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INFORMATION

July 29, 1985

To: Members of the Executive Board  
From: The Secretary  
Subject: European Monetary System - Realignment of Exchange Rates

There is attached for the information of the Executive Directors a paper on recent realignment of exchange rates within the European Monetary System. Mrs. Ter-Minassian (ext. 8844) or Mr. Spitaeller (ext. 8838) are available to answer technical or factual questions relating to this paper.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

European Monetary System--Realignment of Exchange Rates

Prepared by the European Department

(In consultation with other Departments  
and the Office in Europe)

Approved by L. A. Whittome

July 26, 1985

I. Introduction

On July 20, 1985 the Ministers and Central Bank Governors of the EC member countries decided on an adjustment of central rates within the European Monetary System. Notifications to the Fund of these adjustments by the countries participating in the exchange rate mechanism of the EMS are being distributed to the Board as they are received. The communique issued after the realignment is presented in Appendix I and sets out the following percentage changes in central rates: +2 percent for the Irish pound, French franc, Danish krone, Netherlands guilder, deutsche mark, Belgian franc and Luxembourg franc; -6 percent for the Italian lira. These changes involve an increase of 8.5 percent in the bilateral central rates of the lira in terms of each of the other EMS currencies (a decline of 7.8 percent expressed as foreign currency per lira). All other bilateral central rates remain unchanged from the levels set in the previous realignment. The new bilateral central rates and intervention limits, effective as of July 22, 1985 are presented in Table 1, while Table 2 compares this realignment with the seven previous ones.

Table 3 sets out the new central rates of currencies participating in the EMS in terms of the ECU. The new rates in terms of the ECU--which includes the pound sterling and the Greek drachma along with the currencies participating in the EMS exchange rate mechanism--are calculated taking into account notional central rates for the pound and the drachma. These were set on the basis of market levels for these currencies on July 19, 1985, involving an appreciation of the pound sterling of 5.5 percent and a depreciation of the drachma of 13.1 percent. Given the relatively large weight of the pound in the ECU basket, the central rates of the currencies in the exchange rate mechanism of the EMS (other than the lira) involve an appreciation of only 0.2 percent in terms of the ECU, while the central rate of the lira depreciated by 7.7 percent in terms of the ECU.

The recent realignment follows more than two years of exchange rate stability within the EMS. This stability was promoted, on the one hand, by increased convergence in economic policies and developments among EMS members and, on the other, by the strength of the U.S. dollar. The

realignment was carried out at the request of the Italian authorities who had been concerned with the rapid deterioration in Italy's balance of payments, reflecting a growth of domestic demand substantially faster than abroad as well as a worsening of competitiveness vis-à-vis the rest of the EC. Section II of this paper discusses the background to the realignment, focussing on recent trends in the Italian economy, especially the deterioration in the external accounts. Section III presents a staff appraisal.

## II. Background

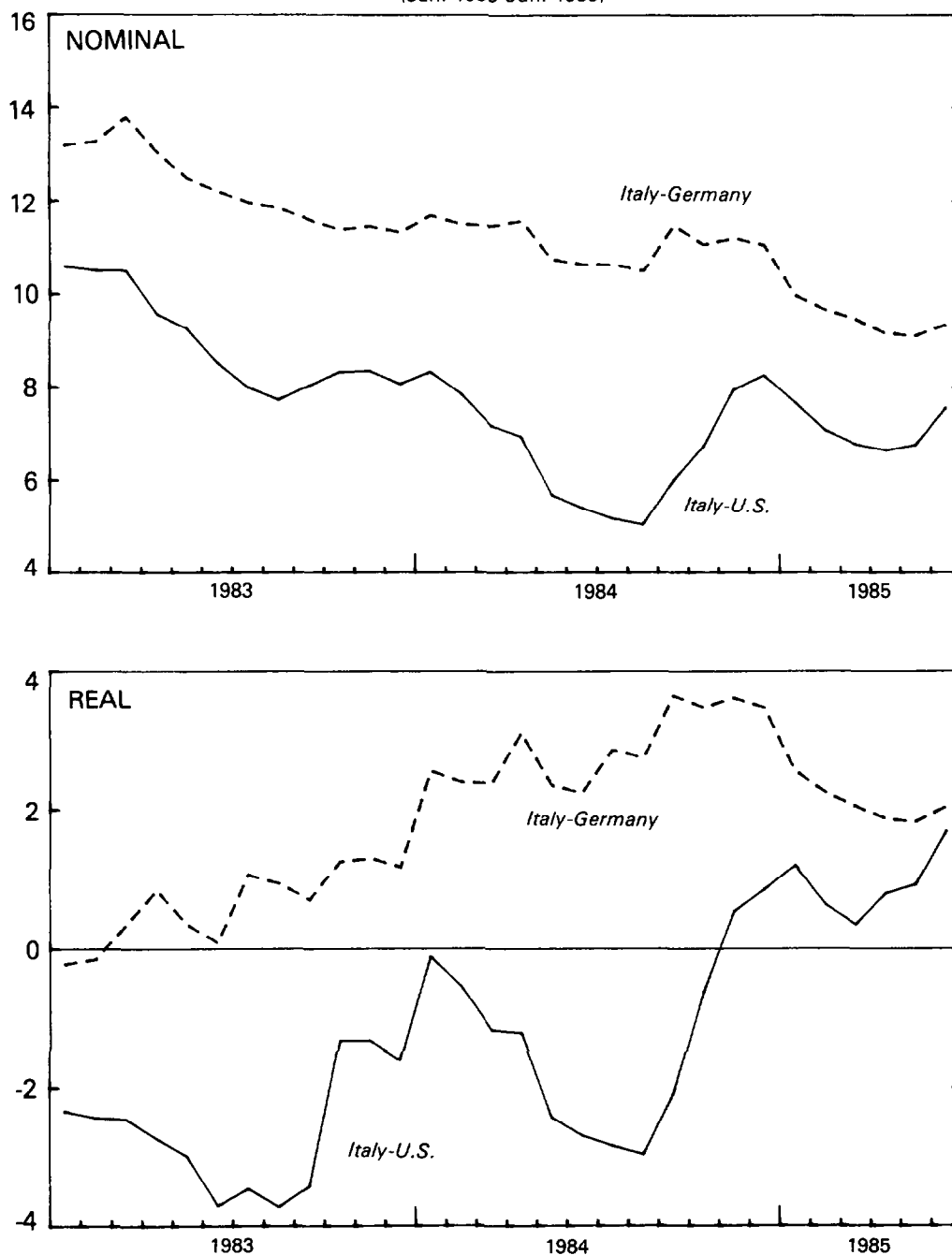
Italy's economic performance in 1984 and prospects for 1985 were reviewed in the staff report for 1985 Article IV consultation (SM/85/119, 4/26/85) which was considered by the Executive Board on May 24, 1985. At that meeting Directors noted with concern that the cohesion of economic policies evident in early 1984 had weakened in the course of the year, with the public sector deficit providing a significant stimulus to domestic demand, at the same time as there was an easing of monetary policy. They urged the Italian authorities to take prompt and decisive corrective action, particularly in the fiscal area.

Since then the situation has deteriorated, threatening to halt and possibly reverse the progress made in 1984 on the inflation front and leading to a large deterioration in the external accounts. The stance of fiscal policy has weakened in the first half of this year, owing to a lack of control over spending, especially of peripheral public entities, and to shortfalls in some tax and nontax revenues. According to preliminary data, the deficit of the state sector in the first half of 1985 exceeded the level of the corresponding period of last year by over 35 percent, severely threatening the achievement of the Government's aim of containing the deficit for the year as a whole to around Lit 100 trillion (14.6 percent of GDP), compared with Lit 94 trillion (15.4 percent of GDP) in 1984 (Table 4). Moreover, resort by the Treasury to monetary base financing increased sharply in the first months of 1985, leading to an acceleration in the rate of growth of the monetary base to nearly 18 percent in the 12 months to May, compared with less than 14 1/2 percent for the calendar year 1984. The annualized rate of growth of M2 during the first five months of 1985 exceeded 16 percent, compared with less than 12 percent in 1984. The monetary authorities reduced the discount rate by one point in January, in response to the deceleration of inflation that had occurred through the end of 1984, but interest rates on treasury bills had to be raised in April in an effort to promote purchases of government paper by the nonbank public and so check the growth of the monetary base. Interest rates remain relatively high in both nominal and real terms (Table 4 and Chart 1).

The relative ease of financial policies was primarily responsible for the fact that the rate of growth of domestic demand has remained in the last 12 months (at over 3 1/2 percent) significantly in excess of rates prevailing in Italy's main trading partners. The rate of growth of real wages remained modest, reflecting the reduction in indexation in

CHART 1  
ITALY  
SHORT-TERM INTEREST RATE DIFFERENTIALS<sup>1</sup>

(Jan. 1983-Jun. 1985)



Source: IMF, Research Department.

<sup>1</sup>The short-term interest rates are monthly averages of daily rates on money market instruments of about 90 days' maturity. Specifically the interest rates are the three-month interbank loan rate in Milan for Italy, the Frankfurt Interbank loan rates for Germany, and the rate on three-month certificates of deposit, secondary market, in the United States. Real short-term interest rates are obtained by deflating the nominal rates by a measure of the expected rate of inflation, approximately by a weighted average of the growth rate of the deflator of final domestic demand in the current quarter and the following two quarters.



the last couple of years and the absence of major contractual increases (Table 5). The shift in the relative cyclical position of Italy vis-à-vis other major industrial countries, especially in Europe, is the main factor behind the sharp deterioration in the external accounts in 1984 and so far in 1985. The trade deficit widened from Lit 11.5 trillion (US\$5.5 billion) in 1983 to Lit 19.2 trillion (US\$7.7 billion) in 1984, reflecting a growth in volume of imports (over 9 percent) significantly in excess of that of exports (6.5 percent), as well as a 1.7 percentage point deterioration in the terms of trade. In the first five months of 1985 the trade deficit was over 60 percent higher than in the same period of 1984, as the growth of imports in value terms (22.4 percent) far outpaced that of exports (15.3 percent) (Table 6). On the basis of preliminary information, it appears that this further deterioration primarily reflected a worsening of the real balance, although the terms of trade probably continued to deteriorate as well. The current account balance shifted from a surplus of Lit 1.2 trillion (US\$0.8 billion) in 1983 to a deficit of Lit 5.2 trillion (US\$3 billion or 0.9 percent of GDP) in 1984 as the widening of the trade deficit was accompanied by a small decline of the surplus on invisibles. No data are yet available on developments in the current account (on a transactions basis) so far in 1985 but indications are that the deterioration in the trade deficit has been largely reflected in the current account.

It is difficult to assess the impact of developments in competitiveness on Italy's external accounts. Available indicators of competitiveness in manufacturing (Chart 2) point to a slight improvement in relative unit labor costs on average in 1984, following a sharp deterioration in the two previous years. This improvement reflected the moderation in nominal wages and sizable gains in productivity, typical of the early phase of cyclical recovery. On the other hand, the gap between the GDP deflator and export unit values widened in 1983-84, suggesting increased profit margins on the domestic as compared with the export market, a fact which, in conjunction with the increase in domestic demand, reduced the incentive for Italian enterprises to seek outlets abroad. Available indicators point to a slight deterioration in the overall competitive position in the first quarter of 1985.

The weakening of competitiveness is more marked vis-à-vis other EC countries. The Bank of Italy's preferred indicator of competitiveness (relative wholesale prices of non-oil manufactures) indicates that the real exchange rate worsened significantly in 1983 and 1984 vis-à-vis the EC (Tables 7a, b, and c). By January 1985 it stood about 4 percentage points above the level following the previous EMS realignment and over 13 percentage points above the level at the inception of the EMS. The deterioration was significantly more pronounced in relation to Germany. The concern of the Italian authorities over the weakening of competitiveness vis-à-vis the EC was heightened by the slowdown in economic activity in the United States in 1985.

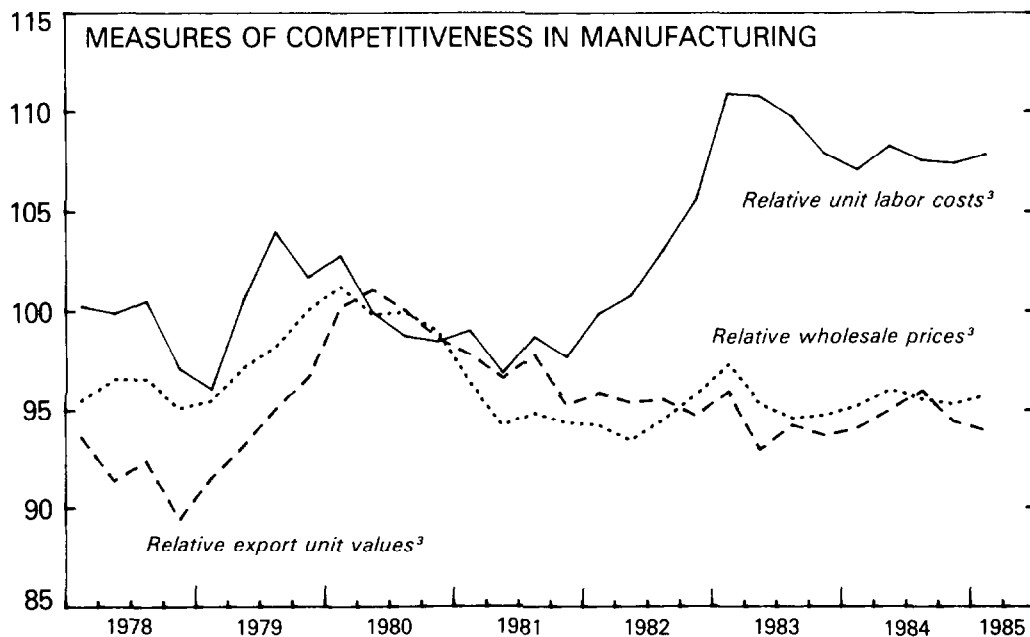
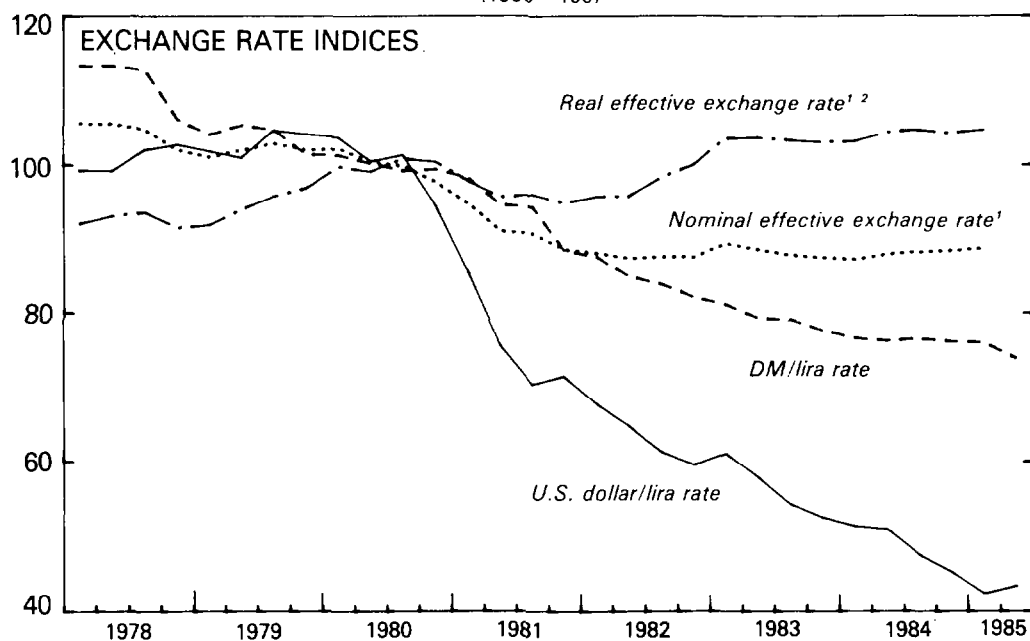
Developments in the capital account of the balance of payments were strongly influenced in 1984 and so far in 1985 by interest rate movements. The maintenance of high nominal interest differentials, in conjunction with stable exchange rate expectations, promoted large capital inflows in 1984 especially in the form of an increase in foreign indebtedness of commercial banks. Following a decision by the monetary authorities to freeze the banks' indebtedness in September 1984, further substantial inflows in the form of commercial credits occurred in the fourth quarter. Provisional information on developments in the balance of payments on a settlement basis for the first half of 1985 suggest that net capital flows remained generally positive so far in the year. The overall balance of payments showed a deficit for the period January-June 1985 of Lit 6.5 trillion, compared with Lit 4.2 trillion in the corresponding period of 1984. A significant further increase in the foreign indebtedness of the commercial banks cushioned the impact of the overall deficit on official foreign exchange reserves, which at the end of June 1985 stood at the equivalent of US\$18.7 billion (2.5 months of imports).

The exchange rate of the lira weakened significantly vis-à-vis the U.S. dollar in the course of the first quarter of 1985 but recovered subsequently (Chart 2). On July 19, 1985 it stood (at Lit 1,870) about 3 1/2 percent above the level at the end of 1984. Vis-à-vis the deutsche mark, the lira depreciated by 5 1/2 percent over the same period. The realignment of July 22, 1985 was not preceded by substantial pressures on the exchange rate of the lira or on reserves, with the exception of July 19, 1985 when, with the Bank of Italy abstaining from intervention in the market in anticipation of a realignment over the weekend, a thin market was temporarily upset by a sizable transaction, which pushed the exchange rate vis-à-vis the U.S. dollar to Lit 2,200, at which point the authorities decided to close the market early. During the four days following the realignment, the exchange rate of the lira vis-à-vis the U.S. dollar has averaged Lit 1,918 involving a 2.5 percent depreciation with respect to the rate at the fixing on July 19. The average exchange rate vis-a-vis the DM during the same period (Lit 668.7) also registered a depreciation of 2.5 percent compared with the prerealignment level and stood 1.6 percent above the bilateral central rate.

On July 20, the Italian authorities announced a package of measures primarily of a revenue raising nature aimed at containing the foreseeable excess of the fiscal deficit over the Lit 100 trillion target. These measures consist of increases in social security contributions--estimated to add about 1 percentage point to labor costs in 1985--and an anticipation to 1985 of part of the receipts from an amnesty on construction that had been illegally undertaken in the past. These measures, together with a recall into the Treasury of bank deposits of peripheral public entities, are expected to reduce the on present trends borrowing requirement of the Central Government by Lit 5-6 trillion in 1985 and by about the same amount in 1986 due to the onceover nature of some of them. It seems unlikely that these measures will suffice to allow the containment of the deficit to the Lit 100 trillion target. Estimates of the state sector deficit before the measures put it at significantly over Lit 110 trillion. At the same time, the Government announced that it had agreed with the

CHART 2  
ITALY  
SELECTED EXCHANGE RATE INDICES AND MEASURES  
OF COMPETITIVENESS IN MANUFACTURING

(1980 = 100)



Sources: IMF, *International Financial Statistics*; Research Department and ETR.

<sup>1</sup> Vis à vis 36 partner countries.

<sup>2</sup> Based on the consumer price index.

<sup>3</sup> Adjusted for exchange rate changes, vis-a vis 14 industrial countries.



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trade unions that the scala mobile wage indexation mechanism should be modified to move from quarterly to semiannual adjustments and to exclude the effect of increases in indirect taxes from the index. The shift to a semiannual frequency of indexation would eliminate the scala mobile increase of November 1985. The employers' association (Confindustria) has announced that as of January 1, 1986 it would no longer observe the scala mobile agreement. Negotiations on a new wage determination mechanism agreement for 1986 are expected to resume in September of this year.

### III. Staff Appraisal

The performance of the Italian economy deteriorated significantly in the first half of 1985, especially in the fiscal and external accounts. The marked worsening of the current account reflected primarily the maintenance of a sustained rate of growth of domestic demand in the face of a deceleration of demand in the United States and continued slow growth in the rest of Europe. The impact on the external accounts of the shift in relative cyclical positions was aggravated by the lagged effects of a significant loss of competitiveness vis-à-vis the EC over the last two years.

The recent exchange rate realignment within the EMS provides the lira with an adequate margin to secure a significant improvement in competitiveness in 1985. It is important that this improvement should not be quickly eroded and that a more satisfactory balance be re-established in the current account. To this end it is essential that inflation be quickly put back on a decelerating trend and that the rate of growth of domestic demand be checked through a tightening of financial policies and further moderation in the growth of real incomes. This will require that the rates of growth of the monetary base and the money supply, which have accelerated in recent months, be brought rapidly down to avoid perpetuating the boost to prices stemming from the depreciation of the exchange rate.

In the view of the staff, it is crucial that a major contribution to the deceleration in the monetary aggregates be made by the containment of the public sector deficit, which has been running well above target in the first half of this year. The costs of monetary restraint without fiscal retrenchment are rapidly increasing, for the public sector debt is over 90 percent of GDP and interest payments on this debt are equivalent to nearly 10 percent of GDP. In this respect the staff notes with concern that the measures announced so far are unlikely to ensure that the target for the deficit for the year as a whole will be adhered to. In the view of the staff, supplementary measures should be implemented soon, including selective increases in indirect taxes and administered prices, which would help contain the growth of consumption, and, more importantly, expenditure cuts. It is also to be hoped that, in the context of the preparation of the 1986 budget, the Government will take the necessary steps that will lead to a progressive reduction in the public sector deficit in the years ahead. The main weight should be given to reforms

in the areas of social expenditures--on pensions, health, and the Wage Supplementation Fund--which have been rising and on present trends are projected to continue to rise at unsustainable rates, and to ensuring a closer coordination of spending and revenue raising responsibilities.

It is also to be hoped that the forthcoming negotiations on wage determination for 1986 result in an agreement which reduces the automaticity of wage increases, gives greater room for differentiation in accordance with productivity differentials and ensures a continued deceleration in unit labor costs, despite the boost to the latter by the recently announced increases in social security contributions. The agreement reached between the Government and the unions to exclude the effects of indirect tax increases from the scala mobile and to shift to semiannual adjustments represents an important step in the right direction.

It is clear that unless adequate progress is made on curbing monetary expansion, reducing the public sector deficit and containing labor costs, the performance of the Italian economy in the external accounts, inflation and ultimately growth would worsen further in 1986 and beyond.

Table 1. European Monetary System: Bilateral Central Rates and Intervention Limits

(Effective July 22, 1985)

		100 Belgian/ Luxembourg francs	100 Danish kroner	100 deutsche mark	100 French francs	1,000 Italian lire	1 Irish pound	100 Nether- lands guilder
Belgian/Luxembourg franc	U	...	564.10	2,048.35	668.00	31.305	63.2810	1818.00
	C	...	551.536	2,002.85	653.144	29.4831	61.8732	1777.58
	L	...	539.30	1,958.50	638.60	27.765	60.4965	1738.00
Danish krone	U	18.543	...	371.40	121.11	5.676	11.4735	329.630
	C	18.1312	...	363.141	118.423	5.34563	11.2184	322.297
	L	17.727	...	355.06	115.78	5.035	10.9687	315.13
Deutsch mark	U	5.106	28.165	...	33.350	1.5630	3.160	90.770
	C	4.99288	27.5375	...	32.6107	1.47205	3.08925	88.7526
	L	4.882	26.925	...	31.885	1.3865	3.021	86.780
French franc	U	15.659	86.365	313.63	...	4.79300	9.6885	278.35
	C	15.3106	84.4432	306.648	...	4.51402	9.47313	272.158
	L	14.97	82.565	299.85	...	4.25150	9.2625	266.10
Italian lira	U	3601.40	19863.0	72,131.0	23522.0	...	2,228.29	64,020.0
	C	3391.77	18706.9	67,932.5	22153.2	...	2,098.60	60,291.5
	L	3194.30	17618.0	63,978.0	20863.0	...	1,976.46	56,786.0
Irish pound	U	1.6530	9.1168	33.1015	10.7964	0.505956	...	29.3832
	C	1.61621	8.91396	32.3703	10.5562	0.476508	...	28.7295
	L	1.5803	8.7157	31.6455	10.3214	0.448775	...	28.0904
Netherlands guilder	U	5.7535	31.7325	115.235	37.58	1.76100	3.5600	...
	C	5.62561	31.0273	112.673	36.7434	1.65861	3.48075	...
	L	5.5005	30.3375	110.1675	35.925	1.56200	3.4030	...

Source: EC Commission.

Legend: U = upper limit; C = bilateral central rate; L = lower limit.

Table 2. EMS Realignment

	Sept. 24, 1979	Nov. 30, 1979	Mar. 23, 1981	Nov. 5, 1981	Feb. 22, 1983	June 14, 1982	Mar. 21, 1983	July 22, 1985
Percentage changes in bilateral central rates <sup>1/</sup>								
Belgian-Luxembourg franc	...	...	...	...	-8.5	...	1.5	2.0
Danish krone	-2.9	-4.8	...	...	-3.0	...	2.5	2.0
Deutsche mark	2.0	...	...	5.5	...	4.25	5.5	2.0
French franc	...	...	...	-3.0	...	-5.75	-2.5	2.0
Italian lira	...	...	-6.0	-3.0	...	-2.75	-2.5	-6.0
Irish pound	...	...	...	...	...	...	-3.5	2.0
Netherlands guilder	...	...	...	5.5	...	4.25	3.5	2.0

Source: EC Commission.

<sup>1/</sup> Calculated as the percentage change against the group of currencies whose bilateral parities remained unchanged in the realignment; except in the case of the realignments of March 21, 1983 and of July 22, 1985, where, all currencies having moved, bilateral shifts need to be derived by combining the relative movements of the two currencies concerned.

Table 3. Changes in Central Rates of EMS Currencies in Terms of ECU

	ECU Central Rates		Central Rate Change
	Previous <u>1/</u>	New	(Percent)
Realignment of July 20, 1985			
Belgian-Luxembourg franc	44.9008	44.8320	0.2
Danish krone	8.14104	8.12857	0.2
Deutsche mark	2.24184	2.23840	0.2
French franc	6.87456	6.86402	0.2
Italian lira	1,403.49	1,520.60	-7.7
Irish pound	0.725690	0.724578	0.2
Netherlands guilder	2.52595	2.52208	0.2
Pound sterling <u>2/</u>	0.585992	0.555312	5.5
Greek drachma <u>2/</u>	87.4813	100.7190	-13.1

Source: EC Commission

1/ September 17, 1984 for the pound sterling and Greek drachma and May 18, 1983 for the other currencies.

2/ The pound sterling and Greek drachma are included in the calculations of the ECU; notional central rates have to be ascribed to both for the calculation of the divergence indicator, and for other reasons related both to the workings of the EMS and the Common Agricultural Policy.

Table 4. Italy: Selected Financial Indicators, 1981-85

	1981	1982	1983	1984 <u>1/</u>	1985 <u>2/</u>		
	(As percent of GDP)						
Fiscal indicators							
State sector							
Revenues	30.0	35.1	35.4	35.9	25.2	<u>3/</u>	(26.6) <u>4/</u>
Expenditures	42.8	50.2	51.8	51.3	41.9	<u>3/</u>	(40.5) <u>4/</u>
Overall balance <u>5/</u>	-12.8	-15.1	-16.4	-15.4	-16.7	<u>3/</u>	(-13.9) <u>4/</u>
Share of deficit financed through:							
Medium- and long-term bond	10.9	34.2	78.6	60.4	64.4		(79.6)
Short-term paper	57.7	44.9	14.9	26.7	11.4		(7.9)
Monetary base creation	26.7	17.4	5.1	10.5	23.8		(10.8)
	(End of period; percentage change except as otherwise indicated)						
Monetary variables							
Monetary base	13.3	14.1	15.0	14.4	17.8	<u>6/</u>	
M2	9.9	16.9	13.3	11.8	14.7	<u>6/</u>	
M3	16.0	17.2	14.6	13.9	15.3	<u>7/</u>	
Total domestic credit	17.8	20.6	20.6	19.6 <u>8/</u>	19.5	<u>6/</u>	
Bank lending to nonstate sector	13.5	13.4	13.2	15.2 <u>8/</u>	13.6	<u>6/</u>	
Share of credit to the state sector in total domestic credit expansion	61.6	68.7	71.0	66.0 <u>8/</u>	83.0	<u>9/</u>	
Total financial assets <u>10/</u>	19.2	20.1	20.4	19.2	19.0	<u>11/</u>	
	(In percent; period averages unless otherwise indicated)						
Interest rates							
Discount rate (end of period)	19.0	18.0	17.0	16.5	15.5	<u>6/</u>	
Three-month Treasury bills	19.6	19.4	17.8	15.3	14.2	<u>12/</u>	
Prime rate	21.4	21.6	19.4	17.7	17.0	<u>6/</u>	
Average deposit rate	12.6	13.4	12.5	11.8	10.9	<u>13/</u>	

Sources: Data provided by the Italian authorities

1/ Provisional estimates.

2/ Most recent data.

3/ January-May, at annual rates. The Government's objective is to contain the overall deficit of the state sector to the equivalent of 14.6 percent of GDP for 1985 as a whole.

4/ January-May 1984, at annual rates.

5/ Including net lending but excluding debt liquidations.

6/ May.

7/ April.

8/ Adjusted for distortions related to the removal of credit ceilings.

9/ January-May.

10/ Domestic component of financial assets, net of shares.

11/ March.

12/ July.

13/ June.

Table 5. Italy: Main Economic Variables, 1981-85

(Percent changes)

	1981	1982	1983	1984	1985 <u>1/</u>
Real demand and output					
Private consumption	0.5	0.5	-0.3	1.8)	3.5 <u>2/3/</u>
Public consumption	3.3	2.6	2.4	2.7)	
Fixed investment	0.6	-5.2	-3.8	4.1	4.5 <u>2/</u>
Stockbuilding <u>4/</u>	<u>-3.1</u>	<u>—</u>	<u>-0.7</u>	<u>0.6</u>	<u>...</u>
Total domestic demand	-2.2	-0.3	-1.2	2.9	3.6 <u>2/</u>
Exports of goods and services	5.2	0.4	3.3	7.0	3.6 <u>2/</u>
Imports of goods and services	<u>-5.3</u>	<u>1.5</u>	<u>0.1</u>	<u>9.6</u>	<u>11.7</u> <u>2/</u>
Foreign balance <u>4/</u>	2.3	-0.2	0.8	-0.3	-1.6 <u>2/</u>
GDP	0.2	-0.5	-0.4	2.6	1.8 <u>2/</u>
Industrial production	-1.6	-3.0	-3.2	3.1	3.8 <u>2/</u>
Wages, costs and prices					
Wage rates in manufacturing <u>5/</u>	24.1	19.1	17.5	13.7	9.0 <u>2/</u>
Productivity in manufacturing <u>5/</u>	3.4	0.6	1.9	8.0	2.6 <u>2/</u>
Unit labor costs in manufacturing <u>5/</u>	20.0	18.6	15.3	5.3	6.2 <u>2/</u>
Cost of living index	18.7	16.3	15.1	10.7	8.7 <u>6/</u>
GDP deflator	18.4	17.9	15.1	10.7	8.8 <u>2/</u>
Unemployment rate (levels)	8.3	9.6	9.8	10.4	10.2 <u>7/</u>
Disposable income of households	20.9	17.1	13.8	13.5	...

Sources: Ministry of the Budget and Ministry of the Treasury, Relazione Generale sulla Situazione Economica del Paese; Bank of Italy, Relazione Annuale; and data provided by Italian authorities.

1/ Most recent data.

2/ First quarter 1985, year-on-year.

3/ Change in private consumption, public consumption and inventory investment combined.

4/ Changes in stockbuilding and the foreign balance are expressed as percentage of GDP in the previous year.

5/ Adjusted for the impact of the Wage Supplementation Fund.

6/ June, year-on-year.

7/ April.



Table 6. Italy: External Developments, 1981-85

	1981	1982	1983	1984 <u>1/</u>	1985 <u>2/</u>
Trade developments (percent changes)					
Imports, c.i.f., customs basis					
Unit value	36.6	8.6	4.8	11.3	10.3 <u>3/</u>
Volume	-11.3	3.2	0.2	9.1	12.3 <u>3/</u>
Exports, f.o.b., customs basis					
Unit value	23.2	15.0	7.4	9.6	7.1 <u>3/</u>
Volume	4.7	0.3	3.7	6.6	1.9 <u>3/</u>
Trade balance, f.o.b.-c.i.f. (in billions of lire)	-17,634	-16,965	-11,465	-19,164	-14,554 <u>4/</u> (-8,978) <u>5/</u>
Balance of payments summary (in billions of lire)					
Trade balance, f.o.b.-f.o.b.	-12,032	-10,739	-4,682	-10,785	...
Services	1,945	2,159	4,088	3,648	...
Private transfers	1,639	1,987	2,131	2,311	...
Official transfers	-777	-819	-354	-362	...
Current balance	-9,225	-7,412	1,183	-5,188	...
(As percent of GDP)	-2.3	-1.6	0.2	-0.9	...
Nonmonetary capital	11,386	5,185	1,900	2,363	...
Errors and omissions	-628	-294	710	2,882	...
Overall balance	1,533	-2,521	3,793	57	1,446 <u>6/</u> -6,521 <u>7/</u> (-4,234) <u>8/</u>
Foreign exchange holdings	18,617	12,610	18,259	19,065	16,737 <u>9/</u> 18,699) <u>6/</u>
Gross official reserves (excluding gold) <u>10/</u>	20,134	14,090	20,105	20,774	19,460 <u>11/</u>
Net foreign position of commercial banks <u>10/</u>	-13,391	-10,631	-12,870	-15,139	-16,060 <u>12/</u>
External debt outstanding <u>10/13/</u> (As percent of GDP)	48,600 14.5	51,000 14.9	54,600 16.8	56,500 19.4	...
<b>Memorandum items:</b>					
Average exchange rates					
Italian lire per U.S. dollar	1,136.8	1,352.5	1,518.8	1,757.0	1,954.1 <u>6/</u>
Percent change in lira/US\$ rate <u>14/</u>	32.7	19.0	12.3	15.7	15.3 <u>15/</u>
Effective exchange rate (MERM weights, 1980 = 100)	86.7	80.2	76.1	71.1	67.5 <u>6/</u>

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

- 1/ Provisional estimates for 1984.
- 2/ Most recent data.
- 3/ January-February; year-on-year.
- 4/ January-May.
- 5/ January-May 1984.
- 6/ June.
- 7/ January-June.
- 8/ January-June 1984.
- 9/ March.
- 10/ End of period, in millions of U.S. dollars.
- 11/ May.
- 12/ April.
- 13/ Includes the net external liabilities of commercial banks.
- 14/ Positive sign indicates a depreciation.
- 15/ June, year-on-year.

Table 7a. Italy: Indicators of Competitiveness Vis-à-vis  
13 Industrial Countries, 1979-85 1/

	Nominal Effective Exchange Rate		Relative Wholesale Prices in Manufacturing		Real Exchange Rate	
	Level	Change	Level	Change	Level	Change
	(1980=100)	(in percent year-on-year)	(1980=100)	(in percent year-on-year)	(1980=100)	(in percent year-on-year)
	(1)	(2)	(3)	(4)	(5)	(6)
1979	104.2	-4.3	91.0	5.9	94.9	1.4
1980	100.0	-4.0	100.0	9.8	100.0	5.3
1981	90.8	-9.2	106.3	6.4	96.5	-3.4
1982	85.1	-6.4	112.7	6.0	95.4	-0.7
1983	82.0	-3.6	119.9	6.4	98.4	2.6
1984	78.6	-4.3	124.8	4.1	98.0	-0.4
1984						
I	79.1	-5.9	122.6	3.5	97.0	-2.6
II	78.9	-4.4	124.2	3.5	98.0	-1.0
III	78.9	-3.7	125.4	4.5	98.4	0.6
IV	77.7	-3.0	127.0	4.7	98.7	1.6
1985 <u>2/</u>						
Jan.	78.1	-1.5	128.4	5.2	100.3	3.6
Feb.	77.6	-1.8	128.6	4.8	99.7	3.0
Mar.	75.7	-4.2	129.5	5.2	98.1	0.7
Apr.	75.0	-5.2	130.1	5.3	97.6	-0.2

Source: Bank of Italy.

1/ A minus (plus) sign indicates a depreciation (appreciation).

2/ Preliminary estimates.

Table 7b. Italy: Indicators of Competitiveness Vis-à-vis EC, 1979-85 <sup>1/</sup>

	Nominal Effective Exchange Rate		Relative Wholesale Prices in Manufacturing		Real Exchange Rate	
	Level	Change	Level	Change	Level	Change
	(1980=100)	(in percent year-on-year)	(1980=100)	(in percent year-on-year)	(1980=100)	(in percent year-on-year)
	(1)	(2)	(3)	(4)	(5)	(6)
1979	104.7	-5.6	90.2	6.1	94.5	0.1
1980	100.0	-4.5	100.0	10.8	100.0	5.8
1981	94.2	-5.8	106.1	6.2	100.0	0.0
1982	89.7	-4.8	111.6	5.1	100.1	0.1
1983	88.0	-1.9	117.8	5.6	103.7	3.6
1984	85.0	-2.4	121.6	3.2	104.4	0.7
1984						
I	86.0	-1.5	119.8	2.5	103.0	-1.2
II	85.8	-1.7	121.1	2.7	103.9	-0.2
III	85.0	-2.2	122.1	3.7	104.9	1.4
IV	84.7	-3.0	123.5	4.0	105.8	2.7
1985 <sup>2/</sup>						
Jan.	86.5	-0.2	124.7	4.6	107.9	4.4
Feb.	86.2	0.5	124.9	4.2	107.7	4.8
Mar.	84.2	-1.6	125.8	4.6	105.9	2.9
Apr.	82.6	-3.7	126.5	4.9	104.4	1.0

Source: Bank of Italy.

<sup>1/</sup> A minus (plus) sign indicates a depreciation (appreciation).

<sup>2/</sup> Preliminary estimates.

Table 7c. Italy: Bilateral Indicators of Competitiveness, 1979-85 1/

	Germany (1)	France (2)	United Kingdom (3)	Netherlands (4)	Belgium (5)
1979 (December)	6.2	2.9	-1.5	10.2	11.0
1980 (December)	9.0	5.7	-14.9	5.4	8.2
1981 (December)	-4.5	-2.1	-0.3	-6.4	-0.1
1982 (December)	-0.3	6.9	6.7	-0.6	12.9
1983 (December)	2.7	-2.7	-1.5	3.9	5.3
1984 (December)	5.1	-1.0	8.7	4.7	3.0
1984					
I	0.7	-3.7	-6.9	1.0	4.3
II	2.4	-5.6	1.5	1.1	3.9
III	3.7	-4.1	5.5	3.4	3.4
IV	4.9	-2.5	7.3	4.3	3.0
1985 <u>2/</u>					
January	5.6	-0.4	12.8	7.0	2.9
February	6.4	-0.3	11.2	8.8	3.3
March	4.8	-1.0	4.3	7.0	2.2
April	3.2	-1.7	-2.0	4.9	0.2

Source: Bank of Italy.

1/ Year-on-year changes in the relative wholesale prices of manufactures (adjusted for exchange rate changes) of Italy vis-a-vis countries in stub.

2/ Preliminary estimates.

European Communities

Basle, Switzerland  
July 20, 1985

Communique

On July 20, 1985, the Ministers and Central Bank Governors of the EEC member countries have by mutual agreement, in a common procedure involving the Commission and on the basis of a proposal from the Monetary Committee, decided on an adjustment of central rates within the European Monetary System.

The new bilateral central rates result from the following relative changes:

Irish pound:	+ 2 percent
French franc:	+ 2 percent
Danish kroners:	+ 2 percent
Dutch guilder	+ 2 percent
German mark:	+ 2 percent
Belgian franc:	+ 2 percent
Luxembourg franc:	+ 2 percent
Italian lira:	- 6 percent

The new ECU central rates are the following: (in units of national currency per ECU)

IRL	0.724578
FF	6.86402
DKR	8.12857
HFL	2.52208
DM	2.2384
BFR	44.832
LFR	44.832
LIT	1520.6
UKL	0.555312
DRA	100.719

The new bilateral central rates and the compulsory intervention rates will be communicated by the monetary authorities in time for the opening of foreign exchange markets on July 22, 1985.