

CONFIDENTIAL

From: Sir G.Littler
Date: 18 November 1988

MR J M G TAYLOR

c.c. Sir P.Middleton
Mr Scholar
Miss O'Mara

BILATERAL WITH SIGNOR AMATO : EMU

The Chancellor is pretty familiar with the ground, which I agreed with Sarcinelli that we could divide into three parts.

Progress in the EMS generally

2. I see as possible topics:

- £ and ERM: Amato is bound to ask. He has a particular interest in relation to the Italian 'wider margins'; he may want to probe whether we would be interested in such an arrangement and we need to make it clear that, while we might see general advantage in a slightly wider normal range than the present 'narrow band', a concession there would not buy our entry.
- Possible technical improvements: we see scope for and shall be pursuing in the Monetary Committee ideas such as more symmetrical intervention in some circumstances, use of Community currencies and therefore diversification of reserves, use of the ecu, closer liaison on interest rate management.
- Disequilibrium: it might be worth asking whether Amato sees future parity changes (Lira and Franc versus DM) as having a role in the correction of the persistent imbalances within the Community.

CONFIDENTIAL

The Ecu

3. It might be worth asking whether Amato sees a possibility of Italy engaging in the kind of Ecu issue we have done (rather than the more circumscribed Italian issues hitherto).

4. It would be worth making it clear that our ideas for the development of the Ecu do not go towards 'parallel currency' and certainly not fiduciary issues. What are his views?

Delors Committee

5. Our impression is that Amato is not starry-eyed about any 'union' ideas, but his Prime Minister may be tempted. It must be worth while therefore to emphasise that we shall not change our views on 'union'; and that this goes along with refusal to contemplate treaty amendment and rejection of premature changes of an institutional character.

6. But this does not mean rejecting further progress in EMS - on the lines mentioned in paragraph 2 above which will be generally palatable to Amato.

7. The main question is how far we could look for support from Italy for practical as distinct from over-ambitious ideas.



(Geoffrey Littler)



H.M. CUSTOMS AND EXCISE
DEPARTMENTAL PLANNING UNIT
NEW KING'S BEAM HOUSE, 22 UPPER GROUND
LONDON SG1 9PJ
01-620 1313 Ext 5028

FROM: J K OXFORD
Departmental Planning Unit
DATE: 18 November 1988

1. MR ALLEN *RA 18/xi*
2. PS/CHANCELLOR

INDIRECT TAXES

BILATERAL WITH SIGNOR AMATO : 21 NOVEMBER

As requested in your note of 15 November, I attach a note on the latest developments relating to indirect tax approximation.

John Oxenford

J K OXFORD

Circulation:

PS/Chief Secretary	CPS
PS/Economic Secretary	Mr Jefferson Smith
Sir G Littler	Mr Nash
Mr Scholar	Mr Wilmott
Mr S W Matthews	Mr Cockerell
	Mr Knox

CHANCELLOR'S BILATERAL MEETING WITH SIGNOR AMATO : 21 NOVEMBER

BACKGROUND NOTE ON INDIRECT TAX APPROXIMATION

There have been no major developments in the field of tax approximation since the September ECOFIN. The bilaterals with Lord Cockfield are under way: The Paymaster General is to meet him on 23 November. The UK objectives at the bilaterals will be:

- To highlight Member States' problems with the Commission's proposals (particularly on the excise side).
- To make clear that the ultimate aim of the UK's alternative approach is the removal of fiscal frontier controls, with achievable progress in the interim.
- To impress upon the Commission the need to keep an open mind about other solutions to the problem.

The Commission has submitted its report under Article 8(B) of the Treaty. Its tone when referring to tax approximation is generally offensive: it claims there is no 'viable or even plausible alternative'; refers to ECOFIN'S 'reluctance to face up to the

issues involved'; and accuses ECOFIN of wasting time by 're-examining so-called alternatives which have repeatedly been rejected as often as not by Member States themselves'. The report also claims that Ministers dealing with the problems of arms, terrorists and drugs are 'wedded to their present inefficient frontier controls rather than actively seeking out new and better ways of confronting these issues', but offers no suggestions for alternative controls. It maintains that stopping travellers at frontiers is acceptable only if the authorities have 'evidence or reasonable suspicion' of an offence; no concessions are made to the efficacy of our checks in making 'cold' finds. Despite the rhetoric, the report contains nothing unexpected, nor anything that could not have been predicted from the Commission's attitude so far.

1. Julie Ch - Michael has a luncheon 21/11 at Reuters which he is willing to postpone.

2. Chancellor

This all looks v. sensible,

From: Sir G. Littler
Date: 8 November 1988

grateful:-

MR J M G TAYLOR

though apparently T Lankester is in Washington on 21/11, so can't

c.c. Mr Lankester

BILATERAL WITH AMATO

come. Geoff has suggested Michael Schuler as a substitute (cf. EMU, tax etc. in the draft agenda).

I suggest we also invite Biancheri, the Italian Ambassador, to cover up the numbers. Content? OK

I discussed this with Sarcinelli in Brussels yesterday.

2. Amato is likely to bring with him just Sarcinelli and Vento (the latter is a diplomatic adviser in Amato's cabinet). I forgot to ask whether they would expect a London Embassy man to join them but I guess they would be happy for us to invite the Ambassador. They will expect their Embassy to meet and transport them here and to arrive in Downing Street around 11 a.m. (coming from Rome that morning) and leave with no particular rush after lunch. Sarcinelli said these plans had not been settled with Amato yet but we could confidently make our arrangements on this basis.

Sir G.
To
JMGT
8/11

3. I said I thought it would suit the Chancellor to have a meeting beginning around 11, lunch around 1, finish between 2.30 and 3. I thought our team would be Chancellor, myself, Lankester and a Private Secretary - we would not have any posse of experts - we might add an extra name or so for lunch (I had in mind that the Chancellor sometimes asks Peter Middleton or Terry Burns), but we would continue working discussion at lunch. All acceptable.

4. We agreed ad referendum the attached list of subjects.

5. I said we would confirm arrangements and agenda by fax.

Thanks:-

(Geoffrey Littler)

DRAFT AGENDA (as agreed between JGL + Sarcinelli).

1. Developments in respective national economies:

- United Kingdom: Amato finds UK press reports of our monetary policies confusing and tantalising; he would like to hear the Chancellor's own version!
- Italy: I thought the Chancellor would want to ask about prospects for budget control after the new parliamentary voting agreement.

2. E.M.U. - (articulated under three headings by Sarcinelli):

- progress in the EMS generally;
- the ECU;
- the Delors Committee.

3. Taxation in the Community:

- indirect tax approximation (VAT and Excise);
- direct tax and savings.

4. Middle Income Debt:

- the French, etc, proposals - or what should we do.

5. Tornados

6. The US post-election - (if anything to say).

AB also Tornados.

[see also latest monthly economic report, behind]

ITALIAN ECONOMY

The following table gives summary statistics for 1986 and 1987 and provisional OECD forecasts for 1988 and 1989. The Italian Treasury's Budget Forecasts for economic growth and inflation are given in brackets. Signor Amato recently suggested that economic growth could be as high as 4 per cent this year.

Italy: Key Economic Statistics*

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
GDP: Nominal	10.9	8.6	8½	8
Real	2.9	3.1	3½ (3.6)	3½ (3.0)
Real domestic demand	3.2	4.7	4	3½
Consumer prices	5.9	4.8	5 (4.7)	4½ (4.0)
Unemployment rate (%)	10.3	10.9	11	11½
Current balance (\$bn)	4.1	-1.0	-3	-6

* Percentage changes.

Source: Draft OECD Economic Outlook for December.

2. Activity has benefited from buoyant domestic and world demand, and performance on inflation and the balance of payments have so far deteriorated only marginally.

3. The inflation rate has edged up very slightly, from 4½ per cent a year ago to 5 per cent. At around 6½ per cent, wage increases in industry have been much lower than in the public sector. And continued strong growth in productivity (4½-5 per cent in manufacturing between the first halves of 1987 and 1988) has helped to contain the rise in unit labour costs. Nonetheless the Government's target of a 4 per cent average inflation rate next year looks decidedly optimistic.

4. Though imports have risen rapidly, so have exports (by 14 per cent in value between the first halves of 1987 and 1988). The balance of payments is also benefitting from the fall in oil prices. A small deficit on current account is expected in 1988, following near balance in 1987.

Fiscal and monetary policies

5. Buoyant domestic demand partly reflects fiscal and monetary policies. In the run-up to the May General Election, the Government gave in to public sector pay increases (which averaged 15 per cent between the first halves of 1987 and 1988) and control over public spending weakened. And, following the lifting of credit ceilings in March, lending has surged and the lira has come under pressure within the ERM.

6. Since the Election, the Government has been obliged to tighten policy. Budget measures (most notably an increase in the standard rate of VAT from 18 to 19 per cent) in May and July were aimed at cutting the budget deficit by L8½ trillion, bringing it down to L114½ trillion (10.9 of GDP) in 1988. This is however still L5 trillion above the original budget target. And, given the continued pace of spending and the effect on debt interest of recent interest rate rises, the revised target is likely to be overshot.

7. Italian short term interest rates have risen by about 1 per cent since the start of 1989 and at 11.8 per cent, are slightly lower than in the UK.

8. The Draft Budget for 1989, which was presented to Parliament on 30 September but has still to be agreed, sets a target for the deficit of L117.4 trillion (10.2 per cent of GDP). This is part of a medium-term strategy aimed at eliminating the primary budget deficit (3½-4 per cent of GDP currently) by 1992 - thereby stabilising a ratio of public debt to GDP which is now approaching 100 per cent.

9. The Budget proposals include spending cuts (particularly on health, pensions and transfers to local authorities) and an increase (some time next year) in the 2 per cent VAT rate to 4 per cent. Cash limits have been imposed on local authorities, health authorities and the railways.

UNCLASSIFIED

SAVING BY BAG

BY BAG

FROM ROME

TO FCO

SAVING NO 11

UNCLASSIFIED

FRAME ECONOMIC

TO FCO SAVING TELEGRAM NO 11 OF 10 NOVEMBER 1988
AND INFORMATION SAVING
WASHINGTON, PARIS, BONN, OTTAWA, UKDEL IMF/IBRD, UKDEL OECD,
UKREP BRUSSELS, CONSULATES IN ITALY.

MONTHLY ECONOMIC REPORT : ITALY: OCTOBER 1988

1. SUMMARY

Italy's economy continues to perform robustly. August industrial production figures were the best for 10 years. The number of strikes in the public sector diminished sharply in October. The July survey showed employment at record levels: unemployment continues to fall slowly but the gap between south and north is widening. Inflation in October fell to 4.7%. July and August both recorded trade surpluses after 10 months of deficits. The September balance of payments deficit of 2,306 billion lire reflected pressure on the lira in that month. There was again strong demand in October for short and long term government securities.

The Finance Bill was approved by the Budget Committee at the end of the month with only minor changes and a recommendation for some further revenue raising measures e.g. a higher tax on diesel and reintroduction of health diagnostic charges. The bill now goes to the floor of the Chamber of Deputies.

2. ECONOMIC ACTIVITY (Tables 1, 1A and 2)

According to the latest ISTAT figures GDP at 1980 prices grew by 0.6% in Q2 over Q1 and by 3.1% over Q2 1987 (for other year on year figures see Table 1A). Imports of goods and services grew by 6.7% over the previous quarter but exports by an amazing 16.1%. ISTAT officials say the results are true and not influenced by introduction of the Single Administrative Document. Gross fixed investment grew by only 0.4% with a 2.7% increase in equipment but a fall of 1.9% in transport and of 1.4% in construction. This followed two quarters of significant investment in all three

sectors. Consumer expenditure rose by 1.1%, composed of 1.2% private and 0.7% government. There was a marked increase in purchase of semi-durable (+2.4%) and non-durable (+1.5%) goods.

ISTAT's seasonally adjusted industrial production index at 110.4 reached its highest level in August since the base year was adjusted to 1980 (this represented a 1.5% increase over the July record of 108.8). The unadjusted index showed a 14% rise over August last year with only 1 working day more. The fact that many factories still shut down for August holidays means the figures should be treated with caution but other evidence tends to support the impression that the economy is enjoying a substained period of growth. Sectors reporting increased activity include vehicles, office machinery, rubber, electrical equipment, precision instruments, metal and plastic products. Poor results were reported by clothing, oil processing, mining and first working of metals.

According to ENEL electricity consumption in October rose year on year by 4.4%. The largest increases in demand this month were in Palermo (+6.7%), Milan (+5.5%) and Naples (+5%). On an annual basis Milan leads the table with +6.4%.

On the basis of the ENEL figures, IRS predict a seasonally adjusted rise of 5% in their industrial production index in October.

The July figures for orders and invoices show a slowing of the rise in demand due to seasonal factors but foreign demand continues to hold up well. Invoicing was up 4.4% year on year and orders by 4% (0.4% domestic, 12.1% export). In the first 7 months orders rose by 11.8% year on year (domestic +10.3%, export 16.5%).

There was a record number of new car registrations in September at 163,418 bringing the number of cars sold in Italy in the first 9 months of the year to 1,672,348.

Both business and family surveys by ISCO in October reported a further increase in the already high level of optimism about the economy.

3. LABOUR AND SOCIAL AFFAIRS (Tables 2 and 3)

Labour Affairs

Strike action was threatened by air traffic controllers and airport firecrews during the month but was called off following positive discussions between the unions and government.

A 48 hours strike by train drivers was averted when the Minister of Transport used his power of "precettazione" (direction to work normally). About 80% of trains operated. While the Minister's use of his powers was successful in this case it may lead to COBAS deciding to work to rule rather than to strike in future, which would rule out the possibility of "precettazione".

There were problems at some frontier posts when customs staff unexpectedly took strike action to draw attention to the need for rapid approval of the bill to reform administration. The unions were divided on the issue and the strike was not wholly effective.

The bill to control strikes which had already passed through the Senate was introduced in the Chamber of Deputies and has run into difficulties. A number of amendments have been proposed and if these are accepted the bill will need to be returned to the Senate.

A major split developed within CGIL, the largest of the three Italian confederations which is mainly Communist. The leadership of Pizzinato is being challenged and in a vote on a policy document he survived only because the Socialist element of the union gave him full support. The leaders of the sector unions which form the confederation in general are opposed to Pizzinato. This is a very damaging development for the union at a time when relations between CGIL and the other confederations are still strained after the disagreements over the Fiat contract.

A number of contracts of various types were agreed during the month but a proposal by Olivetti to introduce profit-related pay rises was rejected by CISL. Agreements at Iveco and Pininfarina introduced greater flexibility in the use of labour.

According to an investigation by ASAP private sector workers' pay has increased over the past 7 years in line with increased productivity whereas in the public sector pay has also increased but productivity has fallen. Talks between Confindustria and the trade unions on the continuation and amendment of the scheme of work/training contracts were resumed and are continuing. There is a general feeling on both sides that greater flexibility is required if Italy is to benefit fully from the opportunities of 1992 and beyond.

ISTAT's July survey shows employment at a record 21,468,000, an increase of 419,000 year on year. Service employment grew by 416,000 and there was a welcome increase of 106,000 in manufacturing while agriculture declined by 103,000. The increases were heavily concentrated in the north, and the south increased by only 3,000.

Unemployment nationally continued to fall slowly, but the gap between north and south is growing steadily wider with no real signs that the government is able to do anything about it. The number of young people (under 29) looking for their first job remains extremely high.

ISTAT LABOUR FORCE SURVEY

	July 1988	April 1988	July 1987
	(thousands)		
In employment	21,468	21,113	21,049
Unemployed	2,853*	2,857	2,871
Total Labour Force	24,321	23,970	23,920
Unemployment rates	11.7%	11.9%	12.0%
Male	7.9%	8.0%	8.2%
Female	18.5%	18.7%	18.7%
North	6.4%	6.7%	7.5%
Centre	9.8%	10.1%	9.8%
South	20.6%	20.2%	19.8%
Activity rates	42.8%	42.2%	42.2%
Male	55.9%	55.3%	55.2%
Female	30.4%	29.8%	29.9%

* 1,424,000 were young people looking for their first job. 1,635,000 were women. 72% of total were under 29.

The increase in contractual pay rates over the whole economy was 7% in September year on year, with the highest rates as usual appearing in the public sector.

HOURLY CONTRACTUAL PAY RATES
(1982=100)

Sector	Increase Sep 88/ Sep 87	Increase due to scala mobile indexation system
Whole Economy (171.4)	7.0% *	N/A
Industry	6.2%	3.2%
Commerce	6.3%	3.1%
Transport & Communications	5.7%	2.8%
Banking & Insurance	6.7%	2.0%
Public Administration	7.9%	2.6%
Agriculture	7.2%	3.5%

*Increase in cost-of-living index over same period 4.8%.

ISTAT reported that 4.1 million hours were lost during July because of strike action, mainly in the transport industries, a sharp increase over the 1.6 million hours recorded in June 1988 and 14 million in July 1987. However the cumulative figure for the first 7 months of 1988 (13.942 million) was down by just over 1 million hours compared with 1987.

Social Affairs

There are major problems with the budget for INPS for 1989 which at 37,500 billion lira leaves a gap of 7,000 billion lira in estimated expenditure. The balance is to be found by Budget manoeuvres but this may still leave a shortfall. The current reform of the INPS system is being held up by the Treasury which feels that the reforms may not be sufficient to prevent a complete financial breakdown of the system. State transfers to INPS for 1988 are now estimated to exceed the budget of 36,000 billion lira fixed by the Finance Act by 2,914 billion lira because of provisions approved by Parliament during the year.

INPS own estimates show that by the year 2010 the contributions necessary for employees pensions will be 39% of wages compared with an estimate made 2 years ago of 37%. Confindustria is demanding a complete reform of the system on the grounds that the level of increase in contributions is no longer acceptable.

4. INFLATION

The cost of living index rose by 0.8% in October over September and by 4.7% year on year. The average 12 month rate falls to 4.9% after 3 months at 5%. The year on year rate is the lowest this year despite the high monthly increase. The inflationary impact of raising the 18% VAT rate to 19% and increases in petroleum prices in July seems to have been absorbed. The main reason for the high monthly rise is seasonal increases in clothing prices and the quarterly revision of rents. The low year on year figure reflects the effect on last October's rate of the government's autumn 1987 economic manoeuvre.

COST-OF-LIVING INDEX (OCTOBER) (1985 = 100)

Sector of index	% change over Sep 1988	% change over Oct 1987
General index (118.3)	+0.8	+4.7*
Food	+0.5	+3.8
Clothing	+1.9	+6.1
Housing	+2.1**	+7.3
Fuel & Elec.	-0.3	+3.1
Miscellaneous	+0.7	+5.0

* +4.5% for monitored/controlled prices and tariffs, +4.8% for other prices and tariffs.

**Quarterly review of rents.

Wholesale prices rose in August by 0.7% over July, the highest monthly rise this year. The August year on year figure was 5%, the highest since December 1985. The August figures reflect the government's summer fiscal measures, with diesel up 7.2% and fuel oils up 7.9%. Other sectors showing significant increases include livestock products (+1.7%), fresh and processed meat (+1.3%) and iron and steel (+1.1%). Decreases were recorded in animal foodstuffs (-2.1%) and dressed skins (-0.1%). ISTAT's breakdown of the year on year figures according to economic destination showed the index for final consumption goods rose by 5.3%, for fiscal investment goods by 5.1%, and that for intermediate goods by 4.7%. The production price index for industry excluding construction rose by 0.8% in August over July and by 3.8% year on year.

Confindustria's index of raw material prices shows that in August there was a rise of 1.9% over July in lira terms: in dollar terms there was a fall of 0.8%. The year on year figures are: lira +8.1%, US dollar +4.4%.

5. TRADE (Table 6)

In July the trade balance showed a surplus after 10 months in deficit. There was a much smaller surplus in August. This dampened July's euphoria and concern was again expressed about the level of imports (given the low oil price) and the competitiveness of exports over the medium term.

The July trade surplus was 1,054 billion lira, compared with +813 billion in July 1987. The 1988 7 month figure is -7,399 billion lira compared with -8,311 billion in the same period last year. The energy deficit was 1,409 billion and there was a surplus on other items of 2,463 billion. Year on year July imports rose by 4.1% and exports by 5.5%. Textiles and clothing showed strong export performance after disappointing figures in the first half of the year and engineering products also did well. Imports for use in industrial production were also up sharply, for example a 25% increase in ferrous and non-ferrous metals, 15% in engineering products 6%, in chemicals. Many commentators thought these trends would be confirmed in August and that Italy's strong domestic performance was now also reflected in its external trade.

The August trade surplus of 115 billion lira was less than expected. In August 1987 there was a surplus of 1,150 billion. The 1988 cumulative figure for the first eight months - 7,288 billion lira is very close to that for the same period of 1987, -7,153 billion lira. The energy deficit in August was 1,262 billion lira with a surplus on other goods of 1,377 billion. This compares with an energy deficit of 1,381 billion in August 1987 and a surplus of 2,541 billion on other goods. Year on year 1988 imports were up by a surprising 18.5% while exports rose only by 5.5%. While the rise in imports was partly accounted for by the requirements of industry, increases seem to have been reported in most sectors and private consumption will have played a significant role.

De Mita's visit to Moscow coincided with a large trade fair "Italia 2000" attended by most of Italy's top industrialists. At least 20 new contracts/joint ventures are reported to have been signed and a new credit line of 680 million ecu made available by the Italian government to the Soviet Union. Italian businessmen have been concerned by Italy's drop in the first half of 1988 from 3rd to 5th place in the table for exports to the USSR behind FRG, Finland, USA and Japan.

After two months well in surplus, the balance of payments recorded in September a deficit of 2,306 billion lira. But the 9 month cumulative figure is still well in the black at 1,878 billion lira compared with a deficit of 1,529 billion in the same period last year. The fluctuation of the lira/dollar exchanges in the first half of September led exporters to delay banking receipts and importers to anticipate payments. The second half of the month and early indications for October showed the situation rapidly returning to normal. The Bank of Italy pointed to the sound underlying trend of the trade figures and the international economy. Inward and outward flows of capital "above the line" were broadly in balance. Investment abroad by Italians amounted to around 1,300 billion lira, of which 800 billion represented portfolio operations. There was a net inflow through the banks (below the line) of 363 billion lira. Foreign indebtedness in the banking system was around 40,700 billion lira on the last day of the month. The reserves fell from 79,807 billion lira at end August to 78,578 billion at end September.

OFFICIAL RESERVES
(Billion Lire)

Month	Total net reserves	Gold	Convertible	ECU
August	79,807	37,500	28,499	10,906
September	78,518	37,924*	26,719	10,939

*Quarterly review

Estimates of the balance on current account to end September are around 4,000-4,500 billion. Not only has there been a slight deterioration in Italy's trade position but the traditional large surplus on tourism is being steadily eroded as tourism expenditure in Italy has slightly declined while Italian expenditure on tourism abroad has sharply increased (up 33% in the first half of 1988). But the current deficit is compensated by the large scale investment from abroad in government securities lured by an interest rate some 5-6 points above that available in Germany.

6. FINANCIAL DEVELOPMENTS (Tables 4 and 5)

Confidence in Italy's economic future and high rate of interest have fully restored demand for 2 and 4 year BTP and BTE with virtually all issues heavily oversubscribed. Demand was also sustained for 3, 6 and 12 month BOT. Only the 5 year CCT remains in disfavour and the Treasury has indicated it may temporarily suspend issues although there are some signs of secondary market interest.

GOVERNMENT SECURITIES

	Total issue	Taken by B/Italy	Unplaced	Effective annual yield (compound)(1)	
				gross	net*
		(Billion Lire)		%	
3-mth BOT					
end-Sep	8,250	-	oversubscribed	11.01	9.55
mid-Oct	4,000	1,026	-	11.12	9.73
end-Oct	9,000	733	-	11.47	9.95
6-mth BOT					
end-Sep	12,000	945	-	11.42	9.89
mid-Oct	2,000	-	oversubscribed	11.23	9.83
end-Oct	12,000	750	281	11.31	9.80
12-mth BOT					
end-Sep	9,000	-	oversubscribed	11.89	10.25
mid-Oct	2,000	-	"	11.73	10.11
end-Oct	10,500	-	"	11.73	10.11
5-yr CCT					
Aug	2,500	-	1,190	12.58	10.97
Sep	3,500	-	980	13.15	11.47
Oct	3,500	-	900	13.15	11.47
Nov	1,500	-		13.15	11.47

BTP

1 Sep(2-yr)	5,000	-	oversubscribed	12.38	10.80
(4-yr)	3,000	-	"	13.31	11.61
14 Sep(2-yr)	1,500	-	220	11.82	10.31
16 Sep(4-yr)	1,500	-	oversubscribed	13.31	11.61
3 Oct(2-yr)	5,500	-	"	12.38	10.80
(4-yr)	7,000	-	"	13.31	11.61
13 Oct(2-yr)	1,000	-	"	12.38	10.80
(4-yr)	5,000	-	"	13.31	11.61
2 Nov(3-yr)	3,000	-	"	12.22	10.66
(5-yr)	5,000	-	"	13.15	11.47

BTE

Apr (373 days)	1,000m Ecu	-	oversubscribed	7.49	6.55
Jun (378 days)	1,000m Ecu	-	"	7.80	6.68
Aug (378 days)	750m Ecu	-	"	8.93	7.80

CTE

May (4-yr)	1,000m Ecu	-	-	8.50	7.43
Jul (5-yr)	1,000m Ecu	-	-	8.75	7.66
Sep (5-yr)	1,000m Ecu	-	-	8.75	7.66
Oct (5-yr)	1,000m Ecu	-	-	8.65	7.56

(1) Simple interest for BTE and CTE.

* Net of 12.50% tax deducted at source.

(Total BOT in circulation at end-September: 243,525 bn lire)

According to preliminary Bank of Italy figures, bank lending in September grew by 14.5% on an annual basis but the figure is swollen by the effects of the bank credit ceiling in force in September 1987.

The Bank of Italy has published proposed new rules for banks' compulsory reserves which will give the banks some flexibility in their deployment within quantitative and temporal limits. The proposals now go for approval to the Ministerial Committee on Credit and Savings (CICR) and are expected to enter into force in mid 1989. The banks have generally welcomed the Bank's initiative. The Treasury Ministry's proposals on greater transparency in relations between banks and their clients have been greeted with much more reserve. These, with other proposals on transparency, are currently under discussion in Parliament. Meanwhile ABI, the bankers' association, is going ahead with its own ideas.

Ciampi has also called for new legislation defining the roles and permissible relationship of industrial holdings and credit institutions whose separation was decreed under Italy's 1936 Banking Law which is still in force.

The banks are also under heavy pressure from the Bank of Italy to press on with improvements to the payments system. All in all, the process of modernisation of Italy's financial sector in preparation for 1992 is picking up speed. In the process Parliament is being largely bypassed or asked to approve very broad framework laws such as that on foreign financial dealings which are then fleshed out by the Treasury and Bank of Italy.

October was a fairly tranquil month for the lira in the ERM. As more months from the last realignment (12 January 1987) elapse, there is a general expectation that there must be another realignment within, say, a year but there does not seem to be any particular pressure for such at present.

EXCHANGE RATES - OCTOBER
(in Lire)

Currency	Highest parity	Lowest parity	end-month parity
£	2,373.450 (12 Oct)	2,331.850 (24 Oct)	2,342.225
\$	1,392.700 (7 Oct)	1,316.450 (31 Oct)	1,316.450
DM	746.265 (21 Oct)	744.000 (31 Oct)	744.000

Change in weighted value against other EC currencies since 9 February 1973: end-August -63.51%; end-September -63.61%; end-October -61.99%.

One year exactly from the 19 October 1989 stockmarkets crash, the Milan bourse recorded its highest level this year (590.35). But although it has recovered most of the ground lost then, it is still far below the heady days of 1986. There are now 210 companies quoted with a total capitalisation of around 152,700 billion lira. Many more companies would be eligible but the market has not yet succeeded in convincing them that it can operate independently of manipulation by the handful of major companies led by FIAT. Investment funds had a slightly better month in October but still recorded net withdrawals of 927 billion lira despite 1,500 billion new subscriptions.

7. FISCAL POLICY

The SSBR for the first nine months of the year is now put by the Treasury at 94,216 billion lira, more than 10% above the corresponding figures for 1987. To achieve the latest end year target of 118,000 billion the Q4 figure must be restrained to 24,000 billion which will be difficult given that the Q4 1987 figure was 30,000 billion.

Tax revenue in August was up 22.7% over August 1987 and for the period January-August up 13.5% against a forecast increase for the year of 10%.

The Financial Law and Budget were approved by the Budget Commission of the Chamber of Deputies at the end of the month and go to the floor of the house on 7 November. After approval by the Chamber of Deputies as a whole they will then go to the Senate. Changes amounting to some 600 billion lira were made by the Budget Commission but compensating savings were apparently found for all increased expenditure leaving the SSBR unaltered at 117,350 billion lira. The Commission however seemed doubtful about the overall costing of the budget and recommended consideration of some additional revenue raising provisions principally increased tax on diesel and a charge on diagnostic health tests, also possibly a re-evaluation of the property register.

But the greatest difficulty facing the government on the Budget is, as was predictable, the relationship between it and the 9 official accompanying measures as well as the 4 other relevant bills. It is difficult to see how sufficient Parliamentary time can be found: this will become a real difficulty in November when the bills are taken by the Chamber of Deputies as a whole.

8. ASSESSMENT OF ECONOMIC PROSPECTS

IRS has corrected downwards its previous forecasts for 1989. World growth will slow but so will inflation. Italy's GDP growth is put at 3.7% in 1988 and 2.9% in 1989; other elements are (percentage increase):

	1988	1989
Gross fixed investment	5	3.2
Domestic consumption	4.2	3.2
Exports	6.3	4.5
Imports	8	5.5
Current A/C	-4,391 bn	-6,709 bn
Retail price index	4.8	4.4

Prometeia's autumn forecast is relatively optimistic assuming that current government strategy can be maintained, oil prices remain low and that there is no sharp reduction in world demand:

	1988	1989	1990
GDP	3.6	3.1	3.2
Imports	8.4	5.3	5.3
Total Domestic Demand	4.3	3.3	3.5
Exports	5.8	4.6	4.1
Current A/C	-4,938 bn	-9,042 bn	-12,476 bn
Consumer prices	5	5.5	5.8
SSBR	120,186 bn	123,897 bn	130,262 bn
Interest 3m BOT	11	11.5	11.7
Average bank interest rate	13.6	14.1	14.3
M2	8.4	7.9	7.7

TABLE 1: EXPENDITURE ON GNP

Source: ISTAT, New National Accounts.

All figures seasonally adjusted. Billions of lire; (1)-(7) 1980 prices, (8) current prices.

	Real GDP	Consumer Expenditure		Investment	Stockbuilding	Domestic Demand*	Exports	Imports	Nominal GDP
		Private	Govt						
		(1)	(2)						
1983	399,987	252,068	63,092	87,159	1,529	403,848	84,069	87,930	633,571
1984	412,680	258,165	64,722	91,764	5,162	419,813	90,752	97,586	727,798
1985	424,581	265,793	67,004	94,074	5,927	432,798	93,928	102,145	815,630
1986	436,831	275,225	69,102	95,367	6,933	446,627	97,161	106,958	902,238
1987	450,398	287,132	71,433	100,364	8,469	467,398	100,644	117,644	982,595
1985 Q3	106,410	66,819	16,831	23,384	1,250	108,284	23,184	25,059	207,025
Q4	107,328	67,297	16,967	23,617	1,360	109,241	24,359	26,272	210,789
1986 Q1	107,100	67,846	17,126	23,307	2,029	110,308	23,624	26,833	214,752
Q2	109,179	68,277	17,258	23,750	1,003	110,288	25,070	26,179	224,000
Q3	110,111	69,075	17,276	24,062	2,369	112,782	25,052	27,723	230,145
Q4	110,441	70,027	17,442	24,248	1,532	113,249	23,415	26,223	233,341
1987 Q1	111,206	70,850	17,641	24,449	1,807	114,747	24,838	28,379	236,672
Q2	112,295	71,836	17,811	25,439	2,711	117,797	24,215	29,717	243,882
Q3	113,257	72,227	17,972	24,936	1,086	116,221	26,065	29,029	248,985
Q4	113,640	72,219	18,009	25,540	2,865	118,633	25,526	30,519	253,055
1988 Q1	115,061	73,568	18,054	26,231	1,779	119,632	24,861	29,431	N/A
Q2	115,793	74,473	18,181	26,341	-659	118,336	28,862	31,406	N/A

*(2)+(3)+(4). NB: Figures are revised each quarter.

TABLE 1A: EXPENDITURE ON GNP

Source: ISTAT, New National Accounts. (All figures seasonally adjusted.)
 Percentage changes (year-on-year); (1)-(7) 1980 prices, (8) current prices.

	Real GDP	Consumer Expenditure		Investment	Stockbuilding	Domestic Demand*	Exports	Imports	Nominal GDP
		Private	Govt						
	(1)	(2)		(3)	(4)	(5)	(6)	(7)	(8)
1983	0.5	0.4	2.8	-1.6	-	-0.4	2.3	-1.6	15.9
1984	3.5	2.2	2.0	4.4	-	4.4	7.6	11.3	14.1
1985	2.9	3.0	3.5	2.5	-	3.1	3.8	4.7	12.1
1986	2.9	3.5	3.1	1.4	-	3.2	3.4	4.7	10.6
1987	3.1	4.3	3.4	5.2	-	4.6	3.6	10.0	8.9
1985 Q3	2.9	3.6	3.8	0.4	-	2.7	0.4	2.3	12.7
Q4	3.0	3.6	3.2	1.3	-	3.1	4.6	3.0	11.4
1986 Q1	2.0	3.6	3.5	-1.0	-	3.0	1.3	5.6	9.7
Q2	3.2	3.1	3.6	0.9	-	1.9	8.7	3.0	10.9
Q3	3.5	3.4	2.6	2.9	-	4.1	8.1	10.6	11.2
Q4	2.9	4.0	2.8	2.7	-	3.7	-3.9	-0.2	10.7
1987 Q1	3.7	4.6	3.0	5.4	-	4.0	-0.9	4.9	10.2
Q2	2.9	5.2	3.2	7.1	-	6.8	-3.4	13.5	8.9
Q3	2.9	4.6	4.0	3.6	-	3.0	4.0	4.7	8.2
Q4	2.9	3.1	3.3	5.3	-	4.7	9.0	16.4	8.4
1988 Q1	3.5	3.8	2.3	7.3	-	4.3	0.1	3.7	N/A
Q2	3.1	3.7	2.1	3.5	-	0.5	19.2	5.7	N/A

*(2)+(3)+(4). NB: Figures are revised each quarter.

TABLE 2: PRODUCTION AND EMPLOYMENT

Source ISTAT Figures not seasonally adjusted unless so indicated.

	Ind. Prod. Total (1)	Invoices		Orders		Employ- ment '000s (4)	Unem- ploymt '000s (5)	Unem- ploymt rate (6)	Strikes '000 hrs lost (7)
		Dom.	Export	Dom.	Export				
	(1980=100)	(1980=100)		(1980=100)					
1985	96.5	172.4	197.6	169.4	195.4	\$20,742	\$2,327	10.1	26,815
1986	99.2	175.9	196.0	189.2	194.5	\$20,856	\$2,611	11.1	39,506
1987	103.1								32,240
1986 Q1	100.2	173.8	197.8	194.1	203.3	20,686	2,535	10.9	9,523
Q2	104.4	181.5	203.6	195.6	203.0	20,696	2,477	10.7	3,733
Q3	88.7	161.4	180.7	165.2	172.8	21,009	2,530	10.7	1,416
Q4	103.3	187.0	201.7	201.9	198.8	21,049	2,771	11.6	23,001
1987 Q1	103.3	178.0	196.4	201.6	202.5	20,723	2,803	11.9	9,411
Q2	109.6	195.9	212.5	207.7	201.4	20,672	2,725	11.6	4,178
Q3	91.1	176.1	191.8	184.6	181.0	21,049	2,871	12.0	2,469
Q4	108.4	212.8	220.4	217.1	216.1	20,901	2,930	12.3	16,182
1988 Q1	111.1	198.2	221.4	236.7	239.5	20,778	2,945	12.4	4,292
Q2	105.9					21,113	2,857	11.9	5,491
Q3						21,468	2,853	11.7	
	(a)								
'86 OCT	99.9	199.3	213.5	210.7	224.6				6,504
NOV	100.6	175.7	190.6	188.2	178.3				9,997
DEC	102.2	185.9	201.1	206.8	193.6				6,500
'87 JAN	101.5	153.2	172.1	170.2	186.7				2,957
FEB	101.2	172.7	194.8	207.6	198.9				4,733
MAR	101.7	208.0	222.4	227.0	221.8				1,721
APR	102.8	196.4	198.8	211.6	196.6				1,541
MAY	104.2	189.7	206.7	192.6	183.3				842
JUN	102.1	201.8	231.9	218.9	224.2				1,795
JUL	102.1	211.3	257.6	219.7	224.2				1,370
AUG	102.0	101.3	95.4	70.8	85.8				40
SEP	103.1	215.7	219.7	263.4	232.6				1,059
OCT	104.8	219.3	224.7	230.0	233.6				1,154
NOV	103.8	201.8	218.1	204.9	196.4				13,682
DEC	103.5	217.2	218.4	216.5	218.4				1,346
'88 JAN	108.8	169.3	192.0	205.7	212.7				914
FEB	106.0	197.2	222.3	233.4	228.1				1,609
MAR	104.8	228.1	249.9	270.9	227.8				1,769
APR	107.2	198.6	208.6	218.8	229.4				1,471
MAY	104.9								2,479
JUN	105.8								1,541
JUL	108.8*								4,100*
AUG	110.4*								

(a) Seasonally adjusted.

§Average annual Quarterly series surveys carried out end Jan, Apr, Jul, Oct.

* Provisional.

NB August figures distorted by holiday closures.

TABLE 3: PRICES AND EARNINGS

Source: ISTAT. Annual and quarterly series Bank of Italy based on ISTAT.
Per cent change on a year earlier; not seasonally adjusted

	Consumer Prices (1)	Cost of Living Index (2)	Wholesale Prices (3)	Hourly Pay (Contractual) (4)
1985	9.2	8.6	7.3	10.3
1986	5.9	6.1	-0.9	4.6
1987	4.7	4.6	2.6	7.1
1986 Q1	7.5	7.6	2.5	5.8
Q2	6.0	6.4	-1.4	4.9
Q3	5.5	5.9	-2.2	3.7
Q4	4.5	4.7	-2.4	4.0
1987 Q1	4.3	4.3	-0.4	5.2
Q2	4.4	4.2	+2.4	6.8
Q3	4.9	4.6	+4.1	8.0
Q4	5.4	5.2	+4.6	8.1
1988 Q1	5.1	4.9	4.1	9.2
Q2	5.0	4.9	4.5	7.9
Q3		4.9		6.9
1986 OCT	4.7	5.1	-2.4	3.3
NOV	4.4	4.7	-2.3	4.3
DEC	4.3	4.3	-2.5	4.3
1987 JAN	4.2	4.5	-1.7	4.6
FEB	4.4	4.2	-0.2	5.4
MAR	4.2	4.2	0.6	5.6
APR	4.4	4.2	1.6	6.0
MAY	4.4	4.2	2.7	7.1
JUN	4.5	4.1	2.9	7.2
JUL	4.7	4.4	3.8	8.0
AUG	4.8	4.5	4.1	8.2
SEP	5.2	5.0	4.3	8.0
OCT	5.5	5.3	4.5	8.2
NOV	5.4	5.2	4.6	8.2
DEC	5.2	5.1	4.7	8.3
1988 JAN	5.2	5.0	3.9	9.7
FEB	5.0	4.9	4.2	8.8
MAR	5.2	4.9	4.3	9.1
APR	5.1	5.0	4.4	8.7
MAY	5.0	4.9	4.5	7.5
JUN	5.0	4.9	4.5	7.7
JUL		4.9	4.7	6.6
AUG		5.0	5.0	7.0
SEP		4.8		7.0
OCT		4.7		

TABLE 4: MONETARY AGGREGATES

Source: Bank of Italy. Per cent change on a year earlier.

	Monetary Base (1)	M1 (2)	M2 (3)	M3 (4)	Total Domestic Credit (5)
1985	16.6	10.4	11.0	14.4	19.2
1986	10.6	10.7	9.4	8.8	16.2
1987		7.6	8.4		
1986 Q1	12.2	10.0	9.7	11.0	16.5
Q2	11.2	10.8	8.8	9.2	16.3
Q3	9.9	9.2	7.9	7.1	16.0
Q4	8.8	10.9	9.5	8.1	15.9
1987 Q1	9.5	9.9	10.3	7.7	15.6
Q2	11.4	10.8	12.0	9.0	15.2
Q3	12.3	10.9	10.5	10.5	14.5
Q4	10.8	8.6	9.3	11.5	13.2
1988 Q1	8.8	7.0	7.1	11.9	12.8
Q2		6.5	6.8		13.2
1986 Sep	8.9	9.5	8.2	7.0	15.9
Oct	9.1	10.6	9.1	7.9	16.3
Nov	10.2	11.3	9.9	8.2	16.1
Dec	7.2	10.7	9.4	8.2	15.2
1987 Jan	10.3	10.0	9.6	7.7	15.9
Feb	9.4	10.1	10.4	7.7	15.7
Mar	8.9	9.8	10.8	7.6	15.2
Apr	11.9	10.4	11.5	8.6	15.0
May	10.9	10.6	12.0	9.0	15.0
Jun	11.3	11.5	12.4	9.4	15.5
Jul	11.7	11.5	12.0	10.0	14.8
Aug	12.4	11.2	11.6	10.4	14.8
Sep	12.7	10.2	10.8	11.2	13.9
Oct	12.9	10.0	10.3	11.4	13.5
Nov	9.7	8.5	9.3	11.9	13.1
Dec	10.0	7.4	8.3	11.4	13.1
1988 Jan	9.2	7.1	7.5	11.5	13.0
Feb	8.6	7.0	7.1	12.1	12.5
Mar	8.8	6.9	6.9	12.3	12.9
Apr	6.5	6.9	6.8	11.9	12.9
May	6.6	6.1	6.4	11.9	13.2
Jun		6.6	7.2		13.5
Jul		7.4	8.2		13.4

NB: Figures are revised periodically.

TABLE 5: EXCHANGE AND INTEREST RATES

Sources: (1)(2)(3) Bank of Italy; (4) Banca Commerciale Italiana; (5) Ufficio Italiano Cambi.

	One-month Interbank rates (1)	Govt securities		Lira real effective exch rate (1980=100) (4)	Exchange rates (Average)	
		CCT (2)	12-month BOT (3)		Lira/US\$ (5)	Lira/£ster
1985	14.93	14.68	13.63	87.1	1,909.7	2,462.5
1986	13.00	12.49	10.92	89.6	1,490.8	2,187.1
1987	11.32	10.66	10.55	91.7	1,296.4	2,122.4
1986 Q1	16.31	14.44	13.05	91.2	1,599.6	2,302.3
Q2	12.44	13.44	11.13	89.7	1,538.9	2,321.9
Q3	11.46	11.47	10.38	91.3	1,436.9	2,141.3
Q4	11.79	10.63	10.03	93.6	1,389.5	1,985.8
1987 Q1	11.29	10.22	9.78	94.5	1,306.2	2,016.2
Q2	10.71	9.89	9.66	92.8	1,299.8	2,135.1
Q3	12.25	10.92	10.88	91.0	1,331.1	2,151.8
Q4	11.05	11.60	11.88	92.0	1,248.5	2,188.3
1988 Q1	10.96	10.70	10.54		1,235.6	2,219.6
Q2	10.50	11.14	10.96		1,268.1	2,334.5
Q3			11.58		1,385.6	2,348.2
1986 Dec	11.88	10.51	10.01	94.1	1,380.3	1,984.6
1987 Jan	11.88	10.39	9.93	94.8	1,314.70	1,983.10
Feb	11.63	10.24	9.74	94.8	1,299.60	1,982.50
Mar	10.38	10.04	9.68	94.1	1,304.60	2,076.90
Apr	9.88	9.89	9.65	94.0	1,292.20	2,106.20
May	11.13	9.87	9.66	93.0	1,291.10	2,153.70
Jun	11.13	9.91	9.68	91.6	1,316.00	2,145.50
Jul	11.63	10.25	10.56	90.9	1,337.10	2,152.10
Aug	12.88	11.18	10.62	90.8	1,345.80	2,149.00
Sep	12.25	11.33	11.45	91.3	1,310.30	2,154.40
Oct	10.63	11.58	12.17	90.8	1,303.10	2,164.50
Nov	11.88	11.91	12.14	91.2	1,239.40	2,199.70
Dec	10.63	11.30	11.33	94.0	1,202.90	2,200.60
1988 Jan	10.88	10.92	10.56	94.0	1,215.00	2,190.20
Feb	11.00	10.62	10.50	93.7	1,250.30	2,196.30
Mar	11.00	10.58	10.56		1,241.40	2,272.40
Apr	10.00	10.86	10.96		1,242.20	2,330.50
May	10.63	11.21	10.99		1,258.66	2,352.81
Jun	10.88	11.34	10.93		1,303.43	2,320.07
Jul			11.42		1,366.46	2,329.20
Aug			11.42		1,397.87	2,371.54
Sep			11.89		1,392.50	2,343.86
Oct			11.73		1,316.45\$	2,342.23\$

(1) Bid-offer average. (2) gross yield expected if interest rates unchanged. (3) gross yield on end month issues. (4) Wholesale prices. (5) End month rates.

TABLE 6. TRADE/BALANCE OF PAYMENTS

Source ISTAT; (4)&(5) Bank of Italy. Figures not seasonally adjusted.

	Imports c.i.f.	Exports f.o.b.	Trade Balance	Overall Balance (Current + Capital movements, errors and omissions)	Current Account	Import Volume	Export Volume
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	billions of lire					1980=100	
1985	172,816	149,701	-23,115	-8,352	-7,761	110.8	124.2
1986	148,994	145,331	- 3,663	-2,965	-1,311	115.8	126.4
1987	161,597	150,445	-11,143	+1,183	-3,144	127.5	129.4
1986 Q1	41,792	36,117	- 5,675	-6,696	-3,389	117.2	122.2
Q2	37,734	36,665	- 1,069	+4,506	+ 834	117.5	129.0
Q3	32,028	34,612	+ 2,584	+ 465	+5,593	105.6	122.7
Q4	37,444	37,937	+ 493	-1,240	-2,373	122.8	131.9
1987 Q1	38,368	34,379	- 3,989	+1,988	- 882	123.9	119.4
Q2	40,605	35,471	- 5,134	-3,789	- 881	128.9	122.4
Q3	37,953	38,409	+ 463	- 660	+1,686	117.6	132.9
Q4	44,670	42,196	- 2,474	+2,713	-3,067	139.5	142.6
1988 Q1	42,005*	35,570*	- 6,425*	+ 524	-3,377		
Q2	45,816*	44,062*	- 1,754*	-3,084*	-3,362		
1987 Jan	11,641	10,054	- 1,587	- 380	+ 612	114.7	105.9
Feb	12,505	10,548	- 1,957	+1,442	- 768	121.0	109.9
Mar	14,222	13,777	- 445	+ 926	- 726	136.1	142.4
Apr	13,332	11,950	- 1,382	+1,579	+ 357	127.1	123.3
May	13,120	11,686	- 1,434	-2,865	-1,511	125.7	121.9
Jun	14,154	11,834	- 2,320	-2,503	+ 273	133.9	122.1
Jul	14,563	15,376	+ 813	+ 110	+ 645	136.1	159.7
Aug	8,532	9,691	+ 1,159	-1,011	+1,020	79.0	101.6
Sep	14,858	13,342	- 1,516	+1,172	+ 21	137.7	137.4
Oct	14,942	14,251	- 691	+ 237	- 226	138.6	144.4
Nov	14,328	13,480	- 848	+1,656	-1,630	134.1	137.9
Dec	15,400	14,465	- 935	+ 820	-1,211	145.8	145.7
1988 Jan	12,020*	9,680*	- 2,330*	+1,704	- 116		
Feb	13,675*	12,460*	- 1,215*	- 887	-1,463		
Mar	16,310*	13,430*	- 2,880*	- 293	-1,783		
Apr	14,475*	13,810*	- 665*	-3,042	-1,896		
May	15,425*	15,100*	- 325*	- 853	-2,505		
Jun	15,916*	15,152*	- 764*	+ 835			
Jul	15,161*	16,215*	+ 1,054*	+3,581*			
Aug				+3,049*			
Sep				-2,306*			

*Provisional

FRAME ECONOMIC 189
ECD I [-]