

Mario Draghi: Overview of economic and financial developments in Italy

Concluding remarks by Mr Mario Draghi, Governor of the Bank of Italy and Chairman of the Financial Stability Board, at the Ordinary Meeting of Shareholders 2009 – 116th Financial Year, Bank of Italy, Rome, 31 May 2010.

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Ladies and Gentlemen,

The reorganization of the Bank of Italy's branch network to enhance the efficiency of its essential functions, which was begun in September 2008, proceeded on schedule last year. A total of 39 of the original 97 branches have ceased operations, and another 25, specializing in services to users, have been streamlined. In six provinces detached units of the corresponding regional branches have been instituted to perform banking and financial supervisory functions. The reorganization is to be completed this year with the specialization of six branches in cash handling. Permanent savings of some €80 million a year have been achieved.

The systematic revision of organizational arrangements and operating processes that was begun in 2007 continued at the central administration as well, last year focusing on banknote production. The use of more advanced technology and the changeover to simpler procedures produced gains in efficiency and in the quality of services to the banking system and to citizens.

In a year of economic and financial crisis and of management and operational challenges to our organizational structures, the skill and dedication of the staff have been decisive.

The Bank of Italy will contribute to next year's celebration of the 150th anniversary of Italian unification with two initiatives.

A research project entrusted to Italian and foreign historians, economists, and legal scholars will examine the ability shown by our economy to adapt to changes in the international environment over the past century and a half.

Next spring we will hold an exhibition on Italian monetary unification – a little known but crucial aspect of the broader process of national unification.

The evolution of the crisis and international cooperation

Twenty months ago the collapse of Lehman Brothers opened up grim prospects for global finance and the world economy. The action of monetary authorities and governments staved off the collapse of confidence among financial operators, savers, investors and consumers. In the G7 countries as a group, public financial support for the economy exceeded 5 percentage points of GDP in 2009. Real short-term interest rates turned negative and the central banks provided unprecedented volumes of liquidity.

Output declined by 2.4 per cent in the United States, 4.1 per cent in the euro area, and 5 per cent in Italy; GDP continued to expand in the emerging economies, although slowing to growth of 2.4 per cent.

This year the leading international institutions predict that world output will grow by more than 4 per cent. However, this is the average of widely disparate rates: high in the emerging economies, above all China; substantial in the United States and Japan; and weak in Europe, where output is still well below the pre-crisis level.

Government budget deficits and public debt have spiralled. Relief at having avoided catastrophe has given way on international financial markets to apprehension about the sustainability of growing sovereign debt. Sales target the government securities of countries

with large budget deficits and high levels of public debt, in particular those that combine these two characteristics with weak economic growth. The weaker this growth, the more exacting and pressing are the demands by international investors for a rapid adjustment of imbalances in the public finances.

These countries have no alternative but to map out promptly a path to restoring budgetary equilibrium, with a reallocation of current expenditure and with structural reforms aimed at raising potential output and competitiveness.

These are difficult courses of action and unless coordinated at international level they risk extinguishing the hesitant recovery. The crisis has attenuated, not eliminated, the worrying geographical imbalances in world demand. The curbing of debt and increase in saving in the United States and some European economies are compressing consumption and investment; they should be offset, more than is already happening, by stronger expansion in domestic demand in the countries that have built up large external surpluses. In Pittsburgh last year the G20 launched an ambitious programme of multilateral surveillance of macroeconomic and structural policies. It is important that this be translated into concrete strategies to restore balance and support growth. However, it is probable that the process will not be rapid; the deficits will need to be financed, requiring sound and transparent markets.

Lessons from the crisis

The roots of the crisis that has beset the world for nearly three years lie in regulatory and supervisory deficiencies in the main financial centres. The expansionary monetary policy conducted by the United States from the end of the 1990s helped to create a financial environment conducive to the explosion in private debt and the aggravation of global imbalances; these factors heightened the effects of the crisis and fostered their transmission. Clear indications derive from this for the future, regarding both the system of financial regulation and monetary policies.

From the start of the crisis the Financial Stability Board was entrusted by the world's highest political authorities with responsibility for designing the regulatory framework in which the financial industry will operate in the years to come. On several occasions I have described the guidelines that continue to inform this plan; how they draw from the diagnosis of past weaknesses a model for present and future action; and how the ultimate objective of this work is to make the system more resistant to crises. Some crises may be prevented, others will be inevitable; but we can take action to limit their damage and contagion.

The agenda develops in four directions:

- (i) draw up general rules for the banks: a more robust capital base, lower financial leverage and control of liquidity risk are the pillars of this;
- (ii) introduce specific provisions for systemic intermediaries designed to reduce the likelihood of their failing, enable their orderly administration if this should happen, and prevent contagion;
- (iii) reduce the importance of ratings in supervision, while simultaneously increasing the competition between rating agencies and exercising effective control over the integrity of their decision-making and the transparency of their evaluations;
- (iv) increase the transparency of trading on regulated financial markets; and bring over-the-counter markets back within a framework of universally accepted rules that impose standard contracts and the settlement of trades with central counterparties that are subject to supervision.

The first set of reforms requires the utmost international convergence, otherwise regulatory arbitrage and market integration will preclude their effectiveness. For the second set it would

be more appropriate to talk of minimum harmonization: all countries should adopt measures in respect of systemic intermediaries, but it is illusory to imagine that the method and timing of their implementation will be the same across countries because differences in institutions, markets, business models and economic history are too great. Only when governments and regulators can allow the institutions that deserve to fail to do so without causing a catastrophe such as that following the collapse of Lehman Brothers will they have regained true independence from the financial services industry.

In the United States an ambitious project to reform the regulation of the financial system is taking shape; for the aspects bearing most closely on international cooperation it is in line with the agenda of the FSB, whose work is proceeding according to schedule. However, this year's appointments will be decisive. The most important deadline is the presentation to the G20 Summit in Seoul next November of the new rules reforming the Basel II Accord.

The financial industry contends that the regulatory reform could impede the recovery. But the application of the new rules will be gradual and will not begin until the recovery has gathered force. The changeover to the new definition of banks' capital will be long enough to render its effects on banks' market value and on credit negligible during the transition. It is important that the difficulties of the moment not lead to a loosening of the long-term objectives, which must be kept firm.

The experience of the crisis also influences the design of monetary policies. Their objective continues to be price stability, but they must be more prepared to counter developments in credit and money that can fuel financial disequilibria, even in the absence of immediate inflationary dangers.

Our analyses, among others, show that in order to attenuate the volatility of credit, financial asset prices and economic activity it is also necessary to prepare instruments such as countercyclical variations in banks' capital requirements or in loan-to-value ratios. This is what is known as macroprudential policy. The central banks must play a role in designing and implementing it.

In times of severe crisis the balance sheets of financial intermediaries are altered and, with them, the monetary policy transmission channels. The constraints on the availability of credit, which are only marginally binding in normal times, become stringent when the markets do not function in an orderly manner; support for credit has a much greater effect on the economy than the expansion of the monetary aggregates. Changes in the size and composition of central banks' balance sheets have proven useful in the efforts to stabilize the markets. This is what the ECB has done and is doing.

The euro area

Euro-area monetary policy has been strongly expansionary for some time. It has ensured orderly conditions in the credit system and provided support for the recovery of the economy in a context of moderate inflation expectations firmly anchored to price stability.

The exceptional liquidity expansion measures averted a systemic crisis; they pushed down interest rates in the money market and helped to reduce those on loans to firms and households. In order to extend intermediaries' access to funds, refinancing operations were conducted at a fixed rate and with full allotment of the amounts requested; the range of financial assets eligible as collateral was widened; the maturity of operations was lengthened to twelve months. At the end of last year, the Governing Council of the ECB, while not renewing some exceptional measures it deemed no longer indispensable, continued to provide all the liquidity necessary to support the economy and the financial system.

But in the last few months the consequences of the crisis have tested the cohesion of the euro area. The massive creation of public debt, in a phase in which extraordinary quantities of bank bonds are falling due on the markets, suddenly increased the risk premium on some

sovereign debtors. For Greece, the question had been posed for some time: the loss of credibility of the public finances, the magnitude of the budget deficit, the public debt and the external current account deficit, low growth, and the country's weak industrial structure and unsustainable wage dynamics were pitching Greece into a fiscal crisis that the country's authorities were slow to recognize.

Just as in the case of American private debt, political indecision and the absence of crisis resolution mechanisms aggravated the situation. In the Greek case the difficulty of finding a European accord on a rescue plan, but also the unavailability of a process permitting orderly management of the debt crises of sovereign states, amplified the damage and the contagion and at the same time heightened moral hazard.

What was paralyzing the markets was the prospect that Greece's fiscal crisis might lead, through a deterioration in the quality of collateral, to a collapse of the country's banking system, which would no longer have had access to ECB refinancing. In addition, there were fears for other countries' banks with large exposures to Greek counterparties. The risk was becoming systemic: interbank liquidity was evaporating, the stock markets were plunging.

The ECB and the national central banks intervened promptly, maintaining the option to accept lower-rated collateral; reactivating the unlimited supply of liquidity in long-term refinancing operations; and initiating, with the Securities Markets Programme, purchases of securities in order to resuscitate markets that had become illiquid. The governments of the euro-area countries and the European Union, in agreement with the International Monetary Fund, allocated €110 billion for loans to Greece and prepared a mechanism able to mobilize up to €750 billion in financial assistance to euro-area sovereign debtors hit by a liquidity crisis, with a contribution of the IMF. The beneficiary countries will have to draw up adjustment programmes which, if approved by the European Council, will be subject to periodic verification.

In evaluating the exceptional circumstances that justified intervention in the government securities market, the Governing Council of the ECB considered that the functioning of the monetary policy transmission mechanism was endangered and the stability of the euro's financial system at risk. The ECB sterilizes these interventions, which do not finance public deficits. Its independence is not in question.

These measures will have to be discontinued as quickly as possible, as soon as the markets spontaneously resume trading of the securities of the countries involved. This will require rapid, significant and discernable progress in adjusting government budgets and the fully operational status of the financing mechanism set up by the European Union and the IMF.

But enduring stability of the markets can only come with the resumption of growth, for it must not be forgotten that this crisis is above all a crisis of competitiveness.

The recent events pose, again and more powerfully, the old problem of European economic governance.

A strengthening of the Stability and Growth Pact is urgent. The commitment to achieve a structural budgetary position in balance or in surplus must be made cogent by introducing sanctions, including political sanctions, for non-compliance; the accuracy of statistical information, particularly public finance statistics, must be ensured.

Cogent constraints and commitments must also be introduced for structural policies. The disparities we have been witnessing for some time in actual and potential growth rates and the seriousness of the imbalances in intra-area trade in goods and services signal inadequacies and inconsistencies in national policies. Some objectives of public action to enhance economic growth in the long run, for example those bearing on the labour market participation of both the young and the old and on competition in the markets for services, should be accompanied by controls and, in some cases, sanctions.

The Italian economy

In the two years 2008–09 GDP contracted by 6.3 per cent, almost half the entire growth achieved in the ten preceding years. Households' real income diminished by 3.4 per cent, their consumption by 2.5 per cent. Exports fell by 22 per cent. Rapidly spreading uncertainty and the deteriorating outlook for demand led firms to cut investment, causing it to contract by 16 per cent. Wage supplementation rose to 12 per cent of total hours worked in industry at the end of 2009. Employment decreased by 1.4 per cent, the number of hours worked by 3.7 per cent.

Some 9,400 firms became involved in bankruptcy proceedings in 2009, a quarter more than in the previous year. The firms hardest hit are the smallest ones, which often depend on subcontracted work. Those that had embarked on restructuring before the crisis have withstood its effects better and now have the best prospects. According to the Bank of Italy's periodic survey, they expect their turnover to increase in 2010 by 3 percentage points more than that of comparable firms that had not restructured. Industrial firms with 50 or more employees that had invested in R&D in the three years preceding the crisis expect their turnover to increase by more than 6 per cent.

Economic policy limited the damage, containing the fall in GDP by an estimated two percentage points, of which about one point can be attributed to monetary policy, half a point to the automatic stabilizers built into the budget and the rest to the recomposition of revenue and expenditure enacted by the Government. The extension of income support programmes attenuated the immediate costs of the crisis. The increase in the budget deficit was smaller than in the other main advanced economies, thanks in part to the solidity of the banking system, which did not need significant public support. In the other G7 economies this amounted to 3.8 per cent of GDP on average.

At the beginning of this year it was estimated that the Italian economy would return to the, albeit modest, growth of the ten years preceding the crisis. In the first quarter GDP grew by 0.5 per cent compared with the previous quarter; there was an improvement in the opinions of firms, especially exporters, regarding the performance of orders and their expectations for production. Destocking appeared to have come to an end.

The explosion of the Greek crisis could change the outlook. Some European governments have taken action to reduce their budget deficits.

The Italian Government has reaffirmed the objective of bringing the deficit below the threshold of 3 per cent of GDP by 2012, confirmed the commitment to achieving budgetary balance over a longer time horizon, and brought forward the formulation of the adjustment measures for 2011–12. According to the official estimates, the measures recently approved by the Council of Ministers will reduce the baseline budget deficit in 2012 by €24.9 billion; the measures bear on the main items of expenditure and focus on the operating costs of the public administration. The package is intended to slow the annual growth in primary current expenditure to below 1 per cent in 2011 and 2012, thereby reducing its ratio to GDP by more than 2 percentage points. Over the last ten years expenditure expanded at an average annual rate of 4.6 per cent and rose by nearly 6 percentage points in relation to GDP. Careful monitoring of the effects of the package will therefore be needed to ensure the objectives are achieved.

Italy's financial structure has many strong points. Household wealth, net of debt, is nearly 2 times GDP, considering just the financial component, and about 5.5 times GDP, including real estate. These levels are among the highest in the euro area, while the household debt ratio is among the lowest and that of firms is below the average. The net external debt position of the entire economy can be estimated at 15 per cent of GDP, one of the lowest values in the euro area, except for Germany, which has a large credit position.

The ratio of public debt to GDP declined by 18 percentage points between 1994 and 2007. In the last two years of recession it increased by 12 points, to stand at 115.8 per cent. In the

new market conditions action had to be taken even though the budgetary tightening adversely affects the prospects for economic recovery in the short term.

Competitiveness and growth

In the Monetary Union stagnation, unemployment and, in the long run, budgetary strains are the inevitable consequence of the loss of competitiveness. The consolidation of the public finances needs to be accompanied by the revival of growth.

In the ten years preceding the crisis hourly productivity rose by 3 per cent in Italy, by 14 per cent in the euro area. In the same years the economy grew by 15 per cent in Italy, as against 25 per cent in the euro area. Italy's employment rate remains low, 57 per cent in 2009, 7 percentage points less than in the euro area as a whole. The gap is wider for the young and reaches 12 points for women.

On many other occasions we have addressed the question of structural reforms. The crisis makes them all the more urgent: the fall in GDP increases the burden of financing the public administration; the costs imposed by tax evasion and corruption become even more unsustainable; stagnation destroys human capital, especially among the young.

The management of turnover in the public sector and the cuts in the discretionary expenditure of government departments recently decided by the Council of Ministers must provide the opportunity to rethink the scope and structure of government, rationalize resource allocation and reduce waste and duplication between different entities and levels of government. A reform plan covering the entire public sector is needed, to accompany the measures already adopted to raise the productivity of the public administration by evaluating the performance of managers and the results of individual units.

Fiscal federalism must enhance efficiency in the use of resources. Only a strong budgetary constraint, together with the necessary taxing power, can make the fiscal cost of each decision transparent and cost centres accountable. The specification of the standard costs and financial needs with which central government transfers will be commensurate, with the necessary solidarity component, will need to refer to best practices. Each entity will have to balance its budget, net of investment expenditure, as laid down in Article 119 of the Constitution. The total amount of local investment expenditure must be fixed for a multi-year period, in accordance with the objectives for general government net borrowing. Continuing along the lines laid down for the regions with healthcare deficits, the system of constraints and disincentives for non-compliant entities will need to be strengthened.

But the budgetary rules are not sufficient to guarantee efficient use of resources. Clear and comparable information is needed on the quality of the services provided by the various entities so that single administrations can locate the weak points in their own systems, citizens can evaluate the performance of administrators, and the State can apply sanctions, including the power to take over the management of entities that fail to guarantee essential service levels. Costs and results vary enormously between entities providing the same services; this indicates that there is substantial scope for improvement. But today we are beginning to get the data needed for evaluation and concrete action.

A number of initiatives are moving in this direction. The Ministry of Health has drawn up an experimental set of indicators for healthcare quality, efficiency and appropriateness, both at regional level and for individual hospitals or health units. The Ministry of Education has introduced standardized tests into student evaluations to increase the comparability of the marks awarded and their weight in evaluating teaching effectiveness. The High Council of the Judiciary has identified a methodology to define standard workloads for judges as a tool for assessing their productivity.

Tax evasion is a brake on growth because it imposes higher taxes on those who do pay; it reduces the resources for social policies and obstructs interventions in favour of low-income

persons. The tax wedge on labour is about 5 points higher than the average for the other euro-area countries; the tax rate on low labour incomes and the corporate tax rate, including the regional tax on productive activities, are 6 points higher. Istat estimates that the shadow economy amounts to 16 per cent of GDP. Comparing national accounts data with tax returns, it can be estimated that between 2005 and 2008 30 per cent of the VAT tax base was evaded: in terms of tax receipts, this is more than €30 billion a year, 2 points of GDP.

The Government has introduced measures to combat tax evasion. The immediate objective is to contain the deficit, but in the medium term the reduction of evasion must be a lever for growth by allowing tax rates to be lowered; the connection between the two must be made visible to taxpayers.

Corrupt dealing between private agents and general government, in some cases encouraged by organized crime, is widespread. In the international rankings that are compiled periodically, Italy stands further and further down on the list. Empirical studies show that corruption impedes economic growth. There is a close connection between the density of organized crime and the level of development: in the three regions in the South where 75 per cent of Italy's organized crime is concentrated, per capita value added in the private sector is only 45 per cent of that in the Centre and North.

Action to prevent and combat money laundering continues. The Financial Intelligence Unit and the Bank's Supervision Departments have intensified cooperation with the judicial authorities and the law enforcement forces, especially in cases where there is a close connection with criminal investigations.

The crisis has exacerbated the difficulties of young people in the labour market. In the 20–34 age group, the unemployment rate reached 13 per cent on average in 2009. The fall in the employment rate of younger workers with respect to 2008 was almost seven times that of their older counterparts. This was due both to the more widespread use of fixed-term contracts for young people and to a contraction of 20 per cent in new hiring. For some time now, the gap in employment conditions between the new generations and their predecessors has been widening to the disadvantage of the former. Entry-level wages have stagnated for fifteen years in real terms.

A slow recovery increases the likelihood of persistent unemployment. This condition, particularly at the start of one's working life, tends to be linked to permanently lower earnings later on.

The reform of the labour market must be completed, overcoming segmentation and stimulating participation.

Young people alone cannot cope with the growing burden of an ageing population. Nor will the contribution of foreign workers suffice. Only 36 per cent of Italians aged between 55 and 64 are in employment, against a European average of 46 per cent, and 56 per cent in Germany.

In Italy in the last thirty years, against a lengthening of more than five years in life expectancy at age 60, the average age at retirement in the private sector is estimated to have risen by about two years to around 61. Working life will have to be extended, partly to guarantee an adequate standard of living to the older people of tomorrow. The countries in Europe with the highest employment rate in the 55–64 age group are also those with the highest youth employment.

In 2009 the Government took an important step by automatically establishing a link, from 2015, between the minimum retirement age and changes in life expectancy; a regulation now being drafted will implement this provision. Actions on the so-called retirement "windows" and on regulations for women employed in the public sector move in the same direction. INPS has launched initiatives to give better information to workers about their personal pension position. The process of pension system reform could be completed by measures that gradually standardize the retirement age among different groups of workers, speed up

adjustments to the transformation coefficients of the contributions-based system, and provide greater retirement flexibility.

Banks, supervision

Lending to firms declined by 3.7 per cent on an annual basis between September and December 2009. In 2010 the pace of the contraction eased and in the three months ending in April came to 1 per cent. The sharpest decline has been in northern Italy, where industrial activity is most intensive; lending to firms in the South has begun to grow again. Credit to households has continued to expand, albeit slowly.

Last year's credit contraction largely reflected the weakness of demand for loans, but there were also supply-side tensions. According to the Eurosystem's Bank Lending Survey, these gradually eased from mid-2009 onwards. We recently conducted the survey at regional level, expanding the sample; the results indicate improving supply conditions in the early months of this year in the North-West and the South.

In Italy, as in other countries, the quality of bank loans deteriorates during recession. In 2009 the loan losses of our five largest banking groups absorbed almost 70 per cent of their operating results; their profits fell by over a fifth. The trend, though moderating in early 2010, has continued and is affecting smaller lenders too, who were less badly hit in the early stages of the crisis.

With the onset of the Greek crisis, acute liquidity strains in the interbank market have returned after subsiding last year. Transactions are mostly very short term. There is a large share of collateralized contracts, a tendency to deal with domestic counterparties and frequent recourse to bilateral trades. Banks must be prepared to face recurrent and protracted periods of abnormal market conditions.

As more and more public and private issuers have turned to the markets, in 2011 a flurry of bank bonds are due to mature for very large amounts; banks must continue to strengthen their sources of fund-raising, including by making greater use of covered bonds.

Although 2009 was a year of reduced profits, Italian banks made encouraging progress in strengthening their capital base. Contributions came from market issues, asset divestments, dividend restraint, and injections of public capital. By March of this year the core tier 1 ratio of the five largest Italian banking groups had risen to 7.6 per cent, from 5.8 per cent at the end of 2008.

Our stress tests show that even under adverse scenarios in line with those used in comparable international exercises, such as GDP growth 3 points lower than current estimates in 2010–11, compliance with the minimum regulatory requirements and financial stability would not be at risk in Italy.

However, in the face of persistent market volatility and uncertainty over the macroeconomic outlook, capital strengthening must continue.

Preparations for the new international standards must be made. The analysis of the overall effects that the new capital and liquidity rules will have on Italian banks is still under way. The parameters must be defined; the specific regulatory provisions will be applied flexibly and with a calendar permitting a smooth and gradual transition. Capital instruments already issued based on the old rules will continue to count towards the requirement for a long time (grandfathering).

Supervisory action in Italy has several distinctive features. It does not stop at establishing general prudential principles, leaving their interpretation up to the market. Nor does it limit itself to verifying compliance with the rules. Instead, it weighs intermediaries' strategies and management; without interfering in business decisions, it verifies that governance, organization, operating processes and control systems are consistent with the risks.

Our off-site controls are supplemented by a high level of on-site supervision. In 2009 there were over 200 inspections of banks and other intermediaries. Targeted checks increased substantially. In the largest banking groups the presence of inspectors is continuous and, in cooperation with the other European authorities, is being extended to their cross-border operations.

This system of controls, together with particularly prudent regulations, proved vital in preserving banks' stability during the crisis.

The role of foundations as shareholders in banks cannot be other than that established by law: investors whose sole objective resides in the economic value of the investment. The foundations, in their autonomy, will be the first to safeguard the independence of management.

Major banks are also judged by how they are organized locally: maintaining and capitalizing on relations with the local economy means basing customer assessments on knowledge accumulated over the years, which is much more reliable than that inferable from quantitative models; it means knowing how to discern a creditworthy firm even when the data are not in its favour; it means knowing your business as a banker. The response of large banks to local needs, consistent with sound and prudent management, must be compatible with global strategies and vision.

Thorough supervisory screening of the requirements of officers of banks and other intermediaries is a fundamental instrument of control, a guarantee of stability. So is the possibility of removing those responsible for mismanagement or highly risky conduct before the situation precipitates, necessitating crisis measures against the bank as such. An extension of the Bank of Italy's supervisory powers in this direction would be welcome; supervisory authorities in major economies already have such powers. The Committee of European Banking Supervisors has proposed it and the European Commission is considering its adoption at Community level.

Customer protection is now a supervisory objective in itself. We carefully follow the implementation of our rules on the transparency of banking and financial services and on correctness in relations between intermediaries and customers.

The Banking and Financial Arbitrator, in operation since October, is an independent body that provides customers with rapid responses in disputes with their bank. The majority of the 560 decisions taken to date – on current account and consumer credit charges, mortgage portability and payment card irregularities – have found in favour of the customers.

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The crisis has reminded us, brutally, of the importance of joint action, common objectives and policies, shared sacrifices. This lesson goes for the world, for Europe and for Italy.

The reform of the rules governing finance transcends national borders. It requires consensus among a large number of different jurisdictions. But there is no alternative: a globally integrated financial services industry requires regulation that is universal, at least in its fundamental principles. The harsh experience of the last few years must not be forgotten. Excessive risks exact an extremely high price from the community. Strengthening the defences of the system is indispensable, within each country and at international level. Banking will be less profitable, but also less risky. All will benefit. I am certain that the political project launched by the G20 will succeed.

The euro area as a whole is sounder than other currency areas. Public budgets and the external accounts are more balanced. But the attack on it now under way is not directed against the area as a whole. Exploiting the opportunity offered by the unfinished state of the project, it isolates the weakest members. There is but one answer: the euro lives with all its members, large and small, strong and weak. If in the past it was an illusion to think that the currency alone could "make" Europe, today the only course of action is to reinforce the

construction of Europe: in the political sphere, with a more active government of the Union; in budgetary discipline and in progress on structural reform, with a new stability and growth pact that is at once broader and more binding.

Two years ago I devoted a good part of my concluding remarks to the persistent gap between the North and South of Italy. And it was with that examination that, in practice, the Bank of Italy began the celebration of Italy's 150 years of national unity. We are convinced that national unity must be honoured by strengthening it, ensuring its vitality and adapting it to a new era. This is not the first time in its history that Italy has been faced with an arduous collective challenge. It has faced and overcome many in the past century and a half. Let me mention two examples.

The greatest challenge of all, in terms of structural reforms, arose when Italy, immediately after national unity, prepared to participate in the life of Europe with a population that was 75 per cent illiterate, against 30 per cent in the United Kingdom and 10 per cent in Sweden. National political leaders, administrators, teachers, North and South, joined together to fight the battle for literacy. In the end we did come up to the level of the rest of Europe, and this was one of the factors behind the economic miracle after the Second World War.

In 1992 we were confronted with a much more severe budget crisis than those facing some European countries today. The government of the day presented a financial adjustment plan which, enjoying national consensus, gained credibility in the markets with no assistance either from international institutions or from other countries. The struggle was long drawn out: under a flexible exchange rate regime, three years on, spreads still exceeded 650 basis points. Yet the battle was won, because the successive governments maintained fiscal discipline: stability had been incorporated into the country's political culture.

Today's battle too – to combine fiscal discipline with the return to growth – must be fought by calling on those same values that have enabled us, together, to vanquish the difficulties of the past: the capacity to act, equity; the desire to know, solidarity. Let us take up this challenge in the awareness of the weaknesses that we must overcome but also of the considerable strengths on which we can draw.