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Recent Economic Developments in Italy:
October 1962 to March 1963

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Summary

Resumption of domestic expansion and a substantial deterioration in the balance of payments were the main developments in the Italian economy in the period under review. Prior to October, when a renewed burst of industrial activity commenced, output had failed to rise above the level reached at the start of the year, in part because of strikes in the metallurgical and engineering industries.

The renewed domestic expansion contributed to the over-all payments deficit of \$166 million in the fourth quarter (compared with a surplus of \$122 million a year earlier). A marked rise in the physical volume of imports led to a further deterioration in the underlying trade position. In addition, a heavy clandestine outflow of Italian funds in the form of the export of bank notes to Switzerland continued to dominate the capital account. Uncertainties about the forthcoming elections on April 28 have helped to maintain the clandestine outflow.

The recent expansion in imports has been due to the continuing rapid growth of the economy, a still greater increase in money incomes, and rising price tendencies. In addition, tariff reductions have contributed to the heavier volume of foreign purchases. Duties on imports from the Common Market countries were lowered in January and July 1962. In addition, at the end of

August, Italy unilaterally reduced duties on most imports (irrespective of origin) by 10 per cent as part of an official program to rely upon an increase in imports to help slow down advances in prices and costs.

Despite the over-all payments deficit, Italian official reserves rose by \$333 million in the fourth quarter. The commercial banks reduced their net foreign position by \$503 million during the period by additional foreign borrowing which resulted from the permission granted the banks in October to borrow abroad to make foreign currency loans to Italian residents.

For 1963, economic activity is expected to increase as fast as, or even faster than, in 1962. Consumer demand continues to be the bellweather of the economy. On the external side, external payments were in virtual equilibrium in 1962 and the expectation is for a payments position about in equilibrium or in modest deficit for 1963, since the Italian authorities are continuing to take steps to maintain domestic expansion with recognition that these measures are likely to encourage additional imports.

The intensified rising trend in prices in the fourth quarter remains a disturbing aspect of the present Italian situation. Since December, the government has taken steps to allow greater imports of food in order to dampen domestic price increases.

Balance of payments shifts into deficit in fourth quarter 1962

The deterioration in the Italian balance of payments evident in previous months intensified in the fourth quarter of 1962, when there was an over-all deficit of \$166 million (see Table 1), as compared with a surplus of \$122 million in the corresponding period of 1961.^{1/} The fourth quarter deficit also contrasted with a \$335 million surplus in the third quarter of the year, when international payments showed seasonal strength in tourism, trade, and emigrant remittance accounts. In the fourth quarter, seasonal weakness in tourist receipts was offset by seasonal strength in trade and remittances.

For the full year 1962, Italy's over-all surplus was \$50 million, as against \$577 million in the year 1961.

The worsening of the over-all payments balance in the fourth quarter was due--apart from the seasonal decrease in tourist receipts--almost entirely to the further, and very rapid, widening of the trade deficit. The trade gap of \$539 million in the fourth quarter compares with \$250 million in the third quarter of 1962 and \$266 million in the last quarter of 1961.^{2/} While export receipts declined 2 per cent in the fourth quarter, import payments jumped 19 per cent. The widening of the trade gap stemmed in large part from

^{1/} Developments through September 1962 were reviewed in R. H. Mills, Recent Economic Developments in Italy: July to November 1962, dated January 3, 1963.

^{2/} Specific balance of payments entries so far reported for 1962 must be treated with more than the usual amount of reservation. "Unclassified items" (which include errors and omissions) were especially large, showing a net credit of \$97 million, of which \$41 million in the fourth quarter. This point should be kept in mind throughout the subsequent discussion.

Table 1. Italy: Balance of Payments, 1961-62
(In millions of dollars)

	1961			1962		
	Qtr. <u>III</u>	Qtr. <u>IV</u>	Year	Qtr. <u>III</u>	Qtr. <u>IV</u>	Year
A. CURRENT ACCOUNT						
Imports c.i.f.	-1181	-1284	-4937	-1398	-1661	-5884
Exports	1003	1018	3851	1149	1122	4457
Trade balance	- 178	- 266	-1086	- 250	- 539	-1427
Foreign travel	275	136	648	311	150	724
Emigrant remittances	126	127	418	158	144	511
Other items	105	83	384	108	63	323
Total current account	329	77	362	328	- 181	131
B. PRIVATE CAPITAL						
Recorded Italian capital	- 39	- 31	- 116	- 129	a/	a/
Recorded foreign capital	125	139	617	220	a/	a/
Repatriation of Italian banknotes	- 43	- 87	- 330	- 105	a/	a/
Other	- 3	- 4	- 8	2	a/	a/
Total private capital	39	17	164	- 11	b/- 27	b/- 178
C. PUBLIC CAPITAL						
	- 2	27	49	3	a/ c/	a/ c/
D. UNCLASSIFIED ITEMS						
	23	--	2	16	41	97
E. SURPLUS or DEFICIT						
	390	122	577	335	- 166	50
F. MONETARY MOVEMENTS						
Official reserves	- 390	- 122	- 577	- 335	170	- 63
Other net foreign assets of the UIC	- 262	- 50	- 340	- 13	- 189	- 92
Other net foreign assets of the Bank of Italy	2	- 85	- 74	- 251	- 121	- 502
Commercial banks' net foreign position	- 113	- 38	- 203	- 26	- 23	31
	- 17	50	40	- 45	503	430
G. STATISTICAL DISCREPANCY (F-E)						
	--	--	--	--	- 4	13

Footnotes on succeeding page.

a/ Figures for October-November and January-November are as follows:

	<u>Oct.-Nov.</u>	<u>Jan.-Nov.</u>
<u>Private capital</u>	- 46	-206
Italian capital	- 45	-270
Foreign capital	145	756
Banknote repatriation	-153	-712
Other	7	20
<u>Public capital</u>	<u>3</u>	<u>12</u>

b/ Includes public capital.

c/ Included in total for private capital.

Sources: Bank of Italy, annual report for 1961; Istituto Nazionale per il Commercio Estero, Movimento Valutario, issues for Jan.-Sept. 1962; press release of Ministry of Foreign Trade issued in February 1963 relative to 1962 results; Istituto Nazionale per lo Studio della Congiuntura, Congiuntura Italiana, no. 1, 1963, relative to data in footnote a/.

adverse changes in leads and lags, but Italy's underlying trade position also continued to deteriorate. Net receipts from current invisible transactions, at \$357 million in the fourth quarter, continued to run substantially above a year earlier.

The capital account registered a deficit of \$27 million in the fourth quarter, following a \$7 million deficit in the third. The second half of the year thus showed a substantial improvement compared with the first half, when net capital outflow totalled \$143 million. But there nevertheless remained a marked contrast with the preceding year; in 1961 there was a net capital inflow of \$216 million, of which \$48 million in the final quarter. The repatriation of Italian banknotes--mostly representing illegal capital export--continued on a large scale, amounting to \$80 million in October and \$73 million in November. This brought the January-November total for bank-note repatriation to \$712 million. As noted in previous reports on Italy, the export of banknotes (mostly to Switzerland) stems from fiscal evasion and perhaps, in 1962, investor fears of the Center-Left government in Italy. While the bulk of this illegal capital export returns to Italy (in the guise of "foreign" investment), a substantial part has of late remained abroad. This failure of some of the funds to return to Italy is one reason for the shift in the capital account from surplus to deficit.

Trade gap continues to widen

The fourth-quarter trade results measure the combined effects of two main developments:

(1) As the main factor, trade payments were more adverse than actual shipments because Italian importers accelerated their payments and exporters slowed down the repatriation of their export proceeds.

(2) There was, nevertheless, a further weakening of the more "fundamental" trade position as measured by seasonally-adjusted trade shipments.

Changes in leads and lags in foreign trade payments accounted for over \$200 million of the \$289 million rise in the trade gap, since the deficit on actual (unadjusted) trade shipments rose by only \$75 million. (See Table 2.) Export receipts were nearly equal to shipments in the third quarter but fell short of shipments by \$130 million in the fourth quarter. The reasons for this divergence are not known. On the import side, payments fell short of arrivals through customs by \$119 million in the third quarter but they were virtually identical with arrivals in the fourth quarter.^{3/}

In addition, seasonally-adjusted imports (shipments basis) rose 7 per cent in the fourth quarter while exports rose 4 per cent, and the deficit increased \$57 million. (See Table 3.) In three of the past four quarters, the rise in imports has been very rapid, and much greater than the rise in exports. The quarter-to-quarter percentage increases in 1962 were:

	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>
Imports c.i.f.	6	0.4	9	7
Exports	-1	4	-1.5	4

For the full year 1962, imports were up 16 per cent over 1961. For the second half of the year, the contrast with a year earlier is greater, the year-to-year rise being 22 per cent.

^{3/} In recent years, imports recorded as c.i.f. in the balance of payments have averaged 4.8 per cent less than imports c.i.f. shipped through customs, in part because the former do not include freight on imports carried by Italian shippers. On the basis of this average relationship, payments would have fallen short of shipments by \$69 million in the third quarter and \$76 million in the fourth.

Table 2. Italy: Shipments vs. Payments on Foreign Trade, 1961-62
(In millions of dollars)

	<u>1961</u> Year	<u>1962</u>			
		I	II	III	IV
<u>Imports c.i.f.</u>					
Shipments	5,256	1,454	1,480	1,517	1,666
Payments	4,937	1,389	1,436	1,398	1,661
<u>Exports</u>					
Shipments	4,212	1,085	1,188	1,166	1,252
Payments	3,851	1,093	1,093	1,149	1,122
<u>Balance</u>					
Shipments	-1,024	- 369	- 292	- 351	- 414
Payments	-1,086	- 296	- 343	- 250	- 539

Sources: OECD (shipments); sources for Table 1 (payments).

Table 3. Italy: Seasonally-Adjusted Foreign Trade, 1961-62
(In millions of dollars; monthly average or month)

	<u>Imports c.i.f.</u>	<u>Exports</u>	<u>Balance</u>
<u>1961</u>			
Qtr. I	430	327	-103
II	432	341	- 91
III	443	362	- 81
IV	453	384	- 69
<u>1962</u>			
Qtr. I	479	381	- 98
II	481	397	- 84
III	525	391	-134
IV	561	408	-153

Source: OECD

The much higher level of total imports in 1962 was not confined to a limited range of commodities. In the first 11 months of the year, the physical volume of total imports rose approximately 16 per cent above the year-earlier level. Volume increases by groups between these two periods were about 16 per cent for raw materials, 22 per cent for semi-finished goods, 30 per cent for finished equipment goods, and 35 per cent for finished consumer goods. Only foodstuffs, with a weight of about 20 per cent in total imports, failed to show a large gain over January-November 1961. Even for this group, however, the months September-November saw a much higher volume than a year before.

Imports have been stimulated by the further 5-1/2 per cent growth of real GNP in 1962, and an appreciably larger rise of GNP in money terms. Consumer prices in 1962 averaged 4.6 per cent higher than in 1961, and wholesale prices 3.0 per cent. Industrial production underwent a year-to-year increase of 9-1/2 to 10 per cent. Tariff reductions have also been a factor. Duties on imports from Common Market countries were lowered in January and July, 1962, in accordance with the E.E.C. program. Subsequently, at the end of August, Italy unilaterally reduced the duties on most imports (irrespective of origin) by 10 per cent.

Central reserves rise despite over-all deficit

Although the balance of payments was in deficit by \$166 million in the last quarter of 1962, there was an increase of \$333 million in Italy's central reserves. (See the monetary movements in Table 1.) This broad category comprises:

- (1) the official reserves of gold and convertible currencies (up \$189 million);

(2) other net foreign assets of the Italian Exchange Office (up \$121 million); and

(3) other net foreign assets of the Bank of Italy (up \$23 million).

The deficit was financed by the Italian commercial banks which, in addition, turned over large amounts of foreign exchange to the monetary authorities by reducing their lira-dollar swaps with the UIC. In the quarter, the banks' net foreign position worsened by \$503 million, which combined an increase in foreign liabilities of \$587 million and an increase of \$84 million in assets.

These activities by the banks were a consequence of the measure taken last October permitting Italian banks to borrow foreign currencies abroad for the purpose of foreign exchange loans to Italian residents. The objective of that step--which was realized in substantial amount--was to place more funds at the disposal of the Italian banking system. The increased borrowing abroad also eased the lira position of the banks. The main source of foreign currencies for internal foreign exchange loans (almost all to importers) has been, and to a lesser extent still is, swaps of lire for dollars with the UIC. But these swaps tied up lire which the banks could profitably use for lira loans and investments. The banks reduced them as soon as they were allowed to obtain additional funds abroad, thereby freeing an equivalent amount of lire for other purposes.

Outstanding swaps were \$939 million at the end of last September. The end-1962 figure is not yet available, but the reduction during the fourth quarter probably approximated the \$333 million increase in central reserves.

Lira remains near upper limit

Because the fourth quarter deficit was financed by increased foreign borrowing by the Italian commercial banks, there was no pressure on the exchange rate of the lira. In October-December, the lira fluctuated narrowly around the level of .16105 U. S. cents, or close to its upper limit against the dollar of .16120 cents.

In January, the rate was under some pressure, but the authorities chose to maintain the lira near the previous levels. The rate declined slightly from .16105 U. S. cents on January 3 to .16101 cents on January 31. In February and the first 14 days of March the lira was generally above .1610 cents, falling slightly below that level on three occasions in mid-February.

Renewed expansion of industrial output

There was a renewed burst of industrial activity in the final quarter of 1962. By the start of the current year, more hopeful predictions for business prospects had dispelled some of the caution and uncertainty prevalent in the second and third quarters.

Industrial production, seasonally-adjusted, rose 1.7 per cent in October and 2.9 per cent in November; another rise of about 1 per cent is believed to have occurred in December. Prior to last October, output had failed to rise above the level reached at the start of the year, partly because of strikes in the metallurgical and engineering industries. The autumn upturn was featured by a vigorous spurt in production of consumer goods (particularly foods and automobiles), output of which averaged 4.8 per cent higher in October-November than in the third quarter. The comparable rise for output of investment goods was much less, but at 1.6 per cent it

contrasted with a decline in the second quarter and the absence of any significant advance in the third.

The vigor of consumer goods production is symptomatic of the change in the pattern of demand in 1962. Consumer demand, helped by a year-to-year rise in wage rates of around 15 per cent, was the main driving force in the economy last year, and consumption in real terms is believed to have increased substantially faster than the estimated 5-1/2 per cent growth of real GNP. Data for the first 11 months of the year show consumer goods production up 9-1/2 per cent, compared with a 5-1/2 per cent rise in 1961. Investment outlays increased much less than the year before, and were adversely affected by the nationalization of the electric power industry and by the government's announced intention to widen the scope of planning from a set of regional plans to a program for the nation as a whole. A national plan based on the French model is expected to be completed in the near future. Present uncertainty in business circles may be alleviated when the government's intentions become clear, and by the forthcoming Parliamentary elections on April 28.

Steps taken to curb rising prices

Growing concern over rising prices--with national elections only a few weeks away--has led the government to take measures to dampen the trend by encouraging food imports. Price increases have been particularly sharp for foodstuffs because agricultural production did not rise significantly in 1962. The December import quotas for beef, pork, butter, livestock, and olive oil were increased, as were the February quotas for beef, pork, and butter. Effective February 18, the government suspended the duties as well as the 2.3 per cent turnover tax on imports of fresh fruits and vegetables and olive oil; the turnover tax on imports of fish, several types of meat, and eggs; and the variable levies on imports of eggs.

Price increases accelerated in the closing months of 1962, and the trend was exacerbated in January by the exceptionally severe weather. The consumer price index rose 2.6 per cent from September to December and another 1 per cent in January, to a level 7.2 per cent above a year earlier. The wholesale price index rose 2 per cent in the fourth quarter, so that in December it stood 4.4 per cent above a year previous.

The rise in industrial wages slowed down in the autumn of 1962. Minimum contractual wages in industry increased 1 per cent between September and November, compared with 2 per cent in the comparable period of 1962.

Monetary measures to maintain domestic expansion

A substantial acceleration of the rate of rise in money supply has been an important expansionary factor during 1962. Last November, money supply was up 19 per cent from November 1961, compared with November-to-November increases of 13 per cent in both 1959-60 and 1960-61. This pick-up has been due to a more rapid expansion of bank credit to the private sector, which the Italian authorities have actively encouraged. The banks' required reserve ratio was reduced in early 1962, and last autumn a variety of measures were introduced to augment the lending and investing potential of the banking system. Data are not yet available by which to observe the effects of those measures, other than the changes in the banks' foreign exchange activities reviewed above.

On January 28 the Interministerial Credit Committee introduced a number of additional regulations in the money and credit field designed to divert funds from short-term holdings to longer-term productive investments, partly by increasing the spreads between short-, medium-, and long-term interest

rates. One of the January measures empowers the Bank of Italy to require banks to change the composition of their investment portfolios. In addition, the Committee:

1) Placed a limit of 5 per cent per annum on the interest rate paid on all bonds, deposit certificates, and any other securities that have a maturity of 18 to 60 months and which are issued by commercial banks, savings banks, first-class pawnshop banks and the special credit institutes for medium- and long-term credit (for practical purposes, all the credit institutions in Italy);

2) Subjected the issuance of these instruments to the prior approval of the Bank of Italy, in accordance with the directives of the Committee;

3) Prohibited commercial banks from accepting deposits of over 18 months' maturity, and prohibited the special credit institutes from accepting deposits of less than 18 months' maturity; and

4) Set limits on the amount of medium-term savings securities that can be issued by savings banks, commercial banks, and pawnshop banks, in accordance with the amounts of certain types of assets held by these institutions.

Stock prices rally but sink again

The year-long decline in Italian stock prices, reflecting in part investor misgivings over government actions, came to an end in late October, and from then until mid-December prices moved upward. The 24 Ore index rose 21 per cent from October 24 to December 14. Factors in this revival were the outcome of the October Cuban crisis; recovery in stock markets abroad; the October measures to increase bank resources which were taken, inter alia, to bolster the sagging prices of both stocks and bonds; intensification of the

rise in prices of goods and services; and improved business prospects.

Passage of the bill imposing a 15 per cent withholding tax on dividends sent the market down again in late December. Since then, prices have dropped almost continuously, and on March 8 the I1 Sole index was 16 per cent lower than on December 14.

Public debt to the United States

Italy's public indebtedness to the United States has not changed significantly in recent months. Italy owed \$4 million to the Eximbank at the end of December 1962, and other debts totalled \$38 million at the end of September 1962.