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Recent Economic Developments in Italy:
October 1964 to February 1965

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Summary

By late last year, the cutback in industrial activity in Italy as a result of the credit and fiscal restraints introduced in 1963-64 to bring the large external payments deficit under control seems to have come to an end.^{1/} But business sentiment is still reported to be cautious in judging that an upswing in activity has definitely begun.

Evidence about recent trends in the Italian economy has been mixed. On the financial side, renewed expansionary impulses are evident. The unexpectedly large external surplus and continuing Treasury deficits have contributed to a growth in the money supply which accelerated sharply in late 1964, in part because of an encouraging revival of bank lending. There was also an indicated pick-up in imports in December.

Through November, however, Italian industrial leaders continued to take a pessimistic view about current production and order levels, and inventories of finished goods have continued to rise. But business surveys since June 1964 have no longer revealed expectations of further declines in activity.

^{1/} Earlier developments in Italy are reviewed in "Recent Economic Developments in Italy, July-November," dated December 15, 1964.

This pessimism has in part been attributable to a continuing rise in prices and wages in the five months under review. From the third quarter to December 1964, consumer prices rose a further 1.9 per cent. The rising trend in the cost of living has led to new automatic upward adjustments of Italian wage rates; contractual wage rates rose about 15 per cent in 1964. In public statements, Governor Carli has stressed that moderation in wage demands was a key to Italian business recovery.

Economic indicators demonstrate that the recessionary effects of the Italian stabilization program were neither severe nor of long duration. Seasonally-adjusted industrial production dropped from an index of 250 in the first quarter of 1964 (1953 equals 100) to a low of 228 in August but had recovered to 241 by November. On the employment side, total employed declined less than 300,000 during 1964 although there were widespread reductions in the total work week which, in turn, affected current wage incomes.

During the second half of 1964, the Italian balance of payments was unexpectedly favorable. For the fourth quarter, a surplus of \$485 million was achieved, and official reserves rose an additional \$40 million in January. Higher export receipts, reduced import payments and a sharp rise in private capital inflow have produced this marked strengthening in the Italian external payments position.

Recession low has apparently been passed

Since early last autumn an expectancy of recovery has been "in the air" in Italy because credit conditions have been eased: bank credit has been readily available and both the Treasury deficit and the balance of payments surplus have acted as expansionary factors.

To judge by production trends, the bottom of the Italian recession was apparently reached--though not clearly passed--toward the end of 1964. But it would still be premature to conclude that a definite upward trend in activity has set in. From July to September 1964, seasonally-adjusted production declined by 2.1 per cent (this included a sharp drop in August and a rebound in September that are believed to have been largely accidental). Industrial output held nearly steady in October, and in November it rose by 1.7 per cent. (See Table 1.)

Table 1. Italy: Seasonally-Adjusted Industrial Production, 1963-64
(1953=100; excluding construction)

	<u>General Index</u>	<u>"Immediate Use" Goods^{1/}</u>	<u>Consumer Goods</u>	<u>Investment Goods</u>
1963-Quarter IV	248	316	215	248
1964-Quarter I	250	321	215	246
II	242	332	209	227
III	236	333	202	219
June	239	334	203	224
July	243	335	210	226
August	228	334	194	204
September	238	329	201	227
October	237	332	197	227
November	241	n.a.	n.a.	n.a.

^{1/} Electricity, chemicals, petroleum products.

Sources: OECD and ISCO.

Despite this pick-up in industrial output, however, the General Confederation of Italian Industry declared that "there is no sign as yet of the expected recovery." On the one hand, industrialists surveyed continued to regard current levels of production and orders as low in October and November. (See Table 2.) They thought that inventories of finished goods were high. But on the other hand, they did report in November a slightly less pessimistic view of business prospects three to four months hence than they had recorded earlier.

However, the pessimism reflected in the survey of business expectations in November--when respondents to the ISCO survey generally expected production to fall in the next 3 to 4 months--must be interpreted with caution. In past ISCO monthly surveys, the views of Italian management have in general shown a considerable lag behind the actual changes in business conditions. (See Table 3.)

In early 1965, unused capacity in industry amounted to between 7 and 10 per cent, according to Budget Minister Pieraccini. But the Italian recession has not greatly increased full-time unemployment. The number of employed fell only 295,000 in 1964, according to a statement by ISCO, and outright dismissals accounted for only about 1/3 of the total. Press reports of the Central Statistical Institute indicate that the number of unemployed rose from 184,000 to 301,000 persons in the 12 months ending in October 1964, i.e., from 0.9 per cent of the labor force to about

Table 2. Italy: Results of ISCO Monthly Business Surveys, 1963-64
(balances of percentages of "+" and "-" replies)

	Evaluation of Current Situation			Forecast for 3-4 Months Hence	
	Production (- = low)	Orders (- = low)	Inventories (+ = high)	Production (- = lower)	Orders (- = lower)
1963 - September	+ 5	- 5	- 2	+10	- 4
1964 - January	- 6	-17	+ 6	+14	+ 6
February	- 5	=21	+ 9	- 2	-16
March	- 9	-37	+18	-16	-25
April	-13	-37	+18	- 8	-23
May	-17	-47	+20	-21	-34
June	-28	-51	+29	-37	-45
July	-23	-46	+27	-32	-40
August	-42	-59	+32	-30	-38
September	-32	-56	+36	-32	-33
October	-30	-55	+34	-31	-34
November	-34	-54	+39	-25	-26

Source: ISCO (Istituto Nazionale per gli Studi della Congiuntura).

Table 3. Italy: Forecast and Actual Changes in Industrial Production, 1963-64

Period		Forecast change (- = decline) ^{1/}	Actual change (in per cent) ^{2/}
From	To		
Sept. 1963	Dec. 1963 - Jan. 1964	+10	+0.4
Oct. 1963	Jan. - Feb. 1964	+ 4	-0.1
Nov. 1963	Feb. - March 1964	+ 4	-1.0
Dec. 1963	March - April 1964	+ 7	+0.8
Jan. 1964	April - May 1964	+14	-2.6
Feb. 1964	May - June 1964	- 2	-2.9
March 1964	June - July 1964	-16	-5.7
April 1964	July - Aug. 1964	- 8	-5.5
May 1964	Aug. - Sept. 1964	-21	-3.9
June 1964	Sept. - Oct. 1964	-37	+0.4
July 1964	Oct. - Nov. 1964	-32	-0.1

^{1/} Balances of percentages of "+" (rise) and "-" (decline) replies to ISCO monthly surveys.

^{2/} Change in seasonally-adjusted general index of industrial production.

Sources: ISCO monthly surveys and OECD.

1.5 per cent. In the same period, the number of underemployed (working less than 33 hours a week) increased from 317,000 to 451,000--or from 1.6 to about 2.3 per cent of the labor force. Neither of these categories includes persons in search of their first job: they numbered 214,000 in October 1963 and 230,000 (1.1 per cent of the labor force) in October 1964.

The sluggishness in factory output in the third quarter reflected an accelerated decline in consumer goods output, a halt to the rise in production of "immediate use goods," and a severe slump in automobile production. In April-December, production of passenger cars was reportedly 14 per cent below a year earlier, and output of commercial vehicles was down 23 per cent. Output of investment goods did not decline as fast as in the second quarter. Building activity in both the second and third quarters appears to have been 13 to 14 per cent below a year earlier.

Wage-price spiral continues

Prices in Italy have continued to rise, in spite of unused productive capacity and reduced demand for labor, and this rise served as the automatic basis for new wage increases. The rate of increase in consumer prices in the fourth quarter was somewhat below the rate a year earlier; but in December they were 1.9 per cent higher than the third quarter average and were 5.8 per cent higher than in December 1963. (See Table 4.) Wholesale prices were up 1.6 per cent from the third quarter to December and 1.8 per cent on a year-to-year comparison.

Table 4. Italy: Price and Wage Rate Indexes, 1963-64
(1953 = 100)

Quarter		Consumer prices		Wholesale prices		Wage rates in manufacturing	
		1964	1963	1964	1963	1964	1963
Quarter	I	137.5	130.1	110.7	106.0	190	169
	II	139.1	131.9	110.4	106.7	200	176
	III	141.4	132.5	110.4	107.0	205	180
	IV	143.4	135.4	112.0	109.6	211	183
October:		142.5	134.8	111.8	109.0	206	181
November		143.5	135.3	112.0	109.7	213	184
December		144.1	136.2	112.2	110.2	213	184

Sources: OECD; press reports for December prices.

Table 5. Italy: Increases in Contractual Wage Rates, 1961-64
(in per cent)

	Industry	Agriculture	Transportation	Commerce
<u>Married Workers</u> ^{1/}				
October 1961 to October 1962	8.8	7.9	3.8	4.6
October 1962 to October 1963	12.2	9.5	6.1	10.1
October 1963 to October 1964	14.3	11.9	16.4	12.1
October 1961 to October 1964	39.5	32.3	28.1	29.0
<u>Unmarried Workers</u>				
October 1961 to October 1962	13.8	20.0	5.2	6.4
October 1962 to October 1963	14.8	18.8	8.5	13.6
October 1963 to October 1964	16.0	13.0	18.2	13.7
October 1961 to October 1964	51.5	60.6	34.9	37.4

^{1/} Including family allowances.

Source: Istituto Centrale di Statistica.

Further advances in the cost-of-living index used to calculate the sliding scale in wage contracts produced further rises in contractual wage rates. Press reports state that this cost-of-living index rose 1.47 per cent from May-July to August-October 1964, and a further 1.45 per cent from August-October to November-January: these rises brought automatic wage increases of 1.25 per cent on November 1 and 1.23 per cent on February 1. (A 1 per cent rise in the index causes an 0.85 per cent adjustment in wage rates.)

Industrial wage rates rise 14-16 per cent

The principal factor pushing up Italian prices at a time of considerable slack in the economy was the continued upward wage trend for the third consecutive year. In the fourth quarter, contractual wage rates in manufacturing were 15.3 per cent higher than a year earlier. (See Table 4.) For all industry, the increases in the 12 months to October 1964 were 14.3 per cent for married workers, and 16.0 per cent for unmarried workers; in other sectors, the increases for married workers were 11.9 per cent in agriculture, 16.4 per cent in transportation, and 12.1 per cent in commerce. (See Table 5.)

During 1962 and 1963, wage rates actually paid increased more than contractual rates, but this upward "wage drift" narrowed in 1964. Even so, actual wage rates are said to have risen, on the average, by about 12 per cent in 1964.

But continued union pressure and not the automatic tie to the cost of living index was responsible for the larger portion of the wage increases in 1964, as it was in 1962 and 1963. Between October 1963 and October 1964, cost of living increases added 6.6 per cent to contractual wage rates; but total wage rates in fact rose by much more than this amount, as we have seen.

Rise in money supply accelerated

Even during the Italian recession, the money supply increased. The rise accelerated late in 1964, and reached an annual rate of 16.4 per cent during the months September-November. (See Table 6.)

The recent balance of payments surplus has added heavily to the liquidity of the public. Purchasing power has also been injected into the economy by the continuing deficits of the Treasury, which have been covered largely by drawings on the overdraft with the Bank of Italy and, to a lesser extent, by commercial bank purchases of Treasury bills.

From the end of February to the end of August, bank credit to the private "economy" (all borrowers except the Treasury) declined, first as a result of the tight policy by the Bank of Italy vis-a-vis banks' reserves, and later because customer demand for loans eased with the declines in economic activity.

Since the easing of Bank of Italy policy during the summer, the banks have used much of their reserve gains to repay

Table 6. Italy: Changes in Money Supply and Counterparts, 1963-64
(in billions of lire; no sign = increase)

I. MONEY SUPPLY ^{1/}	Three months ending in:			
	February	May	August	November
Percentage change, annual rate: 1963	20.0	14.4	10.4	9.6
1964	<u>3.6</u>	<u>5.6</u>	<u>4.4</u>	<u>16.4</u>
Absolute change: 1963	475	355	269	255
1964	101	157	121	463
II. COUNTERPARTS, 1964 ^{2/}				
A. Credit to Economy	390	-12	-145	222
1. Securities	38	8	36	111
2. Lira loans	400	34	- 81	60
3. Foreign exchange loans	-48	-54	-100	51
B. Credit to Treasury	113	254	93	194
1. Bank of Italy	90	211	36	174
2. Commercial banks	23	43	57	20
C. Net Foreign Assets	-263	-48	292	304
1. Official	-336	-129	138	325
2. Commercial banks	73	81	104	-21
D. Savings Deposits in Commercial Banks				
(- = increase)	<u>-443</u>	<u>-32</u>	<u>-101</u>	<u>3/ -197</u>
E. All Other	304	- 5	- 18	-60

1/ Currency and demand deposits. The Italian money supply statistics include currency held by the commercial banks.

2/ Based on changes in assets and liabilities of the Bank of Italy and the commercial banks.

3/ Estimated from partial data.

Source: Data assembled by author from Bank of Italy statistics.

Bank of Italy credit and to build up cash balances. But part of the additions to bank reserves since August have been used to increase holdings of non-Treasury securities issued by corporations and the medium- and long-term official credit institutions. In addition, customer loan demand has picked up since August. Loans in lire rose 60 billion lire in September-November. Foreign currency loans to residents (which had been declining continuously since September 1963 as the banks reduced their net foreign borrowing), increased by the equivalent of 51 billion lire.

Treasury deficit stops increasing

The upward climb of the Treasury deficit has been halted in recent months after growing during 1962 and 1963 and in the first half of 1964. The deficit on the combined cash payments and receipts of the Treasury (budgetary and extrabudgetary) and the Cassa Depositi e Prestiti soared from 323 billion lire in 1961 to 881 billion lire in 1963; in the 12 months from July 1963 to June 1964 it reached almost 1,000 billion lire. (See Table 7.) During this period, the Treasury's recourse to the banking system covered the larger portion of these deficits.

But the combined deficit of the Treasury and the Cassa Depositi e Prestiti between July and November (estimated at 335 billion lire) was slightly less than the estimated deficit of 347 billion lire in the same months of 1963, the first year-to-year decline in several years. The rise in the banking system's claims on the

Table 7. Italy: Selected Public Finance Statistics, 1961-64
(in billions of lire)

I. <u>Cash Deficit (-) or Surplus of Treasury and Cassa Depositi e Prestiti</u>		1st Half	July-Nov.	2nd Half	Year
A. Actual: ^{1/}	1961	102	n.a.	-425	-323
	1962	40	n.a.	-480	-440
	1963	-145	n.a.	-736	-881
B. Estimated: ^{2/}	1963	-157	-347	-702	-859
	1964	-253	-335	n.a.	n.a.
II. <u>Increase or Decrease (-) in Banking System's Net Claims on Treasury</u> ^{3/}	1961	-148	- 11	161	13
	1962	-153	114	268	115
	1963	129	293	560	689
	1964	153	234	n.a.	n.a.

^{1/} As shown in the Annual Reports of the Bank of Italy.

^{2/} As estimated from currently available monthly data.

^{3/} Bank of Italy and commercial banks.

Sources: Bank of Italy and Ministry of the Treasury.

Treasury (234 billion lire) was about 60 billion lire less than increases in the corresponding months of 1963.

The halt to the increase in the total deficit was caused by a drop in the expenditures of the Cassa Depositi e Prestiti, whose resources are used to cover the deficits of the local authorities and to purchase new issues of securities offered by nationalized enterprises. Since these expenditures are not directly under central government control, fears had earlier been expressed that leakages in these areas might jeopardize the Italian stabilization effort. The most recent statistics suggest the effectiveness of measures taken to discourage further expansions in these categories of spending.

External surpluses remain large

In the fourth quarter of 1964, Italy's balance of payments continued in heavy surplus. Payments for imports rose but were still relatively depressed; export receipts advanced again; and net capital inflows, registering another upsurge, came to \$225 million. Further reserve gains occurred in January 1965.

The overall surplus of \$485 million in October-December contrasts with a deficit of \$452 million in the same period of 1963. (See Table 8.) The fourth quarter showed a slightly smaller surplus than did the third quarter; the balance on current account deteriorated because of a seasonal drop in tourist receipts and higher import payments. But the adverse change in the current

Table 8. Italy: Balance of Payments, 1963-64
(In millions of dollars)

	1963			1964		
	III	IV	Year	III	IV	Year
I. <u>CURRENT ACCOUNT</u>	-76	-329	-889	477	230	336
Imports cif.	-1,829	-1,967	-7,261	-1,634	-1,772	-7,065
Exports	1,206	1,249	4,763	1,473	1,521	5,578
(Trade balance)	(-624)	(-720)	(-2,498)	(-161)	(-252)	(-1,487)
Invisibles	548	391	1,609	638	482	1,823
II. <u>CAPITAL ACCOUNT</u>	-36	-124	-355	26	255	442
Private capital	-17	-136	-340	—	228	428
Public capital	-19	12	-15	25	27	14
III. <u>OVER-ALL BALANCE (I + II)</u>	<u>-113</u>	<u>-452</u>	<u>-1,244</u>	<u>502</u>	<u>485</u>	<u>777</u>
IV. <u>MONETARY MOVEMENTS</u>	<u>113</u>	<u>452</u>	<u>1,244</u>	<u>-502</u>	<u>-485</u>	<u>-777</u>
(- = Increase in assets or decrease in liabilities)						
Official reserves (gross)	-122	410	435	-258	-444	-497
U.S. lira bonds	—	—	—	—	—	200
IMF gold tranche	-15	-8	-23	-124	-26	80
Other official (net)	47	140	182	-15	-21	-118
Commercial banks (net)	203	-90	650	-105	6	-442

Sources: Ufficio Italiano Cambi; IMF.

account was almost fully offset by a sharp rise in net capital inflows from \$26 million in the third quarter to \$225 million in the fourth; some \$147 million occurred in December alone.

Import payments in the fourth quarter were up 8.4 per cent over July-September, but still showed a 10 per cent reduction from a year earlier--almost as much as the year-to-year shortfall in the third quarter. Seasonally-adjusted import shipments through customs in October-November averaged only 1.4 per cent above the third quarter. However, the sharp increase in payments for imports in the fourth quarter suggests a substantial pick-up in adjusted import shipments in December, especially since imports are seasonally low in that month.

Export receipts exceeded the year-previous period by 22 per cent in both the third and fourth quarters. Seasonally-adjusted export shipments through customs in October-November averaged 1-1/2 per cent below their third quarter level, but receipts for exports in the fourth quarter were up 3.3 per cent from the third quarter.

The turnaround in Italy's payments position last year has led to surpluses totaling \$1,213 million in the months April-December; despite deficits in the first quarter, the year as a whole showed a surplus of \$777 million. In 1963, there was a deficit of \$1,244 million.

In this period, the current account improved by over \$1.2 billion; a shift in capital movements from outflow to inflow

produced a further gain of \$800 million between 1963 and 1964. Capital inflow into Italy last year totaled more than \$440 million.

The main factor in the capital account improvement was a drop in the export of Italian bank notes; the amount of notes remitted for credit by foreign central banks in the first 11 months of the year was \$565 million in 1964, compared with \$1,433 million in 1963. (See Table 9.) Both the credit squeeze and changes in February 1964 in the withholding tax on dividends (which lessened the incentive to evade income taxes by sending capital abroad) contributed to the reduced capital outflow. The recorded inflow of "foreign" capital in January-November was \$164 million less than in the same period of 1963 (\$1,028 million), but these inflows in fact have included Italian capital which had been clandestinely exported in bank note form and returned to Italy in the name of Swiss nominees.

During the year, direct investment increased, and loans to Italy more than doubled. American firms contributed to both these inflows. A significant but unknown portion of the "foreign" loans received was also repatriation of Italian funds. The fall in portfolio investment from over \$600 million to a small negative figure was related to the reduced bank note outflow: in the past, Italian securities have been purchased by foreign nominees with funds sent abroad by their Italian owners.

During the fourth quarter, most of the surplus was used to increase Italy's official reserves by \$444 million. The net

Table 9. Italy: Balance of Payments, Private Capital Account, 1963-64
(in millions of dollars)

	<u>1963</u>	<u>1964</u>
I. <u>Banknotes Returned for Credit</u> <u>by Foreign Banks 1/</u>	-1,540	-663
II. <u>Recorded Italian Capital 1/</u>	- 108	- 98
III. <u>Capital from Abroad 1/</u>	<u>1,192</u>	<u>1,028</u>
Direct investment	316	459
Loans	258	585
Portfolio investment	606	- 23
Miscellaneous	12	7
IV. <u>Unclassified 1/</u>	- 1	- 70
V. <u>Total, first eleven months</u>	-348	295
VI. <u>Total, full year 2/</u>	-340	442

1/ First eleven months.

2/ Includes December, for which details are not yet available.

Source: Ufficio Italiano Cambi.

foreign liabilities of the Italian commercial banks (which have been declining almost uninterruptedly since August 1963 in response to persuasion and other actions by the Bank of Italy) rose slightly in the fourth quarter, probably because of switches by foreigners out of sterling into accounts with Italian banks. Italy's IMF position improved \$26 million because of the British drawing of lire on December 2. Italy was one of the 11 nations which participated in the \$3 billion assistance package for the pound sterling in November, but the assistance did not affect the official reserve statistics. In January 1965, official reserves increased again by \$40 million.