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Recent Economic Developments in Italy,
October 1963 to February 1964

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Summary

Last month, the Italian authorities strengthened their anti-inflation efforts with direct measures to restrain consumer spending and consumer goods imports. These steps supplemented, and are thought to be less important than, earlier restrictive actions in the monetary and fiscal fields.[1/] Balance of payments deficits have continued large in January and probably in February, but some encouraging signs can be found in the stabilization in imports and the tightening in credit supplies in the past few months. However, there was no slowdown in the rise in Italian prices in the fourth quarter.

Severe consumer credit restrictions were imposed in late February, and new taxes were levied on purchases of new cars and on gasoline in order to curb the automobile boom. Late in 1963, the effects of the tightening of credit initiated late last summer had already become evident. Expansion rates of bank credit and the money supply came down sharply in the fourth quarter, as monetary action kept banks' cash reserves from rising, and present policy is allowing the external payments deficit to exert its full deflationary effect on bank reserves and the money supply. On the fiscal side, the government has stated its determination to hold budget outlays at present levels; if realized, this endeavor should reduce greatly the budget deficit.

1/ Earlier developments in Italy are covered in "Recent Economic Developments in Italy, July-December 1963" dated December 24, 1963.

The balance of payments deficits in November-January totaled $407 million. However, the increase over a year earlier was much less than in preceding months. Seasonally-adjusted imports leveled out and then declined during the fourth quarter, probably in response to the tighter credit conditions. Net capital outflow decreased in November, and December actually saw a small net inflow. Declines in official reserves and other official net foreign assets exceeded the payments deficits as Italian banks continued to reduce their net foreign borrowing.

In a move aimed at improving investor sentiment, provisions for withholding taxes on dividends were modified in February. This step weakens incentives to evade taxes by exporting capital.

At year-end there was still no sign of a slowing of internal price rises. On the wage front, implementation of the government's goal of preventing inflationary increases will be crucial to the success of the stabilization effort. Although the rise in wage rates has of late decelerated, there can as yet be no assurance that this will continue.

Production indexes have moved erratically but the trend was perhaps still upward as of last November. Growth of real GNP probably fell to about 5 per cent in 1963 from 6 per cent in 1962.

Government moves to restrict consumption outlays

In late February the Italian government took several steps directly to curb the growth of consumer spending. Outlays for consumption, fed by large increases in wages and (until last summer) abetted by easy financial policies, have been the principal cause of domestic price inflation and the deterioration in the balance of payments over the past two years.[1/]

First, severe consumer credit restrictions were imposed to check spending on autos and other consumer durable goods. In general, downpayments must be 30 per cent of the price, and the credit cannot exceed 12 months. The regulation exempts electrical appliances costing less than $112. The new terms appear quite severe in comparison with those prevailing recently.

A second set of measures was aimed directly at the automobile sector. A special tax of 7 to 15 per cent (depending on cylinder capacity) was imposed on purchases of new automobiles, both imported and domestically-produced, to be effective for two years. At the same time, taxes on gasoline were increased, raising the price 15 per cent. Automobiles have been the most booming sector of the economy. New car registrations in January-October of last year were 50.4 per cent more than a year earlier. Imports of cars in the first eight months of last year, totaling $136 million, were up 129 per cent. The rise in auto imports alone accounted for 13 per cent of the increase in all imports of consumer goods in that period and 8 per cent of the increase in total imports.

Tax changes made to bolster investor confidence.

The measures to restrain consumption were coupled with tax moves affecting Italian stockholders. The changes related to the 15 per cent withholding tax on dividends imposed in January 1963, which has been

1/ Preliminary estimates put 1963 private consumption expenditures at 16 per cent above 1962 at current prices, and up 8-1/2 per cent at constant prices. Real GNP is thought to have risen around 5 per cent in 1963. Imports of consumer goods in the first nine months of 1963 were up 42 per cent over the previous year, compared with a 16 per cent rise in other imports.

one reason for the 1963 stock market weakness and the export of capital.1/ The government wishes both to improve the climate for private investment and to terminate the capital outflow drain on the balance of payments.

The withholding rate was cut from 15 to 5 per cent. In addition, the shareholder was given this option: either (1) pay the 5 per cent withholding tax and report dividends on his income tax return; or (2) pay a 30 per cent withholding and be exempted from reporting his dividends. This puts a 30 per cent tax rate ceiling on dividend income, a rate far below that which wealthy stockholders would otherwise be required to pay under the tax laws. These new regulations do not, of course, eliminate all motivation for tax avoidance or evasion, and the effects on Italy's international capital flows remain to be seen.

Monetary expansion slows further

Monetary policy in the fourth quarter brought about sharp reductions in the expansion of bank credit and the money supply. The balance of payments deficit was deflationary, and offsetting actions by the Bank of Italy went only so far as to keep banks' cash reserves unchanged. (See below.)

The money supply failed to rise in October-November, whereas it rose 2.4 per cent in the same period a year earlier. The year-to-year reduction was proportionately greater than had occurred in the third quarter, when the rate of rise fell to 3-1/2 per cent from 4.3 per cent a year before. Partial data indicate that in December, when the money supply rises seasonally, the increase was considerably less than a year

1/ In the case of tax-motivated capital exports, the consideration is not so much to avoid payment of the withholding tax as to prevent the tax authorities from obtaining information on the taxpayers' stock holdings.

ago. Bank credit to the "economy" (all borrowers but the Treasury) in domestic currency rose 2.8 per cent in October-November compared with 3.5 per cent in the fourth quarter of 1962.

Bank liquidity severely strained in fourth quarter

The tightening of credit policy in the fall of 1963 prevented any increase whatsoever in the cash reserves of Italian banks in the fourth quarter. It was also necessary for the Bank of Italy to make an unprecedented volume of accommodation available to the banking system, in order to obviate a severe liquidity crisis. Apart from seasonal factors, bank liquidity was subjected for the first time to the full force of Italy's huge deficit in international payments.

International transactions cut into banks' cash reserves to the extend of 346 billion lire ($554 million) in October-December. (See Table 1.) This was the counterpart of the decline in official net foreign assets in the period. The decline in official assets occurred for the most part because of the external payments deficit; it also reflected a reduction in the net foreign indebtedness of the commercial banks. In previous periods, despite external deficits, foreign borrowings by the banks had raised both the official external reserves and banking liquidity: external reserves rose 208 billion lire in the final three months of 1962, and reserve losses in the first nine months of 1963 were held to only 28 billion lire.

Table I. Italy: Factors Affecting Bank Reserves, 1962-63
(In billions of lire)

	1962 I - III	1962 IV	1963 I - III	1963 IV
Official net foreign assets	+100	+208	- 28	-346
Note circulation (- = increase)	- 22	-433	- 78	-386
Treasury overdraft with Bank of Italy	-198	+141	+367	+459
Miscellaneous	- 21	+116	- 61	- 69
Subtotal	- 43	+ 32	+190	-342
Bank of Italy credit to commercial banks	+ 33	+168	+ 90	+341
Total = change in banks' cash reserves with Bank of Italy	- 10	+200	+280	- 1
Of which:				
Required	+ 3	+174	+315	+ 7
Free	- 13	+ 26	- 35	- 8

Source: Bank of Italy, Supplemento al Bollettino

The liquidity loss caused by the big seasonal rise in the note circulation was 386 billion lire in the fourth quarter, and miscellaneous factors had a net contractionary effect of 69 billion lire. Only in part were all these contractionary influences offset by a 459 billion lire Treasury drawing on its overdraft at the Bank of Italy, in reflection of the Treasury's still deteriorating cash position.

As a result of these factors, the Bank of Italy found it necessary to increase its accommodation to the banking system by 341 billion lire. This action offset the net contractionary effect of other operations but still allowed no increase in total reserves; free reserves fell slightly. Earlier, monetary policy had directly caused, or indirectly permitted, large accretions to banks' cash holdings in the previous twelve months.

Long-term bond yields have risen very sharply in recent months. After remaining nearly unchanged at about 5.2 per cent from May to August, yields on long-term governments rose from 5.20 per cent (monthly average) in August to 5.57 per cent in January. Yields on bonds issued by the special credit institutes and by corporations rose from an average of 6.05 per cent in August to 6.46 per cent in January. However, despite the tightening of the banks' reserve position, the auction yield on "free investment" (noncompulsory) Treasury bills has held constant at 3.63 per cent.

Fiscal action to reduce inflationary pressures

An important part of the Italian stabilization effort lies in the budgetary field. The four-party agreement of last November called for a "freeze" of budget expenditures, and a reassessment of public investment priorities. This "freeze" consists of holding obligated outlays for the fiscal year ending June 1964 to the initial levels shown in the administrative budget belatedly passed by Parliament last October.1/ Definitive expenditures2/ for the current fiscal year, budgeted at 5,654 billion lire, are in fact 1 per cent below the amount of expenditures obligated in fiscal 1963. (See Table 2) The "freeze" thus means refraining from supplementary obligations which, in fiscal 1963, lifted outlays as much as 20 per cent above the initial forecast (as shown in Table 2).

Table 2. Italy: Administrative Budget, Fiscal 1962-Fiscal 1964
(In billions of lire; fiscal year ends June 30)

	1962	1963		1964
	Final results	Initial estimates	Final results	Initial estimates
Definitive Operations				
Receipts	4,551	4,482	5,150	5,265
Expenditures	4,847	4,761	5,712	5,654
Balance	- 296	- 279	- 562	- 389
"Capital Movements" (net loans, credits, and participations by the State)	- 85	- 110	- 94	- 113
Over-all Balance	- 381	- 389	- 657	- 502
Financing of Deficit:				
Net long-term borrowing	- 31	- 264	- 154	- 304
Unspecified in budget law	+ 412	- 653	+ 811	+ 806

Source: Congiuntura Economica, November 30, 1963

1/ The administrative budget is a budget of obligated expenditures and assessed revenues, not a budget of cash flows.
2/ All expenditures except loans, credits, and participations.

A very sharp reduction in the administrative deficit should result if the line is held on expenditures. In accordance with normal practice, budget receipts were very conservatively estimated in fiscal 1964 at only 2.2 per cent above final results for the preceding year. Even on this basis, the over-all deficit is shown as falling from 657 billion lire last year to 502 billion lire this year. In fact, definitive receipts this year might well be 10 per cent or more above last year, or some 400 billion lire or more higher than shown in the initial estimates, mainly because of a higher price level and growth of real output.[1/] Assuming expenditures at the initially budgeted level, such an excess of actual over initially-estimated receipts would reduce the over-all deficit to the neighborhood of 100 billion lire.

The cash budget showed a deterioration from a year earlier in the months July-November 1963 (latest data available), before the recent decisions to freeze outlays. In these months, when the balance is seasonally favorable, there was a surplus of 48 billion lire in 1963 compared with 69 billion lire in 1962.[2/] (See Table 3) In contrast with a year earlier, it appears that Treasury operations had an expansionary effect on money supply in July-November 1963, despite the surplus in the cash budget. The Treasury drew heavily on its overdraft with the Bank of

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1/ In July-September, actual receipts exceeded initial estimates by 80 billion lire, because of the higher tax base. In addition, the new taxes on gasoline and automobiles levied in February will reportedly yield about 200 billion lire per year. In fiscal 1963, actual definitive receipts were up 13 per cent over the previous year, because of rising prices, increasing output, and soaring imports.

2/ Aside from seasonal factors, cash deficits have been consistently smaller than the administrative deficits because of long lags in disbursements of obligated funds. Compare the 291 billion lire cash deficit in fiscal 1963 with the 657 billion lire administrative deficit in the same period.

Italy in the amount of 348 billion lire. A part of these funds was used to retire 158 billion lire of Treasury bills. Since commercial banks' bill holdings were practically unchanged in this period, the effect was to increase cash holdings of the public.

Table 3. Italy: Cash Budget Operations, Fiscal 1963 and 1964
(In billions of lire)

	Fiscal 1963		Fiscal 1964
	July-Nov.	Dec.-June	July-Nov.
Receipts	1,731	3,286	1,903
Disbursements	1,662	3,646	1,856
Balance	+ 69	- 360	+ 48
Financing:	- 69	+ 360	- 48
Net long-term borrowing	+ 6	- 96	+ 4
Sales of Treasury bills (net)1/	+ 150	- 133	- 158
Special advances from Bank of Italy	-	- 45	-
Treasury coin issue	+ 2	+ 5	+ 2
Drawings on overdraft with Bank of Italy	- 139	+ 478	+ 348
Deposits with Treasury of Post Office Deposit and Loan Fund	+ 45	+ 83	- 50
Miscellaneous Treasury operations	- 133	+ 68	- 194
1/ Change in commercial banks' bill holdings:	+ 61	- 115	+ 1

Source: Ministry of the Treasury, Conto Riassuntivo del Tesoro

Payments picture reveals some hopeful signs

Italian deficits on international payments have continued to run very high, but several recent developments give rise to hopes that the worst may be over. First, imports, which had risen with extreme rapidity for almost two years, levelled off and then fell sharply during the fourth quarter, causing the trade deficit to contract. This behavior probably reflects the rapidly tightening credit situation. Second, net capital outflow declined abruptly in November, and December actually saw a small net flow into Italy. This may have been a consequence of the formation of the Moro government, and the prospects of more stable political conditions. Third, in January (as well as in November-December), the over-all deficit showed a much smaller increase over a year earlier than had been the case in any of the months April-October of 1963.

The monthly over-all deficits (unadjusted for seasonal factors) reached a peak of $185 million in October. A decline to $138 million occurred in November. These were followed by deficits of $128 million in December and $138 million in January. (See Table 4) In November-January, the deficits averaged $56 million per month more than a year previously. This compares with much larger year-to-year increases averaging $132 million a month in the second quarter of 1963 and $156 million per month in July-October.

Table 4. Italy: Balance of Payments, Selected Periods, 1962-64
(In millions of dollars; monthly average or month)

	I	II	III	Oct.	Nov.	Dec.		Jan.
Trade balance								
1962	- 99	-114	- 83	-151	-191	-197	1963	-161
1963	-170	-214	-208	-215	-243	-261	1964	n.a.
Difference	- 71	-100	-125	- 64	- 52	- 64		-
Current invisibles								
1962	93	121	202	186	102	133	1963	121
1963	100	122	181	144	125	126	1964	n.a.
Difference	+ 7	+ 1	- 21	- 42	+ 23	- 7		-
Capital movements								
1962	- 26	- 12	- 8	- 46	- 19	- 9	1963	- 42
1963	- 19	- 45	- 10	-114	- 20	+ 6	1964	n.a.
Difference	+ 7	- 33	- 2	- 68	- 1	+ 15		-
Over-all balance								
1962	- 31	- 6	+112	- 11	-108	- 55	1963	- 82
1963	- 89	-137	- 38	-185	-138	-128	1964	-138
Difference	- 58	-132	-149	-174	- 30	- 73		- 56

Sources: Bank of Italy, *Bollettino*; U. S. Embassy, Rome.

Net capital flows reversed themselves favorably in the course of the fourth quarter. The net outflow rose from $30 million in September to $114 million in October but fell to $20 million in November and became a $6 million net inflow in December.

The changing trade movements are not fully discernible in the payments data because of unfavorable shifts in leads and lags and because of seasonal variations. The deficit on trade payments continued to rise from $624 million in the third quarter to $719 million in the fourth. More indicative is the decline in the deficit on seasonally-adjusted shipments through customs, from $741 million in the third quarter to $720 million in the fourth. Adjusted import shipments leveled off in October-November, and dropped 13 per cent in December. (See Table 5). Export shipments also fell off sharply in December, but in the fourth quarter as a whole were up slightly over the preceding three months.

Table 5. Italy. Seasonally-Adjusted Foreign Trade, 1962-63
(In millions of dollars; monthly average or month)

	Imports c.i.f.	Exports	Balance
1962			
I	475	383	- 92
II	486	395	- 91
III	526	392	-134
IV	559	403	-157
1963			
Quarters.			
I	558	407	-151
II	627	425	-202
III	678	431	-247
IV	673	433	-240
Months:			
September	705	452	-253
October	698	438	-260
November	708	452	-256
December	613	409	-204

Source: OECD

In the four months October-January, official reserves declined $512 million, and other official net foreign assets fell approximately $300 million. These losses covered not only the payments deficits (totaling $589 million) but also continuing repayments of funds borrowed by the Italian commercial banks. The banks reduced their net foreign borrowings $90 million in the fourth quarter and $101 million in January, probably because of declining demand for import credits.

The Bank of Italy took further action at the end of 1963 to regulate the banks' net foreign indebtedness. Under its directive of last September; the commercial banks were requested not to increase their indebtedness above the level of the end of August. After this foreign indebtedness had in fact actually fallen in the fourth quarter, the monetary authorities decided that any resumption of net borrowings, even within the ceiling previously set, would be undesirable because it would supply funds for lending within Italy. Accordingly, each bank was asked to keep net indebtedness below the level of end-November or end-December, whichever was lower.

Price rise was unchecked through December

Fourth quarter price indexes (latest available) do not indicate any slowdown in the rise of Italian prices. In the fourth quarter, the index averages were up over the third quarter averages by 2.4 per cent for wholesale prices and 2.2 per cent for consumer prices. (See Table 6). Comparable increases a year earlier were 1.8 per cent for wholesale prices and 1.6 per cent for consumer prices. In the year ending with the fourth quarter of 1963, the average quarter-to-quarter rise in wholesale prices was 1.4 per cent and that in consumer prices 1.8 per cent. However, comparison of these average quarterly increases with the rise in the last quarter of 1963 is partly invalidated by the seasonal tendency for prices to rise in the final three months of the year.

Table 6. Italy: Selected Economic Indicators, 1962-63
(1953=100)

	Wholesale Prices	Consumer Prices	Hourly Wage in mfg.	Seas. adj. ind. prod.
1962				
I	100.7	120.8	147	219
II	101.8	122.6	150	219
III	101.9	123.9	157	219
IV	103.7	125.9	161	229
1963				
Quarters:				
I	106.0	130.1	169	232
II	106.7	131.9	176	243
III	107.0	132.5	180	238
IV	109.6	135.4	183	n.a.
Months:				
September	107.8	133.3	181	250
October	109.0	134.8	181	248
November	109.7	135.3	184	250
December	110.1	136.2	184	n.a.

Source: OECD

Wage rate rise slows further

A necessary condition for success of the Italian stabilization efforts will be the adjustment of wage rates in line with productivity gains. That means much smaller wage increases than have generally been the case in the last two years. This principle forms part of the four-party economic accord of last November. A further slowing of wage increases in the closing months of 1963 and certain recent developments in labor negotiations encourage the hope that future wage increases will be more moderate. But too much should not be read into the wage figures; a near halt to the upward wage spiral in late 1962 was followed by a renewed burst in 1963.

In the fourth quarter, minimum contractual wage rates in manufacturing averaged 1.7 per cent above the third quarter, the smallest quarterly rise of the year. (See Table 6). Earlier 1963 increases were 5.0 per cent in the first quarter, 4.1 per cent in the second, and 2.2 per cent in the third. These data are not seasonally-adjusted and the seasonal behavior of Italian wage rates, if any, is not known. In addition to possible seasonal characteristics, wage movements are also conditioned by an important random factor, viz., the dates on which labor contracts expire and new ones are made. In 1962, following a steep rise for eight months, minimum contractual rates remained virtually stable for the next five months, but they then rose almost 10 per cent between January and May of 1963.

Production tendencies are clouded

Recent developments in industrial production are among the more clouded aspects of the Italian economy. Data are not available beyond last November, and earlier changes in output indexes are difficult to interpret.

The seasonally-adjusted index of over-all production in industry leveled off in the late spring. Subsequently, it fell 6.2 per cent from June to August, rose 9.6 per cent in September, and was unchanged from September to November. For October-November the index was up 4.6 per cent over the third quarter average and 2.5 per cent over the second. (See Table 6.) Italian economists reportedly are themselves puzzled by these erratic movements and are unable to state if the adjusted indexes have in fact been an accurate indicator of actual output changes.

GNP estimates indicate slower growth in 1963

Preliminary estimates of Italy's national accounts for last year show a drop in the rate of increase in real output for a second successive year. But heavy recourse to foreign resources allowed a rise in the growth of consumption. Despite the anxieties of the business community over government policies, investment apparently increased as much as the year before.

The many published statements on the 1963 estimated results place the real GNP rise between 4.7 and 5.5 per cent. The most detailed estimates, published by the ISCO, put the rise at or just under 5 per cent. This compares with increases of 6.1 per cent in 1962 and 8.6 per cent in 1961. The ISCO estimates that agricultural output fell 1 to 2 per cent in 1963, following a rise of only 1 per cent in 1962. The growth of industrial production was put at 8 to 8-1/2 per cent, down from almost 10 per cent in 1962.

Because of the far greater rise in imports than in exports, the ISCO estimates that resources available for internal consumption rose last year 7-1/2 per cent at constant prices. Consumption in real terms was up nearly 8 per cent compared with 6.6 per cent in 1962; private consumption is thought to have risen over 8-1/2 per cent. The estimated rise of almost 8 per cent in real gross investment was practically unchanged from the increase in the previous year.