

CHANGES IN DEPOSITS (except interbank) HELD BY THE ITALIAN BANKING INSTITUTES (a)

End of Period	Savings and Sundry Deposits			Current Accounts		
	Amount (000,000 lire)	Index 100=1938	Percentage changes in the period	Amount (000,000 lire)	Index 100=1938	Percentage changes in the period
1938 - December	38,037	100	—	17,495	100	—
1939 "	39,995	105.1	+ 5.1 %	20,971	119.9	+ 19.9 %
1940 "	46,079	121.1	+ 15.2 %	26,379	150.8	+ 25.8 %
1941 "	58,130	152.8	+ 26.2 %	35,504	202.9	+ 34.6 %
1942 "	74,818	196.7	+ 28.7 %	43,128	246.5	+ 21.5 %
1943 "	84,216	221.4	+ 12.6 %	59,042	337.5	+ 36.9 %
1944 "	138,353	363.7	+ 64.3 %	105,412	631.2	+ 87.0 %
1945 "	240,609	632.6	+ 73.9 %	165,977	948.7	+ 50.3 %
1946 "	368,249	968.1	+ 53.0 %	229,806 (b)	1,305.1	+ 98.7 %
1947 - January	371,364	1,002.6	+ 3.6 %	228,061	1,305.3	- 0.3 %
February	398,749	1,048.3	+ 4.6 %	241,515	1,372.1	+ 3.8 %
March	415,156	1,097.5	+ 4.1 %	265,608	1,518.7	+ 7.1 %

(a) Beginning 1942, this table and those following relate to 365 Institutes, holding about 99 % of all Bank deposits.

(b) Beginning December 1946, current accounts are exclusive of the "valuta accounts" (instituted after March 1946), which at the end of 1946 were in excess of 23 milliard lire.

bonds and through deposits by banks in their current accounts with the Treasury (see Table II).

TABLE II

DIRECT BANK LENDING TO THE TREASURY (a)  
(in millions of lire)

End of period	Holdings of Government Securities	Current accounts with the Treasury	Total
1938 - December	14,860	2,294	17,154
1939 "	15,920	2,539	18,459
1940 "	20,831	5,649	26,480
1941 "	32,848	4,500	37,348
1942 "	46,944	5,466	52,410
1943 "	60,896	6,000	66,896
1944 "	87,109	10,800	97,909
1945 "	133,551	28,506	162,057
1946 - March	163,532	35,311	198,843
" - June	182,595	50,277	232,872
" - September	199,593	52,790	252,383
" - December	203,895	37,623	241,518

(a) Sight and time deposits held by Banking Institutes (*Istituti di Credito*) with the Bank of Italy are excluded (see Table V, note (a), and Table VI, note (a), 3).

At that time, chiefly as a result of their increasingly liquid position, Italian banks had

## The Italian Money Market and the Financing of the Treasury

by

MARCELLO MANCINI

1. — A matter that is claiming the attention of Italian banking circles to-day is that of the relationships between the banks and the Treasury. A retrospective examination of the development of such relationships in the framework of public finance will show how they have become increasingly intimate and close, especially as a result of war conditions. In Italy, as in all other belligerent countries, an effort was made during the war to limit recourse to the printing press by the adoption, in financing Treasury requirements, of the system known as the "monetary circuit". Through the reduction of consumption and the regulation of foreign exchange rates and transactions, the control of prices and the block of investments in reality, this policy was designed to direct liquid assets, in excess of essential production and consumption requirements, towards investments in Government securities or in other Government debts. In other words, the idea underlying the project was to favour the backflow to the Treasury of all surplus assets through subscriptions to Government loans, as well as by taxation.

Notwithstanding some friction, in part due to unpredictable psychological factors, this scheme proved adequate to meet the requirements of the war effort up to the end of 1942. It was at that time however that, as a result of the growth in Government spending, the time-lag between expenditures and backflow of excess purchasing power became increasingly marked: in this situation, also due to other unfavourable circumstances, recourse to the printing press increased. The first signs of a breakdown in the operation of the monetary circuit appeared and rapid deterioration ensued: by

September 1943, when Italy signed her armistice, the direct flow of money from the market to the Treasury no longer operated.

In these conditions a dangerous advance in the level of the currency circulation was avoided by the adoption of appropriate legislative measures and the manipulation of some interest rates and above all thanks to some special conditions then prevailing on the Italian money market: a scheme somewhat different, which I call the "indirect monetary circuit", viz. the flow of money from the market to the Treasury through the banking system (market-banks-Treasury, or market-banks-bank of issue-Treasury), began to operate. Needed funds were in this case chiefly supplied by banks which, as had been the case also in other countries, were in an increasingly liquid position due to a decline in lending activities coupled with a steady advance of deposits and especially of clients' current accounts (see Table I).

Treasury requirements were however financed in part by banks even prior to the break-down of the "direct monetary circuit". In that period liquid assets, chiefly of the principal banks, flowed also to the Central Bank, though in lesser proportion than to the Treasury, as the Bank of Italy until then had not done much to encourage such a development (1); indeed, up to 1942 it was the Treasury which called on available liquid assets of the banks through the sale of Government

(1) See M. Mancini, *Aspetti dell'andamento dei depositi bancari e postali rispetto alla circolazione monetaria in periodo bellico* (Aspects of the Movement of Bank and Postal Deposits in Relation to the Monetary Circulation in War-time), in *Conguntura Economica*, February 1947, p. 12.

grown almost entirely independent of the Bank of Issue. At the end of 1942, when the breakdown of the "direct monetary circuit" became apparent, a cautious and systematic policy designed to re-establish the connections of the Bank of Issue with other banks was envisaged to favour the operation of the "indirect monetary circuit".

2. — The methods adopted by the Bank of Italy in draining liquid assets from the money market to make them available for the Treasury were: the introduction of new categories of deposit accounts with special interest rates, and the compulsory deposit with the Bank of Issue of a percentage of the monthly increase in deposits and current accounts at banks.

The new schedule of interest rates was applied for the first time during the period December 1942-January 1943 when banks and other institutions were required to hold with the Bank of Italy time deposits at an interest rate established at 3 per cent (15 days notice) or 2.50 per cent (8 days notice) and when the rate of interest on demand deposits was raised to 1 per cent.

As for compulsory deposits, it was ruled in January 1943 that all banks whose total depo-

sits exceeded 100 million lire should place each month with the Bank of Italy an amount corresponding to 75 per cent of the increment recorded by deposits and current accounts during the previous month, after deduction of the amount invested for some particular war purposes (2). These deposits were entered in special interest bearing current accounts and withdrawals were allowed only in exceptional cases. This provision proved to be merely a timid and complicate attempt which, when applied, gave only indirect results. The deductions consented were too numerous and this made evasion possible; the fact that the provision regarded only banks with total deposits exceeding 100 million lire also explains its limited success (3).

A provision of an old law might also have been useful for the same purpose, a provision that had had practically no application before; but then, as a result of the substantial increase in deposits at banks, the situation presented an entirely new aspect.

This was art. 15 of the decree-law n. 1830 of November 6, 1926, merely designed to protect depositors. On the basis of this provision the ratio of bank deposits to capital plus reserves was not to exceed 20 to 1. Any amount in excess of this should be invested, not later than six months after ascertainment, in Government bonds or should be deposited or placed in a non-interest bearing current account with

(2) Investments in Government bonds or Government guaranteed securities; investments in debentures of industrial companies directly engaged in war production, or in debentures and similar securities of banks and financial companies issued against loans made to industrial companies or for financing the wheat pools; funds deposited in current accounts held with the Treasury or with the Bank of Italy; investments of particular interest for the country's war effort.

Later on these additional deductions were allowed:  
— deposits of savings banks at the "Istituto di Credito per le Casse di Risparmio Italiane" up to the amounts deposited by the latter with the Treasury or invested in Government bonds;

— funds supplied by its stock-holders to the regional agricultural credit institutes to be used in financing the pools of farm products or in financing normal farming activities or improvements;

— loans to public administrations, when Government authority was previously obtained;

— financing of organizations dealing with the food policy;  
— advances against Government securities, made during the month.

(3) This provision was repealed early in 1945.

the Bank of Italy. The *Ispettorato del Credito*, a Government Agency at that time charged with control of credit, issued provisions for the strict implementation of this law; however, the ratio 20 to 1 was not exceeded by all banks, and often some opposition against application of the law was made. This explains the scant success of this provision.

Briefly, the new policy proved only moderately successful during the first period (first half of 1943). Presumably, circumstances did not allow of more. Its results have been quite different since September 1943.

2. — From the armistice (Sept. 1943) to the unification of the national territory—Italy had been divided in two parts by the front lines—the Treasury, both in the northern and southern territory, financed its requirements almost wholly with means supplied by the money market because, as can be easily understood, the yield of taxation had shrunk greatly and it was very difficult to raise money through loans.

The "indirect monetary circuit" by that time had completely replaced the direct one, and it must be recognized that its successful operation was chiefly a result of the circumstances and conditions which in that period characterized the Italian economy. Due to the stand-still in productive and commercial activities brought about by war, liquid assets of banks could not find investment in business activity and were naturally shifted to Government investments. Liquid assets flowed in large amounts to the Bank of Italy, which in May 1944 opened, in its branch offices of the South, other kinds of time deposits in the name of banks. These deposits—available for the Treasury—were made for longer periods and at higher rates of interest (3 and 4 months at the rate of 4 and 4.50 per cent). This further strengthened the "indirect monetary circuit".

In this way the position of the Treasury was greatly improved not only because it obtained substantial amounts without calling for excessive efforts on its part, but also because it was thus possible to avoid recourse to the printing press and the consequent pressure on the note circulation, so widely practiced by the Ger-

man and Allied Authorities. The large-scale hoarding of new notes was also beneficial, especially in some parts of the country, where it contributed to check price increases. Soon after the unification of the national territory, a partial dishoarding of notes took place, and the flow of money from the market to the Treasury, through subscriptions to medium-term Treasury bonds and through an increase in bank deposits with the Bank of Issue and with the Treasury, went on at a sustained rate. This inflow, now automatic and favoured by the existence of liquid assets in excess of needs, by the sharp reduction in economic activity and, especially in the North, by the relatively low level of prices and wages, resulted in a considerable reduction of the interest burden on the greatly expanded amount of deposits at the Central Bank, owing to a decrease in the interest rates coupled with an extension of the notice required for withdrawals; this interest burden was, however, later on transferred to the Treasury which made use of the means thus placed at its disposal.

4. — This system, adopted in a period of emergency for Italian economy and finance, could not, however, become permanent. Sooner or later it was bound to weaken and become impracticable.

Statistics of the Treasury cash position during the war and in the early post-war months show how large was the contribution made to the Treasury by the money market and that in the course of time the market undoubtedly showed signs of exhaustion.

From July 1, 1938 to June 30, 1946, total Government payments and receipts aggregated 1,312 and 420 milliard lire respectively (see Table III). The deficit of 898 milliards was in part financed with the issue of medium term bonds (5 and 9 year Treasury bonds) leading to variations shown under the heading "movement of capital", and in part by resorting to ordinary and extraordinary Treasury means. It can be stated however that the deficit was met largely with funds obtained from the money market (by increasing the

Treasury debt and particularly the floating debt).

This was chiefly due to the different characteristics of these two sources. It is known in fact that loans can be successfully floated only when certain technical and psychological conditions prevail in the financial market. But there are no limits to an expansion in Treasury debt, the bulk of which is accounted for by the floating debt, except for some items; this was largely responsible for the increasing recourse to this source of cash when other sources had dried up.

Briefly, the deficit of 898 milliard lire by June 30, 1946 was met for 185 milliards by loans and other small items, while 696 milliards were supplied by the money market, and 18.5 milliards by other Treasury debts and credits; the balance, i.e. 2 milliards, was available as cash on hand.

With respect to the money market, the largest contribution to the Treasury was made in the form of advances by the Bank of Italy (342 milliards) and, in diminishing order, by Treasury bills of 1 year or less (229 milliards, of which no less than 138 milliards subscribed by banks and 68 milliards by the Bank of Italy with funds obtained from the banking system), by the "Cassa depositi e prestiti" (77 milliards) which holds deposits of the postal savings banks, and by bank deposits with the Treasury (47 milliards). These few figures afford a summary idea of the contribution that the money market, through the banking system, has made to the Treasury during the period Jul 1, 1938, June 30, 1946.

But when examining the contribution made by the money market, special attention should be paid to its successive developments. In the course of the fiscal year 1944-45 the indirect circuit developed to an unforeseen extent. The money market by supplying 380 milliard lire made the biggest contribution of the whole war period. With the end of the war, however, in all likelihood a rapid revival of productive activities would have resulted in a diminished supply of money to the Treasury, and perhaps even in a contrary trend. A sudden and massive return to the market of the funds drained

off by the Treasury during the war years and in the period immediately following the liberation of the whole country, might have led to dangerous inflationary developments—which up to that time had been more or less averted—with all the unfavourable consequences that this implies.

The end of the war was indeed followed by a business revival; a more intense demand for credit by productive activities induced the banks, whose first thought is for their profit and loss account, to shift their capital from Government investments to more profitable forms of credit. As a result of this, the yield of the money market to the Treasury fell from 380 milliardi in 1944-45 to 146 milliardi in the first post-war fiscal year 1945-46; this shrinkage (see Table III) is even more marked when we remember that the lira had depreciated greatly during that year.

During the past fiscal year (1946-47), the depletion of the money market (4) has become increasingly evident (see Table IV); in the period July-October 1946 the monthly amounts raised by the Treasury gradually declined from about 18 milliard lire in July to less than 9 milliardi in October. From November 1946 to April 1947 this decline continued at an accelerated rate. In December 1946 and January 1947, at the time of the issue of the "Reconstruction Loan", a reversal in trend took place: it can be broadly stated that during that period large amounts of money flowed from the Treasury to the market. This abrupt change was caused by the considerable quantity of Treasury bills converted into the new issue and by the withdrawal by banks of substantial amounts which they held in their current accounts with the Treasury (see Table II). This new development (a shrinkage of 12 milliard lire in Treasury bills outstanding and of nearly 17 milliardi in bank deposits with the Treasury) did not result in a corresponding shrinkage in the volume of total floating debt, which diminished only by 2.4 milliardi during De-

ember 1946. This is explained by additional Treasury calls on the Bank of Issue in December, to an amount of nearly 22 milliard lire, representing funds supplied to the Allied Authorities by the Bank of Italy in the course of 1946.

When the money market was no longer under the impact of the "Reconstruction Loan" it again contributed to meet Treasury needs, but to a smaller extent than prior to the floating of the new issue.

5. — Attention should now be focused exclusively on bank current accounts with the Treasury and bank time deposits with the Bank of Italy, leaving aside bank investments in Government securities, because in all likelihood banks will keep them at their present level, and bank sight deposits held at the Bank of Issue, as their volume is less than the volume of time deposits, and because, by their very nature, they are subject to fluctuations of a temporary character and cannot therefore be taken to represent the general trend.

Bank total liquid assets held with the Bank of Italy and at the Treasury (see Table V) reached a record high in October 1946, i.e. 106.7 milliard lire. It was then that the flow of money from the Treasury to the market commenced, rapidly accelerating its pace in December 1946, as the combined result of the issue of the "Reconstruction Loan" and of the expansion of bank credit.

The market situation was such that the yield of deposits held by banks with the Bank of Italy and with the Treasury was comparatively inadequate, while banks were reluctant to make further investments in Government securities, of which they already held a large volume. Data in Table V compare the downward trend shown by bank deposits with the Bank of Issue and with the Treasury, and the rate of increase shown by bank deposits. A further and rapid growth in bank credit would no doubt result in the withdrawal of larger funds from the Treasury. Some light on this development may be thrown by considering the varying ratios to bank deposits shown (e) by Government investments (this percentage

(4) See M. MANCINI, *Il gettito del mercato monetario nell'esercizio finanziario in corso* (Funds Supplied by the Money Market in the Current Fiscal Year) in *Rivista del Commercio*, July, 1947.

TABLE III  
CASH INCOME AND CASH OUTGO OF THE ITALIAN TREASURY AND RECOURSE TO THE MONEY MARKET  
(in millions of lire)

Fiscal year beginning 1 July	Treasury Account Current Items		Cash Deficit	Net balance of movement of capital	Total net balance	Floating debt				Other Treasury Debts & Credits	Cash on hand	
	Cash income	Cash outgo				Treasury Bills	Advances by the Bank of Italy	Cassa Depositi e Prestiti (a)	Bank current accounts with the Treasury			Total
1938-39	25,097	35,510	9,523	217	9,740	3,205	3,092	3,012	517	11,655	2,022	136
1939-40	29,073	50,235	20,352	31,351	2,099	3,771	5,058	8,653	185	977	3,643	3,643
1940-41	31,577	94,755	62,228	14,303	47,635	17,639	13,072	8,267	4,738	44,616	3,662	448
1941-42	38,559	112,205	73,706	46,518	27,188	9,841	9,680	10,431	1,315	28,037	4,237	5,086
1942-43	45,334	129,077	81,693	29,384	54,311	9,633	24,950	10,301	6,403	51,377	2,050	4,084
1943-44	43,578	126,468	82,890	3,770	86,660	8,691	19,660	2,594	6,720	32,267	42,424	96,817
1944-45	55,714	351,714	308,000	34,473	273,237	95,806	259,844	4,667	38,806	380,213	717	107,673
1945-46	148,866	466,745	357,879	42,455	215,424	81,314	12,326	51,158	1,511	146,390	35,381	13,734
	420,588	1,318,759	898,171	185,955	712,316	229,360	342,012	77,580	47,380	666,272	18,118	2,074

TABLE IV

1946-47 July	4,655	14,711	10,096	803	10,899	13,581	6,030	1,661	17,959	8,126	15,217
August	20,527	26,634	6,107	384	5,723	5,235	7,011	1,425	11,611	9,218	3,397
September	16,866	45,452	28,586	1,390	29,685	1,827	3,290	5,209	10,376	7,539	13,256
October	26,660	47,397	20,737	1,741	18,996	4,571	1,378	3,665	9,114	4,113	5,295
November	23,040	60,244	36,304	17,544	18,262	1,538	4,611	1,276	4,821	5,464	5,495
December	30,868	49,495	18,627	53,098	24,471	12,172	4,445	16,096	2,206	13,198	13,399
January	23,218	58,154	34,936	46,321	31,817	11,554	4,270	718	2,498	22,005	5,873
February	30,348	45,482	15,134	46,321	31,817	11,554	7,225	794	18,094	5,484	8,573
March	24,045	69,695	41,690	2,376	44,026	2,666	1,140	2,704	7,102	22,172	14,753
April	38,446	62,597	24,121	1,263	25,884	94	4,404	3,034	2,870	24,897	1,372
	239,573	675,831	436,258	166,700	69,558	30,560	22,872	16,668	77,195	803	6,834

(a) The *Cassa Depositi e Prestiti* — a Government Institution — administers the deposits collected by the Post Office Savings Banks (*Cassa postale*).  
(b) Beginning Dec. 1946, the Treasury account for the amount of lire advanced to the Allied is only responsible for the item "Advances by the Bank of Italy".

showed a declining trend after 1945) and (b) by private investments (increasing percentage since 1945) (see Table VI).

20 to 30. This increase did not seem sufficient and a 40 to 1 or a 50 to 1 ratio was suggested. It was also proposed that current accounts should not be included in total deposits; that

on capital plus reserves. In accordance with these proposed provisions all banks would be required to deposit 30 per cent of the difference between their total deposits and an amount

underlying the 1926 law. In addition to the protection of depositors, it also tends to favour the flow to the Treasury of a part of the savings collected by the banks; it also enables

vailing in Italy, which are still far from having attained a stable equilibrium, it appears obvious that banks could not possibly abstain from financing the Treasury, to devote all their liquid assets to the financing of production. Apart from the fact that excessive credit, when business is still feeling the effects of war, might be used in financing speculative activities, uneconomic ventures, and wasteful longterm investments, there is the risk that an easy money policy might stimulate post war activities beyond the limits set by economic possibilities. Furthermore, this policy would accentuate the conditions prevailing in the second half of 1946 and early in 1947, characterised by dwindling supplies to the Treasury from the money market; this would lead to a further deterioration of the monetary situation and thus hinder, rather than favour, a business revival. In other words the "indirect circuit" must be maintained, at least until tax revenue is adequate to cover a considerable part of the Government deficit, leaving the issue of loans to cover the rest.

The chief problem is therefore that of securing a more rational distribution of available deposits; this should be done by gradually increasing the amount used in financing productive activities, including foreign trade, while proportionately reducing amounts used in financing Treasury requirements.

No doubt it will not be an easy task to take a decision on the right apportionment of bank funds between business activities and the Treasury.

The objectives of the new credit policy make the 1926 legislation appear obsolete. Even if the ratio set by such legislation (20 to 1, later increased to 30) were raised to 40, as suggested, the position of large banks would not be greatly improved because, in their case, deposits exceed capital plus reserves by much larger amounts; furthermore, any improvement would only be short-lived because the actual ratio of deposits to capital plus reserves is an increasing one, owing to the steady growth of deposits and the unvarying amount of capital plus reserves (8).

(8) See Report of the Bank of Italy, March 31, 1947.

The new scheme would instead introduce a distinction between the present volume of deposits and its further growth and allow for changes to be made in the percentages; it seems a more flexible scheme that could readily adjust itself to the ever changing market situation. Furthermore, as a result of this new system, banks would not be forced to shift their capital from one investment to another; they would know in advance the percentage of the increase in deposits that they cannot dispose of and thus they could adopt a suitable loan policy.

Finally, the new system would secure greater uniformity in the percentages which were widely diverging from bank to bank under the old system, ranging, as pointed out above, from 7 to 75 per cent.

Important problems are those relating to the scope of the new scheme, and to the establishment of the percentages, which are now only tentatively set.

As for the first problem, it must be decided whether the rule regarding the ratio of deposits to capital and reserves should be applied also to some credit institutions heretofore exempted but which now engage in operations formerly proper to regular banks and whether, should the application of the rule be generalised, the same percentages should be applied to all banking institutes.

The fixing of the percentages and their possible subsequent variations will be one of the most delicate features in the execution of the new system. A too severe policy might result in a paradoxical choice of investments by banks; some less profitable operations might be avoided in favour of others, profitable from a business view-point, but which are precisely those the policy aims at discouraging. The matter is certainly a difficult one, especially under present Italian conditions; and will call for special skill on the part of the Authorities charged with assuring the role to be played by the banking system in facing a progressive inflationary expansion of the currency.