

# Recent Developments in Banking Activity in Italy

by

AMEDEO GAMBINO

1. — It has long been observed that during periods of monetary expansion, such as that during the War, the increase in the volume of bank deposits tends to lag somewhat behind the increase in the volume of notes in circulation.

A prominent place was given to this consideration by the Bank for International Settlements in its *Fourteenth Annual Report* (published at the end of 1944): "The general

Finland and Sweden, the corresponding recession was by about one-half; and in Germany, Hungary and Switzerland it was by three-quarters" (1).

The Report does not furnish data concerning Italy, and therefore does not notice that during the war years this tendency was even more pronounced in Italy than in any other country. In fact, at the end of 1938, as shown in Table I (2), the ratio of deposits to notes in circulation

LEGAL TENDER CURRENCY AND BANK DEPOSITS IN ITALY

TABLE I

End of Period	Legal tender currency		Bank Deposits (a)		Ratio of deposits to currency	
	Amount (milliard lire)	Index number (1938=100)	Amount (milliard lire)	Index number (1938=100)	%	Index (1938=100)
1938	22.5	100.0	55.5	100.0	246.7	100.0
1939	28.5	126.7	61.0	109.9	214.0	86.7
1940	35.4	157.4	72.4	130.5	204.5	82.9
1941	54.9	244.0	93.6	168.6	179.5	69.1
1942	79.2	352.1	117.9	212.4	148.9	60.4
1943	181.2	805.5	142.9	257.5	78.9	32.0
1944	319.4	1,419.9	248.8	448.3	77.9	31.6
1945	389.8	1,732.8	406.6	732.6	104.3	42.3
1946	512.7	2,279.2	721.5	1,300.0	140.7	57.0

(a) Includes: savings and sundry deposits and current accounts (except interbank).

trend of the Bank deposits has, of course, been upwards, but the increase has been less marked than that of the note issues, with the result that notes in circulation have everywhere gained in importance in relation to the volume of deposits. The relative decline at the big commercial banks has been less pronounced in the United Kingdom, where, from 1929 to 1943, deposits at the 'big five' receded by about one-quarter in relation to the note circulation; in the United States, France, Holland, Denmark,

in Italy was 246.7%: as against 22.5 milliards in notes emitted the over-all amount of bank deposits totalled 55.5 milliard lire. By the end of 1942 this ratio had already declined by two-fifths, dropping to 148.9%. And subsequent-

(1) Bank for International Settlements, *Fourteenth Annual Report*, Basle, end of 1944, p. 299.

(2) This table and those following have been elaborated using statistical data published by the Bank of Italy; such data, since 1943, relate to the principal 365 Italian Banking Institutes, holding about 99% of total bank deposits in Italy.

ly the fall became even faster: by the end of 1943 we had neared the 77.9% minimum reached at the end of 1944. At that time deposits totalled 248.8 milliardi against a note circulation totalling 319.4 milliard lire.

2. — Quite naturally this trend led to belief that in Italy, as in all other countries, the importance of the means available to the banking system, seen as a limit to their credit capacity, had substantially decreased; and that the system had therefore lost ground in its basic function of serving as the credit intermediary between those who furnish capital in monetary form and those who need it.

Indeed, even had prices not increased more than the emission of banknotes, the fact that from the end of 1938 to the end of 1944 the volume of deposits increased only 4.5 times while note circulation increased 14.2 times meant that the credit potential of the banks expressed in real terms was not even one-third of the pre-war level. And meanwhile requirements of monetary capital had substantially increased in all fields of economic activity as a result of reconstruction needs. At the very moment when the need for mobilizing all the Nation's credit resources was being most acutely felt, the banking system found itself with a diminished capacity to fulfill its intermediary function. The consequences of this constriction are obvious, also for the profitability of the banking business, the latter being from several viewpoints a far from negligible prerequisite of efficiency in the banking system.

It is well understandable therefore that the banks interpreted "reconstruction" of the banking structure to mean restoration of their previous status and return to a deposits-note circulation ratio not much different from and possibly larger than that of the pre-war. Fully legitimate, therefore, was the tendency of the individual banks to expand their deposits by all means, not to say at any cost, in order to restore their former credit potential. Indeed, this tendency could well be considered as in the general interest since only by recovery of the individual banks could the banking system as a whole increase its contribution to meet the

financial requirements of economic reconstruction.

3. — In truth, there were and possibly still are some doubts as to the possibility of such a recovery in the deposits-note circulation ratio, a recovery which at the end of 1944 would have required trebling the volume of deposits, assuming that the emission of banknotes remained unchanged.

The traditional concept—which, from the presupposition that deposits and the formation of new savings must have an almost invariably parallel increase, concludes that an increase in bank deposits normally entails a corresponding increase in depositors' savings—has not, in fact, been completely dismissed. And drawing from savings, under the circumstances of this post-war economy, which has suffered a heavy curtailment of income and consequently of saving capacity, the huge amounts required to restore bank deposits to their former proportions would have had and would still have highly problematic results.

However, a mistaken assumption was implicit in this concept: the world of credit was considered as a mere sector of the world of wealth rather than as a modified reflection thereof. This means that the supporters of that concept did not reckon with the fact that although credit of any form must always have a base of tangible wealth, the same base can support a greater or lesser quantity of credit; there can be, in other words, a creation of credit out of "nothing", i.e., without any variation in the amount of wealth. Thus bank deposits, which are only a particular kind of credits, credits extended by the public to the banking system, can well increase without there being a corresponding increase in the existing amount of real wealth; sufficient that there occur a variation, according to Cannan's clear expression, in "the degree in which the banks occupy the position of intermediaries between the persons who provide capital and the persons or institutions which want to be entrusted with it" (3). In other words, it is sufficient to

(3) E. CANNAN, *Modern Currency and the Regulation of its Value*, London, 1931, p. 91.

vary the degree of the "banking mobilization of wealth", that is the ratio between the amount of deposits and the amount of real wealth existing at a given moment.

The flow of fresh savings to the banks is therefore but one of the factors which can result in a variation in the volume of bank deposits. But these, we repeat, can and normally do vary without requiring a corresponding formation of fresh savings, either voluntary or forced. The variation in the amount of deposits is also and above all dependent on the changes made in the distribution of pre-existing savings among the various types of investments; deposits may increase even without an influx of fresh savings if there be an increase in public preference for bank deposits to other forms of investment, among which is of course included the holding of banknotes. This is what is meant by saying that it is sufficient to vary the "degree of banking mobilization" of the existing wealth.

Under the specific circumstances referred to—the rapid expansion of note circulation—the increase in deposits required for the desired recovery is an increase expressed in monetary terms, and not a "real" increase; as such, references to existing wealth should be made only with its expression in current monetary terms rather than in its real value.

We thus bring into the picture not only savings from current income, which already and of themselves are likely to expand considerably with the expansion of currency and prices, but above all "savings" from gains resulting from the revaluation of existing property. At the same time these revaluation gains may result in a variation of the "degree of banking mobilization" of the existing wealth: as the existing real wealth becomes adjusted to the changing value of money, the individual owners of this wealth acquire a correlated possibility of monetary "savings" which can result in an increase in the "degree of banking mobilization" if and as the revalued capital is converted into currency deposited at a bank.

This may occur, and under the above circumstances we think that it does occur to a large extent, not only for wealth that is capital

in the strict sense of the word, such as manufacturing materials held by producers, but also for durable consumer goods held by consumers.

Thus, for instance, any "consumer" can increase his deposits until (deliberately or not) they reach their former ratio to the volume of banknotes held on hand, even if he realizes no savings from his current income (indeed, even if his expenses are in excess of his produced income) by simply selling an automobile, a picture, an apartment, or some other object and depositing part of the sum realized at a bank (4).

The recovery of bank deposits can therefore be considered as but one specific case of recovery in the nominal level of all the various types of assets which make up the wealth of the individual and directly or indirectly in aggregate make up the evaluation of the national wealth. It is well known that such adjustment is not immediate, that its speed varies from one asset to another; depending upon circumstances it may be faster in the field of movable property (Stock Exchange quotations, etc.) than of real estate, or viceversa. And the same may be said of bank deposits, the recovery of which, as for any other asset, should therefore not be considered as necessarily dependent upon an increase in the public's desire and capacity to save.

4. — These considerations explain why during 1945 and '46 the volume of bank deposits could register an increase noticeably exceeding the increase of note circulation.

Actually, because of the serious doubts entertained as to the reliability of the evaluations of real income and consumption in those years, it is rather difficult to determine whether the increment in monetary income was really being derived from savings on current income. Among the many conjectures, the correct one

(4) If the purchaser pays in bank money and he (or others in his behalf) does not resort to bank credit to procure it, there is no increase in the over-all volume of deposits. The same must be said of deposits made by individual consumers as savings from current income that involve no change in the "degree of banking mobilization". This results from the fact that an almost equal increase in credits extended by the banks may be a necessary, even if not sufficient, condition for the increase of bank deposits.

may be that for the economy as a whole the aggregate of the various kinds of savings could not have exceeded the total value of foreign remittances, and these remittances, considering their actual yield in lire, are lower than the increase in bank deposits. However, during the two years considered, and especially in 1946, revaluation of various property assets has progressed rapidly, and it is with this revaluation that we can rightly connect the increase of bank deposits, which totalled 157.8 milliard lire in 1945 and 314.9 milliards in 1946.

In spite of such considerable increases (63.4 per cent in 1945 and 77.4 % in 1946), the desired "recovery" of deposits, in the meaning set forth above, is still far from attained. In fact, since meanwhile new banknotes were being emitted (increase of currency: 22 % in 1945 and 31.5 % in 1946), although the deposits-note circulation ratio has considerably increased (from 77.9 % at the end of 1944 to 104.3 % at the end of 1945 to 140.7 % at the end of 1946), it has remained less than three-fifths of the prewar level.

5. — This confirms, of course, that the banks are still lagging behind their former status as credit intermediaries, considering the real value of the funds they have at their disposal.

However, besides considering the status and the amounts available for investment at given dates (e.g., at the end of the year), we should not lose sight of the variations and movements occurring within those dates. In fact, while on one hand an appraisal of bank funds can be of considerable interest in determining the banks' position in the sense above discussed, on the other hand the investigation of movements through time can be of no less interest in determining what degree of influence the banks exert on the dynamics of money and credit.

In this connection it is almost needless to recall that besides their credit function the banks exercise a no less essential monetary function, which consists in the mere fact that they, according to John Stuart Mill's brilliant definition, "coin" the credits entrusted to them

by the public, turning them into "bank money" especially such types as current account deposits, which can be utilized by means of checks or giro operations. In other words, besides and independently of the influence they can exert on deposits through their credit function, the banks carry out a monetary function as a result of the mere fact that they "collect" deposits. It is also needless to recall the importance that bank deposits have gradually acquired as "bank money" compared with banknotes as legal tender currency: according to Fisher's keen remark "the tail now wags the dog" (5).

In both the monetary and the credit function the most important factor affecting the economic dynamics is movements rather than quantities. The important thing is not that the volume of note circulation or bank money has reached a given level, be it high or low, but rather that it is moving with greater or less speed towards expansion or shrinkage. In other words, just as we look at the variations and not the volume of banknotes to study dynamics, so we should look at the variations and not the volume of bank deposits.

6. — From this last viewpoint it can definitely not be said that the banks have lost their importance. Far from it.

As a basis for comparison it may be borne in mind that in the pre-war period the expansion of deposits which took place in 1936 and 1937, after a period of shrinkage lasting from 1927 to 1935, was respectively 5.8 and 1.6 milliards (including interbank accounts), that is, a 12.1 per cent and a 2.9 % increase over the respective volume of deposits at the beginning of the year. In real terms, this increase even in 1936 did not reach 5 % of the national income.

But during 1945 and '46 the increase in deposits was 157.8 milliards and 314.9 milliards, which with all due allowance for the depreciated value of the lira are figures far higher than those reached before the war. This is emphasized by the percentage of increase over the volume of deposits at the be-

(5) I. FISHER, *The Money Illusion*, New York, 1930, p. 129.

ginning of the year: as shown in the Table II it was 63.4 % in 1945 and 77.4 % in 1946; and also from the order of magnitude of the increment of deposits for 1946 which can be estimated above 10 % of the national income.

TABLE II  
YEARLY VARIATIONS IN CURRENCY  
AND BANK DEPOSITS IN ITALY

Period	Yearly variations in currency		Yearly variations in bank deposits	
	Amount of increase (milliard lire)	Percentage increase	Amount of increase (milliard lire)	Percentage increase
1939	6.0	26.6	5.5	9.9
1940	6.9	24.2	11.4	18.7
1941	19.5	55.0	21.2	29.3
1942	24.3	44.3	24.3	26.0
1943	102.0	128.8	25.0	23.8
1944	138.2	76.3	705.9	74.1
1945	70.4	22.0	157.8	63.4
1946	122.9	31.5	314.9	77.4

To be sure, if we want to correctly evaluate the importance of the variations of deposits, it would be unjustified to consider only the factors outlined above. Due consideration should also be given, as we said at the beginning, to the greater money and credit requirements which were and still are being experienced in every sector of economic activity, especially in connection with reconstruction needs. But one must also proceed with caution in evaluating these greater requirements, always bearing in mind Ricardo's classical admonition that "the sum required for such purpose cannot be defined. Commerce is insatiable in its demands, and the same portion of it may employ 10 millions or 100 millions of circulating medium; the quantity depends wholly on its value" (6). In other words, as Bresciani-Turroni observed in connection with the vicissitudes of the German mark, it is not to be believed that the increase in note circulation (and therefore, we add, in bank money) are a consequence rather than a cause of inflation because of the mere fact that

(6) D. RICARDO, *Reply to Mr. Boisjquet's Practical Objections on the Report of the Bullion-Committee in The Works of David Ricardo*, ed. John Murray, London 1852, p. 341.

these increases are preceded by price increases and therefore by greater monetary and credit requirements.

All things considered, we therefore believe that one may affirm that taking into consideration the variations in deposits, the Italian banks have acquired in this phase an influence on the monetary and credit dynamics such as they never had in the past.

7. — One then happens to wonder whether the banks have acquired this greater influence through their own actions or merely as a resultant of circumstances. This, substantially, means wondering whether the appreciable increases in deposits can or cannot be ascribed to the credit policy pursued by the banks: whether, in other words, the banks are in a position to "create" deposits at their own will.

It is understandable that in the banking field there would be no wholly clear ideas on this matter since even the major economists have contributed to render this question "confused and confusing". The acceptance as an abnormal phenomenon, or even as a determining factor in the business cycle, of the fact that deposits can, as we saw, increase without a corresponding inflow of fresh or at least voluntary savings has led to belief that besides the "true" deposits, representing real savings and allegedly acting as the "healthy" basis for the bulk of deposits, there exist "fictitious" deposits corresponding to the "cash funds" of business concerns deposited with banks (the so-called *giacenze di cassa*). And only for these "cash funds" would it be generally admitted that the volume depends upon the credit extended by the banks, as if in this relationship there were something abnormal if not improper.

It is obvious that the "cash funds" may depend on credits whenever the depositor (the bank's creditor) enjoys at the same time the bank's credit (becomes the bank's debtor). The designation of "fictitious" to these deposits is in a certain sense appropriate: the bank's assets and liabilities cancel out on this transaction without any real change in the net position of either bank or depositor. The si-

tuation is not much different if the various business concerns are considered as an entity and the banking system too as a single entity: the credit extended by any bank to any concern can be passed on to another concern, which in turn may deposit at the same or another bank its now increased "cash funds". In substance, as long as we remain within the circle of business concerns, it is apparent that the interlinking of credits which interconnects their "cash funds" in an involved network of the most varied relationships makes it possible to "create" deposits by an extension of credit.

However, if the situation is carefully analyzed, this must also be admitted as true for all other types of deposits, even the typical savings account saved coin by coin and entered in the savings book. Even these deposits—and it seems a paradox—could be considered as "fictitious" according to those same criteria whereby the deposits created in the form of "cash funds" are classed as fictitious. The credit interlinking of "cash funds" is not confined to the business circle but more or less finishes by affecting, of course to a lesser extent, the typical savers. Thus, for instance, a typical country saver who deposits his money in a rural bank can or cannot keep his deposits up to a certain figure depending on whether, buying a plow or fertilizer or whatever else, he may arrange to make deferred payments (a credit facility) with his dealer, who in turn is or is not in a position to grant this facility depending on whether he can obtain credit from his bank with greater or less abundance and promptness.

The same is obvious for a typical city saver trying to arrange for deferred payments when buying an apartment, an automobile, a radio set, or a suit. Therefore, "creation" is not of peculiar importance to "cash funds" as compared with other types of deposits; it is not a question of setting up a contrast but only of acknowledging that in the former the phenomenon of credit interlinking can operate more promptly and intensely.

Should we then infer from this that all deposits can be created by the banks by an act of their own exclusive will? The very contrary

is true, for we must recognize that the increase of "cash funds" depends upon the same conditions required for the increase of the other deposits. In the case of the "cash funds" the good will of the business concerns keeping these amounts at the bank is required; we must always reckon with the public's "preferences" within this meaning of the term. That is, the public must prefer to extend credit to the bank and hold bank deposits rather than other types of investments, including banknotes.

Although rejecting the conclusion that the banks can create deposits at their own exclusive will, and therefore that they are capable of creating credits "out of nothing", it remains however easy to argue that for "cash funds" as well as for other categories of deposits the concession of credit by the banks can decisively influence the trend of deposits (7). Indeed, credit interlinking can in itself act as a sufficient factor in persuading the public to vary the "degree of banking mobilization" of wealth; as an outside hypothesis, anyone can have deposits at a bank while having no property at all, or even negative property, in consequence of credits extended to him by other persons who in turn are the more or less direct recipients of banking credit. Aside from the credit interlinking (which we mentioned first not because it is the most important system of deposit expansion but simply because we had started talking about the "cash funds", which interlinking is especially operative), there are also other ways by which the extension of credits can influence the increase of deposits: they can vary the "degree of banking mobilization", affect the size and distribution of the current national income, give rise to considerable development and emergency profits (such as the above-mentioned revaluation gains). It is especially on these latter possibilities of income variations, either ordinary or emergency, and upon the related possibilities of changes in the volume of voluntary savings that are

(7) Indeed, as mentioned in footnote 4 above, an approximately comparable increase in the volume of credit extended by the banks to the public can be considered a necessary, even if not sufficient, condition for the increase of deposits as a whole.

based the so-called "productivistic" conceptions of credit, in connection with which, without referring as far back as the book *La Magia del Credito Svelata* (The Magic of Credit Revealed) by the Italian writer Fuoco (1824), we would do well to recall the still living pages written by Francesco Ferrara (1857).

In conclusion, therefore, the banks taken as a system have through many different ways and methods a considerable capacity to exert a decisive influence upon the volume of deposits by means of the credits they extend to the public.

8. — In accepting the conception outlined above, we acknowledge that mutually dependent relations exist between bank deposits and credits just as in other fields of economic activity. We recognize, in other words, that the "gathering" of deposits is not a phenomenon that exists by itself, necessary as an antecedent to the extension of credits, but rather that the "gathering" process is also a function of the uses of the deposits.

However, the reference to a general interdependence among the various factors of economic activity implies that the credits and deposits interconnection is not only between themselves, as is implied by some mechanistic theories on the creation of deposits, but that one can affect the other only if, and to the extent that, other factors concur, among which, as we have already noted, a special importance is to be attached to the public's "preferences".

It may therefore be accepted that on the one hand each credit extended by the banks in whatever manner and form always gives rise to the possibility of an increase of deposits. And, on the other hand, there is no way of finding out if, in what measure, and with how much delay, this possibility actually materializes. In other words, it is impossible to deduce from the movement of deposits and credits how much of the variation of the one is to be attributed to variation in the other. However, even without arriving at quantitative estimates, it can be assumed that the larger the upward and downward swings of credit, the greater are

their chances of driving deposits in the same direction.

And therefore this discussion of how the banks employ the means at their disposition also serves to determine the direction in which they may affect the "creation of deposits". In the particular case in question, it tells us whether the banks have been instrumental in neutralizing or in aggravating the inflation of legal tender currency through the obstacles they have imposed or the impetus they have given to the expansion of bank money.

9. — Before going into such a study of the mode of employment of banking funds it should be pointed out, if not already obvious, that everything said above about deposits is also true for *assegni circolari* in circulation (8).

As shown by Table III, the volume of *assegni circolari* grew considerably faster than the volume of circulation, and more rapidly still than that of deposits: at the end of 1946 it had increased 61 times since the end of 1938, while notes emitted had increased 23 times, and the volume of deposits only 13 times.

It is therefore natural that *assegni circolari* have acquired an importance to the banking system which they never had before: while at the end of 1938 they made up only 2.3% of the total "alien funds" (*fondi dei terzi*) (9), at the end of 1946 they were up to 9.9%.

It therefore follows that the trend in the employment of bank funds should be consid-

(8) The *assegno circolare* is literally translated as "circular check", but does not correspond exactly to the instrument called by that name in English. It is a specially regulated negotiable instrument signed and issued only by duly authorized credit institutions for a specified amount and to the order of a specified person and payable at sight to the payee or indorsee at all offices of the issuing institution; the amount must be made available by the customer to the credit institution at the moment of issuing by payment through cash (the most frequent case), deposit account, or credit facilities. It is therefore quite different from an order to pay, resembling rather a promissory note; in the Italian market it has gained much importance, as a convenient and safe means of making payments and of transmitting funds from place to place (see R.D.L. No. 1345 of 21 September 1931).

(9) The outside capital placed at disposal of the banks, i.e., savings and sundry deposits and current accounts of the clients, plus *assegni circolari* in circulation.

ered in connection with the behavior of "alien funds" as shown in Table IV, and not with the behavior of deposits alone.

able increase in the so-called "available assets" (*disponibilità*) (10), not only of those deposited at the Bank of Issue in "ordinary" and "spe-

TABLE III  
"ASSEGNI CIRCOLARI" (a) IN CIRCULATION IN ITALY

End of Period	Total <i>assegni circolari</i> in circulation			Yearly variations	
	Amount (milliard lire)	Index number (1938=100)	Ratio to currency %	Amount of increase (milliard lire)	Percentage increase
1938	1.3	100.0	5.8	—	—
1939	2.1	161.5	7.4	0.8	51.5
1940	2.6	200.0	7.3	0.5	23.8
1941	3.9	300.0	7.1	1.3	60.0
1942	6.0	461.5	7.6	2.1	53.8
1943	7.9	607.7	4.4	1.9	31.7
1944	28.4	2,184.6	8.9	20.5	259.5
1945	44.6	3,430.8	11.4	16.2	57.0
1946	79.3	6,100.0	15.5	34.7	77.8

(a) See footnote 8.

10. — It is quite natural that the employment of bank funds during the war years followed the same pattern in Italy as that more

cial" accounts but also, and in amounts far from negligible, at the Treasury. These "available assets" increase by the end of 1944 to

TABLE IV  
"ALIEN FUNDS" (a) IN ITALIAN BANKING INSTITUTES

End of Period	Total "alien funds"			Yearly variations	
	Amount (milliard lire)	Index number (1938=100)	Ratio to currency %	Amount of increase (milliard lire)	Percentage increase
1938	56.8	100.0	252.5	—	—
1939	63.1	111.1	221.4	6.3	11.1
1940	75.0	132.0	211.8	1.9	18.6
1941	97.5	171.6	177.6	22.5	30.0
1942	123.9	218.1	156.5	26.4	27.1
1943	150.8	265.5	83.2	26.9	21.7
1944	277.2	488.0	86.8	126.4	83.8
1945	351.2	794.4	115.7	174.0	62.8
1946	806.8	1,409.9	156.2	349.6	77.5

(a) As stated above in footnote 9, this item (normally designated as *fondi dei terzi*) includes savings and sundry deposits and current accounts of the clients, plus *assegni circolari* in circulation.

or less followed in other countries. Considering the principal categories of bank assets and their ratio to the "alien funds" (Table V), we see that there occurred first of all a consider-

(10) *Disponibilità* ("available assets") is the practical and simplified Italian banking slang used for cash on hand and other funds which are considered comparatively liquid assets, "available" for typical bank credits, such as those deposited at the Treasury, bank of issue, and similar institutions.

50.7% of the total amount of "alien funds", as against 14.7% at the end of 1938. Less sharp variations were registered by the investments in securities, the bulk of which were Treasury bills and other State-issued securities; the percentage in these investments moved from 36.4% at the end of 1938 up to a peak of 45.8% at the end of 1943, then down to 34.2

absolute figures as well as the percentages: the over-all amount invested in credits to bank clients dropped from 79.4 milliard lire at the end of 1942 to 66.8 milliards at the end of 1943; at the end of 1944 it was only 73.9 milliards, 165.3% of the 1938 figure while notes emitted were up to 1419.9% and "alien funds" to 488%.

TABLE V  
PRINCIPAL CATEGORIES OF ITALIAN BANKS ASSETS AND COMPARISON WITH "ALIEN FUNDS"

End of Period	"Available assets" (a)			Securities (b)			Credits to clients (c)		
	Amount (milliard lire)	Index number (1938=100)	Ratio to "alien funds" %	Amount (milliard lire)	Index number (1938=100)	Ratio to "alien funds" %	Amount (milliard lire)	Index number (1938=100)	Ratio to "alien funds" %
End 1938	8.3	100.0	14.7	20.7	100.0	36.4	44.7	100.0	58.7
1939	10.4	125.3	16.5	21.8	106.3	34.5	47.5	106.3	75.3
1940	13.2	159.0	17.6	26.7	129.0	35.6	52.3	117.0	69.7
1941	14.6	175.9	14.8	39.3	189.9	40.3	66.5	148.8	68.2
1942	21.6	260.2	17.4	54.4	262.8	43.9	79.4	177.6	64.1
1943	48.1	579.5	31.9	69.0	333.3	45.8	66.8	148.8	44.3
1944	140.5	1,692.7	59.7	94.7	457.5	34.2	73.9	165.3	26.7
1945	189.4	2,281.9	42.0	143.1	691.3	31.7	160.7	359.5	35.6
1946	220.6	2,657.8	27.5	224.3	1,083.6	28.0	436.0	975.4	54.4

(a) As explained above in footnote 10, includes: a) cash on hand (*contanti*); b) sums available at sight (*risparmio disponibile a vista*, mainly current accounts with the Treasury and sight deposits at the Bank of Italy); c) time deposits with the Treasury and other Institutions (*depositi vincolati presso il Tesoro e altri Istituti*, mainly Bank of Italy) (see *Bollettino mensile* of the Bank of Italy, 1947, n. 1, Table XX, p. 38).

(b) Includes mainly Government securities (totalling 203.9 milliard lire by the end of 1946).

(c) Includes the so-called *impieghi*, i.e., the items specified in Table VI, note b, of p. 107, except since 1942 current accounts with Sections for special credits, loans of Pledge Banks and loans recoverable on salaries; these special items totalled only about 9.1 milliard lire at the end 1946.

per cent at the end of 1944. On the other hand, mainly as a counterpart to the increase in "available assets", there was a sharp curtailment in advances and other credits to clients which dropped to 26.7% in 1944 as against 58.7% in 1938.

This shows how much ground the banks had lost in their credit intermediary activity. Not only had the amount of the "alien funds", as compared with the volume of note circulation, dropped to as low as one third its pre-war level (the ratio of "alien funds" to currency emitted having dropped between the end of 1938 and 1944 from 252.5 to 86.8%), but hardly one-quarter of this curtailment was invested in advances and other credits to clients, as against three-quarters thus invested in the pre-war period. This decrease is shown in the

It was quite reasonable that the banks should tend to revert to previous proportions among the various kinds of investments. It was quite natural for the individual banks to interpret "reconstruction" as meaning not only the return to their former deposits-note circulation ratio but also the restoring of the former ratio between the credits extended to clients and the volume of the "alien funds".

And it is therefore easy to see why subsequent "recovery" of bank lending activity in 1945 and '46 was received with unalloyed satisfaction, and not only by banking circles; why, in other words, it was considered significant evidence of the mighty contribution which the banking system through its own recovery was capable of giving to the general economic reconstruction. During these two years, as we

already mentioned, not only did the banks fill a substantial proportion of the gap between the level reached by the note circulation and the new level of deposits, but they also reverted with unexpected speed towards their former proportions among investments. By the end of 1946, advances and other credits to clients had actually reached 54.4% of the "alien funds", a percentage twice as high as in 1944; and their absolute amount had increased 6 times from 73.9 milliardi at the end of 1944 to 436 milliardi at the end of 1946.

11. — Evaluation of this behaviour cannot but leave one perplexed if, instead of considering, as we have so far done, the amount of the various investments at the various dates, we consider the variations gradually registered by these investments: instead of considering how much importance the banks were able to recover in their credit intermediary function, we consider the amount of influence the banking system was in a position to exert upon the dynamics for currency and credit.

It is clear that the influence exerted during 1945 and '46 was opposite to that exerted during the war years. During the war, as shown by the figures on Table VI, the variations of advances and other credits to clients were extremely modest, and in 1943 even negative, as was mentioned above. At that time banking

activity, either deliberately or unintentionally, tended to neutralize growing inflation in bank-note emissions. Following the reasoning used in discussing the creation of deposits, one may come to the conclusion that this limitation of credits has served to brake rather than encourage the expansion of deposits. In other words, the initially pointed out sharp decrease in deposits as compared with note circulation is also to be attributed to the limitation of credits on the part of the banks. And thus, in a certain sense and measure, the expansion of legal currency could be, at least partially, counterbalanced by controlling the volume of bank money.

During 1945 and '46 the reverse phenomenon took place, and this too, in a certain sense and measure, could be considered unavoidable. Actually, if the banks were to recover their former positions, including their former distribution of investments, it was unavoidable that the increase in credits to bank clients should absorb a larger portion of the increase of deposits than in preceding years. It was not necessary, however, that the "recovery" in distribution of investments took place at the same time as the "recovery" in the deposits-note circulation ratio, and much less so for the said "recovery" of investment distribution to take place with such a fast "crescendo" as first appeared in 1945 and reached its peak during the second half of 1946.

YEARLY VARIATIONS IN PRINCIPAL CATEGORIES OF ITALIAN BANKS ASSETS AND COMPARISON WITH "ALIEN FUNDS"

TABLE V

Period	Yearly variations in "available assets"			Yearly variations in securities			Yearly variations in credits to clients		
	Amount of increase (milliard lire)	Percentage increase	Ratio increase to increase in "alien funds" %	Amount of increase (milliard lire)	Percentage increase	Ratio increase to increase in "alien funds" %	Amount of increase (milliard lire)	Percentage increase	Ratio increase to increase in "alien funds" %
1939	2.1	25.3	33.3	1.1	5.3	17.4	2.8	6.3	44.4
1940	2.8	25.0	33.5	4.9	22.5	11.2	4.8	10.1	40.3
1941	1.4	10.6	6.2	12.6	47.2	56.0	14.2	27.2	69.1
1942	7.0	47.9	26.5	15.1	38.4	57.2	12.9	19.4	48.9
1943	26.5	122.7	98.5	14.6	26.8	54.3	— 12.6	— 15.9	— 46.8
1944	92.4	192.1	72.8	25.7	37.2	20.3	6.1	9.1	4.3
1945	48.9	34.8	28.1	48.4	51.1	27.8	86.8	117.5	49.9
1946	31.2	60.7	8.9	81.2	56.7	23.2	275.3	171.3	78.7

It is enough to remember that, during the peak expansion of bank credits registered before the war (1936), the increment was 2.2 milliard lire compared with a total volume of credits to clients in the vicinity of 40 milliardi, while the increment in the 1945 expansion was 86.8 milliardi and in the 1946 expansion 275.3 milliardi, corresponding respectively to 147.5 per cent and 171.3% of the volume of credits at the beginning of the year. And, as for the "crescendo" of credit granting, it is sufficient to notice that, during the third (or fourth) quarter of 1946, the percentage of increase for some of the principal banks was 3 times that of the first quarter.

Of course, the increased reconstruction needs in themselves called for appreciable increases in bank credits. However, we cannot overcome the suspicion that under the various circumstances that physically limited economic activity—lack of electric power, raw materials, etc.—the increase of credits may have gone beyond the actual needs. Or rather, we cannot reject the possibility that it was this very increase of credits which, as per Ricardo's above-quoted admonition, caused the increased requirements of business activity under the most varied aspects inasmuch as it mostly resulted in price and wage increases and a correlated acceleration in the revaluation of capital property, including stocks.

12. — This tends to confirm, based on a study of the employment of banking funds, what has been said based on the study of the "gathering" of deposits. It is true that the banks have lost importance as regards their position in the credit intermediary system, but at the same time—and especially during the second half of 1946—they have acquired an unprecedented importance in the influence they can exert on the dynamics of currency and credit. In Italy too the tail may have wagged the dog.

Actually, the credit expansion, considering its amount and rate, could not but affect the creation of deposits in the sense amply set forth above. Besides other reasons, we saw (para. 3) that the increase of deposits may be considered as one particular case of the reval-

uation of property assets. And we have also suggested (para. 11) that the successive waves of credits inserted by the banks into the productive process may have substantially contributed to this revaluation. Under few other circumstances, perhaps, could the creation of deposits have had such a decisive effect as it may be presumed to have had in Italy during 1946. The expansion of credits would have therefore been the propellant factor in the expansion of deposits, so that the inflation of legal tender currency was accompanied and even out-run by a no less serious inflation of the bank money.

This occurrence could have been avoided, or at least reduced to almost negligible proportions, had the "recovery" in the distribution of investments, that is, in the increase of credits to clients, been kept under control as long as the "recovery" of the deposits-note circulation ratio was in progress, i.e., while the increase in deposits was following an upward trend (11).

It may even be wondered whether one of these "recoveries" is not incompatible with the other. Or at least it cannot be believed that the "recovery" of the deposits-note circulation ratio can be permanently achieved as long as there is a "crescendo" in the emission of banknotes. Such recovery did take place from 1944 to 1946 inasmuch as from 1944 to 1945 currency was being emitted at a decreasing rate (see Table II): from 128.8% of the initial volume in 1943 the increase dropped to 76.3% in 1944 and to 22% in 1945. It is possible, although over-all data are still unavailable, that the "recovery" of this ratio had already ceased by 30 June 1947 as a result of both the increase

(11) It can be argued that the limitation of credits advocated, apart from the influence which it could have exerted on deposits, would also have been instrumental in preventing the bulk of the new emission of banknotes. In fact, had the 1946 increases of the "alien funds" been distributed in the same percentages as in the preceding year (see Table V), the amount of credit extended to clients would have increased by only 174.5 milliardi instead of 275.3 milliardi, while the difference of a little over 100 milliardi would have been distributed among investments in securities and *disponibilità*, in either way resulting in a correspondingly lower issuance of banknotes. The issuance, in this case, could have been kept within less than one-fifth of the amount actually reached (122.9 milliardi). In any event, even if allowance is made for the probable reduction of deposits, a limitation of credits could have appreciably reduced the emission of banknotes.

in the emission of notes and of the opposing declining rate of deposit increase.

This conclusion would also be consistent with the fact that, with just this intention of preventing the piling of a credit inflation on top of a monetary inflation, it has already (second quarter of 1947) been necessary to consider the advisability of restricting the extension of credits — and such restriction has actually occurred. It is not beyond possibility that this policy of restrictions may be further extended in order to face the expected decrease of deposits; but, in so doing, while each individual bank would be following the "sound" rules of traditional banking policy, the banking system as a whole would be running after its shadow: endeavoring to counterbalance the reduction of deposits by reducing credits, which very initiative in addition to other factors would further reduce deposits.

And thus the banks would once again exert a dominating influence upon the dynamics of currency and credit: they would be causing, even with the best intentions of checking inflation, a true credit deflation that would be no less harmful than the inflation they proposed to fight.

13. — What conclusions can we draw from the analysis, perhaps overly spelled out, of the preceding paragraphs? In truth, they are all but farfetched.

First of all, it is to be stressed that the banks have the greatest interest in preventing monetary and credit inflation. Only by stopping inflation can they recover their former importance in their essential function as credit intermediaries. Needless to repeat, it would be vain for them to hope to recover that importance without preventing, in proper manner and in due time, an excessive expansion of their credits — and it would also be vain to hope to rescue the situation by pursuing a contrary policy of credit contraction.

This leads to the stressing of another fundamental aspect of banking policy, which is that while in other fields Adam Smith's thesis

may still be valid, that the best interests of all individuals are served by each individual operating for his own private benefit, in the banking field this does not apply. No matter how much each banking institution seeks its own good, maintaining the most scrupulous compliance with its duties, the banking system as a whole can cause, or at least intensify, the "seesawing" to the opposite phases of the cycle with all those serious disturbances of the general economic activity which are nowadays rightly considered so important, especially as regards employment.

As far as this question is concerned, it may be said that a general agreement has been reached in the field of general economic policy, whatever the "creed" of the individual economist. It was Hayek, the staunchest supporter of economic freedom, who represented an uncontrolled banking system as a cart travelling down a road bordered on each side by walls, which instead of keeping to the middle of the road, proceeds by bumping back and forth from one wall to another (12).

All feel that this should be prevented, and this, proceeding from the metaphor to the concrete, means that banking policy must be governed by an integrated understanding of the over-all needs, especially those that affect the dynamics of currency and credit. It means that those who are responsible for banking policy must be given, through an appropriate choice among the various technical possibilities, the "levers" necessary to implement their functions.

This, to be sure, will impose restrictions on the initiative of the individual institutions. But these restrictions, on the basis of what has been said above, rather than braking the opportunities of each bank, should serve to ensure a more steady and consistent progress, so that the individual bank and the banking system as a whole may effectively and stably recover and even-increase their former importance.

(12) F. A. von HAYEK, *Profits, Interest and Investment*, London, 1939, pp. 90-91.