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INFORMATION MEMO

Summary of the third Quarterly Survey on the economic situation
in the Community

The EEC Commission has just published its third Quarterly Survey for 1966 on the economic situation in the Community.

The Survey outlines the main characteristics of the economic situation in the Community for the second quarter and the summer. It also examines the prospects of the Community and of each member country in the final months of 1966 and for the whole of 1967, together with the relevant short-term policy problems. Annexed to Part I of the Survey - on the overall situation in the Community - is the text of the Short-term Economic Policy Committee's formal Opinion (28 July 1966) on the preliminary economic budgets for 1967. Annexed to Part II - on the situation in each member country - is the Council's Recommendation (18 July 1966) on the adoption of certain provisions that will improve the statistics on the economic situation.

On the overall situation, the Commission finds that the considerable expansion of aggregate demand and of domestic supply previously noted in the Community continued in the second quarter of 1966 and in the early part of the summer.

The growth of effective demand from abroad, especially visible exports to non-member countries, was even more rapid than in the preceding months, largely because purchases by the developing countries were rising faster than before. Customs statistics show that the value of goods exported in the second quarter was some 10.5% higher than in the corresponding quarter of 1965.

On the other hand the expansion of domestic demand began to show signs of weakening. Investment in building, for instance, which in the first quarter had benefited from the exceptionally good weather, subsequently expanded more slowly, in part as a result of the earlier speed-up and in part because the expansion of building demand, especially in housing, has been losing momentum in several of the Member States. In France, the vigorous expansion of investment in plant and machinery has, if anything, become more vigorous, while in Italy its progress has been reduced as a result of strikes in the capital goods industries. This situation is one of the reasons why the advances made in these two countries were insufficient to offset the further weakening of the investment boom in the Federal Republic of Germany and a similar though less marked weakening in the Netherlands.

Furthermore stock-building, which till the beginning of 1966 had been expanding faster than production, appears to have been slowing up in the last few months; the change is partly a reaction to the easing registered in certain important international raw materials prices, but it is also in part due to financing difficulties.

Finally, the pace at which private consumers' expenditure was growing has become somewhat more modest, primarily as a result of the more moderate pace at which the total wages bill has been climbing in the Federal Republic of Germany.

The Community's domestic supply expanded further, but here, too, the pace seems to have become somewhat slower, at any rate in the industrial sector; the SOEC index of industrial production (which excludes construction, food, tobacco and beverages and is adjusted for seasonal and fortuitous fluctuations) shows a rise of some 1% between the first and second quarters, after rises of 1.5% in the two preceding quarters. For the second quarter the unadjusted index was none the less 6% higher than a year earlier.

During this time there were slight signs of an easier situation on the Community's labour markets; only in France and Italy were there appreciable increases in the total numbers employed, and in Italy the figure for unemployment was slightly down. There was nevertheless still a considerable shortage of manpower, particularly in the Federal Republic of Germany and in the Netherlands, where the number of unfilled vacancies continued to be several times as high as the numbers out of work.

The Community's visible imports from non-member countries have hardly risen, the main reasons being the slower pace at which stocks of raw materials and semi-finished goods were being built up, and the reduction in imports of foodstuffs and defence goods; the total value of imports from non-member countries in the second quarter was none the less 6% higher in the corresponding period of 1965. Imports of services appear to have maintained their greater vigour.

Unlike imports from non-member countries, visible trade between the countries of the Community continued to climb steeply. In terms of the value of imports its year-to-year increase in the second quarter was 13.5%.

At the beginning of the second quarter the consumer price level was rising even faster than before, but towards the end of the quarter and during the summer months the rate of rise eased considerably, especially in the Netherlands, in Belgium and in the Federal Republic of Germany; the relevant indices showed no change or were even slightly down. This was, however, due more to falls in the prices fetched by various foodstuffs than to the trend of demand and costs; the lower prices paid for foodstuffs were caused on the one hand by normal seasonal factors and on the other by the weather, which was not so unfavourable for various products as it had been in 1965, when it had been responsible for prices being marked up quite considerably.

The more rapid growth of exports coupled with a slower growth of imports led to a reversal of the tendency, noticed since the beginning of 1965, for the visible trade balance of the Community to deteriorate; at 385 million u.a. the deficit for the second quarter was only half as heavy as in the first. This undoubtedly had a beneficial effect on the current payments position. In addition, there were - particularly towards the end of the second quarter - net inflows of capital, so that the overall balance of payments of the Community will probably have closed with a distinct surplus. At any rate the gross official gold and currency reserves of the member countries rose by 385 million u.a. during the second quarter, after falling 413 million u.a. between December 1965 and the end of March 1966.

In the remaining months of 1966, the Commission considers that the economic expansion of the Community should be maintained, although aggregate monetary demand may continue to rise less vigorously than in the early months of the year. The expansion of exports to non-member countries is again likely to be fairly high; but in view of the further weakening to be expected in outlay on investment in the Federal Republic of Germany, overall expenditure on investment in the Community can hardly gather speed, while private consumers' expenditure may rise somewhat less rapidly than in the first half of the year. The impact of stock-building on the growth of aggregate demand is once again likely to be, if anything, negative.

The growth of production in the Community may none the less pick up a little more rapidly, as the rise in prices in the second half of the year will undoubtedly be more moderate than it was in the first half and as, in addition, the balance of payments situation can be expected to improve.

There may nevertheless well be a tendency for the rise in consumer prices to accelerate again somewhat in the final months of the year, as the helpful climatic factors referred to above decline in importance. The rise in prices connected with the business cycle will tend to fade out, particularly in the Federal Republic of Germany and in Belgium; this is not, however, likely to be sufficient to prevent some fresh acceleration in the upward movement of consumer prices.

At the present stage of the stock-building cycle, imports of raw materials will undoubtedly remain hesitant unless there is some change in the present quiet trend of world market prices. This, added to the slower expansion of other domestic elements in monetary demand, will hold back the growth of purchases from non-member countries. As exports can be expected to expand more vigorously, there may well be a further improvement in the Community's trade balance.

Examination of the economic developments that have occurred so far this year and of the latest views on the developments that will occur in the remaining months does not call for any essential change in the forecasts made for the main quantitative results for the full year. In all probability, then, the real gross Community product in 1966 will be some 4.5% higher than it was in 1965; the external balance, however, might turn out to be higher than previously expected.

For 1967 too, the Commission judges the business outlook to be on the whole encouraging. True, the growth of exports from the Community is likely to be less vigorous; the information at present available suggests however that monetary demand within the Community will continue to grow at practically undiminished speed, and in view of some easing of the upward thrust of prices coupled with the likelihood that changes in the external balance will be slight, the real gross product of the Community could once again be some 4.5% higher than in the preceding year. The growth of internal trade within the Community will remain brisk and will continue to make a contribution to economic balance and, by and large, to the promotion of output.

Economic expansion in the Federal Republic of Germany may pick up speed again in the course of 1967; in Italy, and perhaps also in France and in the Grand Duchy of Luxembourg, it may for the full year be greater than it was in 1966; in Belgium there may be no change and in the Netherlands there might be some loss of momentum. Total imports from non-member countries are very hard to forecast in view of the latest changes of trend in the stock-building sector, but in 1967 their rise may be somewhat less rapid than in 1966. With exports also likely to be expanding less vigorously, there may well be no great change in the Community's deficit on visible trade.

Prices in the Federal Republic of Germany and in Belgium are likely to rise less in 1967 than they did in 1966; in the Netherlands, too, there might conceivably be less advance than before. In all three countries, however, and particularly in the Netherlands, present forecasts suggest that the upward thrust of prices will still be such that there can be no talk of even approximate stabilization. In France, where the upward thrust of prices has so far been modest, there might even be some acceleration in the upward thrust of prices. There is also a risk that the high level of stability achieved in Italy may be upset by fresh pressures on costs and prices.

Looked at from the angle of short-term policy, the latest economic developments in the Community and the further outlook suggest that some change in the economic climate is under way and that stabilization policy is beginning to show greater results than hitherto. The Commission does not, however, consider that this could justify any premature relaxation of the efforts to achieve stability and still less any attempt to follow a more expansionary policy. In the countries where there have been inflationary developments - the Netherlands, the Federal Republic of Germany, Belgium and to some extent Luxembourg as well - those responsible for short-term economic policy should rather aim at reinforcing the tendencies that contribute to stability, while in those countries - Italy and France - where the business situation is recovering from a period of weakness, those responsible for policy should seek to keep the growth of domestic monetary demand within those limits beyond which there will be a recrudescence of pressures on prices and costs. This does not mean that the promotion of growth should be unduly neglected. On the contrary, the more short-term economic policy gains or maintains control over the expansion of consumption expenditure, the greater will be the margin for investment - and without sufficient expansion of investment there can be no economic growth in the longer term.