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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

July 1, 1963

Recent Economic Developments in Italy  
January-June 1963 13 pages

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Recent Economic Developments in Italy, January--June, 1963

Summary

The Italian balance of payments deficit increased again in the first quarter of 1963. There were further reserve losses in May, and the lira declined in foreign exchange markets in mid-June. Continued large wage rate increases helped to maintain the upward trend of prices, and industrial production rebounded in March after two months of declines. Monetary expansion has continued to be rapid.

The external deficit widened to \$268 million in January-March from \$166 million in the preceding quarter. Seasonal factors and changes in leads and lags in trade payments appear to have caused about one-third of this \$100 million increase. The seasonally-adjusted trade deficit increased somewhat further, and the capital account deteriorated as the banknote outflow increased sharply.

The first quarter payments deficit was settled by a \$115 million drop in official reserves and a \$154 million increase in the net foreign liabilities of the Italian commercial banks, which amounted to \$758 million at the end of March. Stability of official reserves in April was followed by a \$43 million drop in May, and the commercial banks' foreign position probably deteriorated further in the second quarter.

Internally, the rate of increase in wage rates, which has been very rapid since 1961, accelerated in the first quarter and continued to outstrip gains in productivity. Wholesale prices rose 1.6 per cent in the first quarter, and consumer prices 2.8 per cent. The increase in consumer prices exceeded that in both the fourth quarter and the year-earlier period. The increase in wholesale prices was about the same as a year previous but less than in the final quarter of 1962.

The seasonally-adjusted industrial production index rose 4.1 per cent in March, to a level 1.1 per cent under last December. This reflected the passing of

winter and settlement of a labor dispute. Earlier, weather and labor conditions had caused a sharp decline between December and February.

Money supply increased nearly 10 per cent between September and March-- somewhat faster than a year earlier--mainly because of a 14 per cent increase in private bank credit. The balance of payments deficit in these six months has not slowed monetary expansion because, over this period as a whole, it has been financed by commercial bank foreign borrowing, while a drawdown of Treasury cash balances with the Bank of Italy has been a major factor supplying reserves to the banking system.

#### External deficit widens

There was a further worsening of the Italian external position in the first quarter of 1963. After holding steady in April, Italian official reserves decreased \$43 million in May, and in June the lira was allowed to decline on the exchange markets. The commercial banks' foreign position probably deteriorated in the second quarter.

The balance of payments deficit increased to \$268 million in the January-March quarter from \$94 million in the like period last year and \$166 million in the final three months of 1962. (See Table 1.) Of the approximately \$100 million increase over the fourth quarter, roughly one-third apparently reflected the combined effects of seasonal factors and changes in leads and lags in trade payments.

The trade returns showed a deficit of \$539 million, and the surplus on non-trade current operations dropped to \$274 million in January-March. Although this was largely the product of seasonal weakness in tourism and emigrant remittances, the Bank of Italy has estimated that, after allowance for seasonal influences, the surplus on services was about \$25 million smaller in the January-March quarter than in the preceding three months.

Table 1. Italy: Balance of Payments, 1962-63  
(in millions of dollars)

	1962		1963
	Qtr. I	Qtr. IV	Qtr. I
<b>A. CURRENT ACCOUNT</b>			
Imports c.i.f. 1/	-1,389	-1,661	1,641
Exports	<u>1,093</u>	<u>1,123</u>	<u>1,130</u>
Trade balance	- 296	- 539	- 510
Foreign travel	90	150	97
Emigrant remittances	97	144	99
Other items	<u>93</u>	<u>106</u>	<u>103</u>
Total current account	- 16	- 139	- 211
<b>B. PRIVATE CAPITAL</b>	- 86	- 40	- 57
Banknote repatriation	- 252	- 207	- 525
Other (net) 2/	166	166	467
<b>C. PUBLIC CAPITAL</b>	<u>8</u>	<u>13</u>	<u>1</u>
<b>D. DEFICIT (A+B+C)</b>	<u>- 94</u>	<u>- 166</u>	<u>- 268</u>
<b>E. MONETARY MOVEMENTS (-=increase)</b>	<u>94</u>	<u>166</u>	<u>268</u>
Official reserves	140	- 189	115
Other net foreign assets of the UIC and Bank of Italy	- 3	- 148	- 1
Commercial banks' net foreign position	- 44	503	154

1/ Excludes freight and insurance paid to residents.

2/ Details not available for 1963. See Table 6 for details of years 1961-62.

Sources: Bank of Italy and Istituto Nazionale per il Commercio Estero.

In this period, favorable changes in leads and lags in trade payments somewhat more than offset the unfavorable effects of seasonal trade factors.<sup>1/</sup>

The deficit on private capital account widened from \$40 million in October-December to \$57 million in January-March. The amount of banknotes returned to Italy by foreign banks, which came to \$207 million in the last quarter of 1962, soared to \$525 million in the first quarter of this year; the monthly repatriations rose progressively from \$54 million in December to \$259 million in March. The private capital deficit did not rise correspondingly because the higher remittances of notes was nearly matched by a return flow, through foreign nominees, of the Italian capital exported in banknote form.

This heavy step-up in banknote exports in all probability derived from changes in Italian tax laws, effective January 1, which provided additional incentive to evade taxes by exporting capital (viz., to Switzerland) and then reinvesting it in Italy in the name of Swiss nominees. Beginning January 1, a 15 per cent withholding tax was applied to dividends paid on Italian shares (including those held in the name of foreigners) and taxpayers must now list stock holdings on their tax returns. The added incentive to register shares in the name of foreign nominees is to prevent the Italian tax authorities from obtaining the vital information on share holdings registered in the names of residents that is now provided to them by the withholding process. Wealthy shareholders are content to pay the 15 per cent withholding on shares registered in foreign names as the price of anonymity.

The January-March deficit of \$268 million resulted in a decrease in official reserves of \$115 million. The remainder was settled by a further deterioration in the

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<sup>1/</sup> This may be seen from comparing both the trade payments and the adjusted shipments with the unadjusted shipments. The latter show an increase in the deficit from \$417 million in October-December to \$522 million, at a quarterly rate, in January-February.

Table 2. Italy: Foreign Trade, 1961-63  
(In millions of dollars; monthly average or month)

	<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
<u>Seasonally-adjusted</u>			
1961-year	438	351	- 87
1962-Qtr. I	479	381	- 98
II	481	397	- 84
III	525	391	-134
IV	561	408	-154
1963-January	538	395	-143
February	586	403	-183
<u>Unadjusted</u>			
1961-year	438	351	- 87
1962-Qtr. I	484	376	-108
II	490	384	-106
III	502	388	-114
IV	557	418	-139
1963-January	555	361	-194
February	546	392	-154

Source: OECD

Table 3. Italy: Commercial Banks' Foreign Position, 1961-63 1/  
(In millions of dollars)

	<u>1961</u>	<u>1962</u>		<u>1963</u>
	<u>Dec.</u>	<u>Sept.</u>	<u>Dec.</u>	<u>Mar.</u>
<u>I. Assets with foreigners</u>				
<u>A. In convertible foreign exchange</u>				
1. Sight items	933	1,310	1,384	1,420
2. Time deposits and short-term investments	350	480	503	484
3. Short-term credits	481	701	719	780
B. In inconvertible foreign exchange	102	129	162	156
C. In lire	3	3	3	3
	43	60	70	113
Total assets	979	1,373	1,457	1,536
<u>II. Liabilities to foreigners</u>				
<u>A. In convertible foreign exchange</u>				
1. Deposits	868	1,126	1,747	1,949
2. Short-term credits	798	1,024	1,570	1,766
B. In inconvertible foreign exchange	70	102	177	181
C. In lire	3	5	3	3
	283	344	312	345
Total liabilities	1,153	1,475	2,062	2,294
<u>III. Net position (I-II)</u>	- 174	- 102	- 605	- 758

1/ The foreign position does not include foreign exchange assets and liabilities with residents.

Source: Bank of Italy.

net foreign position of the Italian commercial banks. Foreign assets of the commercial banks increased \$79 million (of which \$36 million in foreign exchange) while liabilities rose \$233 million (of which \$200 million in foreign exchange). (See Table 3.) The net foreign liabilities of the Italian commercial banks amounted to \$758 million at the end of March, of which \$526 million in foreign exchange.

The Italian banks' lira-dollar swaps and other dollar acquisitions from the Bank of Italy--which had been greatly reduced in late 1962--were increased a total of \$50 million in January-March. (See Table 4.) All of the increase occurred in January when the liquidity needs of the banks lessened. The effect of the increase in these acquisitions was to accentuate by \$50 million the decrease in Italy's official reserves but to temper by \$50 million the deterioration in the banks' foreign position, since they are an alternative to foreign borrowing. Transfers of foreign exchange between the Bank of Italy and the commercial banks, whether by swaps or other means, do not change the international position of the country.

Banknote outflow is analyzed

Bank of Italy investigations have resulted in estimates of the destination of the capital outflow via banknotes and the consequent net effect on the Italian balance of payments. The amounts of banknote repatriation in 1958-62 are shown in Table 5. The Bank of Italy believes that in 1960 and 1961 about 95 per cent of the capital exported in this manner returned to Italy, still in Italian ownership but in the name of Swiss nominees. However, in 1962 the percentage is thought to have dropped sharply to around 75 per cent. Thus, the net capital outflow stemming from banknote exports, i.e., net of Italian funds returned through nominees, was only about \$9 million in 1960 and \$17 million in 1961, but it rose sharply to about \$192 million in 1962 because of increases in both the absolute volume of note exports and the percentage share of the capital outflow that remained abroad instead of returning to Italy.

Table 4. Italy: Dollars Obtained by Commercial Banks  
from the Italian Exchange Office, 1960-63

(In millions of dollars; amounts outstanding, end of period)

	Swaps	Outright purchases(net)	Deposits <sup>1/</sup>	Total
1960-December:	398	14		411
1961-December:	364	5	302	671
1962-March	664	5	113	782
June	683	5	207	895
September	790	6	143	939
December:	435	7	143	585
1963-March	466	26	143	635

<sup>1/</sup> Deposits of the Exchange office (UIC) with the commercial banks.

Source: Bank of Italy

Table 5 Italy: Repatriation of Italian Banknotes, and Net Capital Movements 1958-63

(In millions of dollars)

	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>
<u>Banknotes repatriated:</u>						
January		15	14	22	65	115
February		15	11	26	80	150
March		5	18	29	107	259
Quarter I	--	34	43	77	252	525
II	1		40	123	202	n.a
III <sup>a/</sup>	3	5	26	43	105	
IV	<u>3</u>	<u>23</u>	<u>77</u>	<u>86</u>	<u>207</u>	
Total for year	7	62	185	330	766	

Bank of Italy estimates:

Italian capital exported via  
banknotes which:

Returned through nominees	n.a.	n.a.	176	313	574
Remained abroad	n.a.	n.a.	9	17	192

a/ The diminutions noted in the third quarter reflect increased purchases of Italian banknotes in foreign centers by foreigners intending to travel to Italy.

Source: Bank of Italy

Presumably the step-up in this net outflow was a reaction to the policies of the Center-Left government.

These estimates throw much light on the recent behavior of other elements in the private capital account. The total private capital account changed from a net inflow of \$173 million in 1961 to a net outflow of \$219 million in 1962. (See Table 6.) The adverse change between these two years was thus \$392 million. Of this change, the increase in the net outflow of Italian capital effected via banknote export, i.e., net of subsequent return through foreign nominees, accounted for some \$175 million. Much of the remainder is explained by a big increase in recorded Italian capital export--from \$83 million to \$305 million.

Finally, genuine foreign investment in Italy apparently declined somewhat in 1962. The recorded figures--which include returning Italian funds through nominees--show an increase from \$614 million to \$845 million. If the estimates of the disguised Italian component in these inflows are deducted, as shown in Table 6, genuine foreign investment appears to have fallen off to approximately \$271 million in 1962 from about \$301 million the year before.

#### Lira declines on exchange markets in June

After holding steady at about .1610 U.S. cents, or 0.6 per cent above parity, the lira declined against the dollar in June. The rate fell from .1610 U.S. cents on June 3 to between .16080 and .16085 cents in the period June 6-14, and dropped further to .1607 cents on June 19. Subsequently, the lira strengthened and was quoted at .1609 cents on June 28.

#### Wage rate increases outstrip productivity gains

Another strong upward push in wage rates took place in the first quarter of 1963. Increases between December and March in minimum contractual hourly wage rates amounted to 5.6 per cent in industry, 4.4 per cent in agriculture, 7-1/2 per cent in

Table 6. Italy: International Private Capital Flows, 1962-63  
(In millions of dollars)

	<u>1961</u>	<u>1962</u>
<u>I. Italian Investment Abroad</u>		
A. <u>Banknote repatriation</u>	330	766
B. <u>Less: Estimated Italian funds returned through nominees</u>	(313)	(574)
C. <u>Estimated net outflow via banknotes</u>	( 17)	(192)
D. <u>Other recorded movements</u>	114	305
1. Credits (net)	31	110
2. Direct and portfolio (net)	83	194
E. <u>Total: recorded (A+D)</u>	444	1,071
F. <u>Total: estimated genuine (C+D)</u>	(131)	(497)
<u>II. Foreign Investment in Italy</u>		
A. <u>Recorded</u>	614	845
1. Credits (net)	121	74
2. Direct and portfolio (net)	493	772
B. <u>Less: Estimated Italian funds returned through nominees</u>	(313)	(574)
C. <u>Total: recorded (A)</u>	614	845
D. <u>Total: estimated genuine (A-B)</u>	(301)	(271)
<u>III. Other Capital Movements (net)</u>	3	7
<u>IV. Total Net Capital Flow (-=outflow)</u>	173	-219

Source: Data taken from Bank of Italy annual report for 1962.

Table 7. Italy: Wage Rate and Price Indexes, 1961-63  
(1953=100)

	<u>Year</u>		<u>Month</u>			
	<u>1961</u>	<u>1962</u>	<u>1961</u>	<u>1962</u>		<u>1963</u>
			<u>Dec.</u>	<u>Mar.</u>	<u>Dec.</u>	<u>Mar.</u>
<u>Minimum contractual wages</u>						
Industry	139.5	155.2	143.1	149.2	162.1	171.2
Agriculture	133.3	153.3	135.9	141.8	169.1	176.5
Commerce	139.5	148.2	142.1	144.6	152.5	163.9
Transportation	140.5	157.0	151.8	153.2	161.5	165.4
<u>Actual wages</u>						
Industry	<u>a/146.9</u>	<u>a/168.4</u>	<u>b/153.3</u>	163.0	<u>b/180.1</u>	n. a.
<u>Wholesale prices</u>	99.0	102.0	99.9	101.4	104.5	106.2
Of which: agricultural goods	103.8	112.8	107.0	112.2	117.8	120.3
all other	97.9	99.2	98.0	98.6	101.0	102.4
<u>Consumer prices</u>	117.8	123.3	119.6	121.5	127.4	131.0
Of which: food	113.8	118.8	116.0	116.7	123.8	127.8
all other	122.1	128.2	123.6	126.7	131.3	134.5

a/ First 11 months.

b/ November.

Source: Bank of Italy.

commerce, and 2.4 per cent in transportation. (See Table 7.) Except for agricultural wages, these percentage increases were larger than the average quarterly percentage increases granted during the year 1962. In industry, hourly wage rates actually paid increased considerably faster last year than did the minimum contractual rates, as Table 7 shows. The rise in wage rates in 1962 was far in excess of the gains in productivity in Italy, and this relationship has thus continued into the early months of 1962.

The Bank of Italy has estimated that in 1962 the cost of labor in Italian industry as a whole, per unit of product produced, averaged 10 per cent higher than in 1961. This was in very marked contrast to the earlier Italian experience. Over the eight years from 1953 to 1961, the unit cost of labor in industry followed a flat trend, and year-to-year changes never exceeded 2-1/2 per cent. In a selected group of 24 manufacturing industries, examined in detail by the Bank of Italy, the unit cost of labor directly applied to the productive process was 6.3 per cent higher in 1962 than in 1961. Previously, there had been a rise of 2.2 per cent in 1961 and annual decreases in all the years from 1954 to 1960, so that in 1961 these labor costs were 20 per cent less than in 1953.<sup>1/</sup>

Within the national income totals (at current prices), labor income increased 16.6 per cent in 1962 (over the preceding year) compared with 7.8 per cent for all other incomes in the economy; the 1961 increases were 10.1 per cent for labor and 9.4 per cent for all others. The Bank of Italy has noted that the redistribution of incomes last year put a squeeze on profits and contributed to the expansion of consumer demand at the expense of savings and investment.

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<sup>1/</sup> The contrast between the two series stems from the decrease in the number of "production workers" as a percentage of total labor employed in industry.

Price rise continues into 1963

Prices continued to rise in Italy in the first quarter of 1963. Although the winter accentuated price tensions, basically the price increases in these months reflected a continuing upsurge in labor costs. At the wholesale level, increases in January and February were followed by a slight decline in March, and the general index in March was 1.6 per cent above the December level. (See Table 7.) Earlier, the index had risen 2.2 per cent from September to December and 1-1/2 per cent in the first quarter of 1962. The index in March was 4.7 per cent above a year earlier. Over those twelve months, agricultural prices rose 7.2 per cent and prices of non-agricultural goods 3.9 per cent.

Consumer prices, which have been rising faster than wholesale prices, continued to trend upward in all of the first three months of this year. The rise from December to March was 2.8 per cent compared with 2.6 per cent in the previous three months and 1.6 per cent in the quarter a year earlier. The rise in the general consumer price index over the twelve months ending last March was 7.8 per cent. Food prices rose 9-1/2 per cent in this period, and the rise in prices of other consumer goods and services came to 6.2 per cent.

Industrial output declines and revives again

The exceptionally rapid recovery in Italian industrial production last autumn was halted in January-February, but output again revived in March when the index rose 4.1 per cent.

The seasonally-adjusted index fell 1.7 per cent in January and a further 3.3 per cent in February. Bank of Italy economists attribute the declines to these three factors: (1) the severe winter weather; (2) an intensification of work stoppages in the metal and engineering industries; and (3) a natural tendency for production to advance more slowly after the autumn upsurge (5-1/2 per cent from

September to December). Milder weather and the settlement of the long labor dispute in the metal and engineering industries were reflected in the March upturn.

Information recently made available shows that over-all output in Italy again rose rapidly in 1962 but by less than the year before. Real GNP in 1962 was up 6.1 per cent at 1961 prices; at current prices the increase was 12.2 per cent, or twice as large, in reflection of a 5.7 per cent rise in the domestic price level. The 1962 expansion in real GNP was nearly identical with the average annual increase of 6.0 per cent recorded over the years 1950-61, but was down from the 8.1 per cent gain in 1961 because the gain in agricultural production dropped from 6.5 to 1.0 per cent. The 9.2 per cent rise in the deflated value of industrial output in 1962 nearly matched the 9.4 per cent increase of the preceding year. Because imports of goods and services in 1962 rose faster than exports, the real value of all resources available for internal use was up 6.8 per cent, or appreciably more than real GNP.

The pattern of internal resource use shifted in 1962 toward consumption and away from investment. Despite the smaller rise in the deflated value of total availabilities, consumption in real terms increased 6.4 per cent or at about the same rate as in 1961, while the gain in investment was substantially smaller. Inventory investment in real terms was about 14 per cent smaller than in 1961, and the rise in gross fixed investment at constant prices dropped to 8.9 per cent in 1962 from 11.2 per cent in 1961.

#### Monetary expansion continues

Monetary expansion has continued to be rapid in recent months despite the deficits in the balance of payments since last summer. Money supply rose 9.6 per cent between October 1962 and March 1963 or slightly faster than in the same period a year earlier (8.4 per cent). Loans and securities of the commercial and savings

banks (excluding Treasury bills forming part of the required reserves) increased 13.2 per cent between the end of September and the end of March, with loans (which are much greater in volume than security holdings) increasing by 14 per cent.

The external deficits since last September have not impeded internal monetary expansion because, over the period as a whole, they have been financed by commercial bank net borrowing abroad. From October 1962 through March 1963, official reserves and other net foreign assets of the monetary authorities in fact increased \$223 million, thereby increasing the banks' lending potential. These official holdings rose \$337 million in the fourth quarter of last year and dropped only \$114 million in the first quarter of this year. The net foreign liabilities of the commercial banks increased a total of \$657 million in these six months, of which \$503 million in October-December and \$154 million in January-March.

By far the largest factor in the rise in money supply in this period has been the expansion of bank loans (and to a small extent of bank security holdings). The increased bank reserves necessary for credit expansion have come in part from the increase in official reserves and other net foreign assets and to a limited extent from a rise in Bank of Italy credit to the banking system. But the most important single source has been a drawdown of Treasury balances with the central bank. Although the Treasury's cash deficit has tended to increase somewhat, principally this represents a shift in the distribution of credit to the Treasury.