if the Italian public sector had not increased its borrowings abroad. Last year these borrowings included ENEL's \$50 million "parallel" bond issue on European capital markets.

The net flow of Italian capital to foreign countries last year, amounting to \$1,149 million, was slightly less than in the previous year, but this near-stability was the product of two opposing influences. Easier financial conditions in Italy, coupled with tightening money and capital markets almost everywhere else in the world, induced a larger outflow of Italian direct investments and loans, while these same considerations and the strong surge of Italian exports led to a big rise in the volume of commercial credits granted to foreigners by Italian traders.

The total outflow of Italian capital would have risen by \$250 million last year had it not been for a second successive contraction in the outflow of Italian banknotes; the returns of banknotes to Italy by foreign banks fell by about \$260 million, to the level of \$313 million in 1965. The banknote outflows have been motivated, basically, by confidence factors and fiscal considerations, although their magnitudes have also been affected by the degree of credit ease prevailing at the time. The contraction in the banknote outflow in 1965 probably reflected increased confidence that Italy would enjoy more stable political conditions than in the previous few years, and that the Center-Left coalition would not take any major further actions that business and investor circles would

deem inimical to their interests. It also seems likely that the relative annual totals for the banknote outflow in 1964 and 1965 were affected by the legislation passed during 1964 which eased the terms for imposition of the withholding tax on dividends.

Through the first eight months of 1966, the Italian balance of payments registered a surplus of \$778 million, considerably under the \$1,127 million surplus of the comparable months of last year. (See Table 12.) The capital account this year has undergone a further big shift that has kept the overall surplus much smaller than it would otherwise be. Measured by foreign exchange flows (as opposed to the "transactions basis" method of reporting used for the annual data discussion in earlier paragraphs), there was a net capital outflow of \$363 million in January-August 1966 in contrast to a \$58 million surplus in the same period of 1965.^{2/} The current account surplus has run slightly higher this year. The surplus on current invisible items has recorded another large increase

^{2/} On the exchange flow basis, in 1965 the overall net outflow of capital was only \$96 million, as opposed to the \$458 million figure given in the "transactions basis" balance of payments. The principal reason for this discrepancy was a \$375 million excess of trade credits extended over trade credits received; such credits of course do not appear in the data relating to exchange flows.

The overall surplus, which is measured by the monetary movements (below the "line"), is the same under both methods of presentation, because the discrepancies on capital account have their counterpart in discrepancies of opposite sign in either the current account or the errors and omissions. In the case of trade credits, the offsetting discrepancy is the difference between the movements of goods through customs and the movements of exchange in payment thereof.

Table 12. Italy: Balance of Payments,
January-August 1965-66
(exchange movements basis; in millions of dollars)

	<u>1965</u>	<u>1966</u>
Imports, c.i.f. <u>1/</u>	4,568	5,427
Exports	<u>4,292</u>	<u>4,983</u>
Trade balance	- 276	- 445
Foreign travel	724	837
Emigrant remittances	422	469
Other services and unilateral transfers	<u>200</u>	<u>280</u>
Total current account	1,069	1,141
Private capital	10	- 310
Public capital	<u>48</u>	<u>- 53</u>
<u>Over-all surplus</u>	1,127	778

Monetary movements (minus = increase)	-1,127	- 778
of which:		
official net foreign assets	- 594	- 482
commercial banks net foreign position	- 533	- 295

1/ Excluding freight and insurance paid to Italian residents.
Source: Bank of Italy.

this year thanks mainly to the further rise of tourist receipts: in January-August, the net receipts on services and unilateral transfers were \$240 million more than in the like months of 1965. This improvement has more than offset a year to year deterioration shown by the trade accounts.

Details on capital movements available for the first six months of this year show a further large reduction in foreign loans to Italian business. (See Table 13.) At the same time, exports of Italian capital in the form of banknotes underwent a marked increase this year, in contrast to the decrease registered last year.

Table 13. Italy: Balance of Payments Private Capital Account,
January-June 1965-66
(exchange movement basis; in millions of dollars)

	<u>1965</u>	<u>1966</u>
<u>Foreign capital</u>		
Direct investment	132	124
Portfolio investment	- 17	- 77
Loans	125	2
Miscellaneous investments	<u>12</u>	<u>12</u>
Total foreign capital	151	60
<u>Italian capital</u>		
Direct investment	) -47	) -23
Portfolio investment	) -20	) -55
Loans	- 20	- 55
Remittances of Italian banknotes	<u>-182</u>	<u>-281</u>
Total Italian capital	-249	-358
<u>Unclassified</u>	4	69
<u>Total private capital</u>	6	-229

Source: Ufficio Italiano dei Cambi.

In the first half of this year, the Italian trade deficit (customs basis, imports c.i.f.) was somewhat larger than a year earlier. However, this widening occurred in the latter part of last year, and it has not continued in 1966. In fact, some improvement in the trade balance has taken place recently. The rise in exports became even more rapid this past spring; imports, following their rapid increase last year, tended to decline during February-May, and although they surged in June they were not much higher than they had been in January. This weakening of the pace of imports will, however, in all probability prove to be temporary, since all signs currently point to strong demand growth in Italy in the foreseeable future.

The continuing large surplus in Italy's balance of payments finds its origin in the relatively small size of the trade deficit, which at present is being swamped by the surplus on current invisibles. There are two main reasons why exports are covering a much higher percentage of imports than has traditionally been the case in Italy. One is the exceptional export growth of the last three years, as a result of which Italy's exports in the first half of the current year were 62 per cent more than in the first six months of 1963. The second of these reasons is that the level of imports is still being held back by the severe plunge of investment demand in Italy during 1964-65.

Imports have made a fast recovery since the summer of 1964, and during this year they have been running at levels that exceeded the peak reached in late 1963. At that time, inflationary pressures

in Italy were very acute, and it is more appropriate to compare current import levels with those of early 1963. In January-May 1966 total imports exceeded imports in January-May 1963 by 17 per cent in value and 9 per cent in volume.

But this rise in the volume of total imports falls short of the 17 per cent rise in industrial production occurring between January-May 1963 and January-May 1966. Between these two periods, Italian imports of fuels and raw materials have increased in response to the rise in industrial production (as well as the structural changes that have caused petroleum imports to rise very rapidly), and consumer goods imports as a whole have undergone a large rise, mostly because of increased imports of foodstuffs. The level of imports is being held down by weakened demand for investment goods, a very important category of imports which accounted for nearly 40 per cent of total imports in 1963. These imports, nearly all of which consist of machinery, industrial vehicles and other types of equipment, have been reviving this year; however because of the steepness of their earlier decline, in January-May of this year they were 7 per cent less in value than three years earlier.