# Mr Fazio gives an address on the Italian capital markets and the need for new strategies in Euroland

Address given by Mr Antonio Fazio, Governor of the Bank of Italy, at the Euromoney Conference, held in Rome on 23 November 1999.

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Between 1985 and 1998 the stock of public and private-sector bonds issued in the Group of Ten countries rose from 90% to 130% of their combined GDP; the market value of listed shares rose from 30% to 100%. The use of derivatives grew even faster: between 1990 and 1997 the notional value of those traded in organized markets rose from 40% to 200% of GDP.

The flow of loans granted to non-residents by banks of the countries reporting to the Bank for International Settlements amounted to $1,100 billion in 1997, or 5% of the reporting countries' GDP.

The integration of financial markets, the prospects for growth in the emerging countries and the transformation of the economies in transition have created the conditions for an increase in allocative efficiency at the global level. The constraint imposed by the scarcity of financial resources for investment has been eased, especially in the developing countries.

The growing dissociation between the generation and use of savings may nonetheless increase the riskiness of investments. Strategies aimed at maximizing profits in the short run and herding have added to the volatility of prices. Large-scale recourse to derivatives, which are extremely useful in controlling financial risks, has aggravated the adverse effects of speculative behaviour in some instances.

The new context calls for careful assessment of the adequacy of national economic policies and the efficiency of the financial system, as well as careful control of borrowers' creditworthiness and the use to which they actually put the resources they raise. In recent years intermediaries sometimes persisted in directing large volumes of resources towards countries with serious imbalances. This behaviour generated tensions and in the end led to crises.

Italy's financial system is increasingly integrated into the global economy; the adoption of the single European currency has intensified the process of integration. The return to monetary stability has created macroeconomnic conditions conducive to the expansion of the securities market. The size gap with respect to the other leading industrial countries remains to be closed.

## Bonds

The reduction at the global level in the volume of savings absorbed by public debt issues has freed resources for productive investment and contributed to the decline in interest rates.

In Europe, the elimination of exchange risk has lent special vigour to the growth of the market in private-sector securities. The volume of corporate bond issues has grown enormously both in national markets and in the Euromarket. The larger average size of issues and the standardization of their features have fostered the growth of the secondary market. In 1998, with the approach of the euro, issues denominated in ecus once more became substantial while the share of dollar-denominated issues declined.

In Italy, in the first ten months of 1999 virtually all bond issues were denominated in euros. In France and Germany, the euro's share of corporate bond issues remained somewhat lower, at 86% and 73% respectively. In the same period, the volume of bonds issued in the Euromarket by German, French and Italian residents between January and October this year was considerably larger than that recorded in 1998. This reflects the interest of issuers in gaining visibility in this new segment. The tendency for companies to make very large issues was encouraged by investors' preference for liquid assets.

The volume of corporate bond issues by Italian firms has also been boosted by the need to finance takeovers of listed firms. The issues of Italian enterprises have mostly been made through financial subsidiaries.

The additional scope provided by the adjustment of the public finances is greater in Italy than elsewhere. The growth prospects of the private-sector bond market are enhanced by the efficiency of the secondary market and the opening of new regulated wholesale and retail markets for private-sector securities. A further contribution to the development of this segment will come as banks increasingly securitize their loans.

The money market is highly efficient. The possibility of screen-based trading enables the Italian interbank deposit market to play an important role in Europe.

Italy's screen-based secondary market in government securities, MTS, is one of the most advanced of its kind. Created to facilitate the management of the public debt, this market has grown without interruption and average daily turnover has risen from Lit300 trillion in 1988 to over Lit19,000 trillion in the first nine months of 1999.

MTS bid-ask spreads are extremely narrow, averaging around 4 basis points in 1999. The operational efficiency of this market and its privatization have been conducive to its international opening: trading involves some 200 Italian and foreign intermediaries, including some with remote access.

MTS has served as a model for other European countries' government securities markets.

**Equities**

The capitalization of the Italian stock market rose from 18% of GDP in 1994 to 50% in 1999, as against 75% in France and 56% in Germany. The gap compared with the United Kingdom and the United States is very large.

At the end of 1998 there were 223 listed companies in Italy, the same number as in 1994. The composition of the official list has improved: many of the private-sector companies that have turned to the market are industrial firms and do not belong to groups that were already present on the stock exchange. In the same period the number of listed domestic companies rose from 423 to 740 in Germany, from 489 to 754 in France, and from 2,070 to 2,399 in the United Kingdom.

The development of the Italian stock market has been influenced by the large proportion of small firms and the still limited propensity of medium-sized and large companies to seek a listing.

The rise in share prices since 1994 has been partly due to the fall in nominal and real interest rates. Privatizations have accounted for the greater part of the contribution new listings have made to the market's growth.

The success of the offerings of state-owned companies' equity on the market testifies to Italian savers' lively interest in equity investment.

With domestic supply still limited, Italian savers' demand for shares has also given rise to substantial investment in foreign securities. In 1998 purchases of foreign shares amounted to around €24 billion; in 1999 they have increased further, rising to around €22 billion in the first nine months. Savings pooled in investment funds contributed substantially to the outflow of capital.

Pension funds continue to be of limited importance in Italy, whereas they play a pre-eminent role in the countries with more highly developed financial systems. Their equity portfolios are equal to about one third of total market capitalization in the United States and the United Kingdom.

The growth of the stock market in Italy over the last five years has benefited from legislative innovations and tax incentives. Far-reaching measures have improved the organization of the market, considerably increasing the liquidity and transparency of trading. In 1998 the ratio of market turnover to capitalization was close to 100%.

The growth of derivative products contributed to the increase. Last year the Italian market in equity futures ranked second in Europe in terms of trading volume. The use of derivatives has enhanced the efficiency of spot prices, whose daily volatility has declined compared with the first half of the 1990s and is approaching the levels recorded in more mature markets.

Borsa Italiana has reached an agreement permitting its participants access to other European financial centres; interconnection will enable each market to exploit to the full the benefits of the massive investment that has already been made in technology while maintaining a close relationship with domestic firms.

Foreign investors hold just over 10% of listed Italian shares; they are more active in derivatives, where they are involved in one third of all trades.

Compared with the leading stock markets, Italy's includes a smaller proportion of non-financial companies. Although they account for more than 90% of the value added at factor cost of the private sector in Italy, their share of market capitalization was 54% at the end of 1998. Non-financial companies account for more than 70% of total market capitalization in Germany, more than 75% in the United Kingdom and more than 85% in France.

By contrast, the propensity of banks to go public is higher in Italy than in other leading countries. Banks account for 27% of the stock market in Italy, compared with values of between 10% and 15% elsewhere.

A contribution to increasing the number of listed Italian shares may come from the Euro-NM circuit, reserved for innovative small and medium-sized firms with high growth potential. A few months after its inauguration it has 330 securities, listed jointly on several European exchanges, and a total market capitalization of €80 billion. Borsa Italiana joined the circuit in June; the five Italian companies now listed account for about 3% of the total capitalization.

## Conclusion

The global financial market has seen a marked increase in the activity of institutional investors, able to deploy advanced techniques that reduce the costs and risks associated with their investments. Stronger competition sometimes prompts asset managers to pursue short-term objectives, thereby tending to accentuate the variance of securities prices around their long-term values.

The disappearance of the segmentation caused by exchange risk will foster the creation of a Europe-wide stock market. Financial intermediaries can look forward to an increase in their volume business. Their task is to allocate the flows of savings between countries.

In Italy, a substantial increase in the role of pension funds is needed.

It is becoming increasingly important to monitor not only the performance of economies but also single sectors and investment projects. Careful selection in the allocation of resources fosters the expansion of the global economy.

Italy is endowed with professional and entrepreneurial expertise, labour and savings allowing it to compete successfully with other economies in the new and more competitive European and global environment.

The many small firms present in the Italian economy can be a strong point, in view of their ability to use new technology and adapt rapidly to changes in external conditions. However, the increase in competition requires a major expansion in innovative sectors, something that larger companies are better able to achieve.

The financial system can make a fundamental contribution by making finance available to the most viable investment projects, helping to keep domestic savings in Italy and attracting resources from abroad.

The restructuring of the credit system under way and the formation of major banking groups will support the activity of medium-sized and large firms and their growth. It is these firms, together with the multitude of highly flexible and productive small enterprises, that can make a decisive contribution to the achievement of higher levels of investment, to the introduction of advanced technology in companies' modus operandi and production processes and to the growth of savings and employment.