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Recent Economic Developments in Italy:
July-November 1964

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Recent Economic Developments in Italy: July-November 1964

Summary

With the balance of payments continuing to show a very large surplus and wage pressures diminishing, the Italian authorities have moved to initiate a recovery of domestic production, and an official document forecasts a revival of economic activity in 1965. 1/ An improvement in business sentiment and a possible halt to the decline in production in the third quarter were encouraging. But the continuing rapid rise in consumer prices, with accompanying cost-of-living wage increases, showed that inflationary pressures had not yet been eliminated.

The balance of payments has recorded further improvements as exports continued to rise and the severe drop in imports extended at least through August. The total of the third quarter payments surplus together with October official reserve gains exceeded $560 million, and added substantially to the money supply and to commercial bank reserves. But monetary expansion remained small as business demand for bank credit stagnated, and the banks used reserve accretion largely to pay off central bank credit.

Bank of Italy action was one indicator of the new emphasis on recovery in Italian financial policies. In August, the Bank widened its credit lines to

1/ For a review of previous developments, see Recent Economic Developments in Italy, April-August 1964, dated September 11, 1964.

commercial banks, and in October made a direct injection of funds into the economy through the intermediation of the savings banks (see page 15 for details). On the fiscal side, the budget for 1965, presented on September 30, calls for a 14 per cent increase in expenditures relative to this year's initial estimates, and places emphasis on public investment. The special purchase tax on autos, imposed in February, was repealed in November. Over-all industrial production (excluding construction) in June-July was down 5 per cent from the first quarter, and output of investment goods was off more than 10 per cent. Because of the steep fall in new building starts, building activity in the second quarter was well below last year. Automobile purchases were also far below last year, but domestic production has suffered much less than have imports.

On the basis of incomplete data, the fall in industrial production may have bottomed out in August. The various expansionary measures mentioned above, together with the improved business sentiment as the balance of payments has turned favorable, are thought to have been sufficient to arrest the deterioration in domestic activity. In fact, government projections for 1965 show real GNP up 3 to 4 per cent over 1964; they also expect the upward momentum to gather speed over the course of the year. A sharp revival of equipment investment is expected in these estimates.1/

The present balance of payments position gives scope for an increase in imports without producting external financing difficulties. At the same time, manpower and plant capacity in the Italian economy are underutilized. Wage

1/ Gross investment (in real terms) in Italy this year may show an absolute fall of 5 per cent from last year. However, agricultural production will probably be up 4 to 5 per cent with improved growing conditions for major crops; as a result, real GNP may be up 3 per cent (in terms of annual averages) compared with the 4.8 per cent rise last year and much larger percentage increases in the immediately preceding years.

pressures have diminished and are expected to abate further. However, contractual wages are certain to follow any further rise in the cost of living which continued to climb sharply further in the third quarter. In September, despite nearly a year of business recession, consumer prices were 6-1/2 per cent higher than a year earlier.

External accounts record additional surpluses

Italy's balance of payments registered further improvement over last year during the months July-October, with exports higher and imports depressed. The third-quarter surplus exceeded $500 million, and official reserves rose $160 million in October.

Receipts from exports (unadjusted) in the third quarter exceeded the year ago level by $266 million (22 per cent). (See Table 1.) Seasonally adjusted exports through customs continued to increase, and in July-August averaged 4.6 per cent above the second quarter; in addition, the unadjusted data suggest a further rise from August to September. Because of slackening domestic demand, Italian producers this year made strenuous efforts to increase their foreign sales, even at profit levels which would be considered to be extremely low by past precedent. Over the three months June-August, seasonally-adjusted exports ran above the same period last year at an annual rate of close to $900 million; all major categories of exports have contributed to the gain.

Imports on a payments basis in the third quarter were down $195 million (11 per cent) from last year. However, this comparison fails to bring out the extent of the decline in imports this year; seasonally-adjusted imports on a

Table 1. Italy: Balance of Payments 1963-64
(in millions of dollars)

	1963			1964		
	I	II	III	I	II	III
I. CURRENT ACCOUNT	-210	-274	-76	-427	57	477
Imports c.i.f.	1,641	1,824	1,829	1,932	1,727	1,634
Exports	1,132	1,178	1,206	1,254	1,331	1,472
Trade balance	-509	-646	-624	-679	-396	-161
Foreign travel	97	190	326	89	184	352
Other invisibles	202	182	222	163	269	286
II. PRIVATE CAPITAL	-45	-142	-17	-23	223	--
Italian banknotes returned for conversion into foreign exchange	-525	-500	1/ (-88)	-262	-142	1/ (-70)
Foreign investment in Italy:						
Direct and portfolio	474	325	1/ (83)	108	221	1/ (60)
Loans	41	80	1/ (69)	138	209	1/ (39)
Italian investment abroad	-38	-42	1/ (-4)	-29	-32	1/ (-44)
Unclassified	3	-6	1/ (-59)	-21	-52	1/ (-40)
III. PUBLIC CAPITAL	-13	5	-19	15	-53	25
IV. OVER-ALL BALANCE (I + II + III)	-268	-412	-113	-436	227	[illegible]2
V. MONETARY MOVEMENTS (- = increase in foreign assets or decrease in foreign liabilities)	268	412	113	436	-227	-502
Official reserves (gross) 2/	124	13	-122	235	-36	-258
Other official (net)	-10	16	32	398	-44	-139
Commercial banks (net)	154	383	203	-197	-147	-105

1/ July-August only.

2/ In September, 1964 official reserves were redefined to include convertible foreign exchange held by the Bank of Italy, amounting to between $113 and $122 million at month-end during the first nine months of 1964. All figures in the table are based on the new definition. Most of the foreign exchange component of the official reserves is held by the Ufficio Italiano dei Cambi ($1,012 million on September 30, 1964). Gold reserves on September 30 were $2,104 million.

Source: Bank of Italy.

customs (i.e. shipment) basis were 23 per cent less in July-August than in the last quarter of 1963. (See Table 2.) At an annual rate, this decline amounts to $1,900 million. The decline in imports this year has been general, but heaviest for consumer goods. (See Table 3.)

The balance on private capital account in June-September contrasted with a $223 million net inflow in the second quarter. The second quarter (on which details have only recently become available) showed an extraordinary improvement over a year earlier because of a big increase in foreign loans, and a sharp decrease in the volume of returned banknotes with a reduced clandestine capital outflow. Higher genuine foreign investment and a repatriation of Italian funds previously sent abroad both contributed to the improved capital accounts.

The Italian commercial banks continued to contract their net foreign liabilities in the third quarter, but over half of the surplus went to increase official reserves. A $139 million increase in other official net foreign assets was mainly caused by Italy's transactions with the International Monetary Fund in August, viz., the $57.5 million gold payment on its quota increase and the $65 million partial repayment of the March drawing.

Monetary expansion remains small; bank liquidity rises

Monetary expansion remained small in the third quarter, despite the heavy balance of payments surplus, because of stagnant demand for credit on the part of business enterprises. The money supply increase in the third quarter was 1.0 per cent compared with 3.5 per cent a year earlier. (See Table 4.) Although the rise in official net foreign assets injected 249 billion lire into

Table 2. Italy: Seasonally Adjusted Foreign Trade, 1963-64
(in millions of dollars; monthly average or month)

Quarters	Imports c.i.f.	Exports	Balance
1963 - I	561	409	-153
II	630	421	-209
III	675	432	-243
IV	681	443	-237
1964 I	671	452	-219
II	619	480	-138
Months			
1963 - November	1/698	446	-251
1964 - March	648	463	-184
June	618	493	-145
July	544	532	-12
August	502	472	-30

1/ Monthly high to date

Source: OECD

Table 3. Italy: Imports by Commodity Groups, 1962-64

Values (in billions of lire)

	Year		Quarter			
			1962	1963	1963	19[illegible]
	1962	1963	IV	II	IV	II
Consumer goods	1,484	2,042	431	515	551	511
Food	626	965	292	240	266	234
Other non-durables	524	586	42	152	152	167
Durables	334	491	96	123	133	110
Investment goods	1,534	1,770	401	450	459	438
Construction materials	198	226	50	60	59	58
Industrial transport equipment	153	162	37	45	40	48
Plant and machinery	1,183	1,381	314	345	360	332
Industrial raw materials	774	900	214	221	244	250
Total	3,792	4,712	1,046	1,186	1,254	1,199

Change in Quarter II from preceding Quarter IV

	In per cent		In billion lire	
	1963	1964	1963	1964
Consumer goods	+19.5	-7.3	+84	-40
Food	-17.8	-12.0	-52	-32
Other non-durables	+261.9	+9.9	+110	+15
Durables	+28.1	-17.3	+27	-23
Investment goods	+12.2	-4.6	+49	-21
Construction materials	+20.0	-1.7	+10	-1
Industrial transport equipment	+21.6	+20.0	+8	+8
Plant and machinery	+9.9	-7.8	+31	-28
Industrial raw materials	+13.4	+2.5	+23	+6
Total	+13.4	-4.6	+140	-55

Source: Istituto Centrale di Statistica.

Table 4. Italy: Changes in Money Supply and Counterparts, 1963-64
(In billions of lire; no sign = increase)

	1963			1964		
	I	II	III	I	II	III
MONEY SUPPLY[1/]	-190	317	366	-586	168	115
(In per cent)	(-1.8)	(+3.1)	(+3.5)	(-5.0)	(+1.5)	(+1.0)
COUNTERPARTS	-190	317	366	-586	168	115
A. Official net foreign assets	-70	-21	63	-397	45	249
B. Bank of Italy credit:						
1. To Treasury	212	-73	122	-64	113	49
2. To special credit institutes	4	-21	29	5	-35	52
C. Commercial banks:						
1. Treasury securities	7	-17	27	76	28	81
2. Lira loans and other securities	250	560	512	-145	53	-3
3. Net foreign liabilities (- = increase)	-96	-239	-127	123	92	65
4. Domestic loans in foreign exchange	139	108	42	-43	-77	-78
D. Savings deposits with banks (- = increase)	-211	-119	-208	-61	-11	2/ -165
E. Other (net)	425	139	-94	-80	-40	-135

1/ Checking accounts and currency outstanding, including banks' vault cash.
2/ Estimated from incomplete data.
Source: Computed by author from Bank of Italy data.

Table 5. Italy: Factors Affecting Banks' Liquidity, 1964
(In billions of lire; no sign = increase)

	I	II	III	October
I. Factors Affecting Reserves	4	56	46	60
Official net foreign assets	-396	44	250	108
Bank of Italy credit to Treasury	-64	113	49	-128
Currency (- = increase)	264	-14	-40	n.a.
Other (net)	56	-111	91	n.a.
Subtotal	-140	32	396	74
Bank of Italy credit to commercial banks:	144	24	-350	-14
advances	69	-20	-113	39
rediscounts and other	75	44	-237	-53
II. Change in Reserves with Bank of Italy	4	56	46	60
Required (in cash and Treasury bills)	18	46	10	47
Free (in cash)	-14	10	36	13
III. Change in Unused Margin on Bank of Italy Advances	-114	51	173	-39
Credit line	-45	31	60	--
Advances obtained	69	-20	-113	39

Source: Computed by author from Bank of Italy data.

the economy, and central and commercial bank credit to the Treasury some 130 billion lire, the money supply increased only 115 billion lire because of additions to savings deposits and other offsets. From end-June to end-September, commercial bank credit to the economy 1/ in the form of lira loans and non-Treasury securities was essentially unchanged in contrast with the large rise of 4.3 per cent (512 billion lire) in the corresponding quarter last year. Once again, the banks reduced both their net foreign liabilities and their foreign exchange loans to residents by roughly equal amounts. The rise in official net foreign assets in the third quarter and in October added heavily to bank reserves, but the banks have used most of their reserve gains to reduce their indebtedness to the central bank. (See Table 5.)

However, the lending potential of the banking system has increased, partly because of an easier Bank of Italy policy. Free reserves have risen. In addition, the Bank of Italy has increased the lines of credit under which the commercial banks obtain advances (but not rediscounts or other credits). Since the banks have in fact reduced their outstanding advances, the unutilized margin has increased.

Decline in industrial production may have halted

Industrial production may have bottomed out in August, and an apparent rise in September, coupled with an improvement in business sentiment, may herald a change in trend.

1/ For Italy, the term "commercial bank" includes the savings banks, which do a large commercial banking business.

The sharp decline in seasonally-adjusted production in the second quarter was followed by a small rise in July. On the basis of partial data for later months, ISCO, Italy's foremost economic research institute, believes that seasonally-adjusted production dropped again in August to a new low, but recovered in September to around the June-July level.

In their replies to the ISCO monthly surveys of the business situation, producers stated that production and order backlogs declined further between June and August. However, between June and August, there were slight improvements in producers' outlook for production and orders in the coming 3 or 4 months. These results supplement other reports of improved business sentiment based on the following developments: (1) the favorable trend of exports; (2) the extraordinary improvement in the balance of payments which has allowed the Bank of Italy to adopt an easier monetary policy; (3) the government's decision in August to reduce employers' social security contributions; (4) official forecasts that real GNP in 1965 will average 3 to 4 per cent above 1964, and that equipment investment may be up 10 to 12 per cent; (5) the 1965 budget which provides for a big expansion of government investment outlays.

Economic activity declined sharply in second quarter

In July, seasonally adjusted industrial production (which excludes construction) was down 4.9 per cent from the first quarter, when output fluctuated around the level reached in late 1963. (See Table 6.) Production of investment goods declined almost twice as much as that of consumer goods. Output of electricity, chemicals and petroleum products rose through March but then declined.

Table 6. Italy: Industrial Production and Unemployment, 1963-64

		Industrial production[1/] (1953 = 100)				Unemployment[3/]
		Total	Investment goods	Consumer goods	Other[2/]	(000's)
Quarters:	1963 -- I	230.5	233.9	198.5	290.5	594
	II	241.3	248.2	207.4	300.5	455
	III	242.7	245.4	210.4	304.7	502
	IV	249.7	246.5	217.8	320.0	440
	1964 I	250.1	247.7	216.8	321.5	529
	II	242.3	229.8	208.4	331.7	516
Months:	1963 - November	252.0	245.7	221.2	324.4	4/
	1964 - March	252.2	245.5	217.2	333.5	4/
	June	236.8	221.2	203.7	332.9	4/
	July	239.0	221.6	206.6	330.8	608
1964--%Percent change from Quarter I to June-July		-4.9	-10.6	-5.4	+3.2	

1/ Excludes construction.
2/ Electricity, petroleum products, and chemicals.
3/ First month of quarter.
4/ Published only for first month of each quarter.

Sources: Industrial production indexes from ISCO (Istituto Nazionale per lo Studio della Congiuntura); unemployment from OECD.

The building and automobile sectors have suffered especially severe reductions in activity in recent months. Although building completions in 1964 have been well ahead of last year, starts as measured by the number of permits issued have been dropping rapidly, relative to a year earlier, since the third quarter of 1963; in the second quarter of 1964 they showed a year-to-year decrease of almost 25 per cent. (See Table 7.) Total work in progress (as estimated by the sum of permits and completions) was down 12 to 13 per cent in April - June from the like period of 1963, at a time of practically no year-to-year change in industrial production.

In the automobile sector, new car registrations fell off after the special 7-15 per cent purchase tax was imposed in February, and in July they were almost 30 per cent fewer than last year. (See Table 8.) However, domestic production (down in June by 9 per cent from last year) has suffered proportionately less. Demand for imported cars has fallen much more severely than demand for Italian-made autos, partly because of the shortening in April, from 360 to 30 days, of the allowed delay in payments for imports of autos and many other consumer durables. Moreover, there has been a notable expansion of exports of cars this year.

Further slackening of wage pressures is expected

The extraordinary rise in Italian wage rates since 1961 has continued in 1964, but the pace has slackened and is expected to diminish further in the coming year.

Table 7. Italy: Building Activity, 1963-64

	Volume (million cubic meters)			Per cent Change from 12 months earlier		
	Residential	non-residential	Total	Residential	non-residential	Total
Completions						
1963 - Quarter III	21.0	2.7	23.8	+3.0	-17.8	+0.1
IV	30.0	3.5	33.5	+3.3	-12.2	+1.4
1964 - Quarter I	21.8	4.2	26.0	+4.6	+19.3	+6.7
II	23.0	4.5	27.5	+8.2	+54.8	+13.8
Permits						
1963 - Quarter III	39.5	8.9	48.4	+27.1	+13.6	+24.4
IV	40.0	8.9	48.9	+9.5	-4.2	+6.7
1964 - Quarter I	35.1	8.1	43.2	-5.4	-28.1	-10.7
II	32.5	7.9	40.3	-23.1	-30.0	-24.6
Sum of Completions and Permits						
1963 - Quarter III			72.2			+15.2
IV			82.4			+4.5
1964 - Quarter I			69.2			-4.9
II			67.8			-12.6

Source: Istituto Centrale di Statistica

Table 8. Italy: Selected Statistics on Passenger Automobiles, 1962-64
(in thousands of units)

	Registrations		Production		Imports 1/		Exports 1/	
	1962	1963	1962	1963	1962	1963	1962	1963
Year	634.6	916.6	877.8	1,105.3	106.8	206.5	306.1	273.9
	1963	1964	1963	1964	1963	1964	1963	1964
January	75.1	90.1	92.0	100.6	14.2	15.8	25.1	19.0
February	65.2	82.0	81.9	102.6	13.3	21.0	22.3	22.9
March	75.7	87.2	89.6	97.6	15.8	15.8	29.2	30.9
April	81.8	74.1	91.8	98.1	19.7	11.2	22.8	32.9
May	87.5	59.1	102.7	86.0	21.2	10.1	24.6	23.9
June	82.6	66.3	95.2	86.5	19.1	13.3	20.5	30.4
July	100.6	2/ 72.0	115.3	n.a.	27.5	2/ 9.0	26.6	2/ 33.0

1/ Includes trucks and buses; however, these are a small share of the total.
2/ Approximate figure taken from a graph.

Source: Istituto Centrale di Statistica.

In a Parliamentary speech in November, Budget Minister Pieraccini cited changes in 1963 and 1964 in de facto wage rates (those actually paid); these rates have been substantially in excess of the minimum contractual rates used in the calculation of published wage indexes. In 1963, when minimum contractual rates averaged 16.9 per cent above 1962, the rise in de facto rates was 21.6 per cent. This year, the relative movements have been the reverse of last year and the gap between the two sets of rates has narrowed. "So far in 1964," said the Minister, contractual rates have run 15 per cent above last year but de facto rates are up only 12.5 per cent.

There are two grounds for the expectation that wage pressures will abate further. In the first place, no important new wage contracts will go into effect until the last few weeks of 1965. Furthermore, the phased increased in contractual rates provided in existing wage contracts are expected to be significantly smaller in forthcoming months than they have been in the past.

However, under the existing sliding scale clauses, contractual rates will at least keep pace with the cost of living. In recent months, contractual rates showed seasonal stability in June-July but rose 2.5 per cent in August, largely or wholly because of the increase, from April to July, in the unpublished cost of living index to which they are tied. (See Table 9.)

Consumer prices continue to rise rapidly

Consumer prices have continued to rise rapidly despite stagnant or falling production, drastic reductions in hours worked, and some rise in unemployment. The further increase in the third quarter was 1.3 per cent (compared

Table 9. Italy: Price and Wage Rate Indexes, 1962-64
(1953 = 100)

		Consumer prices	Wholesale prices	Wage rates in manufacturing 1/
Indexes:	1962 - December	127.4	104.5	162
	1963 - September	133.3	107.8	181
	December	136.2	110.2	184
	1964 - March	137.8	110.7	197
	June	140.1	110.3	201
	August	141.3	110.2	206
	September	141.9	110.9	n.a.
Per cent change in 3 months ending in:				
	1963 - March	+2.8	+1.6	-6.2
	June	+0.8	+0.8	+3.5
	August	+0.5	+0.2	+1.7
	September	+1.0	+0.7	+1.7
	1964 - March	+1.2	+0.5	+7.0
	June	+1.7	-0.4	+2.0
	August	+1.5	-0.1	+2.5
	September	+1.3	+0.5	n.a.

1/ These indexes refer to minimum contractual rates, not to wage rates actually paid.

Sources: Prices from Istituto Centrale di Statistica; wage rates from OECD.

with 1.0 per cent in the same quarter of last year), so that in September they were up 6.5 per cent from a year earlier. (See Table 9.) The relative stability of wholesale prices in 1964 was broken by an 0.6 per cent jump in September; the rise in the third quarter was 0.5 per cent, and while this was a bit less than in the third quarter of last year the comparison is less favorable than for the first two quarters.

Steps are taken to stimulate output

Since mid-summer, Italian officials have acted in several fields to facilitate a revival of production. In the official view, total spending can now be increased without great danger of inflation or a serious external deficit because of the present balance of payments surplus, the existence of unutilized productive capacity and reduced hours worked, and diminishing wage pressures.

First, on the monetary front, since August the Bank of Italy has made more credit available to the banks, although through October the banks did not utilize any of the additional credit availability because customer loan demand failed to rise. To inject money into the economy, the Bank of Italy and the savings banks made arrangements in October whereby the Bank of Italy would purchase about 200 billion lire of Treasury bills held by the savings banks as part of their compulsory reserves. The latter would then use the proceeds to purchase bonds to be issued by several public enterprises. The figure of 200 billion lire equals about 2 per cent of the current money supply.

Second, in mid-November the government repealed the special tax of 7 to 15 per cent imposed in February on purchases of automobiles.

Finally, the budget estimates for 1965 presented on September 30 are expansionary. Total outlay estimates for next year (excluding debt redemptions) are nearly 14 per cent higher than the initial estimates for 1964; priority is being given to public investment (up 27 per cent) as opposed to current expenditures (up 11 per cent). 1/ Because receipts (excluding borrowing) are projected at 18 per cent above 1964, in reflection of expected recovery, past price increases, and new taxes levied this year, the forecast deficit of 430 billion lire is somewhat smaller than that for 1964. The Italian authorities are unable to estimate the likely monetary impact of Treasury operations in 1965 because of uncertainties concerning not only the tax base but also the following: 1) supplementary expenditure authorizations, which in the recent past have been as high as 20 per cent of initially forecast outlays; 2) the customary long lags between authorizations and actual cash disbursements; 3) the heavy extrabudgetary net expenditures of the Cassa Depositi e Prestiti, which are planned on a month-to-month basis; and 4) the extent to which recourse must be had to the Bank of Italy to finance the Treasury's deficit.

Official document forecasts recovery

The "Preview and Planning Report" accompanying the 1965 budget, submitted on September 30, forecasts a recovery of Italian output next year. The basis for the forecasts has not been made known; however, it is plain that

1/ The 1965 estimates are here compared with the sum of 1) one-half of the initial estimates for fiscal 1964, ending June 30, 1964, and 2) the initial estimates for the Interim Budget covering July-December 1964. The fiscal year will correspond with the calendar year beginning in 1965.

the government and the Bank of Italy are now actively promoting a revival of economic activity.

In real terms, GNP in 1965 is expected to average 3 to 4 per cent above 1964, with the annual rate increasing to 6-8 per cent by the end of the year. Industrial production will average 6 to 6-1/2 per cent higher than in 1964, and will increase 11 per cent from December 1964 to December 1965; 1965 agricultural output will be up 2.4 per cent, construction will be close to or not much below 1964, and tertiary activities will be 4 per cent higher. While consumption is forecast at 3 to 4 per cent above 1964 (the same rise as for GNP), investment outlays might rise as much as 6 per cent. A 10 to 12 per cent increase in equipment outlays is expected, but total investment will reflect the stagnation of construction.

Estimates of the national accounts for 1964 show a further slowing of the rise in real GNP from 4.8 per cent last year to, at most, 3 per cent this year (but 8 to 9 per cent in money terms). Much of this is accounted for by a 4 to 5 per cent increase in agricultural production; industrial production will average scarcely higher (1 to 2 per cent) than last year, a gain totally accounted for by the increases in the second half of last year. Investment outlays, which rose at progressively slower rates in 1962 and 1963, are expected to undergo an actual decline of some 5 per cent this year.