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December 30, 1983

To: Members of the Executive Board

From: The Acting Secretary

Subject: Italy - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Italy. This subject has been tentatively scheduled for discussion on Friday, January 27, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mrs. Ter-Minassian, ext. 60853.

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INTERNATIONAL MONETARY FUND

ITALY

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the
1983 Article IV Consultation with Italy

Approved by L. A. Whittome and C. David Finch

December 30, 1983

I. Introduction

A staff team consisting of Mr. L. A. Whittome, Mrs. T. Ter-Minassian, Messrs. E. Spitaeller, L. Perez, Ms. K. Swiderski and, as secretary, Miss I. Jones (all EUR) visited Rome from October 25 to November 8, 1983 to conduct Article IV consultation discussions. Mr. Lovato, Executive Director for Italy, attended the meetings as observer. The previous consultation discussions had taken place in June 1982 and the report was considered by the Executive Board on September 22, 1982.

Fund holdings of Italian lire stood at SDR 1.2 billion (65.7 percent of quota) on October 31, 1983. Italy maintains a restriction on the amount of foreign exchange available for tourist travel which is subject to approval under Article VIII. A staff recommendation in this respect appears in section IV, below.

II. Background

The adjustment of the Italian economy to the second "oil shock" began significantly later than those of its main industrial partners. In 1979-80 a rapid growth of domestic demand, well in excess of the average of other industrial countries, led to a marked worsening of the external accounts and of the inflation performance. The subsequent tightening of monetary policy in 1981 ushered in a phase of recession in domestic demand and output which, despite sporadic and short-lived upturns, continued through the first half of 1983. Domestic demand declined by a cumulative 4 percentage points during the 1981-83 period, following an increase of about 13 percentage points over the preceding two years (Table 1).

The downturn affected most components of domestic demand, except for public consumption, which continued to rise at an average annual rate of over 2 percent. Private consumption virtually stagnated in 1981 and in 1982, and is expected to decline by almost 1 percent in 1983, reflecting primarily a fall in real disposable income of households. The latter is estimated to have stagnated in real terms on average during the last four years, with a significant decline in 1983, due to delays in the renewal of wage contracts, some reduction in employment and a marked increase in the burden of taxation on personal incomes. The savings ratio, which in 1980 had declined significantly from the record level of 1978-79, reflecting the upturn in inflationary expectations, recovered somewhat in 1981-82 in response to an increase in real interest rates and to growing uneasiness about employment prospects, but is estimated to have fallen again in 1983 as households attempted to cushion the impact on consumption of the decline in real disposable income.

The effects of a relatively tight stance of monetary policy, in the face of high and rising public sector deficits, were especially felt on investment and stockbuilding as enterprises, faced with rising real interest rates as well as with low levels of capacity utilization and narrowing profit margins, cutback on capacity expansion and on stock accumulation. Although available evidence points to the continuation of significant investment in the replacement of technologically or economically obsolescent machinery in both small and large industrial enterprises, accompanied by a pronounced shedding of labor, total fixed investment declined by a cumulative 10 percentage points between 1980 and 1983. Stockbuilding is estimated to have fallen by 1983 to its lowest level in real terms since 1975. The impact of the fall in domestic demand on output was only partly offset by an improvement in the foreign balance, leading to a cumulative decline in GDP of nearly 1 1/2 percent during the recession period (Table 1). In 1983 alone GDP is provisionally estimated to decline by 1.2 percent, even assuming a significant recovery in the second half of the year, of which the most recent indicators provide but partial evidence.

The effects of the recession on the employment figures were cushioned by a sharp increase in the resort by industrial enterprises to temporary layoffs, financed by the Wage Supplementation Fund, which are not included in the unemployment data. Nevertheless, employment in industry fell by a cumulative 5 percentage points between 1981 and mid-1983. This decline, along with the structural fall in agricultural employment, was largely offset by a continued increase in employment in the services sector, at rates in excess of 2 percent a year, so that total employment showed little decline during the recession period. As the labor force, however, continued to grow, albeit at a slower pace than in the previous cyclical phase, unemployment rose to nearly 10 percent by mid-1983 (12 percent after adjustment for temporary layoffs under the Wage Supplementation Fund).

The wage adjustment mechanism, which involves a relatively high (about 70 percent on average) degree of indexation to the past rate of inflation, contributed to the maintenance of a high rate of nominal wage increases during the recession period. Despite protracted delays in the conclusion of major wage contracts, the average wage per worker rose by a cumulative 42 percent in 1981-82 in the economy as a whole (about 3 1/2 percent in real terms before tax). In industry, excluding construction, wage rates rose by 39.5 percent and unit labor costs by 38 percent during the same period. Following months of debate, at the beginning of 1983 the Government obtained the agreement of the social partners to a modification of the scala mobile mechanism designed to reduce the degree of indexation by about 15 percent. In addition, understandings were reached in principle about a review of the agreement at the end of 1983 with a view to reducing the incidence of changes in indirect taxes on the scala mobile index and eliminating from it the effects of a revaluation of the U.S. dollar vis-à-vis European currencies. Finally, industry-wide ceilings were agreed to for contractual wage increases to be negotiated for the period 1983-85. The contracts negotiated in the second half of 1983 are broadly in accordance with the tripartite agreement, with the exception of the important metal mechanic sector. On the whole, wage rates in manufacturing are expected to increase by over 16 percent in 1983. Given the expected decline in productivity, the increase in unit labor costs is likely to reach 18 percent this year.

The maintenance of high rates of growth of labor costs, only partly offset by a sharp deceleration in import prices (Table 2), resulted in a significant squeeze of profit margins in the industrial sector as the growth of output prices was moderated by the slack in domestic and external demand. The deceleration in industrial prices (from over 22 percent in 1980 to around 10 percent in 1983) was not, however, fully reflected in the cost of living index, which decelerated only from 21 1/2 percent in 1980 to around 13 1/2 percent by end-1983. Relatively high rates of price increase in the services sector, in administered prices and in some public tariffs, contributed to the maintenance of a rate of inflation in consumer prices well above the average of industrial countries.

The prolonged recession in activity contributed, along with exogenous factors, to a substantial improvement in the external accounts (Chart 1). The current account deficit, which had reached the equivalent of about US$9.7 billion (2.4 percent of GDP) in 1980, declined to US$5.5 billion or 1.6 percent of GDP in 1982 and to an estimated US$1.4 billion or 0.4 percent of GDP in 1983 (Table 2). The improvement in the real trade balance was especially marked in 1981. Subsequently the export performance weakened significantly, reflecting the downturn in external demand and an erosion of competitiveness, particularly in terms of relative unit labor costs. After rebounding briefly at the beginning of 1982, following the the removal of the import deposit scheme, imports have been on a clear downward trend, in reflection of the decline in domestic demand. The terms of trade improved significantly in both 1982 and 1983, following substantial losses in the previous three years. The traditional surplus on the invisibles account, which had deteriorated in 1981 because of the growing burden of servicing the external debt, improved markedly in 1982 and 1983, in reflection of a strong performance of tourism and, to a lesser extent, of a decline in interest rates abroad. Total external debt (excluding short-term commercial debt but including the net foreign position of commercial banks) stood at around US$50.4 billion (about 15 percent of GDP) at the end of 1982. Preliminary indications suggest that it increased by some US$4 billion in the first half of 1983, mainly because of an increase in the foreign indebtedness of the commercial banks. Debt service remains below 15 percent of foreign exchange receipts.

Foreign exchange reserves, including ECUs, stood at about US$17.8 billion (equivalent to seven weeks of imports) at the end of October 1983, compared with US$12.6 billion at the end of 1982.

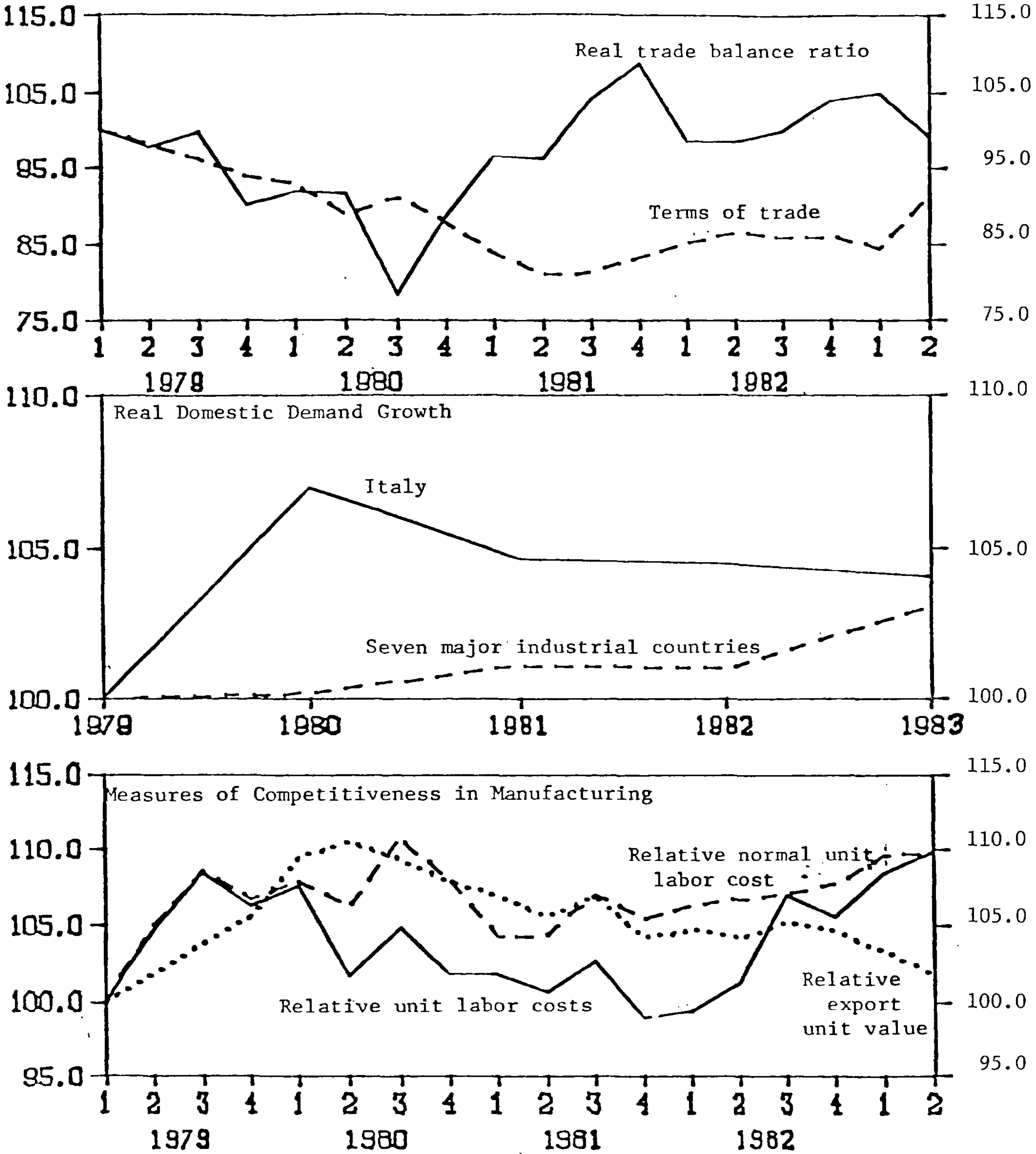
The exchange rate of the lira has weakened sharply vis-à-vis the U.S. dollar in recent years (Chart 2). By October 1983 it stood 15 percent below the average 1982 level and 48 percent below its level in March 1979 when Italy joined the EMS. The depreciation has been substantially less pronounced vis-à-vis European currencies, despite four realignments of the lira within the EMS since the inception of the system. The relative strength of the lira within the EMS appears to be largely related to the stance of monetary policy and, in particular, to the maintenance of relatively high levels of interest rates. The effective depreciation (MERM basis) amounted to less than 8 percent in 1982 and to about 6 percent during the first nine months of 1983. As a result, the real effective exchange rate as measured by relative unit labor costs appreciated significantly in the course of 1982 and 1983, and by mid-1983 the competitive position had deteriorated by about 10 percent compared with the previous peak (Chart 1).

The stance of financial policies has continued to be severely constrained in recent years by the size of the public sector deficit. The borrowing requirement of the state sector, which reflects over 90 percent of the overall public sector deficit, rose sharply between 1980 and 1982 to around 15 percent of GDP (Table 3). Official calculations suggest that about half of the 4 percentage point increase in the deficit in relation to GDP was due to cyclical factors. The increase was entirely a reflection of the escalation of expenditures, particularly current ones, which rose by over 10 percentage points of GDP to around 50 percent in 1982. The most dynamic components of expenditure were transfers to households and enterprises and interest payments on the public debt, which reached 8 1/2 percent of GDP by 1982. Revenue rose by about 6 percentage points of GDP, of which 4 percentage points were accounted for by an increase in the tax burden. The initial budget for 1983 targeted the maintenance of the state sector deficit at the same nominal level as in 1982 (Lit 71 trillion or around 13 1/2 percent of GDP). To secure the target, a package was announced of tax increases and of measures aimed at containing expenditures, particularly those on pensions and health. Failure to implement several of the proposed measures, along with the impact on tax revenues and on some expenditure items of a weaker than expected activity, led to a rise in the deficit to an estimated Lit 90 trillion (nearly 17 percent of GDP) in 1983.

The size of the public sector deficit has represented a major obstacle to a substantial deceleration in the growth of the monetary aggregates. After declining during 1980 from around 23 percent to about 17 percent, the rate of growth of M3 (which includes Treasury bills held by the nonbank public) has oscillated in the 15-17 percent range (Table 3). The rate of growth of M2 showed wider fluctuations, in reflection of shifts in the preference of the public as between bank deposits and Treasury bills. The relative stability in the rate of growth of the

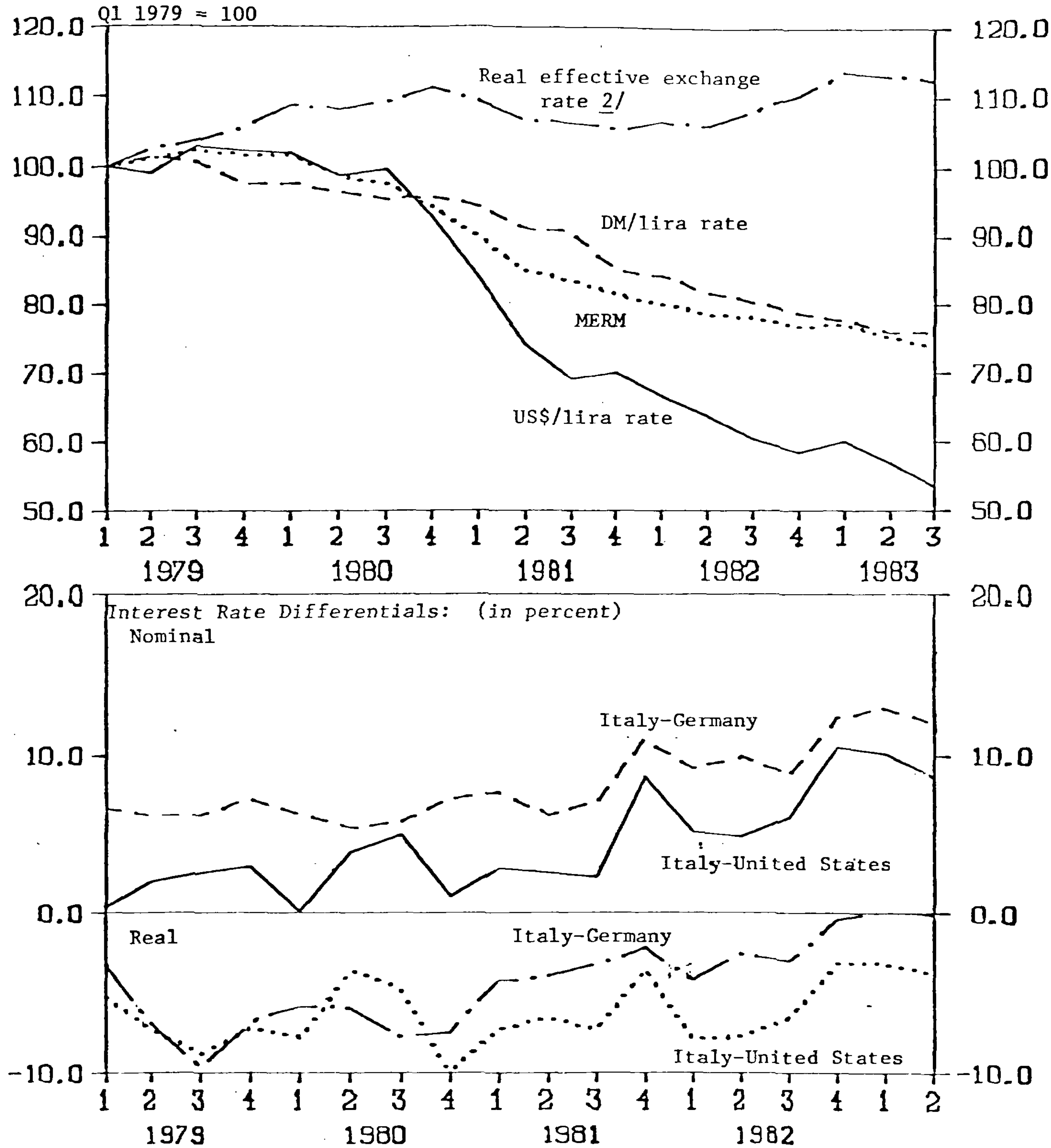
Chart 1. Italy: Selected Indicators of Trade Performance

(Seasonally adjusted indices; 1979(1) = 100)



Sources: Bank of Italy; and IMF, Research Department.

Chart 2. Italy: Exchange Rates and Interest Rate Differentials 1/



Sources: IMF, International Financial Statistics, and Research Department.

1/ The rates are quarterly averages ofmonthly rates on money market instruments of about 90-day maturity deflated by an estimate of the rate of inflation.

2/ Relative price levels measured by consumer price indices.

monetary aggregates in the face of rapidly rising borrowing requirements of the public sector was achieved through a marked decline in the share of the private sector in total domestic credit expansion (Chart 3), only partly compensated for by an increase in current and capital transfers from the budget to the enterprise sector.

In their effort to control the overall credit expansion and to secure the absorption of the financial assets created by the public sector deficit, the authorities have increasingly relied in the last few years on an active interest rate policy. Interest rates on Treasury bills and other government securities were allowed to rise steeply during the initial phase of monetary restraint in 1980-81, to levels significantly positive in real terms (Chart 3), with the subsequent decline lagging the deceleration of inflation. Rates on bank deposits have moved more sluggishly than those on Treasury bills and other financial assets as banks, faced with relatively tight credit ceilings, did not seek a rapid expansion of deposits. Lending rates have hardly declined, and now stand at levels which are quite high in real terms, contributing to the weakness in the demand for credit by the private sector.

III. Report on the Discussions

1. Overview

The payoff of three years of recession and attendant rise in unemployment on the external and especially the inflation performance in Italy has been disappointing, especially in comparison with those of other major industrial countries. The inflation differential between Italy and its main trading partners has widened over the last three years while the current account of the balance of payments remains in deficit at the trough of the recession. This performance compares unfavorably with that in 1977-78, the previous recessionary phase, when inflation declined below 12 percent and the current account shifted into a sizable surplus while growth remained, on average, over 2 percent a year. Much of the consultation discussions focussed on the role that long-standing weaknesses, particularly in the area of the public finances and of income determination mechanisms, have played in this apparent deterioration of the trade off between growth and inflation and on the policy strategy that could be expected to ensure an improved performance in 1984 and beyond.

Upon taking office in July, the new Italian Government set as a priority objective of economic policy a reduction of inflation to 10 percent on average in 1984, as a first step toward securing a greater degree of convergence with other major industrial economies. The policy strategy envisaged in support of this objective included the maintenance of the deficit of the state sector at the same nominal level as in 1983 (which would imply a reduction of nearly 2 percentage points in relation to GDP), the containment of the growth of labor costs at the target rate of inflation and a significant deceleration in the growth of the monetary and credit aggregates. In the view of the authorities, the successful implementation of such a policy stance would be consistent, on the assumption of an improved international environment, with a moderate recovery in output (projected to grow by around 2 percent) and with a further improvement in the current account of the balance of payments, to virtual equilibrium. The discussions focussed on the adequacy of the announced policy stance, in the light of the Government's objectives, on the dangers of slippages in its implementation and on the likely consequences of such slippages.

2. Economic policies

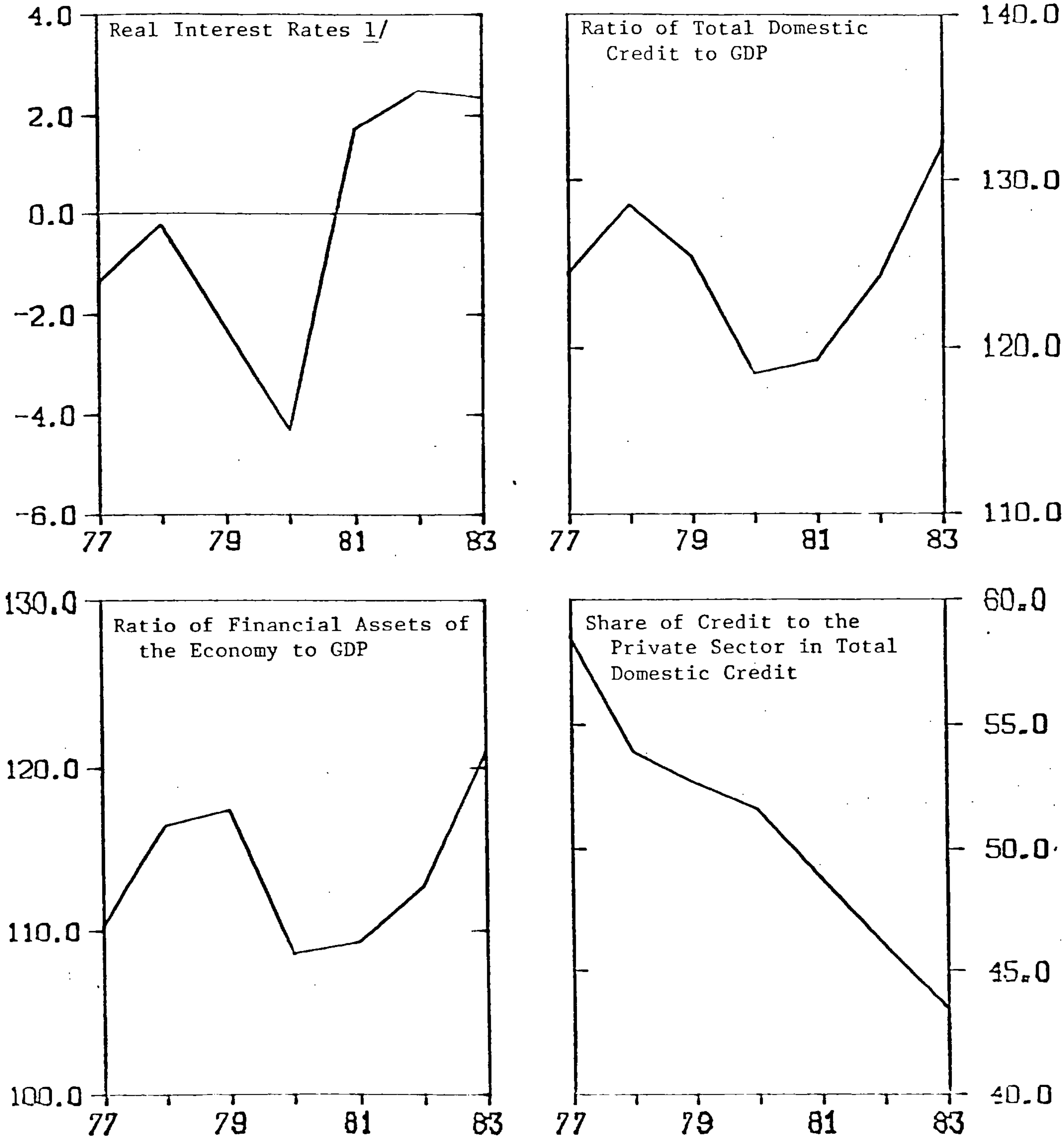
a. Fiscal policy

The public finances have represented a long-standing area of weakness. The borrowing requirement of the public sector trebled in relation to GDP to 12 percent during the 1970s, reflecting an increase of over 10 percentage points in the ratio of expenditure to GDP only partly compensated for by an increase in the tax burden. Despite a continued steep rise in tax revenues, the deficit recorded a further sharp jump in the last three years, to an estimated 17 percent of GDP in 1983, as expenditures increased by nearly another 10 percentage points in relation to GDP. Various calculations indicate that even after adjustment for cyclical factors the levels of public expenditures and of the public sector deficit relative to GDP far exceed those prevailing in Italy's main trading partners.

The roots of the fiscal problem on the expenditure side have been the creation over time of automatic expenditure-generating mechanisms such as the indexation schemes for pensions and civil servants' wages, the decentralization of spending decisions without a corresponding decentralization of revenue-raising responsibilities, and finally the inability of successive governments to resist pressures for discretionary increases in expenditures, for instance to support ailing industries, to improve social benefits, etc. On the revenue side, concern with the impact on the scala mobile of increases in indirect taxes and in charges for public services, as well as with the impact on labor costs of social security contributions, have led to a reliance on the personal income tax as the main source of growth in revenue relative to GDP. Reflecting the combined operation of fiscal drag, a high rate of inflation and discretionary measures, the share of the personal income tax in total tax revenue doubled between 1975 and 1983. However, the uneven distribution of its burden, due to differential rates of evasion and of avoidance among different types of income, is setting increasingly narrow limits to the scope for a further growth of personal income taxation relative to GDP.

An increasingly important role in the escalation of public expenditures and of the deficit in recent years has been played by interest payments on the public debt which in 1983 are estimated to reach 9 percent of GDP, a level far in excess of the average of other industrial countries. The increase in interest payments relative to GDP throughout the 1970s

Chart 3. Italy: Financial Indicators, 1977-83



Source: Bank of Italy.

1/ Six-month Treasury bill rates deflated by the consumer price index.

was wholly a reflection of the rise in the stock of public debt outstanding as average interest rates on the debt remained significantly below the rate of inflation. The Government was thus able to exact a substantial inflation tax from holders of its debt. In the last two or three years, however, the tightening of monetary policy in the face of escalating borrowing requirements of the public sector in an international environment characterized by high real interest rates, has led to a marked increase in interest rates on the public debt (other than that held by the Bank of Italy) to levels which are significantly positive in real terms. Positive, and probably rising, real interest rates on the public debt are likely to continue to be required in the future to induce economic agents to hold a growing stock of financial assets relative to GDP, as well as a rising share of the government debt in these assets. In these circumstances interest payments on the public debt and the budget deficit become locked into a mutually reinforcing cycle.

To highlight the inherent medium-term dynamics of the public deficit, the staff has prepared some illustrative scenarios of its possible development through the end of the 1980s under alternative assumptions about the size and nature of corrective efforts, as well as about inflation, growth and real interest rates (Table 4). These simulations (which are discussed in greater detail in Appendix II of the recent economic developments paper) point to the urgency of securing a sizable reduction in the noninterest component of the deficit, in order to achieve a decline over time in the ratio of interest payments to GDP. Even in the most favorable scenario in which the noninterest deficit is assumed to be halved in relation to GDP by 1986 and to be virtually eliminated by 1990, the ratio of public debt to GDP would continue to rise until nearly the end of the decade. Under the scenario assuming the maintenance of the noninterest component of the deficit at around 9 percent of GDP throughout the period, the situation would become clearly explosive, with the overall deficit more than doubling in relation to GDP from its present high level.

The seemingly unarrestable rise of the public deficit has contributed to the deterioration of the trade-off between growth and inflation in Italy over the last several years. The worsening of the trade-off can be related to the growing preemption of financial resources by the public sector on the one hand, and to a shift in the composition of public spending toward less productive components, on the other. The crowding-out of the private sector, evidenced by the sharp decline in its share in total credit expansion, as well as by the increase in the share of the public debt in total financial assets of the economy, has contributed to a decline in the share of productive investment in GDP, particularly pronounced during the last recessionary phase. At the same time, the increase in the share of those public expenditures, such as interest payments, which have a relatively low impact on demand and output, has contributed to dampening productivity growth in the economy. As the wage indexation mechanism does not allow for a differentiation of wage increases in line with productivity, this has tended to lead to a redistribution of income in favor of wages (Chart 4).

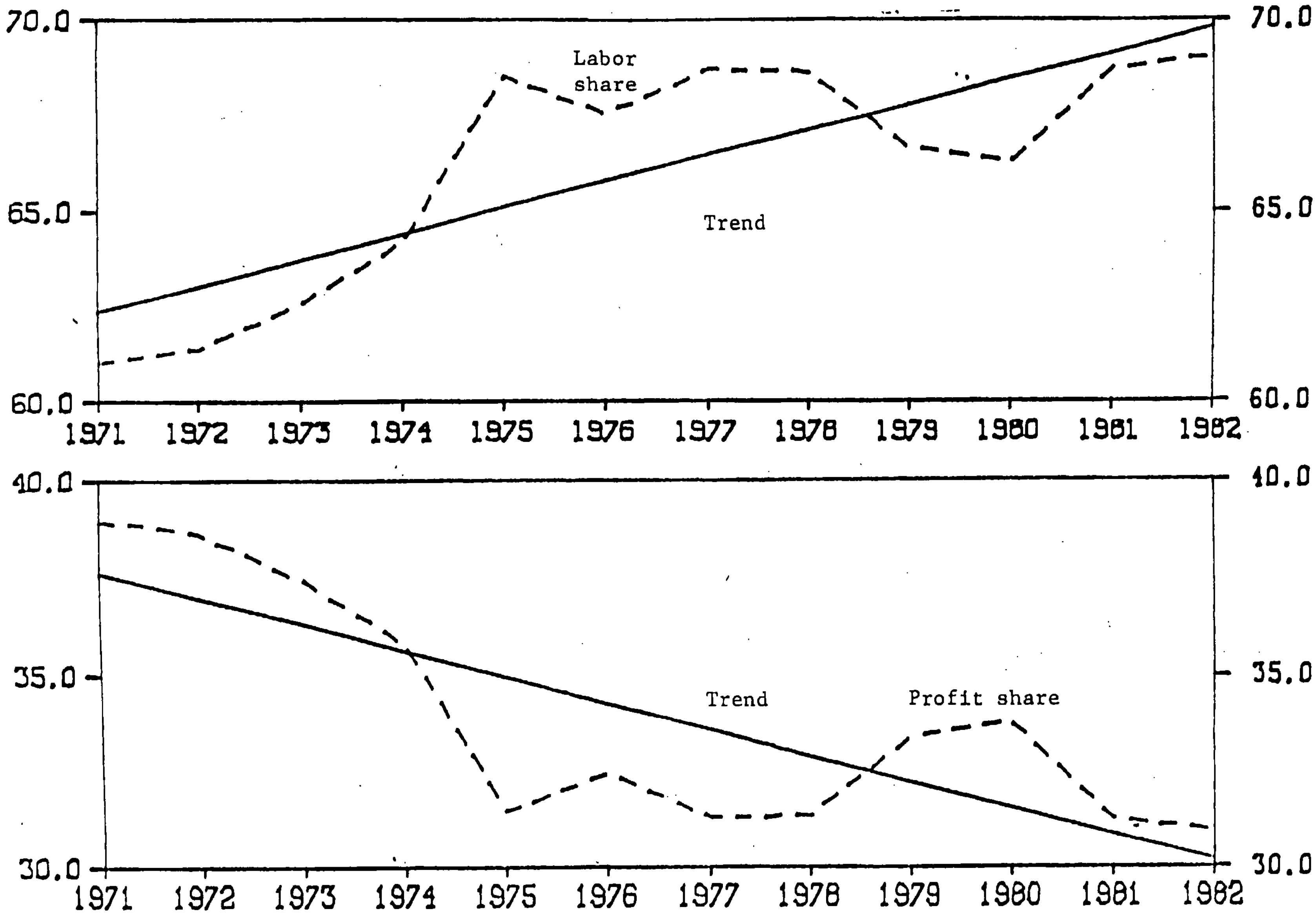
The impact of the large public sector deficit on the balance of payments has traditionally been mitigated by a high savings rate of the household sector which, according to OECD data, exceeded by far the average of industrial countries and by several percentage points the next highest (Japan). 1/ Over the last cycle the increase in the public deficit has been accompanied by a decline in the current account deficit of the balance of payments in reflection of the increase in net household savings and, especially, of the sharp decline in productive investments. However, estimates for 1983 suggest that the net financial savings of households are nearing their previous cyclical peak and the net financial dissavings of the enterprise sector their previous cyclical trough, pointing to the risks that a continued increase in the public deficit would entail for the external current account.

The Italian authorities are fully aware both of the costs that the steady deterioration in the public finances has had for economic performance to date and of the urgent need to secure a reversal of this trend. They expressed the view that a successful implementation of the corrective effort envisaged in the 1984 budget would represent an important step in the right direction. They recognized that the target for the state sector deficit of Lit 90 trillion (around 15 percent of GDP), even if achieved, would imply a further substantial increase in the ratio of the public debt to GDP. However, they were hopeful that the strengthening of confidence which would follow the successful implementation of the announced Government policy would help ensure the absorption of the debt without significant further increases in real interest rates. Nevertheless, they acknowledged that many risks of slippages exist in the implementation of the budget. To begin with, it is possible that the underlying trend of the deficit in the absence of corrective actions has been underestimated, particularly as regards pensions and health expenditures. Moreover, some elements of the corrective effort are either as yet undefined or unlikely to be approved by Parliament in full. A further element of concern is the fact that almost one third of the proposed budgetary savings stems from measures of a once-over nature (such as a fiscal amnesty on illegal construction) which will have no beneficial effects on the deficit beyond 1984. The authorities indicated their intention to undertake a comprehensive review of the budgetary prospects for 1984 after the approval of the budget by Parliament, in order to identify the required size and possible composition of an additional set of measures designed to ensure the containment of the deficit at the targeted level.

1/ The high recorded savings rate of the households sector is partly a reflection of the inclusion in the sector of unincorporated enterprises which are more prevalent in Italy than in other major industrial countries. There are also grounds for believing that the rate may be overestimated to the extent that a part of savings stem from unrecorded income produced in the so-called undergound economy, which some estimates put at 15-20 percent of GDP in Italy.

Chart 4. Italy: Trends in Labor and Profit Shares in National Income, 1971-82

(In percent)



b. Monetary policy

Traditionally, the Italian authorities have focussed on total domestic credit expansion (defined to include bond issues) as the main intermediate target of monetary policy. The emphasis on domestic credit has been justified by the importance attached to external objectives in the conduct of monetary policy and by the fact that Italian enterprises depend heavily on bank credit for the financing of their working capital and investments. Thus, throughout the 1970s, when the private sector's share in total domestic credit remained relatively high, a tightening of the ceilings on bank credit expansion to the private sector tended to have a rapid and strong impact on domestic spending and on the balance of payments.

The effectiveness of the credit ceilings as an instrument of monetary control has been increasingly eroded in recent years by the rise in the public sector's share in domestic credit expansion and by the fact that enterprises stepped up resort to forms of financing not included under the credit ceilings (bankers' acceptances, credits in foreign currency, leasing and factoring, etc.). The authorities' initial reaction to this development was a progressive extension of the ceilings which, as a result, by 1982 covered over 90 percent of bank lending to the private sector, compared with just over 50 percent two years before. At the same time, penalties were introduced for noncompliance with the ceilings. More recently, however, a growing recognition of the allocative costs of a prolonged use of credit ceilings, as well as the fact that the demand for credit by the private sector tended to remain below the ceilings, prompted the authorities not to extend the latter beyond mid-1983. To avoid risks of an abrupt upturn in credit expansion, the authorities, however, have resorted to "moral suasion", requesting the banks to keep the rate of growth of credit within 14 percent for 1983 as a whole, and have strengthened the credit monitoring mechanisms.

The rapid increase in the public sector deficit has prompted the authorities to place increased emphasis, in the conduct of monetary policy, on moderating the impact of the deficit on primary liquidity. For this purpose, following the so-called "divorce" between the Bank of Italy and the Treasury in 1981, whereby the Bank ceased to be the residual buyer at the Treasury bill auctions, the authorities have engaged in an active open market policy. At the same time they have endeavoured to lengthen the average maturity of the public debt by stepping up issues of medium-term securities, particularly the so-called certificates of credit of the Treasury (CCTs) with rates indexed to the six-month Treasury bills. The success of this effort is illustrated by the increase of the share of the CCTs in public debt issues from 11 percent in 1980 to nearly 50 percent in 1982, a trend which has continued in 1983.

For 1984, the Italian authorities have indicated their intention to maintain a moderately restrictive stance of monetary policy, to complement their efforts to secure fiscal retrenchment and a moderation of labor costs through incomes policy. The initial monetary program for

1984 targets a rate of growth of domestic credit to the private sector around 12 1/2 percent, which would imply an increase in real terms on the assumption that the inflation objective of the government program were to be realized. If the Lit 90 trillion target for the state sector deficit was broadly held to, the rate of growth of total domestic credit would decelerate from the 23 percent expected for 1983 to below 21 percent. Both domestic credit and financial assets would continue to rise at rates significantly in excess of the projected growth of nominal GDP. Although no precise objectives have been set for the rates of growth of the monetary base and of the money supply (M2), the authorities expect to succeed in keeping them within the 12-14 percent range.

The Italian representatives recognized that, even if the efforts to contain the public deficit at the target level were successful, there would be no scope for a decline in real interest rates. In the event that the target for the budget deficit was exceeded by a significant margin, real interest rates would have to rise. The Italian authorities noted, however, that it would not be desirable, in their view, fully to compensate for any excess in the deficit with a corresponding reduction in credit to the private sector. Thus, a sizable budget overrun would most probably result in a higher rate of inflation than targeted in the government program. Its impact on real growth would be more difficult to predict in the short run; over the longer term, however, the continued preemption of resources by the public sector would probably lead to a reduction in the growth potential of the economy.

c. Incomes and labor market policies

The weaknesses of the present system of wage determination in Italy, and in particular those of the scala mobile mechanism, have been discussed at length in previous staff reports. The Italian representatives noted that the rigidity entailed by the automatic, albeit less than full, response of wages to the past rate of inflation made it more difficult to secure a substantial deceleration in the rate of inflation. While recognizing that, in principle, a sustained decline in the rate of growth of nominal wages could be obtained over the medium term through a tightening of the stance of financial policies, they felt that the costs of such a course of action in terms of employment would be too high in social and political terms. They therefore looked to incomes policy as a means of improving the trade-off between inflation and unemployment.

In present circumstances, following the major wage bargaining round in the first half of 1983 which set the guidelines for contractual increases through 1985, the authorities intend to seek the consensus of the social partners to a modification of the indexation mechanism to ensure that the rate of growth of labor costs in 1984 does not exceed the target rate of inflation. The Italian representatives noted that a successful achievement of this aim would also have a beneficial impact on the public finances, by moderating the growth of expenditures especially sensitive to cost and price inflation, such as civil servants' wages, pensions and interest payments on the public debt. Their estimates suggested that these effects would outweigh the negative impact of a deceleration in wages and prices on the revenue side of the budget.

At the time of the consultation discussions, the specific means to secure the targeted wage moderation had not yet been formulated, even less discussed with the social partners. The authorities indicated that the review of the 1983 tripartite agreement, expected to take place before the end of the year, would provide a forum to begin the dialogue. The eventual agreement could take the form of a ceiling on the number of scala mobile points to be paid in each quarter. An open question was what, if any, compensation should be paid at the end of 1984 in the event that the actual rate of inflation exceeded the target. Also open was the question of the concessions that the unions might demand in the form of increased public investments, a moderation in public sector tariffs or of a reduction in the burden of taxation on wage incomes. The authorities indicated their intention to resist demands that would lead to any significant increase of the budget deficit over the targeted amount.

The impact of the prolonged recession on the labor market has been compounded in recent years by a process of accelerated substitution of capital for labor, especially in private industry. The Italian representatives noted that this restructuring had led to a significant improvement in productivity in the enterprises concerned at, however, a significant cost to the budget as resort to the Wage Supplementation Fund had been stepped up in the process. They saw an urgent need for a reform of the Fund, to restore it to its initial function of a short-term cushion against cyclical fluctuations in employment, rather than a mechanism for income maintenance in cases of structural unemployment. A draft proposal of reform, envisaging a gradual phasing out of benefits from the Fund, had been prepared for discussion with the social partners.

The Italian authorities expressed concern about the medium-term prospects for employment. They noted that a significant degree of overmanning remained in certain sectors of industry, particularly in the public enterprises in steel, shipbuilding, chemicals, aluminum, etc. (see Appendix III of the recent economics developments paper). They saw little alternative to some support from the budget to these sectors but stressed that it should remain highly selective, and that the focus should shift from aid to enterprises to maintain employment to the provision of adequate income maintenance schemes to the workers laid off, as well as to actions to promote retraining and mobility of the labor force. Over the longer term, some of the Italian representatives saw a possible relief to the labor market conditions from a significant reduction in the workweek matched by a corresponding reduction in wages. They noted that some union leaders had indicated interest, in principle, in this option.

c. External policies

In their management of the exchange rate since the inception of the EMS, the Italian authorities have generally allowed the effective rate to adjust with a lag but not always fully to the inflation differential. They have also endeavoured to avoid moving the exchange rate under market pressures, accepting at times significant losses of reserves to resist attacks on the lira. They have instead taken advantage of realignments induced by pressures on other currencies to adjust the rate within the EMS. As a result of this policy, the real effective exchange rate, which had appreciated in the course of 1979 and 1980 was restored in the course of 1981 to a level closer to that prevailing at the inception of the EMS but resumed its appreciation in 1982 and 1983, with the loss of competitiveness being more marked in terms of relative unit labor costs than of relative prices.

While recognizing that a sustained real appreciation of the lira would significantly affect the export performance over the medium term, the Italian authorities expressed the view that their policy of less than full accommodation of the inflation differential through the exchange rate had induced industrial enterprises to improve productivity and to resist excessive wage demands. For 1984 they hoped that some weakening of the U.S. dollar would provide room for a depreciation of the lira vis-à-vis the stronger EMS currencies and for an improvement or at least the maintenance of the present level of competitiveness. In present circumstances they did not see a significant danger that the need to maintain relatively high interest rates, in order to secure an adequate nonmonetary financing of the public deficit, would put upward pressure on the lira.

Legislation has been proposed recently to liberalize existing capital controls, mainly by raising the limit above which a violation of these controls entails a criminal penalty. The authorities did not feel that the present and prospective conditions of the balance of payments would justify a more extensive liberalization, including for instance a reduction in the 50 percent noninterest-bearing deposit required for most investments abroad. The existing restriction on the foreign exchange allowance for tourist travel was raised in May 1983 from Lit 1.1 million to Lit 1.6 million (US$1,100) per person per year. This increase (amounting to 45 percent) fell short by a significant margin of the depreciation of the lira vis-à-vis the dollar during the period since the previous liberalization (about 75 percent). Nevertheless, the authorities were not prepared to consider the elimination of the restriction or a further liberalization at this time. They expressed the view that such a move could be interpreted by the public as an indication that the external constraints on economic policy had been substantially reduced and could thus reduce pressure to take corrective measures.

In their trade policy the authorities, while generally supporting an open multilateral trading system, have on occasions intensified their recourse to restrictive measures, both as a result of EC directives and at the national level after consultation with the EC Commission (see Appendix IV of the recent economic developments paper). Within the EC framework Italy has negotiated new bilateral arrangements with its foreign suppliers of steel and textile products which are somewhat more restrictive for major suppliers, and has participated in the Community "self-restraint" arrangement with Japan covering Japanese exports of ten sensitive manufactured products. The authorities did not feel that in the case of Italy the trade restrictions imposed under these agreements could be eliminated in the foreseeable future because of the crises being experienced by the sectors protected by these agreements. In the case of the steel sector, however, they intend to meet the EC target of ending state aids to the steel industry by 1985. At the national level, Italy maintains quantitative restrictions on imports of some 60 items mostly from Japan (textiles, machinery, and vehicles) and from developing countries (foodstuffs and textiles). In addition, Italy has frequently resorted to limiting imports from certain countries for temporary periods and to exercising surveillance on selected imports if they threaten to temporarily disrupt the domestic market.

The Italian representatives felt that the EC Common Agricultural Policy (CAP) had tended on the whole to achieve its objectives of increasing farmers' incomes and self-sufficiency in most agricultural production, both in Italy and in other EC members. In the view of the authorities the budgetary problems of the CAP and the international frictions in agricultural trade arising from its implementation were mostly the result of the surpluses in grain and dairy production, and efforts to control the CAP budget should concentrate on these areas.

3. Prospects

The outlook for 1984 is subject to significant uncertainties concerning the degree of success that the authorities will have in implementing their announced policy stance. The staff projections presented in Tables 1 and 2 illustrate some possible consequences of significant slippages in financial and incomes policies from the initial targets. It is assumed that overruns in expenditure will raise the overall deficit of the state sector to around Lit 110 trillion (over 17 1/2 percent of GDP) and that the Government will not succeed in securing a significant modification in the indexation mechanism. It is, however, assumed that the authorities will endeavour to ensure the absorption of additional financial assets created by the higher budget deficit, and to minimize the impact of the latter on primary liquidity, by allowing a significant increase in real interest rates. As for the effective exchange rate, the working assumption of its maintenance at its present nominal level is made, an hypothesis that does not appear inconsistent with the assumed stance of monetary policy.

Under these assumptions, a relatively unfavorable combination of real output growth and inflation can be expected to persist. Domestic demand is projected to recover moderately, mainly on the strength of a pickup in consumption, stimulated by an increase in real disposable income, and in stockbuilding from the current record-low level. Fixed investment is, however, expected to continue to decline, albeit at a slower pace than in the last three years, in reflection of the maintenance of relatively tight credit conditions, and of low capacity utilization as well as of the lack of a significant improvement in profits.

Exports are projected to record a sizable loss in market shares, due to the continued deterioration in competitiveness entailed by the exchange rate assumption, while imports are expected to pick up significantly, as usual in the early phase of a recovery. On the whole, GDP growth is projected to be between 1.5 and 2 percent, significantly below the average expected for major industrial countries.

Inflation is expected to remain at around its current level and to average 13.5 percent for the year, in reflection of the maintenance of a relatively high rate of increase in unit labor costs. The inflation performance could be significantly worse if in the course of the year the authorities eased the stance of monetary policy and the exchange rate came under pressure.

The external position is projected to worsen somewhat, as a result of the deterioration in the real trade balance, which however is likely to be partly offset by an improvement in the terms of trade implicit in the exchange rate assumption. On the whole, the current account deficit is expected to remain well below the equivalent of 1 percent of GDP.

IV. Staff Appraisal

The payoff of three years of recession in terms of the balance of payments and especially of the inflation performance has been significantly less in Italy than in other major industrial countries. At the trough of the cycle, the rate of inflation in Italy remains more than double the average of its main trading partners while the current account of the balance of payments continues to be in deficit, albeit a relatively small one. This is not the best background for a sustained improvement in growth. Indeed, there is a serious danger that any substantial pickup in domestic demand would lead within a short time to a reacceleration of inflation and to a reemergence of external constraints.

There is a large degree of consensus both in Italy and abroad on the factors responsible for the unsatisfactory performance of the Italian economy. It is therefore all the more disappointing that these weaknesses have yet scarcely been tackled, only discussed. In the view of the staff, the central problem is the excessive growth of public expenditure and of the public sector deficit. Although successive Italian Governments have come to the same conclusion, they have not succeeded so far in arresting the sharply increasing trend in the ratios of public expenditures and the public deficit to GDP.

A growth of the fiscal deficit on the order of magnitude recorded in recent years implies a growth of total financial assets of the economy which is clearly excessive in relation to developments in real output and in real interest rates. Over time this growing divergence is bound to lead to pressure on prices and on the balance of payments, although the precise timing and channels of transmission of this pressure are difficult to predict. At the same time, in order to limit the inflationary pressures, the monetary authorities have to restrict the growth of the monetary base and of total domestic credit. As a result, because of the escalating borrowing requirements of the public sector, the private sector and especially productive investments continue to be crowded out by both the limited availability of credit and the high cost of borrowing. Moreover, it is clear that the pattern of public expenditure in Italy heavily favors consumption over investment and that a large part of public expenditures loosely associated with investment is concentrated in sectors where the motivating forces are social rather than economic considerations. Thus, the allocation of financial and real resources fosters a pattern of expenditure that dampens productivity and that, in the process, puts upward pressure on unit labor costs and on prices while slowing the growth of real output.

A continued escalation of the public deficit will inevitably lead over time to an unsustainable position because of the interaction between the budget deficits and interest payments on the public debt. The latter have already risen to the equivalent of 9 percent of GDP, a ratio twice as high as the average of other major industrial countries. This ratio is bound to continue to rise sharply unless the noninterest component of the deficit is adequately reduced. The staff simulations discussed in section III above suggest that, if only limited corrective measures are taken, the situation will become intolerable over the next few years.

It is thus very urgent to ensure a substantial and sustained improvement in the public sector finances in the short as well as in the medium term. In the 1984 budget the Government has announced its intention to hold the deficit of the state sector to the same nominal level as that recorded in 1983, which would imply a reduction equivalent to almost 2 percentage points of GDP. In the view of the staff, the achievement of this objective would represent a first step in the right direction, but probably an inadequate one, for it would still lead to a further sharp rise in the ratio of total financial assets to GDP, from a level which is already exceptional by historical standards, and it would require the maintenance of relatively high and possibly even rising real interest rates.

Moreover, it is already clear that without additional corrective measures the budget deficit target of Lit 90 trillion will be significantly exceeded in 1984 as it has been in previous years. It appears unlikey that the projected savings from the measures announced so far will be realized in full. Also, new spending legislation continues to be approved by Parliament with little apparent concern over its costs to the budget. The staff welcomes the intention of the Italian authorities to review the budgetary prospects for 1984 before the end of this year and would urge them to prepare a substantial package of additional measures for introduction at the beginning of 1984. In shaping this package inevitably attention will need to be given to considerations such as the speed with which the results will come through and the political feasibility of alternative measures. However, it is to be hoped that as little reliance as possible will be placed on ad hoc measures of a once-over nature which have little, if any, effect on the public finances over the medium term and which already play too large a role in the measures proposed for 1984.

A sustained improvement in the public sector finances over the next few years will require wide ranging changes in current spending legislation and in the existing institutional setup, particularly in the areas of pensions, health and transfers to local entities. Some effort has already been made on all these fronts but, in the staff's view, it falls seriously short of what is needed. On the revenue side, there appears to be scope for a further modest rise in the overall tax burden but this should be achieved mainly through more effective enforcement and a reversal of the erosion of the tax base, rather than by increased pressure on wage earners who already shoulder a disproportionate share of the burden.

The staff shares the Italian authorities' view that a policy of budgetary retrenchment should be complemented by progress in other areas of economic policy, notably incomes and monetary policies. The determined pursuit of consistent fiscal, monetary and incomes policies would enhance the likelihood of success of each individual policy. The improvement in the public finances would be facilitated by an effective policy of wage restraint which would lead to a deceleration in prices. Equally, it is hard to envisage a successful incomes policy against the background of a growing budget deficit and of an expansion of liquidity which will in time lead to a reacceleration of inflation.

The tripartite wage agreement at the beginning of 1983 made a needed contribution to a moderation of labor costs by reducing the degree of indexation. It recognized the need to reduce the impact of indirect tax increases and exchange rate movements on the wage indexation mechanism. Nevertheless, also in reflection of the decline in productivity, unit labor costs have continued to rise at an excessively high rate in 1983. For incomes policy to make an effective contribution to adjustment in 1984, it would appear essential that talks should be reopened between the Government and the social partners virtually immediately, with a view of having an agreement in operation by the beginning of next year. A possible basis for this social contract could be the predetermination of the indexation-related wage increases in accordance with the official inflation objective. In addition, specific action should be taken to isolate the indexation mechanism from terms of trade and indirect tax effects. The Government should set an appropriate example in respect of wages and salaries in the public sector. It is, however, crucial that the agreement should not be achieved at too high a price and thus risk being self-defeating. In the staff's view, the price that should not be paid is that of an increase in the public sector deficit. Any increased outlays on public investment or measures to support employment should be offset by savings in other areas of the budget.

Success in containing the public sector borrowing requirements and in securing moderation of cost pressures would ease the impact of the necessary deceleration in the growth of the monetary aggregates on the productive sector. Realistically, however, there appears to be no scope for a reduction in real interest rates in 1984; indeed, some increase may be unavoidable if the public sector deficit is to continue to be financed--as it should be--mainly through nonmonetary means and if the recent trend toward lesser reliance on administrative controls in the financial field is to continue. In view of the well-known allocative costs of these controls, the staff welcomes the steps taken recently toward greater reliance on market mechanisms in the conduct of monetary policy.

The improvement of the balance of payments in the last two years has been largely a reflection of the downturn in domestic demand, as well as of a recovery of the terms of trade. On the basis of available indicators, the real exchange rate has recorded a significant appreciation in effective terms, which has led to a compression of profit margins in the export sector. While it is difficult to judge the appropriateness of the present level of competitiveness, it is clear that a continued real appreciation of the lira would, over the longer term, significantly affect the export performance and, consequently, the scope for a sustained recovery of domestic demand and output. It would also add to pressures for increased controls in the trade and payments system. In this respect the staff regrets that the Italian authorities have taken no steps in recent years to reduce existing trade barriers in traditionally protected sectors and, in fact, have increased protection in some areas, either under directives from the EC or unilaterally. Reliance on trade restrictions to address structural problems does not contribute to their lasting solution and indeed increases the ultimate costs of the inevitable adjustments. In the view of the staff, Italy could play a more important role in promoting a more liberal trade policy in the EC and in supporting broad based liberalization efforts.

As regards the existing restriction on foreign exchange available for tourist travel, the staff believes that the recent liberalization, although a step in the right direction, falls short of what could have been expected in Italy's present balance of payments conditions. Therefore, continued approval of the restriction is not recommended to the Executive Board.

It is recommended that the next Article IV consultation with Italy be held on the standard 12-month cycle.

Table 1. Italy: Main Economic Variables, 1980-83

(Percent changes)

	1980	1981	1982	1983 1/	1984 2/
Real demand and output					
Private consumption	4.3	0.5	0.3	-0.8	2.0
Public consumption	2.1	3.0	1.8	2.2	1.5
Fixed investment	9.4	-0.6	-5.3	-5.8	-1.0
Stockbuilding 3/	2.1	-3.1	0.3	-0.5	0.5
Total domestic demand	7.0	-2.2	-0.2	-1.7	1.9
Exports of goods and services	-4.3	5.2	1.2	1.4	3.0
Imports of goods and services	8.3	-5.3	2.1	-1.0	4.5
Foreign balance 3/	-2.8	2.3	-0.1	0.4	-0.2
GDP	3.9	0.1	-0.3	-1.2	1.7
Industrial production	5.0	-2.2	-2.7	-4.8	2.5
Wages, costs and prices					
Wage rates in manufacturing	19.2	19.2	17.1	16.1	15.0
Productivity in manufacturing	6.1	1.0	0.5	-1.6	1.5
Unit labor costs in manufacturing	12.4	18.0	16.5	18.0	13.3
Cost of living index	21.1	18.7	16.3	15.3	13.5
GDP deflator	20.6	18.4	17.5	15.1	13.7
Unemployment rate (levels)	7.6	8.4	9.1	9.9	10.2
Disposable income of households	22.7	20.8	17.1	13.0	16.3

Source: Ministry of the Budget and Ministry of the Treasury, Relazione Generale sulla Situazione Economica del Paese.

1/ Official estimates.
2/ Staff projections
3/ Changes in stockbuilding and the foreign balance are expressed as percentage of GDP in the previous year.

Table 2. Italy: External Developments, 1980-83

	1980	1981	1982	1983 1/	1984 1/
Trade developments (percent changes)					
Imports, c.i.f., customs basis					
Unit value	29.5	34.7	10.8	9.0	10.0
Volume	2.1	-10.0	1.2	-2.8	4.5
Exports, f.o.b., customs basis					
Unit value	21.7	22.2	15.9	9.0	11.0
Volume	-8.7	5.6	-0.5	1.2	3.0
Market growth	2.6	1.5	-0.4	1.5	4.0
Balance of payments summary (in billions of lire)					
Trade balance, f.o.b.-f.o.b.	-13,991	-12,032	-10,720	-7,000	-8,900
Services	4,661	1,945	2,159	3,700	4,000
Private transfers	1,174	1,639	1,987	2,200	2,400
Official transfers	-136	-777	-819	-900	-1,000
Current balance	-8,291	-9,225	-7,393	-2,000	-3,500
(As percent of GDP)	-2.4	-2.3	-1.6	-0.4	-0.6
Nonmonetary capital	2,749	11,386	3,687	...	...
Errors and omissions	-716	-628	1,185	...	...
Overall balance	-6,258	1,533	-2,521	...	...
Gross official reserves (excluding gold) 2/	23,140	20,134	14,090	19,287 4/	...
Net foreign position of commercial banks 2/	-15,852	-13,391	-10,631	-12,426 5/	...
External debt outstanding 2/3/	40,600	47,600	50,400	...	...
(As percent of GDP)	11.2	14.2	14.7	...	...
Memorandum items:					
Average exchange rates					
Italian lire per U.S. dollar	856.5	1,136.8	1,352.5	1,483.5 6/	1,619
Percent change in US$/lira rate	-2.8	-24.4	-16.1	-8.9 7/	-7.3
Effective exchange rate (MERM weights, 1975 = 100)	67.2	58.3	53.8	51.8 6/	...

Sources: Bank of Italy, Bollettino; IMF, International Financial Statistics; data provided by the Italian authorities; and staff estimates and projections.

1/ Provisional estimates for 1983, staff projections for 1984.

2/ End of period, in millions of U.S. dollars.

3/ Includes the net external liabilities of commercial banks but excludes short-term commercial debt of the private sector.

4/ End-September 1983.

5/ End-October 1983.

6/ Average of first nine months of 1983.

7/ Average of first nine months of 1983, compared with average of 1982.

Table 3. Italy: Selected Financial Indicators, 1980-83

	1980	1981	1982	1983 1/
	(In relation to GDP)			
Fiscal indicators				
State sector				
Revenues	28.6	30.0	35.2	35.7
Of which:				
Tax receipts	20.4	21.3	23.4	26.0
Current expenditures	33.3	36.3	42.5	44.3
Capital expenditures 2/	3.9	3.9	4.7	5.0
Current deficit	5.5	7.7	8.6	9.6
Overall deficit 3/	10.8	12.8	15.1	16.8
Share of deficit financed through:				
Medium- and long-term bonds	-6.1	11.1	32.8	...
Treasury bills	71.1	53.5	39.4	...
Monetary base creation	32.7	30.4	22.3	...
	(End of period; percentage change except as otherwise indicated)			
Monetary variables				
Monetary base	13.9	13.1	14.1	18.0 4/
M2	12.7	9.9	17.0	16.6 4/
M3	17.3	15.9	17.2	15.2 4/
Total domestic credit	18.5	18.6	20.6	20.7 4/
Commercial bank lending to private sector	19.5	11.6	9.1	14.5 4/
Share of credit to the state sector in total domestic credit expansion	53.8	61.7	67.6	75.6 5/
Total financial assets 6/	16.0	18.8	20.4	22.3
	(In percent; period averages unless otherwise indicates)			
Interest rates				
Discount rate (end of period)	16.5	19.0	18.0	17.0 6/
Three-month Treasury bills	15.9	19.6	19.4	18.2 8/
Prime rate	19.0	21.4	21.6	19.8 8/
Average deposit rate	10.9	12.6	13.4	12.7 8/

Sources: Data provided by the Italian authorities.
1/ Official forecasts.
2/ Net of financial operations.
3/ Including net lending but excluding debt liquidations.
4/ As of end-June 1983.
5/ January-June 1983.
6/ Domestic component of financial assets, net of shares and bankers' acceptances.
7/ As of end-October 1983.
8/ Average of first seven months of the year.

Table 4. Italy: Some Scenarios of Medium-Term Developments in the Public Sector, 1/ 1983-90

(In percent)

	1983	1984	1986	1988	1990
	Scenario A: No adjustment				
Assumptions					
Revenue/GDP ratio	45.6	45.2	46.0	47.0	48.0
Expenditure other than interest/GDP	53.6	54.0	55.0	56.0	57.0
GDP growth rate	-1.2	3.0	2.0	2.0	2.0
Inflation rate	15.2	15.0	17.5	20.5	23.0
Average rate of interest on public debt 2/	12.0	12.4	16.0	19.5	23.0
Results					
Interest payments/GDP	9.0	9.8	14.6	20.5	28.0
Deficit/GDP	16.8	18.5	23.5	29.4	36.9
Public debt/GDP	82.3	88.0	102.9	119.6	140.0
	Scenario B: Rapid adjustment				
Assumptions					
Revenue/GDP	45.6	45.5	46.5	47.5	48.5
Expenditure other than interest/GDP	53.6	51.0	50.5	49.2	49.3
Inflation rate	15.2	12.0	8.0	6.0	5.0
GDP growth rate	-1.2	--	2.0	3.5	4.0
Average rate of interest on public debt 2/	12.0	10.0	6.0	4.0	3.0
Results					
Interest payment/GDP	8.9	8.0	5.1	3.3	2.3
Deficit/GDP	16.8	13.0	9.0	5.0	3.0
Public debt/GDP	82.3	86.5	89.7	85.7	78.2

Source: Staff calculations.

1/ General Government plus autonomous agencies.
2/ Including interest on public debt held by the Bank of Italy.

Fund Relations with Italy

(As at end-November 1983)

Quota:	SDR 1,860 million. The new quota is SDR 2,909 million and was approved by the Italian Parliament on November 30, 1983.
Purchases outstanding:	None.
Fund holdings of Italian lire:	SDR 1,177 million or 63.3 percent of quota.
SDR position:	SDR 974.9 million or 138.8 percent of net cumulative allocation.
Gold distribution:	855,829.6 fine ounces.
Exchange system:	Since March 13, 1979 Italy has participated in the exchange rate mechanism of the European Monetary System with a 6 percent margin. The central rate of the lira was reduced by 3.25 percent in relation to the other EMS currencies on June 14, 1982 and again by 2.5 percent on March 21, 1983. From the end of March 1979 to October 1983, the lira depreciated by 26 percent in effective terms and by 47 1/2 percent with respect to the U.S. dollar in nominal terms. The exchange rate of the lira on October 31, 1983 was US$1 = Lit 1,597.3 and on the same date the MERM index for the lira (1975 = 100) was 49.8.

Basic Data

Area (thousand square kilometers)	301.3
Population (mid-1982)	56.45 million
Labor force (1982 average)	22.75 million
GDP per capita (1982)	Lit 8,322,356 (SDR 5,502)

Use and supply of resources (1982)	In billions of lire	In per cent
Private consumption	298,192	63.5
Public consumption	88,878	18.9
Gross fixed investment	89,259	19.0
Change in stocks	6,612	1.4
Gross domestic expenditure	482,941	102.8
Exports of goods and services	113,858	24.2
Imports of goods and services	-127,002	-27.0
Gross domestic product	469,797	100.0

Selected economic indicators (annual percentage change)	1980	1981	1982	1983 1/ Est.
GDP (at constant prices)	3.9	0.1	-0.3	-1.2
Private consumption (at constant prices)	4.3	0.5	0.3	-0.8
Gross fixed investment (at constant prices)	9.4	0.6	-5.3	-5.8
Industrial production	5.0	-2.2	-2.7	-4.8
Exports of goods (in lire)	11.3	29.0	15.3	3.9 2/
Imports of goods (in lire)	32.5	21.2	12.1	-2.1 2/
Unit labor costs in manufacturing	12.4	18.0	16.5	18.0
Consumer prices	21.2	17.8	16.5	15.0
GDP deflator	20.6	18.4	17.5	15.1
Money and quasi-money (M3; end-year)	17.3	15.9	17.2	15.2 3/
State sector overall deficit (as per cent of GDP)	10.8	12.8	15.1	16.8

Balance of payments (in millions of SDRs)	1980	1981	1982	1983 1/ Est.
Exports of goods, f.o.b.	54,351	60,079	64,783	31,839 2/
Imports of goods, f.o.b.	-65,904	-68,582	-71,870	-34,098 2/
Net services and transfers	4,707	1,984	2,200	1,070 2/
Balance of goods, services, and transfers	-6,845	-6,519	-4,887	-1,189 2/
Net capital movements	1,679	7,603	3,221	1,642 2/
Overall balance	-5,166	1,084	-1,666	453 2/
Gross official reserves (excluding gold, end-year)	18,131	17,299	12,795	18,315 4/

1/ Official forecasts.
2/ As of first half of 1983.
3/ As of end-June 1983.
4/ As of end-September 1983.